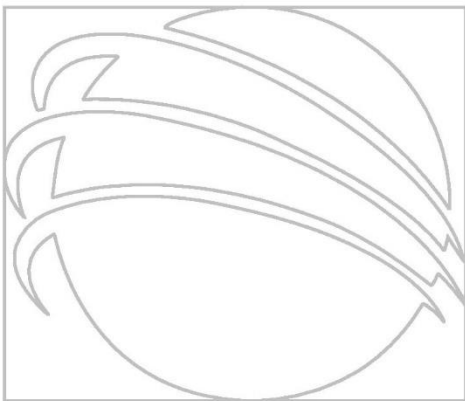


**MRC Working Papers**

No 19\_EN/2020

**COMMENTS ON SEIGNIORAGE IN  
LEBANON**



**NIKOLAY NENOVSKY**  
**PETAR CHOBANOV**

ISSN 2534-9465

September 2020

JEL classification: E51, E52, 053

Keywords: Monetary Policy, Central Bank Balance sheet,  
seigniorage, Lebanon, Financial Crisis

# Comments on Seigniorage in Lebanon

## Nikolay Nenovsky

Professor of Monetary Economics, University of Picardie, France  
Associate Researcher, SU HSE, Moscow  
Member of the Bulgarian National Bank Governing Council  
(nenovsky@gmail.com)

## Petar Chobanov

Professor of Economics, University of National and World Economy, Bulgaria  
Former Minister of Finance

September, 2020

The seigniorage (money income), its size and methods of calculation, as well as its accounting, are an important topic in the debate on the financial crisis in Lebanon. We will focus, firstly, on some principles of seigniorage, and secondly, on how we think the Lebanese data can be interpreted (based on the EY and Deloitte audit, for the end of 2018). We leave aside the political and geopolitical motives that determine the structure of the balance sheet of the Banque de Liban (BdL).

## I On the seigniorage

Seigniorage is the income that the sovereign state power receives through the monetary authority (Central Bank/CB). CB has a monopoly on the national currency issue, controls the monetary base, and normally its balance sheet. Part of the seigniorage generated by the CB remains at its disposal, part goes to the executive branch - the government (through direct transfer or through interest subsidies), part to the banking sector (when interest rate subsidies), and, of course, abroad (in case of unfavourable interest rate differential). Every CB in the world can be considered not only as a monetary institution but also as an investment bank. In this case, we can define two sources of seigniorage - from the issue of currency (theoretically known as **monetary seigniorage**) and from normal banking intermediary activity, i.e. maturities transformation (**banking seigniorage**). Often, the latter seigniorage is known in the literature as seigniorage from "opportunity costs". The total amount seigniorage is the sum of these two parts.

**Monetary seigniorage** is equal to the increase in the volume of currency in circulation (banknotes and coins) multiplied by the interest rate of the assets that stand against them, minus the cost of maintaining money circulation. **Banking seigniorage** is the difference between assets and liabilities multiplied by their respective returns. Unlike monetary seigniorage, the assets generating banking seigniorage are longer-term and riskier (against them are all liabilities in excess of money in circulation and current deposits in national money). Hence, the CB balance sheet can be analytically divided into a balance sheet of an "Issue department" and a balance sheet of a "Banking department" (in Bulgaria, for example,

where we have a Currency Board, this division is legal and therefore two separate balance sheets are published).

In general, according to accounting practice, seigniorage should appear in the “Profit and Loss account”. In the balance sheet, and more precisely in the “General reserves”, remains the part which is retained by the Central Bank.

**Table 1. Analytical presentation of the sources of seigniorage** (simplified balance of BdL)

	Assets	Liabilities
<b>Issue Department</b>  Money seigniorage (theoretical seigniorage)	Highly liquid foreign assets (generally low yield, mostly cash)	Money in circulation and current deposits of banks (in LBP)
<b>Banking Department</b>  Banking/financial seigniorage (seigniorage from financial intermediation)	Loans to banks and loans to banks under financial engineering (in LBP)  Lebanese securities (in LBP)	Term deposits of banks (in USD and LBP) and certificates of deposit (in USD)  Government deposits (in LBP and USD)

Source: authors elaboration

**II On the seigniorage in Lebanon**

There is no clear information on how exactly the seigniorage in Lebanon is calculated, as well as its two components. Below we use the EY and Deloitte audit and data as of the end of 2018 (interesting dynamics in the balance of BdL in 2019 and 2020, are not considered).

In the case of Lebanon, the first type of seigniorage, **monetary seigniorage**, is not large and cannot be. This is determined by the fact that Lebanon is highly dollarized and maintains a fixed to USD exchange rate. Confidence in the fixed exchange rate and the LBP requires the pounds to be covered by highly liquid short-term foreign assets, including dollar cash. In recent

years, this type of assets has zero or even negative returns. In fact, the currency cash (almost equally, - Usd and Euro) covers over 130% of banknotes and coins.

In 2007, the BDL decided officially to record the seigniorage on banknotes and coins (named "seigniorage on currency") in its balance sheet, both as an asset and as a liability. At the end of 2018, the accumulation of this seigniorage reached 8.6 billion dollars. Of these, over the years, 7.9 billion have been transferred to the liability account "deferred interest expenses and other financial costs", where the costs of paying high interest rates to banks, other revaluation financial costs, etc. are deferred. These accounting transfers will stop in 2016. This is because the growth of monetary seigniorage is becoming increasingly insignificant. As a flow, it officially decreases - firstly, due to the weakly demand for pounds (supported only by the payment of wages in pounds in the public sector), and secondly, due to the declining return on foreign assets that stand against these pounds. For example, in 2017 the seigniorage on currency was 266 million dollars (0.7% of GDP), and in 2018 it became 152 million (0.3% of GDP), extremely low figures.

We observe the same dynamics in the second type of seigniorage, **banking seigniorage**. In fact, in net form, it should be negative, due to the subsidy (through interest rates) that BdL makes to the banking sector as a result of its "financial engineering". (BDL pays banks interest on time deposits and CD in the order of 2 billion Usd, and receives interest on loans it has given them 0.5 billion Usd, ie a net of 1.5 billion Usd). This net transfer to the banks has been the subject of fierce criticism in the media. BdL earns about 1.2 billion Usd from the government through treasury bills. It also earned 0.9 billion Usd in BDL deposits abroad. As a result, what remains in BdL from this seigniorage is practically zero. This is indirectly confirmed by the suspension of transfers in 2016 and this type of seigniorage to the account "deferred interest expense and other financial costs".

One clarification. In fact, BdL talks about "seigniorage on treasury bills" and has recorded it in its balance sheet as an asset and liability since 2009 (updated in 2014). Its volume is 50 billion, and officially from it in "deferred interest expense and other financial costs" 12 billion Usd are transferred. In 2017, the income from Lebanese securities increased by 5.1 billion Usd, and in 2018 it was 7 billion Usd. In our opinion, this is the gross income from Lebanese securities, not the "bank seigniorage" in question, which is a net concept.

To compensate for the growing interest costs to banks, i.e. to postpone through accounting reductions of the position "deferred interest expense and other financial costs", BDL introduced on April 11, 2018 in its balance sheet, as an asset and a liability, a third type of seigniorage. It is called "seigniorage on financial stability" and its distribution is determined solely by the Governor. Of the total, written amount of this seigniorage, which is 13.3 billion, in 2018 6.8 billion are transferred to the account "deferred interest expense and other financial costs". It could be assumed that this amount is the expected income from securities from next year, assuming that it will be the same as in 2018. It is assumed, in our opinion, that this accounting virtual compensation will continue until the system stabilizes. That is, deferred interest payments to banks will be offset by future income from securities. That is why Riad Salamé says that seigniorage is "an important instrument of monetary policy" (something conceptually new to monetary theory). Salamé therefore mentions that the "financial

engineering and leverage arrangement mechanism” preserves the exchange rate and saves time for stabilizing public finances. These are the officially declared motives.

The events after 2018 showed that this system was fragile and therefore it collapsed. The causes and mechanisms of the financial catastrophe are well described in the Lebanese press. They are generally well known from the theory of balance of payments crises and crises of the banking system. We will limit to say that the Lebanese crisis is clear proof that a small and dependent country (such as Lebanon) cannot independently control its money supply in a fixed exchange rate regime, and that it cannot be an active financial intermediary. Sooner or later, the net domestic assets of the monetary authorities get out of control, the net external assets become negative and the system collapses. In 2018, for example, with declared gross foreign exchange reserves of 38 billion Usd, but the net external assets of the Central Bank are negative (- 29.6 billion Usd).

A similar process was observed in Argentina in the late 1990s. Bulgaria is one of the few countries that did not repeat these errors. In 1997, a Currency Board was introduced in the country, where domestic assets were removed from the Central Bank's balance sheet. And although the monetary seigniorage is small and even negative, in Bulgaria we do not have the threat of accumulating losses in terms of domestic assets, as well as the temptation for the Central Bank to become a political tool for redistribution.

### **Bibliography**

Deloitte and Ernst and Young (2018). *Central bank of Lebanon financial statements and independent auditors' report, year ended 31 December 2018*, Beirut