LEA's 'Preservation of Deposits' Position Paper: Analysis & Critique

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In this spotlight, we will highlight the main issues discussed in the position paper "Advocating the Preservation of Deposits as Precondition for Economic Recovery with Integrity" prepared by the Lebanese Economic Association (LEA) in collaboration with Executive Magazine, Union of Arab Banks, and 100% Liban. The paper represents a five-year cumulative work by the above mentioned parties and basically describes Lebanon's financial collapse as a liquidity and governance failure rather the faulty narrative of bankruptcy. As such, it rejects the notion of bankruptcy to be settled at the expense of Lebanese citizens. Also, it offers a plan to resolve the financial gap and deposits at banks.

Plans done by previous governments of Prime Minsters Hassan Diab and Najib Mikati centered on writing off a major part of depositors' deposits instead of reviving Lebanese economy. The paper advocates that reaching an agreement with the IMF seems to be difficult as the IMF is insisting to improve the current debt/GDP to a more sustainable one. As such, and since it is hard to increase GDP significantly in a short period of time, thus the fastest way is to decrease debt and most of government's debts are people's deposits. This solution is expected to be rejected by all political parties especially months before the parliamentary elections .

In addition to the financial and economic crisis that hit Lebanon with no actions taken since 2019, the war escalation in fall of 2024 resulted in significant human losses, buildings destruction and economic losses. As per World Bank latest reports, Lebanon need around $11 billion for reconstruction and economic recovery, out of which the major amount will be needed in the upcoming couple of years.

As per the paper, there are eight topics that are critical for departing from the current crisis. These topics are:

- Building trust
- Protection of deposits
- Well prepared constructive negotiations with the International Monetary Fund
- Full respect of our constitution and economic principles and rights
- Sound implementation of national fund solution
- Understanding and Transparency of liquidity needs
- Currency management mechanisms towards economic democracy
- Exit from the crisis

The article stresses on the approach that Government or BDL's liabilities should not be treated as losses as this will have negative consequences and deepens the crisis. Additionally, the article states "The Bank for International Settlements does not endorse deletion of Central Bank losses or pari-passu, deletion of deposits of banks and clients. The BIS endorses the view that losses and negative equity do not directly affect the ability of Central Banks to operate effectively (BIS Bulletin 68 of February 7, 2023).

The solution for deposits should be regaining trust and generating liquidity. To achieve these goals, the paper suggests the following actions to be taken.

First, the state should help in regaining trust in the banking system through maintaining and protecting all deposits.

Second, a free and unified market-determined exchange rate should be applied. In this case, depositors will be able to accept repayment of their foreign currency deposits in LBP at the market rate. In case of repayment in LBP, it could be used through checks, credit cards or digital schemes such as e-wallet in order not to increase currency in circulation which will lead to an increase in exchange rate. As such, banks will enter the FX market, thus the market players will increase and limit its manipulation by few traders. The free and unified rate will also attract foreign investments and stimulates growth.

Third, reduce the required reserve ratio and liquidate excess gold reserves, to obtain liquidity in USD banknotes to repay deposits. The paper advocates that the gold is not owned by the Central Bank, but by the government (as per articles 15 and 113 of the Code of Money and Credit), so it can be used by the government to settle its public debt. As per the paper, freeing $9 billion dollars of Central bank's reserves and a significant amount of gold reserves that are valued at around $28 billion (by end of March 2025) to settle part of depositors' deposits, will provide the needed liquidity to resume normal banking operations.

Lebanon hold around $10.5 billion of required reserves in foreign currencies in addition to around $28 billion in gold and therefore the ratio of reserves to GDP exceeds 100%. This ratio is well higher than that of other countries that mostly range between 10% and 20% of GDP. The paper also states that $7 billion of required reserves and gold is enough compared to Lebanon's GDP. The remaining should be utilized to settle a certain percent of all clients' deposits regardless of its size. The remaining deposits can be considered as savings accounts for a period of four to five years.

Fourth, reschedule all bank and non-bank financial assets and liabilities including public debt for short, medium and long term periods, as term deposits could be rescheduled for the short and medium terms whereas public debt can be rescheduled as per the pre-crisis timeframe period. The rescheduling should be applied and interest and debt service should be delayed until a fiscal primary surplus (surplus without debt service) is achieved. As for foreign currency debt, which is mainly constituted of Eurobonds, it is mainly owned by international financial institutions and private holders (50%), Central Bank (15%), Lebanese commercial banks (7%) in addition to other creditors. However, the foreign currency debt could be reduced by around 20%-25% given that international financial institutions bought an important portion of its portfolio during the crisis at discounted prices. Thus, the primary surpluses can be used to service the rescheduled Eurobonds and local currency debt which became marginal after the depreciation of the local currency.

Additionally, fiscal reforms should be applied to reach a balanced budget in which revenues cover all the expenditures. This can be achieved through freeing FX rate which will lead to an increase in government revenues through its taxes and will in turn allow it to adjust wages, increase investments and service its debt. This article stresses on implementing a fair tax collection system that guarantees that wealthy and political exposed persons to pay their taxes, not only wage earners.

Moreover, banking sector reforms should be implemented in an efficient way to regain some of the lost confidence in this sector. Recapitalizing of BDL gradually by the government as the Code of Money and Banking states in article 113 in addition to rescheduling BDL assets and liabilities along with freeing FX rates will let BDL function normally. Also, BDL administrative restricting is needed to reduce the centralization power of its structure, develop its performance, impose regulations, and give independence to its control task.

Furthermore, public sector institutions need to be managed by private sector as per international procurement standards. The institutions that should be started with are airport, ports, electricity and mobile sectors as these if managed properly can become cash cows for the government.

Also, the paper emphasizes that the full or partial corporatization of the state owned enterprises (SOE) should be allowed and to be listed on Beirut Stock Exchange (BSE). This would be the best solution for SOEs as they were not managed in a way to benefit Lebanese citizens, on contrary; they were the main reason for Lebanese people losing their deposits and the purchasing power of their salaries. One best example is the electricity sector that made Lebanon incur around $50 billion (including interest) in expenses without having electricity. Corporatization of SOEs will allow depositors and foreigners to invest in these companies, but there should be a limit on ownership of 0.5% of total equity to avoid monopolization. An important idea in this paper concerns the privatization of public entities: retaining a 30% of issued equity that will allow the state to use part of the earnings for social safety through helping low income people. In addition, the one-time sale of share equity, taxes on earnings of shareholders’ dividends and the dividends obtained on its own equity will guarantee additional revenues to the government .

Finally, the last action that should be taken by the government as stated by the paper is to compensate the losses of syndicates’ funds, National Social Security Fund (NSSF), government treasury bills and deposits held in the local currency by residents and non-residents. Both syndicate fund and NSSF are very important to insure healthcare for elderly after decades of work.

As such, the paper's deposit recovery scheme option is summarized as follows:

- Settling part of the LBP and foreign currencies deposits from the proceeds of freeing required reserves and selling a significant part of the gold reserves. Also, Lebanese deposits could be allowed to be used through digital payments such as credit cards and e-wallets.
- Sign one to four years saving contracts for the remaining deposits to be similar to the structure of the time deposits before the crisis.
- The savings accounts could be extended for more than four years depending on the liquidity of each bank.
- The Central bank along with the stakeholders in the banking industry (banks and deposits representatives) could oversee the financial assets and liabilities reformation procedure as per each bank's liquidity.

As such, the paper introduced several important ideas regarding deposits protection and economic recovery, which were not included in any of previous governments' plans so far. However, there are some points we believe that should be dealt with in a more cautious way and some ideas were not mentioned in this paper.

First, the paper stressed on freeing all required reserves and selling most of gold reserves and keeping only around $7 billion worth of gold and foreign cash reserves in total as followed by other countries based on the range of 10%-20% of GDP. However, Lebanon's case could not be compared to other countries. No other country faced political and securities issues as Lebanon has faced, noting that since 2005, Lebanon has faced the following political or security issues that urged the Central Bank to intervene:

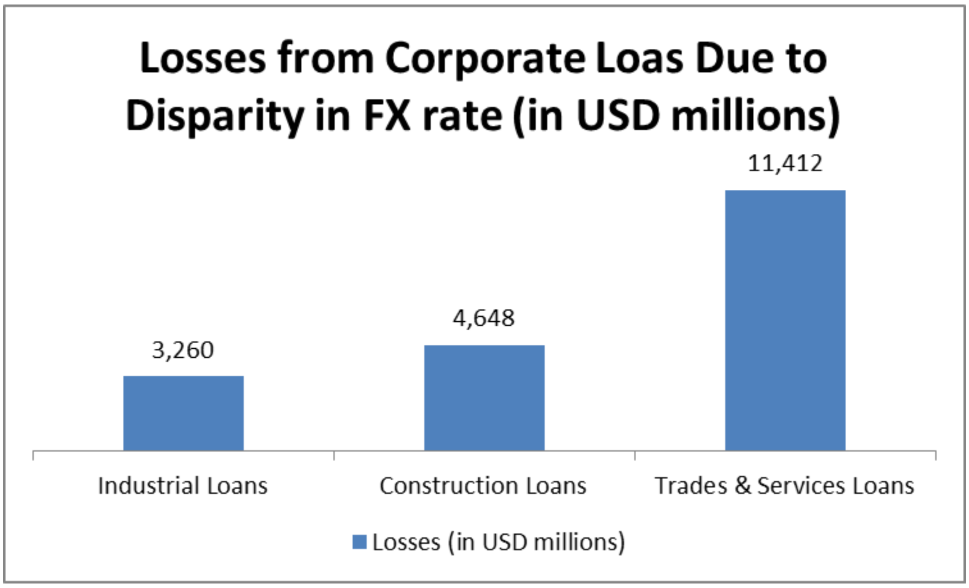
- Assassination of previous Prime Minister Rafik Al Hariri in 2005 followed with tens of assassinations of political figure
- One month war with Israel in July 2006
- Political and security issues in May 2008
- Syrian War in 2011 and its consequences on Lebanon
- PM Saad Al Hariri's resignation in Saudi Arabia in November 2017 which resulted in outward transfers of deposits
- Financial and economic crisis in 2019
- September 2024 war escalation with Israel that remained for 66 days

Thus, we believe that Lebanon should always maintains excess gold reserves as a cushion to face any challenge Lebanon might face, especially that Lebanon did not buy an ounce of gold for more than 40 years. So, in case of selling most of gold reserves, there is no chance that Lebanon will be able to repurchase gold in the foreseen future. Additionally, Lebanon's current Gross Domestic Product (GDP), arguably, does not reflect the real capabilities that Lebanon has. However, we might invest part of the gold reserves that the Central Bank have such as gold leasing, gold swaps or gold-backed securities as detailed in the spotlight we recently published.

As for freeing foreign currency cash reserves, this could be done as these are depositors' money, however a capital control law should be issued before. However, the past experience was not promising as the Lebanese parliament failed to issue a capital control law that could have been done in one day with a couple of sentences only.

Moreover, deposits that were accumulated through corruption should not be treated as deposits that were accumulated through hard work or end of service indemnity. In addition, we believe that it is fairer to repay depositors different percentages depending on the size of the deposits, for a couple of reasons. First, a significant amount of depositors still have small deposits. Second, in case the same percentage is applied on all depositors (35% as suggested in the paper), the depositor who has a USD 10,000 deposit will receive USD 3,500 while another depositor who still has a USD 100 million in deposit will receive USD 35 million. In this case we are not discriminating between depositors as we believe that depositors must get back all their deposits, but we are prioritizing small depositors in the short term period.

Central Bank's intermediate circular 568 should not have been issued as it allowed creditors to settle their retail loans USD bills in LBP at LBP 1,500 and then LBP 3,900 (well below the real value of USD) and corporate loans in checks. This allowed many big companies to purchase checks at a discounted price (reached below 20% of real value) to settle their loans. However, the Central bank should have informed the banks to either reschedule the payments or delay bills' maturities while in the meantime the government should have been working on resolving the financial crisis when there was around $34 billion in reserves at the Central Bank. Thus, it is fair to issue a law to let companies that settled loans after 2019 in checks or on rates that were well below the real value of the USD back then, to pay the real amount of these loans gradually in case it did not have USD deposits at the time of settlement. This proposal is fair since companies were granted these loans in USD and were transferred abroad to purchase raw materials and goods and sold the final products in Lebanon as per the parallel market exchange rate. However, companies should be studied based on a case-by-case scenario since not all companies purchased checks at a discounted rate. As per our previous estimates, the gap on corporate loans from September 2019 till December 2022 was as follows:



Additionally, an audit should be done on the companies benefitted from subsidies for importing food products and impose taxes on companies that benefitted from it as the goods were sold in Lebanon at the parallel market rate (higher than the Sayrafa rate back then) or exported them worldwide.

Lastly, a depository recovery fund should be initiated to be managed by independent and capable individuals. This fund can be financed from a small percentage from state owned enterprises' revenues after managing it in an efficient and transparent way in addition to a small percentage from future oil and gas revenues. In this case, the government participates in a part of deposits recovery. As for the opposing point of view that these are Lebanese citizens' rights and not all Lebanese citizens are depositors, we should keep in mind that all residents (Lebanese and expats did not have deposits in banks) benefitted from fixing the exchange rate to purchase food products, consume fuel, travel, teach their children, purchase real estates at the expense of depositors' money. Therefore, deducting a small percentage of these revenues will note have a significant impact on future generations. Additionally, part of banks' future profits can be deposited in this fund, so banks will also participate in deposits recovery.

In conclusion, preserving deposits will be a challenging task on Lebanon's new executive authorities and will take time. It should be tackled in a way to be fair and each party incurs part of losses depending on their responsibility. For depositors, they should not incur losses on their deposits since they have already lost part of their deposits either in the previous settlement structure of Central Bank circular 158 (50% in LBP at a discounted rate) or in the time value of money. In this respect, the LEA paper is a step in the right direction.

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