Some Neglected Thoughts about the Lebanese Government's Debt to BDL

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One of the main sticking points with the IMF, not to mention with the Ministry of Finance, is the treatment of the Lebanese Government's debt to BDL. BDL had insisted on counting this $16.5 billion in debt when devising its plan to close the financial gap and to return deposits back to its rightful owners; whereas the IMF/MoF seem to insist that it shouldn't. As a compromise, latest proposals show that BDL would agree that the government commits to returning (as part of financial gap closure/deposits retrieval) almost half of its debt, at $8.7 billion. But it seems even that is still questionable, and at this juncture it is under discussion with the IMF team currently visiting Lebanon to iron out the draft of the financial gap law.

We present below a few important thoughts on why the Lebanese government should repay its debt to BDL/depositors in full; barring that, at least in half.

1) The main argument not to pay, especially as propounded by the IMF, is that this debt would render foreign debt unsustainable. In retort, two points could be made.

First, **technically speaking**, **foreign debt is actually debt owned by foreigners, not debt denominated in foreign currency**. What we call 'foreign debt' in Lebanon is about $31 billion and if we count arears it would add up to around $45 billion. But the thing is 45% of this debt is owned by locals (15% by BDL and 30% by local banks), so the 'true' foreign debt burden involves 55% of $45 billion or close to $25 billion only.

Second, even if we accede that foreign debt should be calculated based on denomination, adding $8.7 billion (the compromise amount) to it won't be disastrous. We have shown elsewhere[1] that sustainable debt for Lebanon is about $17 billion, or 60% of GDP, which would imply a haircut of 62% out the $45 billion in total foreign debt. **This haircut would turn to 68% if the total foreign debt rises to $53.7 billion – still within the reasonable range.**

2) It is sometimes argued, though not persuasively, that the government shouldn't repay its debt to BDL because the money borrowed was spent on services to the people (EDL mostly); and, anyways, BDL's money belongs to the government. But this argument is vacuous on two grounds. First, if money borrowed and spent on the people shouldn't be returned, then nobody would ever lend to the government in the first place and no government bonds markets would exist. **Second, BDL's money lent out doesn't belong to the government: it belongs to banks and ultimately to depositors.**

3) Perhaps the most crucial retort is that the government should repay the debt so as to **learn how to live within its means and to avoid the 'moral hazard' that encourages it to always operate under loose budget constraints**. BDL shouldn't have engaged in quasi-fiscal activities and thus shouldn't have lent to the government (it is not its job); but the fact that that it did gave the government the impression that it can spend freely and – worse – corruptively. **This not only should stop (and it has) but the government should atone for it by repaying its debt to BDL.**

4) In the final analysis, if the government repays (assume it is the $8.7 billion) it won't really be doing the depositors any favor because it is ultimately **the taxpayers – i.e. depositors -- who will pay the taxes to fund the payment back (or will pay for it through forgone services)**. And if the government elects not to return the debt and not to pay back the depositors, **then the latter will most likely get a bigger haircut on their returned deposit**s. **So either way it is wash for depositors**. And for the reasons outlined above, it is more optimal and efficient for the government to assume and pay back its debt to BDL.

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[1] "Debt Sustainability Analysis: A Critical Note on Lebanon", *Spotlight, Blominvest Bank Blog, April 2025.*

5) Luckily, the government doesn't even have to tax the public/depositors to pay its debt back. **That is because it already has at BDL public deposits worth $8 billion (mostly in LBP), very close to the compromise amount of $8.7 billion.** These have been accumulated as part of the process of not flooding the market with LBP and in so doing jeopardize the stability of the exchange rate. But over the five-year deposit-return period, these payments can be eased into the economy -- with BDL undertaking the requisite sterilizing operations if need be – so as not to disturb the foreign exchange rate markets.

The Lebanese crisis is a unique crisis and not a standard one. In this sense, 'tunnel vision' and 'one size fits all' policies are not appropriate to deal with its case. Even if they are, we believe the government returning its debt to BDL/depositors carries both economic and moral arguments in its favor. Mind you also that the process of closing the financial gap will become a lot smoother once official development assistance kicks in; and, more important, once confidence and growth are restored to the economy and with them more private capital flows. If unfortunately that doesn't happen, then it would be because political and security matters in the country must have descended into a deep abyss; and in that case the government's debt return to BDL would be the least of our concerns!

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