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FOREIGN EXCHANGE PRACTICES

IN THE ECONOMY

OF

LEBANON

By

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## INTRODUCTION

An introduction is probably best defined as the first step in the departure from complete ignorance. To the inquiring mind, much is left to be learned in later stages. It often expects complete, detailed and comprehensive answers. The reader is cautioned to the fact that this study does not provide such an answer. The questions which it raises probably exceed those which it answers.

In economic inquiry as in research in other fields, the individual mind being of finite consciousness, fails to understand the whole space-time continuum. It cannot compass all its entities. Nor can it perceive all the lines of relationship among these entities. It can only inquire into and study some portions of them. From these relationships it infers lines of causation, analyses them and seeks to derive therefrom its answer to the specific inquiry.

The method has its limitations. It unavoidably compasses a limited number of entities, excludes others which may be of real significance, and often over-exposes some factors to the detriment of others. These limitations cannot be overcome, and the procedure is quite legitimate. However, proper reservations should be applied to the findings and conclusions. Aside from the difficulty of tracking the facts back to their origin, the difficulty of compassing the numerous forces involved in the emergence, development and growth of these forces, and of compre-

hending their interplay and full significance, the researcher is often handicapped by inadequacy of factual data, unreliability of some information and probably by a natural tendency to overlook some facts and overemphasize some others.

Institutions for statistical and scientific exploration of aspects of economic and social life, which are well developed and very common in most Western countries, are practically unknown to Lebanon as well as to most Eastern countries. Thus whereas in the West, economic problems can be approached with measuring rods and instruments of a high degree of precision, in Eastern countries (and Lebanon is no exception), such approaches should be made subject to serious reservations regarding correctness of the underlying estimates and information.

This is no apology for the weaknesses which the present study might have. In fact this paper suffers from a number of inherent weaknesses. They are implied by lack of some necessary data, unreliability of some of the data utilized and arbitrary exclusion of certain non-economic aspects which had or still have significant influence over the economic aspects dealt herewith. This, however, it is believed, does not invalidate the findings and conclusions of the study. They undoubtedly do not distort the portrayed lines of causation among the various phenomena and different forces that are examined. Yet sound analysis requires that these weaknesses be pointed out and the reader cautioned thereto. To borrow Edmond Burke's phrase "We cannot walk surely but by being sensible of our blindness."



With regard to the inquiry into the soundness of the laws and practices with which this study is concerned, it should be stated that these make up an integral part of the system of economic laws and practices of the country as a whole. The roots of this system stretch far beyond the economic arena, deep into the social culture of the society. Such systems or laws usually reflect conditions of the society to which they relate. An economic system which is proper to one country or society need not be proper to another which is of a different economic and social status. The "economic laws" proper to a medieval society with implications of feudalism differ from those proper to the Greek city state where culture was rooted in slave labor, or to a Hindu clan where people belong to different castes according to whether they were born of Manu's head, thighs or feet.. etc. Culture itself is greatly influenced by the type of economic activities which the society undertakes, and these activities are largely determined by the kind of resources with which the country is endowed, and by its climatic conditions and geographical position. It should be borne in mind therefore, that an inquiry into the soundness or appropriateness of an economic system has significance only when reference is made to a given country with a given socio-economic structure.

The purpose of this paper is to study the Lebanese foreign exchange practices with a view to determining their implications and effects on the Lebanese economy. A survey of these practices and of the foreign exchange market occupies a large part of this paper. This survey is not an end in itself. It is rather a

stepping ground to the analysis of the effects of these practices on developments and growth in the economy and their significance therein. To render this analysis possible it was deemed necessary to include a survey of the general structure of the economy under study, depicting its salient features and expounding the growth or decline of the country's important economic activities as have taken place alongside with the relaxation of exchange restrictions. This survey makes up the first chapter in this paper and provides the essential elements in the light of which the significance of the exchange practices are later examined.

Chapter II offers an account of the historical development of the foreign exchange practices. Starting with a brief description of the situation prior to 1939 when exchange restrictions were first instituted in Lebanon, it proceeds following up development and then relaxation of these restrictions up to 1948 when the free market was officially recognized.

Chapter III is a survey of the Beirut foreign exchange market with due account made of exchange operations carried on in other Lebanese centers. The survey covers the nature and size of the market, its important relations with other markets and the forces which govern its activities.

Chapter IV discusses Lebanon's international trading activities within the general framework of the balance of payments and the money market. Particular consideration is made of the

country's commodity trade statistics for the year 1950 through 1954 with respect to the over-all deficit and the composition and direction of trade.

In chapter V the general problems of a free money market are discussed with special emphasis on the implications of the different types of exchange rates as well as of the problems of external solvency, internal monetary stability and capital movements. In the discussion of these problems due reference is made to the special conditions of the Lebanese economy, thus expounding the particular implications of the Lebanese free money market.

Chapter VI concludes this paper by knitting the various threads spun in the preceding chapters, and venturing some conclusions.

In trying to give the text as much unity and order as possible, the subjects treated were dwelt upon in relation to their importance with regard to the freedom of exchange policy. The text as it may be observed has some repetition. This, it is believed, is justified by the nature of the study and the procedure adopted.

## CHAPTER I

### THE STRUCTURE OF THE LEBANESE ECONOMY

#### THE LEBANESE ECONOMY:

Lebanon is a small country of about 10,400<sup>52</sup> square kilometers with a population of about 1,500,000 inhabitants. Within its small area, the country comprises a unique combination of a contrasting variety of physical features. A narrow strip of plains stretches all along the coast. A few kilometers away rises a range of mountains reaching heights of about 3000 meters. Further to the East, rises another range of mountains and running alongside with the forementioned range forms the border line between Lebanon and Syria. Enclosed between the two chains is the country's largest and most fertile plain, the Bekaa' plateau. Other fertile but small plateaus are found on the various mountain slopes. The country as a result of these particular physical features has significant differences in climate within short distances, and consequently a widely diversified agriculture.

Lebanon is densely populated. A large part of its area is mountaineous, and the arable land cannot be greatly extended. No important natural resources have been discovered in Lebanon. Its population, however, through trade and a wide range of services have expanded the boundaries of the economy far beyond the confines of the political state. Basically diversified the

Lebanese economy is now highly dependent on trade and services.

Industrially, the country is far from being fully developed. Owing to market limitations, high costs of production and foreign competition, most Lebanese industries are operating with excess capacity. In addition to these impediments industry in Lebanon suffers from generally low productivity of labor and deficiencies in industrial, technical and managerial qualifications. Nevertheless, Lebanon has a national per capita income that is higher than most countries of the Near East. By Western standards, however, this per capita income is low, and the country is economically underdeveloped.

The population is comparatively well educated. The country is in close contact with the West and is open to its dynamic spiritual and cultural values and ideologies. The people as a result, have become aware of the great chasm between their socio-economic conditions and those of the West. Out of this awareness springs today not only a strong impetus to build the Lebanese economy on modern bases, but also the feeling that Lebanon is called upon to play a special role in the elaboration of a new approach to economic and social problems for the area.

#### THE DOMESTIC SECTOR

##### AA- AGRICULTURE:

In contrast to most countries of the Middle East, Lebanon is the least predominantly agricultural. Only a small portion

not exceeding 37 per cent of its area is suitable for agriculture, and the remaining 63 per cent consists mainly of mountainous land. According to a survey made in 1950, by the Central Office of Statistics, the area of Lebanon is divided as follows:

TABLE I (1)  
Classification of Land in Lebanon

<u>Type of Land</u>	<u>Thousand Hectares</u>
Cultivated Area	273
Irrigated	48
Rainfed	225
Cultivable but uncultivated	115
Forest	74
Rocky and waste area	556
Others	19
TOTAL	<u>1,037</u>

The potentially cultivable area of the country is very limited. It consists mainly of marginal land on which heavy outlay would yield only meagre returns. Plans for the expansion of cultivable land through irrigation are now underway. As yet only a small area is irrigated and considerable water resources are still undeveloped. Irrigation projects are not likely to bring new land under cultivation, but rather irrigate mostly cultivated land that is now rainfed. For this reason Lebanon

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(1) Conference on Agricultural Credit; Report on agricultural Credit in Lebanon, Beirut, October, 1953 p.2.

should direct its efforts to develop its agriculture towards an intensification of cultivation rather than attempt to bring new land into use. (1)

The agricultural land of Lebanon is parcelled out into a large number of very small holdings and a small number of relatively large ones. Most of the farmers own the land which they cultivate; and agricultural landless laborers are not more than 10 per cent of the total farming population. (2) About 95 per cent of the land owners own small holdings of less than 10 hectares each, and a very small proportion not exceeding 0.007 per cent of the land owners own holdings of more than 50 hectares. (3) An increasing number of the small farmers are becoming part time farmers and are supplementing their farm income with wages earned in rural and urban centers.

The population of Lebanon is roughly estimated at about 1,500,000 people, with a density of about 145 persons per square kilometer. These figures are very rough estimates since the last population census was made in 1932, and the registration of births and deaths is far from being complete. In the absence of adequate demographic data, assumptions relating to population

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(1) Sir Alexander Gibb & partners, The Economic Development of Lebanon, 1948, p.41.

(2) Conference on Agricultural Credit; op. cit. p.5.

(3) Ibid. p.5.

may be made by a scrutiny of the birth and death rates determinants which characterize that society. Lebanon is believed to be now in what demographers call the transitional phase from the pre-industrial to the industrial stage. In this transitional stage, society starts acquiring adequate medical services, better nutrition and improved sanitation; death rate therefore, falls. But the rate of birth, being governed by cultural and socio-economic factors which do not change as rapidly as those that determine the death rate, falls at a lower rate. Society then experiences a high rate of population increase which is believed to be true of Lebanon at the present time. There are usually however, social and economic differences between urban and rural communities, with a higher rate of increase in the latter. In the case of Lebanon these differences are so pronounced and significant that a much higher rate of increase for the rural population can be confidently assumed. There are however no reliable estimates for the rural population of Lebanon; the Ministry of Agriculture estimate the number of persons who derive their livelihood from agriculture at about 50 per cent of the total population.<sup>(1)</sup> The population density to the cultivated area is therefore high, and persons engaged in agriculture have on the average an area of only 0.40 hectares of cultivated land. This average is very low, when compared with the 5 hectares per person in Denmark and 28 hectares per person in the United States.<sup>(2)</sup>

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(1) Conference on Agricultural Credit; op.cit. p.2.

(2) F.A.O. "Yearbook of Food and Agricultural Statistics, 1952."



This overpopulation of the cultivated land together with a low productivity of agriculture which characterizes the Lebanese agrarian economy, <sup>(1)</sup> have contributed to a continued and serious movement of population from the rural areas to the urban centers. With these centers offering only a limited number of employment opportunities, emigration abroad has been sought as a partial solution to the problem of overpopulation. Low productivity of agriculture and overpopulation of the cultivated land however, still prevail. They are reflected in a considerably low rural per capita income which does not exceed L.L.300 compared with a L.L.800 <sup>(2)</sup> per capita income for the country in general. An appreciably higher income however, is normally earned by some of the farmers whose land is located on the narrow coastal plain, and who grow high value crops such as citrus and winter vegetables.

Annual income from agriculture is estimated at about LL. 210 million or about 20 per cent of the national income of the country. <sup>(3)</sup> Fruits constitute the principle source of Lebanon's agrarian income, and a substantial portion of the crop is usually exported every year. In 1953 such exports made up about 30 per cent of the total agricultural exports which normally account for slightly less than half the value of the total exports of the country.

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(1) A.Y. Badre, National Income of Lebanon, Monograph No.1.

(2) Ibid.

(3) A.Y. Badre, Report on the National Income of Lebanon for 1948-1950, p.1.

With the exception of fruits and vegetables Lebanon is deficient in the production of most of the important agricultural crops. It has to rely heavily on imports to supply a substantial part of its requirements of wheat, sugar, rice and meat. In 1953, the total imports of Lebanon were valued at LL.361.7 million <sup>(1)</sup> of which approximately LL.119.6 or 33 per cent <sup>(2)</sup> were paid for imports consisting of agricultural products. However, production in both the surplus and deficitary crops is increasing. But while in the case of the former it is increasing at a rate which is higher than is offset by the increase in the local demand, it fails in the case of the deficitary crops to keep pace with the increase in the local requirements. <sup>(3)</sup> Government efforts are now being directed towards increasing production of crops in which the country has a shortage, and towards promoting exportation of surplus products.

#### B - INDUSTRY:

Lebanon is still in its early stages of industrialization. But compared to most countries of the Middle East, it is at present more industrialized. In 1950 income arising in the industrial sector was about LL.140 million or about 13 per cent of the national income of the country. <sup>(4)</sup> With the exception of income from trade and income from agriculture, it was appreciably higher than income from any other sector.

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(1) Direction Generale des Douanes, Statistique du Commerce Exterieur 1953. (Figures computed at official rates).

(2) Ibid.

(3) Ministry of Agriculture, A Special Report Prepared for the Regional Food and Agricultural Conference held in Beirut in October 1954.

(4) A.Y. Badre, Report on the National Income of Lebanon for 1948-1950, p.1.

In addition to about 10,000 persons that were engaged in handicrafts in 1950, there were about 22,000 persons employed in the various manufacturing industries. <sup>(1)</sup> Indications are that during the last four years employment in this sector shows a moderately rising trend.

Prior to 1919 Lebanon had only a few handicraft industries. With the development of sea communications, most of these industries practically disappeared as result of foreign competition. Among those that remained only the silk, the soap and the cotton weaven industries <sup>(2)</sup> were of some importance. Since 1925 substantial investments have been made in textile, cement, soap, tanning and food industries, and in a number of other light industries. Despite the protection offered by relatively high custom duties most of these industries suffered from foreign competition. The second world war however, with the consequent practically complete interruption of sea communications and the great demand created by the occupying armies, offered to the various industries effective protection and a great stimulus. New industries were built, and shared with those that were already in operation, the abnormal profits of the period. Since 1946, with the economic conditions returning to normal, the Lebanese industries in general, have been confronting the problem of strong foreign competition and of a resulting contraction in demand.

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(1) A.Y. Badre, National Income of Lebanon, Monograph No.3 p.23.

(2) G. Menassa, Plan de Reconstruction de l'Economie Libanaise, Beirut, 1948, p.16.

A survey of the Lebanese industrial sector reveals a wide range of light industries producing mainly for the domestic market. <sup>(1)</sup> Exports of industrial products compared to either the output of local industries, or to imports of industrial goods are almost insignificant.

Most Lebanese industries are operating with excess capacity, and significant variations in the utilization of capacity exist among the various industries. The lack of utilization of plants to full capacity is attributed by trade circles to, "market limitations, lack of bilateral trade agreements with other countries, competition of foreign products, lack of encouragement by the government, and high costs of production owing to expensive fuel and lack of raw material." <sup>(2)</sup> Market limitations are undoubtedly serious impediments to economic growth in general. A country with a small home market cannot produce many commodities as cheaply as a country with a large market. The reason being that it has to produce them on a smaller scale. This appears to be true in the case of Lebanon where the home market is small and exploration of foreign markets has not so far been successful. The question of higher fuel and power costs being paid by the Lebanese producer becomes obvious, when comparison with such costs in other countries, is made. A Lebanese producer pays LL. 52 per ton of fuel oil, whereas his

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(1) UNRWA, Present Economic Structure of Lebanon, 1954, p.6.

(2) A.Y. Badre, National Income of Lebanon, Beirut, 1953, Monograph No.3, p.26.

competitor in Egypt pays LL.30 and in Iraq LL.29. He pays LL.70 per ton of gas oil compared to LL.59 paid by producers in Iraq; and PL.6 per kwh of electric power compared to PL.2, PL.0.80 and 2.50 paid by producers in New York, Tennessee Valley and in England respectively. (1)

This however, offers no explanation to the presence of excess capacity among the different industries and a net import of a number of industrial goods which are produced locally. The explanation to this situation, given in the National Income Study of Lebanon, is that products which are made locally and those that are imported are so different in quality that they can be considered as two separate commodities. (2) In other words potential buyers have preference for one commodity over the other, and the two commodities are not perfect substitutes though they may be classified under the same general category.

The National Income Study of Lebanon shows that the percentage of gross output to capital invested in industrial enterprises in Lebanon, is lower than it is in most industrialized countries. (3) It has moreover, shown that this percentage often varies with the different industries. A possible explanation would be the existence of varying degrees of over-capacity in

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(1) L.M. el Dahdah, The Industrial and Commercial Review of Lebanon; May 1954, p.8. (Computation made at free market rate).

(2) A.Y. Badre, op.cit. Monograph No.3, p.26.

(3) Ibid. p.28.

certain industries and of differences in efficiency. Differences in efficiency may be attributed to differences in the <sup>capital</sup> labor ratio and to technical and other factors. The existence of over-capacity however, probably reflects the fact that when these industries were set up, decisions regarding plant capacity, were influenced by conditions of a market characterized by a strong war demand, and an absence of foreign competition. In addition, most entrepreneurial decisions were made at a time when Syria and Lebanon formed one single market.

Most Lebanese industries therefore, having been set up according to decisions that were influenced by abnormal market conditions, confront today with market conditions being more or less normal, the problem of a reduced demand. The existence of over-capacity in such industries is a normal consequence of this situation.

C - SERVICES:

Lebanon provides a wide range of services from which it earns a significant portion of its income. Such earnings are estimated to have been in 1950 about LL.100 million or about 9 per cent of the national income of the country. <sup>(1)</sup> A large number of services however were not accounted for in these computations. Instead they were included in other sectors e.g. trade, transportation, communications, finance, etc. These

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(1) Ibid. Monograph No.4 p.23.

services are of great importance both because of the income they generate or the foreign exchange they yield.

With the available data, a breakdown into services rendered to non-residents of Lebanon and to residents is practically impossible. It is nevertheless, believed that the supply of foreign exchange produced by the sale of services contributes considerably to the equilibrium in the Lebanese balance of payments. <sup>(1)</sup> Such earnings accrue in the form of receipts for medical, educational, recreational and business services rendered to foreigners, (non-residents). Chief among these receipts are those earned from business which include income from transit trade, transportation, insurance, and exchange operations. Foreign exchange earned in 1951 and 1952 from this source alone was equivalent to about LL.130 and 148 million respectively. <sup>(2)</sup> Following in order of importance, are the receipts from foreign travel which include payments by foreigners for summer resorting tourism, educational and medical services. These receipts amounted in 1951 and 1952 to about LL. 20 and 25 million respectively. <sup>(3)</sup>

It is obvious therefore that the income from services is largely dependent on the volume of trade and the prosperity of tourism and estivation. The official recognition by the

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(1) E. Fei and P. Klat, The Balance of Payments of Lebanon 1951 and 1952; 1954, p.4.

(2) ibid, p.4.

(3) ibid, p.29.

government of the free market in 1948, and the persuance henceforth of a policy of economic liberalism, have given strong impetus to the development of such activities, and have contributed greatly to a steady increase in the earnings from transit trade, entrepôt transactions, transportation and exchange operations.

In addition to the benefits from a free market and a free trade policy should be mentioned the benefits reaped from the government encouragement of the free movement of capital. This policy has attracted substantial capital inflow and a large number of foreign companies which have interests in the Middle East. Relative political and economic stability in Lebanon also should not be overlooked as having been of great importance in contributing to the inflow of capital from some Middle Eastern countries which have been suffering from political instability. The building of the Beirut International Airport on the other hand, has contributed to the attracting of foreign companies and has increased appreciably the earnings from foreign travel. The number of incoming and out-going travellers for 1953 and 1954 was 260 and 325 thousands respectively with only a small number of them being of Lebanese nationality. Without accounting for whatever expenditures this small group of Lebanese travellers might have made the expenditures of foreign travellers in 1954 would amount to at least LL.50 million earned in foreign exchange in the form of hotel, transportation, recreation and similar expenses.<sup>(1)</sup>

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(1) F. Shader, Director General of Civil Aviation, Jan. 1955.



A number of other factors have contributed to an increase in the Lebanese earnings from services. Chief among them are the construction of pipelines from the oil-fields in Iraq and Saudi Arabia to the seaports of Tripoli and Saida, and the building of oil refineries at these terminals. Evidently therefore, there has taken place recently a number of developments and changes locally and abroad, which have promoted considerably the services activities of Lebanon, thus increasing appreciably the country's earnings therefrom.

D - MONEY AND BANKING:

I - CURRENCY

From the time it was introduced in 1920 until 1941 the Lebanese currency was linked to the French Franc and therefore followed changes in its value. It thus suffered from considerable fluctuations and depreciation. In March 1943 a French British financial agreement was signed, stipulating that France should undertake to maintain constantly the "countervalue" in pounds Sterling of the "Banque de Syrie et du Liban" holdings in Francs. Five years later, on January 24th, a Lebanese French monetary agreement was signed creating a new basis for the Lebanese currency. It provided also that the Lebanese authorities should within a maximum period of ten years, attain an independent status for their currency. With a view to attain this end and to provide for eventual currency stabilization, the government issued a law on May 24th 1949 defining the gold content of the Lebanese pound and authorizing the Treasury to purchase gold and to issue bonds.

In 1948 owing to the devaluation of the French Franc and Sterling together, the Lebanese note issue lost about one third of the value of its guarantee in French Francs. The Lebanese Government therefore issued on December 1948 treasury bonds to compensate for the loss in value of the Franc assets in the cover. In June 1949, the Lebanese Ministry of Finance began purchasing gold through the Banque de Syrie et du Liban. Ever since the policy seems to have been to increase whenever possible, the amount of gold in the cover.

A study of changes in the elements making up the currency cover, shows that occasionally it included some amounts of foreign exchange. But these were never kept for a long period. Instead they were exchanged for gold causing its percentage in the cover to increase steadily from 2 per cent in 1948 to <sup>90</sup>62 per cent in 195<sup>4</sup>. The table below shows the changes in the currency in circulation and in the gold cover during the last <sup>seven</sup>six years. <sup>(1)</sup>

TABLE II

<u>End of December</u>	<u>Currency in Circulation</u>	<u>Gold in the Cover</u>	<u>Ratio</u>
1948	185,000	3,707	2
1949	168,000	42,496	25
1950	196,000	70,345	36
1951	208,000	92,992	45
1952	200,000	109,179	55
1953	205,000	126,689	62
1954	242,000	218,534	90

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(1) Banque de Syrie et du Liban, Rapport du Conseil d'Administration 1954, p.14.

## II - BANKING

An increasing number of foreign banks have found in Beirut during the last six years a suitable center for their operations. In order to benefit from the free exchange market, they established branches in Lebanon, thus bringing the number of banks operating in Beirut from 21 in 1950 to 32 in December 1954.<sup>(1)</sup> Only ten of these can nevertheless be considered to be large and of importance, and they are all engaged in general banking business. The remaining twenty two banks are relatively small and deal chiefly in foreign exchange, and in lending money at high rates of interest. A general feature of all of them however, is the lack of specialization.

There is lack of commercial banking regulations in Lebanon. Any person or group of persons may engage in commercial banking without being subject to any special restrictions. Alike other commercial operations nevertheless, banking operations are subject to the law of contracts and obligations and to the Lebanese commercial law.

Lebanon has no central bank. The BSL performs certain central banking functions. It has the sole right of note issue, and is the sole government financial agent and depository of the government and other official establishments' funds. It has

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(1) I. Raftapoulo - Assistant Director of the B.S.L. 1954.

no definite money and credit policy of a central bank and has no means of controlling commercial banking operations in the country. However, Beirut developed in the course of the last few years into a center for financial operations of an international character. The number of banking institutions as mentioned above has increased considerably, and Lebanese bankers today, extend their field of activity and operations to most financial centers of the world. Financial activities of the country consequently have been increasing steadily as the following tables show: (1)

TABLE III

Lebanon: Total Deposits, Loans and Notes Discounted and Interbank Clearings in 1950-1954  
(in LL.1,000)

<u>Year</u>	<u>Total Deposits</u>	<u>Loans and Notes Discounted</u>	<u>Interbank Clearing</u>
1950	215,181	280,158	361
1951	259,297	318,333	553
1952	313,222	356,072	722
1953	343,420	357,089	576
1954	392,193	401,971	640

TABLE IV

Lebanon: Total Money Supply, 1950 - 1954, in LL 1,000

	1950	1951	1952	1953	1954
<u>Total money (base year)</u>					
<u>Supply</u>	yearly av.:	av. index	:Av. index	:Av. index	: Av. index
	:	:	:	:	:
	:	:LL.1,000	:	:	:
<u>Fiduciary issue</u>	183,125:100:	208,250:114:	200,250:109:	199,667:109:	246,206:134:
	:	:	:	:	:
<u>Demand dep'ts</u>	202,627:100:	215,831:106:	285,036:141:	314,468:155:	365,524:180:
	:	:	:	:	:
<u>Total money supply</u>	385,752:100:	424,081:110:	485,286:126:	514,135:133:	611,830:159:
	:	:	:	:	:

(1) Lebanon, Ministry of National Economy, Central Statistical Office, Bulletin Statistique Trimestriel, Vols. IV 1951, 1952, 1953 and 1954.

Income arising in the finance sector in 1950 is estimated to have been about LL.65 million or 6 per cent of the total income of the country.<sup>(1)</sup> The noticeable increase in the financial activities of the country as the above tables show, may justify the belief that income from finance is increasing appreciably.

E. GOVERNMENT FINANCE:

Income arising in the government sector is estimated at about LL.75 million a year, or about 7 per cent of the national income of the country.<sup>(2)</sup> Like most economically underdeveloped countries, Lebanon's tax system rests mainly on indirect taxes; these being easier to collect and require only simple government machinery. The revenue which the government derives from such taxes is as high as 75 per cent of its total tax revenue.<sup>(3)</sup>

Chief among the government sources of income are the customs duties which yield normally a little over one fourth of the total government revenue. Other important sources are "the tobacco tax yielding 17 per cent of the government revenue, the gasoline tax yielding 13 per cent, and the income tax yielding about 11 per cent."<sup>(4)</sup> With so large a portion of the government revenue being earned from one sole source, the customs duties, fluctuations in the earnings from this source have usually been readily reflected in the total revenue.

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(1) A.Y. Badre, Report on the National Income of Lebanon, 1948-1950, p.1.

(2) Ibid.

(3) A.Y. Badre, op.cit. Monograph No.5; p.24.

(4) Ibid. p.22.

The budget of the government has since 1953 included all its financial activities with the exception of those related to the National Lottery Bureau and the Telephone Department which have special independent budgets. Prior to 1953 there was a number of independent budgets which were gradually incorporated with the ordinary budget. This budget today presents an almost complete picture of the government revenues and expenditures. The following table shows budget totals, government expenditures according to five broad sources and government expenditures classified according to seven distinct categories:<sup>(1)</sup>

As the table indicates, the larger portion of the budget is devoted to salaries and ordinary operating expenses. The proportion of such expenses to the total government expenditures is approximately 65 per cent (including salaries and administrative expenses of military and internal security forces). There seems to have been very little change in this proportion over the three years surveyed in the table. The total amount devoted annually to public works during the last three years, averages about 10 per cent of the total budget. Increase in such appropriations in 1954 became possible because the last of the post war debts to France, Britain and the United States were paid off in 1953. Sums spent in payment of these debts can now be devoted to construction projects.

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(1) Ministry of Finance, Ordinary Budgets, 1952-54.

Economic development is financed only partly from the ordinary budget and partly from the Developmental Works Fund. Expenditure from the two sources on developmental projects amounted during the last ten years to LL.173 and 133 million respectively. <sup>(1)</sup> The largest amounts were spent on irrigation, drainage, water supply and roads and ports.

Lebanon has no external funded debt. Internally it is indebted by the approximately LL. 23 million in treasury bonds which are all held by the BSL, and are used as partial reserve <sup>(2)</sup> against the government currency issue.

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(1) UNRWA, Present Economic Structure of Lebanon, 1954.

(2) Lebanon, Ministry of National Economy, Central Statistical Office, op.cit. Vol. IV, 1954.

Dept.	BUDGET TOTALS						Source	REVENUES						Type	EXPENDITURES					
	1952		1953		1954			1952		1953		1954			1952		1953		1954	
	Total	% of G.T.	Total	% of G.T.	Total	% of G.T.		Total	% of G.T.	Total	% of G.T.	Total	% of G.T.		Total	% of G.T.	Total	% of G.T.	Total	% of G.T.
Tourism	2675	2.1	1536.8	1.2	574	0.4	Misc. receipts	8300	8.1	10183	7.7	12361	8.5	Public Works	12550.3	9.8	11490.5	8.6	15830	10.9
Lottery	4010	3.2	5100	3.8	5400	3.8	Fees - charges	9760	7.5	11383	8.5	11960	8.2	Social Affairs	6568	5.1	9437.3	7.0	12340.2	8.5
Customs	5300	4.1	3637.5	2.7	3362	2.3	Commercial Oper. & Public Services	19230	14.8	12325	9.2	13520	9.3	Debt Service	8949.3	6.9	7403.3	5.5	3892	2.6
Commercial Budget of the M. of N. Economy (Wheat Office)	16645	12.8	9000	6.7	7585	5.2	Direct Taxes	22615	17.4	26575	19.8	27958	19.3	Misc. Exp. Comm. Op. Wheat Office, Petrol. Subsid. travel refund to encourage Tourism	13445	10.2	10034.3	7.5	7473	5.1
Telephone	7050	5.4	6980	5.2	8737	5.2														
Lighthouse Admin.	-	-	-	-	540	0.4	Indirect Taxes	67775	52.2	73450	54.8	79863	54.8	Inter.Org. & Conf.	275.8	0.2	863.6	0.7	1023.1	0.7
Ordinary State Budget	94250	72.5	107661.7	80.4	119464	82								National Def. & Inter. Security	27445.2	21.1	31318.9	23.4	33305.1	22.9
														Sal.&Contingent Expenses	60696	46.7	63368.1	47.3	71798.6	49.3
Grand Total	129930	100	133916	100	145662	100		129930	100	133916	100	145662	100		129930	100	133916	100	145662	100

Source : The Republic of Lebanon Budgets of 1952, 1953 and 1954, Azar Press 1952, 1953 and 1954 respectively.



### III - THE FOREIGN SECTOR:

#### A - BACKGROUND

Thanks to its geographic situation, its moderate tariffs and to the special abilities of its population, Lebanon prior to the First World War had been distributing imported goods to Syria, Palestine, Iraq, Cilicia and Anatolia, Beirut, Tripoli and Sidon depended for their income largely on trade. (1) The period between the two wars witnessed a number of developments which impeded the growth of Lebanon's trade. Custom duties had been progressively raised for fiscal purposes. Developments in the economies of Palestine and Syria reduced considerably the dependence of these two countries on the trade of Lebanon. The construction of a modern port at Haifa, and the great industrial developments in the economy of Palestine not only deprived Lebanon of an important commercial tributary, but also competed with it strongly over the once tributary market of Jordan. Syria on the other hand with a view to develop its own trade has followed a policy to have Syrian traders assume the functions of the Lebanese traders in their dealings in trade for Syria. In accordance with this policy the Syrian Government has been making great efforts to develop the Lattakia port through which it can channel its trade, thus reducing its need for making use of the Beirut port. In march 1950, the Lebanese and Syrian economies once united in a customs union were finally separated. Since

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(1) G. Menassa, Plan de Reconstruction de l'Economie Libanaise, (Beirut, 1948) p.12.

then serious efforts have been made by the Syrian authorities to have Syrian traders take off as much as possible from the Lebanese traders' activities that have to do with trade for Syria. As a natural result of these developments, Lebanese traders lost grounds in the Syrian market.

However, the loss of the Syrian and Palestinian markets has been more than <sup>compensated</sup> offset by gains realized in the markets of Iraq, Jordan, Saudi Arabia and other countries of the Persian Gulf. The rise in the standards of living of these countries and improvement of communications with them have tended to increase considerably the volume of trade with them.

#### B - COMMERCIAL POLICY:

Realizing its dependence on trade, Lebanon since the termination of customs union with Syria has been following an open-door policy. Within this general framework, trade policies are formulated when it is necessary to meet emergency or special situations. Importation of a number of commodities is subject to the requirement of a prior import licence. Such licences are issued after careful scrutiny by the authorities concerned for the purpose of protecting domestic industries.

In 1951, Lebanon withdrew from the General Agreement on Tariff and Trade, in order to deal individually with other countries on problems of foreign trade. Since then bilateral trade agreements have been negotiated with a number of countries. But recognizing the dependence of the economy on trade, only a few Lebanese have ever advocated rigid bilateral balancing trade policies. Very recently, the pressure exerted by a few advocates

of trade restrictions, resulted in the adoption by the government of a somewhat rigid bilateral balancing trade policy. Prior to the adoption of this policy, trade negotiations were made merely to reduce the disparity between Lebanon's imports from and exports to a certain country. Experience has shown however, that not a single agreement has been successful in alleviating to any appreciable extent the country's balance of trade.

As mentioned above, the country depends on custom duties for revenue. For this reason these duties are maintained at relatively high levels on most imported products. Most agricultural products however, are exempted from such duties; but are subject to a 1.5 per cent ad-valorem municipal tax which is collected on all imports.

C - INCOME FROM AND COMPOSITION OF TRADE

Lebanon's income from trade is considerably higher than the income from any other sectors. It is estimated at about LL.300 million a year or a little less than one third of the country's national income. According to a preliminary study made recently by the Economic Research Institute of the American University of Beirut, income from trade is broken down into the following broad groups: <sup>(1)</sup>

TABLE V

	<u>LL.1,000</u>
Salaries	25,000
Rent	10,000
Profits and interest	<u>264,000</u>
TOTAL	<u>299,000</u>

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(1) A.Y. Badre, Report on the National Income of Lebanon for 1948-1950, p.2.

These data are preliminary and subject to revision. They nevertheless indicate the important place which trade assumes in the economy of the country.

Beirut today maintains the position of a major transit center and principal trade entrepôt for the area. Goods for hundreds of millions of Lebanese pounds are effected in transit through Lebanon every year. Transit trade figures for the last five years manifest a rising trend characterized by a peak in 1951. The unusual increase during that year is attributable to an enhancement of the demand brought about by the Korean war requirements and repercussions.

Aside from oil and wool, most of the transit trade effected through Lebanon is from West to East, with Syria and Jordan as the Chief countries of destination. The following table gives transit trade for the last five years.

TABLE IV

Lebanon: Volume and Value of Transit Trade during 1950-1954 (1)

Year:	<u>GOLD</u>		<u>PETROLEUM</u>		<u>OTHER MERCHAND.</u>		<u>TONS</u>		Index (2)
	M-Tons	LL 1,000	M.Tons	LL 1,000	M.Tons	LL 1,000	M.Tons	LL 1,000	
1950:44:	177,259	5,289,491	111,079	466,450	222,226	5,755,985	510,564	70	
1951:89:	354,614	21,861,583	459,093	614,536	323,088	22,476,208	1,136,795	119	
1952:67:	239,846	22,436,485	471,166	690,158	327,589	23,126,710	1,038,601	100	
1953:73:	285,327	22,519,831	472,842	743,170	304,774	23,263,074	1,062,943	104 <sup>(3)</sup>	
1954:53:	194,108	22,905,708	480,124	861,522	359,782	23,767,283	1,034,014	97.5	

(1) Ministry of National Economy, Central Statistical Office, op.cit. Vol. IV 1950-1954.

(2) To render the figures more significant, petroleum throughput is excluded in computation of the index.

(3) This fall is due to a fall in gold transit that is more than offset by the substantial increase in other merchandise trade.

Because until March 1950 Lebanon and Syria formed a customs union, no separate trade figures for either country are available except from that date and onward. Owing to abnormal conditions created by the Korean war, Lebanon's trade in 1951 was at an unprecedented height. The period thus left is not long enough to warrant a judgement on the underlying trend. Nevertheless there are justifications <sup>(1)</sup> to believe that the Lebanese trade has been experiencing a moderate increase during the last few years.

The two tables <sup>(2)</sup> below show the values of Lebanese exports and imports respectively for 1951-1954 classified according to 12 broad groups.

TABLE VII

Lebanon: Value of Exports for 1951-1954, in LL 1,000 <sup>(3)</sup>

Commodity Group	1951	1952	1953	1954
1. Agricultural products	25,045	32,502	42,735	52,620
2. Mineral products	4,836	4,130	4,753	3,158
3. Chemicals	3,263	1,793	2,224	1,516
4. Skins, hides, leather and rubber products	4,793	2,913	3,668	4,156
5. Lumber and wooden products	898	1,136	1,190	1,750
6. Paper and paper products	1,905	1,373	1,640	1,517
7. Textiles	35,453	20,516	18,889	9,370
8. Shoes, hats and umbrellas	452	732	581	566
9. Precious stones and gold	8,094	79	738	16,136
10. Metal products and Machines, and appliances	12,120	10,857	9,042	7,799
11. Vehicles	508	949	1,767	1,041
12. Miscellaneous	288	450	482	2,151
	97,655	77,430	87,710	105,582

- (1) Reference is made to the section on background for the Foreign Sector, where such justifications are explained.
- (2) Ministry of National Economy. Central Statistical Office, *op.cit.* Vol. IV, 1951-1954.
- (3) The table includes exports of products of Lebanese origin and of products of foreign origin which were imported and on which customs duties were paid.

TABLE VIII

Lebanon: Value of Imports for 1951-1954<sup>(1)</sup>  
in LL 1,000

Commodity Group	1951	1952	1953	1954
1. Agricultural products	106,376	123,296	132,861	148,547
2. Mineral products	25,607	31,223	32,050	31,408
3. Chemicals	14,438	14,810	16,238	19,490
4. Skins, hide, leather and rubber products	8,409	7,942	7,317	10,000
5. Lumber and wooden products	7,884	7,775	7,363	9,276
6. Paper and paper products	7,833	5,831	5,117	7,593
7. Textiles	56,959	46,094	44,122	57,668
8. Shoes, hats and umbrellas	1,254	964	650	680
9. Precious stones and gold	23,217	39,461	47,110	106,993
10. Metal products and machines, and appliances	44,150	47,569	47,888	58,326
11. Vehicles	11,924	13,022	15,076	20,755
12. Miscellaneous	12,811	9,062	5,888	13,666
<b>TOTAL</b>	<b>320,772</b>	<b>347,049</b>	<b>361,680</b>	<b>484,402</b>

The above two tables show that the Lebanese exports consist mainly of primary goods especially agricultural products, and that imports to Lebanon are much more diversified and consist mainly of manufactured goods.

**D - THE TRADE BALANCE:**

If account is made of exports which are of foreign origin and are actually re-exports, and of the undervaluation of imports, the above tables reveal the following facts: Compared to visible imports, visible exports are very low. There is usually an annual deficit in the balance of trade on commodity account, which reads

(1) Conversion of the value of imports is made at the official rate. This rate has normally been about 30 per cent below that of the free market. It is evident therefore that the value of imports as given above is considerably less than what it actually should be.

in hundreds of millions of Lebanese pounds. A study of Lebanese trade with individual countries reveals also the fact that its bilateral trade with practically every country shows a heavy import balance. Few exceptions are some Arab countries which form the major markets for the fruits and vegetables of Lebanon.

**E - BALANCE OF PAYMENTS:**

The presence of a large deficit in the balance of visible trade of Lebanon, when its balance of payments does not experience a deficit, but more likely a surplus, <sup>(1)</sup> should mean either an important invisible export trade or a great net inflow of capital, or the two together. In the absence of the necessary data for an adequate number of years, relative importance cannot be ascribed confidently to either the invisible exports or the inflow of capital. It is generally accepted however, that for Lebanon to pay its way internationally, it has to rely heavily on the exports of services.

The Balance of Payments of Lebanon Study for 1951 and 1952, <sup>(2)</sup> shows that this balance had been in a surplus situation in both years. The large deficit in the balance of visible trade was offset on the current account by credits accruing mainly in the form of net receipts from foreign travel, transportation and insurance and miscellaneous services, and on the capital account

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(1) Ph. Takla, Minister of National Economy and Finance 1951, his report to Parliament on January 22, 1951 during the discussion of the 1952 budget; and E. Fei and P. Klat, The Balance of Payments of Lebanon 1951 and 1952, Beirut 1954.

(2) E. Fei and P. Klat, op.cit. pp. 5 and 6.

by emigrants' remittances and transfers and a net inflow of capital. The net capital inflow for the two years studied was about LL. 80 and 130 million respectively, making the portion of the deficit in the visible trade balance which is offset by the net inflow of capital about 26 per cent in 1951, and 40 per cent in 1952. It is important to note that about 80 per cent of the net inflow of capital in 1951 and 70 per cent in 1952 consisted of emigrants' remittances and transfers, and donations from charitable and cultural institutions.

The results of two years only do not warrant a generalization on the importance of invisible exports or inflow of capital. But because of the nature and structure of the Lebanese economy, much greater importance may be confidently attributed to invisible exports. In view of recent developments in the economy of Lebanon which contribute considerably to the promoting of the invisible trade of the country, balance of payments surpluses, ceteris paribus are to be expected in the coming years.

#### IV. PRESENT TRENDS IN THE LEBANESE ECONOMY:

The Lebanese economy though highly dependent on trade and on a wide range of services is basically diversified. It is thus affected to a large extent by developments in foreign economies and mainly those of neighboring countries with which Lebanon maintains strong trade relations. During the last few years important developments took place locally and in some foreign markets which tended to promote the services and trade activities of Lebanon.



These developments were briefly surveyed above. It suffices here, to state that it is owing to these developments that the services and trade activities of the country have been experiencing a steady growth.

Domestic economic policy having been directed towards free trade, has affected adversely the development of certain industries the promotion of which may require high import tariffs, quotas, foreign exchange restrictions and other protective devices. Lebanese industrialists have often voiced their demand for application of a protective policy but without success. The policy of economic liberalism is still in force. Further developments along these lines may be anticipated resulting in increased impediments to the development of certain domestic industries.

As against these impediments to industrial development, free trade brings into play two important factors. The first is the likelihood that foreign capital flows more easily into a country which has a free market and a free trade policy than it would into a country with a highly protectionist policy. Secondly, the stimulating effect of foreign competition will provide local industries with a driving force resulting in improvement, increased efficiency, and stronger competing power.

Although priority is often given to the development of trade and the activities that benefit from an open-door policy, industrial development is receiving increasing encouragements. Import of commodities produced locally is subject to high tariff

rates. Furthermore, to encourage investment in industry a decree was passed in ~~February~~ 1954 exempting from income tax for a period of ~~five~~ years all investments of a given magnitude, whether of Lebanese or foreign capital, provided that the investment results in a product which is not produced in Lebanon. The undertaking by the government to establish an industrial institute, so as to provide industry with the needed specialists and modern techniques and methods is a further indication of efforts made to develop industry. Another indication is the establishment jointly by the government and private concerns of an Industrial, Agricultural and Hotelry credit bank. This is the first time the government is undertaking to provide or participate in providing industrial credit facilities and although agricultural credit facilities were available prior to the establishment of this bank, they were provided on a very small scale only.

Recent encouragements in agriculture are directed towards improving its productivity and increasing farm earnings. A number of irrigation projects are now under way. Few agricultural schools and experimental stations were established and serious efforts are made to improve the yield and the marketing processes.

Owing to the presence of market limitations and of foreign competition, some producers are ceaselessly seeking to protect their interests against foreign competition, and to secure foreign outlets for their products. A recent drive towards organizing trade on a bilateral basis reflects their success in this connection. The policy is said to be carried out with a view to reduce the deficit of the country's balance of trade. What effects bilateralism, if

strictly applied in its common forms of compensation and clearing would have on the Lebanese economy ? What significance and prospects do the recent developments in some sectors have, are problems the discussion of which is deferred to later stages in this study.

## CHAPTER II

### HISTORICAL DEVELOPMENT OF FOREIGN EXCHANGE REGULATIONS IN LEBANON

#### I. INSTITUTION OF EXCHANGE RESTRICTIONS:

Prior to the year 1939 foreign exchange operations were free from any kind of government restrictions. Dealings in foreign exchange were first organized by decree No.977 of September 1, 1922, which stipulated that no foreign exchange operations were to be effected except through banks and brokers that were registered with the "Beirut Bourse".<sup>(1)</sup>

On the 3rd of December, 1939, exchange control was instituted in Lebanon.<sup>(2)</sup> At that time similar measures were being taken by the Allies, in countries within their spheres of influence. Underlying the undertaking of such measures at that time were two principles which the Allies regarded as of great importance:<sup>(3)</sup>

a) Exchange control was one of the essential factors on which depended ultimate success in economic warfare. It served to deprive the enemy of foreign exchange which he needed for the purchase of raw materials and manufactured goods for his war machine. It also served to keep the foreign exchange within the

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(1) An institution that was established by decree No.1509 of July 3, 1920, originally to serve as a stock market, but which has devoted itself to foreign exchange and gold operations.

(2) Arrete No. LR/338 of Dec. 3, 1939.

(3) Delegation generale de la France Combattante au Liban, Controle des Changes, Feb. 1943, 1st edition, p.3.

economy where exchange control was applied so as to meet the need of such economies for foreign goods.

b) Exchange control was necessary for maintaining stability in the exchange rates, and for regulating direction of trade within each group of countries. It served these two ends through control of the transfers of funds from one country to another.

On July 15th 1941 Lebanon entered the sterling area. Foreign exchange regulations which had been effective since December 1939 were revised accordingly. When in March 1946 Lebanon went off the sterling area, these regulations were again revised. Further revisions were later made towards a gradual relaxation of these regulations, culminating in August 1948, in the official recognition of the free market.

(1)

II. GENERAL REGULATIONS

By arrete No. LR/338 of December 3, 1939, the High Commissioner subjected all foreign exchange operations to control, and prohibited the export of capital unless authorized under certain specified conditions. Arrete No. LR/339 of the same date, elaborated these conditions and the way exchange operations were to be controlled. It stipulated that import of all goods required an import licence. If the imports necessitated payment in foreign exchange the licence

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- (1) It should be pointed out that these regulations were often violated, and that side by side with the official transactions there were many "black market operations". Some of them were carried out with official blessing, and even some were effected by the control officers themselves.

The black market was necessitated by the fact that the supply of foreign exchange by the authorities was very limited and consequently, there existed a substantial unsatisfied demand for foreign currencies. This market was nourished by emigrants' remittances and foreign exchange earned from transit, export and re-export trade. Foreign exchange was thus brought in illegally and was delivered to unauthorized brokers, at black market rates. These brokers in turn supplied it to importers who otherwise could not secure the foreign exchange they needed.

Control over valuation of goods for favor of preventing undervaluation of exports and over-valuation of imports was practically non-existent. Large amounts of foreign exchange were thus secured through such illegal yet uncontrolled methods. Added to the foreign exchange received as remittances and foreign exchange received in various round-about ways, the amounts handled illegally in 1946 and 1947 amounted to about the value of exchange furnished by the authorities. In 1948 it is believed, the foreign exchange supplied illegally by the Beirut market far exceeded the amounts supplied by the exchange authorities. In fact the emergence of the free market in Lebanon was a continuous process that goes back to the last years of World War II. In 1948, when the Government officially liberalized the exchange system, it simply recognized a de facto situation.

had to indicate that the importer was authorized to receive the foreign exchange required for the transaction. If on the other hand payment in foreign exchange was not required, the licence was to give evidence to that effect. The issue of such licences was entrusted to the Economic Affairs Section on the "Haut Commissariat" which was also charged with the undertaking of the investigations required therefor.

According to the same decree, authorized exchange operations were to be made through the Bank of Syria and Lebanon (hereafter referred to as BSL) or through approved banks. <sup>(1)</sup> Non-approved banks and small bankers could deal in foreign exchange only as intermediaries between the public and the approved banks.

Foreign exchange operations and capital export transactions were defined by arrete No. LR/340 of Dec. 3, 1939.

a) The following transactions were considered foreign exchange operations:

1. All operations with abroad involving purchase with, or sale for Lebano-Syrian currency; and,
2. All transactions that involved the sale, transfer or receipt of foreign currency.

b) The following transactions were considered as capital export:

1. The utilization of foreign exchange for the purchase of goods from abroad.

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(1) Approved banks were institutions which had received a special authorization from the Office des Changes to deal in foreign currency.

2. The act of retaining abroad or keeping in foreign currency wholly or partly, proceeds of exports, remuneration for services, revenues accruing abroad to residents in Lebanon and Syria, and grants and legacies in foreign exchange, to residents in Lebanon and Syria.
3. The export of goods or means of payment:
  - i) The act of transferring abroad, wholly or partly, an account in a local bank and,
  - ii) The shift from one account to another of titles kept abroad and which were previously deposited with a local bank.
4. The investment of Lebanese (and Syrian) pounds, in a foreign account in Francs.
5. Accepting payment in Lebanese (and Syrian) currency for:
  - i) exports,
  - ii) services rendered to non-residents,
  - iii) revenues accruing from abroad to residents,
  - iv) gifts and legacies in foreign exchange, to residents.



III. EXCHANGE CONTROL REGULATIONS

A. TRAVELLERS (1)

a) Outgoing non-resident travellers:

Outgoing non-resident travellers regardless of their nationality were not permitted to take out with them means of payment, titles to property or to debts, or movable property unless authorized by the "Office des Changes"<sup>(2)</sup> Residents were allowed to carry out with them without authorization by the Control Office, a maximum amount of LL. 150 or its equivalent in foreign exchange.

When on July 15th 1941, Lebanon entered the sterling area, resident travellers were allowed, upon proving their need for the money, to take out with them in currency of the sterling area, up to the equivalent of LL. 1250 per person. Non-resident travellers, still could not take out with them any means of payment except the amount which they could prove to have brought in with them. For these purposes on leaving the country, travellers had to declare whatever means of payment they had with them. If upon declaration, the amounts carried were found to be in excess of what was authorized, the extra amounts had to be deposited with the customs authorities against receipt. Money thus deposited could be returned to owner upon his return to the country; or could be deposited in his name with an approved bank of his choice.

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(1) Arretes No. LR/341 of Dec. 3, 1939.

(2) The Control Office was charged with application of the foreign exchange control law.

b) Incoming Travellers:

Upon entry to the country a non-resident traveller had to declare to the Customs Office, whatever means of payment he had with him. A copy of such a declaration was given to him for use as evidence upon need. The maximum amount of bank-notes which a traveller was permitted to bring in with him was LL.500 or its equivalent in foreign currency. Any amounts carried by a traveller, over and above this limit had to be deposited with the customs against receipt. Such deposits were returned to the traveller upon leaving the country, or could be deposited abroad in a bank of his choice. The traveller also, if the bank-notes were purchasable by the "Office des Changes", could sell them to this office through a local bank.

Travellers bringing in with them securities or titles to properties, had to deposit them with the customs against receipt. Such deposits were returned to them upon their leaving the country, or upon their request, were delivered to an approved local bank of their choice.

Foreign exchange brought in by travellers was not to be sold except to approved banks.

c) Travellers in Transit:

Upon their entry to the country travellers in transit had to declare all the means of payments which they carried with them. On exit, they were allowed to take out all the means they

declared with the exception of those consisting of banknotes or coins which on departure had to be less than the amount declared upon entry by at least LL. 500.

(1)  
B. TRADE

a. Regulations relating to imports;

1) Import of all goods required a license. This license was issued by the Supply Department and had to be countersigned by the Economic Affairs Advisor in the "Haut Commissariat". Its validity was for four months, for imports from neighboring countries, and six months for countries farther than Adan. During the period when Lebanon belonged to the Sterling area, import licenses for imports from this area no longer required the countersignature of the Economic Affairs Advisor.

With every import license the Supply Department used to issue a certificate authorizing the applicant to purchase from the Office des Changes, the foreign exchange required for the transaction. Applications for foreign exchange were to be made through an approved bank showing the kind and amount of the currency required. The office used to request from applicant a declaration of the foreign exchange which he might have had. Furthermore it had the right to request to have for evidence, any document which it deemed necessary, or to have the applicant pledge in writing, to produce such documents upon arrival of the goods.

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(1) Arrete No. LR/339 of Dec. 3, 1939.

If the imported goods did not necessitate payment in foreign exchange except for transportation, transit or other costs, the required exchange could be purchased from the Office des Changes upon producing the import license and other documents giving evidence about the costs incurred.

Importers were required to present to the Control Office adequate evidence showing that the full amount of exchange obtained was utilized as authorized. Any amount of foreign exchange which the importer, failed to show to have utilized was to be surrendered to the Office des Changes. (1)

ii) Kind of Currency Furnished and the Method followed therefor:

The kind of currency furnished and the method followed varied with the source country of imports.

For this purpose imports were classified into two types:

- a) Imports from the Franc Area and
- b) Imports from other countries.

When Lebanon belonged to the Sterling area, a third type was recognized comprising goods imported from countries in this area.

Payment for goods imported from the Franc Area was made in French Franc, and from countries of the Sterling area in the

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(1) Delegation Generale de la France Combattante au Levant, op.cit., pp. 10 and 11.

currency of the country of origin. Countries outside the sterling and the Franc areas belonged to one of several groups for which special arrangements were in force. These groups consisted of:<sup>(1)</sup>

- a) Countries of Special Account,
- b) Countries of Registered Account,
- c) Countries of Central American Account,
- d) Countries of Authorized Account, and
- e) Countries of Sterling Account.

Payment for imports from countries of the Special and of Central American Accounts was made in sterling by crediting an account or opening a new account in London in the name of a bank or a commercial institution located in the exporter's country of residence. Payments for imports from countries of the authorized and sterling accounts were subject to the same regulations that governed imports from Special Account Countries, except that they could be made in the currencies of the respective country, if such currencies were available at the "Office des Changes". With respect to imports from countries of Registered Account payment was to be made in American dollars or Swiss Francs depending on the availability of these currencies at the "Office des Changes".

In case such currencies were not available, payment could be made in sterling and according to the method followed in paying for imports from countries of Special Account.

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(1) Ibid. p.11.

(1)  
b) Regulations Relating to Exports

i) Export of goods was subject to the requirement of an export license. This license was issued by the Supply Department and had a validity for three months.

On sending his goods an exporter had to obtain a certificate to that effect, and at the same time pledge in writing to repatriate in full, and sell to the Office des Changes, the proceeds of his exports.

The "Office des Changes" was authorized to request for study, any document which it found necessary for verifying that the exchange delivered by the exporter was equivalent to the value of the goods exported. Refusal to produce the documents requested by the Office, or surrender of an amount of foreign exchange less than the actual proceeds, subjected the exporter involved to varying financial or/and imprisonment penalties.

ii) Time Limit for the Surrender of Exports Proceeds

Proceeds of exports of perishable nature were to be surrendered within a period not exceeding one month from the date the goods were sent. Surrender of proceeds of other exports to be made within periods varying between two and nine months according to remoteness of the country of destination.

With a few exceptions, export on consignment was prohibited. Upon authorizing exceptions, the Office des Changes used to fix the period within which surrender of proceeds was to be made.

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(1) Arrete No. LR/339 of Dec. 3, 1939 and Arrete No. LR/247 of Oct. 2, 1940.

iii) Conditions for Settlement of Obligations

In addition to the written pledge by the exporter for repatriation of the exports proceeds, an original bill with adequate evidence that it was the only bill prepared for the exports, and that the goods are of Lebanese origin was required. The obligation was not considered as settled unless the total amount shown by the bill was surrendered. If for any reason a loss was incurred and the proceeds came out to be less than the amount shown by the bill, the exporter had to present to the Office, for evidence, any documents which it requested.

Exporters who failed to deliver the proceeds of their exports within the prescribed period were subject to penalties which the Law provided.

C. TRANSFER OF CAPITAL (1)

1) Foreign Debts

Balances due to foreigners for settlement of foreign debts were transferable abroad provided one of the following conditions was satisfied.

- 1) If the account existed prior to Dec. 3, 1939.
- 2) If it arose after Dec. 3, 1939 through an authorized transaction and,
- 3) If it arose after Dec. 3, 1939, from payment from revenues or from proceeds of such foreign debts as specified above.

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(1) Arrete No. LR/340 of Dec. 3, 1939 and Arrete No. LR/1 of Jan. 4, 1940.

ii) Foreign Balances in Francs or Lebano-Syrian Currency

Foreign accounts in francs or Lebano-Syrian currency in names of non-residents were not to be open in local banks except by special permission from the "Office des Changes." Crediting such accounts similarly required the Office permission unless the new account arose from the sale of foreign exchange to this office.

iii) Transactions not requiring Foreign Exchange

Transfer of capital in francs or Lebano-Syrian currency between countries of the Franc area did not require permission from the "Office des Changes". The transfer however, had to be made through approved intermediaries. Cheques in francs or Lebano-Syrian currency, drawn on a bank within the Franc Area could be sent through an approved bank to residents of any country within this area, without recourse to the Office.

Import of any means of payment except banknotes of the Franc Area was permitted provided the importer sold to the Office all foreign exchange arising from exports of goods, remuneration for services, revenues accruing abroad grants or legacies.

Gold coins and gold bullions were considered as goods. Their import was subject to the requirement of an import license, and their export was prohibited unless authorized by the Office des Changes.

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(1) Delegation Generale de la France Combattante au Levant, op.cit. pp. 24-28.



iv) Capital owned abroad:

With regard to capital owned abroad, the following transactions were permitted:

- 1) The purchase made within the country of capital held abroad, provided the seller was a resident.
- 2) The purchase made outside the country of capital abroad, if the transaction involved new investment of capital previously invested and provided the buyer was a resident. Only currencies of the Sterling area were to be used in such transactions.
- 3) Sale, transfer, or mortgage in the Sterling area of capital abroad.
- 4) Sale, transfer, or mortgage of capital abroad if the transaction is made within the "country", and provided foreign exchange was not sold except to residents.

All other transactions were prohibited unless special authorization is granted.

IV. DEVELOPMENT OF EXCHANGE REGULATIONS SINCE 1944

About the beginning of 1944, there had taken place political changes (declaration of the independence of the Lebanese State) which necessitated among other things, the revision of exchange control regulations and the institutional status related thereto. Alongside with changes introduced to the status and

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(1) Delegation Generale de la France Combattante au Levant, op.cit., pp.24-28.

functions of the "Control des Changes" since May 1944, as shall be shown in due place, the following developments in the exchange control regulations took place:

Countries of the Franc and Sterling areas had already been accorded special privileges in connection with foreign exchange transactions. A protocol signed on April 19, 1944, by the Lebanese (and Syrian) authorities on one hand, and the French on the other, stipulated that the latter would undertake to supply Lebanon (and Syria) with all the foreign exchange they required in their legitimate trade interests. However, before granting any kind of foreign exchange, the French authorities required a detailed statement of the commodities that were to be imported, in order to ascertain whether or not they were essential, and whether they could not be imported from a country whose exchange was not in short supply.

Another agreement signed in the same year between Lebanese, Syrian, French and British authorities provided, within the limits of the resources of the "Office des Changes", for free convertibility of the Lebano-Syrian currency into sterling. With these provisions, the French authorities could continue to direct the trade of the country in favor of a large volume of trade with the Franc area and to a lesser extent with the Sterling area.

On October, 1944, a new arrete was issued revising the regulations related to export and import of capital and foreign

(1)  
exchange operations. It revised also the meaning of terms and redefined areas, as necessitated by the political changes which had taken place.

1. Export and Import of Capital:

The transfer of francs and sterling to the Franc and Sterling areas respectively was allowed, provided the exported capital was to be used within these two areas. Export of capital through transfers of other foreign exchange was subject to a special permit from the "Office des Changes". Export of banknotes was not permitted except by a special permit from the "Office".

Lebanese franc and sterling balances could be retained abroad, except those arising from exports to the Franc and Sterling areas which had to be repatriated. Other Lebanese foreign exchange balances were to be repatriated unless they were earned prior to Dec. 3, 1939. Repatriated foreign exchange had to be delivered to the "Office" against Lebano-Syrian Currency at the official rate.

Residents of Lebanon and Syria could obtain their need of francs and sterling from approved banks. For the acquisition of other foreign currencies they were required to secure a special permit from the "Office". Non-residents on the other hand were required to obtain such a permit for the acquisition of any foreign currency.

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(1) Arrete No. K/2025 of Oct. 11, 1944.

Residents could exchange freely at approved banks, their repatriated franc and sterling balances for Lebano-Syrian currency.

Import of banknotes was not permitted except by special permits from the "Office des Changes".

Resident travellers upon their return to Lebanon (or Syria) were required to surrender to the "Offices des Changes" within eight days from their date of arrival, all foreign banknotes they had, against Lebano-Syrian currency.

2. Capital held within Lebanon and Syria:

Residents were not allowed to sell, give up, transfer or deposit as guarantee of capital outside the Franc and Sterling areas the capital they had, without a special permit from the "Office des Changes". They were not allowed also to retain capital outside these two areas except by special permit from the "Office des Changes". Capital thus retained was not to be used, reinvested, given up, transferred or deposited as guarantee except by special permit from the "Office".

Import of capital held outside the Franc and Sterling areas, and consisting of bills of exchange or other kinds of bills was to be made through approved banks only.

3. Export and Import of Goods

Export and import of goods continued to be subject to the requirement of a special permit.

Importers who had sterling and franc balances in respective areas prior to Dec. 3, 1939, and after February 8, 1944 were permitted to use them to finance their imports. In all other cases the use of balances outside Lebanon and Syria to finance imports was subject to a special permit from the "Office".

On March 22, 1946, Lebanese sterling balances were blocked by the British Government. Eight days later, the Lebanese Government issued a decree <sup>(1)</sup> subjecting imports from the Sterling area to an import license.

#### V. RELAXATION OF THE EXCHANGE CONTROL REGULATIONS

Towards the end of 1948, the Lebanese authorities started a policy of gradual relaxation of the exchange control regulations. On Nov. 5, 1948, a decree was issued stipulating that, subject to a few restrictions, foreign exchange could be sold, purchased, imported or exported without recourse to the "Office des Changes" <sup>(2)</sup>.

Exporters, however, were still required to import all the foreign exchange arising from the export of goods; however, they were required to surrender to the "Office" at the official rate, only 10% of the imported foreign exchange. Contrary to these provisions, commercial concessionary companies were required to surrender to the "Office" at the official rate, 80% of the foreign exchange which they imported.

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(1) Arrete No. 2662 of March 28, 1946.

(2) Arrete No. K/13532 of Nov. 5, 1948.

Purchases of foreign exchange, made by an authorized intermediary in ten days were not to exceed his sale during the same period by more than LL.300,000. With respect to ordinary intermediaries this excess was limited to LL.100,000. Any amount over and above the authorized limits had to be surrendered to the Exchange Office.

For ensurance of proper observance of these provisions, all intermediaries were required to record their transactions in a special register, a copy of which was to be sent to the Exchange Office on the tenth, the twentieth and the end of each month.

Sale and purchase of currencies not quoted at the Office were freed from all restrictions.

Dealings in French francs were subjected to the regulations in force. But the "Office" undertook to provide applicants with the francs they wanted at the official rate. As a result the free market rate and the official rate of the Franc were almost equal. Transfer of this currency was freed from restrictions, and importers of francs were not required to surrender 10% of this exchange to the office.

In Sept. 1949, the requirement of repatriation of exports proceeds was cancelled, together with the requirement to surrender at the official rate of 10% of imports of such proceeds. (1)

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(1) Arrete No. 16369 of Sept. 26, 1949.

In October, 1949, the French franc was added to the list of currencies registered at the "Office". But the surrender at the official rate of 10% of the amounts imported was not required. (1)

In November, 1950, the restrictions pertaining to foreign non-resident accounts were abolished. Non-residents were permitted to open accounts with local banks, and to use such balances without recourse to the Office. (2)

In January, 1952, the government lifted the restrictions which were imposed on currency import and export by Decree No. K/2025 of October 11, 1944. Travellers, whether residents or non-residents were authorized to take out or bring in an unlimited amount of Lebanese or foreign banknotes without having to make any declaration at the borders. (3)

A decree issued in the same month cancelled the requirement to surrender at the official rate, 10% of the foreign exchange imported by either intermediary banks or individuals. (4)

In May 1952, the last restriction on dealings in foreign exchange, the requirement for commercial concessionary companies to surrender at the official rate 80% of their imports of foreign exchange was abolished.

At present all exchange transactions are conducted at free market rates. (5) ✓

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(1) Arrete No.7 of Oct. 7, 1949.

(2) Arrete No. 3309 of Nov. 7, 1950.

(3) Arrete No. 7271 of Jan. 8, 1952.

(4) Arrete No. 7393 of Jan. 26, 1952.

(5) With the exception of Government transactions which are still carried at the official rate.

VI. INSTITUTIONAL CHANGE

a - Setting up of an Office des Changes

On Dec. 3, 1939, the High Commissioner set up as a branch of the "Banque de Syrie et du Liban" an "Office des Changes" which was charged with the application of the exchange control law. <sup>(1)</sup> The "Office" was to operate for the account of the Mandatory power and under its responsibility.

The law that set up the Office stipulated that:

1. This office was to undertake the application of the exchange control law in Lebanon (and Syria).
2. It was charged with the task of issuing the permits that were required for the export of capital.
3. It was to furnish the foreign exchange required for payment for authorized imports.
4. All exchange operations were to be centralized in it; and
5. With a few exceptions, possessors of foreign exchange and foreign securities had to sell same to this "Office".

b - Exchange Control Office

To secure a proper application of the exchange control law, another office, the "Inspection Generale du Controle des Changes" was set up. The Control Office was to operate for the account of the Mandatory power and under the immediate authority of its financial advisor. <sup>(2)</sup>

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(1) Arrete LR/340 of Dec. 3, 1939, p.2.

(2) Ibid. p.2.



This office was charged with making the necessary inspection and investigations to ensure that no unauthorized transactions were made, and that authorized transactions were carried out in accordance with the provisions of the Law. It was granted extensive powers to request and have for inspection and study all documents deemed necessary for its investigations. No limitations, not even those implied often by the secrets of the profession were put on such powers.

In addition to this supervisory function, the Office was granted the power to decide whether a certain operation constituted a violation of the law and therefore necessitated a penalty.

c - Declaration of the Office des Changes an  
Independent Office

On November 12, 1941, three months after the occupation of Lebanon (and Syria) by the Allied armies, the Office des Changes was declared an independent office working for the account of the Free French Delegation and under its responsibility. (1) No changes were introduced in the status of the Office until May 5th, 1944, when a legislative decree No.K/11 declared it a Lebanese-Syrian public office with financial autonomy. This decree stipulated that the new institution was to continue to undertake the application, in Lebanon and Syria of the exchange control regulations promulgated by the Control

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(1) Arrete No. LR/341 of Nov. 12, 1941.

des Changes. In addition, it had to fix the buying and selling exchange rates, upon instructions by the governments' commissaries. Furthermore, the office was to prepare in the beginning of every year together with the governments' commissaries, a list in the names of banks approved and those authorized. The BSL was entrusted with the administration of the Office and therefore was responsible for enforcement of the policy drawn by the "Inspection Generale du Controle". BSL was responsible to the Lebanese and Syrian Governments. Its management of the Office was subject to supervision and inspection by officers of the "Inspection Generale des Controle" and a special commissary from each of the governments of Lebanon and Syria.

On May 5th, 1944, the "Inspection Generale du Controle" was reorganized into an independent institution consisting of representative of the Lebanese Government and another of the Syrian Government headed by a representative of the "Controle des Changes du Block Franc". The "Inspection Generale" was to elaborate the provisions of exchange control in Lebanon and Syria in harmony with dispositions of the "Controle des Changes du Bloc Franc" and with consideration for the dispositions of the exchange control law and the legitimate trade interests of Lebanon and Syria. The Inspection Generale was charged with the task of ensuring complete observance of the exchange control regulations by the Office des Changes and by residents of Lebanon and Syria. Furthermore, it was accorded the authority to grant the exceptions provided by the exchange control law, and to deal with violaters of the Law and ensure collection of

financial penalties.

A decree issued on Sept. 7th, 1948, cancelled the two legislative decrees Nos. k/11 and K/12 of May 5, 1944, and set up within the Ministry of Finance, a Control Office composed of Lebanese personnel only. Three days later, on the 10th of Sept. 1948, another decree was issued organizing the Lebanese Exchange Control Office into two distinct departments: (a) an exchange control office and (b) an exchange office.

The management of the latter was entrusted to BSL whereas management of the former was entrusted to the Ministry of Finance. Both departments, however, had to be run by an official of this Ministry.

The same decree stipulated that the Inspection Generale of Controle would undertake upon approval by the Minister of Finance:

1. The preparation of regulations pertaining to the export and import of capital and to other foreign exchange operations.
2. The supervision of the application of these regulations.
3. The choosing of agreed or authorized banks.
4. The choosing of the foreign currencies dealing in which was authorized; the determining of their selling and buying prices in terms of the Lebanese currency, and the maximum premia which the banks could charge on exchange transactions.
5. The continuing of suits brought against violaters of the exchange law provisions.

6. The furnishing of foreign exchange for authorized transactions and
7. The preparation of the budget of the Controle des Changes.

On October 6, 1949, the government issued Decree No.6 creating a third department in the Exchange Control organization, the Stabilization Fund Board which is to eliminate eventual fluctuations in the exchange rates. As by May 1952, hard currency imports both by banks and individuals and by concessionary companies were no longer subject to any exchange restrictions, decree No.8237 was issued for the reorganization of the Exchange Control Office and revision of its powers. Because of the relaxation of exchange restrictions a large part if not all of the duties of the exchange control office had become obsolete. Powers of the Office therefore had been restricted and the only power which it retained is that of continuing suits brought about by the government against past violaters of exchange control.

Further stipulations of Decree No.8237 had been that the Exchange Control Office is no longer an institution with an autonomous budget. It has been placed with a skeleton staff under the control of the government commissioner to the Bank of Issue. The Exchange Control Board was abolished and its powers have been transferred to the Stabilization Fund Board. Accordingly, suggestions and proposals relating to Exchange Control Regulations have become a part of the duties of this Board.

The Board is composed of the following:

The Minister of Finance - President

The Director General of the Ministry of Finance

The Controller General of Exchange

The Director of the Bank of Issue, and a  
government employee designated by the  
Minister of Finance.

According to the same decree and beginning from the year 1953, the budget of the Exchange Control Office has become a part of the state ordinary budget. The Office is composed of a chief accountant, two controllers, one attorney, two clerks and one messenger. Its receipts are entered in a provisional account opened with the BSL. The proceeds, net of the Bank's commission and the employees share in the fines collected, are credited to the Budget at the end of every year.

### CHAPTER III

#### THE BEIRUT FOREIGN EXCHANGE MARKET

Engagement in foreign trade necessitates the exchange of money from one currency into another. Exports and other sources of receipts from abroad give rise to a continuous supply of foreign exchange. Imports and all kinds of foreign payments on the other hand, give rise to a continuous demand for foreign exchange. Such demand and supply interact in what is called the foreign exchange market which consists of the foreign exchange departments of banks in the country, together with all the brokers who handle foreign currency transactions. <sup>(1)</sup>

The foreign exchange market performs the following functions:

- a) It facilitates payments at a distance by the use of bank drafts and bills of exchange,
- b) it renders possible, for persons handling international transactions to pay or receive payment in their own currency,
- c) it renders possible the extending of credit to importers by the use of time, or long term bills,
- d) it provides so far as purchases equate sales for clearing of international credits and debits. In the event of an uncleared residue, this will show

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(1) N. Crump, The ABC of the Foreign Exchanges, (Macmillan and Co. Ltd., London, 11th ed. 1952), p.30.

up either as a fall or as an increase in the country's  
(1)  
foreign balances as the case may be.

The importance of a foreign exchange market is determined by the nature and magnitude of the factors that give rise to the demand for foreign exchange, and those that bring forth its supply, and by the market direct and indirect contributions to the economy. The present chapter studies the nature and size of the Beirut foreign exchange market, its relations with other markets and the forces governing it.

#### I. DESCRIPTION OF THE MARKET:

A. Nature: The Beirut market is a dollar market. All or practically all foreign exchange transactions are made in terms of the dollar. Rates of the major currencies including the sterling and sterling area currencies are determined on the basis of the Western free markets' cross rates with the dollar. The value of the Syrian pound since its stabilization vis-a-vis the dollar, in 1953, is determined on the basis of the Lebanese pound value in terms of the dollar. Minor deviations may occur sometimes, but they are corrected immediately by arbitrage operations.

The dollar, the major Western European currencies and Near Eastern currencies are regularly quoted in Beirut. Practically all currencies of the world can be sold on the Beirut market in substantial amounts; a few large transactions are made through arbitrage with other markets. This is made possible by the fact

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(1) Ibid. pp. 31-35.

that almost all exchange dealers in Beirut have correspondents abroad and mainly in the large European and American markets.

Being an entrepot market, Beirut developed in the post-war period into an important gold trading center. Gold transit increased from 335 kilograms in 1946 to 53,593 kilograms in 1954. This growth is due primarily to the liberalization on February 17, 1949, of regulations pertaining to the transshipment of gold. Of significant importance, in this connection have been also the liberalization of regulations governing foreign exchange operations and the geographical position of Beirut on the cross routes of the principal airlines. Owing to these factors, Beirut developed into the most important gold entrepot market in the area. Other important gold trading centers in this area with which Beirut maintains close connections, are Kuwait and Tangier.

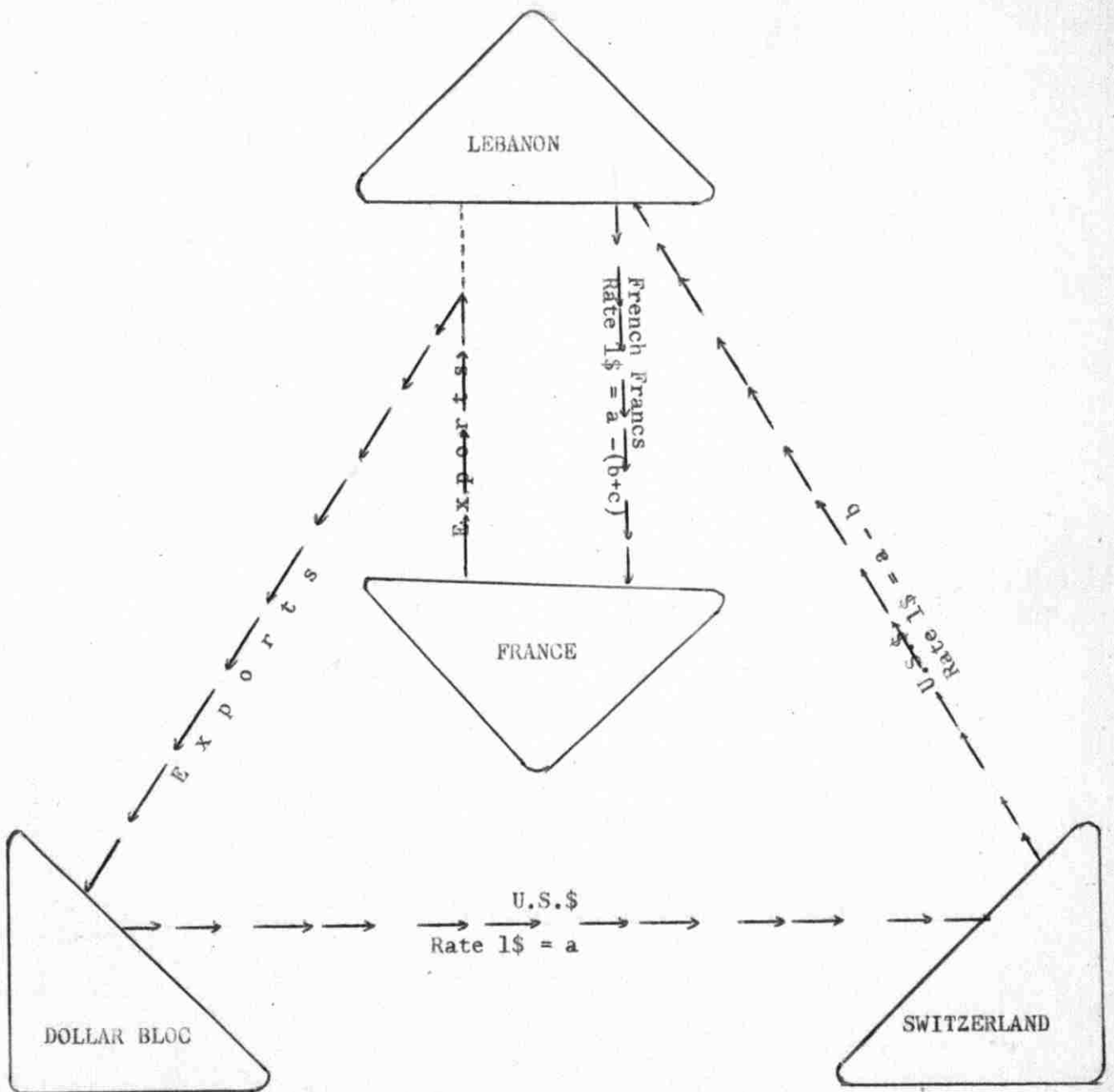
The Beirut money market is practically connected with all money markets of the world. The closest connections, however, are maintained today with the free money markets of Western Europe especially Zurich, and to a lesser extent with Tangier. Until 1952, Beirut market relationships with European markets were closest with Paris. Since then the Zurich market has assumed the place of Beirut's major European contact. Being free from any kind of official restrictions and being in a country enjoying political and economic stability, Zurich has attracted through Beirut a substantial inflow of Egyptian, Saudi and Kuwaiti capital.



The substantial inflow of Egyptian capital to the Beirut market, and then from Beirut to Zurich, started and was greatest in 1952, mainly because of political consideration. Saudi and Kuwaiti capital has also been transferred through Beirut to Zurich, only a small part of it remaining in Lebanon. A second reason which has strengthened Beirut's relations with Zurich is the recent movement into Beirut of Swiss franc balances of Hungary, Rumania and other Eastern European countries, for exchange into dollars. A further and important reason is the increasing volume of triangular trade operations effected by Zurich through the intermediary of Beirut. Transactions involving non-convertible currencies such as the French franc, sterling, etc... being made on the basis of bilateral accounts, often present opportunities for triangular operations. Most important among such operations with respect to the Beirut market are those effected through the circuit Paris-Zurich-Beirut-Paris. (A simplified illustration of such an operation is given below). Because of Zurich's location from, and easy connection with France, Sweden, Belgium etc..., Swiss banks are at close contact with these countries' traders and businessmen and very often induce them to effect such triangular operations which leave sometimes large margins of profit offsetting a probable initial loss in the original business transaction.

For a relatively short period in 1953, Tangier was Beirut's most important foreign market contact. A probable explanation is the migration to Tangier, in that year, of a good number of Lebanese Jewish financiers and consequently of

CHART I.



A TRIANGULAR OPERATION

substantial capital. However, because most of the transactions effected by Tangier are against Pesetas, this market is of no much importance to Beirut which explains why close relationship between the two markets have not been continued. Present connections with Tangier relate mainly to transactions in gold trade.

Among Arab countries, Damascus is the major point of contact. Syria is the country of strongest trade relations with Lebanon. Most of Syrian exports to Lebanon are paid for in dollars, and the Syrian pounds which Lebanon earns are sold to Damascus against dollars. The main reason why the dollar is used in these transactions is that whereas Damascus rates of other currencies are subject to fluctuations, the dollar since 1953 summer has been stabilized vis-a-vis the Syrian pound. Furthermore, the stabilization of the dollar subjected the agio between the Lebanese and Syrian pounds to the relationship of the Lebanese pound to the dollar. The result was closer relationships, and on more than one occasion, the Syrian Foreign Exchange Office had to engage in open market operations in the Beirut market, to reduce or check an increase in the premium of the Lebanese over the Syrian pound.

B. Size: Beirut has at the present time 41 banks and bankers, and 57 brokers all of whom operate in the foreign exchange market. Twenty seven banks and bankers are Lebanese, four banks are branches of French banks, three are branches of Egyptian banks and the others are branches of British, Dutch, Iraqi, Italian, Palestinian, Saudi or Syrian banks.

The paucity of statistics on the volume of transactions carried out through Beirut, renders the best estimate a mere guess. Estimates of the Lebanese balance of payments may indicate a possible minimum of the volume of such gross transactions. These estimates are LL.500 million for 1951 and LL.550 million for 1952<sup>(1)</sup> for payments and for receipts for goods, services and capital flows. No estimates for later years have so far been made. Owing, however, to the great volume of transactions which do not appear in the balance of payments account, significance of this minimum is questionable. The great volume of trade effected through the Free Zone, and of triangular trade carried out through the intermediary of Beirut, together with the large-scale foreign exchange transactions made on the Beirut market, for or by foreigners, render the total volume of transactions carried on through Beirut, far above the quoted minimum.

Informed bankers' estimates of the total net volume of such transactions vary considerably. They range between three and five times the volume of transactions that appear in the balance of payments. Efforts made to narrow this range, have revealed that the net total of transactions should not be far from LL. 25 million per day.

Nevertheless, the market is reported to have been sometimes sensitive to transactions not exceeding \$100,000. The explanation is not that the market is "thin". Much larger

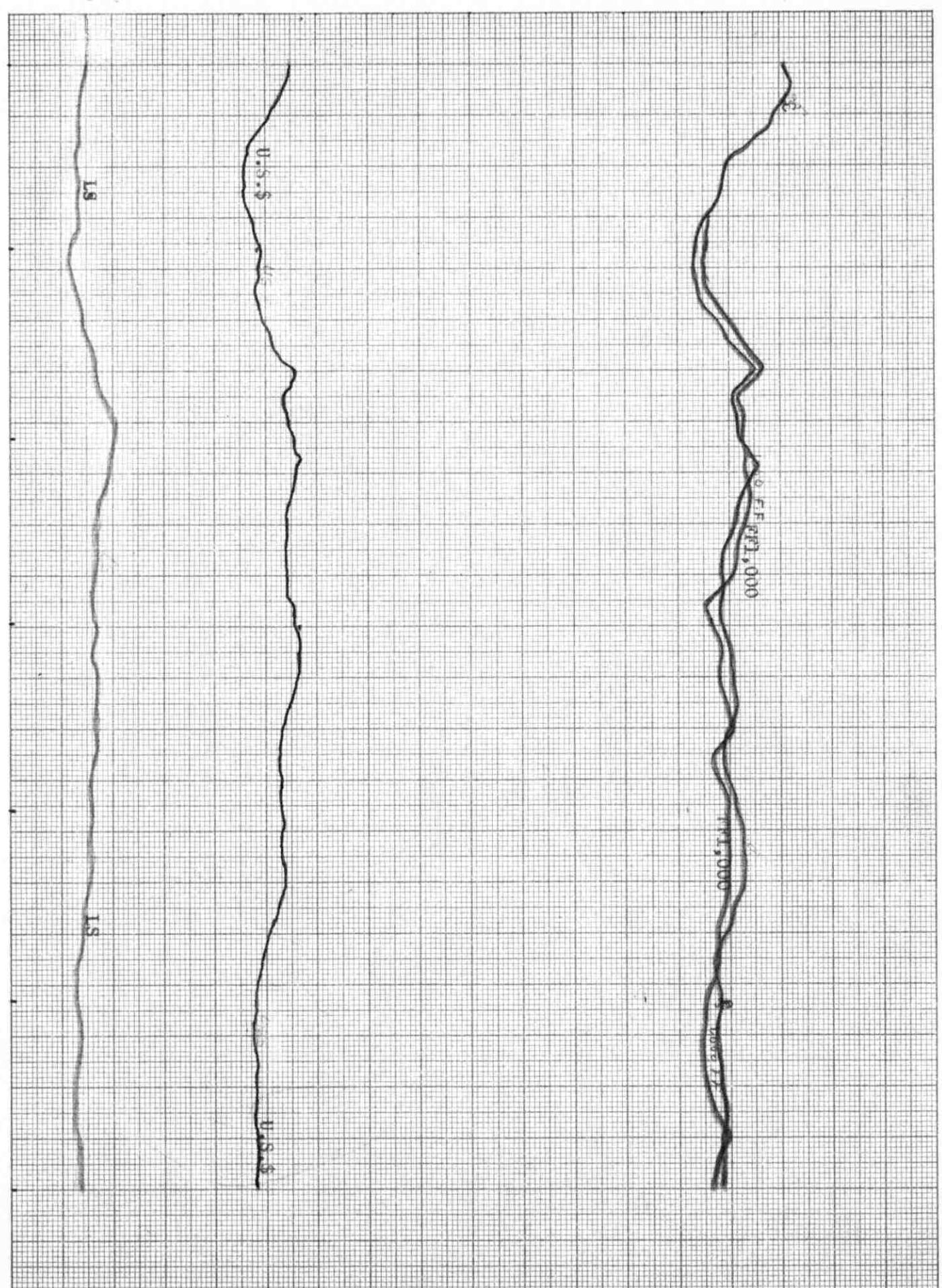
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(1) E. Fei and P. Klat, The Balance of Payments of Lebanon, 1951 and 1952, Beirut, 1954, p.5.

transactions are actually carried out through Beirut without any noticeable effect on the rates. For this purpose, distinction should be made between transactions made against the Lebanese pound or the French franc, Lebanese account and transactions made against other currencies. There is no world demand for the Lebanese pound or the French franc, Lebanese account. The demand for them is relatively, very limited. The Beirut center is very small, and the important exchange dealers are few. News of the offer or purchase on the market of drafts of large amount spread around immediately. If the transaction is to be made against either one of the forementioned two currencies, because the demand for it is comparatively small, the rate will respond. The change will be greater if its direction was the same as that of a movement in the rate at that time. Transactions against other currencies are not likely to affect the rate to any appreciable extent. The demand for them is world wide. Large amounts are obtainable immediately, through correspondents in the respective markets; however the magnitude of the transaction, therefore they are not likely to affect the rate to any appreciable extent.

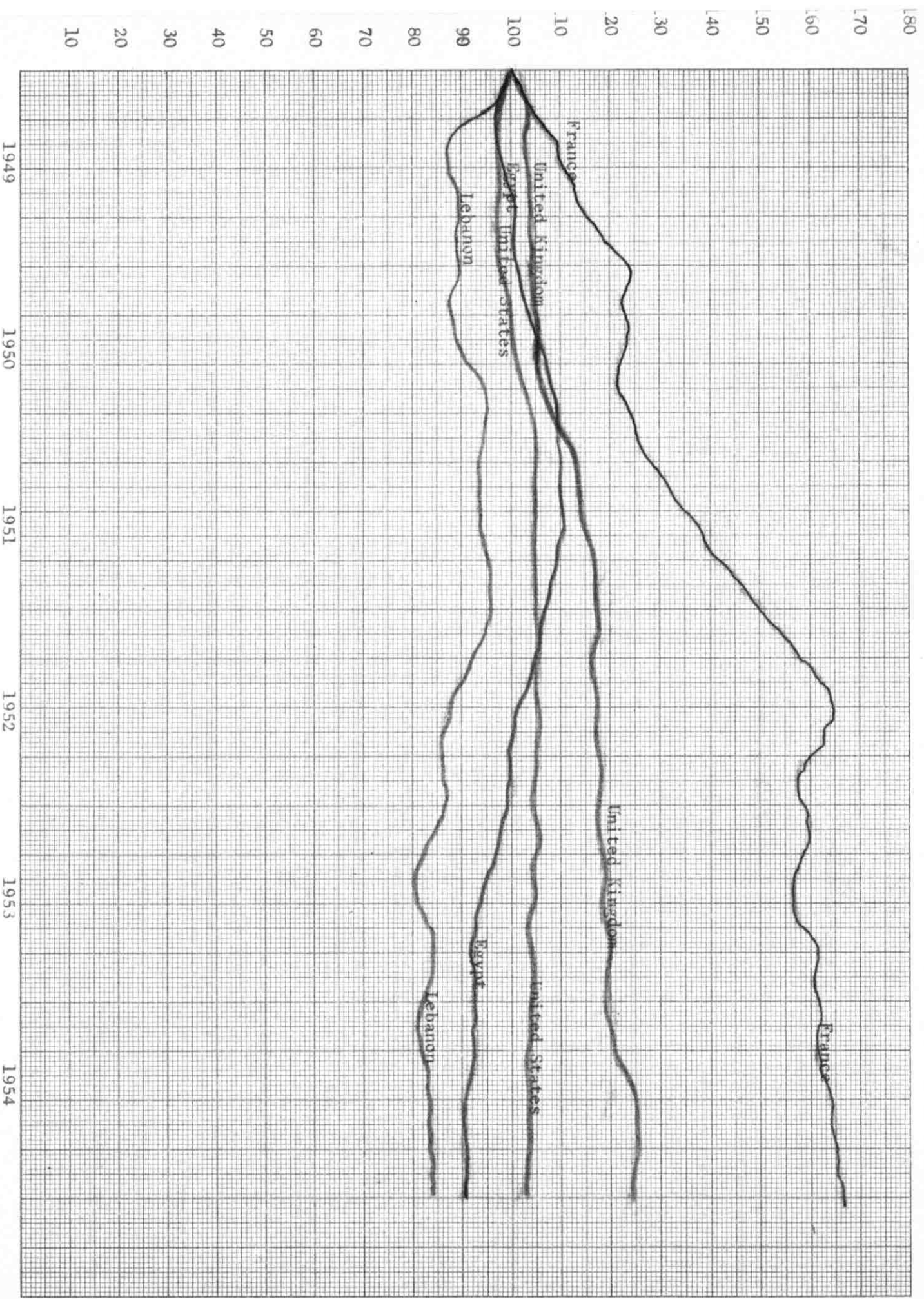
## II. EXCHANGE RATE FLUCTUATIONS SINCE 1950:

As shown in chart II, the Lebanese pound started, early in 1950, a declining trend relative to practically all major currencies dealt with on the Lebanese market. Around April 1952 the trend was reversed and the Lebanese pound started rising in value in terms of all the other currencies. During the course



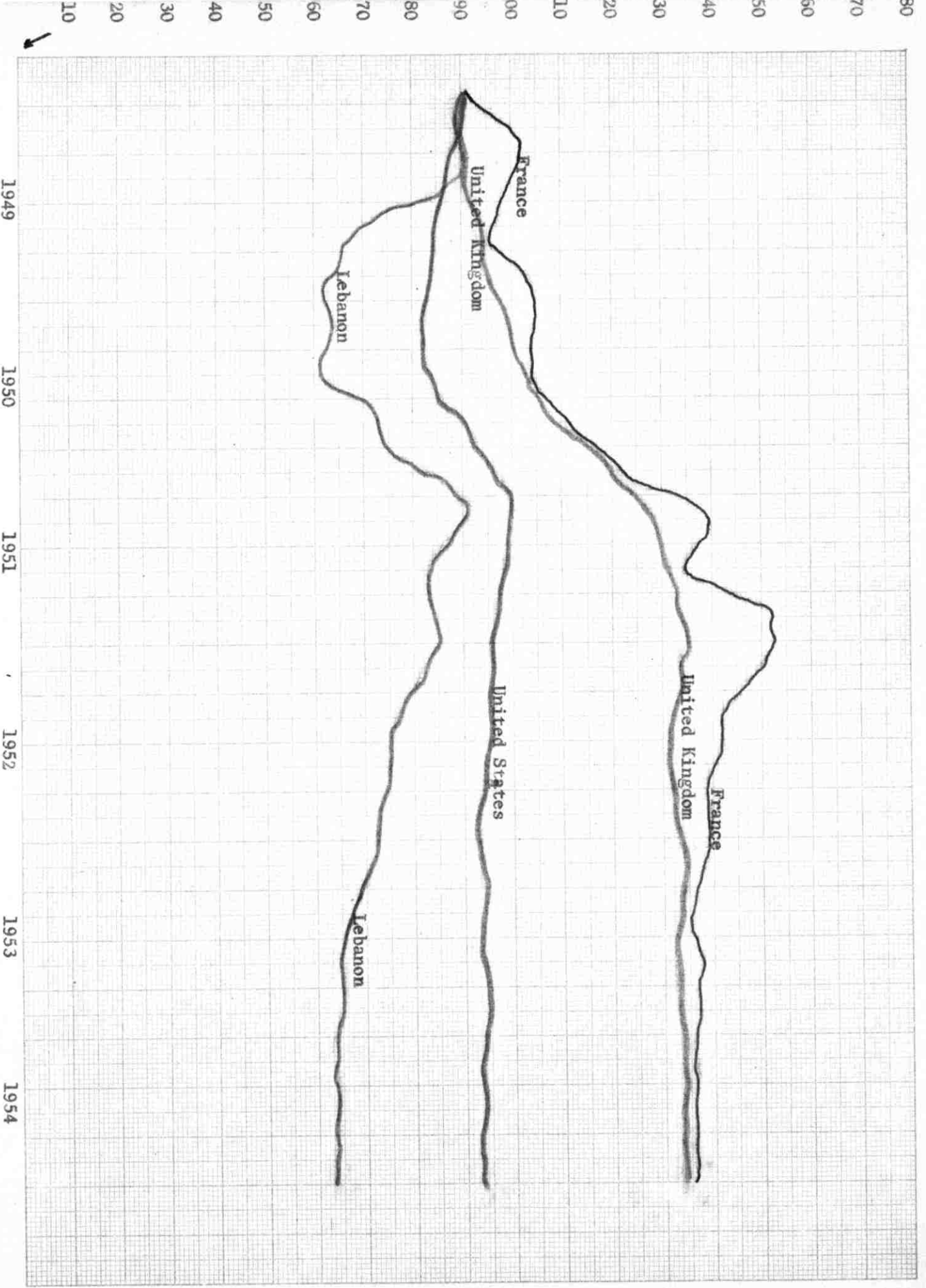
Free Exchange rates - Britain & Market.

10 Minutes to the Centimeter



COST OF LIVING, 1948 = 100

8875 ON



Wholesale Prices, 1948 = 100

STATISTICS



of both trends the proportionate change in the dollar rate was the greatest. Changes in terms of sterling and French francs and currencies linked thereto, were of noticeably smaller magnitudes. A few sharp fluctuations in all these currencies characterized the period between 1949 and the beginning of 1953. Since then and through the end of 1954, the market exchange values of these currencies on the Beirut market were practically stable within a narrow range; but followed the course of a moderately declining trend. The decline in the dollar rate was the most pronounced. Sterling and currencies linked thereto, French francs and Egyptian pounds though declining in terms of the Lebanese pound, appreciated in terms of the dollar and currencies linked to it.

There are different explanations to the rise in value of the Lebanese pound, in the past two years. Whereas one explanation attributes this rise to a weakness of the dollar, another explanation attributes it to a strength of the Lebanese pound - (and the other currencies quoted above -) gained by recovery from a previous weakness. A third explanation is a kind of a compromise between the first two. It maintains that it is a question of both weakness of the dollar and strength of the other currencies.

Over the last 18 or 20 months, the value of the dollar declined in practically all free money markets of the world. The aggregate decline, however, differed in the different markets, and the drop in the rate in these markets took place at different times. However, the decline had been parallel in markets where

currencies are practically left to find their own level without official interference; and this led to the conclusion that the dollar depreciated in value.

A number of points may be raised against this argument. First, only Beirut market is virtually free from official restrictions; other markets are not entirely independent. Second, the period over which the rates are examined is very short, and prior to it these rates moved differently. Third, parallel movements of the rate in free or practically free markets is easily promoted by arbitrage operations. On these bases the parallel decline in the dollar rate, in Beirut, Hong-Kong, Paris and Tangiers money markets, over the past two years, may not be an adequate indication of a weakness of the dollar.

Going behind the exchange rates to the underlying economic conditions to which changes in the rates are only symptoms, a different picture is portrayed. The United States economy compared to economies of the other countries has been since the Second World War, the most stable. Charts III and IV showing comparative wholesale prices and costs of living, give good evidence to this effect. Economies of other countries, in general, faded after the Second World War great difficulties; but have shown in the last two years, some evidence of progress towards stability. On these bases, it is argued that the dollar, compared to the other countries, is a better standard of measurement. It will follow also, that the dollar has not depreciated, but rather that the other currencies have appreciated.

Although economic stability and economic progress have direct bearing on the strength of a country's currency, the international value of a currency is ultimately determined by the interaction of the world demand for and supply of that currency. Conditions in the past two years have been such, that not only the supply of dollars to the world increased, but also the world demand for it fell. It might be more appropriate to say that the need for dollars has become less acute.

The outflow of American capital in its various forms was considerable during the past two years. This capital outflow not only increased the supply of dollars to foreign economies, but having been largely in the form of economic aid, it has helped strengthening these economies thus reducing their need for imports from the dollar area and consequently their need for dollars. This fall in the demand for dollars need not be a fall in the demand for imports. It rather represents a diversion in the direction of trade from countries of the dollar block to countries outside this area, made possible by the economic progress achieved by these countries. The consequent effect on the dollar should have been therefore a depreciation in its value.

Consideration of Lebanon's balance of payments and international reserve position in the past few years, reveals strength acquired by the Lebanese pound. Estimates of the balance of payments show surpluses increasing from LL. 19 million in 1951 to LL.24 million in 1952 to LL. 46 million in 1953. As a result, Lebanon was able to build up a gold reserve which increased

from \$20 million worth in Dec. 1950 to \$63 million worth in Dec. 1954. Figures on the total international reserves show an increase from \$42 million in Dec. 1952 to \$76 million in Dec. 1954.

This improvement in the international financial position of Lebanon is due mainly to the growth of transit and entrepot trade, exchange operations and gold brokerage and to the unprecedented success of the tourist seasons during the past three years. In addition, the United Nations financial aid to the Palestinian refugees in Lebanon which has been flowing since 1948 should also be mentioned.

These factors combined seem to have raised Lebanon's supply of foreign exchange, thus causing the realization of an appreciable annual surplus in the Lebanese balance of payments. It becomes evident that the recent appreciation of the Lebanese pound in terms of the dollar, is not only a question of a weakness of the dollar, but also a question of strength of the Lebanese pound gained during the past two or three years.

### III. Factors Affecting Foreign Exchange Rates on the Beirut Market

#### A. The theory of Exchange Rate Determination:

Exchange rate is the price of one currency expressed in terms of another. A free market exchange rate like the price of any other commodity, is determined by the interaction of demand and supply schedules in the market. A basic and real difference however, distinguishes the forces which underlie the elasticities of demand for and supply of a currency from those underlying the

elasticities of demand and supply of any other commodity.

Elasticity of demand for any commodity simply reflects consumers' preferences. Elasticity of its supply depends basically on the behavior of its costs of production. But because the demand and supply schedules of foreign exchange are a composite of the host of goods and services that **make up** a country's balance of payments, their elasticities are far more complex. They respectively reflect consumers' preferences towards all the balance of payments, goods and services, and behavior of their different cost conditions. Changes in the exchange rate as a result affect buyers and sellers of a wide range of goods and services and have effects which spread in many directions.

Unstable and changing economic and political world conditions which led in the 1920s to great instability in the exchange rates, have made economists devote much attention to the study of exchange rate determination. The theory of purchasing power parity which was developed early in the 19th century, was revived and revised. According to this theory the equilibrium rate of exchange is that rate which expresses equality in the purchasing power of the currencies in question. <sup>(1)</sup> The theory has finally been discarded, because first of difficulties in calculating the par; second, among other things it tacitly assumes that prices of traded and non-traded goods, move together;

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(1) P.T. Ellsworth, The International Economy, its Structure and Operation, (New York, The Macmillan Company, 1950), pp.603-605.

third; it excludes from account all non-commodity items in  
the balance of payments. <sup>(1)</sup> Extensive literature has appeared  
on the subject. It is generally agreed today that an equili-  
brium rate is that rate which keeps the balance of payments in  
equilibrium over a standard period of time without the need  
for resort to trade restrictions, wholesale unemployment or any  
inflationary rise of local prices. <sup>(2)</sup>

With this concept of equilibrium rate in mind, an effort  
is made herebelow to analyse the forces that underlie the Lebanese  
demand for and supply of foreign exchange.

B. DEMAND:

A country's demand for foreign exchange is generally,  
to pay for:

- a) Goods imported whether or not they are subsequently re-exported.
- b) Use of foreign ships and other means of transportation.
- c) Premiums to foreign insurance companies accepting houses, bankers... etc.
- d) Remission of profits to non-residents.
- e) Expenses incurred by the country's tourists and travellers abroad.
- f) Remittances made by resident persons or organizations to relations or organizations abroad.

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(1) Ibid. pp. 593-601.

(2) J.M. Keynes, The Future of the Foreign Exchange, (Lloyd's Bank Monthly Review, Oct.1953), p.528 and P.Ellsworth, op.cit. pp.602-603.

- g) Government expenditures abroad; and
- h) Purchases made for exchange rate stabilization purposes.

No adequate data are available for a comprehensive and complete study of the developments of the Lebanese demand for foreign exchange for each of the above purposes. Nevertheless, by scrutiny of Lebanon's trade figures over the past few years and the overall picture of the other elements of the Lebanese demand for foreign exchange, a judgement about the trend of change in demand, if not the magnitude may be confidently made.

Lebanese imports increased steadily from LL.321 million in 1951 to LL.485 million in 1954. <sup>(1)</sup> Even after due allowance is made for the slight appreciation of the Lebanese pound against most other currencies, it appears that there has been a marked steady increase in the Lebanese demand for foreign exchange for payment for imported goods. Imports alone account for about 85% of the total demand for foreign exchange on items which enter the Lebanese balance of payments. It follows therefore, that changes in Lebanon's imports are of great importance in directing changes in the Lebanese demand for foreign exchange.

The number of foreign companies in Lebanon increased considerably during the past five years. Although one or two large foreign companies were nationalized and some small ones

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(1) Service of General Statistics, Ministry of National Economy, Bulletin Statistique Trimestriel, Vol.V.No.4, Beirut 1954, p.3 (Figures are computed at the official rate. Revaluation at the free market rate will bring them up to LL.407 million and LL.572 million respectively.)

stopped operation, on balance, the total volume of foreign companies' capital invested in Lebanon has since the Second World War increased steadily and considerably. Consequently, the demand for foreign exchange for remission of profits could not have slackened, but rather should have increased. Although there is no evidence of any substantial change in the other elements of the Lebanese demand for foreign exchange, there is no reason to believe that they have slackened. Some of them, namely government and tourists' and travellers' expenditures abroad should have increased. Whereas increase in government expenditures is shown by the budgets' figures, increase of travellers and tourist expenditures is evidenced by the markedly increasing number of Lebanese travellers abroad.

This underlying steady increase in the Lebanese demand for foreign exchange is characterized by seasonal and sporadic fluctuations. As explained earlier, the Lebanese market is sensitive to exchange operations made against Lebanese pounds. Unpredictable changes in the rates may therefore take place, any time large transactions against Lebanese pounds are effected.

A seasonal increase in the volume of operations involving payment of Lebanese currency against foreign exchange, occurs normally in the months of April and May and October and November of each year. This increase is due to increased payments for imports during these periods to meet summer and winter seasons demand.<sup>(1)</sup> Such an increase in the demand for foreign exchange

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(1) Vide import figures by Season Chapt. IV.



drives the rates up unless it is matched on the supply side by a compensating increase.

Aside from such fluctuations in the demand for foreign exchange there might occur changes in the demand because of changes in the methods of payment for imports, such as more or less extended credit terms, payments against documents instead of letters of credit or vice versa. These and similar developments have not been uncommon to the Lebanese market during the past few years. Yet and although they have their significant effects on the market, they are so unpredictable, and of different magnitudes and significance, that no generalization can or need be made.

Compared to analysis of the Lebanese demand for foreign exchange, analysis of the supply is much more complex. This supply is derived from a range of sources of which no single source is of decisive weight. Exports plus re-exports account for about 25% only of the total supply of foreign exchange on items which enter the Lebanese balance of payments. The remaining 75% is earned from a wide range of sources such as tourism, profits on transit and gold trade and on foreign exchange operations, petroleum pipeline transit payments, financial and commercial services, capital flows, unilateral transfers... etc.

a. Exports and Re-exports: Both Lebanese exports and re-exports have been increasing steadily during the past five years. The trend in trade as a result has been towards an increasing demand for foreign exchange. Whereas re-exports do not show any regular seasonal fluctuations, exports appear to have been

highest always in the fourth quarter and generally in the second quarter. These seasonal increases in exports practically parallel the seasonal increases in imports. However, these latter, being of a much greater magnitude beget during the mentioned two periods a substantial increase in the demand for foreign exchange, as far as trade components are concerned.

b. Transit trade: Beirut as an entrepot market, developed in the past war period, into an important gold transit trade center. Transit trade in merchandise also, has increased steadily. <sup>(1)</sup> Gold premia and consequently profitability in gold trade, declined in the last two years. Yet in 1953, Beirut gold trade was at a peak, in terms of value and volume, and in 1954 it declined only slightly.

With the steady increase in the volume of gold and merchandise-transit trade there should have been a steady increase in supply of foreign exchange from this source. For in general, the Beirut merchants are reaping a certain margin of profit from these trades and there are no signs that this margin fell to the extent of offsetting the increase resulting from the increased volume of trade.

c. Tourism: Until five or six years ago, the Lebanese tourist industry meant, largely, summer resorting and mainly by citizens of neighboring countries notably Egypt, Syria and Iraq. The number of both Egyptian and Syrian resorters declined in the past few years because of exchange restrictions in the case of Egyptians and travel restrictions in the case of Syrians. The

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(1) See Chapter IV on Trade and the Balance of Payments.

number of wealthy Saudi and Kuwaiti summer resorters however, has been increasing in the last few years. The likelihood is that, on balance, the total supply of foreign exchange from this source has been increasing rather than declining.

With the development of international air connections at Beirut, the number of foreign visitors passing through Lebanon in transit, and spending usually a few days in the country, has increased very considerably. <sup>(1)</sup> The recent increase in the number of modern and first class hotels in Beirut and the improvement in already existing hotel equipments and services, is due very largely, to this growing movement of foreign visitors. It is believed today that contributions of these visitors to the national income and to the supply of foreign exchange is more important than the contributions of the resorters. The past few years' developments in the Lebanese tourist industry, point towards a steady progress and consequent steady increase in the income and the foreign exchange derived therefrom.

The supply of foreign exchange from visitors is spread all over the year. That from the resorters, however, is concentrated in the short summer period, and thus increases appreciably the supply of foreign exchange during that period.

d. Oil Companies' Payments: There are at present two oil companies that operate in Lebanon, namely the Iraq Petroleum Company and the Trans-Arabian Pipeline Company. Negotiations are

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(1) Vide Chapter I, p.18.

being made between the governments of Lebanon, Iraq and Syria and the I.P.C. for the transfer to the Lebanese coast of the Haifa refinery and the construction, therefor, of new pipelines from the oil fields in Iraq to the coast of Lebanon. Indications are that these negotiations shall end with agreement on the matter, and the new pipelines may be constructed in a reasonably near future. The construction of new pipelines will not only increase the government royalties from the company but it will also increase the company's expenditure in Lebanon especially during the period of construction thus adding to the supply of foreign exchange from this source.

In 1952 the Lebanese Government negotiated with the above-mentioned two companies new transit agreements which provided for increased payments by the companies to the government. The agreement with the I.P.C. has not been ratified, and until recently I.P.C. payments to the government were not increased. Early in 1955 however, the I.P.C. pending the negotiation of a new transit agreement paid to the government the balance due to the latter according to the 1952 agreement.

Payments by Tapline are made according to an agreement concluded with the government in 1952. There are no indications of an increase in these payments in the near future.

Total annual expenditures of the two companies in Lebanon are estimated at LL. 23 million <sup>(1)</sup> and there expenditures

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(1) Information privately secured.

are not likely to increase substantially unless operations are expanded. It may be concluded, therefore, that the supply of foreign exchange from this source is practically steady with a possibility of a substantial increase consequent upon the installation in Lebanon of a new refinery and the ratification of new transit agreements providing for increased payments.

e. Unilateral Transfers: Net emigrants remittances and transfers are estimated to have been in 1951 and 1952 LL.54.4 and LL.69 million respectively. <sup>(1)</sup> It would be believed that the volume of such remittances would decline with the loosening of ties between emigrants and their mother country. Further decline in remittances would also be expected as a result of increased exchange restrictions applied in South Africa and countries of South America where there are large numbers of Lebanese emigrants. Negotiations with the French authorities for favor of authorizing Lebanese emigrants in French Africa to repatriate their capital or a part of their capital, thus far, have not been successful. Nevertheless, Lebanese emigrants in French Africa send money home, in round-about ways, amounting to about 40 million French francs annually. No judgement can be made with confidence, regarding the direction or the magnitude of change in the volume of foreign exchange from this source or from emigrants' remittances in general. Certain informed bankers maintain that there has been no decline in remittances, and that the possible fall due to disappearance of the first generation of emigrants is being offset by an

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(1) E. Fei and P. Klat, op.cit., pp.5-6.

increase in remittances coming from the large number of emigrants of the post-war period, and from new emigrants to Arab countries.

With respect to foreign grants to educational, philanthropic and religious institutions, there is no evidence of any marked change. Developments in some of the already established foreign institutions which are financed from abroad, and the establishment of new foreign organizations in Lebanon point out towards a slight increase in the foreign exchange from this source.

Expenditures of foreign governments in Lebanon increased substantially during the past few years. The most impressive increase comes from the Point IV Economic Aid and the U.N. Aid to the Palestinian refugees in Lebanon. The noticeable increase in the number of diplomatic missions in Lebanon, in the past few years is another contributing factor to the increase of foreign government expenditures in the country.

f. Capital Flows: Thanks to the political and economic stability which Lebanon has had during the past few years, relative to its neighboring countries, and to the complete freedom of the Beirut money market, the country has received a large scale inflow of capital. The main sources of this capital inflow have been Egypt, Syria, Saudi Arabia and Kuwait. Egyptian capital has moved to Beirut in substantial volume since the 1952 disturbances in Cairo, in search of safety. The large movement of Syrian capital to Lebanon during the past few years has also been for the same purpose.

The inflow of Saudi and Kuwaiti capital took place for other reasons. A small part of it has remained in the country being invested in real estate. Whereas Egyptian and Syrian capital has largely been transferred to European and American centers, thus making use of Beirut free market only as a transfer point. There is much doubt that any significant amounts of capital of either of these two sources remained in Lebanon.

From the point of view of supply of foreign exchange, only that portion of capital inflow which remains in the country is of real importance. That portion which only passes through the market creates when it is moving out, a corresponding demand for foreign exchange and thus contributes to the supply only what is earned by the market for services rendered in the process of transfer.

The portion of Saudi and Kuwaiti capital inflow which has remained in the country is kept largely in relatively liquid forms of investments, such as in bank accounts, apartment houses, villas etc. Thus it is subject to a reversal flow which may be brought about by a change in the political or economic climate. Such a reversal flow of capital would create a corresponding demand for foreign exchange and in addition reduce the supply generated by the inflow of capital which thus far continues. The depreciating effect on the Lebanese pound will not equal only the appreciating effect of the inflow, but could be greater.

There are no substantial inflows of capital from other sources. The question of Lebanese capital held abroad, however,

need be considered in this connection. Some residents in Lebanon hold large foreign balances and portfolios of foreign securities. Such capital, being held in liquid forms, is sensitive to economic changes whether at home or in the centers where it is held. A large inflow of capital, for example, is said to have taken place in 1953, in the form of large-scale drawing of Lebanese foreign balances. This drawing of balances is believed to have taken place in response to what was then called an economic crisis, owing to declining sales and non-payment of some Lebanese government obligations in that year.

Owing to a complete lack of banking statistics on capital movements, no assumption regarding the magnitude of such movements, can be made with confidence. However, it is undoubtful that there has been since 1950 a substantial net inflow of capital which has been an important element in the appreciation of the Lebanese pound.

g. Speculation: Speculation plays a significant role in the movements of foreign exchange rates, when these are freely determined by the forces of the market. At the appearance of tendencies for the rates to rise or fall, depending on whether the conditions responsible for the rise or fall are temporary or permanent, speculation in actual or potential holdings of the country's currency will tend to moderate or speed up the movement in the exchange rates. In both cases speculation hastens the approach of the rate to its final position.



Beirut is virtually a free money market. It is generally agreed that speculations plays a significant role in the movements of its rates. But how significant is this role would be a difficult question to answer. As everywhere else where rates are left free to find their own level, the role of speculation is greatest during a rapid decline or a rapid rise in the rates. Particular to Beirut would be the significant role of speculation when it is made against Lebanese pounds or French francs, Lebanese account, the demand for these two currencies being relatively limited.

Compared with other factors responsible for the movements in the rate of the Lebanese pound, some sources consider speculation in foreign exchange as the most important single factor. Although statistical indications for the magnitude of such speculation are not available, nevertheless relying on informed bankers' opinions, it is believed that speculation in foreign exchange in Beirut is continuous and of a large scale nature.

h. Stabilization Fund Operations:

Although established since October 1949, the Stabilization Fund reportedly started operation only in August 1953. It began open market operations for stabilization purposes by entering the market as a buyer of dollars against Lebanese pounds. The purpose was to remedy a certain recession in the market by increasing note circulation. Since then, the Fund has intervened on several occasions to check what appeared to

have been a rapid movement in the rate of exchange.

No information is obtainable on the magnitude of the Fund's operations. There is no question however, that it has been serving its purpose quite successfully and effectively.

(1)  
As mentioned earlier the Syrian Exchange Office entered the Beirut market on certain occasions, for favor of checking an upward trend in the agio of the Lebanese pound over the Syrian pound. It entered the market as buyer of dollars against Lebanese pounds from its holdings of this currency. By doing so, the Office provides an additional supply of the Lebanese currency and thus meets a part or all of the excess demand responsible for the initial rise in the value of the Lebanese pound. In other words the Syrian Office absorbs some of what would have been surplus receipts of foreign exchange at the former rate.

Again information on the magnitude of such operations are not available. Yet it is known that they were effective in bringing about the purposed change in the movement of the rate.

#### IV. CONCLUSIONS:

The above survey of the Beirut foreign exchange market reveals some interesting facts which can be asserted with confidence.

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(1) Vide page 6 of this chapter.

The Lebanese demand for and supply of foreign exchange experienced a steady increase during the past few years. Should the present status of the Beirut money market be preserved these demand and supply would continue their present growth trend.

Elements of the Lebanese supply of foreign exchange are vulnerable to one degree or another. Most of them are nourished by the freedom of the foreign exchange market, and some of them depend entirely on it. These elements comprising in the main a range of services, are of prime importance to the strength shown at present by the Lebanese pound, as well as to the strength of the Lebanese economy itself.

Changes in foreign exchange rates in the Beirut market are unpredictable. The rate is more responsive to transactions made against Lebanese pounds or French francs, Lebanese account than to transactions made against other currencies. Of particular importance is that the rate is responsive to forces that do not pertain to the balance of payments operations. Rates of the major currencies are determined not solely by the interaction of the Lebanese supply of and demand for these currencies; but also by other forces that do not pertain to the balance of payments. A movement in the rate of the Lebanese pound especially when secular, may not be the result of changes in the Lebanese balance of payments position exclusively, but may as well be the outcome of non-balance of payments' forces or a combination of both.

No judgment on the future of the rate of the Lebanese pound can be made with confidence, ~~Yet~~ assuming certain conditions such a judgment may be ventured with some confidence.

If the present growth trend in the elements of the Lebanese supply of foreign exchange is not disturbed by war, political crisis, basic changes in the nature of the Lebanese economy, or by a great increase in the demand for capital for developmental purposes, the Lebanese pound rate will not fall to any substantial degree but may rather follow an appreciation trend.

If the Lebanese Government, however, undertakes to implement projects which require large capital outlays, the Lebanese pound rate may depreciate depending on how large these capital outlays are and on the way the projects are financed. Barring such developments or other international developments which may affect substantially the values of world currencies, the Lebanese pound is more likely to appreciate than to depreciate.

## CHAPTER IV

### TRADE AND THE BALANCE OF PAYMENTS

The present chapter is an attempt to discuss international trading activities of Lebanon within the general framework of the balance of payments and the money market. A study of the commodity trade statistics for the years 1950-54 with respect to the over-all deficit, the composition of trade and its direction are taken up first. Then follows an analysis of the balance of payments for the years 1951 and 1952. <sup>(1)</sup>

#### I. COMMODITY TRADE:

a. Import deficit - Perhaps the most salient feature of the commodity trade activities of Lebanon is the presence of a large and increasing import deficit. This deficit ranged during the past five years between two and a half and four times the total value of commodity exports. From about LL.280 million in 1950, it increased to about LL. 310 million in 1951, LL. 360 million in 1952, LL. 355 million in 1953 and LL. 465 million in 1954. <sup>(2)</sup>

In itself the presence of this large and mounting import deficit is not a serious problem. A large part of it is covered by important foreign exchange receipts in the form of remittances,

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(1) No such estimates for recent years are available.

(2) In fact between 1950 and 1953 only about 25% of the value of imports was covered by the current exportation of goods. Revaluation of imports was made by estimating the portion of their value paid in dollars, sterling and French francs and multiplying this estimate by the ratio of the average free dollar rate for the specific year to its official rate. It is realized that the portion of imports paid for in the above mentioned three currencies cannot be estimated with accuracy and that the ratio is not exactly the same for the three currencies. Yet for the purpose of this study this method is believed to be legitimate..

capital imports and invisible exports. Moreover, Lebanon is an important tourist center. It receives a large number of foreign travellers which has been increasing recently at a markedly high rate. The foreign exchange earned from these two sources increased very considerably during the past few years. It is estimated to have been in 1954 even more than the foreign exchange received from the exportation of goods. A substantial part of these receipts consists of expenditures of foreigners in Lebanon, on imported goods. This fact accounts but partially to the recent marked increase in Lebanon's imports. Table I below shows estimates of Lebanon's earnings from tourism and travel in 1952-1954 as compared with the value of imports for the same years.

TABLE I

<u>YEAR</u>	<u>VALUE OF EXPORTS</u>	<u>EARNINGS FROM TOURISM AND TRAVEL</u>
1952	78,000	50,000
1953	88,000	80,000
1954	106,000	110,000

Pending a fuller discussion of the import deficit problem in section II below, it is worth noting here that the Lebanese economy is geared to a high level of import activities. Should a reduction in the foreign exchange resources take place, it will produce both a direct effect on imports (through reduced foreign exchange receipts) and an indirect effect (via a given marginal propensity to import and reduced income). The high dependence

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(1) These figures were obtained from the Commissariat of Tourism, Beirut, Lebanon. They are very rough estimates and are given very reservedly.

of the Lebanese economy on foreign trade makes these two effects substantial.

The adjustment of imports however to the availability of foreign exchange is subject to a time lag, the duration of which depends on many factors such as the response of domestic production to a reduction of imports, the income elasticity of demand for imports, the reaction of the banking system to an increasing deficit on current account and to a falling exchange rate of the Lebanese pound. This question shall be dwelt upon at length in the following chapter.

b. Seasonal Fluctuations: A second characteristic of Lebanese trading activities is the virtual absence of any marked seasonal fluctuations in imports. Table II below shows the quarterly values of imports and exports in million Lebanese pounds averaged for the years 1950-1954.

(1)  
TABLE II

VALUE OF LEBANESE IMPORTS AND EXPORTS  
IN 1951-1954 BY QUARTER AND IN LL.1,000 (IMPORTS  
VALUED AT OFFICIAL RATE).

	<u>IMPORTS</u>				<u>EXPORTS</u>			
	1951	1952	1953	1954	1951	1952	1953	1954
1st Quar- ter	71,945	83,900	85,762	105,205	24,069	21,950	18,590	21,959
2nd Quar- ter	84,182	73,321	87,962	95,392	35,583	14,130	22,313	19,119
3rd Quar- ter	75,328	82,818	99,911	114,087	15,779	13,428	18,708	25,561
4th Quar- ter	89,317	107,010	92,045	169,718	22,224	27,922	28,099	38,943

(1) Service of General Statistics, Ministry of National Economy, Bulletin Statistique Trimestriel, Vol. V - No.4, Beirut 1954, p.3.

The fourth quarter indicates a noticeably higher import and export activity. In view of the fact that these figures were derived for five years only, and that the deviations between one year and another are quite large, the above figures may not be very significant in indicating the presence of seasonal fluctuations in foreign trade activity. However, a study of the composition of Lebanese trade throws some light on this question. Lebanese exports as table III below shows, consist largely of agricultural products. The main agricultural exportable products of Lebanon are citrus fruits and apples both of which are marketed during the fourth quarter and over a short period of the first quarter. This fact supports the belief that Lebanese exports are usually higher during the fourth quarter than in any other quarter. The study of the composition of imports does not reveal the existence of any forces which tend to enhance imports during any particular quarter. It is generally maintained, however, that demand for consumption goods for summer and winter seasons is concentrated to some degree in the second and fourth quarters which may tend to increase imports during these two quarters.

The exports figures are considerably less important than the import figures when taken to indicate the presence of seasonal fluctuations in the foreign trade activities of the country. Any possible seasonal fluctuations in commodity exports are not likely to be of significant magnitude as compared to the total deficit. It should be mentioned, however, that with respect to the balance of payments, it is not the actual movement



of merchandise that is important; but rather the payment for goods. The methods of payment followed in financing the trade of Lebanon, on the whole, do not suggest any clear deviations in fluctuations in payments from those implied by the fluctuations in the movement of merchandise shown above. Yet the fact that Beirut is a center where international as well as regional trade is financed, renders any seasonal fluctuations, such as those indicated in table II above, of very limited importance.

## II. TRANSIT TRADE ACTIVITIES:

A further characteristic of Lebanese trade activities is a large volume of transit trade. Table III shows the figures on the value of transit trade for 1951-1954, sub-divided into trade in gold, petroleum and other merchandise, valued at official rates.

TABLE III

(in million L.L.)

	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>
Gold	355	240	285	194
Petroleum	459	471	494	480
Other merchandise	<u>323</u>	<u>328</u>	<u>281</u>	<u>360</u>
TOTAL	1137	1039	1060	1034

It will be noted that on the average trade in gold accounted for a little over a fourth of the total value of transit trade, petroleum accounted for about 45 per cent, while all other merchandise accounted for a little over the one fourth of the total transit activities. Trade in gold as shown above declined

markedly during the past three years. This decline is attributed to a fall in gold premia and to more effective application of regulations against smuggling of gold into the markets of far Eastern countries especially India to which most of Lebanese gold was destined.

The income which such activities generate for Lebanon in the form of commissions is estimated to have been in 1950 LL. 54 million.<sup>(1)</sup> A sizeable income from these activities is also generated in forms of transportation, storage, handling services, insurance premium etc. Foreign exchange earned by Lebanon from transit trade activities was estimated in the Balance of Payments of Lebanon at LL. 113.1 million in 1951 and LL. 95.4 million in 1952.<sup>(2)</sup> Compared to the earnings from visible exports, earnings from transit trade would appear to be a relatively important source of foreign exchange.

### III. DIRECTION OF TRADE:

A study of the direction of Lebanese foreign trade reveals some interesting facts. Tables IV and V below give a list of countries which had the most important trade relations with Lebanon during 1950-1954. Import figures are given at the official exchange rates while export figures are given at market exchange rates.

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(1) A.Y. Badre, National Income of Lebanon, Beirut, 1953, Monograph No.8 (Unpublished).

(2) E. Fei and P. Klat, Balance of Payments of Lebanon, 1951-1952, Beirut 1954, p.6.

TABLE IV

(Import in Million LL)

Country of Origin	1950		1951		1952		1953		1954	
	LL. Million Total	% of LL. Total	LL. Million Total	% of LL. Total	LL. Million Total	% of LL. Total	LL. Million Total	% of LL. Total	LL. Million Total	% of LL. Total
France	55	22	38	12	34	10	33	9	39	8
Syria	41	17	59	19	64	18	92	26	109	23
U.S.A.	25	10	57	18	55	15	52	14	72	15
U.K.	23	9	31	9	38	11	34	9	87	18
Iraq	11	4	24	7	18	5	15	4	18	4
Germany	5	2	8	3	10	3	14	4	24	5
Turkey	8	3	7	2	5	1.5	2	.5	3	.5
Italy	8	3	10	4	12	4	11	3	17	4

Table IV indicates that in 1950 imports from France accounted for about 22 per cent of total Lebanese imports. Syria was the second largest source of imports (17%), the United States followed with 10% and the United Kingdom with 9%. The trend in the direction of imports as given for the five years 1950-1954, indicates a sharp decline in the imports from France both in absolute figures and as percentage of total imports. Thus by 1954, imports from France diminished to LL.39 million or 8 per cent of the total. <sup>(1)</sup>

Imports from Syria increased gradually during 1950-1952 and 1953-1954, and markedly between 1952 and 1953. The total increase during the period under study was from LL.41 million <sup>(2)</sup> in 1950 to LL. 109 million in 1954, or from 17 per cent to 23 per cent of the total imports in the respective years.

Imports from the United States, the United Kingdom and Western Germany showed a considerable increase between 1950 and 1954. While the imports from Germany were in 1950 almost negligible, they increased to LL. 24 million in 1954, and Germany now ranks as the fifth largest source of Lebanese imports. The relative importance of the U.S. and the U.K. also increased over the last five years. It thus seems that German, British and United States goods are replacing French goods in the Lebanese market. The probable explanation for this change is that with the relaxation of exchange control regulations and the reorgani-

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(1) Similarly imports from Turkey also showed considerable decrease from LL.8 million in 1950 to about LL.3 million in 1954.

(2) This figure fails to account for imports during the first two and a half months of the year. There was then a customs union between Lebanon and Syria and no such data were recorded.

zation of monetary relations with France both of which had been for a long time geared toward a large volume of imports from France, Lebanese trade has sought other more suitable markets. The increase in imports from Germany is attributed largely to the generous terms of credit granted by this country, and to its supplying the market with diesel machinery.

Table V shows the direction of Lebanese exports.

TABLE V

(Export in Million LL.)

	1950		1951		1952		1953		1954	
	LL Million	% of Total	LL Million	% of Total	LL Million	% of Total	LL Million	% of Total	LL Million	% of Total
Syria	20	30	22	22	16.5	21	14	16	15	14
Saudi Arabia	12.5	19	8	8	7	9	11	12	12	11
Egypt	5	7	9.5	10	7	9	6	7	9	9
U.S.	5	7	23	23	7	9	4.5	5	7	7
U.K.	4	6	2.5	3	4	5.	4.5	5	4	4
Netherlands	4	6	3	3	-	-	.5	1	1.5	1
France	3	4	4.5	5	3.5	4	2.5	3	3	3
Italy	1.5	2	3.5	4	3.5	4	10	11	4.5	4

The figures in Table V indicate that Syria remained the most important market for Lebanese exports though its importance in comparison with other countries diminished gradually. Thus while in 1950 Syria accounted for about 30 per cent of Lebanese commodity exports, it accounted for only 14 per cent in 1954. Total Syrian imports of Lebanese goods in 1954 amounted to LL. 15 million only which compares with LL. 20 million in 1950.

While this fall in Lebanese exports to Syria may be due to the termination in 1950 of Lebano-Syrian Customs Union, and to the subsequent raising of tariff barriers between the two countries, it is worth noting that the restrictions put by Syria on the movement of Syrians to Lebanon have been removed since March 1954, and therefore, a larger amount of goods are bought by Syrians in Lebanon, which upon crossing the border, escape registration by the customs officials. Lebanese exports to Syria in 1954 may therefore be substantially higher than what they are shown to be above.

Saudi Arabia is second in the list of export markets for Lebanese goods. Most of Lebanese exports other than gold to this market are probably destined to Lebanese residents and other foreigners employed by the petroleum companies.

Exports to Egypt and the U.S. show a slight increase between 1950 and 1954. On the other hand, exports to the Netherlands declined by over two million Lebanese pounds during the same period.

IV. RELATIONS WITH INDIVIDUAL MARKETS

An examination of the export and import figures with a view to locate the countries with which Lebanon has either a large deficit or a large surplus shows the following:

TABLE VI

LEBANON'S TRADE DEFICITS WITH ITS IMPORTANT  
(1)  
TRADE PARTNERS

COUNTRY	1950	1951	1952	1953	1954
	<u>LL. 1,000,000</u>				
France	52	35	30	23	34
Syria	22	37	47	78	94
U.S.A.	20	34	48	47	65
U.K.	19	28	34	30	83
Iraq	10	21	9	11	13

It will be noted that by far the largest import balance in 1950 was incurred in the trade with France. This trade deficit, however, decreased gradually from LL.52 million in 1950 to LL.34 million in 1954. The fall was due to the decreasing importance of the imports from France largely for the two reasons mentioned earlier.

The deficits with the U.S.A., Syria and the United Kingdom were the largest in 1954. Lebanon had a total deficit of about LL.242 million with these countries, or about 63% of the total commodity trade import balance with the rest of the world.

(1) Imports from the United States, the United Kingdom, Iraq and France are valued at the official rate. Revaluation at market rate will raise the figures by about one third.



V. Composition of Lebanese Trade:

The composition of Lebanese trade shows that food products constitute the largest group of imports. In 1951 they accounted for about LL.146 million or about 40 per cent of the total value of imports. (1)

Textiles rank second in importance constituting about 20 per cent of the total value of imports in 1951 and about 15 per cent in 1952.

With respect to exports, however, food products accounted for a little over one fourth the total in 1951 and about 42 per cent in 1952. This increase was due mostly to an increase in the export of vegetable products. Textiles were the most important export item in 1951 accounting for about 40 per cent of the total, but were second to food products in importance in 1952, accounting for a little over one fourth the total exports.

However, in spite of the importance of a limited number of products, one can easily discern considerable diversification both in the exports and in the imports of Lebanon. Lebanon thus differs from neighboring countries in that its international trade activities are much more diversified and do not show heavy reliance on a few commodities.

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(1) E. Fei and P. Klat, op.cit., p.63. (This figure includes categories I-IV in the table, and is revalued as well as the total imports, at free market rate).

VI. THE LEBANESE BALANCE OF PAYMENTS:

In this section an attempt will be made to analyze the balance of payments of Lebanon for the years 1951 and 1952 in order to show the effect of trade on other international transactions and on the payments problem. It should be noted however, that this division into commodity trade on the one hand and other international transactions on the other is largely arbitrary. It was made, here primarily for two reasons; first commodity trade is by far the largest single item in the balance of payments. - In 1952, merchandise trade accounted for a little over a half of the total debits and credits in the balance of payments. <sup>(1)</sup> Second, the information on merchandise trade is the most reliable in the balance of payments estimates and was therefore singled out for treatment purposes.

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(1) E. Fei and P. Klat, op. cit., p.5.

## TABLE VII

BALANCE OF PAYMENTS OF LEBANON1951-1952

(in LL Million)

	1951		1952	
	Credit	Debit	Credit	Debit
<b>A. Goods &amp; Services</b>				
Merchandise Trade	124.9	436.1	122.1	454.2
Non-Monetary gold	15.2	14.3	25.0	36.5
Foreign Travel	35.0	14.7	47.6	23.1
Transportation & Insurance	16.3	9.2	21.2	8.5
Investment Income	15.6	11.8	16.2	9.2
Government, not included elsewhere	79.5	9.8	72.2	6.6
Miscellaneous Services				
Transit	113.1	-	95.4	-
Other Services	35.7	-	36.0	-
TOTAL (A)	435.3	496.2	435.7	538.1
<b>B. Private Donations and Capital Movements</b>				
Emigrants' Remittances and Transfers	58.4	4.0	71.7	2.7
Government	0.5	-	2.5	-
Charitable and Cultural Institutions	10.2	-	13.5	-
Capital Movements (net)	14.7	-	43.7	-
TOTAL (B)	83.8	4.0	131.4	2.7
Total (A + B)	519.1	500.2	567.1	540.8
Surplus	18.9		26.3	
<b>Compensatory Financing</b>				
Monetary Gold	-	23.9	-	15.4
Foreign Exchange Assets	0.9	-	-	10.4
Bank Liabilities to Non-Residents	4.1	-	-	0.5
TOTAL (E)	5.0	23.9		26.3

It was noted in the foregoing section that merchandise trade resulted in a considerably large deficit which amounted to about LL. 310 million in 1951 and LL. 360 million in 1952. Reference to the balance of payments estimates, however, reveals that, with the exception of non monetary gold, every item shows a surplus. The largest surpluses are shown by the net export of miscellaneous services, which amounted to LL. 148.8 million in 1951 and LL.131.4 million in 1952, by government receipts from abroad (primarily the expenditure of international organizations on Palestine refugees), which amounted to about LL.69.7 million in 1951 and LL. 65.6 million in 1952, and finally private donations, which amounted to LL. 65.1 million in 1951 and to LL. 85 million in 1952. Net capital movements into Lebanon stood at LL.14.7 million in 1951 and increased to LL.43.7 million in 1952. <sup>(1)</sup>

It will be seen that about 25 per cent of the deficit arising from merchandise trade is covered by private donations mostly from Lebanese emigrants living abroad. In view of the fact that such receipts have no quid pro quo, the regularity of their flow may be questionable. One would expect a constant

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(1) By far the largest proportion of donations comes from the U.S.A. and constitutes a considerable source of dollars. Thus over 80 per cent of the donations received by charitable and educational institutions comes from the U.S.A. The proportion of emigrants' remittances sent from the U.S.A. is also high. Donations thus yield a minimum supply of dollars of about LL. 50 million annually.

decline in their magnitude with the passing of time and the weakening attachment of the Lebanese emigrant to his mother country. This conclusion is valid only if the rate of emigration from Lebanon slackens under the impact of economic development and the provision of greater employment opportunities at home or increased restrictions in emigration. Of the total merchandise imports into Lebanon in 1951, LL. 68 million were direct imports of goods by international organizations for use by the Palestinian refugees.<sup>(1)</sup> These imports declined to LL. 40 million in 1952 as more refugees were integrated in the Lebanese economy and forfeited their ration cards. However, such direct imports are matched by an equal credit entry under the "Government" item.

With respect to the net surplus arising from miscellaneous services, transit trade and particularly gold transit were estimated at LL. 76.2 million. This activity decreased in 1952 as a result of the increasing difficulties of marketing gold in the Far East and a general fall in gold premia. Profits from gold transit stood at LL. 48.6 million in 1952.

Profits from merchandise transit amounted to LL.36.9 million in 1951 and to LL. 46.8 million in 1952. The data available on transit trade for subsequent years indicate further decrease in the profits from gold transit and a compensating increase in the profits from merchandise transit.

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(1) E. Fei and P. Klat, op.cit., p.40.

With regards to the importance of net capital movements into Lebanon, no conclusion can be made on the basis of two years estimates regarding either the magnitude or the trend. The figure for 1951 stood at LL. 14.7 million and increased sharply in 1952 to LL. 43.7 million. The increasing importance of Lebanon as regional center for investment and trade is likely to have resulted in a rise in capital inflow. A comprehensive and detailed study of the countries from which capital is flowing, of the forces behind the flow, and of the forms in which it is held in Lebanon, is therefore of great importance for the stability of the Lebanese economy which may be greatly disturbed by possible sudden unforeseen withdrawals.

The banking system automatically adjusts itself to the flow of capital and to the forms in which it is held. Thus if most of this capital takes the form of demand deposits, the banks are enjoined to keep greater amounts of monetary reserves to meet sudden demand on them. But if such capital takes the form of assets such as houses, shares, etc. no reserves need be kept by the banking system for any sudden withdrawals of capital.

The problem must arise, however, of whether the economy can meet the strain of a heavy capital outflow without having to impose restrictions on the balance of payments and particularly on capital movements. The consistency of such controls with the stability of the balance of payments is also of great importance in this respect.

Reference to the balance of payments estimates seems to indicate that any increased restrictions on payments may have a

radical effect on many credit items. Thus a large part of the services rendered by the Lebanese to the rest of the world are made possible largely because Lebanon has a free and stable money market. Increasing controls on the money market will probably result in an immediate deficit in the balance of payments and increased restrictions on trade and payments.

## CHAPTER V

### IMPLICATIONS OF THE FOREIGN EXCHANGE MARKET

#### I. PROBLEMS OF THE FREE EXCHANGE MARKET

##### A. Interdependence of Modern Economies

As distinct from the so called self-sufficient economy, an open economy such as the Lebanese economy today is greatly dependent on, and influenced by international contacts. Economic and financial complications arise from the external sector, and vary according to the country's composition of trade, elasticities of demand and supply, capital movements and gold and foreign exchange reserves. <sup>(1)</sup> The more a country is dependent on trade the more will variations in trade account for fluctuation in employment and income; and the more it follows a liberal policy, the more its economy becomes susceptible to changes in economic activity abroad, especially in countries which are its main trade contacts.

The international forces responsible for the transmission of such changes may be grouped under five headings: <sup>(2)</sup>

1. Money and credit ties,
2. International capital movements,
3. Variations in foreign exchange rates,
4. Visible trade, and
5. The balance of payments multiplier.

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(1) E. Marcus, Countercyclical Weapons for the Open Economy, the Journal of Political Economy, Chicago, The University of Chicago Press, Vol.LXII, Dec.1954, No.6, p.479.

(2) E. Marcus, op.cit. 479-482.



Briefly stated the play and interplay of these forces are as follows:

Interest rates as well as other prices differentials, and disequilibrium in the international accounts bring about changes in the monetary reserves of the country. "If the country's interest rate structure averages less than that of other important money markets, capital may flow out (or cease flowing in), thus causing a deterioration in the capital account"... "If the interest rate structure is raised, either to maintain equality with competing money markets or to attract capital to offset a weak current account, then the domestic borrowers will tend to become less insistent in their demands. Loans will decline (or increase less) and thus spending and internal activity will be curtailed."<sup>(1)</sup>

In the absence of exchange controls, the existence of interest rate differentials or of imbalance in the international accounts of a given money market gives rise to movements of capital.<sup>(2)</sup> The effects of such movements often extend beyond changes in bank reserves to cyclical influences. If for example, the capital flowing into a country is invested in certain acti-

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(1) Ibid. p.481.

(2) Political conditions have great bearing on such movements of capital. No mention of them is here attempted since consideration is made of money ties influences only. Reservation should be made with regard to applicability of these influences to particular money markets. Unless the market is an important center it is doubtful that it can attract foreign capital because of interest rate differentials alone. Interest rate differentials in small money markets can at best check an outflow of local capital.

vities which add substantially to that country's prosperity, more funds will be attracted, thus adding to the already increasing demand for labor, materials, power, light, etc. (1) In addition to its influence on the flow of capital, this increase in activity and consequently in employment, output and income influences the volume of visible trade through a resulting increase in purchases from both local and foreign markets. The net effect on the balance of trade thus produced is reflected in the over-all balance and therefore in the flow of reserves which in turn acts on the banking system as mentioned earlier. The effects however, do not stop at this point. Expansion in income as a result of an active balance of payments i.e. out of additional exports will be a multiple of the initial surplus. The coefficient of expansion will depend on and vary directly with the proportion of the surplus spent at home. Out of the income generated at home, a part depending on the marginal propensity to import, will be spent on imports. Real payments in the balance of international accounts will therefore increase (2) thus helping in the adjustment of this balance.

#### Economic Changes and the Exchange Rate

The first impact of such changes is on the rate of exchange. A flexible rate, freely determined in an open market readily responds to this impact, and rises or falls depending on whether the tendency is toward a surplus or a deficit in the balance of payments. Movements in the rate themselves have bearing on the

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(1) Jacob Viner, Studies in the Theory of International Trade, (New York, Harper & Bros. 1937), pp. 433-6.

(2) P.T. Ellsworth, op.cit., p.333-5.

interplay of the foresaid international forces and on the direction of their effects on the internal sector.

A rigid exchange rate being maintained by administrative action and thus freed from the influence of the automatic forces of the market, does not respond to the impacts of changes explained above. It thwarts, given adequate reserves, any immediate and temporary manifestation of a deterioration in the foreign payments position. As a result, many exchange crises which under a flexible rate, attract much attention would pass practically unnoticed under a rigid exchange rate. Yet does rigidity in the rate offer the solution to the underlying difficulties? Does it only delay the warning of impending disequilibrium? Or does it really accentuate the elements of instability?

There has appeared extensive literature on the merits and demerits of flexible, rigid and temporarily rigid exchange rates. Flexibility in the rate is often confused with instability, but it does not need to be so unless there is instability in the underlying economic conditions which govern international trade.

Specifically, a flexible exchange rate is objected to for (a) increasing uncertainty in the economic scene, (b) causing fluctuations in domestic prices, and (c) failure of attaining  
(1)  
timely adjustments.

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(1) M. Friedman, Essays in Positive Economics, (Chicago, University of Chicago Press, 1953), p.173.

a) Flexibility in the rate is said to cause uncertainty in the economic scene by making exporters and importers uncertain about the price they will receive or will have to pay for foreign exchange. Such uncertainty has a disruptive effect on trade. However, it must be noted that, under flexible exchange rates, future markets develop readily, and traders can protect themselves against uncertainty of returns by hedging in the future market. Uncertainty then can be shifted to speculators against a small hedging cost.

Moreover, rigidity in the rate does not eliminate uncertainty of returns; it only changes its form and may even increase its extent and enhance its repercussions. While certain about the rate, traders under a rigid rate will be uncertain about internal conditions or availability of exchange. Conditions that cause a flexible rate to decline bring about a shortage of exchange under a rigid rate. Some kind of internal adjustments or administrative allocation of exchange will then be needed. There results an uncertainty about the policy which the authorities will follow, and there is no evidence which warrants assuming that this type of uncertainty is less disruptive to trade than the uncertainty of future rates.

Another factor which is often said to add to the elements of instability under a flexible rate, is speculation in foreign exchange. Speculators, some maintain may take a decline or a rise in the rate as an indication for a further decline or rise and thus offer to sell exchange in the former case and to purchase

in the latter. Thus movements in the rate become sharper than they would have been in the absence of speculation. As a result, there would be danger of immediate capital flight in response to movement in the rate. However, to say that speculators generally follow such a policy is to mean that they buy when the rate is high and sell when it is low, and on the whole undergo a loss. Evidently this cannot be true. Actually experience in all free markets even suggest that speculation is often a stabilizing factor rather than otherwise.

Under a flexible rate relative uncertainty about the direction of the change in the rate and the fact that the change takes place alongside with sales (decline) and purchases (rise) discourage further sales in the former cases and purchases in the latter.

Under a rigid exchange rate changes in which are the result of administrative action, there will seldom be any doubt about the direction of change. Speculators therefore will have every incentive to sell or purchase the country's currency depending on whether a devaluation or an appreciation is expected. An exchange gain will be reaped if the change takes place. If the rate is not changed, the only cost which speculators would bear is a possible loss of interest earnings because of interest rate differentials. Given no direct controls the danger of capital flight as a result of suspicion of a possible change in the rate will therefore, be more serious with a rigid than with

a flexible rate.

b) The second objection to a flexible exchange rate relates to the process of adjustments in domestic to external conditions and the repercussions arising therefrom. Basically "flexible exchange rates promote adjustments to changes in external circumstances by producing changes in the relation between the prices of foreign and domestic goods"<sup>(1)</sup>. Since a decline in the rate raises the prices of foreign goods, in terms of the local currency, it is maintained that it consequently raises the cost of living and creates a demand for wage increases, thus setting in motion forces that tend to create a wage-price-spiral which will continue unless non-market forces intervene.

Aside from its being applicable only to special circumstances making for depreciation in the currency,<sup>(2)</sup> this objection fails to take account of the effects of price elasticities of demand for foreign goods and the probable limited extent of the influence of imported goods on the cost of living. Only when such goods have a significant role in the movements of the cost of living and the price elasticities of demand for them are

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(1) Ibid. p.180.

(2) If the tendency toward a deficit in the balance of payments were the result of a monetary deflation abroad, depreciation in the currency would prevent transmission to the country, of the fall in external prices and thus prevent monetary and consequent disturbances. Again if depreciation in the currency is caused by an inflation at home, it would clearly be the result and not the cause of it.

generally low, a fall in the rate will result in a rise in the cost of living through raising the prices of foreign goods. Nevertheless assuming the point, the rise in the cost of living does not of itself lead to a wage increase or at least to a wage increase without a reduction in employment. It only adds to the many reasons behind the demand for wage increase depending on the ratio of imports to national income, on the proportion of imports consisting of consumers' goods and on the importance of imported consumers goods in the cost of living.<sup>(1)</sup>

Assuming that the likelihood is for the rise in prices of imported goods to lead to a wage increase, a rigid rate does not eliminate the forces responsible for such a rise in prices of imported goods. It only implies that controls (holding the rate rigid) are used to perpetuate the disequilibrium in the form of an unsatisfied excess demand for foreign exchange. In this case, monetary policy that may neutralize the effects or some of the effects of devaluation is probably preferable to controls.

c) One further criticism of a flexible exchange rate is said to be the failure to attain timely adjustments. The ultimate change in internal economic conditions in adjustment to changes in external conditions would undoubtedly take some time. The length of this period varies widely depending on the

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(1) W.L. Thorp. Trade Aid or What? (a Report on International Economic Policy). (The Johns Hopkins Press, 1954, 1st ed.) p.45.

type of adaptation required. For example, curtailment by a high price of the purchase of a certain imported good to which competitive goods are available on the domestic market, would require a considerably shorter period of time than does the development of a new industry to produce goods to be substituted for others formerly imported. Yet for every change in the allocation of productive resources in response to external changes there is some optimum pace and timing of adjustment.

Under a flexible rate, adjustment will be achieved through changes in the allocation of resources induced by changes in the rate. The initial change in the rate in response to the tendency toward a deficit or a surplus in the balance of payments, is often maintained to be greater than the ultimate change required for the adjustment. With the achievement of some adjustments (since certain adjustments take place before others), the rate will rebound moving gradually towards the final position. To maintain that speculation is destabilizing implies that with a flexible rate, speculation would lead to an undesirable pace and timing of adjustment through the increased instability and complications that it creates. The maintenance of the view that speculation is stabilizing rather than destabilizing on the other hand, leads to a contrary corollary. The tendency for the rate to fall (or to rise) initially more than ultimately induces speculators to buy (or to sell) the currency at the time of the initial decline (or to rise) in the rate and sell (or to buy) it at a higher (or to a lower) price later. Furthermore, the appreciation of a currency of a given country is equivalent to



a rise in the interest rate for loans to that country, and a decline to a fall in the rate. In the former case, foreign capital will be attracted and in the latter it will be dis-  
tracted. (1) From this it can be concluded that speculation need not add complications to the process of adjustment, but rather may help it running its course.

However, this does not warrant concluding that a flexible exchange rate would bring about the optimum pace and timing adjustment required. But "there seems no reason to expect the timing or pace of adjustment under the assumed conditions to be systematically biased in one direction or the other from the optimum." (2)

### C. TECHNIQUES OF ADAPTATION TO ECONOMIC CHANGES

Under rigid exchange rates the techniques of adaptation are: changes in internal prices, direct controls, and the use of monetary reserves.

#### Changes in internal prices

In principle, changes in internal prices and direct controls on imports, exports and capital movements can produce the same effects on trade as changes in the exchange rate. In practice, however, owing first to the inflexibility of prices and second to the different degrees of prices inflexibility, adjustments of internal conditions in response to external changes through

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(1) It should be noted that this is not significant except in the case of countries that are important money-market centers.

(2) M. Friedman, op.cit., p.185.

changes in internal prices are subject to distortions. Whereas adjustment in one sector might be achieved through changes in prices, it might take the form of a change in output in another. Economic conditions today seem to require continuous adjustments necessitated by continuous changes in the real underlying conditions of trade. Many of such changes often require substantial changes in the output or relative prices of particular commodities and only minor changes with respect to other commodities. With this need for almost continuous changes in the allocation of resources and, more importantly for changes in employment this method of adjustment is probably undesirable.

### Direct Controls

Adjustment by direct controls also has its demerits. Aside from the question of unpredictability of changes in exports and imports, and consequently of the difficulty of effecting through controls the appropriate changes required, such direct controls necessitate official intervention in many internal matters and may well interfere with the efficiency of production and distribution of goods.<sup>(1)</sup>

In addition to these disadvantages direct controls, because of their limitations on the use of the currency, reduce the demand for that currency probably more than do the fluctuations in exchange rates. Further disadvantages of this method are evidenced by administrative considerations which limit the extent of imposition and enforcement of direct controls, and by personal and political considerations to which economic affairs

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(1) M. Friedman, op.cit., p.168.

are often subverted. (1)

### 3. Use of Monetary Reserves

The use of monetary reserves has its own advantages when applied to correct small and temporary movements in the rate. However, when the movements are great and lasting this method of adjustment becomes subject to a number of limitations. First and most important among them is the possibly limited size of the reserves of foreign currency. Second is the necessity to accumulate foreign exchange indefinitely to provide the domestic currency required and meet added monetary complications arising therefrom. In addition to these monetary complications, accumulation of foreign exchange means an exchange of some of the country's products for hoards of currency. Such an exchange will be most undesirable when conditions are working for depreciation of the foreign currency.

From the above it can be concluded that no country can escape the impact of changes abroad on its external trade and domestic conditions unless external trade is eliminated completely; and that the more a country follows a liberal policy the more its economy becomes susceptible to changes in economic activity abroad. It is consequently concluded that the primary

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(1) W.L. Thorp, op.cit., pp.50-2.

aim of policy will be to develop an efficient system of adaptation to these forces and changes, and that for an open economy that is largely dependent on trade a free exchange rate is an important part of such a system.

## II. EXTERNAL SOLVENCY

External solvency is a question of great importance for any economy. Owing to the fact that foreign trade leakages in open economies are great and consequently the possible loss of their gold and foreign exchange reserves is substantial, the question of maintenance of external solvency for such economies requires particular consideration.

### A. COUNTERCYCLICAL MEASURES UNDER CONDITIONS OF PROSPERITY

Under conditions of prosperity <sup>(1)</sup> the tendency toward an inflationary situation may be checked by means of raising interest rates, raising bank reserves ratio; open market operations and countercyclical budgetary policies without adverse effects resulting from the openness of the economy. <sup>(2)</sup> This however assumes the existence of a well developed money market and a banking system well organized to ensure efficient implementation of such policies. The banking system of Lebanon at

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(1) If the country's exports are in a great demand, or if the country is receiving a great capital inflow, or if together with other countries it is experiencing a boom and it is the only country that tries to check it.

(2) E. Marcus, op.cit., p.484.

present, does not satisfy these conditions. <sup>(1)</sup> The BSL which performs certain central banking functions has no effective means of controlling commercial banking operations in the country. It is a private and profit seeking institution, the objectives of which conflict fundamentally with objectives of central banking. Nevertheless the Lebanese money market is comparatively small, and the BSL share in the market activity is relatively large; if the BSL wishes to help checking an inflationary tendency it can achieve this end by means of its credit policy. (e.g. by restricting opening credit accounts). However, banking activity in Lebanon as shown before is experiencing a great and steady increase. The more this activity grows the smaller becomes the relative share of the BSL in the market and the weaker becomes its power to influence the market.

Another method of checking an inflationary tendency is the appreciation of the exchange rate. This deflationary device however, may not be feasible unless the country has a surplus current account or a substantial inflow of capital. In the absence of such conditions, appreciation of the rate may encourage imports and discourage exports resulting in an undesirable weakening of the current account. In a controlled economy such results may be avoided by administrative action - assuming other countries do not take retaliatory measures - whereas in an open economy no such action is taken to prevent them from taking place. In the case of Lebanon, the visible exports consist largely of agricultural products which can be secured from other close markets. Appreciation of the Lebanese pound therefore may strengthen the competitive position of such

1) Please refer to chapter one of this study, p.19.

markets and as a result reduce the Lebanese exports substantially. But invisible exports which are by far more important, are not subject to the same conditions. The nature of the various Lebanese invisible exports, <sup>(1)</sup> suggests that an appreciation of the rate of a practical magnitude, would affect only slightly if at all the volume of these exports. Lebanese imports on the other hand are quite diversified. The effect of exchange appreciation on the volume of each variety might differ widely. Yet the likelihood is that an appreciation of the rate will result in a noticeable increase in these imports. The net effect of exchange appreciation therefore will still be deflationary; but its effectiveness would have been greater had a smaller part of the receipts been due to invisibles which are comparatively less responsive to price differentials.

Other instruments may also be used depending on the degree of the development of the money market, the efficiency of the administrative machine of the country in question, and the strength of its monetary weapons. Such instruments may vary from manipulation of sales taxes and social security contributions to control of the stock market, credit policy... etc. The Lebanese economy thus far has not developed such instruments, and they cannot be counted among potential deflationary devices for the Lebanese authorities.

With regard to the capital account of a country resorting to deflationary devices, special consideration need be made. The

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(1) See Chapter IV "Composition of Lebanese Trade".

effect of a deflationary policy on investment of foreign capital in export industries is different from its effect on investment in industries producing for the domestic market. Whereas the former would be encouraged through the decline in internal costs which is not offset by a decline in returns (i.e. export markets not undergoing similar deflationary situations), the latter will be deterred through a decline in anticipated returns.

In an earlier stage of this study, it was shown that Lebanon experienced recently a substantial inflow of capital. The capital remaining in the country is held partly in the form of bank balances and is partly invested in establishing and operating branches of foreign banks and other companies and in villas, apartment houses, etc., and generally in service producing activities.

Although these services are very largely destined for exports, the fact that they are purchased and consumed within the country, renders the effect of inflationary or deflationary tendencies on investment of foreign capital in such activities practically the same as that on investment of foreign capital in activities producing for the domestic market.

A deflationary policy therefore would tend to discourage the inflow of capital to Lebanon and may even induce a capital flight.

If the deflationary device is an appreciation of the exchange rate, foreign investors would reap a capital gain.

Expectation of further appreciation may encourage the inflow of capital, especially for speculative purposes. But appreciation of the rate means also an inducement for increased imports and decreased exports; it may therefore discourage capital inflow through a pressure on the prospective returns. Thus the net effect on the capital account is not clear. It can be discussed meaningfully only with reference to particular countries and under particular conditions. Given the present conditions of the Lebanese economy it is believed that any deflationary device would weaken the country's capital account.

It should be concluded now that with the present monetary and fiscal weapons at its disposal, Lebanon can check tendencies toward inflationary situations without difficulties or adverse effects resulting from the openness of the Lebanese economy.

B. COUNTERCYCLICAL MEASURES UNDER CONDITIONS OF DEPRESSION:

If the open economy is depressed, effectiveness of its countercyclical weapons will be limited, depending on whether it has a strong or a weak current account.

An expansionary policy very likely would increase consumption and expand purchases of materials for added production by raising incomes and output. It thus would increase imports and worsen the current account. Such a policy therefore is feasible only if the economy has a favorable balance. It would be limited by the extent of the surplus if a drain of the reserves is to be avoided. This would obviously put a limitation on



recovery by deficit financing and the orthodox monetary measures. The extent of this limitation would be determined by the rate of import leakages i.e. rate of increase in imports due to application of an expansionary policy as implied by the specific projects undertaken.

A further limitation is implied by the danger that the program might prove to be inflationary and thus discourage an inflow of capital, turn it into an outflow or start a flight from the currency. Under such circumstances the recovery program might be hampered or even prove to be a failure. <sup>(1)</sup> Similar to what would happen when the balance of payments is not favorable, recovery, i.e. expansion of output and consumption would lead to a deficit on current account and a loss of reserves through an increase in imports which is not matched by a corresponding increase in exports.

Under such circumstances a country would resort to either direct controls over foreign trade or currency depreciation. Direct controls over trade would destroy the objectives of the free flow of international trade and result in a loss of the gains reaped therefrom. In addition there are the political implications

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(1) Selective use of certain instruments of control as complementary to the recovery program, may help appreciably in widening the limits imposed by the rate of import leakages. An example of such selective controls would be the keeping high of the rates on loans for specific types of projects the implementation of which requires high imports whilst the rates for other projects requiring little imports are kept low and consumers purchases from products of the latter type of projects are encouraged.

of such controls. Trade partners would object to them and very likely would retaliate against the country's exports. No generalization can be made with respect to the consequences. Yet the likelihood is that economies involved will be affected adversely to one degree or another.

Currency depreciation on the other hand generally stimulates exports and discourages imports, by making the former cheaper to foreigners and the latter costlier to residents. It appears then, that the direct effects of depreciation on trade are induced by price differentials. The magnitude of such effects would therefore depend on the price elasticities of the foreign demand for the country's exports and of the domestic demand for imports. The higher are these elasticities the greater will be the desirable effects of depreciation. The lower they are the more will be the pressure on the exchange rate with probably further declines and still more pressures.

Briefly stated the above arguments show that open economies can combat inflationary movements quite successfully, but their ability to guide the course of recovery from a depression is questionable. In both cases the balance of payments and the monetary reserves need to be favorable, but this need is much stronger in the case of a recovery policy. The international account then should be unusually favorable if resort to intervention in the international sector is to be avoided.

There is no mathematical measurement of the adequacy of a country's reserves. The degree of their adequacy at a particular time depends upon the trade and payments objectives of the country

as well as upon its state of economic development, its probable position on the business cycle and on a number of other economic conditions. A good test for the adequacy of a country's reserves is the capability of that country to balance its external accounts over a cycle without resort to official intervention, though it might undergo some payment deficits in some years.

Referring to the Lebanese economy, the figures of the Lebanese foreign exchange reserves per se do not warrant passing a judgement on the adequacy or inadequacy of these reserves. Aside from the question of the relative importance of these reserves as compared to the value of the country's trade activities, consideration should be given to whether Lebanon is in a slump or a recovery, in a boom or in a state of recession, and to what developmental projects are being implemented.

Lebanon's foreign exchange reserves stand today at about \$55 million. <sup>(1)</sup> Relative to the value of the country's trade in 1954, these figures appear to be quite substantial. Yet consideration of the vulnerability of many of the sources of Lebanon's foreign exchange earnings, the present marked prosperity of some of the foreign exchange earning activities, and the large projects which are being planned for immediate implementation would leave little or no doubt that these reserves are inadequate.

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(1) Information privately secured.

The expansion and development of Beirut and Tripoli ports, the implementation of the Litani project and construction of the planned international highways alone would require outlays in foreign exchange far beyond the exchange earning capacity of the Lebanese economy,<sup>(1)</sup> and thus may reduce the present reserves to a bare minimum.

### III. INTERNAL MONETARY STABILITY

Of more importance than a country's external solvency is its internal monetary stability. Regardless of the policy adopted, the main objective should be the promotion of internal monetary stability i.e. avoidance of deflation or inflation. The question that interests us now is: given an open economy what system of exchange rates would promote achievement of such objective ?

It has been shown above, but it is worth restating that countries today are economically very interdependent and that open economies in particular are very susceptible to changes in economic activity abroad. What is required therefore is a system which would combine economic interdependence among countries with a maximum of internal monetary independence.

In the light of the arguments presented above<sup>(2)</sup> one can easily discern that with a system of rigid exchange rates this

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(1) Due allowance is made for payments for ordinary imports.

(2) See problems of the free exchange market above.

objective is unattainable unless all the country's trade partners follow successfully such a policy. An inflation in any one of the important markets leaves no alternative for the remaining countries but to accumulate currency balances of the inflating country or following a similar inflation themselves. The failure of any one important country to maintain monetary stability would under a system of rigid exchange rates result in transmission of this country's difficulties to its trade partners and tends to disrupt the whole structure.

A system of flexible exchange rates offers the mechanism by means of which a country can follow separately a stable internal monetary policy. Under such a system, an inflation or a deflation has its primary effects on the exchange rate. The movement in the rate offsets the effect of the inflation or deflation on the country's international trade position and reduces or eliminates the tendency for transmission of its difficulties to its trade partners. One effect however, which the system of flexible rates cannot eliminate is that which is induced by the resulting change in the real income position of the country. In fact "flexible exchange rates are a means of combining interdependence among countries through trade with a maximum of internal monetary independence; they are a means of permitting each country to seek for monetary stability according to its own lights, without either imposing its mistakes on its neighbors

or having their mistakes imposed on it".<sup>(1)</sup>

Promotion of internal monetary stability is therefore more feasible under a system of flexible exchange rates than under a system of rigid rates.<sup>(2)</sup> Moreover, harmonization of internal monetary and fiscal policies would be attained and internal monetary stability achieved without risks of formal and far-reaching coordination of such policies.

#### IV. CONTRIBUTION TO THE NATIONAL INCOME

Throughout this study the contribution of the free exchange market to the development of specific economic activities and consequently to the income derived therefrom was mentioned whenever appropriate. In most instances contribution of the free market cannot be isolated from contributions of other factors. Measurement of the magnitude of the free market's contributions to the national income is therefore extremely difficult. In the case of certain activities, mainly industrial, the free market has had an adverse effect which is also not easily measurable. Nevertheless such effects should not be overlooked when contributions of the free market are under consideration.

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(1) M. Friedman, op.cit., pp.199-200.

(2) The mere existence of a link that tends to transmit economic changes in one economy to trade partners' economies, creates an incentive to engage in inflationary action. The reason being that inflationary currency issue means acquisition of resources from abroad in the form of accumulated balances of such currency by trade partner currencies.

The considerable increase during the past few years, in Lebanon's transit and ordinary trade, in employment in banking business, in the number of foreign companies operating in Lebanon and the employment therewith, in the number of foreign travellers and tourists etc. is undoubtedly due largely to the free commercial and exchange policies which the country has followed. The influence of the change in per capita income and standard of living in Lebanon and neighboring countries, the increasing requirements of economic development therein, and even the mere obtaining by Lebanon of its political independence together with other factors have undoubtedly contributed to the promotion of the forementioned economic activities. To consider these factors as having been constant and attribute the total increase to the freedom of exchange and trade policies is to bias this study deliberately.

The only direct and assessible contribution of the free market to the national income is in the form of the exchange commission earned on foreign exchange transactions effected for or on behalf of foreign concerns. This commission averages around 0.50 per cent on transactions effected by banks and around 0.75 per cent on transactions effected by other dealers in foreign exchange. It is estimated that about 50 per cent of the total value of Beirut market foreign exchange transactions are effected by banks and the remaining 50% by non-bank dealers. Assuming as stated earlier that the volume of these transactions in 1954 equalled about four times the volume of the balance of payments transactions in that year, total profits would appear

to have been about LL. 37 million. There is no reason to maintain that the same ratio between balance of payments and non-balance of payments exchange operations is the same for every year. No such correlation exists; further it would be misleading to assume that the volume of non-balance of payments exchange operations fall or rise at a certain fixed ratio with the volume of balance of payments operations. Developments in other foreign exchange markets have a great bearing on Beirut's international exchange operations. Given the present economic conditions of the Lebanese and foreign markets, however, indications would point toward further growth in this Lebanese activity and in the earnings accruing therefrom.

Growth in other economic activities benefiting from the existence of a free exchange market, also depend on internal and external economic and political developments. Such developments are often unpredictable and may be of slight, moderate or disruptive effects. In other words, Lebanon's earnings from most of its activities that are nourished by the existence of a free market are vulnerable to one degree or another in the sense that they depend largely on forces that fall within the <sup>out</sup> the domain of the political state and are therefore affected greatly by developments abroad, whether political or economic.

#### V. CAPITAL MOVEMENTS

From the reservations made above with respect to the effectiveness of discount or interest differentials in attracting capital flows to particular money markets, there can be ascer-



tained the corollary that capital movements to and from a certain money market may be completely independent from the influence of interest and discount rates differentials. This is particularly true of the Lebanese money market. It is unlikely that Beirut will attract funds from New York, Paris or London simply because the rate offered in Beirut is higher than the rate offered in those markets. At best it can stop or reduce an outflow of domestic capital. Nevertheless, as has been shown earlier, Lebanon is receiving a substantial inflow of foreign capital. The forces behind this movement of capital are not only economic in nature, but also political and probably social.

A substantial portion of the capital inflow as stated before has been due to political instability in the source countries. Such capital was largely transferred abroad with Beirut used only as a transfer point. The forces attracting this capital to Beirut or rather through it, are very probably the freedom of the market, its geographical position from the source countries and its familiarity to them. Should it have been a question of interest rate differentials, promising investment opportunities or the like, the capital would have remained in Lebanon rather than sought other markets.

A part of the capital inflow however, remained in Lebanon. This portion should have been attracted therefore by forces different from those acting behind the movement of capital through

Lebanon. The capital that remained in Lebanon is largely invested in villas, apartments, houses, establishment of branches of foreign countries, and some of it is held in bank balances. The forces attracting this type of capital inflow may be the availability of promising investment opportunities, familiarity with the market, its complete freedom or a combination of these forces. It is rather difficult to state which of these forces provides the strongest inducement to the capital inflow. Yet the freedom of the market obviously has great bearing on the effectiveness of the other two forces which, without it, might not offer any inducement to the inflow of capital. With regards to the foreign capital invested in the establishment and running in Lebanon of branches of foreign companies such as banks, insurance companies, travel agencies... etc. there is no doubt that the strongest single attracting force is the freedom of the market.

In brief it can be stated that with the exception of expenditures in Lebanon by foreign governments, emigrants remittances and other forms of foreign grants to Lebanese residents, there remains a substantial inflow of capital which is attracted chiefly by the freedom of the Lebanese market.

It is generally recognized, and experience has shown, that business capital does not move in any substantial volume, to underdeveloped or low-income countries for the purpose of producing for the domestic market.<sup>(1)</sup> The limited size of the

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(1) R. Nurkse, Problems of Capital Formation in Underdeveloped Countries. (Oxford, Basil Blackwell, 1953), p.106.

market in such countries offers a great obstacle to such an inflow of capital. Yet given certain conditions, the limited size of the domestic market does not hinder the inflow of foreign capital for investment in export industries. Most outstanding among these conditions aside from cost of production advantages, would be the economic and political stability, the relative freedom of the market and probably its location. The case of the Lebanese market is a good illustration supporting the validity of this argument. Business capital flowing into Lebanon is invested largely in export industries, chiefly service-producing activities. As mentioned above this inflow of business capital into Lebanon is largely due to the freedom of the Lebanese market. It is invested in activities which owe their existence to a great extent, to this freedom of the market. The institution of restrictive measures therefore would tend to stop this inflow of capital and may even tend to turn it into an outflow. It should be added that substantial domestic capital is invested in these types of activities which owe their existence wholly or largely, to the existing freedom of the market. Should any fundamental changes be introduced in the present free commercial and economic policy of the country, domestic capital invested in the forementioned type of activities, alike foreign capital invested in these activities, will face great difficulties.

In other words the Lebanese economy has been geared towards developments of activities which flourish under conditions of an open door policy. Adoption of this kind of policy has directed investments to special types of activities and

furthermore has resulted in the localization of these activities according to a particular pattern. Investors in these activities are greatly concerned in perpetuating the free commercial policy of the country. They undoubtedly will exert whatever pressure they can, not only against enactment of laws that would restrict the freedom of commerce, but also against the enactment of any business law that may infringe upon any of the business freedom which they enjoy at present.

Briefly stated, implementation of a liberal economic policy by the Lebanese Government alongside with other complementary laws and regulations has shaped the Lebanese economy in a particular structure which is described in the beginning of this study. Its special characteristics will further strengthen as long as the present liberal policy persists. Consequences of this tendency will be dwelt upon at length in the following chapter. It suffices here to state that any fundamental change towards the institution of restrictions will have a disturbing impact on the structure of the economy. It may probably be reflected in a fall in national income, a deterioration in the international financial position of the country, and a complete change in the relative importance of the various sectors of the Lebanese economy.

## CHAPTER VI

### CONCLUSION

Having discussed the various elements of the inquiry with which this paper is concerned, an attempt is made in this concluding chapter, to gather together the various threads of this study and derive therefrom some conclusions.

The national income of Lebanon is stated to have been about LL. 1,070 million in 1950. Assuming the population of Lebanon was then about 1.35 million, the per capita income in Lebanon would have been about LL.800. Compared to per capita incomes in practically all countries of the Middle East this figure would appear to be the highest. Indications are that the per capita income in Lebanon as well as the national income are experiencing a steady increase since 1950.

Lebanon's national income is distributed among the various sectors of the economy as follows: <sup>(1)</sup>

<u>Sector</u>	<u>LL.1,000,000</u>	<u>Percentage</u>
Trade	299	28
Agriculture	206	19
Industry	137	13
Services	100	9
Real Estate	96	9
Government	72	7
Finance	65	6
Construction	42	4
Transportation	38	4
Rest of the World	14	1
	<u>1,069</u>	<u>100</u>

(1) A.Y. Badre, National Income of Lebanon, 1954, A special report prepared for the Economic Planning and Development Board of Lebanon.

The earnings of employment in the trade sector amounted in 1950 to 10% of the income arising in this sector, in the industrial sector they amounted to 36%, in the services sector to 37%, in the construction sector to 66%, and in the transportation sector to 47%.<sup>(1)</sup> The per capita share in the income from trade is the highest among per capita shares in all other sectors. It is about two and a half times the per capita share in the agricultural sector and roughly two and one fourth what it is in other sectors. Thus it can be concluded that trade activities provide a much smaller amount of employment than other activities.<sup>(2)</sup>

This situation owes its prevalence to the existing open door policy which characterizes the economy of Lebanon. Its acquisition of the present shape or structure has been due mainly to the geographical position of the country on the crossroads of three large continents, familiarity of the chief foreign languages, cultures and markets to the Lebanese entrepreneurs, spread of Lebanese emigrants almost all over important commercial centers and the fact that Lebanese businessmen have been exploring this field much earlier than any of their neighbors.

This situation has led to the concentration of activities in Beirut, the single important commercial center of the country, to the detriment of the remaining cities which do not have the transportation and ports facilities which commerce requires.

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(1) Share of employment in the income arising in the agricultural sector could not be computed. The Lebanese system of land tenure however, suggests that this share should be relatively high at least when compared to that in the trade sector.

(2) Computed from the "National Income of Lebanon, Beirut, 1953", by A.Y. Badre and A.Y. Nasr.

This fact created a large movement of population from the rural areas and even from the other cities of Lebanon to Beirut diverting investments and development from agriculture and other economic activities towards trade and services. It furthermore led to concentration of political power in the hands of a small group of wealthy businessmen. This last outcome of the application of an open door policy is a great factor that contributes to continuity in application of this policy. Once in power, businessmen undoubtedly defend their interests which lie in the preservation of the free commercial policy to which their activities owe their prosperity.

The question that pauses itself now is the following: Is perpetuation of this policy the right path which Lebanon should follow? It has been pointed out earlier that the economic prosperity which Lebanon is enjoying and which is manifested in a steady increase in the national income, is largely due to application of a free commercial policy. Contribution of this policy to growth and development of some activities, has been explained in earlier stages, with due consideration given to the activities that were depressed as result of application of this policy.

To answer our question one further question need be asked: Is the economic situation which is largely the outcome of the free commercial policy, sound?

Discussion of the trade and balance of payments of the country (Chapter IV of this study) revealed the following facts about the international financial position of Lebanon:

1. The balance of trade of Lebanon is characterized by a large and increasing import deficit which amounted in 1954 to about four times the total value of recorded commodity exports.

2. Notwithstanding this large deficit in the country's balance of trade, its balance of payments is in a surplus position.

3. Although the value of imports increased substantially during the past few years and more than the increase in value of exports could cope with, the surplus in the balance of payments appears to have been increasing. This situation is the result of large increasing invisible exports and of receipt of substantial amounts of remittances, grants and capital inflow which increased markedly during the last few years. Earnings from tourism and travel appear to have more than doubled during the past three years.

If we add here that the national income also, has experienced in the past few years, a steady increase, the economic conditions of the country will appear to be undoubtedly prospering. Yet to show whether the situation is sound or not further investigation into the nature of the elements of this prosperity should be made.

Grants, remittances and capital inflow and invisible exports are shown to be responsible for the favorable position of the balance of payments. As sources of income to Lebanon these are influenced to varying degrees by forces taken place outside the sphere of control by Lebanese authorities. The grants, remittances and capital inflow may be hindered and thus



reduced slightly or greatly, by restrictions instituted by the foreign authorities concerned with no influence by the Lebanese authorities, except when those can be made through diplomatic channels or retaliatory measures. The capital flowing into Lebanon was shown earlier to be invested largely in projects which do not add much to growth in the economy and moreover is subject to sudden withdrawal. Furthermore this capital inflow was shown to have been due largely to extraordinary situations arising in the source countries. Once such situations disappear, the capital flow will be reduced, stopped or even turned into an outflow for repatriation purpose. The invisible exports on the other hand are in general less responsive than the forementioned sources of income, to measures instituted by foreign authorities. Nevertheless they are subject to serious changes resulting from decisions taken abroad.

It would appear then that the present economic prosperity which Lebanon enjoys and which is manifested in a favorable balance of payments and increasing national and per capita incomes, is the result of growth in activities that are vulnerable to one degree or another. Should the present economic situation therefore be termed as unsound? And should a new economic policy be substituted for that which is now in force? Indications evidencing soundness and strength of the economic situation in Lebanon are not lacking. The Lebanese balance of payments has been favorable for a number of years and its surplus has been experiencing a steady increase. Income from services activities as well, manifests a steady increase. Some of these activities are

growing at a markedly high rate and are assuming some degree of unassailability. Furthermore, the Lebanese economy is becoming more and more integrated in the regional economic "system" with leadership in international trade activities and in a number of services of an international demand. Barring unforeseen fundamental changes, the Lebanese economic situation is therefore sound. However, there should not be concluded that the economic policy in force at the present time, should not be revised or reoriented. Application of this policy was shown to have stimulated activities that contribute comparatively little to employment. It has also led to concentration of activities in one center to the detriment of activities in the remaining centers. Application of a policy that would encourage activities which contribute more than trade, to employment, and which would decentralize economic activities, with preservation of free commercial policy is quite feasible. Such a policy should be directed towards development of Lebanese industry and agriculture. Industry can be encouraged by reducing costs of production, preserving the local market by protective tariffs and by stimulating export industries and promoting the export of their products. Development of agriculture on the other hand can be achieved by intensifying cultivation, irrigation and mechanization and by improving the marketing processes.

Such policy if enforced will tend to stimulate production of goods without adverse repercussions on production of services. It is shown earlier that present trends in the Lebanese economic policy point out towards adoption of such a policy. It is hoped

that these trends will be carried on to reap the benefits of this policy in full.

At this point and having taken a definite stand from the Commercial policy enforced by Lebanon at present, it becomes necessary to comment on what may be considered an essential element of the system, namely the rate of exchange. Should a fixed rate be maintained? Or should it be left to find its own level in the free market? A fluctuating rate was shown to have some adverse implications on trade and that forward markets nullify most of such implications. Maintenance of a fixed rate would undoubtedly do away completely with this particular type of implications. The cost however, may be high and may not be justified by the achievements.

The government will have to maintain a fixed rate in a free market. It will have to be capable and prepared to purchase or sell whatever amounts of foreign exchange are offered or demanded at the fixed rate. This would imply that the government should keep an adequate reserve of the currencies required which in a way means keeping some of the country's capital in the form of "unproductive" hoards of money. It furthermore means a possible loss by the government anytime the market forces require intervention of the authorities to peg up the rate. This is particularly undesirable when forces are working towards depreciation in the value of foreign currencies hoarded. The loss undergone looked upon from another angle, is a subsidy granted by the government to traders and dealers in foreign exchange whose holdings in foreign

exchange would have been falling in terms of value as a result of a fall in the rate. It has been shown earlier that this policy has its implications and that it is not the best for promotion of trade through elimination of the risk of changes in the rate. Furthermore, a fixed exchange rate for the Lebanese pound would be objected to, on different grounds. It was shown that rate in Beirut is not determined solely by balance of payments transactions and that substantial foreign exchange operations effected on behalf of foreigners are very common to the Beirut market. In addition to the difficulties to find an equilibrium rate for the Lebanese pound therefore this rate may become subject to frequent fluctuations resulting from unpredictable forces. It would furthermore imply that the part of the loss underw~~ent~~ent by the government in pegging up the rate goes to foreigners in the form of subsidy in compensation for their loss in exchange.

A further reason for recommending for Lebanon, a free rate determined by the market forces is the fact that as was shown earlier, the Beirut market is more responsive to operations made against Lebanese pounds than to those made against foreign currencies. Elimination of temporary fluctuations in the rate can therefore be made through relatively small stabilization operations which will not require large currency reserves. Success of the Stabilization Fund with its reportedly relatively small reserves, in achieving its objects offers a satisfactory proof to this effect.

Elimination of lasting changes in the rate however, would undoubtedly require the carrying of large operations and therefore

necessitate the availability of large reserves of foreign currencies. The Stabilization Fund need not carry on such operations and the rate should be left to respond to fundamental changes for proper adjustment of internal economic conditions to fundamental economic changes within the economy and abroad.

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