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Why a Currency Board would not work in Lebanon

Riad Obegi|

In Lebanon today, the new fad is the Currency Board. Its proponents claim that this “panacea” would have avoided our present ills, would establish a discipline that roots out corruption, would avoid the Central Bank messing with the banking sector and helps establish an advanced state. Proof to that they offer the case of Hong Kong as success story of a Currency Board.
If a comforting example does not prove the rightness of a theory, a counterexample is sufficient to establish its wrongness.
The successes of Hong Kong probably lie more with geography, Chinese discipline and sound economic policies than with their praised Currency Board. Argentina’s currency boards on another hand, were clearly not successes (allegedly for idiosyncratic reasons).
More generally, historic currency boards could be considered as an expression of subsidiarity where the local central banks had a delegation to issue currency but under the monetary authority of the British Central Bank. In that respect, today’s national central banks in the European Monetary Union could be viewed as successful currency boards under a unified currency.
If Lebanon were to establish a Currency Board, should the Banque du Liban keep foreign reserves equal to cash money and deposits by commercial banks (M0) in BDL? Since Lebanon has a dual currency circulation (less so after the crisis) should it keep additional reserves on the dollar M0? Since the currency crisis erupted despite the BDL having reserves equal to more than three times M0 in local currency, should the reserves take into account the M0 plus sight deposits with commercial banks (M1), or maybe with term deposits (M2)?There are clearly no experience and no clear theory.Let us then examine the question on a simple model. Let us assume that in a normal country (resembling Lebanon) the GDP is $50 billion, the state debt is $100 billion, the deposits in banks are $50 billion, the cash in circulation and the deposits at Central Bank are $2 billion. The Central Bank is operating under a Currency Board and has $2 billion in foreign reserves. Suddenly economic agents are worried and want to change their local currency against international currency.
Clearly reserves will not be enough in a state of panic, it would need the full M2 or even the full state debt to be covered lest local currency to collapse and inflation to soar.
More importantly, whatever the reserves, they are wasted in a seignorage in favor of the country on which currency the national one is pegged. In our previous example, $2 billion are not invested in the country but rather in a foreign country. Those $2 billion should generate, if invested in Lebanon, more than $200 million a year. Wasted!The real problem is the possibility by the state to borrow in national currency. As long as it has this possibility, it will always be tempted to renege its obligations, creditors will always be worried by this possibility, interest rates will always be higher than market prices and insecurity will always hamper business by economic agents.

Riad Obegi is the chairman and general manager of BEMO Bank.