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By Thomas Schellen

BANKING FOR THE COMMON PERSON

Lebanese banks are stuck at an intersection marked by disgruntled depositors and absent legislators

"You can take it to the bank," is an idiomatic expression commonly uttered by someone – usually a politician or manly man with business power – to express a very high degree of confidence that their latest assertion or promise, such as winning an impending election, is going to be fulfilled. It is an example for how deeply and easily our minds can correlate the notion of trust with the concept of banking.

The exact opposite association has been building up in Lebanon, where banking is being demonized. The animosity against banks has been festering in an environment of supercharged activism, to a point where an assault on a bank branch ignores the possibility of traumatizing customers and employees for the sake of raking in an emblematic amount of cash under a claim of "one's right to one's money."

Taken in this context of a lost societal glue, the investigation of the three-plus years-long banking crisis of Lebanon (the exact moment of its start in 2019 is arguable and can be posited a few months before the overwhelming evidence of the troubles appeared at the end of October) is much more than research into accounting for losses, attribution of blame, and attempts at however partial short-term restitution of their rightful belongings to the depositors. It is an exercise that turns into an arduous and sometimes agonizing journey of the mind. Reflecting on what is gone amiss in Lebanon with the shock of the abrupt shuttering of many banking services, the use of which previously had been almost self-evident and certainly indispensable part of daily life, requires a conscious effort that also might serve as a reminder of the importance of recovering the principle of trust that underlies finance, money, and the entire economy.

THE CURRENT STATUS QUO

It is frequently overlooked that Lebanese banks have suffered along with their depositors. The latest news is that the suffering of banks, in a manner of speaking, has eased. According to numbers cited in Bank Audi's Lebanon Weekly Monitor (LWM) publication, the contraction of customer deposits in the banking sector has slowed when comparing the first seven months of 2022 to the same period in the previous year. Deposits are said to stand at $127.8 billion at the end of July.

Amounting to $1.7 billion for the period, the contraction in deposits looks almost benign when compared to the rates of stricture, which stood from January 1 to July 31, respectively, at $5.89 billion and $15.57 billion in 2021 and 2020. Unsurprisingly, LBP deposits grew in 2022 while FX deposits contracted. This brought the deposit dollarization ratio down by almost three percentage points. An estimated $2 billion in dollar deposits are "fresh."

The slowing in contraction of deposits is a dangerously double-edged phenomenon as banks are still illicitly holding these deposits, which are their liabilities, back from the people to whom they belong. On the other hand, one can interpret the narrowing in the rate of deposit contractions as a relative indication that the overall financial situation, albeit in the perverse manner of a bank run that is frozen in time, has moved from extreme convulsions towards a glimmer of financial health.

On the side of assets, banks' loan portfolios contracted by $4.45 billion over the reporting period to reach $23.3 billion. This compares with contractions of $4.75 billion and $9.5 billion in the first seven months of the previous two years. Shareholder equity stood at $16.9 billion in July 2022, a reduction of $0.9 billion from December 2021, a weakening which the publication attributed to losses related to FX costs, operating expenses, inflation, and needed provisioning.

"The banks' Eurobond portfolio contracted from $4.4 billion in December 2021 to $3.9 billion in July 2022, a contraction of $0.5 billion. The contraction in this year's Eurobond portfolio is mainly the result of the provisioning requirements imposed by the Central Bank of Lebanon," Bank Audi said. In terms of net foreign assets at the central bank, the contraction, attributed primarily to currency interventions, was reported as $3 billion.

Another noteworthy set of data was related to the number and concentration of existing bank accounts. Citing the 2021 Annual Report of Association of Banks in Lebanon – which Executive did not see – the LWM noted that the banking sector's resident depositor base at the end of last year was 2.35 million account holders, of whom more than 56 percent held deposits of less than LBP 5 million (LBP values calculated at the rate of LBP 1.507 to the dollar).

Interestingly, the majority of these banking clients own a dismal 0.7 percent of total deposits, or LBP 1.3 trillion out of LBP 188.6 trillion at the aforementioned "official" rate of LBP/USD conversion. The holdings of depositors overwhelmingly do not exceed LBP 300 million per account, with 29 percent of cumulative deposits' value held by 95.2 percent of depositors, whose account balances at the end of 2021 were below that threshold. According to ABL's disclosures, some 114,000 account holders – the remaining 4.8 percent of the depositor base – call 71 percent of total deposits their own, in the nominal value of LBP 134 trillion.

As extreme as this concentration of wealth in the hands of approximately 2 percent of Lebanese citizenry and the top 5 percent of bank account holders is, and as much as it sends strong signals for policy making in favor of better tax collection, a redistributive tax system, and perhaps even an annual wealth tax (as banker Riad Obegi proposed when talking to Executive), the reported concentration is somewhat less severe than has been rumored by some activists and in social media posts.

■ It is frequently overlooked that Lebanese banks have suffered along with their depositors

Yet, the veracity of the above numbers is not easy to ascertain in an atmosphere where some bankers have been evading accountability. Moreover, reliance of data is marred by well-founded skepticism if any data on the banking sector is actually relevant in any way, given that banks have been holding depositors' hostage for three years.

This notwithstanding, it is a continuing reality that banks in Lebanon, despite selling international units, closing departments, downsizing branch networks, overworking tellers and reducing headcounts, have remained operational and in some counter-intuitive manner, shown resilience. In legal language, both the largest commercial banks and the sector at large are not formally bankrupt – even though insiders of the industry occasionally, and publicly, declare that they consider all of the 14 largest lenders in the country, to be de-facto bankrupt.

This contradiction in itself makes Lebanese banking an intriguing object of study; inviting a deep dive into the situation of banks, the impact of their behavior over the past three years on society, and the changed realities of the sector in banking players' own perception, beyond their slightly improved annual numbers (in comparison with the two previous years). Additionally, it constitutes the minimum of diligence to inquire about the longer-term outlook of Lebanese banking, and to evaluate from a wider social and economic perspective, but also considering banking sector financial signals; trends of high relevance in the economy and society that have emerged over the past three years.

SAMPLING NEW REALITIES AND INFLECTION POINTS

So, what has changed in the experience of finance at banks, from a public observation point of view, and for banks in their own perspective? The second part of the question cannot be answered comprehensively for all banks. Too many chief executives and board chairmen are covering behind veils of determined, counterproductive, and one assumes, either helpless or desperate silence. However, a sample of creative perspectives from the sector can be obtained by listening to a minority of bankers who are confident enough to talk.

One new reality is a departure from banks' past group behavior, which until 2019 conveyed the impression of a well-controlled and mutually intertwined collective identity among all lenders. "I think that for the first time in the past 30 years, the outlook and behavior of banks is taking different routes. A bank like [AM Bank], which is a medium sized bank that has handled the crisis more efficiently than some other banks, does not see itself as necessarily aligned [with] a much larger bank that did not handle the crisis properly and is now hated by most of its clients," Marwan Kheireddine, chairman of AM Bank, tells Executive.

Although he describes banks as having different opinions in response to the economic crisis, he says that they are still behaving mostly as one group. "This is because no bank has gone bankrupt and the central bank has made it clear that it does not wish to bankrupt banks. Also, we are in this wait-and-see game to see what laws the government is going to enact, so that we can devise our strategies accordingly," Kheireddine continues.

"But for sure, you have today some banks that have a much higher exposure to government risk than others, and therefore the objectives [of banks] have to differ from one another. There is far more in common between medium and small banks than with larger banks. This does not mean that banks will fight against each other but it means that depending on government policy, some banks might establish different strategies from other banks," he elaborates.

Economist Jean Tawile is a board member of the Rassemblement des Dirigeants et Chefs d'entreprise Libanais (RDCL), an association of business leaders, who has in recent months authored papers discussing crony capitalism, as well as good bank, bad bank solutions for restructuring the financial sector. In his analysis, many banks are too weak to transform themselves, while others are not ready to accept that their equity will fall to zero and need to be rebuilt, while a third group have accepted the need to reset equity to the zero point and rebuild.

> The decision makers are showing very little respect for the people and they are also showing very little understanding

"Under a good bank, bad bank model, you are structuring a banking sector on the size of the commercial portfolio of loans. There are banks that hold no commercial loan assets, so they would be completely under the bad bank side of the structure," he says. This third group is willing to embark on ways of addressing the solvency problem over time and operating as a legitimate bank by obtaining some fresh dollar inflows, while in the meantime tackling the liquidity problem in collaboration with international financial institutions (IFIs) by way of giving loans through the banking channel.

For Riad Obegi, chairman and CEO of Banque BEMO, the situation of banks has become comparable to a person who is kept every day in uncertainty over whether they might be executed the next day. "The decision makers are showing very little respect for the people and they are also showing very little understanding," he says, in reference to not only the government of Lebanon, but also foreign governments and IFIs. "The problem is to bring back trust, and

The central bank has not fulfilled its role, and it costs a lot

you will not bring back trust by talking every day that you will take someone's head off."

In searching for exit routes from the endless anticipation of what laws may be adopted, and ways to end the paralysis of banking, his thoughts do not stop at the idea of shaking the defining institutions of money and banking in Lebanon. "Society wants full dollarization – so why would you fight society?" He argues that there is no need to hold on to Banque du Liban (BDL) as the central bank for the purpose of issuing currency. In his reckoning, the central bank has not succeeded in its core functions of managing a monetary policy, supervising the banks, and printing money responsibly. He goes on to compare BDL with a railway company; keeping a nonfunctioning railroad operator may be inexpensive and worthwhile in the longer run, but the maintenance of a central bank is very dear.

"The central bank has not fulfilled its role, and it costs a lot. Is there a chance that it will do its job in the future, [with regard to] one, the currency, two, the monetary policy, and three, the integrity of banks?" he asks rhetorically. Positing that a return of reserves to commercial lenders and the handover of gold would enable banks to restart lending – providing they succeed in deferring to honor their depositors' withdrawal demands under a clear time schedule of several years – he presents the dissolution of BDL as a step that would help banks return to a path of orderly business in service to the economy.

PROPOSED TAXATION SOMERSAULTS AND DEBT AEROBICS

As well as improving state revenues towards fiscal balances, Obegi envisions an annual wealth tax as the best method. "Taxes on profits are regressive, unprogressive and in my opinion immoral. I personally believe that tax on profit is bad but tax on wealth is good." he say, before continuing: "If the aim of the state is to create more solidarity among people, and have taxation that creates growth and does not destroy growth, taxes should not be on revenues but on wealth." He believes that a combination of a 10 percent value-added tax as the conduit to steer consumption, in combination with a one-percent annual wealth, could replace other taxes as a flat but continual wealth tax could bring in the equivalent of more than 10 percent of GDP per year.

The assumption of the state's responsibility for paying its debts is crucial for a solution. Obegi emphasizes that banks must be accountable for the mistakes they made. But he contends that analyses of the risk exposure accepted by banks are incomplete, without taking into account that banks had to operate under the law and in a small country with a highly interconnected set of economic behaviors. He refers to the zero-coupon bonds through which banks were obliged to channel funding to government needs for a limited time in the early 2000s, as an example of this. "Banks could not not abide by that," he says, delivering a model sentence of double negation, before asserting that he also sees it as a non-negotiable red line that banks have to abide vis-à-vis to their customers. “Before the depositor gets a haircut, the bank needs to go bankrupt.”

“I think banks have to assume a level of responsibility [for the crisis] that is commensurate with the risk that each one of them has taken, as recorded on their balance sheet,” Kheireddine says. According to him, the central bank will have to bear some responsibility when it comes to providing the government with US dollars versus receiving Lebanese pounds, though he concedes: “But it was an open market at the time, and in my opinion the central bank had no choice. But the elephant in the room is the Lebanese government. Our government has run budget deficits every single year for the past 30 years,” Kheireddine says.

DANGEROUS INTERSECTIONS

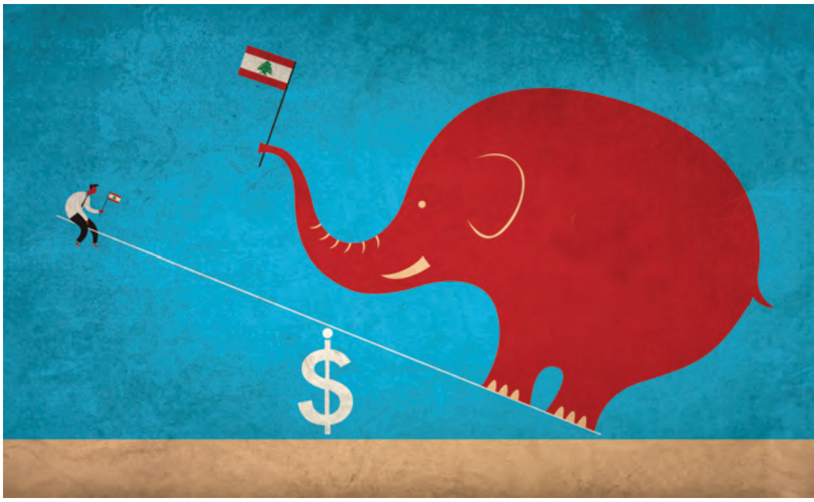
It is a common perception that Lebanon has slid into an intersection where one road leads deeper into the abyss and the other offers uncertain and difficult improvements of the economy. While deeply political in terms of requiring a clear presidential election and a political will for reforms and sacrifices that many bankers and economists do not see as forthcoming, the intersection can be seen as also including economic and financial inflection points.

INFLECTION POINT: DOLLARIZATION

In early discussions of the unhinged Lebanese pound back in 2020 and also in 2021, it appeared pertinent to assess the pros and cons of two opposing currency regimes – free float versus hard peg. Deliberations at roundtables and in expert papers more closely explored currency regime variants, such as full dollarization and currency board solutions on the hard-peg side, an intermediate model such as a crawling peg and currency basket, and options such as a radical free float or managed float.

Currency regime choices, even in theory, were not many in the spring and summer of 2020, but the number of solutions with reasonable prospects for popular acceptance, seems to have further evaporated during this year.

The rational choice for most people is dollarization. BEMO’s Obegi compares it to a fever that helps a body recover its health. On one hand, he says “society is doing this dollarization to fight corruption: the corruption of decision makers.” Yet on the other hand, “people are moving toward dollarization because it is the way in which they can go on living.” Spinning the metaphor further, he adds that fighting against soci-



ety’s choice of dollarization at the current time would be like fighting the healing process, and result in no cure for the country’s ills, except for the most radical cure: cutting off your head. “Dollarization is good. Fighting this would be fighting the healing process.”

The diagnosis, but not the treatment angle is shared by economist Tawile. “The economy is being dollarized and the local currency is only for the public sector,” he says. An ancillary journalist’s look at the dollarization phenomena on a street level of people’s economic choices – which are rational by their respective experiences – provides ample anecdotal evidence of growth in practical dollarization.

Some local restaurants, tired of having to adjust Lebanese pound prices all the time, changed their prices this year to dollars. George T., a neighborhood hairdresser who has worked for 25 years in the same spot in Achrafieh, put up a sign pricing his standard haircut at “$10 (Sayrafa)” in June, switching a sign that had successively read “50,000”; “75,000”; “100,000” and “LL150,000” over the previous 24 months. Across the street, a chocolatier called Roger calculates his margins in the US currency before telling his clients a Lebanese pound price. He explains that he charges 20 percent less on a dollar basis when compared with 2018, despite sharp rises in the cost of imported materials and local electricity supply. Wherever one looks, society has been adopting the dollar not only for communicating prices of imported goods but also for pricing local services.

INFLECTION POINT: THE OVERBOARDING INFORMALITY OF NETWORKS AND ACTIVITIES

In Tawile’s analysis, the divisive economic reality is also manifesting as further escalation of an already high level of informality that has roared beyond 50 percent. "We have [a] two-speed society, one [part of which is equipped] with dollars, and all the others. Dollarization is based entirely on cash and today, the parallel economy for me is much bigger than the formal economy. This is the biggest problem in Lebanon," he says. Operating solely on the basis of the formal economy, and dependent on fiscal management for its compliance with taxes and standards set by the government, any current budgetary planning will be handicapped by the fact that the formal half of the economy will be bearing the cost of the entire economy, he adds.

Correlated to dollarization, economic informality, and distrust in banks is the entrenchment of unconventional financial networks that are at play; from family-level support between expatriates and their loved ones in Lebanon, to disbursements of cash support from international NGOs to needy persons in the country. Although, previously regarded as fragile and possibly temporary, in light of research of soaring inbound cash transfers directly after the Beirut Port explosion of August 4, 2020, this segment of the financial industry has been stable and growing in user numbers up to the middle of this year. This is according to data announced at the beginning of this month by BDL, and information from inbound market leader, OMT. Together with another local partner company of global money transfer operator, Western Union, OMT dominates this particular business, which on a micro-level contributes to cash in the pockets of beneficiaries, and on the macro-scale helps a bit with the current account balance.

According to BDL data cited in the Lebanon This Week (LTW) publication of Byblos Bank, inflows of remittances stood at $6.4 billion for the full year of 2021 – a decrease of 3.6 percent from $6.63 billion in 2020. However, net remittance inflows were $4.3 billion for last year, 16.6 percent more than in 2020, an increase which LTW attributed to a significant drop in remittance outflows between 2020 and 2021.

Although the money transfer segment of the local financial industry has to contend with numerous logistical issues and market complexity according to OMT, which can act as barriers to competitors, some new entrants say they are seeking to establish franchises with stronger digital aspects, besides promising to lower cost and work for financial inclusion. "By launching our services in Lebanon in 2021, we opened the doors for people all around the world to contribute and be more involved in the Middle East market through sending remittances and supporting those economies," Imane Charioui, the director of francophone Africa and Middle East at money transfer Fintech WorldRemit, tells Executive.

Taking all inflection factors and distortions into account, the picture of the Lebanese economy looks an increasingly fragmented system operating not just with two speeds, but which is subject to many centrifugal forces compelling its pieces further apart from one another and from the state as the organizational center; because of the formal and informal, dollarized and lira-based contours of pieces in the economy that comprise differing inflationary pressures and, in some cases, experience deflationary moments. And as the formal financial market, historically controlled by banking and not well-balanced between equity and debt markets, is caught in a stupor of political and banking confusion, the untenable lives of the common person, become more untenable even in the time it takes to produce a single analytical banking story.

A visit to conduct a routine cashless transaction at a bank branch located barely a kilometer from the location of a branch assault on September 14, 2022, took five times as long as one month ago and included an hour's wait on a stair in front of branch doors that admitted persons on individual basis, since they were not allowed to enter the branch freely, resulting from measures in place since a wave in anti-bank activism. In the following days, banks declared a three-day closure following an alarming same-day surge of hold-ups by armed depositors at banks across Lebanon, and subsequent announcements by the Depositors' Outcry Association to conduct more heists.

■ Society has been adopting the dollar not only for prices of imported goods but also for local services

Aware of the fact that the state in Lebanon has been taken to the verge of total failure, or "hell," the people of Lebanon have been suffering from deprivation of more than their meager financial assets. But vigilantism will not open ways to solve the financial and economic dysfunctionality that underlies the state's failings, because of the dictum that a functional and legitimate state is dependent on its monopoly over coercive capacities. Further, at a time when vigilantism and escalations are perceived by many as alternative to investing into a viable state, the need to rebuild banking as a key to better economic performance, and thereby provision of fiscal revenue, converges with the urgency of building a stronger state. A system in which reform mandates also enforce law and justice against the powerful, who might consider themselves too rich to be held accountable. In this context, banking becomes a vital channel for the return to societal hope as it is for the economy.

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By Thomas Schellen

THE LEGALITY AND THE PERCEPTIONS OF BANKING BASED IN LEBANON

The public has been unwittingly enjoying a governmental charade of discussions, statements, and little change

To the interest of anyone who is not a part of the political and banking power ensemble, an absurd theater of dance and song is being played out on the nation's institutional public stages. But this year's summer theater is being performed in rationality-defying ways; as if the goal was an emulation of an ancient Athenian tragedy whose protagonists' immersion into inescapable misfortune and his aims at catharsis are available only on the basis of divine intervention.

These are some of the acts in which the legal drama has been progressing: After a staff-level agreement between the Lebanese government and the International Monetary Fund (IMF) was announced on April 7, the choirs of politicians were immediately intoning praises and hymns with promises of rapid action. Even the Association of Banks in Lebanon (ABL) congratulated the government on the staff-level agreement in a letter, calling it "a crucial first step towards the implementation of an IMF program." But then the progress towards actually signing an IMF agreement over the following five months resembled a play of double-talk, twists and intrigues. It invited the thought of how social media, or today's Erinyes - the epitome of vengeance for broken promises - will be busy for years. It would give any ancient Greek tragedian a run for their money.

The bewildering performance in the national theater has been commented upon by a chorus of media and civil society voices attempting to vocalize the hidden agendas and unspoken fears of the main actors to the spectator. In one example of the chorus-worthy drama, the presidential signature for the banking secrecy law was reportedly held back in August, because of pending evaluatory responses to a revised draft. In September, news agency Reuters reported that the IMF uncovered "key deficiencies" in the recent modifications by Lebanese lawmakers to the draft of the banking secrecy law. The law is one of several prerequisites for the IMF agreement.

Another such prerequisite is the capital controls law, which by September 2022 is approximately 35 months late. Local media site, Naharnet, reported on the last day of August that a joint session of involved parliament committees "agreed on finding a capital control solution that would both preserve the rights of depositors and the 'existence' of banks." No decisions were reported from the joint committees' meeting. Government representatives, however, have been waxing wisely that the country is at a crossroads and has to go toward reform or further collapse. Soon after, advocacy organization Legal Agenda added its two cents by commenting: "The Government, like parliament, is still unable or refusing to take any step on the road to reform or exit from the crisis, which puts the whole country in front of risks whose limits are difficult to predict." The group also decried that along with the failure to produce a capital controls law, a governmental economic rescue plan has been debated to no avail on three occasions during the eight-month period up to September 2022.

And so, throughout this summer it has continued; a now three-years-long charade of conferences, plans, law discussions, expressions of absolute determination, and non-implementation of anything decisive, least of all honest reforms and laws prerequisite for an agreement with the IMF. The local audience of this charade, long mired in disbelief of political assurances, in the meanwhile is held captive to a macabre dance of depreciation of the local currency, alongside domestic, pass-through, and now global inflation, and desperate struggles for their livelihoods. A dance of a slow economic death that is separating the haves-of-a-few-real-dollars from the haves-of-near-worthless-lira by an ever-widening gulf of inequality.

A CLEAR LIST OF LEGISLATIVE AND ORGANIZATIONAL NEEDS

One perspective shared by virtually every economist and expert heard by Executive throughout this year is that Lebanon will not recover without a viable financial sector. Although, the views of these experts vary regarding important nuances; nevertheless economically relevant laws are necessary to the foundation on which to rebuild banking and the economy. Driving this point home in an interview on the legislative priorities and the legality of banks' behaviors, lawyer and former minister Ziad Baroud leaves no doubt that the legal requirements make room for any ambiguity. "The IMF staff level agreement is very clear in envisaging a package deal of at least four laws to be voted [in]: [laws on] the budget, capital controls, bank restructuring, and banking secrecy," he tells Executive.

Noting that laws on banking secrecy and capital controls have been initiated, while a budget is the minimum that any country should commit to and legislate in a timely manner, Baroud elaborates on the order of these laws' importance. In his view, the bank restructuring law deserves the utmost attention. "In my reading, the number one priority is the restructuring of the banking sector because the other three laws would not create much impact unless you restructure the banking sector. And if you don't have banks, you don't have an economy," he explains.

> Government representatives have been waxing wisely that the country is at a crossroads and has to go toward reform or further collapse

There are many contentious issues in local debates about all banking-related laws however. These debates show how crucial the legality of bank actions is for the current and future relationship between banks and their depositors, and even their imagined stakeholders. Here, uncertainties and misconceptions abound over issues such as the use of reserves at the central bank, along with the baseline liabilities and responsibilities of politicians, central bank, and commercial banks. "But before talking about reserves and the legality of their use, I want to say that deposits are protected by law. Thus, everything that has been happening since Oct 2019, is de facto not really legal," Baroud emphasizes.

According to him, the mandatory or compulsory reserves is an instrument granted to Banque du Liban (BDL) by virtue of the Code of Money and Credit, Article 76, paragraph D, according to which the central bank can deposit with banks up to 15 percent of their respective obligations. "Such reserve is provided in order for the BDL to perform its operational tasks in terms of liquidity and – for instance – credit policy. Therefore, it cannot be regarded as deposits' guarantee; this is a common blunder. It's a tool in the hands of the central bank, which can consider the Treasury Bonds as part of said compulsory reserves as per the law," Baroud clarifies.

This seems divergent to positions expressed by ABL in 2021, under which the association blamed the central bank for submitting - when it lowered the reserve requirements by a percentage point - to pressures from "the political authorities, contrary to the Monetary and Credit Law where the purpose of the mandatory reserves is limited to the needs of the banking sector." However, as to whether the mandatory reserves are actually fixed at an exact level of 15 percent, Baroud explains that this is a ceiling set in the Code of Money and Credit, and the central bank can lower it.

A quick headline query on the subject of reserve requirements by central banks shows that comparable steps to the one enacted by BDL in 2021 have been taken by many central banks elsewhere, or that such requirements in developed economies commonly range in the low single digits, in terms of what central banks require from commercial banks. For example, the European Central Bank (ECB) tells online visitors: "Reserve requirements are a standard monetary policy tool in central banking, but are not required by all central banks," citing as examples of the latter Australia, Canada, and Sweden. According to the ECB, banks in the eurozone had to hold a minimum of 2 percent of relevant liabilities as reserves in accounts at national central banks until 2012, after which time the rate was halved to 1 percent.

For Lebanon, dealing with the commercial bank's unsecured deposits, the lawyer points out that as the regulator of the banking sector, the central bank has a huge supervisory obligation. Moreover, it is not some private enterprise but part of the Lebanese Republic, and therefore carries responsibility on par with those who hold political responsibility. As a combination of economic and monetary factors, together with a lack of transparency, have engendered the crisis, the problem over the use of reserves is essentially interlaced with central bank independence, discretionary power, and responsibility. "The main problem we are facing is linked in my reading to the lack of transparency in the operations pertaining to the reserves and more specifically to the undefined and open-ended boundaries between the needs of the government and the margins of maneuver of the BDL," Baroud says. "In any case, compulsory reserves are definitely not the guarantee for deposits, at least from a legal perspective, although [they are] viewed as such by the depositors at large."

PERCEPTIONS AND SELF-PERCEPTIONS

As Baroud further notes, banks have historically been transparent and compliant enough when interacting with correspondent banks and counterparties abroad. Yet they also went to great

We need more transparency in the banking sector, better monitoring by the regulator and by the shareholders and boards of directors lengths – and successfully so – to conceal their real data from public scrutiny and local stakeholders. "We need more transparency in the banking sector, better monitoring by the regulator and by the shareholders and boards of directors," he says, adding that under a 1994 law, each bank in Lebanon should appoint at least one independent, non-executive board member.

The demand for improved governance and transparency at Lebanese banks is well known to the readers of Executive magazine. Today, it resonates even larger, as for the past two years banks have done astoundingly little to communicate their real situations, both relating to meaningful data and staff welfare factors.

Despite conducting previous interviews with multiple leaders of ABL, like Salim Sfeir, the organization's current president, he did not accept Executive's invitation to be questioned for this issue. Sadly, nixing our hope to understand his current views on the resilience of banks.

In our most recent in-depth interview with him in the summer of 2019, Sfeir had acknowledged a wave of deliberate social media assaults on the banking sector which occurred in the second half of the 2010s. At the time, however, he opined dismissively about the sector's reputation problems, "no, it is not a problem," displaying with hindsight an unseeming confidence that banking was valued in society as the "services industry that existed to best serve the interests of its customers."

Two mid-tier banks that responded affirmatively to our interview requests, however, provide glimpses into the mindsets of bankers who are battered by the furies of public opinion. Marwan Kheireddine, the chairman of AM Bank confesses that he has gathered overflowing experience in being misunderstood, and much of that on purpose.

"Because I am visible in the media, I constantly get attacked," Kheireddine says as he meets Executive in his office in Hamra. An hour earlier, further down the street, a chaotic scene had been unfolding involving protestors, a bank, and one shotgun-wielding depositor demanding access to his money. "In reality, I am defending the free market economy," he says.

"Bankers in general feel bullied, feel threatened, and feel that they are [made to bear] responsibility for something that they did not do. [Bankers] find it very hard to have an educated conversation with society overall as they have been under attack for two and a half years," Kheireddine says of the experiences of his peers. Though, he admonishes that on their part, banks failed to create a lobby to defend against attacks in the media or on social media, which have morphed from unpredictable moments into much more harmful incidents.

"My message to banks is that they should be more courageous," agrees Riad Obegi, chairman and general manager of Banque BEMO. For him, the role of banks in society is not limited to financial markets, and not even limited to their contribution to the economy. "Banks are like a symbiotic virus. If our host dies, we die as well. If we are becoming too strong, our hosts become too weak. There must be an equilibrium. We need to help our hosts become stronger so that we become stronger," he tells Executive.

> Banks also went to great lengths – and successfully so – to conceal their real data from public scrutiny and local stakeholders

Quarrels over the liability of banks between depositors and banks as their debtors have been playing out in cycles of varying intensity over the past three years, with emotive peaks of distress and litigious energy. There are no improvements to date as far as restoration of trust between the Lebanese people and their government or their banks.

Irrespective of the depressing short- and medium-term pecuniary realities that are prevailing in the country, alongside the backdrop of evading accountability attempts by actors responsible for the ongoing tragedy, there may be no reason to expect that banks will be resolved lastingly of their moral and legal obligations in the ultra-long-term.

Today's examinations bring to mind how the realms of long-delayed accountability for past misdeeds across the globe have lately been expanding in time. We have been seeing judicial reckonings of corporate crimes involving apologies and financial payouts by religious and civil organizations to victims of abuse, national governments scrambling to restitute art treasures to former colonies, inner-European legal conflicts over claims for reparations 70 years after World War II, and struggles of ethnic groups for compensations from their ancestors' slave masters. Accountability may be coming late, but its arm is proverbially long and getting longer. Moreover, in the even longer run, the unknown does rule and other challenges will beckon, raising questions that are as likely to remain unsolved as all big questions of humanity but these questions will render today's worries and preoccupations of bankers and depositors, as ever, absurd.

By Sasha Matar

In collaboration with KONRAD ADENAUER STIFTUNG

THE LOCAL BITCOIN MARKET AND THE CRISIS

The young currency remains a topic of the day

Lebanon's banking crisis is yet to offer depositors any cushion to soften the blow of capital control restrictions, a crumbling currency, and an uncertain future. As depositors become well versed at queuing outside banks and fighting for their money, some have begun looking for alternative methods to storing their money - not under the mattress, but digitally, through cryptocurrency. "My clients who buy cryptocurrencies or exchange them for fiat, are the ones who do not feel that it is safe to deal with banks anymore, not now, not ever. The banking crisis alone has created ample conditions for the interest in cryptocurrencies, namely Bitcoin," Nader Dirany, a cryptocurrency consultant and founder of one of the first cryptocurrency exchange counters in Lebanon, tells Executive.

Linkages between cryptocurrencies and financial crises seem to be anchored in recent history. To many, the appearance of Bitcoin during the Great Recession was not a coincidence. Although the rationale of Bitcoin in the original white paper published by a person or group of persons under the Satoshi Nakamoto pseudonym, did not refer to banking crises in general or the period's subprime problems in particular, cryptocurrency users can easily perceive the digital currency to address the failure of banks, presuming that Bitcoin will not fail the world the way the banking system and the central banks did in 2008-09. For Lebanon, the banking breakdown arrived a decade later, when a liquidity shock rippled through banks at the end of 2019, forcing them to impose tight capital controls which prohibited depositors from spending money abroad and from access to accounts, in an attempt to stem capital flight amid a widespread shortage of US dollars. The conditions sowed the seeds for the beginnings of a cryptocurrency community in Lebanon.

FERTILE SOIL FOR BITCOIN

The cryptocurrency story is tied to the global financial crisis of 2007-09. Early crypto enthusiasts were thrilled by the idea of a currency that is authenticated by a foolproof chain of digital evidence on the internet, named the 'blockchain', which is free from the chains of central bank controls. This anarchic hope, embedded into the mysterious narrative of Bitcoin, was soon paired with interest from speculators, money launderers, black market drug sellers, and people who looked for alternatives to "fiat" money issued by central banks. The invention of Bitcoin in 2008 in one sense got a boost from the global crisis, and the rise of Bitcoin from the fancy of a few tech enthusiasts and monetary anarchists took shape over several waves, riding both speculative gains and immense losses.

While there were local enthusiasts who were excitedly embracing the Bitcoin concept in finance and academia, the dominant local mood about cryptocurrency during the first ten years of the story was one of disinterest and indifference. Lebanon was not really affected by the 2008 financial crisis. It was not until banks blocked depositors' access to their funds in 2019, that Bitcoin earned widespread attention locally. Banks that were once the protectors of foreign capital inflow, including the diaspora's money in particular, turned into exchange counters after 2019. They stopped providing financial services and were no longer allowing transfers abroad, nor providing loans, or savings premiums. Cryptocurrencies, on the other hand, are a digital and decentralized cross-border medium of payment exchange which can be used to buy regular goods and services, despite their highly volatile nature. In addition, Bitcoin is allowing Lebanese to transmit wealth abroad through electronic wallets, without the intervention of any third party.

By definition, Bitcoin is a peer-to-peer electronic cash system. It is by design intended to facilitate the transfer from point A to point B by eliminating the intervention of an institutional party. It removes bureaucratic procedures, elevating limitations on transactions, saving time, and shifting complete control to the transacting parties while disrupting traditional banking systems. To help onboard more local users, Dirany suggests supporting merchants to accept payments in crypto and stablecoins (digital tokens that declare they are backed by real-world assets), considering the difficulties surrounding bank card payments. "An announcement attributed to Banque du Liban would for instance incite merchants to explore the cryptocurrency culture," Dirany says. "The Bitcoin community of Lebanon, that interacts in groups on messaging platforms, mainly Telegram and hosts tens of thousands of users, is ready to start lobbying for the implementations of regulations and the foundation of a syndicate for the cryptocurrencies exchange counters."

FROM SWITZERLAND OF THE EAST TO VENEZUELA OF THE EAST

Several historical factors influenced the promotion of the banking sector to its prominent position in Lebanon. In short, the Lebanese economy became part of the famous Bretton Woods monetary system. As a result of the 1944 Bretton Woods conference, countries agreed that their central banks would maintain fixed exchange rates between their currencies and the US dollar, which was in turn pegged to the price of gold. In 1956, the Lebanese parliament enacted the Banking Secrecy Law, which kickstarted foreign capital inflow into the country.

After the 1971 Nixon Shock, when US president Richard Nixon's new policy ended the Bretton Woods system or the Gold Standard era, the Lebanese currency remained pegged to the dollar. Banque du Liban (BDL) and bankers in the early 1970s believed that the peg was a cornerstone for stability. As a result, it attracted traders and foreign investors to a now-dollarized Lebanese economy. Foreign inflow was also generated from diaspora remittances and neighboring Arab nations like Syria, United Arab Emirates, Saudi Arabia, Kuwait, Qatar, and so forth.

Whether they simply wanted to store their money in a trusted banking system that offered concealment from the prying eyes of tax collectors, or were attracted by the interest returns on banking deposits in the Lebanese market, or had other reasons not to entrust funds to the banks in their home countries, inflows from foreign depositors found their way to domestic banks. From early on in the post-conflict reconstruction of the 1990s, high yields of government-issued treasury bills, certificates of deposit, and later Eurobonds, drew banks to provide funds to the government. When maturing after a few months or years, these debts were rolled over into new debts, in what was a profitable and comfortable spiral from the perspective of the lenders. But as time went on, the government stopped paying its debt to both local and foreign lenders, which resulted in mushrooming debt and a lack of liquidity.

CRYPTOCURRENCY STATUS QUO

Despite the contraction of the trade balance deficit as a result of the decline in purchasing power and multiple local and international efforts to boost local exports, the imports of goods reached $14 billion at the end of 2021, according to Bank Audi's Lebanon Economic Report for the second quarter of 2022. As a result of the recent measures taken by banks, suppliers have been seeking alternatives to banks to conduct business transactions with cross-border traders. This is particularly significant as the Lebanese economy depends largely on imports (up to 60 percent of goods as a percentage of GDP are imported). Within these circumstances, a digital currency with the characteristics of Bitcoin has allowed traders to transmit wealth abroad through electronic wallets, without the intervention of any third party. However, the current market cap in Lebanon is difficult to establish and the volume cannot be tracked since most transactions entail off-exchanges, through an underground market or motorcycle delivery exchanges, sources interviewed for this article told Executive.

> The invention of Bitcoin in 2008 in one sense got a boost from the global crisis

Dirany guesses there are hundreds of "ad-hoc sellers" in the crypto community in Lebanon, and says there are only two other over-the-counter markets besides his. "For this reason, it is hard to tell what is the exact exchange volume of Bitcoin," he adds. This year traders saw extreme volatility in the price of Bitcoin, and as such the expectations of the local community vary according to their power of purchase. Large traders consider Bitcoin as a long-term investment, according to Michel Haber, crypto expert and CEO of Astrofi, a digital marketing platform. Meanwhile, small traders who are attracted by the 'get-rich-fast scheme' are there for the excitement, speculation, and a potential way to make a passive income when Bitcoin's price goes up. A survey by the Dutch bank ING on the perceptions around cryptocurrencies showed that countries with lower per-capita income levels are more likely to consider using cryptocurrency as a payment medium.

LEGAL ASPECTS

To help curb scams and internally regulate his business, Dirany requires his customers to show a valid government-issued ID with every transaction, which is the most basic know-your-customer (KYC) step any financial institution would require, despite its contradiction with Bitcoin's anonymous philosophy. The exchange fees at the counter vary between minus five to seven percent, depending on demand, while charges among peers could be non-existent, depending on trust. "This business is subject to supply and demand rules par excellence," Dirany says.

Lebanon does not yet have regulation on cryptocurrency, leaving exchange counters in a regulatory desert. Charbel Choueh, attorney and expert in blockchain and cyber law, points out that the absence of legislation puts clients at risk. Choueh suggests that BDL, along with legislators and local crypto experts, should issue regulations that would require such counters to register their business, in the same way other money exchangers are required to deposit a guarantee in an accredited renowned bank or at BDL. Such licenses should meet the international requirements of the anti-money laundering and KYC process for the founders and the clients, and be compliant with Lebanese law. This requirement would set up guidelines to eliminate the risk of fraud.

According to Choueh, local regulations do not prohibit ownership or the use of cryptocurrencies, yet they are not accepted as payment methods. Under Lebanese law, transactions in cryptocurrencies, such as retail exchanges of goods or services against Bitcoin, are considered barter deals. In the case of fraud, users should deposit their claim at the Cybercrime Bureau, where a division revises the claims and presents them to the Public Prosecution Office at the Court of Appeal. Choueh says that this Bureau needs to be equipped with the latest technologies to be able to follow up and track users' complaints.

Regulating the environment surrounding the trade of Bitcoin does not necessarily mean the adoption of crypto as a legal tender. There have been a few jurisdictions around the world that moved to make Bitcoin a legal tender but many internal and external reasons stand in the way of such a decision for Lebanon. The International Monetary Fund and the World Bank have issued multiple statements to El Salvador against the usage of decentralized cryptocurrencies, due to the high volatility risks. Despite these warnings, Bitcoin according to its proponents, continues to appear as a potential global unit of account - necessary to measure value and price fairly – and more specifically for countries, like Lebanon, that rely heavily on imports.

UNCERTAIN FUTURE

On one hand, the argument that Bitcoin trading is risky because of its volatile nature is accurate; Bitcoin is influenced by supply and demand, user feelings, and government regulations. More than once, Bitcoin's price altered drastically following a tweet from the tech giant Elon Musk; like in 2021, when Musk announced that Tesla would stop accepting Bitcoin as a payment method. Although Tesla is expected to resume accepting Bitcoin, and it will be interesting to watch the subsequent behavior of the market. Others praise Bitcoin for its deflationary aspect, due to the halving technique which means that the supply of Bitcoins created would be cut by 'halves' or 50 percent every four years until the year 2140, when the limit of 21 million supply capacity of Bitcoin is expected to be reached.

Yet, all currencies with hard supply limits, such as gold, silver, and Bitcoin, have deflationary properties. Conceptually, monetary theorists fear that the halving of new supply is only a way that might delay the moment when the supply of Bitcoin is insufficient to meet the money needs of growing economies; this has not been tested in any economy that we know. But whether risks in the future of digital currencies reside more in issues of volatility or are rooted in deflationary dangers, Lebanon is consumed with more urgent and more immediate money problems, which is reflected in the fact that most people (and many longstanding finance experts) seem far away from regarding Bitcoin as an alternative to payment transactions. The physical relation the population has established with cash has grown since the absence of banks, and the psychological distance with virtual money is riskier according to behavioral economics, especially to a society that lost a lot of physical belongings over the past couple of years.

معرض ومؤتمر الشرق الأوسط للطاقة النظيفة

Middle East Clean Energy

Exhibition & Conference 2022

Organized by EDUCITY Beirut Expo

Deals worth USD50 million were recorded at the 1st edition of Middle East Clean Energy

Last weekend witnessed the end of the activities of the Middle East Clean Energy, the first clean & renewable energy trade fair & conference in Lebanon. The conference was held in Beirut between September 7 and 9, 2022. The event, announced that the total of its deals exceeded fifty million US dollars during the days of the exhibition, was an opportunity for exhibitors and agents of international brands to search for representatives and distributors in the country and the region, as well as open dialogue between industry stakeholders and encourage strategic partnerships in promoting their products and services for the general public.

MECE was an opportunity for engineers, specialists, and the general public to closely familiarize themselves with the most prominent technologies in the field of clean and renewable energy, and an opportunity to provide clients with a variety of options to choose the best deal.
The Middle East Clean Energy included a very rich and intense conference program composed from twenty-four experts and specialists, in order to promote innovation and new technologies and to educate the audience about new clean energy technologies, these were divided into six sessions:

the first session focused on highlighting the importance of creating a national industry in the field of clean energy, which help to Empower younger generations and entrepreneurs, the second session concentrated on energy efficiency, the third session on energy transition from fuel to clean energy, the fourth session on the challenges of the clean energy market in Lebanon to discuss the sector's problems and challenges, the fifth session was held on the challenges of marketing and selling clean energy solutions in the Levant, and the sixth, and final session, focused on the personal growth of employees in light of crises.
The exhibition provided a unique opportunity for engineers, specialists and workers in clean energy to meet together in the heart of Beirut, opening a door for cooperation and networking.
Middle East clean Energy was organized by EDUCITY and Beirut Expo, two leading institutions in the fields of exhibitions and conferences, which announced that the second edition of the expo will be held in March 2023, in Beirut.

In collaboration with KONRAD ADENAUER STIFTUNG

By Sarah Hourany

NFTS IN LEBANON: JUST A CRAZE OR A PROMISING OPPORTUNITY?

'Digital nights', an NFT artwork by Lebanese artist Ralph Khoury, known as 'Ginger Potter'

As trust in traditional banking declines, financial preservation using digital methods are starting to be cooked up

In periods of economic uncertainties, people look for safe havens to preserve the value of their money and assets, and the choices of investors during the current global and local economic crisis has proven no exception. Be it cryptocurrency or Non-Fungible Tokens (NFTs), a significant number of individuals have turned to digital markets to curtail the repercussions of a crippling recession.

The picture in Lebanon, however, has been characterized by one major obstacle blocking NFTs development. This summer, Lebanese artists were banned from the world's largest NFT market OpenSea, headquartered in New York, dealing a blow to the sector and artists like Ralph Khoury, a Lebanese NFT artist known as 'Ginger Potter'. Following the unexplainable prohibition, Khoury said that many Lebanese artists resorted to virtual private network alterations to access OpenSea's website. Shortly after, their accounts were deleted and their collections removed. These sudden restrictions prevented the artists from reaping revenues and harmed their relations with their collectors, as their NFTs vanished from the blockchain.

Such barriers have frustrated the growth of the young market in Lebanon, albeit globally, it also remains a novel field. Is it a sound investment? Studies and data have yet to prove it. Nonetheless, some facts are undeniable: users across the globe spent an estimated $44.2 billion worth of NFTs in 2021, up from $106 million in 2020, according to the blockchain data company Chainalysis' latest market report, almost amounting to the size of the global fine art market. In Lebanon, the NFT is well-adopted as per experts, although there is an absence of available concrete figures to showcase it. On the other hand, cryptocurrencies' adoption is increasing with volume hitting $26 billion, placing the country second in the region behind Turkey ($132 billion) and ahead of the United Arab Emirates (UAE) with $25 billion, as per a recent report by PwC, the global accountancy firm.

A PRIMER ON NFTS

NFTs are a type of cryptocurrency that can store data on blockchains, specifically Ethereum, and differ from classical cryptocurrencies, such as Bitcoin, in their fundamental features. In economics, 'fungibility' refers to the interchangeability of a good or asset with other specific ones of the same type. For instance, currencies, Bitcoins and commodities are fungible, which allow them to serve as a medium of exchange, facilitating global trade. Explained simply, a $10 note can be exchanged with two $5 notes or with a product worth $10 in the market. In contrast, a non-fungible token is not intrinsically substitutable with other digital assets. This enables it to depict something or someone in a unique way. To be more specific, under NFTs, a creator can easily demonstrate the existence and ownership of digital assets including videos, photos, and audio files; itself a major step towards more robust intellectual property protection. As a matter of fact, pre-NFT, digital content was accessible either legally on free online platforms such as Google Images or YouTube, or illegally on black market streaming sites, thereby placing their authenticity in question, and making them vulnerable to replication.

According to various research papers published in renowned business journals, NFTs have three characteristics which enable them to resolve the problem of original ownership in digital markets.

Firstly, NFTs are non-interchangeable: each NFT is connected to a digital or physical asset indicating the value, proprietorship, trading rights, and other specifications. Secondly, NFTs are immutable; meaning that they cannot be changed or forged, given that they are stored on a decentralized network of computers and algorithms where they go through a specific validation and authentication process. As such, the blockchain verifies that each NFT is original and unique and once its information is recorded, ensures that it cannot be modified. Thirdly, NFTs are transparent in the sense that their properties and ownership are clearly visible to all parties.

> Another distingiushing mark of NFTs are the royalities secured to the orginal creator whenever a NFT is traded or exchanged

Yet, some critics remain skeptical about the uniqueness of NFTs; there could be many similar NFTs copied from an original one, pretending to be novel. But for Mohamad Sheet, product specialist at Oasis X, a Dubai-based NFT marketplace and creator studio, these arguments are not convincing: "If you copy a Louis Vuitton bag, it doesn't make it original. In the real market, it will cost you time and energy to verify its authenticity. In the NFT world, the issue is much simpler as blockchain technology makes it easy to verify ownership." Indeed, traceability is a major characteristic tied to blockchains. "Smart contracts provide collectors with all the details related to the NFTs, so if someone takes a screenshot of a certain creation it would be easy to know which file came out first," Najib Khanafer adds, Sheet's colleague and co-founder of Oasis X.

Another distinguishing mark of NFTs are the royalties secured to the original creator whenever a NFT is traded or exchanged. This is an appealing feature as artists normally do not receive future earnings after their art is first sold. "The continuous monetization of the NFTs is one of the attractive aspects for creators, especially that art appreciates with time," Khanafer says.

For Khoury, the Lebanese NFT artist whose 'Ginger Potter', moniker was acquired in part from friends and in part from his round eye glasses likened to those worn by the book character Harry Potter, NFTs provided an opportunity to showcase his talent, away from traditional galleries that were either unreachable or limited when it comes to art genres. Not only did it enable him to generate money during the worst economic downturn in Lebanon's recent history, but it also offered him a passive income from these royalties. According to Khoury, who has been creating NFTs for nearly a year, his fellow Lebanese NFT artists are generating several thousands of dollars monthly, a remarkable number given the current average income in the country.

A RECENT BLOW TO THE MARKET

The recent ascendancy of interest in NFTs by Lebanese digital artists is what makes the sudden exclusion of several individuals from a well-known marketplace disappointing. "The situation with OpenSea is very unfortunate and unfair for many artists and traders that found themselves banned overnight and their accounts deleted," explains Nagham Hassan, the founder of Bintcoin, a platform which disseminates information about Web3 in the Arab region. "It is especially disappointing that users were not given any advance notice of these measures."

Khoury believes that the ban is political, given that users from other countries such as Cuba, Syria and Iran were subject to similar restrictions. This is a view shared by Hassan: "While blockchain is decentralized and permission-less, service providers like NFT marketplaces are still very much centralized companies subject to government oversight and political agendas."

Several Lebanese artists reached out to the platform for clarification but received no response. Although, a statement from an OpenSea spokesperson published on Cointelegraph, a digital media dedicated to covering crypto, blockchain and Fintech issues, said that the marketplace restricts users based on the US government's sanctions list. "Our terms of service explicitly prohibit sanctioned users or users in sanctioned territories from using our services. We have a zero-tolerance policy for the use of our services by sanctioned individuals or entities and people located in sanctioned countries. If we find individuals to be in violation of our sanctions policy, we take swift action to ban the associated accounts."

NFTS IN LEBANON: A HIDDEN OPPORTUNITY?

Irrespective of questions over the ethical implications that politically motivated sanctions of digi-


'Ginger Potter's 'Complicated' appears to capture Lebanese finances

A NFT created by the artist Pak, called 'The Merge' sold for a record sum of $91.8 million in December 2021

tal artists might raise with any advocate of artistic freedom, Khanafer says that the local market for NFTs boomed despite Lebanon's economic crisis. People were looking for alternatives to store and preserve their money and assets, in a period when trust in the banking system was completely eroded. As a matter of fact, a PwC report titled 'The UAE Virtual Assets Market' issued this year suggests that the key reason behind the high rate for crypto adoption in Lebanon is value preservation.

Besides, the popularity of NFTs was gradually growing in early 2020 before reaching its peak the following year. A NFT created by the artist Pak, called 'The Merge' sold for a record sum of $91.8 million in December 2021. Another piece, titled 'Everyday: the first 5000 days' was sold for $69.3 million at auction by Christie's the same year.

Nonetheless, many factors still stand in the way of the sector. In addition to the political complications that reduce the possibility of establishing international cryptocurrency companies in Lebanon, given the operational difficulties they could face from a legal standpoint, the access to internet and technology is also a major drawback, Khanafer says.

The internet infrastructure of Lebanon improved during the 2010s, compared to the dial-in days of the 1990s and the underpowered and overpriced conditions of the 2000s. But arguably it is far from complete. The Economist Intelligence Unit's Inclusive Internet Index report issued in 2022 pointed out that Lebanon's main weakness continues to stem from its policy environment. It ranked Lebanon in 72nd place out of 100 countries, regressing from 60th place in 2020. The index is based on four criteria: availability, which evaluates the quality and range of the existing infrastructure required for access and levels of internet usage; affordability, which mainly measures the cost of access compared to income levels; relevance, which assesses the existence and extent of local language and relevant content; and readiness which studies the capacity to access the internet, including skills, cultural acceptance, and supporting policy.

Another impediment concerns the access to the type of information investors need, according to Khanafer. While experts attend conferences and events, build connections, and receive accurate information, not everyone is included in such opportunities. Another challenge, Khoury says, is access to cryptocurrencies. Lebanese banks do not permit cryptocurrencies, adding challenges and even discouraging people, at the same time creating ripe conditions for a crypto black market.

The absence of regulatory authorities and governing bodies is also one of the major obstacles at a time when nearby countries, particularly the UAE, have been fostering a welcoming environment for crypto and NFTs. Earlier this year, the Government of Dubai enacted Law No. 4 of 2022 on the 'Regulation of Virtual Assets' and set up the Dubai Virtual Assets Regulatory Authority. The establishment of such a legal framework will likely set the scene for entrepreneurs and investors lured by blockchain technology.

"There is no noteworthy effort focused on creating regulatory clarity around NFTs in Lebanon at the moment," Bintcoin's Hassan says. "Additionally, I doubt that the regulation of digital and virtual assets is at the top of the country's priority list." Investors and entrepreneurs are indeed looking for countries that allow them a clear and fast framework to set up business. Hassan also mentions how the Lebanese are naturally technical and business savvy people, who would benefit if given the opportunity. She recommends that Lebanese policy makers set clear definitions and laws for digital assets and cryptocurrencies by collaborating or consulting with experts in the industry, as they can give adequate guidance to set laws which can govern the space without hindering innovation.

A PROMISING OUTLOOK?

According to Hassan, NFTs are viewed by many as speculative investments. As such, they usually suffer in risk-off environments where preferences shift to assets that are perceived as safe, or exiting a market altogether. NFTs are especially vulnerable as their non-fungible nature means that they are relatively illiquid in the sense that they cannot be easily converted to cash, she adds.

Hassan says that NFTs, as a technology, is an excellent investment as it is already disrupting the entertainment, gaming, and ticketing industries, to name a few. Some of the biggest brands are also launching loyalty programs and special collectibles in the form of NFTs. However, NFTs as a speculative asset, is a riskier investment as the performance of the asset will depend greatly on the team behind the project. She warns against projects originating from anonymous teams.

Hassan also mentions how the Lebanese are naturally technical and business savvy people, who would benefit if given the opportunity

Despite all the hurdles, those interviewed by Executive believe that the outlook for NFTs in the country is promising. The Lebanese public is increasingly interested in the NFT world, with more people attending NFT club virtual or physical meetups and joining Telegram groups. OasisX is currently approaching Lebanese celebrities, news agencies and companies who according to OasisX operators, all showed interest in collaborations. Undeniably, NFTs are not limited to art but are increasingly used for business purposes. Ticketing, marketing, memberships, digital collectibles, token-gated commerce and gaming are sectors expected to witness further development.

In a country struggling to preserve its decaying infrastructure, NFT development may seem far-fetched, but any concrete reform - when you have skilled human capital - would have a multiplier effect. After all, you only need a mobile phone and internet access to be part of the NFT world.

In collaboration with KONRAD ADENAUER STIFTUNG

By Rudy Shoushany

A WEAK POSITION IN THE UNDECLARED CYBER WAR

Lebanon lacks the sufficient talent, resources and up-to-date technologies to ensure robust cyber defenses

We live in a time when hardly a day goes by without hearing about a cybersecurity incident. The need for a safe and secure digital world significantly grew after the COVID-19 pandemic, as human behavior merged online even more than before, and remote working became an everyday reality. Lebanon is no different to this escalating threat.

Since 2019, however, Lebanon has undergone an economic meltdown; a financial and monetary crisis alongside the challenges related to the health pandemic. Perhaps most importantly, Lebanon witnessed the collapse of its main economic pillar: the banking sector.

Out of all sectors, Lebanese banks had the biggest budgets to invest in cyber defense. As such, they invested significantly on infrastructure, technology, and awareness to reach what was deemed an acceptable protection level. On the other hand, the public sector was left under protected by a budget unable to guarantee a robust and proper digital transformation and cyber defense. What is more, the public sector was mainly dependent on international donors, since there was no national priority to step into the 21st century of a citizen-focused digital experience.

Many local institutions, particularly in 2018, have suffered attacks and breaches. Unfortunately, it is far too easy to access various entities in the public and private sectors. As a result, a secure transformation is greatly called for.

LEBANON'S CYBERSECURITY STATUS

Lebanon is ranked 109th in the world and 12th regionally in the ITU Global Cybersecurity Index 2020. Lebanon is expected to drop further in the new upcoming index. Earlier this year, in May, the Lebanese Cybersecurity Empowering Research Team, a group of ethical white hackers, found major cyber-attacks on Lebanon. More than 2.5 million attacks had been conducted within 21 days; an alarming amount.

Various public sectors, businesses, educational institutes, and the banking sector suffer from an absence of coordination and implementation of a cyber security risk strategy. The banking sector, which was once considered the forefront of digital innovation and cybersecurity spending, is now suffering from the devaluation of the Lebanese pound, and subsequent inability to pay monthly or yearly software and hardware contracts, hindering its ability to stay up to date. There is a high possibility of software expiring without being replaced, which would arouse further dangers.

Today, Banque du Liban's Circular 144 of November 28, 2017 regarding the protection of banks against cybercrime, is not ranked as a high priority for implementation or enforcement vis a vis the financial crisis.

The migration of cybersecurity talent or human capital, skills shortage, and inadequate salaries in the private and public sector bring a lot of challenges in maintaining and enhancing cyber security operations in Lebanon, creating a climate of "low-hanging fruits" for cyber-attacks.

The Internal Security Forces are the official body responsible for combating and investigating cybercrime, but they are in dire need of new skills, the latest technologies, legislative changes and even reliable electrical power. It is worth noting that Lebanon lacks specialized judges or lawyers in the field of information technology. In addition, from a legal framework perspective, Law 81/2018 relating to electronic transactions and personal data, has yet to be enforced despite being approved by the Cabinet four years ago.

Although, the ten-year Digital Transformation Strategy was approved in May 2022. Needless to highlight that implementing this strategy is a big challenge, regarding a lack of commitment, funding, adopting simplified and standardized measures in a Lebanese national data center, as well as a waste of time and financial resources.

2019 CYBERSECURITY STRATEGY

After lengthy work, the three-year National Cybersecurity Strategy was published on August 29, 2019 by the government, two months before the October 17 uprising and the beginning of the economic downfall (technically the strategy should have been implemented by now).

Even though different international grants are actually supporting the strategy, having a well-planned implementation framework supported by state authority is crucial for robust coordination with the 2022 Digital Transformation Strategy.

The strategy aims to protect government assets, markets, commercial sectors, and citizens from cyber threats and attacks. It is composed of two main sections: 1) preparation of a cybersecurity strategy and 2) establishment of a national cybersecurity agency.

THE FIRST PART RESTS ON EIGHT PILLARS:

1. Defend, deter, and reinforce safeguards against external and internal threats
2. Foster international cooperation in the field of cybersecurity
3. Expand state capacity to support the development of ICT
4. Bolster Lebanon's educational capacity within the realm of cybersecurity
5. Build up industrial and technical capacity
6. Promote exports and the global expansion of Lebanese cybersecurity companies
7. Strengthen collaboration between the public and private sectors
8. Expand the role of security and intelligence services in cybersecurity while boosting cooperation and coordination among the agencies with the support and supervision of higher authorities

FUTURE OUTLOOK

Lebanon has a chance to bounce back with the implementation of both the Digital Transformation Strategy and the National Cybersecurity Strategy, by strengthening its position and focusing on digital economy opportunities and citizen services.

■ Lebanon is ranked 109th in the world and 12th regionally in the ITU Global Cybersecurity Index 2020, and is expected to drop further

The country is a greenfield environment for cyber developments, especially on the public sector side, since not many e-Government services are established or implemented. It actually lays the foundations to secure the right design to the full implementation, while focusing on citizenship centricity alongside contingency plans to ward off local, regional, and international threats.

CYBERSECURITY GENERAL RECOMMENDATIONS

Since the Cybersecurity Strategy was approved, there is an opening for Lebanon's digital transformation, and with it comes an urgency for cybersecurity, like fighting cybercrime, maintaining good standards for data security, system integrity and preventing high-profile breaches. Such improvements will place Lebanon in a better position and give the country a chance to improve its position on the ITU Global Cybersecurity Index.

LEBANESE NATIONAL DATACENTER

For a successful digital transformation, a national data center is not just an option but rather a necessity to host both the public and private sector; particularly considering the range of challenges like electricity cuts and high operating costs. There is fragmentation across the board at present, including within the banking sector; demonstrating the need for the cooperation of security information and critical security data sharing.

A national datacenter will (a) resolve the data residency problems, (b) provide 24/7 operations, (c) ensure business continuity, (d) secure better solutions, (e) centralize the management, (f) allow efficient security analysis and response and, (g) most importantly assure lower cost.

COOPERATION ACROSS ALL SECTORS

A public private community partnership should be enabled; particularly to help empower the cybersecurity strategy and have a new business model to move away from outdated and inefficient systems.

Locally developed solutions coming from the private sector and the community can bridge the gap of accessing new affordable solutions; like licensing, upgrades, and more cost-effective management, whilst at the same time boosting the national digital economy.

OUTDATED SYSTEMS

The worsening economic situation and lack of foreign investment is significantly affecting the delivery of basic services and management of digital resources. Major capacity constraints are increasing the prevalence of old systems (hardware and software) with an outdated maintenance status. It is important to note that such obsolete systems increase vulnerabilities for hacking attacks directly or indirectly. Among the objectives of both national cybersecurity and digital transformation strategies is to realize the best approach for addressing this emerging deficiency in financial resources.

GOVERNANCE AND LEGISLATION

Despite the government's approved Cybersecurity Strategy and with it the establishment of a 'National Commission against Cybercrime and for the Strengthening of Cybersecurity', efforts need to be taken towards the actual formation of this commission and other relevant groups. Such a commission is essential to monitor the effectiveness of proposed interventions, sharing of data among various agencies and planning further initiatives to address the impacts of cybercrime. The commission can compel other administrations to comply with decisions or coordinate with automation projects. In this regard, a sustainable institutional framework with comprehensive mandate for co-ordination of all cybersecurity activities and interventions is also critical, and is currently lacking.

However, implementation of the strategy with appropriate human and financial resources are required for the effective enforcement of the Law 81/2018. In addition, implementation decrees for the management of cybersecurity interventions need to be formulated as soon as possible.

The legal and technical approach should also be enhanced, with the main goal of identifying penal responsibilities throughout the investigation phases, while efficiently implementing actions and measures to combat cybercrimes.

One of the main challenges is to formulate a modern legal framework and to strengthen the law enforcement agencies: Army, Internal Security Forces, General Security, and State Security to provide an updated and comprehensive security system and to establish a national Community Emergency Response Team.

CYBERSECURITY SKILLS AND RESEARCH

The shortage in human resources with cyber skills is contributing further to a national vulnerability for cybercrimes. As such, capacity building and knowledge are indispensable to meet cybersecurity provisions in both public and private sectors. In addition, raising awareness and providing formal training in cybersecurity for all employees who deal with any system in any capacity is necessary to win the undeclared cyber war.

> Major capacity constraints are increasing the prevalence of old systems

Higher education institutions, like universities, can take a lead role to direct careers towards filling the skills gap, and most importantly be at the forefront of cybersecurity research and development for arising innovation in the field.

LASTLY, BEING PROACTIVE, NOT REACTIVE

A proactive approach seeks to prevent cyberattacks from occurring in the first place which can lead to a much higher benefit, strong continuity of operations, return on investment and excellent reputation.

The only way to combat all of the above cyber threats and attacks is through the establishment of a nation-wide system capable of orchestrating a coordinated response within a unified framework incorporating technical and legal aspects.

Rudy Shoushany is the founder and host of DxTalks and an expert in the governance of cybercrime and transformation. He is also chair of LMAG Internet Governance Forum – (IGF) Lebanon Chapter.


Children's Cancer Center
Lebanon
كلّو إلا الدواء
ساعدونا ما نقول لأ لأي طفل مصاب بالسرطان
سوا منكمل مسيرتنا لتأمين العلاج
لأطفال مرضى السرطان.
أكثر من ٥٤٠ طفل، على كافة الأراضي
اللبنانية، بحاجة للدوا والعلاج.
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In collaboration with KONRAD ADENAUER STIFTUNG

By Marwan A. Marshi and Samer Marchi

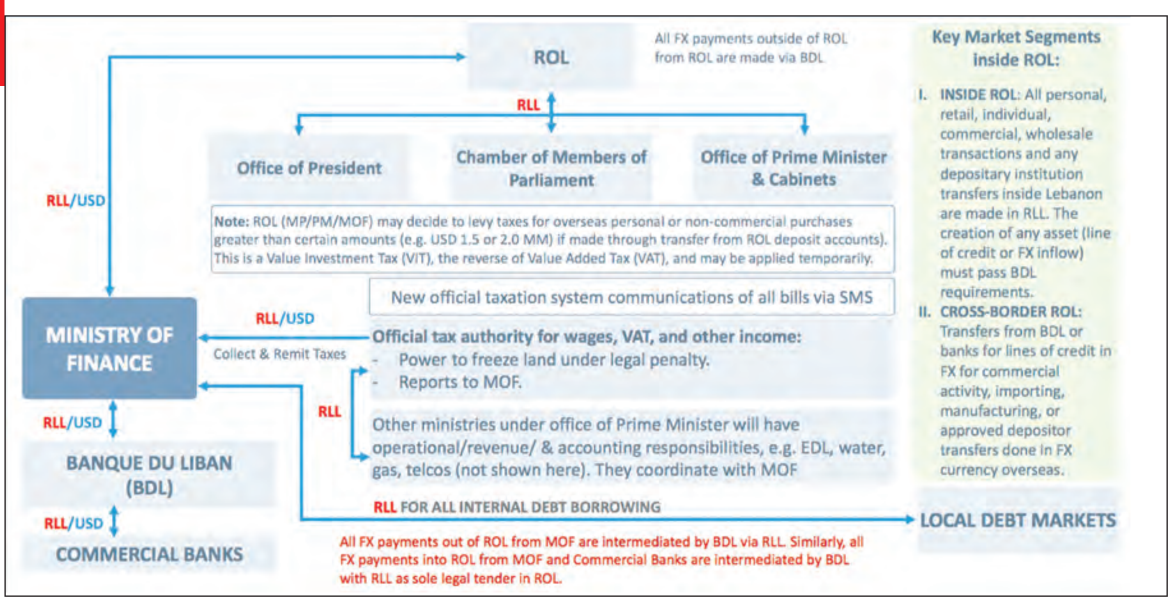
ONE PATH TO SURVIVAL WITH NO FORKS IN THE ROAD

A new financial system is required to lift the nation from its bowels of misery

Lebanon's socio-political-economic cancer has metastasized through critical levels of political corruption and nepotism, with flagrant economic and social exploitations, from politicians, their institutions, and the elitists who surround them. The country's fiscal and monetary platforms need a thorough overhaul, which stand as the formal starting point to remedy the state's inherent calamities.

Earlier this year, on June 22, Marshi & Partners (MAP) presented a comprehensive Reform Plan (RP) for Lebanon. MAP's newly designed financial system is presented in Exhibit I (below). Its primary focus is simple – creating robust, independent divisions with the necessary knowledge, and checks and balances, legislated by a judicial infrastructure. Every successful nation across the globe employs similar processes.

REPUBLIC OF LEBANON (ROL)



The proposal provides executable solutions for the majority of the catastrophes that plagued Lebanon since its days of prosperity in the early 1970s. Lebanon's self-inflicted problems resulted from actions and decisions bordering on deliberate and institutional fraud. They destroyed the moral identity, integrity, and dignity of the nation, disrespecting our citizens, while abandoning future generations with shameful legacies that require too long to heal.

MAP designed a restructuring of Lebanon's financial system, consistent with best practices. The proposed new financial structure analyzes three pillars: (A) Ministry of Finance (MOF); (B) Banque du Liban (BDL); and (C) Commercial Banks. The primary emphasis is on BDL, as it is the most critical component of the system today, marred with a current convoluted and haphazard structure, compounded by irresponsible input from MOF and commercial banks (A and C). Once the state is serious about restructuring; we could see ripples of confidence and trust in nine months to a year.

It is practically impossible to establish sustainable solutions for around 95 percent of Lebanon's population – primarily middle-class and lower-class citizens, and those below poverty lines – unless fiscal and monetary financial discourse is fixed first. The approach must include fiscal control of governmental expenditures, efficient tax collection, along with monetary actions to inject confidence in the local currency, control inflation, lower unemployment, and expand GDP.

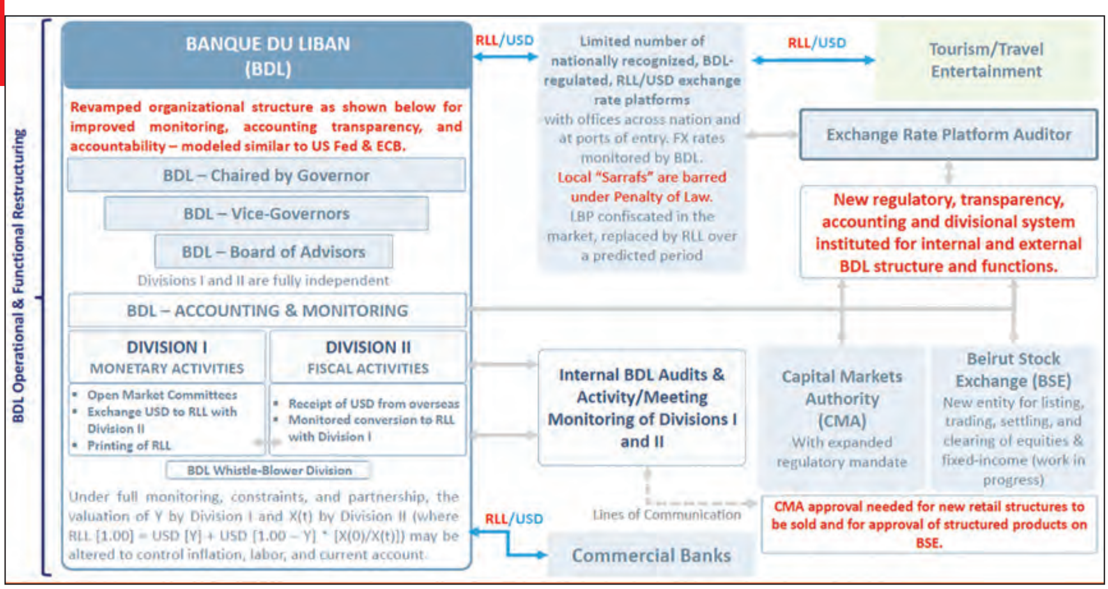
> Lebanon was robbed of its stature and wealth through domineering foreign affairs

In developed, prosperous, and democratic countries, whenever political and financial problems collide, financial solutions usually out-trump politics towards reform. Political agendas ebb and flow and are often overly debated. What may be popular one year may become toxic in another. Alternately, the health of financial markets is always necessary, and it generates an atmosphere of productivity and efficiency.

Lebanon is a developing country, and over the past decades, our government's political and monetary strategies grew in obstinate directions of sectarian divides, mired by exceptional fiscal embezzlement and corruptibility. Lebanon was robbed of its stature and wealth through domineering foreign affairs, mostly found on fraud, malfeasance, and exploitation, against a backdrop of impunity. Decades of financial carnage resulted in the collapse of the commercial banking sector and BDL, the central bank, just before the end of 2019. The civil uprising of October 2019 was the straw that broke the camel's back, as frustrations and inequalities of the past near decade eventually erupted, in a somewhat peaceful, yet aggressive, nationwide manner, never witnessed before in Lebanon's modern history.

Ironically, the savior for politicians against the government's compounded misfortunes arrived as

BANQUE DU LIBAN (BDL)



Page 31

a result of the outbreak of the global COVID-19 pandemic in January 2020, when protesting was banned for health reasons and became legally and practically prohibited – a significant win for the government to procrastinate, especially as no solutions were agreed to let alone contemplated.

From the onset of 2020, two of several debacles sent Lebanon reeling further downwards. The first was the announcement of the government's first-ever international debt moratorium in March 2020 by Prime Minister Hassan Diab, the short-lived replacement after the resignation of Prime Minister Saad Hariri. The second was the heinous Beirut Port explosion in August 2020, the combination of which led to Hassan Diab's resignation. The country's woes continue to disintegrate, as the World Bank defined the financial crisis as one of the worst in the world since the mid-19th century.

Let us not forget that since its independence from France in 1943, Lebanon has advanced with the most highly qualified educational, social, and medical institutions in the Arab world, with one of the highest literacy rates in the Middle East. It championed robust, westernized, international banking and commercial organizations, with a cosmopolitan, multi-lingual environment, under a democratic constitution, albeit one that needs restructuring, to appease current times. Lebanon commanded tourism, with a breathtaking, fertile landscape, a complete western Mediterranean coast, countless rivers, ski-high mountains, and deep tree-lined valleys, envied by most nations in the region. The country, with all its problems, has always been a beacon of hope, with resilience under any duress.

Lebanon's character and history provide a unique opportunity to reengage in principles of fairness and morality, so long as the government abides by its mandate for integrity and fairness. If we fail with solutions in the now, our day of reckoning is around the corner.

FISCAL PROGRAM

In the fiscal part, MAP designed a program to reduce the Ministry of Finance's total debt outstanding. We investigated all our indentures, covenants, and our Fiscal Agency Agreement, and designed what we termed the Switch Exchange Offer (SEO).

SEO is a unique strategy that allows for the exercise of our Collective Action Clause (CAC), in a manner that applies to all Eurodebt. It allows MOF to restructure the liabilities by extending maturity, lowering interest expenses, and reducing principal outstanding. The restructuring of local debt is not as involved, particularly because it is governed by local law, and the Lebanese pound (LBP) depreciated significantly. In our fiscal phase, we reduce our debt from close to USD 104 billion pre-crisis to around USD 20 billion post-restructuring. The entire process could be completed in less than one year.

MONETARY PROGRAM

Since 1997, post the Taif Agreement that ended the Lebanese civil war, the Lebanese pound was pegged to the US dollar (USD) at a constant rate of LBP 1,500/USD 1.00. It was not until 2019 that the Lebanese pound collapsed and by early September, 2022 reached levels as high as LBP 35,000/USD 1.00.

For any return of confidence in our currency, a change in structure is required. A significant portion of problems arose from the careless printing of the pound and irresponsible acts of financial engineering.

With this in mind, MAP has incorporated a new "benchmark currency" into the strategy, called the Republic of Lebanon Lira (RLL). RLL is not the central theme that restores confidence, but it nevertheless represents a vital ingredient.

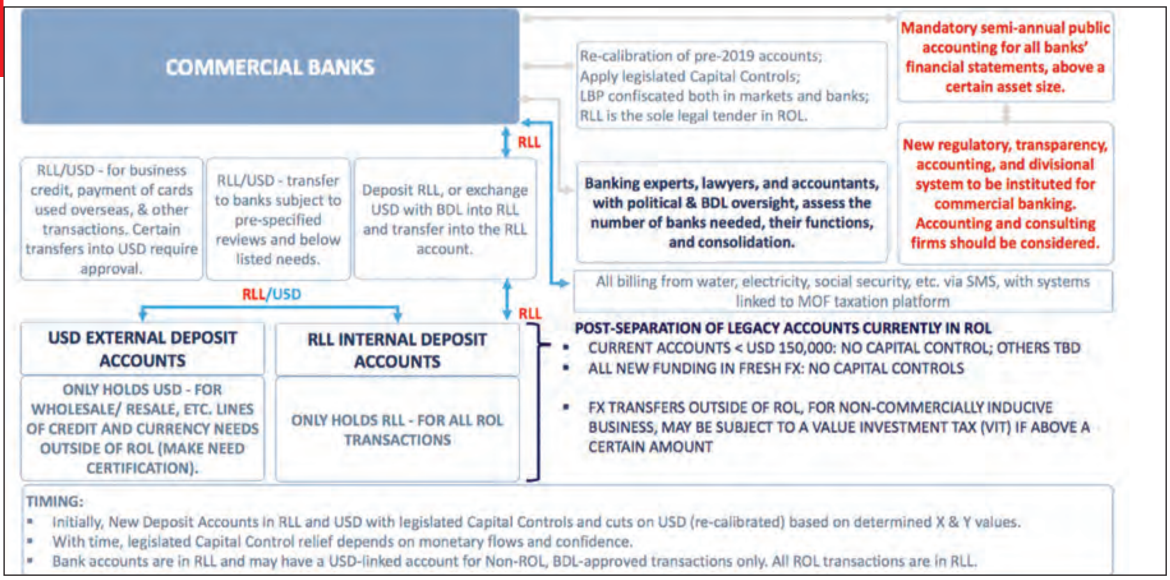
MAP proposes the following scenario. RLL becomes the new and sole legal tender, the only currency accepted for any transaction inside Lebanon. Concurrently, LBP is confiscated in exchange for RLL. RLL bills for circulation will be newly minted, and RLL will enter the Fedwire system for electronic international transfers, post-conversion to USD, at then-prevailing exchange rates, as defined below. RLL will have two components, a pre-determined amount of USD and a Lebanese Lira-Indexed (LLI) Value. The stapled nature of RLL makes it a single unit that cannot be separated into individual elements and is "collateralized" by them. Cross-border transactions will be dealt with using RLL in local bank accounts, converted to foreign currencies, using reserves at BDL. To apply some level of consistency, RLL should be somehow related to the confiscated Lebanese pounds, and that may be accomplished, albeit at controlled levels of monitored "issuance."

> RLL becomes the new and sole legal tender, the only currency accepted for any transaction inside Lebanon

Assume the following exchange rate equation applies between RLL and USD:

- RLL [1.00] = USD [Y] + USD [1.00 – Y] * [X(0)/X(t)], where

COMMERCIAL BANKS



- RLL = New Republic of Lebanon Lira
- USD = US Dollar
- Y = Pre-determined fixed USD amount, for an 'initial parity condition,' so RLL 1.00 = USD 1.00
- X(0) = Constant exchange rate, for the initial parity level of legacy LBP to USD
- X(t) = "Monetary Variable" representing a Lebanon Lira-Index (LLI) to manage monetary policy, to control inflation, unemployment, and GDP.

When RLL is introduced, at t = 0, RLL 1.00 will equal USD 1.00, by definition. X(0) will be the initial parity level of legacy LBP/USD. As an example, if Y is set at USD 0.70, which appears as a reasonable approximation of the current percentage of Lebanon's GDP in USD; and X(0) equals legacy LBP 20,000/USD, Lebanon meets its preliminary parity objective, RLL 1.00 = USD 1.00.

If X(t) is changed to LBP 30,000/USD at a future period t, then RLL = USD 0.90. Alternately, if X(t) is changed to LBP 10,000/USD at a future period t, then RLL = USD 1.30.

It is difficult to set the equation parameters presently, without full knowledge of the existing data. Importantly, future BDL monetary changes are instituted through changes in X(t) at time intervals of t. The value of X(t) will be managed by a pre-determined percentage change by several institutions to ensure fairness and transparency. At the outset, and until Lebanon's economic confidence is retrieved, the International Monetary Fund, the World Bank, BDL, and the MOF will be in charge of setting X(0) and the percentage range within which X(t) can alter periodically, based on extensive historical, economic, monetary, and statistical data, with appreciation of market dynamics and reactions. Eventually, after trust in BDL is achieved with the highest integrity, the value of X(t) will be determined by BDL, as shown on page 31.

Once Y, X(0), and the parameters influencing X(t) are established, RLL is produced. Legacy Lebanese pound, LBP, will be translated into RLL and confiscated. All commercial banking deposits will be translated into RLL, through systematic and transparent processes, not described in this article for simplicity. Local transactions will be performed in RLL as the sole currency, while cross border activity is executed through exchanging RLL into USD at prevailing exchange rates through BDL's FX reserves.

Legacy Lebanese pound, LBP, will be translated into RLL and confiscated

The advantages of replacing the Lebanese pound are numerous. Firstly, any constant peg of LBP would be gone, and with it the outlandish mispricing opportunities in parallel and black markets. The exchange shops, or "sarrafs" would be outlawed, and a limited number of nationally regulated exchange rate entities would be established with offices all around Lebanon.

BDL would be divided into independent Divisions I and II, with various, yet complementary functions to separate the flows of USD and RLL inside Lebanon. Division II will be tasked with exchanging all USD net transfers across Lebanon (such as proceeds and payments of foreign borrowings, internal remittances and external transfers, and financing current account deficits), in exchange for RLL from Division I at prevailing RLL/USD exchange rates. Division I will be tasked with exchanging all USD net transfers within Lebanon in exchange for RLL with Division II at prevailing RLL/USD exchange rates, and is the only entity allowed to print RLL. In such a manner, all Lebanese constituents, such as merchants, suppliers, and retail bank customers perform USD transactions under the checks and balances between Divisions I and II as follows: To the extent Lebanese constituents require USD transfers outside Lebanon, Division II withdraws RLL from the Lebanese constituents RLL commercial banks accounts and exchanges them into USD from Division I for such transfers. The reverse processes apply for Lebanese constituents' RLL commercial bank accounts receiving USD from outside Lebanon. While we use USD here to explain the flows between Divisions, any other international currency may be substituted. We use USD as the primary example because a) Lebanon has a predominantly dollarized economy and b) the USD is the reserve currency of the world.

All RLL/USD exchanges between the two Divisions are pre-approved, recorded, and monitored. Divisions I and II, within BDL, operate under different management and are accounted for and monitored separately and independently. Both Divisions jointly establish monetary policy for inflation, labor, and current account stability, and intermediate with the MOF to assess fiscal policy.

The three charts in this comment are our exhibit I, which illustrates the proposal of our new financial system, with emphasis on Part (B), BDL's operational restructuring. Exhibit I may appear complex, because it is a full and robust description of A, B and C. In real life, it is simple to develop, given the advances in financial system speed and technology.

There are exceptional advantages to instituting RLL as the new currency. For purposes of illustration below, we set Y at USD 0.70; X(0) at LBP 20,000/USD; and use X to denote X(t).

1. RLL cannot be separated into its individual components; namely, USD 0.70 and the remaining LLI portion of the RLL, and the issuance of RLL is fully monitored and controlled by BDL's Divisions I and II.

2. RLL will be the sole legal tender accepted in Lebanon, with judicial penalties against any violations. Further, all commercial bank deposits will be denominated in RLL, with fluent access to transact in foreign currencies outside Lebanon, through BDL's Divisions.

3. RLL is neither a "peg" nor a "free-float" currency; its value can be adjusted based on changes in its variables with the USD: a fixed component, Y, and a tight range-bound variable component, X.

4. X does not change daily or independently, rather it is altered periodically by BDL and its advisory committees, as and if needed by market conditions.

5. RLL will generally be similar in currency composition to Lebanon's GDP composition, providing for more efficient stability in Lebanon's current account.

6. RLL's volatility is estimated to be less than one-fourth the volatility of the defunct legacy LBP, as a result of the stabilizing impact of a constant Y value, and the tight range-bound X value, offering consumers comfort and stability in valuations and inflation.

7. RLL's value for X is limited in reasonably stable markets, and will generally be calibrated such that RLL remains within USD 0.80 to USD 1.20, over a long time period, unless unmitigated conditions warrant otherwise.

8. RLL's downside limit is USD 0.70 plus the residual USD value from X's LLI component.

9. Unregulated "sarrafs" will be outlawed, and a limited number of nationally regulated exchange rate entities would be established to provide RLL in exchange for USD, for tourism and other small retail transactions.

MAP's logic is based on history, using the two extremes of currency exchangeability. At one extreme would be the 'peg concept,' perhaps at LBP 20,000/USD, or whichever alternate constant figure. At the other extreme, the currency is allowed to 'float freely' against other currencies. History has proved that neither extreme would be successful for Lebanon. Hence, MAP applied a point in between, designed to calibrate the local financial environment, by X adjustments. The country can apply specific constraints on RLL allowing it to serve as the common nucleus needed to advance and confront the most critical problem we face.

■ Citizens are exhausted from their collective miseries, observing one of history's worst brain drains

Taken holistically, we believe that along with MOF's domestic and foreign debt reduction program, RLL's stated advantages make it an ideal monetary product for Lebanon.

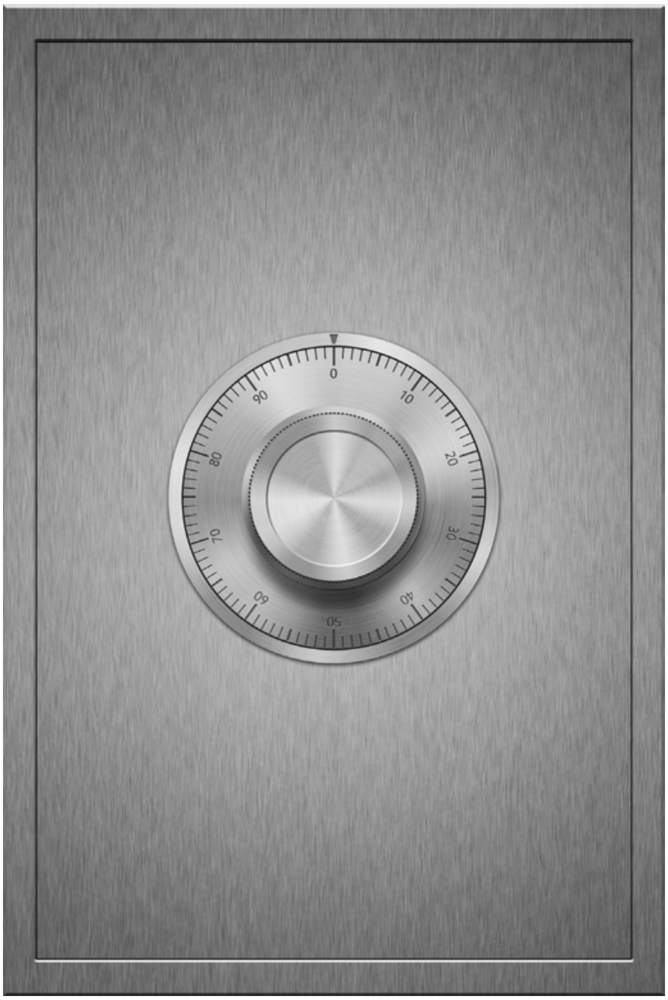
If Lebanon places belief solely behind the sanctity of politics or finance, independently, we will surely fail for several more years, perhaps decades, to come. Citizens are exhausted from their collective miseries, observing one of history's worst brain drains, under a mere two hours of electricity per day.

The will of the people must prevail. With that, the only way to stabilize the nation is by first revamping our financial system, outlawing corruption, and retrieving confidence. Once those are done, political problems and standoffs, whatever their genesis, will be resolved. The Lebanon of the past must retreat from its old processes and mannerisms if we are to save the nation.

Marwan A. Marshi is the founder and chairman of Marshi & Partners, a financial innovation boutique specializing in the advice and execution of corporate and sovereign liability and risk management strategies. Samer Marchi is a founding member and director of Marshi & Partners.

By Mounir Rached

AN INFAMOUS DEBT BUILD UP



Economic reform first, then debt rescheduling will follow

Lebanon's fiscal policy over the past decades has been in most years very expansionary. Fiscal deficits at the end of the civil war relied heavily on domestic currency financing. Foreign exchange had been largely depleted by disruption to trade, while inflows declined as families immigrated. Due to the scarcity of financing in US dollars, combined with a need to start reconstruction, the government started to rely to a larger extent on borrowing domestically and internationally in dollars.

Central bank reserves in the 1990s were quite low as the war years depleted Banque du Liban (BDL) of its foreign exchange. Relying only on domestic markets for foreign currency financing was perceived to exert further pressure on the exchange rate. Borrowing in dollars was prompted by two factors: the need to finance reconstruction and the need to have sufficient FX to maintain the peg that was adopted in 1997.

During that period, the Lebanese pound (LBP) interest rate was quite high, in the double-digit range, which also contributed to the worsening of the deficit. The government was attracted to foreign borrowing to secure needed foreign money for the budget, ease pressure on the exchange rate, as well as lowering its cost. The higher return rate provided by Lebanese banks, relative to regional and international markets, attracted increased inflow of FX into Lebanon; and banks discovered it as a lucrative channel to borrow from international markets through short-term deposit inflows and lend locally at a good interest rate with differential margin in its favor. This process made it easier for the government to borrow in dollars without straining the FX market. The government then made an official arrangement to issue Eurobonds under the jurisdiction of the state of New York later on in 1990s.

Political division and the absence of clear fiscal and debt policy encouraged the government to expand its spending as long as financing was available and its service was guaranteed by further borrowing. It created a vicious circle - borrow to finance FX needs and borrow again to service FX debt.

As is well known, public debt is generated by fiscal deficits, and even in years when a primary surplus was achieved, it served as an illusion that current operations excluding debt service provided a sustainable debt scenario. Only a manageable deficit, preferably with a primary surplus, a low interest rate, and a high growth rate can provide debt sustainability, which means placing the debt to GDP ratio on a declining trend. These ingredients were not stable and also difficult to attain in Lebanon due to several factors. Government spending for the most part was current in nature, capital spending was sustained at a very low level and priority was being given to current spending, while cost of capital remained at a high level.

The sustainability of debt has to have reliable ingredients and based on the determinants of the debt ratio to GDP. It is presented in this simple relationship:

D=(1+i-g) *D-1 – PS

Where D is debt to GDP ratio ***i*** is the effective real rate of interest rate on debt, ***g*** is real growth rate and PS is primary surplus as a ratio of GDP. The growth rate of the economy, the primary deficit, and interest cost are the three dominant outcomes used to determine the debt outlook and sustainability. These variables can be displayed in nominal terms as well but the substance of the analysis remains the same.

Debt increases whenever a real interest rate exceeds growth, and with a negative primary balance (overall deficit without interest payment). The primary balance comprises total revenues less total current expenditure (excluding interest) and capital spending. Current spending contains mostly wages and salaries and spending on goods and services.

The distinction between primary balance and total balance (deficit) is largely connotative. When a surplus is realized in the primary budget it means that, had the debt of a country been non-existent and there was no debt service, then the budget could have realized a surplus. It is meaningful when a country has a potential to undertake a debt rescheduling; reducing interest payments or spreading them over a longer period. It could help the country either to significantly reduce its deficit or even achieve a balanced outcome. Therefore, the larger the primary surplus, the better the sustainability outlook, as part of interest cost can now be covered from the primary balance.

The post-war strategy of Lebanon was based on several critical choices that led to a rapid accumulation of fiscal deficits and debt. These included the need to accelerate growth, enhance security, law and order, provide social services, rebuild infrastructure, recover trust in the Lebanese currency, and improve living conditions.

This vision required increased spending at all levels while the room to advance tax collection remained limited with a weak tax base in an economy emerging from 15 years of war. At that time, the government perceived that it was essential to increase public wages, including retirement compensation for the civil and security service, increase spending on infrastructure, health and education, and allocate funding to return refugees to their towns and villages. The government's vision to boost spending despite a limited tax base, necessitated embarking on a grand borrowing scheme from internal and external sources. The monetary policy then strived, without success, to lower interest rates in order to pacify the escalating debt service cost while maintaining Lebanon as an attractive destination for capital inflows. The challenges facing the economy limited the opportunities created by foreign borrowing under the umbrellas of Paris I and II conference in 2001 and 2002.

To have a declining debt ratio, the real growth in the economy should be greater than the real interest rate, and revenues should exceed expenditures. Debt sustainability is interpreted as the condition that stabilizes the debt ratio which is satisfied if the ratio of excess revenue to GDP is at least equal to the excess of interest rate over growth. In simplified words, the debt ratio is stable when change in debt to GDP ratio becomes zero.

DEBT PROGRESSION 2011-2019

In spite of political turmoil that prevailed following the assassination of former Prime Minister Rafic Hariri in 2005, successive governments had been able to arrest economic deterioration; growth rebounded, the balance of payments (BOP) achieved significant surpluses, and interest rates stabilized. Exceptional performance was recorded between 2007 and 2010. Growth was recorded in the range of 8 percent for four consecutive years (2007-2010), and the debt ratios declined for the first time in a decade. Certainly, external aid under Paris II and III aided in lowering interest rates and in improving the debt dynamics. Fiscal deficits reductions were supported by growth rates, lower interest rates, and stable expenditure.

Following 2011, the period witnessed political and economic terrain change for the worse

Following 2011, the period witnessed political and economic terrain change for the worse, alongside the backdrop of political instability in Syria, growth rates declined as well as state revenues, and interest rates started rising again, leading to higher deficits. Debt accumulation escalated since then and the BOP recorded large deficits.

Several factors have pointed to the fact that the beginning of 2011 was a turning point for both the fiscal and the balance of payments. In 2011 and 2012, a commitment was made to increase wages and retirement payments by more than 10 percent. But at the same time, no revenue measures were taken to compensate for the wage increases. Resultingly, deficits started escalating due in part to irregular recruitment on a contractual basis without recurrence to official standards. Increased spending and deficits coincided with a slower pace of growth. Deficits continued to rise in excess of 7 percent of GDP in most years.

In 2017, another decision was taken to increase wages and retirement payments by more than 20 percent, though it was not implemented until the following year. Electricity sector subsidies, especially in years of higher oil prices, posed an additional burden on spending and the deficits.

The debt profile was on an unsustainable path even before the beginning of the crisis in 2019. Lebanese banks were already hesitating to lend to the government in the ten years prior. The central bank with induced interest rates became the major debtor to banks, instead of the government. Higher interest rates attracted banks to lend their foreign exchange reserves that were placed in international markets to BDL and benefit from their higher interest rates. BDL became a main source of financing for the government and most domestic debt was financed by BDL, as well as a sizable portion of the dollar debt issued as Eurobonds.

Banks then would deposit most of their dollar reserves with BDL and in turn BDL would lend the government. The higher interest rates, inducing slower growth, contributed to the worsening of the fiscal and debt outlook. Banks did not respect prudential guidelines nor did the Banking Control Commission impose any. Nearly 70 percent of bank deposits were channeled to BDL and the government, in violation of the guidelines of the Code of Money and Credit. Banks, as well as depositors, came under the absolute control of BDL. Higher interest rates were provided for longer maturity CDs, which made bank operations rather simple but involving much higher risk, due to the concentration of their loans in the public sector at a time when net reserves of BDL were declining.

The government's access to easy financing, in spite of its higher cost, lured it away from engaging in genuine reform. To the contrary, it continued its pattern of high spending without any concern for the consequences.

Certainly, the debt build-up that evolved to a crisis level in October 2019 reflects mismanagement of the economy on every level. Expenditure strategy and government plans were not designed to achieve a clear framework objective. Often economic targets were disengaged from the needed policies to achieve them, while government budget responded to the needs of politicians.

The major causes of debt build up and derailed debt policy can be summed up as follows:

- The political spectrum revealed deep divisions that ended in a protracted formation of the legislative body as well as the executive body. Formation of parliaments suffered a cumulative delay of 2,321 days between 2006 and 2018.
- The parliament which was supposed to end its term in December 2006 was extended until June 2013, and the parliament that ended it term on June 20, 2013 was extended until the May 6, 2018. Government formation at the Council of Ministers level during the same period took 1,449 days.
- Presidential elections were delayed 1,073 days in 2007-08 before the election of President Michel Suleiman and in 2014-16 before the election of President Michel Aoun.
- The continued deficit in the power sector.
- The size of the debt itself.
- The previous two actors absorbed nearly 90 percent of the debt service.
- The number of public sector workers has expanded exponentially during the past decade.
- Currency stabilization often required higher interest rates to attract a continued inflow of capital, which constituted an increased cost.

The confrontation between the public and government came heads on when, on October 17, 2019, a proposed policy to impose levies on voice-over-IP calls of the popular application, WhatsApp, was the climax in a culmination of mismanagement and state distrust. The public expressed its anger in a nationwide protest movement demanding political upheaval and revealing major state and governmental mistrust.

Lebanese banks were already hesitating to lend to the government in the ten years prior

Fiscal and debt problems peaked when the government defaulted on its Eurobond debt in the spring of 2020.The default induced banks to sell Eurobonds in order to generate liquidity as BDL announced that it no longer supports the peg.

As the government suspended payment of debt amortization and interest on Eurobonds to domestic and foreign holders, debt accumulation built up. Since then, arrears on debt service have been accumulating and the debt issue has worsened today. The issue of debt service in dollars resulted in sizable balance of payments deficits since 2011 and the decline in BDL reserves. Under pressure to

DEBT PROFILE (BILLION LL) USING OFFICIAL EXCHANGE RATE OF LL 1507.5 TO THE DOLLAR

	Dec 2019	*April 2022*
Total debt	138150	152337
Local currency	87279	92710
BDL	50712	59430
Com,Bnks	25316	18533
Other local	11246	14742
Foreign currency	50871	59667
Bilateral	(95)	(742)
Multilateral	(2074)	(2450)
Eurobonds	(47225)	(56430)
Banks' holdings	(20826)	(6018)
Arrears	(0)	(15118)

Source: Ministry of Finance

preserve foreign exchange as much as possible, BDL took the decision to terminate the exchange rate peg prematurely. At that time, June 2019, BDL still held a comfortable level of reserves at $34 billion, sufficient to finance the BOP for another several years; although the net reserve position of BDL was negative even before then. There was concern that in the absence of any corrective fiscal adjustment and potential to correct the BOP deficit, BDL took a pre-emptive decision to terminate its commitment to finance banks. Then, over $60 billion were held as FX liabilities to banks.

It's apparent that sovereign debt is on an upward trajectory due to continued fiscal deficits and accumulation of arrears on Eurobond principal and accrued interest.

The depreciation of the currency has certainly changed the debt profile. The total debt in dollars shrank from $100 billion to $42 billion, as the pound lost 95 percent of its value. Since GDP data in dollars remains dubious (according to the World Bank it is in the $25 billion range), the debt ratio is about 168 percent. The debt profile did not change much from the pre-crisis period as a result of gains recorded in Lebanese pound debt which compensated significantly for the dollar drop in GDP.

The profile of debt financing sources has changed since the crisis. Banks reduced their financing of the government in both domestic and foreign currencies. Commercial banks financing of the government in Lebanese pounds declined from LL25 trillion at the end of December 2019 to LL18 trillion at the end of April 2022. Domestic debt held by BDL grew and its holdings of treasury bills increased from LL51 to LL59 trillion.

Foreign currency debt holdings of banks dropped sharply from LL20 trillion or $13 billion, to LL6 trillion in an attempt by banks to obtain foreign exchange as the supply line of BDL dried up. Most of the decrease was absorbed by international financial institutions. These bonds were offered at a highly discounted price; ranging from 15 percent to 25 percent in the later transactions. Foreign financial institutions, in spite of the government default, wanted to increase their holdings to above 40 percent of total issues in order to maintain a decisive role in a resettlement or rescheduling agreement.

NEED TO CHANGE

The view of successive governments, especially those of the numerous Councils of Ministers headed by Prime Minister Rafic Hariri between 1992 and 2005, did not foresee the complications that face Lebanon: the limited administrative capacity, weak government institutions, widespread corruption, deep political divisions, and the long-term damage exerted by the pegged exchange rate. The latter actually was strongly supported as an anchor of stability, ignoring the high cost of debt service that accompanies massive borrowing schemes. All these factors have hindered the planned progress of any government.

The elder Hariri built his vision for Lebanon's reconstruction and development in the 1990s on the assumption that peace in the Middle East is inevitable and substantial aid could flow into Lebanon in compensation for settling the Palestinian issue and the return of internally displaced Lebanese to their towns and villages. However, none of these optimistic scenarios was fully realized. Lebanon was provided with European financial support thanks to several Paris agreements under the auspices of French President Chirac. But ineffective successive governments did not make full benefit of such generosity. Billions of dollars were wasted due to both mismanagement and corruption. Policies were never fully implemented and many were not in the proper frame for Lebanon. It became apparent that debt build up would continue year after year, into the future. Since the current crisis began, no significant reform has taken place and debt has reached the LL152 trillion.

To get out of its dilemma, Lebanon has to embark on a serious and massive reform plan first, rather than reschedule its debt without it. Reform has to take place in all branches of the public sector, fiscal, monetary, civil service, and the public enterprise sector. The energy sector alone has been a major cause of foreign currency debt accumulation. Simply rescheduling debt is not enough to place Lebanon on a sustainable debt track.

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In collaboration with KONRAD ADENAUER STIFTUNG

By Mounir Rached

NO LEGAL LEGS TO STAND ON: MIKATI'S PLAN FOR THE FINANCIAL CRISIS

The Government's proposals are undesirable for depositors

Since the start of Lebanon's financial woes at the end of 2019, the government has proposed several measures to address the liquidity crisis in banks. Yet all the suggested measures signify blatant infringements on the financial assets and deposits of individuals as well as those of institutions. This means there is a possibility that measures, if adopted, will trigger judicial procedures. Such court action might arise from Lebanese expatriates and it could also harm relations with the countries where these expatriates reside, including in the Gulf and European nations. In another flaw, the plan does not address the fate of deposits in Lebanese pounds and the huge losses incurred.

Furthermore, while representing major infringements to depositors, the government's plan does so without providing convincing justifications. The failure of Banque du Liban (BDL) and the state to service its debts to commercial banks and depositors is a violation of the Constitution, and the Code of Money and Credit. In fact, these funds deposited with BDL by commercial banks amounted to around $71 billion, of which $58 billion has been spent by the state in financing its deficit and subsidies with hard currency, and over the past two years, used by BDL to manage the fluctuations in the parallel market rate.

The $71 billion estimate is a residual figure calculated from the balance sheet of the central bank and the commercial banks. BDL intervened in the currency market with its negative net foreign exchange positions. Under such circumstances, it must have abandoned the policy of pegging the exchange rate of LL1,500 to the dollar to save deposits and the banking sector.

The financial rescue plan composed by Caretaker Prime Minister Najib Mikati and approved by the Council of Ministers in May 2022, just before the government dissolved prior to the parliamentary elections, targeted the write-off of all categories of deposits, even the smallest ones. The write-off and discounts of depositor's money can be summarized below. However, it should be noted that these figures, though lifted from the government's plan, have to be viewed with room for error.

Mikati's plan for the distribution of $104 billion in losses is as follows (all exchange rates are hypothetical):

- $16 billion is to be converted to deposits in Lebanese pounds (LBP) at the exchange rate of LL5,000/$1, and this amount can be withdrawn by the respective depositors over a period of 15 years. When using an exchange rate of LL20,000 to the dollar for calculation of the aggregate loss of this action to depositors, the result is $12 billion, which means that the equivalent of $4 billion will be preserved as LBP. This amount's present value, at a 7 percent discount, is $2 billion.
- $35 billion, also withdrawable over a period of 15 years, will be converted into deposits in Lebanese pounds calculated on an exchange of LL12,000/$1. This would be the equivalent of $21 billion, so the loss will be $14 billion on the exchange rate. Its current value is $10.6 billion.

• $25 billion will be paid in dollars on deposits below $150,000. With a ceiling per deposit of $150,000, these deposits would also be withdrawable over a 15-year period. This tranche's current value is $12.5 billion.
• $6 billion dollars will be paid for deposits between $150,000 and $500,000 and transferred in lira at the rate of LL20,000/$1 and paid within 15 years. Its current value is $3 billion.
• Perpetual bonds, without checking their current value, will be subjected to bail-in at $22 billion turned into bank shares ($12 billion)
• Perpetual interest-bearing bonds (unspecified) from banks ($10 billion)

The total that will be converted into Lebanese pounds is $79 billion out of $104 billion ($104 billion minus $25 billion). The present value of all deposits after these measures reaches only $28.2 billion. By excluding stocks and bonds, only $12.6 billion in dollar deposits will remain of the total $104 billion, and the remainder is converted into the lira, and its current value reaches the equivalent of $15.6 billion. Therefore, 88 percent of dollar deposits will be written off.

WHAT THE PLAN FAILS TO ADDRESS

The calculation of the accumulated interests since 2015 includes all the interests that exceed a certain percentage (which has not been specified). As such, there are many unanswered questions: Does it include the interest that was transferred abroad and if so, why is it not included? Are those who transferred their money abroad required to return the excess interest? And does this, therefore, mean that whoever kept his money in Lebanon will bear the burdens of money transferred outside by others?

The fault, of course, is not on the part of the depositor, but on the part of the banks and BDL, the latter is responsible for showering the markets with high interest rates. These interest rates accordingly tempted deposits, which were then deposited at BDL by banks with high interest rates.

As for the deposits that were converted into US dollars (estimated at $35 billion), $14 billion will be lost through the exchange rate of LL12,000 to the dollar. Although, it is possible that this money was originally converted from dollars to pounds and then to dollars. How are we going to deal with it?

The amount of $91.4 billion has been written off from deposits (calculated by deducting $12.6 billion in current value from $104 billion), is equivalent to 88 percent of the total. Therefore, only 12 percent of the dollar accounts will remain and 88

The economic impact of this measure will be devastating

percent of all dollar deposits will be subject to be converted into Lebanese pounds. All the money converted into pounds and the rest in dollars will be withdrawn from banks over a period of 15 years. This means more write-offs are incurred due to the regressive time value of money.

It is necessary to review the risks of this plan because the government intends to place the burden on the depositors. It should be noted that Caretaker Prime Minister Mikati has reiterated on several occasions that the biggest burden will be on the citizen and announced that the cancellation of deposits will be mostly for accounts exceeding $100,000, but in fact, the write offs of deposits impact all categories of accounts.

A WRITE-OFF FOR THE ECONOMY

The economic impact of this measure will be devastating; depleting citizen's purchasing power, alongside the lost trust in the state and the banking system. There are simple alternatives to this that are useful and confidence-building in the economy. The most important of which is the complete liberalization of the exchange rate, which in turn will contribute to reducing the deficit, which must be reduced to the lowest levels in the first year, and then move towards balance afterwards. Public sector debts, as well as the assets and liabilities of banks must be rescheduled based on the practices that prevailed before the crisis. This will allow deposit holders to withdraw from their deposits in dollars or in pounds from dollar accounts on the free currency rate if the dollar is not available in sufficient quantity.

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