THE MONETARY SYSTEM OF LEBANON

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PREFACE

The object of this essay is to study the monetary system or mechanism of Lebanon. By monetary mechanism is meant "the instrumentalities and organizations by which money is supplied to the economy and through which money expenditures are made."[1] The scope of this study is confined to the description and analysis of monetary institutions in Lebanon with due regard to the present and future monetary policy of the country. The theme of this study has recently received much interest from both private and official circles. This is witnessed by the resolutions of the 1st Annual Economic Congress of May 1955 who recommended the carrying out of monetary reform. The government itself has recently become aware of the pressing need for such reform, and has called upon an international financial expert, Mr. F. Keesing of the International Monetary Fund to study the monetary and banking system of Lebanon and give his opinion thereupon.

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1. J. Marvin Peterson, "The Functioning of Our Present-Day Monetary Mechanism," in American Financial Institutions, Ed. Hebert V. Prochnow, (Prentice Hall, New York: 1951), 97.

Any study of the Lebanese monetary system ought necessarily to be started with a historical sketch which would permit the reader to follow the evolution of the system. A survey of the history of the system occupies the first part of Chapter I. The second part analyses the Franco-Lebanese Monetary Agreement of 1948 which is truly considered as a turning point in the evolution of the monetary system of Lebanon. Chapter I ends with the description and evaluation of the Monetary Law of 1949 which is the natural outcome of the Franco-Lebanese Agreement, and has been the first step toward the establishment of an independent currency.

Chapter II starts with a description of the main features of the Lebanese banking system. Its main object, however, is the study and appraisal of the monetary function of this system.

The Beirut money market is an essential part of the monetary system of the country. A description of its present organization and functions is given in Chapter III.

Chapter IV is devoted to the analysis of Banque de Syrie et du Liban (BSL) and its role in the Lebanese monetary organization. BSL's activities are described in the light of the Convention of 1937.

Chapter V discusses the governmental monetary institutions, that is to say those institutions whose management lies with the Ministry of Finance (and not with BSL), and describes their policies.

At this juncture, I should like to thank Mr. Talha Yaffi, of the Economics Section of the American University of Beirut, for his help throughout this essay. Mr. Yaffi has provided me with very valuable information from his draft Ph.D. dissertation on "The Monetary and Banking System of Lebanon with Special Reference to Central Banking Reform", and has permitted me to use some of the unpublished data obtained for him in his capacity as member of Lebanon's Planning and Development Board. Were it not for Mr. Yaffi's references, analyses and documents, this essay would not have bee n nearly as complete.

I should like also to express my special indebtedness and sincere gratitude to my supervisor, Professor Paul Klat, who has generously given his advice and care to my work. His numerous and helpful comments and criticisms have greatly contributed towards improving the work both in argument and presentation. This essay has, moreover, considerably benefited from Professor Klat's post-graduate seminar on "Monetary Organizations in the Arab Middle East".

Last but not least, I wish to thank the Beirut Representative and officers of the British Council whose generous scholarships for the last three years have made it possible for me to continue and finish my studies at the American University of Beirut.

A B S T R A C T

During the past ten years, the Lebanese economy has become increasingly monetized. The considerable rise in the volume of money is a witness to this effect. The growth of the money sector and its increasing complexity was not, however, accompanied by a concomitant adaptation of the monetary institutions to the new requirements of the economy. This essay attempts to make a critical analysis and appraisal of the Lebanese monetary system in the light of these new requirements.

The monetary legislation of Lebanon consists of the Convention of 1939 with BSL (i.e. Banque de Syrie et du Liban) and the Monetary Law of 1949. The Convention of 1939 endows BSL with some central banking functions. Thus this bank has the exclusive right of note issue, and is the Government's financial and fiscal agent; at the same time, it is an ordinary commercial bank. The privileges granted to BSL could be justified when they were originally given in the early twenties; BSL was then the only commercial bank in the country and had to assure the carrying out of mercantile credit operations. But since then thirty two commercial banks have opened branches in Lebanon; some of these have larger resources than BSL. Most of the banks

in Lebanon, specially the purely Lebanese institutions, resent the unfair competition of BSL, a situation which jeopardizes the successful and smooth working of the Lebanese banking system.

Another most noteworthy fact is the absence of specific banking legislation. According to the Lebanese Commercial Code, banking institutions are still considered ordinary commercial establishments. There are no provisions to ensure proper liquidity and solvency standards, and the protection of depositors. The absence of government legislation and control appears also in the Money market. Credit operations are not subject to definite regulations and the growth of the Beirut money market is handicapped by several defects, chief among which are its inefficient organization and the absence of a lender of last resort - namely a central bank.

The Monetary Law of 1949 regulates note issue only. Although this law has given some safety (but little flexibility) to the Lebanese pound, its main defect is its incompleteness: the law does not regulate demand deposits which constitute nowadays the largest component of money supply.

The monetary policy of Lebanon is left almost completely in the hands of BSL. Besides, no serious governmental attempt has been made so far to influence the monetary events of the country in the light of public interest.

The analysis of the Lebanese monetary system clearly shows that the need for monetary reform is imperative. The objectives of this reform can be summarized as follows: full employment, economic development and economic stability. It is the author's belief that a national Money and Credit Board ought to be created in order to take over gradually from BSL the responsibility of controlling the Lebanese monetary system, and eventually assist in the setting up of a national central bank.

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I. The Background

The historical part briefly covers the period between the years 1920-1948, i.e. the inter-war period, the second world war period and the post war period until 1948. The inter-war period witnessed the creation of the Lebanese currency and the signing of the agreements with the Banque de Syrie et du Grand Liban (later called Banque de Syrie et du Liban); the following period bred war exchange regulations, and the last one, the circumstances which made Lebanon join the sterling area and then have a sterling guarantee on her franc assets.

1. The Creation of a Lebanese Currency

Prior to November 1918, Lebanon was part of the Ottoman Empire, with only limited autonomy. As such, it had no independent monetary system, separate from the general Turkish system. After that date, as Lebanon and Syria were occupied by Franco-British troups, the Franco-British authorities demonetized the Turkish banknote and substituted for it the Egyptian pound, then on the sterling exchange standard.[1]

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1. It should be noted that in introducing the Egyptian pound as the official legal tender, the occupying authorities were able to defray

On the 1st of April 1920 when France became the mandatory power over Lebanon and Syria, the French High Commissioner suspended the use of the Egyptian pound and established by decree a Lebano-Syrian paper currency. The latter was made the sole legal tender after January 1st, 1921 (arrêté No. 607). The Banque de Syrie et du Grand Liban (hereafter referred to as BSL) which was a subsidiary of the Imperial Ottoman Bank, was then authorized to issue Lebano-Syrian pounds (hereafter referred to as LLS). The pound was made divisible into 100 piasters and redeemable by cheques on Paris (or Marseilles) for 20 French francs.

2. The Agreements between the Lebanese Government and BSL

The privilege of note issue was later confirmed by the Convention of January 23rd, 1924 signed by BSL on one side and Syria and Lebanon on the other. This privilege was to run for fifteen years starting April 1st 1924. BSL was also to function as the official bank, i.e. to be the custodian of the government's deposits and its fiscal agent.

A ceiling on the note issue was provided for by a maximum issue limit of LLS 25 million and a prescribed reserve consisting of the following assets:

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their army expenditures by their own credit. In this manner, they avoided the expensive process of buying Turkish gold pounds to pay for their expenditures in Lebanon and Syria.

(a) Gold and foreign governments' obligations payable in gold;

(b) Commercial bills maturing within 90 days (not to exceed 7% of the note circulation, nor LLS 1 million);

(c) Obligatory deposits with the French Treasury bearing 1.5% interest per annum (b & c not to exceed 21% of the note circulation);

(d) French Government obligations payable within two years.

These proportions were not adhered to strictly and the note cover averaged for that period of fifteen years as follows: 4% gold, 41% deposits with the French Treasury, 55% French Government bonds.[1]

Before the termination of this Convention, negotiations between the Government of Lebanon and BSL led to the signing of a new Convention on May 29th, 1937 for a period of twenty five years (as compared with 15 years for the previous Convention) beginning April 1st, 1939. No maximum limit for note issue was stipulated. The volume of note circulation had to be fully covered by a reserve consisting of an obligatory reserve and an optional reserve. The obligatory reserve included (a) not less than 10% in gold coin or bullion; (b) 25 to 26% in francs deposited with the French Treasury

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1. For further details on the period 1920-1935 see Sa'id B. Himadeh, *Monetary and Banking System of Syria*, (American Press, 1935), chaps. vii and viii, 73-123.

in Paris bearing interest of not less than 1.75% and (c) an interest free loan of LL 250,000 to the Lebanese Government. The optional reserves included: (a) three signatures commercial bills expressed in Lebanese pounds maturing within 90 days; (b) French Government bonds maturing within five years (those with two years maturity should not exceed 25% of the total); (c) a demand deposit in francs at the French Treasury provided the amount does not exceed 6% of the total note circulation and (d) a current account loan for economic development of a maximum value of LL 1.5 million advanced to the Lebanese Government at 4% per annum.[1]

The new Convention differs from the convention of 23rd January, 1924 in a number of respects:

First, the new convention makes the Lebanese currency the sole legal tender currency and the sole standard of value and of deferred payments, whereas the old Convention acknowledged the right (given by the arrêté of January 23rd, 1924) of making contracts of a duration of more than five days in any foreign currency, but with the condition that payment must be made in Lebano-Syrian currency.

Second, the new Convention separates the Syrian from the Lebanese currency (at least nominally) for the first time.

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1. Every legislation referred to in this paper is published in the Al Jarida Al Rasmia (The Official Gazette). Monetary Legislation is also published in:
   - Lebanese Ministry of Justice, Majmu'at Al Kawanin: See Section on Nukud wa kat' (Money and Exchange).
   - Al Majmu'at Al Haditha Lilkawanin Al Lubnania, Eds. A. Barud, M. Saleh and S. Hatem, Vol. 7, (Sader Press, Beirut); see Section on Nukud wa Kat' (Money and Exchange).

Third, the new Convention provides for a minimum gold reserve whereas the old Convention did not.

Fourth, the new Convention stipulates that the whole gain arising from an increase in the value of gold reserve in terms of francs belongs to the contracting state, whereas the old Convention did not have such a provision.

Fifth, the new Convention subjects BSL to taxes whereas the old Convention exonerated it from all taxes and duties, present or future.

Sixth, according to the old Convention, BSL paid the government a percentage of the gain from the reserve of the note circulation varying, in accordance with the average daily note-circulation during the year, from 10% to 50%. On the average the proportion of the gain which went to Lebanon and Syria was about one third, BSL keeping two-thirds of the gain. The new Convention provides a complicated way of dividing the gain from the fiduciary reserve between BSL and the contracting state (details on this point are given in Chapter III).

The terms of the 1937 Convention concerning the note cover were subsequently changed by a series of arrêtés of the French High Commissioner owing to war conditions.

3. The Franc Exchange System and its Viscissitudes

From the time it was introduced in May 1920, the Lebano-Syrian currency suffered considerable fluctuations and depreciations following the changes in the value of the French franc.

The eleven successive devaluations of the franc from June 1926 until September 1949 depicts the continuous instability of the Lebanese pound since the latter was until 1941 on the French franc exchange standard, and until 1948, it was backed, almost completely by French franc assets. We can distinguish five phases in the history of the Lebanese pound, as affected by changes in the value of the franc.

The first phase covers the period 1920-1926. During that period the franc had fluctuated widely. Thus the American dollar which was quoted at 54.7 Lebano-Syrian piasters (PLS) in April 1922 was worth as much as PLS 202.8 in July 1926; then fell to PLS 127.5 in the month of August of the same year. These fluctuations in the value of the Lebanese pound (as a result of changes in the value of the franc) made the Lebanese people suffer great inconvenience and loss. To lessen the evils of fluctuation, measures were taken to permit the use of foreign moneys as the standard of deferred payment for all contracts over five days term.

The second phase covers the period 1926-1936. The franc was de facto stabilized in September 1926 (although the de jure stabilization did not occur until in June 1928) at 0.0635 gr. of gold 900/1000th fineness, or at about one fifth of its value in 1920 (Table 1). Lebanon therefore enjoyed the benefits of the gold standard system, mainly the benefit of stability in the foreign exchange rates, for a period of 10 years.

The third phase extends over the years 1936-1941. On the 1st of October 1936 as France left the gold standard, the monetary standard of Lebanon reverted to the French franc paper standard. After that date the franc depreciated causing likewise depreciation in the Lebano-Syrian pound. On February 29th, 1940, the franc was worth 0.02334 gr. of gold or 8% of its value in 1920.

In June 1941 as Lebanon and Syria were occupied by the British and Free French troups, the Lebano-Syrian pound left the franc exchange standard. The Franco-Lebano-Syrian agreement of February 9th, 1944 sanctioned this step and guaranteed the franc assets of the Lebano-Syrian pound in terms of sterling.

The last phase in the relation of the Lebanese pound and the French franc covers the period of the Franco-Lebanese Monetary Agreement of 1948, i.e. the years 1948-1958. The conditions of this Agreement as well as the effects of the franc devaluations on the Lebanese pound franc assets are discussed later.

It is a well known fact that the recurrent depreciation of the Lebanese currency (as a result of French franc devaluations) caused great prejudice and hardships to the economy of the country.[1] Under the franc exchange standard, it was the

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1. In a period of 25 years, i.e. from 1920 till 1945, the franc fell in value by more than 97.5%.

economic, social and political instability of France vis-à-vis the outside world that affected the Lebanese currency and thereby the Lebanese economy to the detriment of the social and economic welfare of the people of Lebanon. Lebanon at that time did not have an independent monetary policy and the devaluations of the Lebanese pound were unrelated to Lebanon's balance of payments. Thus although Lebanon might have had a surplus in her balance of payments, it had to devalue parallely with the franc.

4. The War Period

Exchange control was actually established on the 12th of June 1940[1] when the French High Commissioner charged BSL with the work of giving permits for the export of capital through a bureau of exchange called the "Office des Changes". The latter had been created on December 3rd, 1939.[2] All possessors of foreign exchange and foreign securities were required to sell them to this Office. The Mandatory Power was made able to buy thus foreign exchange from Lebanon and Syria by printing more LLS against French bonds.

On November 12th, 1941, i.e. three months after the occupation of Lebanon and Syria by the Allied armies, the Delegate General - General Catroux - made the Office des Changes an independent office working for the account of the Free French Delegation and on its responsibility.[3] The administration

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1. Arrêté LR/152.
2. Arrêté LR/338.
3. Arrêté FL/381.

of the Office des Changes (hereafter referred to as the Office) was entrusted to BSL. The purchase price of the pound sterling was fixed at PLS 883.125, and the purchase prices of other currencies were fixed according to their equivalents in sterling in the London exchange market. The Office was authorized on May 30th, 1943 to sell sterling to residents of Lebanon and Syria, as belonging to the Sterling Bloc, without limitation as to amount or purpose.

A monetary agreement was signed on the 25th of January 1944 between Great Britain and France, and was followed by a similar Franco-Lebano-Syrian agreement signed in Damascus on February 9th, 1944. It stipulated that:

(a) A guaranteed parity in terms of sterling between the Lebano-Syrian pound on one hand and the French franc should be maintained:

LLS 1 = FF 22.65
£ 1 = FF 200
£ 1 = LLS 8.83/100

(b) The unrestricted purchase of sterling pounds by residents of Lebanon and Syria would not be modified without the consent of the governments of the two States.

From August 1941 until March 13th, 1946, about LLS 700 million had been transferred to the sterling area or served to import goods and gold into Lebanon and Syria.[1]

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1. Joseph Naggear, "Le Problème Monétaire du Liban" in Les Conférences du Cénacle, Ed. Michel Asmar, IV, No. 5-6, (Beirut: May 25th, 1950), 112.

TABLE 1

Successive Franc Devaluations

Definition of the Law of 7 Germinal, year XI March 28th, 1803):

"The franc is the monetary unit of the French. It weighs 0.32258 gr. of gold to the title of 900/1000."

1920-June 1928
FF 1 = 0.32258 gr. of gold
25th June 1928
FF 1 = 0.0635 gr. of gold
1st October 1936 : "elastic" franc
FF 1 varying between 0.043 and 0.049 gr. of gold
21st July 1937
FF 1 = 0.043 gr. of gold
12th November 1938
FF 1 = 0.0275 gr. of gold
29th February 1940
FF 1 = 0.02334 gr. of gold

LL1 = FF20

At the Liberation of France
£ 1 = FF 200
$ 1 = FF 49.62
LL 1 = FF 22.65
26th December 1945
£ 1 = FF 480
$ 1 = FF 119
LL 1 = FF 54.35
26th January 1948
£ 1 = FF 864
$ 1 = FF 214 to 313
LL 1 = FF 97.83
17th October 1948
£ 1 = FF 1061
$ 1 = FF 264
LL 1 = FF 120.30

27th April 1949
£ 1 = FF 1097
$ 1 = FF 270 to 330
LL 1 = FF 124.10
19th September 1949
£ 1 = FF 980
$ 1 = FF 350
LL 1 = FF 159.70

Source: Bulletin Economique et Financier (BEF) Bimonthly, Liban-Syrie, No. 14 (A. Lapied Press, Paris: (2nd fortnight of September 1949), 7.

The privilege of free sterling transfer was, however, unilaterally revoked by the French on March 15th, 1946, and the purchase of sterling was restricted by the exchange control authorities.

5. Post War Exchange Restrictions 1944-1948

In compliance with the agreement of April 18th, 1944 between the French Authorities and the Lebanese and Syrian Governments, the management of the Office des Changes was transferred from the French Delegation to the local governments. However, this transfer remained nominal and the French control continued until the date of signature of the 1948 Franco-Lebanese Monetary Agreement. The Office's foreign exchange assets, 90% of which consisted of French francs, were transferred to BSL. Lebanese and Syrian nationals had to depend upon the French authorities for converting their franc balances to meet their needs for dollars, sterling and other foreign currencies.

The Contrôle des Changes was managed by a committee of three members representing the franc bloc, the Lebanese Government and the Syrian Government respectively. This committee nominated a French general inspector assisted by Lebanese and Syrian inspectors.[1] Foreign exchange resources were earmarked, 45% to Lebanon and 55% to Syria. This allocation

1. Protocole of April 19th, 1944 and legislative decrees No. K/11 and No. K/12 of May 5th, 1944.

went on until January 1st, 1946, after which date each government had its independent resources. The meetings of the committee were discontinued after January 24th, 1948 - date of the signature of the Franco-Lebanese Monetary Agreement.[1]

Exchange restrictions during the period 1944-1948 consisted of the following:[2]

1. Foreign exchange resulting from the export of goods had to be surrendered to the Office des Changes. Foreign exchange for the import of goods had to be provided by the Office.

2. The movement of capital was free between Lebanon and Syria on one hand, and the franc and sterling blocs on the other.[3]

3. Non-residents when desiring to open accounts in Lebano-Syrian pounds had to do so with agreed or authorized banks. They could not acquire exchange from the sterling or franc blocs without the authorization of the Office.

4. The import or export of foreign banknotes or Lebano-Syrian pounds was forbidden subject to the permission of the Office.

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1. Lebanese Republic, Al Watha'ek Wal Nusus - Arabic (Documents and Texts Concerning the Economic and Financial Relations Between Syria and Lebanon (October 1943 - March 14th, 1950), 34.

2. Decree No. K/2025 of October 11th, 1944.

3. The free transfer of sterling was stopped on March 15th, 1946.

All exchange regulations were to be conducted at the official rate with the par value of LLS. 2.191 per U.S. dollar. The open market where free rates prevailed, although not officially recognized until November 1948, was, however, used for a large portion of exchange transactions since 1946.[1] The authorities tolerated the open market mainly because they were unable to provide the necessary exchange at the official rates.

6. <u>The French Revocation of the 1944 Agreement</u>

On the 1st of July 1945 when the franc devalued from FF 176 to 200 per pound sterling, France paid BSL (in French Government bonds of 3 months maturity and bearing 1% interest) FF 287,229,729. This was in conformity with General Catroux letter of January 25th, 1944. Accordingly the value of the Lebano-Syrian pound was raised from FF 20 to FF 22.65. On December 26th, 1945, the French franc was devalued again from FF 200 to 480 to the pound sterling: France paid FF 16,600,246,810 for the note cover and FF 32,415,441 for privately held franc assets,[2] and the LLS 1 was raised from FF 22.65 to 54.35.

On January 10th, 1946, the French Government notified the Governments of Syria and Lebanon that though it was responsible for making good the loss in the value of the francs

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1. <u>International Financial Statistics</u>, Vol. v, No. 10, (October 1953), 112.

2. "Relations Financières avec la Syrie et le Liban", in <u>L'Economie</u>, Ed. H. Peyret, 3rd year, No. 109, (Paris: July 3rd, 1947), 26.

in the note cover of currency and deposits with BSL prior to that date, it was not responsible for losses from future devaluations. Moreover, the free conversion of LLS into sterling was stopped in March 1946. The Governments of Syria and Lebanon refused to accept the French interpretation of the promises of General Catroux and insisted that the guarantee of losses is not limited in time as shown by the following extract of the Catroux Letter:

> "If the exchange rate between the French franc and sterling of 200 francs to the pound is altered again, the French Committee of National Liberation undertakes to take the necessary steps in order to maintain constantly the sterling value of the French assets of Banque de Syrie et du Liban, including those covering the note issue.
>
> According to this undertaking the French Committee of National Liberation will, in the event of a new devaluation of French franc to sterling, add to the above mentioned franc assets up to the point where their total value converted in sterling at this new rate becomes equal to what it was when converted at the rate of 200 francs." 1

Syria and Lebanon claimed that when France undertook to maintain constantly the sterling value of the French assets, it was providing a guarantee against all future devaluations of the French franc, while France stated that its undertaking to guarantee their assets in the event of "a new devaluation" applies to the year 1945 only. As a result of this disagreement in the interpretation of the Catroux letter, protracted

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1. Gabriel Menassa, Plan de Reconstruction de l'Economie Libanaise et de réforme de l'Etat, (Société Libanaise d'Economie Politique, Beirut: March 1948), 487-488.

monetary negotiations took place in 1946 and 1947 between Lebanon and Syria on one hand, and the French Government on the other.

7. <u>Progress of Negotiations and Withdrawal of Syria</u>

The Lebanese and Syrian delegates agreed not to meet the French party if other than economic problems (e.g. political or cultural) would be discussed. Soon after negotiations started, the French claimed the sum of LLS 200 million which, they said, the Lebano-Syrian "Caisse des Intêréts Communs" spent for military expenditures during 1940-1945. However, the French withdrew their claim after the Lebano-Syrian delegates categorically refused to enter into such a discussion.[1]

After 130 days of negotiations, the Lebanese delegates were instructed to sign the newly reached agreement on January 24th, 1948. The Syrians had withdrawn 5 days earlier. The reasons given by the Syrian Government were that the draft Agreement: (a) did not provide for a full guarantee of the Lebano-Syrian official franc assets as stipulated in the Catroux letter of January 25th, 1944; (b) did not provide for an adequate amount of "hard currencies" and obliged the country to import from France and its dominions; (c) did not settle completely the currency relationships with France; (d) recognized the concessions and special privileges which French companies

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1. Republic of Lebanon, <u>Al Majles Ál Niyabeh - Minutes of the Lebanese Parliament</u>, (Beirut: February 4th, 1948), 475-476.

had obtained during the French Mandate.[1]

The Syrian Government believed that arbitration at the High Court of Justice would give it better results than direct negotiations with the French Government. However, the Lebanese Government was not of the same opinion. The reasons given by the Lebanese Government for requesting its delegates to sign the Agreement were (a) that the Government could not bear the loss that would result to the currency cover from the devaluation of the franc on January 25th, 1948, and (b) that it was not ready to devaluate its currency, believing that prices would rise correspondingly, entailing serious repercussions on the finances of the government.

II. The 1948 Franco-Lebanese Monetary Agreement

1. Provisions of the Agreement

The Monetary Agreement of 1948 is not, as a matter of fact, an accord concerned with monetary problems exclusively. Both parties wanted to liquidate or settle several issues in suspense besides that of the sterling guarantee of the Lebanese held franc assets. These issues dealt with such matters, as the French properties in Lebanon, French concessionary companies, commercial relations, capital transfers, exchange control, etc.

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1. Dr. Awad Barakat, in Le Commerce du Levant, (Beirut: March 6th, 1948), 1.

The following is a summary of the chief provisions of the 1948 Agreement. The Agreement can be divided into two broad parts, the monetary part and the non-monetary part. The first part was intended to replace the Catroux Convention of January 25th, 1944 related to the sterling guarantee of Lebanese held franc balances, i.e. franc assets in the note cover and those of the Office des Changes. The new Agreement provided for a ten-year sterling exchange guarantee for balances in the note cover only (which were 67.30% of the total franc assets), but these balances had to be blocked until 1953 after which date they were to be released in annual installments. The non guaranteed balances were released for immediate use in France or for the purchase of certain European currencies.

The main provisions for the liquidation of the Lebanese held French franc assets can be summarized as follows:

(1) The franc assets of the Lebanese branch of BSL outstanding at the date of agreement (a little more than FF 13 billion) were divided into "Old No. 1 Account" and "Old No. 2 Account".

(2) The Old No. 1 Account (representing the note issue cover) carried a ten-year sterling exchange guarantee and was credited with FF 8,984,994,274;[1] it could be debited for the following purposes:

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1. In other words, its countervalue in sterling, viz. £ 18,720,000 was to be kept constant.

(a) To compensate France for the value of French Government property in Lebanon (buildings, telephone system, military equipment, broadcasting station) estimated at LL 20 million. This account was to be debited in five equal annual installments of LL 4 million starting June 30th, 1949. This obligation to France carried a sterling exchange guarantee.[1]

(b) To provide current exchange resources; annual releases were not to exceed one tenth of the original amount credited to No. 1 Account (i.e. FF 898.5 million per year) and were to be made only beginning July 1953 (i.e. after the debt for French properties is paid). The two parties could agree under extraordinary circumstances to larger releases (These annual releases were to be credited to a new No. 3 Account).

The outstanding value of No. 1 Account was FF 3,327,129,388 on the 31st of December 1955.[2] Thus if annual releases are not to exceed FF 898.5 million, Lebanon will be left with an amount over FF 1.53 billion at the end of the Agreement (i.e. on January 25th, 1958). If the Agreement is not renewed, the balance in No. 1 Account will be liquidated either similarly to No. 2 Account or, if exchange

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1. This debt of Lebanon to France bore 1% interest per annum. Al Majles Al Niyabeh, (August 30th, 1948), 999.

2. See Table 7 of Chapter V.

restrictions are removed, in whatever currency is requested by Lebanon.

(3) The Old No. 2 Account representing the unguaranteed balances, viz. FF 4,084,369,938, could be debited with:

(a) The value (converted at official rates) of certain European currencies other than French francs purchased by Lebanon. This could not exceed half the total of No. 2 Account in any one year (or FF 2.024 billion). The dates of payment and the kind of European currencies in which they were to be effected were subject to special ad hoc agreements between the two countries.

(b) The residual of the balance of No. 2 Account (if not used completely during the first three years of the Agreement) could be transferred as the need arose to the new No. 3 Account.

It is reported that this account was liquidated before the end of the first year of the Agreement.[1]

The second part of the Agreement dealt with various points not included in the Catroux Letter of 1944. The most important of which are covered below:

(1) Capital transfers from Lebanon to the French monetary union were to be free from any restrictions. Transfers in the opposite direction were subject to French exchange control

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1. Adnan Al Jisr, Al Majles Al Niyabeh, (August 28th, 1948), 986.

regulations, though there was some relaxation of control in certain cases (e.g. for urgent family needs, to cover education expenses, transfers of dividends, transfers of capital by emigrants returning definitively to their country).

(2) The terms of the concessions of the French companies operating in Lebanon were not to be altered except by agreement between the companies and the Lebanese Government within the framework of existing legislation.

(3) The settlement of all transactions between Lebanon and the French Union were to be made in French francs or Lebanese pounds. Settlements in other currencies required the specific approval of both parties.

(4) With regard to trade between the two countries the Agreement provided that, if the export of certain goods were limited by quantitative restrictions, the traditional trade between the two countries and the needs of their respective economies would be taken into consideration in determining the quotas. In addition, the Agreement stipulated that the French Government would endeavour to favour the export of equipment to Lebanon. In case of deficit in Account No. 3,[1] the exchange offices of the two parties could manage the movements of funds toward Lebanon in order to restore equilibrium.

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1. Account No. 3 credits exports of goods from Lebanon to the French Union and the movement of capital from the latter into Lebanon. It debits the reverse operations, i.e. imports of goods from the French Union into Lebanon and export of capital from Lebanon to the French Union.

(5) The exchange control office of April 19th, 1944 was to be replaced by mutual agreement so as to promote the good functioning of financial relations between Lebanon and the French Union, and make Lebanon profit from agreements with other countries concerning payments to the franc zone.

(6) Interests and dividends on securities of French companies operating in Lebanon (which securities are owned by Lebanese nationals) were exempted from French taxes.[1]

2. Disadvantages of the Agreement

Our appraisal is confined to the monetary aspect of the Agreement. Briefly stated the chief objections to the monetary part of the Agreement are the following:

First, Lebanon relinquishes her right to the sterling guarantee of both the monetary cover (about FF 9 billion) and the franc holdings of the Office des Changes (FF 4 billion) as it was provided for in General Catroux letter of January 26th, 1944. The monetary cover got a sterling guarantee while the non-guaranteed balance of the Office des Changes sustained several losses: a 44.4% loss at the time the French franc devalued on January 26th, 1948, and a 20% loss on October 17th, 1948 (in terms of gold or dollars)[2] - (Table 1).

The second objection to the Agreement is that the purchase of European moneys is done by using half of Account

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1. République Libanaise, Recueil des Traités et Conventions Bilatéraux, (Dar Al Hayat Press, Beirut: November, 1951), 111-167.

2. Account No. 2 was not subject to the franc devaluation of 1949 since it had been completely used up in 1948.

No. 2 in 1948-1950 and Account No. 1 after July 1953. No foreign exchange is provided for the period in between. Moreover, the choice of European exchange is left to the discretion of the Central Bank of France. It must be remembered that most of the francs in the monetary cover and the Office des Changes would have been sterling had the French Authorities not taken the sterling exchange resulting from the expenditures of the British army in Lebanon and Syria and put francs instead in the cover.

Besides, the French francs - as provided for in the Agreement - are restricted in use to the purchase of goods (except for half of Account No. 2) from the French Union - and the acquisition of the so-called French properties in Lebanon.[1]

The third objection to the Agreement is that it does not insure the attainment of an independent currency and monetary policy since it implicitly provides for the continuance of the convention of BSL (as it provides for the respecting of conventions of French companies operating in Lebanon, though these concessions were given under the French mandate). The Lebanese Government could have insisted on a separation of the question of settlement of the franc balances of an independent currency. The first is a question of indebtedness which may be settled even with a substantial loss

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1. Habib Abi Shahla, <u>Al Majles Al Niyabeh</u>, (August 30th, 1948), 1002.

to Lebanon while the second has considerable bearing on its sovereignty, the exercise of which is inconceivable without autonomy in financial and monetary matters.

The fourth objection is that the Agreement differentiates between the rights of France and those of Lebanon with regard to the transfer of funds resulting from invisible trade. Transfers from Lebanon to France and its dominions may be made without restriction except that they should be made through approved medias, whereas transfers from France and its dominions to Lebanon can be made only subject to conditions laid down by the French Exchange Control. If restrictions of the latter are prejudicial to the interests of Lebanon, the Lebanese Government will not be able to retaliate.

Some experts, consider further that the Agreement is objectionable as it does not give Lebanon the advantage of a gold guarantee instead of a sterling one; as it does not permit a quick settlement of debts and credits, and as it does not provide Lebanon with sufficient convertible currencies.[1]

3. Advantages of the Agreement

Against the foregoing objections to the monetary part of the Agreement, two advantages may be cited. First, the

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1. Van Zeeland, "Report to the Lebanese Government on the Franco-Lebanese Monetary Agreement of 1948" in Al Majmu'ah Al Iktisadeyah Al Sanaweyat, Ed. Aleppo Chamber of Commerce, (Maronite Press, Aleppo: 1949), 453-460.

French Government, after breaking the promises of General Catroux of January 25th, 1944, provides a reimbursement of the loss on the FF 9 billion assets resulting from the franc devaluation of January 25th, 1948 and from devaluations which may take place during the next 10 years, and relieves Lebanon from having to bring up the case to the International Court of Justice, which may or may not decide in its favour. Secondly, the Agreement settles all financial questions, resulting from the liquidation of the mandate, which had been left outstanding, and prepares the way for developing relations of mutual benefit in the future.

III. The Monetary Law of May 1949

1. Provisions

Following the Monetary Agreement with France, Lebanon promulgated on May 24th, 1949 a law regulating the note issue and the composition of the note cover. It is to be noted that the law was intended to assert the independence of the Lebanese currency vis-à-vis the French franc. It replaces the provisions of the 1937 Convention with BSL pertaining to note issuing.[1] The Law, it was hoped, should bring confidence in and stability to the Lebanese currency. The provisions of the Law can be summarized as follows:

(1) The monetary unit is the Lebanese pound (LL); it is divisible into 100 piasters. The Institute of Issue of BSL issues notes of values equal or greater

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1. See Chapter IV.

than one Lebanese pound. The Public Treasury issues subsidiary notes and coins whose values are less than LL 1, and it may eventually issue gold coins.

(2) Banknotes in circulation issued by the Institute of Issue are 100% guaranteed by

- 50% gold and foreign exchange
- 50% government loans and securities, securities of institutions accepted by the State and commercial bills.

The exact proportion of each element in the note cover was to be determined by a decree taken in Council of Ministers. Thus decree No. K/15105 of May 27th, 1949 stipulates that:

(1) Gold and foreign exchange reserves are to be recorded at the official price of the Lebanese pound as accepted by the International Monetary Fund (LL 1 = 405.512 mgm of pure gold).[1] If gold (or foreign exchange) is bought or sold above or below the official price or if the official price changes, the change in its total value when positive - becomes an obligatory deposit, when negative - is compensated by a government guarantee for the debiting balance. Both creditor and debitor balances constitute a part of the note cover. They do not bear interest and the debitor balance cannot exceed the official value of gold (or foreign exchange) in the cover.

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1. Lebanon joined the IMF in July 1947; the official rate of the dollar as declared to the IMF is $ 1 = LL 2.19 $\frac{14}{100}$ (Law of April 22nd, 1947).

Gold reserves should reach 10% of the note circulation by the end of 1950, 20% by the end of 1951 and 30% by the end of 1952. However, these proportions are not obligatory when the monetary conditions of the country prove that their fulfillment is difficult. The proportions and eligibility of foreign exchange entering in the reserves of note cover will be determined jointly by the representatives of the Lebanese Government and BSL - the latter acting in its quality as the manager of the Office des Changes. These note reserves shall include the guaranteed francs of the cover of the Lebanese pound, and other foreign exchange[1] and government bonds. If BSL buys and/or sells foreign governments or IBRD securities and if the transactions result in a net profit, this sum becomes part of the note cover reserves; in case of a loss BSL supports it.

(2) The remaining half of the note cover may be composed of

- Government bonds and advances to the government or guaranteed by it.
- Commercial bills not to exceed 15% of the note circulation, maturing within 90 days and bearing three signatures (one signature can be replaced by a warrant issued by public firms accepted by

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(1) Forty percent of the receipts of the Office des Changes in any currency shall serve as cover reserves (decree No. K/15106 of May 27th, 1949).

the State against goods, on the condition that this bill is not accepted at a price higher than half of the goods value).

2. Appraisal of the Monetary Law of 1949

The purpose of the Lebanese Government in legislating the monetary law of May 24th, 1949 was to create external and internal confidence in the Lebanese currency. To achieve this purpose, the monetary law provides for a 100% cover, at least 50% of which shall be gold and foreign exchange.

A few writers consider that the 50% proportion of gold and foreign exchange in the note cover is too small for a country of the size of Lebanon. Only big countries like the United States and Great Britain can afford to have a proportion of 30 to 40% of gold in the note cover since the absolute value of their holdings in gold may be considerable. The volume of the assets of the big countries - these writers argue - is a sufficient guarantee against international speculations and internal panic. A country like Lebanon ought to have therefore a much higher proportion of gold reserves in the note cover so that the absolute value of gold becomes significant in combatting international speculation and internal panic.[1]

In answer to the above argument, it should be made clear that the Monetary Law sets only a minimum - viz. 50% - of gold and foreign exchange in the note cover. This percentage has been largely exceeded, and the gold cover was over 95% at the

1. Menassa G., op. cit., 293.
   Naggear J., op. cit., 133.

end of 1955. Still, even a 95% or 100% gold cover does not make it possible for a small country like Lebanon to meet the events of international speculation and internal panic. It is understood that a country like Lebanon which depends highly on foreign trade has a greater need for a stable currency, but to say that such stability can only be attained by a 100% gold or foreign exchange cover is certainly not justifiable.

Another objection to the Monetary Law pertains to the provision which maintains the official parity of the Lebanese pound at LL 1 = 405.512 mgm of pure gold. This parity is overvalued by about one third and is of little practical significance. It seems, that, for the time being, the government is not willing to change the present par value especially when it does not know which other rate to adopt and defend.

The Monetary Law provides also for the issue of gold coins by the Treasury. Should this issue of gold coins be made at the official parity of the Lebanese pound, there would be a rush to buy and hold these coins especially since their real market value would be greater by one third than their face value. However, such issue is unlikely to arise. The government in enacting the Monetary Law did not "mean" the actual minting of gold coins to go in circulation, its aim was inspired by political expediency: the right to issue gold coins is considered a symbol of sovereignty, and as such, the Monetary Law of 1949 provides the government with this right as a proof of the economic and political emancipation of Lebanon.[1]

A serious objection to the Monetary Law of 1949 arises from its restrictive provisions. This may apply to the provision concerning trade bills that are acceptable in the note cover. The Monetary law provides for a maximum proportion of 15% of trade bills in the note reserves. Although at present even the 15% is not used, a larger volume may prove to be necessary in time of emergency. Thus in a period of recession, when an expansion in the money supply is desirable, an increase in the volume of trade bills in the note cover may give the prospected effects (i.e. an expansion of money supply). Not only the volume provided for commercial bills is relatively small but also the requirements are too exacting, especially those concerning three signatures (or their substitutes) and the 90-day maturity. Central banks in many of the developed and developing economies may accept bills up to 9 months maturity when the need for such action arises. They may also accept agricultural and industrial credit instruments of certain defined types; Unfortunately, this is not provided for in the Monetary Law of 1949. It may be argued that these assets are less liquid than trade bills. This is true, but still we should not forget that they are instrumental in the implementation of

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1. Riad El Solh, "The Monetary Law of May 24th, 1949", Al Majles Al Niyabeh, (May 24th, 1949), 496.

monetary policy and help in the economic development of the country.

The Monetary Law of 1949 is incomplete by its being strictly limited to the function of note issuing. It is well known that the function of note issuing cannot be divorced from the other functions of central banking. By definition, a central bank is a note issuing institution empowered by the state with the responsibility of managing the expansion and contraction of money supply in the interest of the community. The present monetary legislation, however, cannot ensure the stability of the Lebanese currency if there is no comprehensive legislation for the regulation of the volume of money - both note circulation and demand deposits. At present such legislation is lacking and BSL does not act as a central bank although it has some central banking functions. It is therefore of great importance to the stability and security of the Lebanese monetary system that a comprehensive monetary and banking legislation be enacted as soon as possible.

3. Recent Changes in the Note Circulation and the Note Cover

The object of this section is twofold, first to study the variations in the volume of note circulation and second to account for changes in the composition of the note cover. Our analysis starts with the year 1948, at the date of the signing of the Monetary Agreement with France and of the first real separation of the Lebanese pound and Syrian pound. An attempt is made at finding out how the provisions of the 1949 Monetary

Law have been carried out. All the information given below comes from published information or from interviews with officials.[1]

A. Changes in the Note Circulation

Early in 1948, the volume of note circulation increased sharply. From LL 162.5 million only at the end of January 1948, it rose to LL 205 million at the end of the next month, i.e. February 1948. This rise was due to the exchange of some 49 million Syrian pounds then circulating in Lebanon, against Lebanese notes. The note circulation went on steadily down after that date. The lowest point reached was LL 164 million in the period of August-September 1949. It was reported that that period was a period of business contraction and unemployment.[2] The recession, it is believed, was accentuated by relatively high budgetary surpluses.[3] The government - partially with the view of alleviating the economic crisis in the country - instructed BSL to purchase gold and foreign exchange in the Beirut market. The value of gold purchased

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1. Special studies on Treasury bonds and the Syrian debt as well as the complete figures on the note circulation and cover are put in appendix.

2. Unemployment was estimated as follows: 50,000 completely unemployed and 90,000 partially unemployed.
Source: BEF, No. 14 (2nd fortnight, September 1949), 4.

3. BSL, Exercise 1953, (Imp. Chaix, Paris: 1954), 16. See also Chapter IV.

locally was estimated to be LL 30 million.[1] The government purchases in the open market led to an increase of note circulation. The rise of the latter was later accelerated by the outbreak of the hostilities in Korea. Note circulation rose from LL 164 million in September 1949 to LL 211 million in June 1951. The rise in the note circulation levelled off in 1952 and started declining in 1953 as business activity subsided. In June 1953, it was LL 196 million only. This decline was concomitant to the peaceful settlement of the Korean conflict, and the world recession of 1953. The decline in the note circulation was however stopped as a result of the Exchange Stabilization Fund's purchase of dollars in the Beirut open market.[2] From September 1953 on, note circulation went on steadily rising and it reached LL 266 million at the end of 1955.

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1. Interview with Mr. Joseph Oughourlian, Advisor for Lebanon at BSL.
The Lebanese Government bought towards the middle of 1949, 370,000 gold coins at the free market rate of Beirut. It had also acquired 60,000 ounces of gold from the Federal Reserve Bank of New York with dollars bought in the open market.
Source: BEF, No. 14, (2nd fortnight, September 1949), 2. Towards the end of 1949, another lot of 3,110 kg. of gold were bought from the Federal Reserve Bank of New York: BEF, No. 22, (2nd fortnight, January 1950), 1.

2. Infra.

The continuous rise in the note circulation for the last two years is mainly due to a general rise in business activities and to a flow of foreign capital - mainly Arab. It should be noted here that the volume of money in Lebanon is greatly influenced by international conditions. This is mainly due to the fact that the foreign trade sector accounts for about one third of Lebanon's national income.

B. Composition of the Note Cover

To understand how the provisions of the 1949 Monetary Law have been applied we have to analyse the composition of the note cover. In the monthly statements of BSL, five elements are quoted, gold, foreign exchange, difference in exchange rates covered by the State, advances for the exchange of Syrian notes (for a certain time) and other elements. The last three items represent the government obligations.[1] The following is an analysis of the major changes in the cover elements during the period of 1948-1955 - refer to Chart I.

(1) Gold constitutes now the largest item of the note cover. It has been steadily increasing both absolutely and relatively from a low point of 2% of the note cover in January 1948 (about LL 5 million worth) to a high point of over 95% of the note cover in December 1955 (about LL 252.8 million).

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1. Infra., Appendix.

The gold cover is quoted at the purchase price which has on several occasions been higher than the official price. The difference between the value of gold at the purchase price and its value at the official price is debited in a compensatory account not bearing interest and entered in the gold cover. However, this compensatory account cannot exceed the official value of gold put in the cover, otherwise the balance is charged against the Lebanese Treasury in its current account with BSL.[1] The value of gold at the official price of LL1 = 405.512 mgm of pure gold was LL 162,175,200 (i.e. 2,106,172 ounces of pure gold) on the 31st of December 1955.[2] The compensatory account amounted therefore to LL 90,647,776 or to about 56% of the official value of gold.

(2) Foreign exchange in the note cover is regulated by provisions identical to those governing the gold cover concerning pricing at the official rate and the compensatory account. While gold has been steadily rising in amount, foreign exchange in the note cover has been steadily declining. From a high point of 97% in January 1948, foreign exchange disappeared completely from the note cover after

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1. Decree No. K/15105, Art. 2.

2. See Table 6 of Chapter V.

May 1952. It had a temporary reappearance in the period September-December of 1953. Almost all of the foreign exchange was composed of franc assets, however the small amount of foreign exchange (viz. LL 6.566 million) that appeared in 1953 was composed of dollars.[1] Most of the foreign exchange in the note cover was used to buy gold either by converting our French franc assets into gold at the Paris market or by using the dollar exchange to buy gold at the Federal Reserve Bank of New York.

(3) The remainder of the assets of the note reserves consist of government obligations. Their proportion as well as their amount have been greatly varying during the last eight years. They were practically inexistent in January 1951. Three years later, i.e. in April 1951, they rose to the record amount of LL 105.5 million (or 50% of the note cover). The increase in government obligations in the note cover is usually the result of a shifting of these assets from BSL Banking Department to the Issue Department. Such transfer is likely to happen when BSL Banking Department is in need of money. It is worthwhile noting here that the provisions of the 1949 Monetary Law concerning the note cover were

1. These dollars were purchased by the Exchange Stabilization Fund in the Beirut market - see Chapter V.

not strictly observed by BSL Issue Department. The Law stipulates that the proportion of gold and foreign exchange should not be less than 50% of the note cover,[1] or in other words, government obligations should not exceed 50% of the note cover. This regulation was on several occasions countermanded as government obligations rose to over 50% of the note cover, e.g. to 56% in October 1949, with gold and foreign exchange 44% of the note cover only. This percentage (viz. 56%) was the highest one ever reached by government obligations. The latter went on declining both in absolute amount and in percentage. At the end of 1955, they were only LL 12.9 million (or less than 5% of the note circulation). This amount is the lowest one reached since early 1948. The decrease in government securities in the cover indicates a continued surplus in the government's fiscal operations.[2]

It is recalled here that government obligations consist of three main elements: "differences in the exchange rates covered by the State", "advances for the exchange of Syrian notes" and "advances to the State or guaranteed by the State."

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1. Decree No. K/15015, Art. 2, par. 8.

2. See Chapter V.

The first item represents the Treasury bonds which were issued to make up for the loss in the franc note cover owing to the sterling devaluation of September 1949.[1] The second item appeared early in 1948 and was liquidated in October 1954.[2] The other elements did not constitute at any time an important portion of the note cover. They consist of a small interest-free advance to the State (LL 250,000)[3], loans to municipalities, to industries and to SCAIL, guaranteed by the government.[4] At the end of 1955, Treasury bonds in the note cover were LL 12,924,000, while the other government obligations were insignificant (a LL 250,000 advance to the State and a LL 3,024 loan guaranteed by the government).

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1. Decree No. K/15105, Art. 4. See Appendix 3.
2. Appendix 2 gives a detailed account of this item.
3. BSL Convention of May 29th, 1937, Art. 9.
4. SCAIL (Société de Crédit Agricol et Industriel du Liban), was established by BSL, in March 1949, in agreement with the Lebanese Government, and was designed to supply agriculture and industry with medium and long term credit.

CHAPTER II

THE LEBANESE BANKING SYSTEM

The circulating media of the Lebanese monetary system includes, in order of importance, (1) checking deposits at commercial banks, (2) paper money issued by BSL and (3) coins of various kinds and divisionary notes issued by the Public Treasury. The last component of the money supply is of little importance as the amount of coins and notes issued by the Treasury never exceeds LL 5 million or 2.5% of the total currency circulation (see Chapter IV). Paper money issued by BSL has been for a long time the only important means of payments. But with the growth of commercial banks and the development of banking practices among the Lebanese public, checking deposits have come to constitute nowadays a major part of Lebanon's money supply, viz. 55% of the total.

After the study of the note circulation in Chapter I, it becomes only natural to study after it the Lebanese banking system (as the creator and destroyer of deposit money). With this chapter, we complete therefore the description of the two components of money supply in Lebanon, namely note issue and demand deposits. The purpose of this chapter is to describe and analyze the operations of commercial banks in so far as they affect the money supply in Lebanon. However, it has been found appropriate to introduce this chapter with a brief description of the main features of the Lebanese banking system. The study of the monetary function of the commercial banks winds up with an analysis of some of the problems of the Lebanese banking system, mainly its solvency and its liquidity.

I. General Features of the Lebanese Banking System

This section endeavours to describe the main features of the Lebanese banking system. It has been found convenient to account for the distinguishing characteristics of the banking system under the following four headings: commercial versus o ther bank credit, classification of banks, inter-bank relationships, and banking legislation and government control.

1. Commercial Versus Other Bank Credit

Of the 27 first class banks operating in Lebanon as by May 31st, 1956, there are only 4 non-commercial banks: SCAIL, BCAIF, the Compagnie Méditerranéenne de Placement et de Gestion and the Monts de Piété Egyptiens. Moreover, as is shown by Table 1, the aggregate capital of commercial banks operating in Lebanon is by far greater than the capital of non-commercial banks. The predominance of commercial banking establishments as well as their relatively large total capital clearly proves that commercial bank credit is the main form of credit available in this country.

The first two non-commercial banks mentioned above give medium and long term loans to agriculture, industry and real estate against mortgage of real property. SCAIL charges 8 to 9% interest p.a. on the loans it extends with the exception of government guaranteed loans.[1] BCAIF (i.e. Banque de Crédit Agricol, Industriel et Foncier) charges 5% interest p.a. on loans it gives. Its capital is LL 5 million, 40% of which is subscribed by the government. The government has also guaranteed a BSL loan of LL 25 million to BCAIF for forty years at 2% interest p.a.[2]

The two other non-commercial banks are French companies. The Compagnie Méditerranéenne de Placement et de Gestion is an investment bank, subsidiary of the Crédit Foncier d'Algérie et de Tunisie. Its operations consist in buying shares of corporations established in Lebanon or abroad. The Monts de Piété Egyptiens is a small French company which gives advances against the security of movable goods or merchandise (including precious metals and jewelry). The operations of these two companies are considered to be small in volume.

Commercial banks' operations in Lebanon are in general limited to the finance of short term mercantile transactions

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1. The total amount of loans, with government guarantee, that was extended through SCAIL during the period 1942-1955 was about LL 22 million. The interest charge thereupon was 5% p.a.

2. During its first year of operation, i.e. in 1955-1956, BCAIF extended LL 8.5 million in term loans.

although some are authorized to undertake lending on mortgage.[1] The instruments of credit used by commercial banks in Lebanon are broadly speaking overdrafts, advances, discounts and documentary credits. Overdrafts may be secured or unsecured. Banks granting overdrafts may be satisfied with the name of the drawee or his guarantor. If not, they require some kind of security (trade bills, stocks, promissory notes, or foreign moneys - mainly dollars or sterling -). The bank usually gives 70 to 80% of the nominal values of securities. The interest charged for prime names or securities varies between 5 and 6%. Overdraft facilities are usually granted by contract for the period of one year and are subject to renewal.

The second instrument of credit is trade discounts. The period of discounted bills does not generally exceed four months - it is usually three months. The discount rate for prime names bills varied in 1955 between 5.16 and 5.32 p.a. (see Table 4 of Chapter IV). Documentary credit assumes considerable importance among other instruments of commercial credit owing to its widespread use in the finance of international trade. The commission charged on opening a letter of credit is $1^{0}/00$ per quarter or any fraction thereof. The opening of a letter of credit requires a down payment of at least 10% of the value of the transaction. This percentage is

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1. Foreign banks have to secure a specific authorization to lend on mortgage (Art. 3 of legislative decree No. 196 of July 24th, 1942).

raised up to 50% for non essential and highly specialized goods. The interest charged on the unpaid balance is 6 to 7% p.a. during the time of the shipment of the goods.

2. Classification of Commercial Banking Establishments

The Ministry of Finance distinguishes between three types of commercial banking institutions: "agreed" banks, "non-agreed" banks and "banquiers" or discount houses (Table 1). Agreed banks are those banks whose guarantee is accepted by the Lebanese Government, and are as such considered first class banks. Of the 27 agreed banks in Lebanon, 13 are Lebanese, four French,[1] two American, two British and one of each of the ~~sixen~~ following nationalities: Egypt, Holland, Iraq, Italy, Jordan and Saudi Arabia. Although Lebanon has the largest number of agreed banks, many of them are owned and/or controlled by foreign banks. Banks which are largely owned by Lebanese people had at the end of 1954 about LL 80 million in deposits[2] while all other banking institutions (owned and/or controlled by foreign banks) had twice as much.

Non agreed banks are few in number - four Lebanese and one Syrian. Like agreed banks, they have the corporate form.

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1. It is to be noted that these French banks were the first established in Lebanon. They were encouraged to come to Lebanon by the French Mandate because of their long experience in North Africa.

2. *Le Commerce du Levant*, (February 28th, 1956), II.

However, they are considered second class banks in view of the small volume of their banking operations. The third group of commercial banking institutions is the discount houses. Their main operations consist in discounting trade bills, although a few of them accept deposits and make advances.[1] It is to be noted that all discount houses are privately owned whereas all commercial banks are incorporated.

3. <u>Inter-Bank Relationships</u>

The Lebanese banking system is characterized by a high degree of individualism; each bank tries to be financially autonomous. In general, banks do not help each other "dovetail temporary liquidity surpluses or deficiencies",[2] and many banks are reluctant to call on other banks for help since they consider it to be a sign of weakness.

Attempts for cooperation among bankers in Lebanon have so far failed. Thus on the 11th of June 1954, the directors of three Lebanese banks, the Banque Libanaise pour le Commerce, the Federal Bank of Lebanon and Intra Bank decided to form an association of Lebanese bankers. This project failed as Intra Bank withdrew at the last moment. While Lebanese bankers were

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1. The discount market is discussed more fully in Chapter III, in connection with the Beirut money market.

2. Economic Research Institute, <u>Business Legislation in Lebanon</u>, memiographed, (January 1956), 41.

TABLE 1

BANKS OPERATING IN LEBANON

(May 31st, 1956)

List of Agreed Banks

Name	Places of Incorporation	1st Date of Establishment in Lebanon	Nominal Capital (in Million)
1. BSL x	France	2- 1-1919	FF 300
2. Crédit Foncier d'Algerie et de Tunisie x	France	1921	FF 765
3. Banque Nationale pour le Commerce et l'Industrie - Afrique*	France	1- 6-1927	FF 500
4. Banque Misr-Syrie-Liban *x	Lebanon	4- 6-1929	LL 3
5. Compagnie Algérienne x	France	15- 1-1931	FF1500
6. Banco Di Roma x	Italy	12- 3-1936	IL1000
7. Banque Tohmé	Lebanon	28-10-1942	LL 1
8. Arab Bank x	Jordan	31- 1-1944	JD 3.5
9. Eastern Commercial Bank	Lebanon	1944	LL 1
10. Banque Zilkha x	Lebanon	4- 9-1946	LL 1
11. British Bank of the Middle East x	Gt.Britain	15-10-1946	£ 1
12. Rafidain Bank	Iraq	1- 6-1948	ID 1
13. Banque Libanaise pour le Commerce x	Lebanon	10-11-1949	LL 5
14. Banque Sabbagh (Banque d'Indochine)*x	Lebanon	20- 6-1950	LL 2
15. Banque G. Trad - Crédit Lyonnais *x	Lebanon	10- 3-1951	LL 1
16. Banque du Liban et d'Outre Mer x	Lebanon	8- 5-1951	LL 5
17. Federal Bank of Lebanon	Lebanon	25-10-1951	LL 7
18. Intra Bank	Lebanon	17-11-1951	LL 12
19. The Saudi National Commercial Bank	S.Arabia	6-1952	LL 1 (for Lebanon)
20. Banque Al Ahli x	Lebanon	7-11-1952	LL 5
21. Banque Belgo-Libanaise*x	Lebanon	13- 8-1953	LL 5
22. Banque du Caire x	Egypt	9-1953	EL 0.5
23. Nederlandsche Handel Maa ttachappij	Holland	15- 6-1954	OF 75.03
24. The Chase Manhattan	USA	- 8-1955	$ 150
25. The First National City Bank of New York x	US	-10-1955	$ 200
26. La Banque de Beyrouth et des Pays Arabes (not yet agreed)	Lebanon	14- 3-1956	LL 2
27. The Eastern Bank Ltd.	Gt.Britain	30- 4-1956	£ 2

Other Commercial Banks

Name	Places of Incorporation	1st Date of Establishment in Lebanon	Nominal Capital (in Million)
1. Banque Albert Homsy	Syria	-1895	LS 2
2. Beirut's Bank	Lebanon	9-11-1936	LL 6.5
3. Societé Anonyme d'Economie Generale	Lebanon	30-12-1949	LL 0.4
4. Banque Shartuni	Lebanon	1-1951	LL 2
5. Commercial Bank	Lebanon	18- 3-1954	LL 0.2

Non-Commercial Banks

1. Compagnie Mediterranienne de Gestion et de Placement	France	17- 5-1919	FF 6
2. Monts de Piété Egyptiens	France	23- 2-1934	FF 6.4
3. SCAIL	Lebanon	6- 3-1939	LL 1
4. BCAIF	Lebanon	23-10-1954	LL 5

* Largely owned and/or controlled by foreign banks.

x Members of the Centrale des Risques.

Sources: BSL - Research Department supplemented by information from the Ministry of National Economy of Lebanon and the Al Jarida Al Rasmia (Official Gazette).

not successful in their attempts, some foreign bankers[1] have on the 16th of January 1956 agreed to form a bankers' association. Many of the local bankers look at this project with great suspicion.[2]

As to BSL relationships with most commercial banks, it is well known that they are not intimate. The study of this point is deferred to Chapter IV.

We can therefore conclude in saying that the Lebanese banking system shows a great lack of coordination and homogeneity. This lack of harmony and mututal help between commercial banks in Lebanon may prove to be detrimental to the Lebanese economy especially in time of crisis or emergency.

4. Banking Legislation and Government Control

There is no specific legislation defining the banking profession. Exchange and banking operations are considered by law similar in nature to acts of commerce, and as such are subject to commercial legislation. Bankers are identified with merchants and are subject to the provision of the Commercial Code.[3] There are few specific provisions pertaining to the contractual aspects of certain banking operations, namely those relating to deposits. There is no legal reserve requirements, no legal maximum rates of

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1. Banque Hollandaise, Credit Foncier, Arab Bank, Banque Al Ahli and Banque du Caire.

2. Interview with Mr. Joseph Sa'ab, Director of the Federal Bank of Lebanon.

3. Legislative decree No. 304 of April 7th, 1943, Art.6.

interest on deposits and the various instruments of credit, and above all no central banking institution invested with the power of regulating the volume of money in circulation and of carrying out open market operations. There is also no effective government supervision on banking practices.

II. The Monetary Function of Commercial Banks

Commercial banks are dealers in debt. They buy the debts of others (mainly individuals, corporations or government) and pay for them largely by issuing debt claims against themselves; these are the banks' liabilities of their obligation to pay legal tender money on demand. These obligations are also called demand or checking deposits. They constitute, in addition to the total amount of coins and paper money outside banks, the money supply of Lebanon. It should be made clear that from commercial banks deposits be excluded (a) foreign deposit claims. (b) Treasury holdings of cash and deposits at BSL and (c) time deposits. [1] All these claims are not money, as are monetary liabilities. The latter are perfectly liquid, i.e., they remain at par in terms of the monetary unit at all times, and they are generall acceptable at face value in payment of debts and for the purchase of goods and services.[2]

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1. F. Lester, V. Chandler, The Economics of Money and Banking, (Harper, New Yord: 1953), 77.

2. Ibid., 67

It is really unfortunate that the few published banking statistics are either unreliable or incomplete to be of much use for the purpose of economic analysis. In 1953, banking statistics covered 22 banks only and 7 out of the 30 discount houses. Since the beginning of 1954, two of the banks and six of the discount houses were also excluded.[1] Moreover, available statistics do not permit comparison over a long period of years mainly because starting the year 1954, deposits in foreign exchange have been excluded while they were included before that date. Another gap in the banking statistics is the absence of a consolidated balance sheet of banks assets and liabilities. What is published is time and demand deposits on one side, and advances and discounts combined together on the other side.

Although the banking statistics present the shortcomings accounted for above, they may still serve the purpose of representing the volume of money created by the banking system. We can rely for this purpose on the statistics of the last two years. These statistics exclude foreign exchange deposits, and it has been possible to deduct government deposits with BSL.[2] The figures of deposits in Table 2 include (a) cur-

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1. It is reported that this exclusion created a decline in demand deposits of only LL 2 million. (Interview with Mr. Hazarabedian of the Ministry of National Economy).

2. Government deposits should be left out of the money supply since they represent money extracted from the public by tax collections. Besides they represent more or less dormant deposits.

rent creditors accounts, (b) checking accounts for individuals and (c) transitory accounts in way to an outside financial center. Are excluded from deposit statistics (a) blocked deposits, guarantees of documentary credit or other engagements, (b) all accounts with head offices and agencies, (c) all deposits of other banks and (d) government deposits. Although our definition of money excluded foreign deposit claims, the deposit statistics include them. However, it is believed that these foreign deposit claims are mainly held in foreign exchange which do not appear in the banking statistics. The foreign claims in Lebanese pounds may be considered to be of minor significance.

TABLE 2

PRIVATE DEPOSITS WITH MAJOR BANKS (1) AND THE NOTE CIRCULATION (2)

End of	1954 Deposits*	1954 Notes	1955 Deposits*	1955 Notes
Jan.	189	205	254	242
Feb.	195	206	260	242
Mar.	202	208	268	243
Apr.	207	210	269	246
May	215	215	287	249
June	222	219	297	252
July	231	222	311	252
Aug.	249	231	310	255
Sep.	248	236	299	264
Oct.	232	241	303	266
Nov.	237	242	305	268
Dec.	247	242	299	266

* rounded to the nearest million.

Sources: (1) Privately secured from Mr. Talha Yaffi, (Member of the Planning and Development Board).

(2) Bulletin Statistique Trimestriel.

Table 2 shows recent changes in the volume of checking deposits. It is worthwhile noting that the amount of deposit money has been rising relatively more than note issue. Thus while demand deposits were LL 189 million or 48% of the total money supply at the end of January 1954, they rose to LL 311 million at the end of July 1955 or to about 55% of the total money supply. At the end of 1955, demand deposits were a little over LL 299 million, while the note issue was LL 266 million. In a period of 11 months demand deposits had risen by over 57%.

It is to be noted that this rise in demand deposits is due to several factors: the increase in the checking habits of the Lebanese public, the rise of interest on deposits, the increase in the number of banks (reporting as well as total), the increase in loans extended to business, and last but not least the government purchases of dollars.

As far as the development of checking habits of the Lebanese public is concerned, Table 3 shows that there has been a tremendous increase in the use of checks. Thus in a period of twelve years, the number of checks declared as well as their total value rose by about twenty times.[1] More and more checks are being used by business concerns for payments over LL 10,000.

The development of checking habits was stimulated by the rise of interest on demand deposits. The latter earn 2.5

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1. All agreed banks are members of the Beirut Clearing Office.

to 3% per annum on the monthly average of deposits. This situation is abnormal since checking deposits being subject to immediate withdrawal, normally earn no interest. However, Lebanese depositors do not have the western mentality vis-à-vis checking deposits. They rarely may consider their deposits as demand money.

TABLE 3

BEIRUT CLEARING OFFICE

	Number	Value (LL 1000)	Average
1943	5 610	52 381	9 337
1944	6 934	64 697	9 330
1945	8 746	116 611	13 330
1946	7 886	90 971	11 538
1947	9 728	140 263	14 418
1948	15 778	261 737	16 565
1949	20 387	275 791	13 527
1950	27 328	363 925	13 317
1951	34 845	552 701	15 862
1952	46 763	722 064	15 441
1953	65 575	574 523	8 761
1954	101 360	639 506	9 269
1955	154 476	925 680	5 990

Source: Bulletin Statistique Trimestriel.

Another factor in the development of checking practices is the increase in the number of banks. In Lebanon, there are over 60 bank branches, half of which are in Beirut, the remaining are scattered in the cities. In a period of 5 years, 13 commercial banks opened branches in Beirut. It can be therefore concluded that there has developed familiarity, trust and convenience of adopting the more profitable way of utilising money, namely in the form of demand deposits.

All the factors described above contributed to an increase in the deposit of cash money, i.e. primary deposits with banks. The creation of money, i.e. the secondary deposits, would not have occurred if the commercial banks did not increase their assets, mainly advances and discounts. Table 4 shows that in a period of less than two years, advances rose from LL 77.5 million at the end of January 1954 to LL 181.6 million at the end of 1955, i.e. by about 135%. The rise of discounts was also considerable; they were LL 64.2 million at the end of January 1954 and became LL 138.8 million at the end of 1955; the rise was therefore by about 110%.

TABLE 4

NON-PUBLIC ADVANCES AND DISCOUNTS IN LEBANESE MONEY
(LL Million)

	1954			1955		
End of	Advances	Discounts	Total	Advances	Discounts	Total
Jan.	77.5	64.2	141.7	136.0	97.0	233.0
Feb.	78.3	66.8	145.1	142.5	103.3	245.8
Mar.	81.2	79.6	160.8	142.3	109.4	251.7
Apr.	89.6	79.8	169.4	142.4	113.3	255.7
May	91.0	71.9	162.9	149.3	116.0	265.3
June	92.1	76.3	168.4	156.4	119.8	276.2
July	99.6	75.1	174.7	165.7	121.6	287.3
Aug.	103.6	76.2	179.8	172.1	114.4	286.5
Sep.	110.0	82.5	192.5	172.5	124.8	297.3
Oct.	110.9	88.9	199.8	180.8	121.6	302.4
Nov.	121.3	88.4	209.8	196.0	129.0	325.0
Dec.	116.8	118.0	234.8	181.6	138.8	320.4

Source: Privately secured from Mr. Talha Yaffi, (Member of the Planning and Development Board).

Among other factors which contributed to a rise in the money supply are the recent government purchases of dollars in the local market which have had a considerable effect on the volume of deposits and currency. The government holdings of gold (which are put in the note cover) increased by LL 124.6 million from early 1954 to the end of 1955. During the same period note circulation rose by LL 61 million only. These dollar purchases (which were subsequently converted into gold) have therefore contributed to a rise in demand deposits[1] for that amount which was not matched by a rise in the note circulation, (i.e. for about LL 63.6 million). The Minister of Finance instructed BSL to purchase dollars in the open market and these dollars were later used to purchase gold at the Federal Reserve Bank of New York. The purchase of dollars and in general foreign exchange in the Beirut money market is usually done from banks. The latter after selling their foreign exchange are in a position to expend their discounts and advances on the basis of the newly acquired Lebanese pounds. It should be noted that the increase in commercial banks holdings of foreign exchange belongs to the private depositors - viz. traders and businessmen. This increase was the result of favourable balance of payments to Lebanon.[2]

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1. It may be argued that the rise in government holdings of gold may be due to a conversion of its French franc assets into gold. This is not so since the latter's amount has been more or less stable over the last two years. IFS, IX, 2, (February 1956), 143.

2. Cf. IFS, IX, 4, (April 1956), 144.

III. Problems of the Lebanese Banking System

The recent considerable increase in the number of banking institutions working in Lebanon has squeezed the profits of banks. These profits were further cut owing to two other factors namely, the decline in the volume and lucrativeness of gold and foreign exchange transactions in the Beirut market,[1] and the diversion of some banking and trading operations from Lebanon to Syria.[2] [As a result of a decline in banks profits, the Lebanese banking system may be faced with the problems of liquidity and safety. Banks may consequently try to increase their loans keeping little reserves, i.e. reducing their liquidity, or may invest in unsafe and unstable assets of the speculative types but with higher returns. The two points of safety and liquidity are discussed below.

1. Bank Liquidity

Liquidity may concern an individual bank or the banking system as a whole. By the liquidity of a bank we mean its ability to exchange its assets for cash to meet requests for payment on demand.[3] Suppose that an individual

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1. A banker earns PL 1/4 on the exchange of a dollar in Beirut while he gets as much as PL 6 on the same operation in Jeddah - Saudi Arabia. Interview with Mr. Spagnolo of Banque Du Liban et d'Outre Mer.

2. Syrian Legislative Decree No. 151 of March,3rd, 1952.

3. Chandler, L., <u>op.cit.</u>, 238.

bank is under pressure to pay legal tender. It will use first of all currency from its vaults-including the bank's branches -, then its deposits with other commercial banks - mainly BSL. The next step will be to call on funds from the head office or other branches outside the country - in case the bank is a foreign bank - or from correspondent banks outside Lebanon. Thus if a Lebanese bank is in need of funds, it may contract a loan, in dollars say, from an American bank for a definite period and convert this loan into Lebanese pounds to meet its claims. The Lebanese banker will not resort to this operation unless he hedges the borrowing of dollars (and their conversion into Lebanese pounds) by another term exchange transaction. In other words, he has to find a seller of dollars at the original exchange rate on the date of the maturity of the loan. In this way, he would have avoided the risk on possible exchange fluctuations.

These steps may not be sufficient to ensure the liquidity of the individual banker. He may have, therefore, to resort to a sale of some of his assets. Such a sale of banks' assets may prove onerous if other banks are also facing demand pressures for cash payments. When all banks are faced with a rush by depositors asking for payment in legal tender, the only source of ultimate liquidity can be secured from BSL, acting in its quality as note issuer.[1]

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1. Chapter IV describes how BSL acts as lender of last resort.

It is reported that the liquidity of the Lebanese banking system has been lately declining owing to two reasons: first, the competitive rise of interest on deposits as well as the decline of interest on advances and discounts have induced banks to use a large portion of their loanable funds in order to have a sufficient income, leaving relatively little reserves behind deposits; second, the decline in the liquidity of the Syrian banking system owing to a bad crop season and an unfortunate monetary policy may have affected the liquidity of the Lebanese banking system, because of the close relations between the two banking systems.[1]

2. Solvency of the Banking System

A bank is considered solvent when the value of its assets is at least great enough to cover all its liabilities except those to its owners;[2] It is insolvent when the value of its assets is insufficient to cover all the nonowner claims against it. There is no consolidated balance sheet of banks operating in Lebanon so as to determine the general position of banks. However, it has been possible to compute, for some major Lebanese banks, the ratio of their assets to their liabilities (see definitions, Appendix 4).

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1. Prof. Paul J. Klat in Le Commerce du Levant, (February 28th, 1956), II.

2. Chandler, L., op.cit., 238.

Appendix 4 shows that the ratio of what some Lebanese banks owe to what they own ranges between 50 and 90%.[1] If we take into consideration that some banks pay as much as 3% on demand deposits and that they keep around 30% cash reserves, we are led to conclude that bankers are tempted to acquire risky assets with higher returns in order to have sufficient profit to cover their overhead expenses. Some banks for instance[2] participate in capital and fixed investments whose liquidity and price stability may be low, a fact which affects adversely banks solvency.

There is no regulation in Lebanon to forbid commercial banks to hold common stocks, real e state, inadequately secured mortgages or highly questionable short term papers. There is no limitation on the proportion of assets that may be held in any form. The limited number of the instruments of credit limits the diversification of banks assets and the reduction of risk - these assets are confined to discounts, overdrafts and investments, the latter being in industry or real e state.

Solvency of banks depends not only on the stability of value of their assets, but also on the size of their capital

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1. The few figures of Appendix 4 show that banks incorporated in Lebanon but largely owned by foreign institutions (like Banque Misr-Syrie-Liban, Banque Belgo-Libanaise and Banque Al Ahli) have a low margin of reserves (about 12%) since in time of need they may call on the mother establishment, while purely owned Lebanese banks (like Intra Bank, Banque du Liban et d'Outre Mer and Banque Libanaise pour le Commerce) have a larger margin (about 50%) since they do not have usually recourse to other banking establishments.

2. Intra Bank for example.

accounts. If these accounts are large relative to bank assets, creditors enjoy a large cushion of safety while if they are small, a decline in assets values will wipe out owners' equities and endanger creditors. As some Lebanese banks have small capital and make risky loans, such situation will certainly endanger creditors. Other banks may have a large nominal capital, but the stock would not be paid for with money but with promissory notes of the owners; such stockholders debts may not be fully collectible. There is no regulation as to the minimum ratio of paid up capital to assets.

One attempt has been made towards increasing the safety of banks assets and therefore the solvency of the Lebanese banking system by creating a "Centrale des Risques". After the wave of bankruptcies in the summer of 1953, BSL in agreement with the Lebanese Government has formed a Centrale des Risques whose responsibility is to pool monthly information about the amount of total loans extended to the customers by bankers, members of this office. The latter are then able to assess the credit worthiness of every borrower by comparing the total value of outstanding loans contracted by him to his capital. Unfortunately only 9 foreign banks and 8 Lebanese have so far participated in this organization[1] - those who are not in it consider the Centrale des Risques a means used by

1. See Table 1.

BSL to look into the affairs of other banks. An important limitation on the scope of activities of this office is that it records only loans of over LL 50,000, while bankers rightly consider that the danger comes equally, if not more, from small rather than big borrowers.

The Lebanese banking system, to conclude, plays an important role in the monetary system of this country. To carry out its role safely, there is great need for building up comprehensive banking legislation under the direction of a monetary institution (namely a Money and Credit Board) which will act as the manager of the central bank of the country. The deficiencies of the banking system as well as its weaknesses cannot be remedied unless there is an overall reorganization in the country's monetary system.

CHAPTER III

THE BEIRUT MONEY MARKET

Chapter two has been concerned with the description of the monetary function of the Lebanese banking system. It is now clear that commercial banks in Lebanon indulge mainly in short term financing, and to a great extent, they constitute the Beirut money market as they are the largest dealers in short term funds. The purpose of this chapter is to give the main features of the Beirut money market and show in what respect it compares with more developed markets.

A money market is usually defined as the organization for the lending and borrowing of short term funds. S.N. Sen in his book on "Central Banking in Undeveloped Money Markets" gives six main features to a developed money market: (a) a highly organized banking system, (b) sub-markets for different types of short term credit instruments, (c) a large number of dealers, (d) a substantial volume of operations which can be carried out without affecting prices or money rates, (e) an integrated structure in the sub-markets and (f) a sensitiveness to international influences.

The Beirut money market has been developing with the growth of the Lebanese banking system. The rise in the number of banking establishments has undoubtedly contributed

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1. S.N. Sen, Central Banking in Underdeveloped Money Markets, (Bookland, Calcutta: 1952), 15-20.

to the widening of the scope of the money market. The volume of loanable funds provided by the banking system has considerably increased in the last few years and has permitted consequently a rise in the volume of short-term credit transactions. The existence of a developed money market depends primarily on the presence of an organized banking system. In Lebanon, the banking system is not well organized, mainly because of the absence of banking legislation and of a central banking institution. It is fundamental for an organized banking system to have an agency ready to act as lender of last resort. BSL could be considered as a lender of last resort since it is the custodian of government deposits and the sole issuer of note. But banks do not know before time the type and extent of credit facilities BSL is ready to give them. Moreover, lending on the part of BSL is a commercial operation and is usually motivated by profit making.

Although the liquidity of the Beirut money market is not well assured, it has been rising concomitantly with the rise of banks branches and the increase in loanable funds. In the Beirut money market, we can distinguish three sub-markets which are by order of importance the discount market, the acceptance market and the collateral loan market, the first is by far the most important. In the following pages, we are going to give a description of their functioning.

1. The Discount Market

Trade bills are the most important negotiable instruments for financing short term mercantile transactions in Lebanon. They arise out of the sale of goods and mature within a period not exceeding six months, usually three months. There are in Beirut about thirty discount houses whose exclusive function is to discount or purchase bills offered in the market. A number of "running brokers" act as intermediaries between sellers of bills, viz. traders, and buyers, viz. discount houses. The reputation of brokers depends on the soundness of bills they forward for discount. The commission they take varies between 1 and 2%.

The loanable funds of discount houses come from their capital, time deposits of friends and relatives, and to a larger extent from commercial banks. The rate that discount houses give on time deposits varies between 4 and 6%. However, discount houses prefer to rediscount their bills with commercial banks at rates varying between 5 and 5.5% p.a. on prime names.[1] The reason is that they have to pay interest to depositors regardless of the possibilities of employing these funds; and instead of keeping idle funds, discount houses will have recourse to rediscounting bills with commercial banks when in need of money. The discount rate of discount houses for first class trade bills is around 8%.

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1. The discount rate on a prime name trade bill with three signatures and 90 days maturity was 5.26% at the end of 1955 - see Table 4 of Chapter IV.

Commercial banks appear only on the buying side of the discount market since the sale of bills from their own portfolio is contrary to their tradition of individualism and financial autonomy. They usually prefer to rediscount bills which have already been endorsed by discount houses, thus relieving themselves from the risk of default by the drawee. They keep these bills until maturity. The Beirut discount market is a market only in the limited sense of the word. Trade bills can be rediscounted with any commercial bank, but once placed there, they do not appear into the market again and are usually kept until maturity by the purchasing bank. Under certain circumstances, a commercial bank may ask a discount house to repurchase instantly the trade bills it had rediscounted for it.[1] There is tacit agreement between banks and discount houses to this effect. The fact that there is an understanding between bankers and discount houses allowing the former to call back their loans from the discount market makes of the latter a quasi-call money market.

When discount houses are refused short-term credit facilities by bankers, they have no lender of last resort. If bankers are restricting their credit facilities, it is most

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1. A bank does not usually order a discount house to repurchase the trade bills it has rediscounted except when it knows that the drawee is no more credit worthy or when it is badly in need of funds, (interview with Armand Hanna - Assistant Director of Comptoire Bancaire de Beyrouth).

probable that BSL is also restricting its advances to the money market. Discount houses will have therefore to support the shock of a drain in the liquidity of the market. An example will illustrate the difficult situation in which discount houses may be found. Early in 1953, BSL called back some of its loans as it sensed symptoms of bad business conditions in the Beirut Market. Commercial banks followed suit. Many traders were not in a position to sell the goods they had accumulated during the Korean hostilities. They wanted an extension of credit for a certain time so as to liquidate the stocks of piled goods and pay back their debts. But as they were refused such facilities, a number of them had to resort to forced sales of their goods with considerable losses; others were declared insolvent and bankrupt.[1] The number of protested bills[2] quadrupled - (Table 1). They rose from LL 367,000 in value in July 1953 to LL 1,208,000 in September, to LL 1,052,000 in October 1953. The volume of protested bills fell sharply afterwards to LL 432,000 in November 1953 partly owing to the government advising bankers and especially BSL to liberalize credit to traders and industrialists to overcome their temporary illiquidity.[3] It is therefore BSL which is ultimately responsible for supplying the Beirut money market with adequate liquidity in time of need and emergency.

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1. L'Orient, (September 18th, 1953), 1.

2. Protested bills are those bills which are not amortized on due time, (Commercial Code, Art. 377).

3. President Camille Sham'oun called Mr. Oudot - President of the Board of Directors of BSL and conferred with him on this subject; L'Orient, (September 9th, 1953), 1.

TABLE 1

PROTESTED BILLS IN BEIRUT
(LL 1000)

Month	1953		1954		1955	
	No.	LL.	No.	LL.	No.	LL.
Jan.	142	220	247	330	183	470
Feb.	87	189	202	408	145	220
Mar.	116	132	220	373	194	267
Apr.	117	218	218	315	133	126
May	144	387	229	293	144	161
June	194	455	239	324	140	152
July	205	367	251	295	231	428
Aug.	443	722	154	197	248	302
Sep.	487	1208	159	222	226	379
Oct.	477	1052	140	193	260	413
Nov.	285	432	115	197	191	295
Dec.	347	658	195	422	227	305

Source: Bulletin Statistique Trimestriel.

Under present conditions, it is the discount houses which support a strain on the liquidity of the Beirut money market, and take the risk of the default of drawees.

The bill market has considerably developed in the last few years, mainly because the trading and banking practices are favourable to its growth. In a period of less than two years, the volume of bills discounted by commercial banks more than doubled - (see Table 4 of Chapter II). This Table shows that discounts in Lebanese money rose from LL 64.2 million at the end of January 1954 to LL 138.8 million at the end of 1955, (a 110% rise). Discounts in foreign moneys are of minor importance, and although they rose fourfold from LL 1.2 million at the end of January 1954 to LL 5.1 million at the end of 1955, they constituted only a small proportion, viz. about 4% of the total volume of discounts at the end of 1955.

The discount market will keep on growing if trade bills continue to be commonly used and if adequate liquidity is provided to this market. If traders in Lebanon adopt the practice of borrowing on the system of overdrafts, there will be a dearth of bills, and an impossibility of developing a bill market. This situation did not present itself so far although the overdraft practice is developing at a greater rate than the bills.[1]

2. The Acceptance Market

The acceptance market comes second in importance after the discount market. A banker's acceptance may be defined as a bill financing the importation of goods into Lebanon, drawn by the exporter abroad on a Lebanese bank and accepted by the latter. The usual procedure is that the Lebanese importer requests his bank to establish a credit to the exporter. The importer will therefore establish a letter of credit which contains the bank's promise to accept the draft drawn on it in accordance with an agreement concerning the amount of the draft, the time of shipping the goods, and other specifications.[2] The importer deposits with his bank an amount varying between 10

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1. Table 4 of Chapter II shows that the volume of overdraft rose from LL 77.5 million at the end of January 1954 to LL 181.6 million at the end of 1955, i.e. by 135%, or 25% more than the percentage rise in the volume of discounts.

2. John T. Madden and Marcus Nadler, The International Money Market, (Prentice-Hall, New York: 1935), 442.

and 50% of the value of the goods shipped - the percentage being higher in the case of goods which do not have a ready market. The balance is charged an interest of 6 to 7% for the time of financing the import of the goods. The commission of the accepting bank is 1‰ per quarter or any fraction thereof on the total value of credit. These bank acceptances are usually held until maturity by the Lebanese accepting banks. Though they are negotiable, local bankers are reluctant to sell them to other banks mainly because each wants to retain its own customers.

Table 2 shows the total volume of advances in foreign currencies. These advances consist mainly of bankers acceptances secured through the letter of credit system of payment which is always written in foreign moneys.

TABLE 2

ADVANCES AND DISCOUNTS IN FOREIGN EXCHANGE
(LL 1000)

	1954		1955	
End of	Advances	Discounts	Advances	Discounts
Jan.	21,113	1,177	34,850	4,426
Feb.	27,198	1,777	34,929	5,541
Mar.	26,185	2,417	38,745	5,580
Apr.	22,840	876	40,932	5,659
May	27,558	1,693	45,816	5,208
June	30,160	1,727	42,152	5,708
July	34,126	1,695	39,895	6,263
Aug.	36,464	2,460	40,952	6,242
Sep.	37,433	1,729	42,805	5,805
Oct.	31,449	2,986	42,308	4,619
Nov.	34,571	3,495	54,830	4,669
Dec.	33,225	4,129	44,102	5,105

Source: Privately secured from Mr. Talha Yaffi, (Member of the Planning and Development Board).

It is clear from the figures given above that the main form of financing the international trade of Lebanon is through advances primarily constituted of bankers acceptances. In a span of less than two years, they rose from LL 21.1 million at the end of January 1954 to LL 44.1 million at the end of December 1955, i.e. by a little over 100%. The growing importance of this market is no doubt attributable to a great extent to the importance of Beirut as a center of distribution of goods imported from different parts of the world into the Middle East. This function is mainly due to its large port and free zone. Moreover, its credit and insurance facilities as well as its freedom on exchange transactions and liberality of its import policy have made of it a remarkable center of international trade and arbitrage in goods and moneys.

3. The Collateral Loan Market

The collateral loan market is the third important sub-market in Beirut. The chief purposes of collateral loans as summarized by the U.S.A. Senate Committee on Banking and Currency are:[1]

1. Carrying of securities pending distribution to investors
2. Carrying of securities with the intention of reselling them at a rise in price, to permit payment of the loan out of the proceeds

1. Maden, J.T., op.cit., 179.

3. Carrying of securities for long term investment, the borrower expecting to liquidate the loan out of income
4. Carrying of securities for indefinite periods for purposes of corporate control, etc.
5. For business, agricultural, and commercial uses
6. For consumption purposes.

It is believed that commercial banks in Lebanon extend collateral loans mainly to satisfy the two first purposes, viz. carrying of securities pending distribution to investors and carrying of securities with the intention of reselling them at a rise in price, to permit repayment of the loan out of the proceeds. Commercial banks in Lebanon are the main dealers in collateral loans. They do not advance an amount equal to the full market value of the securities pledged since a slight decline in market prices may result in the loan's not being completely secured. A margin of safety is set to protect the lender, and the borrower is consequently given 50 to 80% of the securities value varying with the type of securities pledged as collateral and their price stability.[1] The interest charged is around 6.5% p.a. Loans may be called after a notice of a certain period agreed upon by the lender and borrower; it may be one day or more, though usually it is more than one day.

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1. Although the securities pledged as collateral are usually stocks or bonds, it is quite common in the Beirut Money market to extend collateral loans with the security of foreign exchange. The loan is then around 80% of the value of the collateral and it may be contracted for consumption purposes.

The development of the short term loans on collateral has been seriously hampered by both legal and structural obstacles. The chief legal difficulty resides in Article 271 of the Commercial Code. This article requires that in the case of default on a collateral loan the creditor may not sell the security pledged until eight days, giving to the debtor notice of his intention to do so. This provision greatly impairs the liquidity of short-term collateral loans.

The structural obstacle consists in the absence of a developed capital market and in particular a developed stock exchange. The Beirut stock exchange market, commonly called "Bourse", carries out transactions in stocks and bonds of some major companies operating in Lebanon.[1] Although there are over 100 joint stock companies operating in Lebanon, 25 only are listed in the Bourse of which 12 are actively traded in, mainly French concessionary companies operating in Lebanon.[2] The operations of the Bourse are growing in volume, they were LL 36.5 million in value during 1955. However, the Beirut stock market is still restricted to the trading of a few local securities and international stocks or bonds are not listed. The Beirut capital market in general

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1. The Law of June 18th, 1954 regulates the activities of the Bourse. The Bourse can also trade in foreign currencies and gold. However, its operations on the latter have decreased tremendously as profit margins declined.

2. The most actively traded companies' stocks are: Port de Beyrouth (French), D.H.P. (French) Radio-Orient (French), BSL (French), Kadischa, Foncière de Syrie (French), Nahr Ibrahim, Nahr El Bared, Electricité d'Alep (French), Ciments Libanais, Cie Générale du Levant (French), Cie Libanaise des Pétroles. See Le Commerce du Levant, (February 29th, 1956), 6.

does not permit the pooling of capital savings for investment, the floating of securities and bonds. The absence of a developed capital market retards the development of the collateral loan market. Some of the factors which are at the origin of the inexistence of a developed capital market are mainly the predominance of private ownership in business as against the corporate form, absence of savings institutions, or other investment channels and unfamiliarity of the Lebanese public with the savings and investments in intangibles like stocks and bonds.

4. Short Term Government Securities

The amount of government securities outstanding at the end of January 1956 was LL 57.2 million. These securities are of one year maturity and earn 1% interest per annum. This interest yield is considered very low and does not encourage the public to hold them. Moreover, these securities although they mature in a year period, have to be renewed except 3% of the total. These conditions make them unmarketable. All Treasury bonds are held now by BSL in its Issue and Banking Departments.[1]

Evaluation of the Beirut Money Market.

The Beirut money market offers an interesting picture of a developing money market. It is characterized by a large

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1. See Appendix 2.

number of commercial banks, a number of sub-markets, some developed e.g. the bill market, others developing, e.g. the collateral loan market and still others not yet formed, e.g. the short term government securities. Moreover, the number of dealers (lenders, borrowers and intermediaries) is sufficiently large in the more developed sub-markets and little in the less developed ones. The main reason is that the large volume of operations in the former necessitates the presence of a large number of dealers.

The sensitiveness of the Beirut money market to the impact of international influences is not yet proven. Some bankers believe that the stability of the exchange rates has had a favourable influence on short term funds which sought investment in highly liquid assets (viz. trade bills) or were deposited with banks (at an attractive rate of 3% per annum). Banks operating in Lebanon may have recourse to borrowing from other financial centers, e.g. New York, at favourable rates of 4% for one year period. However, they will not convert their dollar loans into Lebanese pounds unless they can secure a term transaction at the same purchase rate. This will not be possible unless it is expected that the dollar rate will be stable over the period of use of the loan. However, this means of borrowing dollar loans is not resorted to frequently because of the risk involved in exchange fluctuations. We cannot therefore estimate the sensitiveness of the Beirut money market to international influences. We are rather inclined to think that the impact of these influences is slight.

The Beirut money market presents some basic and important defects which impede its progress, chief among which are the following:

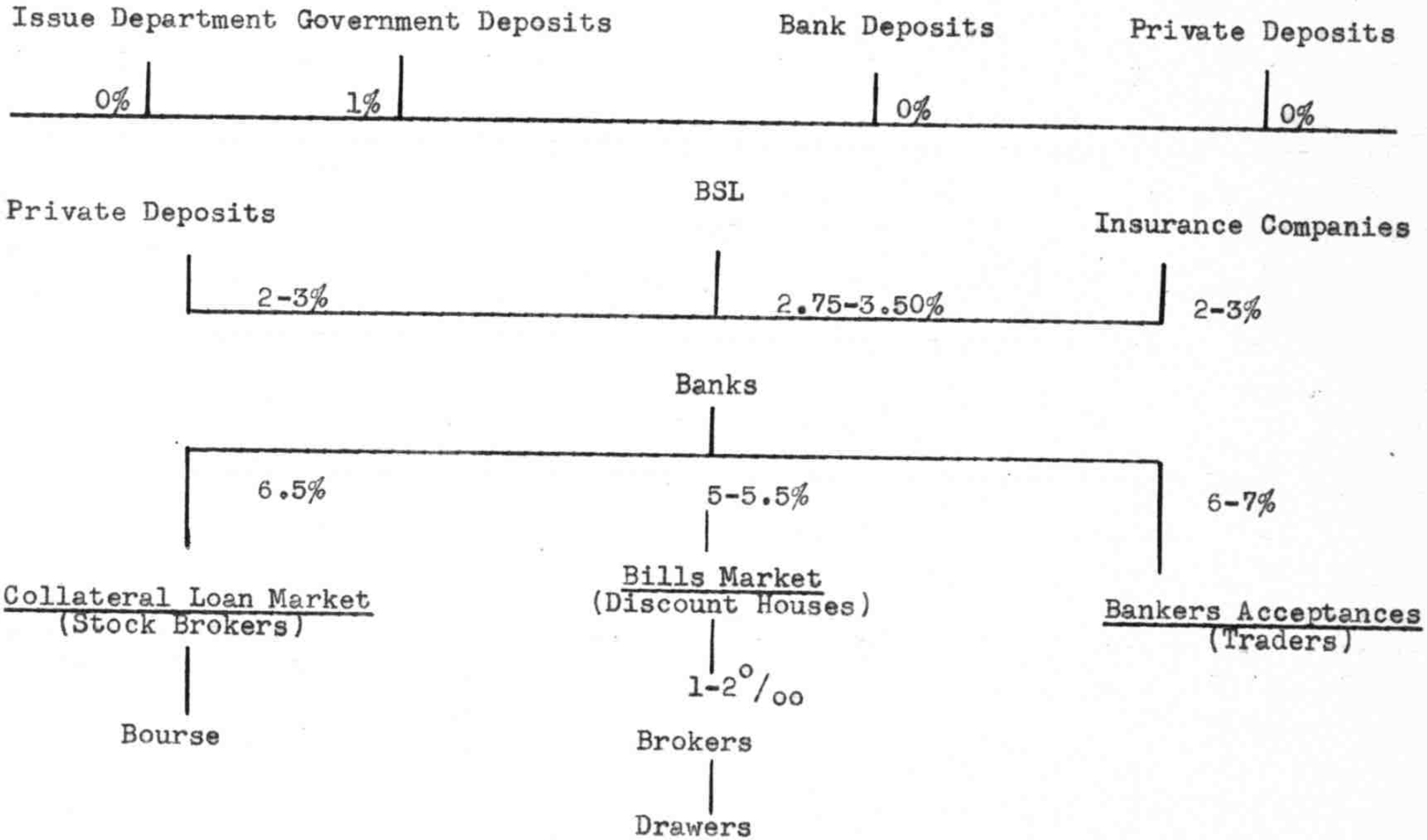
1. The fundamental defect is the absence of a national central bank ready, in periods of crisis or emergency, to exchange the operators' assets into money when all other sources of liquidity have dried up. This condition is not properly filled by BSL. The latter seems reluctant in periods of tightness to help the money market if it believes that this will not be beneficial to its own interests.
2. Another defect is the absence of direct contact between the money market and BSL. Thus if there is a sudden call of money by commercial banks, discount houses would be in an impasse. BSL is loath to rediscount for them trade bills (especially when market conditions are uncertain), and commercial banks are not ready to call on BSL for assistance. Therefore, discount houses have to bear the shocks of money calls from commercial banks without hoping to find in BSL the lender of last resort.

Among other defects of the Beirut money market are its inflexibility, the lack of competitiveness and integration between the different sub-markets, and the absence of a systematic organization of both the money and capital markets. However, there are some signs of strength in the Beirut money market and this strength resides in the Lebanese banking system.

We have noticed that most banks operating in Lebanon are foreign establishments which have excellent connections with international financial centers. Moreover, Lebanese banks are formed with emigrants' capital and their owners still keep contacts with the countries to which they emigrated. The Lebanese banking system is in a position to support a large volume of credit operations. The unique geographical position of Beirut, its port, free zone and insurance facilities, the liberal policy Lebanon follows and its relative political stability have also helped in making of Lebanon an international financial market. This position will be strengthened further if adequate banking legislation is enacted.

CHART I

A SKETCH OF THE BEIRUT MONEY MARKET



CHAPTER IV

BANQUE DE SYRIE ET DU LIBAN

In the course of our study, we have realised the major importance BSL assumes vis-à-vis other commercial banks, and the money market in general. Owing to the privileges it has been granted by the Convention of May 29th, 1937, BSL is in a position to have large control over the monetary system of Lebanon. As already mentioned in Chapter I, the Franco-Lebanese monetary Agreement of 1948 stipulates that Lebanon shall respect the concessions of French companies operating in Lebanon - among which the Convention of BSL. It has been found appropriate to devote this chapter to the analysis of the functions of BSL according to this Convention and the statutes of BSL. This chapter is divided into five main parts: BSL activities are analyzed as an Issue Department, as a Government Bank, as a Bankers' Bank, and as a Commercial Bank. The chapter concludes with an evaluation of BSL role in the banking and monetary system of Lebanon.

I. BSL Note Issue Department

This section endeavours to present the institutional set-up of the Issue Department and the powers given to BSL in this respect. Some provisions of the 1937 Convention were superseded by the enactment of the Monetary Law of May 1949 and of other legislations already covered in the early part of this study.[1] Only those provisions which are still operating today are discussed here below.

By virtue of the 1937 Convention, BSL has the sole right of note issue in Lebanon. The Issue Department is to be "distinct and absolutely independent from any other service of the Bank. It has separate accounts for all operations of issue and withdrawal of notes" (Article 4). However, this "absolute separation" of the Issue and Banking Departments is only nominal. Experience shows that the Issue Department has been readily affected by the conditions prevailing in the Banking Department. Thus it has been shown how a shortage of liquid funds in the latter will induce a shift of eligible assets (as defined by the 1949 Monetary Law) to the note Issue Department against an increase in the cash reserves of BSL Banking Department.

The earnings of the note cover are to be divided between BSL and the Lebanese Government. The 1937 Convention provides a complicated way of dividing the gain from the fiduciary reserve between the Bank and the contracting State. The Bank

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1. See Chapter I for the regulation of the note circulation and cover. Many of the functions of the Issue Department were already covered in connection with the Monetary Law of 1949. Only those provisions which have not been given so far are described in this section.

first retains from the gain a sum calculated as follows: (a) 1.50% on the first 6,500,000 pounds of the average daily note circulation during the year; (b) 0.50% on the next 3,500,000 pounds of the note circulation; (c) 0.30% on the amount of the note circulation exceeding LL 10,000,000. If the price of 43 milligrams of gold 900/1000 fine[1] rises by more than 10%, the actual average daily note circulation is reduced by multiplying it by the reciprocal of the new price of gold, and then the above rates are applied to this reduced note circulation.[2] The resulting amount is raised by the proportion of the rise in the price of gold, and this will be the actual amount deductible from the gain. The remainder of the gain after the deductible amount is subtracted, is shared with the state in the following way. The contracting State receives proportions of the remainder of the gain, increasing from 55% on the first LL 110,000 to 70% on the next LL 390,000, to 75% on the amount above LL 500,000. The balance after payment of these proportions is retained by BSL.

The Lebanese Government has lately relinquished its right to share in the note cover earnings. It believes that the earnings of the Issue Department from the note cover have decreased considerably owing to an increase in gold and other

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1. Being the value of the franc in gold at the time the Convention was drawn.

2. This means in effect that the rates increase with the depreciation of the Lebanese pound.

non earning assets. And since the government was responsible for this increase in non-earning assets, it thought it fair not to require from BSL the share of the State from the note cover proceeds, in the belief that the Issue Department is not covering its operation costs. Table 1 of Appendix 2 shows that the interest receipts of BSL from Treasury bonds (which are largely kept with the Issue Department) averaged LL 700,000 per annum. This sum is considered sufficient to cover the expenses of the Issue Department.[1] At any rate, the Convention of 1937 does not require the government to insure BSL Issue Department with stable earnings.

TABLE 1

SHARE OF THE GOVERNMENT IN THE ISSUE DEPARTMENT

Profits

Year	LL
1948	138,811
1949	70,175
1950	14,225
1951	–

Source: Bulletin Statistique Trimestriel.

Table 1 shows that the government share in the earnings of the note cover declined steadily from LL 138,811 in 1948 to LL 70,175 in 1949 and to only LL 14,225 in 1950. This decline in the government share in the earnings of the Issue Department was concomitant to the rise in unproductive assets,

1. Interview with a responsible official at BSL.

mainly gold. The latter rose from a low point of 2% of note circulation at the end of 1948, to 25% at the end of 1949, to 36% at the end of 1950 and to 45% at the end of 1951.

II. BSL Banking Department

BSL Banking Department carries out banking operations pertaining both to the public and private sectors of the economy. Its activities in the private sector affects the banking as well as the non banking public. The activities of BSL in all sectors are discussed separately.

1. The Government Bank

In addition to its having the sole privilege of note issue, BSL also acts as the government bank and as its fiscal agent. As such it keeps the deposits of all public administrations. These deposits receive an interest equal to the discount rate of the Banque de France minus 2% for demand deposits, and minus 1.25% for time deposits with three months prior notice. Almost all government deposits with BSL are on demand so that the government may be able to draw any amount and at any time it likes to meet its current expenditures. The discount rate of the Banque de France has been on the average around 3%. Interest therefore earned on government deposits becomes 1%, while other commercial banks, even big

French banks like BNCI[1] may give as much as 3% on demand deposits and 4% on time deposits. Not only interest earned on government deposits with BSL is low but also the rationale behind adopting the discount rate of the Banque de France as the basis of computing the interest on government deposits is obsolete. This rate would have been economically meaningful if the note cover were still mainly composed of French franc assets.

As to the volume of government deposits, BSL can determine the amount it may hold to satisfy its employment possibilities. Any excess may be deposited at any other bank as the government may see fit. This provision did not come to reality since BSL could always use government deposits regardless of their amount. Table 2 shows the volume of government deposits outstanding at different dates and the interest earned thereupon.

TABLE 2

GOVERNMENT DEPOSITS WITH BSL AND THE INTEREST CHARGE

End of	Deposits (LL Million)	Interest Charge (LL)*	End of	Deposits (LL Million)	Interest Charge(LL)*
1948	60 x	326,993	1952	69.2	525,000
1949	54 x	730,962	1953	108	1131,000
1950	24.3	563,756	1954	115.5	932,000
1951	31.8	485,795	1955	144.9	

Sources: x IFS, Vol. III, No. 10, (October 1950), p. 95.

* Bulletin Statistique Trimestriel
Privately secured from Mr. Talha Yaffi, (Member of the Planning and Development Board).

1. Banque Nationale du Commerce et de l'Industrie - Algiers.

It should be noted that deposits figures quoted above are for the end of the respective years, they do not represent therefore a yearly average while the interest charge is earned on deposits all over the corresponding year. It is very likely that the volume of deposits is different at the end of the year from the yearly average. One interesting remark Table 2 permits to make is that government deposits averaged high levels during the recession years of 1949 and 1953 as the government receipts from its deposits were LL 730,962 in 1949 (against LL 326,993 in 1948) and LL 1,131,000 in 1953 (against LL 525,000 in 1952). The increase in government deposits during the years 1949 and 1953 has had a deflationary effect as it diminished the public's money supply because such balances represent money taken from the public by tax collections. This explains why the note circulation declined from LL 184 million at the end of January 1949 to LL 164.5 million at the end of November 1949. In 1953, the decline was less sharp, mainly because it was mitigated by the operations of the Exchange Stabilization Fund. At any rate, note circulation fell from LL 203 million at the end of October 1952 to LL 196 million at the end of July 1953. BSL did not, as central banks are supposed to do, counteract the deflationary effects of the increase in government deposits. As is shown later in this chapter, it did not try to stabilize the volume of money supply by increasing the total volume of its private deposits, on the contrary it decreased the latter during these periods of recession.

TABLE 3

DEPOSITS OF AND ADVANCES TO THE GOVERNMENT

(LL Million)

End of	1954 Deposits	1954 Advances	1955 Deposits	1955 Advances
Jan.	105.5	105.2	122.0	94.3
Feb.	103.7	104.4	127.7	94.5
Mar.	104.8	104.8	128.2	94.4
Apr.	104.4	104.8	126.3	94.1
May	104.9	100.0	122.6	93.3
June	111.0	103.8	119.5	87.8
July	113.8	103.9	121.8	88.2
Aug.	101.7	103.3	130.8	89.2
Sep.	102.0	103.3	137.4	89.3
Oct.	113.5	98.4	141.5	89.5
Nov.	116.6	98.4	144.6	89.2
Dec.	115.5	94.4	144.9	87.2

Source: Privately secured from Mr. Talha Yaffi, (Member of the Planning and Development Board).

Table 3 shows the importance of government deposits and advances.[1] Government deposits were almost LL 145 million or 50% of private deposits at the end of 1955. Their volume is considerable and affects greatly money supply. BSL does not attempt to neutralize the disruptive effects that changes in government deposits and advances may have as long as it is profitable to its interests not to do so.

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1. These government advances consisted towards the end of 1955 of loans to municipalities (LL 38 million) to semi-public agencies as BCAIF (LL 25 million) and loans to private electric companies (LL 9 million). The remaining were advances to the Telephone Authority and other institutions.
Al Majles Al Niyabeh, (December 22nd, 1955), 476.

The government is authorized by the Convention of 1939 to get a loan from BSL not exceeding LL 1.5 million at 4% per annum. It is worthwhile noting here that while the government earns 1% on its deposits, it is allowed a loan at a 4% interest. All advances to the government or public agencies should be provided by BSL unless the government is offered better terms by other banks. Obviously other banks are not, however, able to compete with BSL as long as the latter has the privilege of note issue in Lebanon.

As the government bank, BSL has many other functions besides those of keeping government deposits and granting it loans. It has, in addition, to provide free of charge and at request payments to public departments, movement of funds in the country or between Lebanon and the outside world, and the custody of securities.[1] BSL is also the financial agent of the government for all operations of credit. Moreover, the director of the Issue Department acts as member of the Exchange Stabilization Fund whose operations are conducted by BSL.[2] A function which has lost its meaning is that of the management of the Office des Changes. All that BSL does nowadays is to keep the assets of this Office in its Banking Department.

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1. BSL is the custodian of the government subscription in international organizations; thus it keeps LL 9,375,651 on behalf of IMF, LL 2 million on behalf of IBRD and LL 0.5 million in the name of the Federal Reserve Bank of New York. Al Majles Al Niyabeh, (January 16th, 1951), 327.

2. A discussion of the operations of the Exchange Stabilization Fund is given in connection with the chapter on the government i.e. Chapter V.

2. The Bankers' Bank

BSL is in a position to act as the bankers' bank and in particular as a lender of last resort. Its free access to the Issue Department permits it to shift trade bills up to 15% of the note cover and/or government obligations (loans to or guaranteed by the government) up to 50% of the note cover. BSL has also at its disposal a large amount of government deposits (LL 144.9 million at the end of 1955).

There are three possible ways for a commercial bank to borrow from BSL. The first consists in giving the commercial bank an unsecured open account subject to overdraft up to a certain maximum point. Repayment is usually after one year and it is agreed upon by contract. However, it is a general practice that BSL can call back the loan after a 45 days notice.[1] Commercial banks have therefore to lend for a lesser period. This way of borrowing is also not encouraged by BSL since the latter wants a shorter lending period as well as secured loans.

It is because of these two reasons that rediscount of trade bills to other banks is more resorted to. These bills must have two signatures and the banker's acceptance. Their maturity period should not exceed three months. Local bankers are often loath to use these rediscounting facilities partly

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1. Economic Research Institute, op.cit., 40.

because BSL is considered a competitor to whom they are often reluctant to communicate the name of their clients and partly because it is a loss of prestige to bankers to make their customers pay at BSL desks.

To overcome the latter objection, BSL has adopted for the last two years a new device, known as borrowing en pension. "A pension transaction is simply a sale of bonds or bills under a repurchase agreement."[1] The bank needing funds sells a bundle of trade bills to BSL and receives the latter's check in payment. The period of advance is 7 days subject to extension on a 7 days basis. After the lapse of the agreed period the seller repurchases the trade bills. In this way the objection to borrowing at BSL is obviated.

At any rate, some large Beirut banks consider it inconsistent with their prestige to use BSL credit facilities and prefer to keep excess reserves or use excess liquidity of their other branches rather than obtain short term financial accommodation at BSL. The principal borrowers from BSL are in general the French owned or French controlled banks. The interest charge varies between 2.75 and 3.50.

The discounting facilities to commercial banks (at rates varying between 3 and 3.5% p.a.) are based on purely a commercial basis. This means that during periods of high economic activity BSL increases its discounts and during periods of low economic activity it decreases its discounts. Such a policy is diametrically the opposite to the discount rate policy

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1. Madden J.T., op.cit., 339.

pursued by central banks. In other words, it is the policy of central banks to lower the discount rate in periods of low activity to promote credit expansion and in periods of high economic activity to raise discount rates to check inflationary credit expansion.

BSL has some other functions of a banker's bank. It acts as the clearing agency of the Lebanese commercial banking system. All agreed banks keep deposits with BSL for clearing purposes. It is reported that these deposits amount to about LL 20 million.[1] However, there is no banking law requiring these banks to maintain a prescribed percentage of their demand deposits as a legal cash reserve policy. BSL has no power to prescribe nor to manipulate commercial bank reserves. Thus BSL is <u>not</u> able to maintain and command a certain percentage of liquid assets <u>nor</u> is it able to manipulate the cash reserve requirements so as to expand or contract the money supply and bank credit.

Among its other functions of a bankers' bank BSL manages the Centrale des Risques. This office although technically a part of the Ministry of Finance, is managed by an official from BSL (see Chapter III).

3. The Commercial Bank

Besides its being the government bank and to a lesser extent the bankers' bank, BSL Banking Department indulges in ordinary commercial banking activities. These activities are

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1. Mr. Sharif Yakin, Manager of the Rafidain Beirut Branch.

specified in the by-laws of BSL. This section accounts for BSL banking operations owing to their impact on the monetary events of Lebanon. The Bank is authorized to carry out all banking and financial operations pertaining to Lebanon and Syria except those related to real estate and mortgage loans. This provision has not been strictly observed, and it is reported that BSL has issued long term loans against mortgages.[1] BSL cannot have any branch outside Lebanon and Syria, besides its Paris branch. The permissible activities of BSL as provided for in the by-laws are the following:

1. Grant loans to financially autonomous public institutions. The interest rate charged varies between 2 and 4% per annum.
2. Discount all commercial papers of not more than 180 days maturity. Table 4 gives variations in discount rates.
3. Grant loans duly secured with (a) warrants or receipts on goods; (b) deposit of money or precious metals; (c) bills of lading; (d) government bonds or other securities accepted by the Council of Administration of the Bank.
4. Overdrafts not exceeding 180 days and granted to credit worthy persons. The rate charged for prime names is around 5.5% per annum.

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1. M.F. Abcarius and P.W. Bakarian, <u>Notes on the Lebanese Credit System</u>, - memiographed) - (September 30th, 1952), 5.

5. Accept deposits of money, precious metals, securities and other financial papers; open accounts for deposits. There is no interest on demand deposits while time deposits earn 1% only.

6. Collect, pay and keep all kinds of financial papers; carry commission operations for governments, companies and individuals.

7. Issue, purchase and sell public bonds, financial papers, exchange bills, cheques, drafts. BSL keeps with it all Treasury bonds issued and on which it receives 1% interest.

8. Raise loans on behalf of a third party.

9. Trade in precious metals.

At least three fourths of the total value of sight drafts or other securities payable in Lebanon or Syria ought to bear three signatures or their substitutes as provided for in point 3 above. Loans cannot exceed 60% of the market value of mortgages or securities, and the maximum term is 6 months. Loans on (a) precious metals or notes, (b) French Government bonds and (c) public work equipment may reach as much as 80% of the market value of mortgages or securities. Loans to industries carrying a government guarantee may run over a number of years and reach a rate as low as 3%.[1]

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1. The electric company of Nahr El Bared has contracted a loan of LL 4 million from BSL for a term of 20 years and at a rate of 3% annually. This loan is guaranteed by the government. Francois Debbané, "Finances Publiques et Redistribution des Revenus" in L'Economie Libanaise et le Progrés Social, (Ed. Les Lettres Orientales, Beirut, 1955), 129.

In short, it can be said that BSL credit activities are almost exclusively concentrated on financing short term mercantile credit in the form of direct loans, overdrafts or discounts. The bank's discounting and general credit policy is purely motivated by its commercial interest. This is because the bank, being fundamentally a commercial bank, is in business to make profits. Thus it is only natural that in periods of business expansion, it increases its credit and discounting facilities and in periods of recession it decreases and discourages its credit and discounting activities. Such a policy is inevitable for a private banking institution if it wants to remain in competitive position with other banks.

Table 4 depicts variations in discount rates of 3-signature commercial bills of up to 90 days' maturity. It is noticeable that during periods of recession, BSL raised the discount rate and in periods of expansion it lowered it. Thus during the course of 1948 when business activity was thriving BSL discount rate was as low as 6.50 but when deflationary pressures affected the market in 1949, BSL discount rates rose up to 7.00. Again in 1951 the discount rate declined as trade expanded. At the peak of the recession in 1953, i.e. in the month of September, BSL discount rate was at 6.18 compared to 5.97 in June of the same year. Though the government incited BSL to expand its credit facilities to business, the discount rate went on rising up to 6.26 in November 1953. These figures clearly prove that BSL does not follow a countercyclical policy if its profits may be affected.

TABLE 4

BSL DISCOUNT RATES

	1948	1949	1950	1951	1952	1953	1954	1955
Jan.	6.50	7.00	...	6.75	6.64	6.28	6.00	5.32
Feb.	6.50	7.00	6.97	6.70	6.83	6.23	5.99	5.20
Mar.	6.50	7.00	6.84	6.58	6.59	6.13	5.70	5.14
Apr.	6.50	6.90	6.83	6.57	6.50	6.19	5.62	5.12
May	6.50	7.00	6.85	6.72	6.67	6.25	5.45	5.14
June	6.50	6.80	0.85	6.58	6.39	5.97	5.63	5.14
July	6.50	6.90	6.65	6.66	6.38	6.13	5.52	5.16
Aug.	6.50	6.90	6.69	...	6.54	6.02	5.40	5.21
Sept.	6.50	6.90	5.77	...	6.33	6.18	5.30	5.25
Oct.	6.80	6.90	6.76	6.57	6.35	6.09	5.32	5.20
Nov.	7.10	6.90	6.73	6.54	6.39	6.26	4.72	5.24
Dec.	7.00	6.90	6.75	6.56	6.58	6.11	5.11	5.26

Source: International Financial Statistics

It has been possible for us to determine the importance of BSL operations in Lebanon for the last few years. Moreover, we were able to distinguish between the operations of BSL to the government and its operations to the private sector (including banks).

TABLE 5

BSL DEPOSITS, ADVANCES AND DISCOUNTS COMPARED TO TOTAL DEPOSITS, ADVANCES AND DISCOUNTS OF MAIN BANKS

(LL Million)

End of	Deposits			Advances and Discounts		
	BSL		All Banks	BSL		All Banks
	Private	Private & Public	Private	Private & Public	% of Total	Private & Public
1951	88.5	120.3	227.5	138.9	64	216.6
1952	79.4	148.7	244.0	189.6	72	263.2
1853	55.7	163.3	235.4	210.2	80	277.3
1953*	35.9	143.9	216.4			
1954*	43.8	158.3	273.3			

* Revised so as to include deposits in Lebanese money only.

Source: BSL, Exercises 1952-1954 (Annual Financial Reports) - arranged by the writer.

Table 5 reveals many interesting facts about the banking operations of BSL. Private deposits at BSL constituted 38% of total private deposits with banks at the end of 1951. This proportion went on steadily declining and became 16% of the total at the end of 1954.[1] This sharp decline in private deposits at BSL is largely due to the opening of new banks in Beirut (13 first class banks have been established during the

1. It should be noted that deposits of individuals and private institutions would be much less if we excluded deposits of commercial banks with BSL which amounted to about LL 20 million at the end of 1955.

last 5 years) and the increasing competition from the part of all commercial banks. These latter offer as much as 3% on demand deposits so as to attract new clients while BSL does not offer any interest to private depositors. BSL may be contented with the large volume of government deposits it has.

Table 5 shows also that private deposits in foreign moneys with BSL amounted to about LL 19.5 million at the end of 1953. They represented 35% of its total private deposits in Lebanese pounds. No information is, however, available on the volume of BSL discounts and advances to the private sector. It is believed, (and Table 3 suggests) that advances to the government constitute about half of total BSL discounts and advances. Thus while the latter were LL 210.2 million at the end of December 1953, advances to the government were LL 105.2 million at the end of January 1954.

A most note worthy fact revealed by Table 5 is the policy followed by BSL during a recession. BSL private deposits declined during the recession period of 1953. They fell from LL 79.4 million at the end of 1952 to LL 55.7 million at the end of 1953, a decline of about LL 24 million (if we include both deposits in Lebanese and deposits in non Lebanese money). When business conditions proved more favourable in 1954, private deposits rose from LL 35.9 million at the end of 1953 to 43.8 million at the end of 1954 (considering deposits in Lebanese money only). These figures clearly prove that BSL does not follow deliberately a policy of credit expansion during a recession period and a policy of credit contraction during a period of business activity.

III. BSL Reserves and Profits

In its yearly statements, BSL publishes its reserves and profits for the Bank's operations in both Lebanon and Syria. BSL capital account (capital stocks FF 300 million and reserves F 794 million) did not exceed LL 9.9 million while its total deposits amounted to about LL 60 million (viz. about FF 54 billion) at the end of 1954. The balance sheet of BSL at the end of 1954 shows that the advances and discounts are 26 times of the capital account, and deposits 50 times.

Table 6 gives us the percentage value of distributed profit in terms of BSL capital. The percentage of distributed

TABLE 6

BSL DISTRIBUTED PROFIT IN TERMS OF ITS CAPITAL

Year	Percentage	Year	Percentage
1948	36	1952	0.6
1949	18.3	1953	24
1950	21.7	1954	24
1951	21.6		

Source: BSL, Exercises 1948-1954, (computed by the writer).

profit averaged 20% of BSL capital. This percentage is considered very high by western standards especially for a bank acting as a central bank and not supposed as such to be motivated by profit making. However, BSL is a private institution and by the very nature of its statutes looks after its own interest. Table 6 shows that there has been a decline in the percentage of distributed profits. This decline is only relative to the capital of BSL since the latter's capital was raised in 1949 from FF 57.4 million to FF 300 million out of accumulated reserves. The declared net profits of BSL have been steadily rising from FF 74 million in 1952 (or 25% of the capital) to FF 90 million in 1953 (or 30% of the capital) to FF 104 million in 1954 (or 35% of the capital).

V. Effects of BSL Status on its Functions as a Central Bank

On several occasions, it has been claimed by BSL directors that the "essential role of the Bank is to see to the safety of money and that there is no abuse of credit which may lead to inflation."[1] The best security against inflation, they believe, is a 100% gold cover. Nothing is said about regulating the volume of credit (or demand deposits) to prevent inflation as well as deflation. BSL administrators contend that they are "aware of their tasks before the State and the nation. The Bank shall, within its powers participate in any sector of the economy and beneficially contribute to the equipment of the country. It will not spare for this purpose, and with tireless diligence, neither the studies, nor the credits, nor the encouragements. Our care for the prosperity of Lebanon is not lesser than that of the Authorities."[2]

1. Le Commerce du Levant - Declaration of Mr. De Blitterie, President of BSL, (December 10th, 1955), 1.
2. BSL, Exercise 1952, p.7-8.

Experience has shown that BSL is primarily motivated by the interest of its stockholders. This is clearly proven by the policy followed during the two recessionary periods of 1949 and 1953. Table 4 shows that it raised discount rates then, thus affecting adversely the Lebanese economy. Thus, it is possible that BSL policy may have had the effect of accentuating the recession to come soon in 1953 by its policy of calling loans and raising its discount rate. The policy BSL follows is the natural result of the provisions of the 1937 Convention. There are some basic objections to the latter, chief among which are the following:

First, the provisions of the 1937 Convention with BSL are those of the 1924 Convention. Conditions which were prevailing 36 years ago, i.e. since the establishment of the Bank in 1920 have since changed greatly while the organization and functions of BSL remained much the same without any adequate adaptation to new conditions. Thus when the French High Commissioner authorized BSL to carry out ordinary banking operations besides its functions of a central bank, he was probably justified in doing so. BSL had then to assure the growth of banking operations while it was at the same time the sole note issuer and the government Banker. This authorization to undertake ordinary banking operations was not only justifiable but also desirable as no other banking institution was then established in Lebanon. However, when commercial banks opened branches in Lebanon, the original purpose of BSL carrying out ordinary banking operations became obsolete. This function of BSL has been affecting the banking system in two ways: (a) it permits BSL to compete at a comparative advantage with other banks and (b) it makes BSL look after its private interest of profit only. In other words, the first objection to BSL Convention is that this Convention is a contract which does not permit some flexibility to the determination of the monetary system of the country. This flexibility is of utmost necessity when the social, economic and political conditions of the country have changed.

The second objection to the 1937 Convention is that it empowers BSL with a mission of public interest but does not give the State an effective control over the operations of the Bank. The Government commissary to BSL cannot inspect the banking operations of BSL although the latter may affect one way or the other the course of monetary events in Lebanon. His role is confined to a simple checking of the operations of the Issue Department without being in the least in a position to determine the amount of note issue appropriate for the various circumstances. In other words, he cannot prevent any shifting of assets from BSL Banking Department to the Issue Department and thus restraint an increase in the note circulation.

The third objection to BSL Convention is that this Bank which is privately owned is also a foreign bank. This condition may bias its policy to the advantage of certain vested interests of foreign powers or foreign establishments.[1]

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1. République Syrienne, Ministère des Finances, _Statut Organique de la Monnaie et Création de la Banque Centrale de Syrie, Exposé de Motifs_, (March 1952), 2-4.

CHAPTER V

THE GOVERNMENT

This chapter is concerned with the role of the government and in particular the Ministry of Finance in the monetary system of Lebanon. It deals with the organization of the governmental monetary institutions as well as with their functioning. An attempt is also made to discuss the monetary policy followed by the government and to determine the underlying principles of this policy.

I. The Monetary Institutions of the Ministry of Finance

This part describes the organization and functioning of monetary institutions which are managed by the government, namely those concerned with the issue of divisionary notes, exchange regulations, control of note issue and exchange stabilization.

1. Issue of Divisionary Notes and Token Coins

Article 2 of the monetary law of May 24th, 1949, provides for the issue of notes and subsidiary coins of silver or of any other metal by the Public Treasury. Their values vary between half a piaster and fifty piasters. The face value ~~as~~ of the coins is significantly greater than their real value as materials in the commodity market.[1] No cover is provided for these divisionary notes and coins.

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1. In 1948, many silver coins disappeared from circulation as their value in the commodity market was greater than their monetary value.

TABLE 1

CURRENCY CIRCULATION

(LL 1000)

End of	Banknotes	Silver Coins	Other Coins	Divisionary Notes	Total
1948	185,000	710	467	1,903	188,080
1949	168,000	710	467	2,027	171,204
1950	196,000	710	496	2,750	199,956
1951	208,000	706	493	3,113	212,312
1952	200,000	706	486	3,751	204,946
1953	205,000	886	820	2,545	209,251
1954	242,000	880	901	2,425	246,206
1955	266,000	1,405	1,294	1,852	270,551

Source: Bulletin Statistique Trimestriel.

The amount of divisionary notes and coins did not exceed at any time 2.5% of the total currency circulation. It has been, however, increasing so as to meet the needs of the public faced with a higher volume of transactions. Their amount which was around LL 3 million in December 1948 increased to almost LL 5 million in December 1952. At the end of 1955 they were about LL 4.5 million or only 1.7% of the total note circulation.

2. The Exchange System

The "Office des Changes" is now a department of the Ministry of Finance. It is recalled here that exchange regulations were first established in Lebanon at the time the Office des Changes was created on December 3rd, 1939.[1] It has been

1. Arrêté No. LR/338.

noted in Chapter I that soon after Lebanon and Syria obtained their independence late in 1943, the Office des Changes (hereafter referred to as the Office) was transferred from the French delegation to the Syrian and Lebanese Governments, and it was consequently made a Lebano-Syrian autonomous public service.[1] On the 7th of September 1948, Lebanon created an independent Lebanese Office des Changes.[2]

Exchange restrictions which existed during the post-war period and until November 1948, were a legacy from the war time conditions and their maintenance was short lived. It seems also that during that period, the government was rather lenient in enforcing exchange control regulations and it is reported that a large portion of exchange transactions took place outside the Office.[3]

The official recognition of the "free market" was brought about by decree No. K/13532 of November 5th, 1948.[4] The main provisions of this decree can be summarized briefly as follows:

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1. Protocol of April 18th, 1944.

2. Law of September 7th, 1948 and Decree K/13051 of September 10th, 1948.

3. IFS, Vol. V, No. 10, (October 1953), p. 112.

4. It has been an act of great moment and consequence that of recognizing the free exchange market. Many give credit to ex-President Bechara El Khoury for his realizing that the prosperity of Lebanon can only be achieved in an atmosphere of freedom.

1. Individuals and agents are free to dispose of all foreign exchange they may possess in Lebanon.
2. Ninety percent of foreign exchange can be disposed of freely, the remaining 10% ought to be surrendered to the Office des Changes at the official rate.
3. The repatriation of proceeds from exports continues to be required.
4. Companies which have special contracts with the government (viz. concessionary cos. and petroleum cos.) have to surrender at the official rate 80% of their imports of foreign exchange into Lebanon.
5. Purchases of foreign exchange, made by an authorized intermediary during a period of 10 days are not to exceed his sales during the same period by more than LL 300,000. This provision is LL 100,000 for ordinary intermediaries.
6. Operations of purchases or sales of foreign exchange not quoted by the Office are free from any control.
7. Purchases and sales of notes and coins are also free.

The complete freeing of exchange restrictions went on after this first step was made. On September 26th, 1949, exporters were no more required to surrender 10% of the export proceeds at the official rate. Moreover, the requirement of repatriation of export proceeds was removed.[1] On November 7th,

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1. Decree No. K/16369.

1950, non-residents were authorized to open free accounts with intermediary banks in Lebanon without prior licensing from the Contrôle Géneral des Changes.[1] The import and the export of any currency notes were authorized after January 8th, 1952.[2] In the same month (or 26th of January 1952), imports of foreign exchange were freed from the 10% surrender at the official rate.[3] Commercial companies which had special contracts with the government were also exempted on the 17th of May 1952 from delivering the 80% of their imports of foreign exchange at the official rate to the Office.[4] Table 2 summarizes the expansion of the use of the free rate.

TABLE 2

EXPANSION OF THE USE OF THE FREE RATE

Date	Change
September 1949	Use of the free rate was extended to all export proceeds.
June 21-October 31, 1950) June 15-October 31, 1951)	Summer tourists were permitted to use the free rate for all their local currency requirements.
January 26, 1952	All exchange receipts except those accruing to companies under special contract were made eligible for the free rate.
May 17, 1952	Companies under special contract were authorized to cover all their local currency requirements at the free rate

Source: IFS, Vol. V, No. 10, (October 1953), p. 112.

1. Decree No. K/3309.
2. Decree No. K/2025.
3. Decree No. 7393.
4. Decree No. 6300.

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3. Decree No. 7393.
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Currently all exchange transactions (except for few government transactions conducted at the par value of US $1 = LL 2.191) are conducted at the free market rates of exchange with broken cross rates between currencies. Though almost all exchange transactions are carried out in the free market, the Office des Changes keeps on publishing the official rates of exchange of eight currencies: these are the French franc, the sterling pound, the Egyptian pound, the Iraqi dinar, the US dollar, the Swiss franc, the Belgian franc, and the Tchechoslovaki crown.

The use of the official exchange rate of the Lebanese pound is nowadays confined to a limited number of governmental operations:

1 - The government receipts in foreign exchange (mainly as royalties from petroleum companies and to a lesser extent consular fees - see Table 3) as well as the spending of foreign exchange (mainly by diplomatic missions) are recorded at the official rate.

TABLE 3

SOME FOREIGN EXCHANGE RECEIPTS

(LL 1000)

	Petroleum Companies	Consular Fees
1948	26	76
1949	-	109
1950	318	131
1951	878	604
1952	5,454	n.a.*
1953	2,159	n.a.
1954	3,490	n.a.

* n.a. = not available.

Source: Bulletin Statistique Trimestriel.

2 - The official rate is used as a basis for computing import duties on merchandises and organizing foreign trade statistics. This practice overvalues imports from Syria and undervalues imports in other currencies, mainly imports in dollars and sterling. This is so because the free exchange rate of the Syrian pound is below the official rate (which is LL 1 = LS 1) while the sterling and dollar free rates are higher than the official rates.

3. The Commissary of the Government to BSL

Another monetary function of the Ministry of Finance - besides the two already described - consists in supervising BSL operations with the government. Article 22 of the Convention of May 29th, 1937, between the Republic of Lebanon and BSL states that the Lebanese Government can delegate a Commissary,[1] to see to it that the provisions of the Convention are strictly observed. This Commissary can control at any time the receipts, the portofolio and the accounting of the Issue Department. He may verify the statements published by BSL concerning the note circulation and cover, and he may inspect the government financial operations with BSL. He cannot, however, mix in the administration or management of BSL banking affairs.

The Convention of 1937 does not give the government any power of control over the volume of money and credit. The

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1. The Commissary of the government to BSL is also a member of the Exchange Stabilization Fund and assists the director-general of the Ministry of Finance in the Contrôle des Changes.

Commissary of the government is not empowered with any authority to direct the monetary policy of BSL. His supervision of the technical issue of notes has no economic significance since he cannot influence the volume, composition and direction of BSL credit operations.

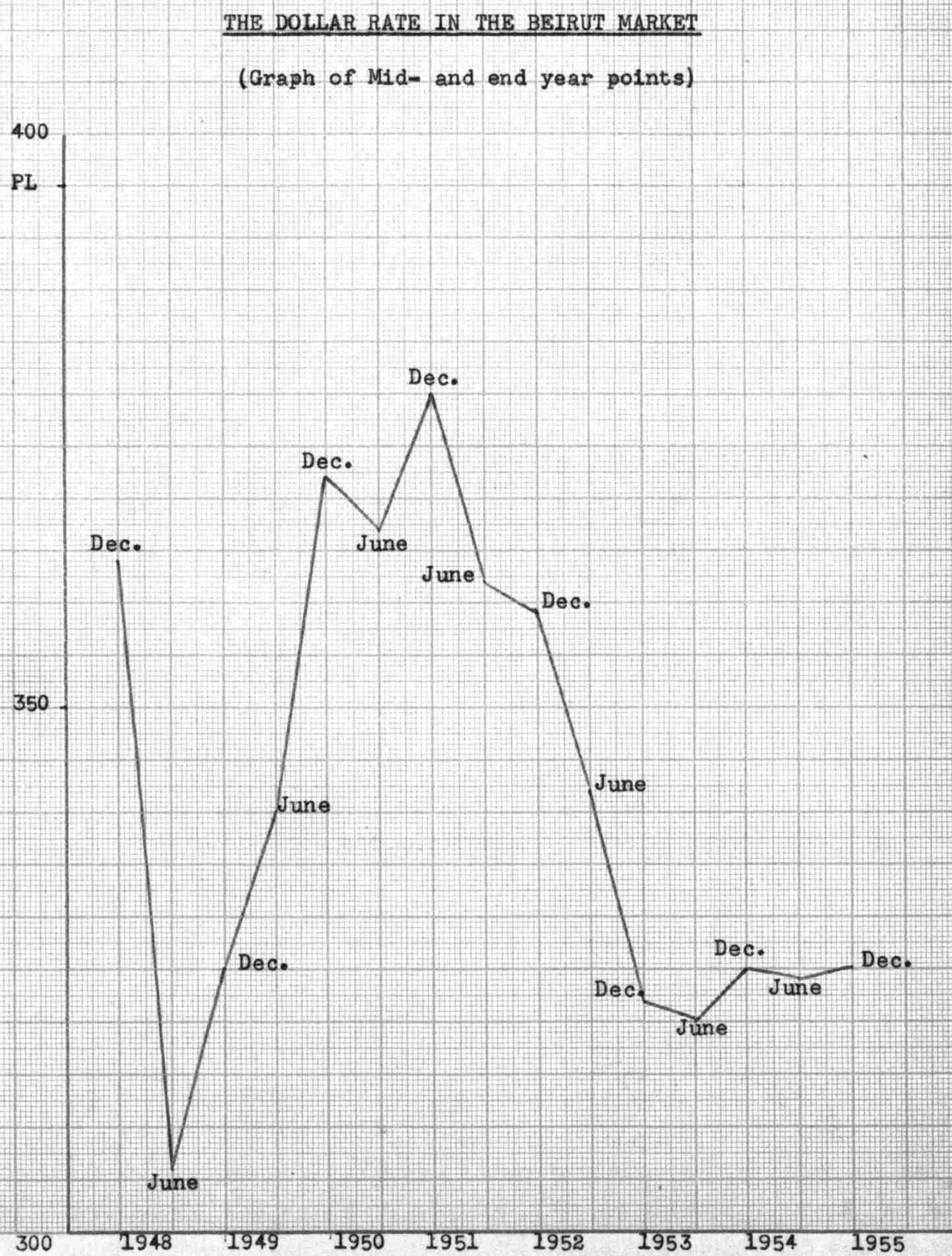
4. The Exchange Stabilization Fund

Besides the issue of divisionary notes and coins, the management of the Office des Changes and the technical inspection of note issue, the Ministry of Finance has an additional function which is taking more and more importance; it is the function of exchange stabilization. Decree No. 8 of October 6th, 1949 establishes an Exchange Stabilization Fund composed as follows:

Minister of Finance	President
Director General of Finance	Members
Controller General of Exchange	Members
Director of the Issue Department	Members
Official Delegated by the Minister of Finance	Members

The original purpose behind the formation of the Fund was to mitigate undue fluctuations in the exchange rate of the Lebanese pound after the devaluations of 1949 and especially since exchange restrictions were abolished in 1948. Although established in 1949, the Fund did not come to action before September 1953. As Table 4 shows, the dollar rate has been

CHART I


THE DOLLAR RATE IN THE BEIRUT MARKET
(Graph of Mid- and end year points)
400
PL
350
300
1948
1949
1950
1951
1952
1953
1954
1955
Dec.
June
Dec.
June
Dec.
June
Dec.
June
Dec.
June
Dec.
June
Dec.
June
Dec.

dropped. The lower dollar rate incited traders to increase their imports since they could buy the same goods at cheaper prices. During the fall of 1953, many merchants became insolvent and then bankrupt as a result of their inability to liquidate their stocks of piled goods, most of which were bought at relatively high exchange rates.[1] The Fund "which feared that further appreciation might impair the country's competitive position"[2] and raise the number of bankruptcies got into the exchange market and bought dollars whenever its rate fell below LL 3.20.

The Fund purchased in the second half of the month of September about $2 million with LL 6,566,187. The procedure followed in this purchase was the following. The Fund had access to government deposits with BSL. It used these deposits for its purchases of dollars. Subsequently, these dollars were put in the note cover against an increase in fiduciary issue. This additional issue of notes was paid back to the current account of the government at BSL thus replenishing government deposits which were used to buy the dollars. Table 5 shows the situation in the note cover before and after the purchase was done.

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1. Supra., Chapter III.

2. United Nations, Economic Development in the Middle East, 1945 to 1954, (New York: 1955), 172.

TABLE 5

NOTE COVER COMPOSITION (1953)

(LL)

	30th September	15th September
Gold	126,688,900	126,688,900
Treasury bonds	42,740,000	47,306,000
"Syrian Notes"	26,753,449	26,753,449
Other elements	251,464	251,651
Foreign Exchange	6,566,187	-
	203,000,000	201,000,000

Source: L'Orient, (October 5th, 1953), 2.

The Fund's purpose in using these dollar purchases as part of the note cover was to increase note circulation and "attenuate the fiduciary deflation."[1] Its intention to do so was, however, thwarted by BSL. The latter had called early in the recession of 1953 a large amount of its outstanding loans,[2] thus bringing about excess funds at its disposal in the Banking Department. BSL used these additional reserves by transferring some of the note cover earning assets - namely Treasury bonds - to the Banking Department. This transfer had the effect of cutting down note circulation. In fact, the figures of Table 5 show that while foreign exchange in the note cover increased by LL 6,566,187 (as the result of the Fund's action) from September 15th to September 30th,

1. Ibid.

2. Supra., Chapter IV.

Treasury bonds declined by LL 4,566,000. The net increase in note circulation was only LL 2 million instead of LL 6.5 million.

The Fund's intervention in the open market may have large or small repercussions on the domestic credit system. If it confines itself strictly to an exchange of government deposits for foreign exchange or gold, its intervention in the exchange market will have no effect on the primary reserves of banks. If its exchange dealings are with banks, its activities will cause a change in secondary bank reserves and in deposits, and a change in reserve ratios. Thus the Fund's purchase of dollars from commercial banks (as was the case in 1953) will increase the latter's reserves in Lebanese pounds. With these reserves, the banking system can create new deposits in Lebanese money and thus increase the volume of monetary supply.[1]

5. Official Reserves

The government publishes global figures on official reserves in the International Financial Statistics. Table 6 shows their outstanding amounts at the end of the last few years.

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1. See League of Nations, International Currency Experience, (1944), 142.

TABLE 6

OFFICIAL RESERVES

($ Million)

End of	1948	1949	1950	1951	1952	1953	1954	1955
Gold	1.7	19.7	20.0	26.3	30.6	34.7	63.1	73.7
Foreign Exchange	72.4	28.0*	18.5	13.2	11.6	20.5	13.0	12.8
French Francs	70.0	26.9*	16.1	12.0	10.9	12.8	11.6	10.1
TOTAL	74.1	40.7	38.5	39.5	42.2	55.2	76.1	86.5

* September

Source: IFS, IX, 2, (February 1956), 143.

Table 6 shows that official reserves have been changing in composition as well as in amount. At the beginning of the year, 1948, Lebanon had about FF 13 billion in French francs and $1.7 million in gold assets - the total makes about $ 112 million.[1] After the successive French franc devaluations of 1948, the value of Lebanon's official reserves - which were mainly composed of French francs - fell to $74.1 million. Their value was further cut as a result of the franc and sterling devaluations of September 1949 vis-à-vis the dollar. At the end of 1949, official reserves were only $ 38.5 million.

As shown by Table 6, the composition of the official reserves has been considerably changing. French francs which constituted about 90% of total reserves at the end of 1948 were only about 10% of the total at the end of 1955. On the other hand gold reserves have been steadily rising. They were $ 1.7 million at the end of 1948, they became $ 73.7 million

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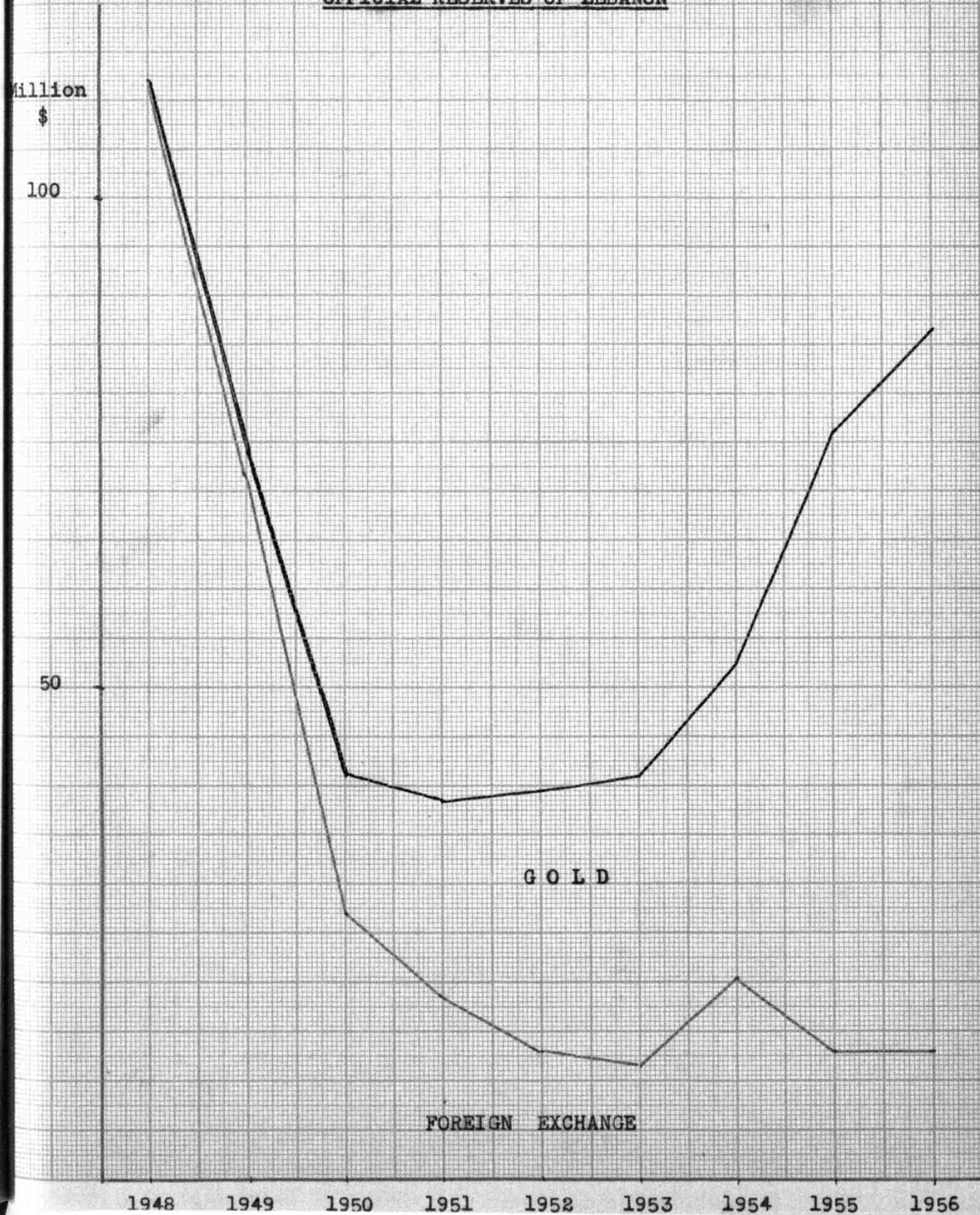
1. The official parity of the French franc was then FF1 = US ¢ 0.839,583.

CHART II

OFFICIAL RESERVES OF LEBANON



at the end of 1955. The rise in gold assets was partly due to a conversion of Lebanon French francs into gold and partly to purchases of dollars in the local market,[1] later converted into gold.

Table 7 gives a detailed account of government official holdings at the end of 1955. These holdings are divided into three parts: the Office des Changes, the Exchange Stabilization Fund and the Note Cover. French francs constitute the largest portion of the Office des Changes holdings. They represent what the French Government owes Lebanon in virtue of the 1948 Monetary Agreement; and almost all these francs are not yet available. The two other largest groups of foreign exchange are sterling pounds (636 thousands) and American dollars (408 thousands) which mainly constitute the royalties paid by petroleum companies.

The Exchange Stabilization Fund holdings are almost all in dollars. The Fund's assets, about $ 0.5 million, are very little. However, it should be noted that the Fund has access to government deposits with BSL and the appropriateness and adequacy of its assets for intervention in the market cannot be therefore measured in terms of the figures reported in Table 7 under the holdings of the Exchange Stabilization Fund.

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1. The increase in official reserves (and in particular the increase in gold) are the result of favourable balance of payments.

TABLE 7

LEBANON OFFICIAL HOLDINGS IN FOREIGN EXCHANGE AND GOLD ON THE 31ST OF DECEMBER, 1955

In the Exchange Office	
French francs: "disponibles"	198,694,321
"indisponibles"	3,327,129,388
	3,525,823,709
Sterling pound	636,055/19/1
Jordanian dinar	16,288.834
Egyptien pound	2,133.205
Iraqi dinar	45.049
American dollar	408,029
Swiss franc	1,010.50
Belgium franc	1,048.48
In the Exchange Stabilization Fund	
American dollar	474,091.07
Other foreign exchange (in $)	2,700
In the Note Cover	
Once Troy of pure gold	2,106,171.5

Source: Privately secured from Mr. Talha Yaffi, (Member of the Planning and Development Board).

The total value of official holdings did not exceed $ 86.53 million (official price) at the end of 1955. In addition, Lebanon's private dollar holdings in the United States as reported by IFS, were about $ 20 million at the end of 1955. Figures of other reserves in sterling and other European currencies are not available; their value is believed not to be very significant.[1] Lebanon holdings (private and

1. See Economic Research Institute, op.cit., 61.

public) in international reserves amounted at the end of 1955 to about $110 million or 50% of the value of our imports in 1955.[1]

II. The Monetary Authorities

It would be of interest to find out what are the official bodies which may influence the conduct of monetary events. These bodies may be considered to consist of three groups: the Parliamentary Financial Committee, the Planning and Development Board and the Minister of Finance. In the following pages, we attempt to determine the role of each in influencing the monetary policy of Lebanon.

1. The Parliamentary Financial Committee[2]

The Parliamentary Financial Committee is composed of eleven deputies elected by the members of Parliament. It is supposed to study all financial and budgetary matters submitted to Parliament. The Financial Committee has an advisory status. It cannot decide on the enactment of a project.

The Financial Committee has suggested in the past that the formation of a national central bank is desirable.[3]

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1. The value of Lebanon imports in 1955 amounted to about $ 210 million (adjusted figures).

2. Law of September 11th, 1953 concerning the by-laws of the Lebanese Parliament, Articles 18-37.

3. The report of the Parliamentary Financial Committee on the Budget Bill of 1953 recommends the formation of a National Central Bank "to regulate and encourage credit operations" and to supervise and help banks. <u>Al Majles Al Nėyabėh</u>, (September 24th, 1953), 410-411.

However, the committee considers now that for the time being and until the concession of BSL ends, the existing conditions should go on.[1]

2. <u>The Planning and Development Board</u>

The Planning and Development Board (hereafter referred to as the PDE) has been established on the 15th of April 1953 by the legislative decree No. 32. This governmental body is supposed to prepare statistics for all the resources of the country, and primarily to establish a general plan of economic development as well as detailed programmes for developing all sectors of the economy. The PDE does not have, however, the authority to implement any of the projects it recommends; it is believed that its power in influencing government policy is slight and many of its recommendations are not seriously considered.

The only comprehensive work on monetary problems in Lebanon prepared at the request of the PDE is the Keesing report of May 10th, 1955. The PDE has, in compliance with Keesing report, prepared a draft law for the creation of a statistical center in the Ministry of Finance for the purpose of collecting financial and banking statistics in Lebanon.[2] This, it is hoped, will be a nucleus for a research department in the Ministry of Finance which will eventually be in a

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1. <u>Al Majles Al Néyabeh</u>, (January 24th, 1956), 680.

2. See Chapter VI.

position to take over from BSL the direction of monetary and credit policy.

3. The Minister of Finance

It has been observed in the course of our study that the Ministry of Finance does not have any effective control over the monetary and credit system of Lebanon and the regulation of the latter is deferred to BSL. It seems, however, that a new tradition is building up whereby the Minister of Finance is having direct contacts with bankers. These meetings are becoming periodical and thus enable the Minister to be constantly aware of bankers' opinions. The Minister of Finance has come also to advise bankers on the credit policy they ought to follow.

III. Objectives of Monetary Policy

The monetary authorities in Lebanon still believe that a free economic policy is most advantageous to the well being of Lebanon. It is undoubted that the Lebanese economy has been considerably profiting from the absence of restrictions on private initiative, as a large portion of its national income accrues from the services of intermediaries (traders and bankers) in the international movement of goods and capitals. In the present atmosphere of freedom, individuals are in a position to follow the most profitable lines of business - away from government interference.

This freedom and the absence of government control and regulations is most conspicuous in the money and banking sector of the economy. The existing monetary legislation - mainly the Convention of 1937 with BSL - does not enable the Lebanese Government to know the credit positions of banks and to direct accordingly the operations of the latter in the interest of the public.

In this section, the objectives of the present Lebanese monetary policy are compared to those generally considered "desirable" by modern states. To the latter, the objectives of monetary policy are five: safety and flexibility of the money supply, liquidity and solvency of the banking system, convertibility, stability of the economy and last but not least economic development.[1] Each of these objectives is discussed hereafter.

1. Safety and Flexibility of the Money Supply

The objective of safety and flexibility of the volume of money is one of the most important goals of monetary policy. The volume of money includes both currency in circulation and demand deposits with banks.

The safety of the note circulation is believed to be assured by the Monetary Law of May 24th, 1949. The latter

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1. See Sa'id Himadeh, "Monetary Policy in Lebanon", in Al Majmu'ah Al Iktisadeyah Al Sanaweyah, Aleppo Chamber of Commerce, (Al Dad Press, Aleppo: 1955), 199-206.

provides for a minimum of 50% of the note circulation cover in gold and foreign exchange, the remaining of the cover can be government obligations and trade bills - the latter not to exceed 15% of the total note cover.[1] The provisions of the Monetary Law of 1949 are considered by the Public Authorities to inspire great confidence in the Lebanese currency as they set a limit on the ability of BSL Issue Department to issue notes. The policy of the government has been to increase the gold cover to prove the strength of the Lebanese currency.[2]

Demand deposits which constitute over half of the money supply have no similar provisions. Banks assets are not subject to any safety requirements and government inspection is completely absent.

The Monetary Law of 1949, though it provided for some security in the note issue, did not give sufficient flexibility to the composition of the note cover and consequently to the volume of note circulation. The law is too exacting concerning the conditions of eligibility of assets to form part of the note cover. It also does not make possible the use of agricultural or industrial credit instruments as part of the note

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1. Refer to Chapter I, part III.

2. See:- President Shamoun's Declaration in <u>Le Commerce du Levant</u> (August 10th, 1955), 3. - Lebanese Government, Ministry of Finance, <u>Fathlakat</u> (budget bill of the year 1956), Dar <u>el Funun</u> Press. The reason for preferring gold to foreign exchange is due to the unfortunate experience of the Lebanese pound when it was backed by French francs and was susceptible to the recurrent fluctuations of the latter. Gold although unproductive has the advantage of being generally stable in value.

cover. This use is justified for a country which does not have developed money and capital markets and which wants to promote development or counteract cyclical fluctuations.

Although inadequate, the flexibility in the note issue is however not completely lacking. It may be partly assured through the medium of BSL. The latter is in a position to shift part of its earning assets from the Banking Department to the Issue Department against an additional issue of notes to be eventually used by BSL Banking Department. This flexibility in the note issue does not follow general central banking rules. In other words, BSL when transferring funds between the two departments is solely motivated by its own interests.[1]

The flexibility of bank deposits is also not properly assured, mainly because of the absence of a central bank. Thus when commercial banks are in need of liquid funds to meet a rise in business activity, they are not sure of BSL assistance. Moreover, BSL cannot affect the cash reserves of banks in order to increase or decrease the total volume of bank credit. This situation has undoubtedly the effect of reducing the flexibility in the volume of demand deposits whose creation depends on the amount of reserves.

2. <u>Liquidity and Solvency of the Banking System</u>

We found in Chapter II that there is no legislation in Lebanon to protect the solvency and liquidity of commercial

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1. This point was discussed in Chapter IV.

banks. The published banking statistics do not permit the analysis of the evolution of banking conditions and of the present situation of banking establishments. However, we realize that the liquidity and safety of the Lebanese banking system is affected by three factors: (1) commercial banks are not sure of the type of financial help they may get from BSL; (2) the Beirut money market is insufficiently organized to permit banks to rely on it in case of emergency, and (3) the increased competition of banks leads a few banks to resort to unconventional banking practices.[1]

3. <u>Stability in the Exchange Rates</u>

Lebanon has promised, on joining the International Monetary Fund, to observe the provisions of Article IV, sections 3 and 4 of the Articles of Agreement.[2] These provisions have not so far, however, been strictly adhered to, and Lebanon has multiple currency practices; thus a few government transactions are carried out at the official rate while all other transactions

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1. For further details refer to Chapter II.

2. Section 3 provides that "The maximum and the minimum rates for exchange transactions between the currencies of members taking place within their territories shall not differ from parity..... by more than one percent in case of spot exchange transactions." Section 4 requests each member to "undertake to collaborate with the Fund to promote exchange stability to maintain orderly exchange arrangements with other members, and to avoid the competitive exchange alterations."

are made in the free market. Moreover, the free market rate is a fluctuating rate. The Exchange Stabilization Fund has recently prevented any fall of the dollar below LL 3.20, but no attempt is made to prevent its rise above this point.[1] The reason is that the government is not confident of what new parity to adopt and defend. There is, first, a fear that if the government uses its gold reserves, the subsequent reduction in the gold note cover may have unfavourable psychological repercussions. Another reason deterring the Lebanese Government from stabilizing the Lebanese currency is the fear of a sudden and large withdrawal of funds from Lebanon.

To obviate the first objection, the monetary authorities should keep, say 50% only of the note cover in gold or foreign exchange. Any excess over this percentage will then be put in a special account to serve as buffer in cases of adverse balance of payments. As far as the fear of large withdrawals of foreign capitals is concerned, it may be considered unjustifiable as long as there is free convertibility of the Lebanese pound and as long as economic and political stability prevail.

Table 8 shows that the volume of foreign exchange deposits is considerable (over LL 70 million at the end of

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1. It is reported that the annual purchases of dollars by the Fund amount to about $2.1 million. Al Majles Al Niyabeh, (December 22nd, 1955), 476.

TABLE 8

PRIVATE DEPOSITS IN FOREIGN EXCHANGE

(LL 1000)*

End of	1954 Demand	1954 Time	1955 Demand	1955 Time
Jan.	45,192	6,651	47,277	5,819
Feb.	51,598	6,413	49,184	8,690
Mar.	52,071	5,805	50,300	8,969
Apr.	52,594	2,637	45,398	9,218
May	48,832	8,059	47,314	2,425
June	46,360	6,269	48,559	2,380
July	46,446	5,542	48,428	2,629
Aug.	42,131	7,358	47,804	2,731
Sep.	44,905	7,593	52,565	2,680
Oct.	42,500	7,583	56,412	9,698
Nov.	40,105	6,895	60,751	9,260
Dec.	47,452	6,570	58,516	12,661

* Deposits are converted at the free exchange rate of the LL.

Source: Privately secured from Mr. Talha Yaffi, (Member of the Planning and Development Board).

1955). Their amount may vary substantially from one month to the other. It may be argued that the current exchange rate of the Lebanese pound, viz. $1 = LL 3.23, is undervalued. The reason being that the equilibrium (or even surplus) we have in our balance of payments at this rate may be due to an influx of "equilibrating" short term balances (as Table 8 suggests), mainly from Arab countries seeking refuge and security. If at any time these funds leave the country - the existing rate may prove to be inadequate.

4. <u>Economic Stability</u>

An important objective of monetary policy is that aiming at counteracting cyclical fluctuations, internal and external. Cyclical fluctuations due to outside factors are of particular importance since the Lebanese economy is an open economy with about one third of its national income arising from the foreign trade sector.[1] The recessions of 1949 and 1953 and the boom of 1950-1951 (at the outbreak of hostilities in Korea) show the sensitivity of Lebanon to changes in international business activity. The Lebanese Government does not deliberately attempt to iron out fluctuations in the business cycle although the action of the Exchange Stabilization Fund late in 1953 helped to mitigate the harmful effects of the recession.

Moreover, there is no fiscal policy aiming at counteracting business cycle fluctuations. The relatively large

TABLE 9

BUDGETARY SURPLUSES

Year	LL
1948	23,425,326
1949	25,590,774
1950	17,287,296
1951	32,997,858
1952	58,904,615
1953	66,208,758
1954	46,261,547

Source: Lebanese Government, Ministry of Finance, Fathlakat - (Budget Bill of 1956 -, (Dar El Funun Press 1955), pp. 4-16.

1. Paul Klat, " Le Commerce et ses Incidences Sociales", in L'Economie Libanaise, op.cit., 79-104.

budgetary surplus of 1949 (LL 25.6 million) was partially responsible for the deflation during that year. Note circulation declined from LL 185 at the end of December 1948 to LL 168 at the end of December 1949. The same happened in 1953. The large budget surplus of that year - namely LL 66.2 million - led to a decline of note circulation from LL 203 million at the end of October 1952 to LL 196 at the end of July 1953. Were it not for the intervention of the Exchange Stabilization Fund, the decline would have been greater.

On the other hand, it has been found that BSL which has some central banking functions has not followed a counter-cyclical policy. The reason is that BSL is by its statutes primarily a commercial bank and is motivated by the maximization of profit.[1]

5. Economic Development

The Lebanese Government is on the threshold of embarking on a large programme of economic development estimated to cost over a billion in the next 20 years.[2] Although it is probable that this figure will prove fictitious and is being surely used as a means of political propaganda, large spendings on the part of the government are likely to have inflationary tendencies. Thus assume that the government intends to use

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1. See chapter IV.

2. Al Majles Al Neyabeh, (January, 24th, 1956), 681.

its deposits with BSL (which amounted to about LL 145 million at the end of 1955), BSL may be then compelled to issue additional notes by shifting eligible assets from its Banking Department to the Issue Department. This action will be motivated by the loss of government's deposits on which it relied for its ordinary banking operations. This may create pressure on prices and costs. Moreover, any economic development necessitates the use of foreign exchange for the purchase of capital equipment. Increased imports may drain up the international reserves of the country, and these reserves instead of being used for the import of capital goods - ought primarily to serve filling in a temporary deficit in Lebanon's balance of payments.

In general, it is of primary importance for a country embarking on economic development to avoid procedures of finance susceptible to be inflationary. It should be borne in mind that "inflation does not make any additional resources available to an economy; in fact, by the very price and profit distortions it creates, it usually diverts resources into less essential and less useful activities. Inflation has the twofold disadvantage of undermining the community's desire to save as well as making it less likely that savings will be channelled into the most productive purposes. For these reasons, the more limited are the resources available to a country for investment,[1] the more costly will be the wasteful effects of inflation."

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1. IBRD Mission, The Economy of Turkey, (The Johns Hopkins Press, New York: 1951), 207.

It can be concluded from the above exposé that the monetary policy Lebanon follows at present does not satisfy the generally accepted objectives of monetary policy. Moreover, the existing Lebanese monetary institutions are inadequate to implement these objectives effectively, mainly because they are not well equipped with the necessary instruments of action. To carry out monetary policy successfully, there are some basic requirements to secure. These requirements consist in building up banking statistics, enacting central banking and commercial banking legislation and organizing the money and capital markets. This situation calls therefore for a reform in the present monetary system of Lebanon affecting both monetary institutions and goals of monetary policy.

CHAPTER VI

MONETARY REFORM

In the preceding chapters, the conditions which govern the present monetary and banking system were discussed, and it was found that there are several defects which impede its ability "to promote stability in the economy at high levels of production and employment".[1] These defects pertain to the existing monetary institutions. They can be best divided - for the sake of analysis - into those related to the banking system and those related to central banking functions.

As far as the banking system is concerned, it was found that the following basic defects hinder its harmonious and efficient working: (a) a high degree of individualism among bankers; (b) the lack of government control; (c) the absence of general banking legislation to protect depositors and safeguard the solvency and liquidity of banks, and most important; (d) the absence of a central banking institution.

BSL is not a central bank although it performs some of the functions of a central bank. Past experience has shown that the position and role of BSL do not satisfy the economic requirements of Lebanon - and in particular in respect to the monetary system. Some of the chief objections to BSL are:
(a) BSL in its dual role as commercial bank and as the government

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1. Peterson, M.J., op.cit., 114.

bank is in a position to compete unfairly with other commercial banks - and in particular with the Lebanese banks; (b) BSL confines its activities to short term mercantile credit and does not give due consideration to the development of industry and agriculture; (c) BSL is not subject to governmental control in its banking operations; (d) the BSL policy is primarily motivated by the welfare of its own stockholders rather than the public welfare, and finally (e) BSL is a foreign bank, a condition which may bias its policy to the advantage of foreign institutions or individuals.

The deficiencies in the Lebanese monetary system call for a revision of the existing monetary legislation - namely the 1937 Convention of BSL - and the enactment of a general banking legislation to fill the vacuum in the field of banking. The need for monetary reform has been, however, questioned by a number of persons, especially as this reform will affect the position of BSL in the Lebanese monetary system.

Some people question the need of having a central bank. They contend that the type of central banking functions performed by BSL is satisfactory and no attempt should be made to create an institution which is not needed. They argue that although the Convention with BSL dates from 1924 and was not significantly amended afterwards, the management of BSL has been wise enough to adapt its activities to the new conditions. They point out with pride to the stable position of the Lebanese pound and the soundness of the banking system. They conclude that BSL is working successfully and that consequently the State "should not be interested in banking and credit affairs."[1] This type of argument appeals to government officials who are not willing to meddle in money and credit operations.

Another group defends BSL on the basis of the inability of the government to replace it. And although they believe that a central bank - at least in theory - might be beneficial to Lebanon, its efficiency would be considerably reduced if it were to be operated by the State. The Lebanese Government is so inefficient, and the Ministry of Finance so unfamiliar with the banking conditions of the country, that if we were to entrust the management of a central bank to the

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1. Joseph Oughourlian, "Problèmes Economiques et Financiers" in Les Conférences du Cénacle, Ed. Michel Asmar, VIII, 3, (February 15th, 1954), 110.

   In the same article, Mr. Oughourlian says:

   "Nous disons qu'une bonne monnaie doit être libre et indépendante. Qu'est-ce que cela veut dire? Cela veut dire deux choses
   - Elle doit être d'abord nationale: nous l'avons vu, "la notion de monnaie est soudée à la notion de patrie". Son sort doit être lié dans une inter-dépendance exclusive à celle de l'économie nationale...
   - La loi d'une bonne monnaie est qu'elle soit libre vis-à-vis de l'Etat".

   Ibid., 103.

   In other words, Mr. Oughourlian advocates - and truly so - the independence of a currency vis-a-vis other nations as well as the State. And although he did not want to discredit BSL but rather to justify its existence, his very argument proves the inconsistency of having a foreign and privately owned institution, namely BSL, to manage an "independent national currency - the Lebanese pound".

Ministry of Finance it would be, they claim, disastrous.[1] They cite as an illustration of government inefficiency the rise in the prices of electricity after the nationalization of the Beirut Electricity Company.[2]

A third group believes that for the time being and until the concession of BSL expires on April 1st, 1964, there is no need to consider the establishment of a central bank although the Convention of 1937 does not prevent the government from taking steps in this direction.

Analysis of the above contentions shows that three of the premises are true. First, that the financial situation in Lebanon is relatively good. This is partly due, especially with regard to the issue of currency, to the efficient management of BSL. Secondly, that the Lebanese Government is inefficient. This should make us wary of entrusting an additional function to the government when it is unlikely that it could undertake it adequately. Third, that we should not break the concession of BSL. It is not in the tradition of Lebanon to break contracts; anyway such a policy may not serve the interest of the nation in the long run.

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1. Cf. Dr. Albert Badre lecture on "The Economic Policy of Lebanon" in Les Conférences du Cénacle, (April 23rd, 1956).

2. Before sequestration, the Beirut Electricity Company refused the offer to buy electricity from the Bared company at PL 4 the kw. After sequestration it accepted to pay as much as PL 6.25 the kw. to the Bared. Debbané, F., op. cit., 128-129.

This does not mean however, that there is no need for a central bank; moreover, nothing should prevent the government from taking steps to equip itself so that in 1964 (at the expiration of the BSL Convention) it will be in a position to operate such a bank. To those who claim that there is no need for monetary reform, it should be told that:

First, no country which claims to be independent and which is embarking on a large development programme can afford to leave the all important function of a central bank and the monetary weapons which go with central banking in the hands of a private institution which is primarily led by profit motives. Besides, BSL is a foreign institution. It is of the utmost importance that the State must have in its own hands (or in the hands of nationals) the weapons of monetary policy; for as long as Lebanon does not have these instruments of monetary policy and does not know how to manipulate them, it will stay under the financial mandate of whoever holds these instruments.

Secondly, in modern countries a central banking institution does not only control note issue but also affects economic activity by altering the credit situation to promote economic development in an atmosphere of monetary stability. If the Lebanese Government cannot undertake this responsibility, it will have failed in its economic duty.

Thirdly, BSL's objective of profit making - as was shown earlier - is incompatible with its central banking functions.

Central banks have a great liquidity since they can use government deposits and have access to the issue department; consequently, they can compete unfairly with other banks. On these grounds, most central banks in the world are increasingly denied the right to deal with individuals. In Lebanon BSL has a very small capital in comparison to the extent of its operations. It has, however, access to government deposits and to the Issue Department.[1] Why BSL should be given this tremendous advantage over other institutions (and in particular the wholly Lebanese banks)?

Owing to the defects of the present monetary system, it is deemed necessary that the government prepares for the creation of a national central bank. With this in view, the Lebanese Government asked for the expert advice of the International Monetary Fund. The Fund consequently delegated Mr. Keesing to study the possibility of drafting a general banking legislation for Lebanon. In his report of June 1955, Mr. Keesing recommended that the government should undertake monetary reform in four stages: the collection of banking and monetary statistics and the interpretation of these statistics; the enactment of general banking legislation; the formation of a Money and Credit Board; and the establishment of a Central Bank.

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1. The capital of BSL is FF 300 million, or about LL 2.5 million while its assets were about LL 66.4 million at the end of 1954.

Banking statistics are undoubtedly most important for the formulation of monetary policy. They permit the monetary authorities to be constantly aware of the monetary and banking conditions of the economy and to enlighten them prior to the enacting of comprehensive banking statistics. In compliance with Mr. Keesing's report, the Planning and Development Board has prepared a draft bill providing for the collection of banking statistics, as the first step in monetary reform.[1] The bill recommends the establishment of a banking statistics department in the Ministry of Finance with the object of collecting yearly and periodical statistics. The yearly statistics consist of annual financial statements of commercial banks regarding their operations in Lebanon, (i.e. annual balance sheets and profit and loss statements). The periodical statistics consist of detailed accounts on the assets and liabilities of banks, their holdings in foreign exchange as well as other necessary information. As the preparation of these statements is highly technical and exacting, the bill recommends calling upon a financial expert to help in their preparation.

Certain local economists believe that the formation of a Money and Credit Board need not await the collection of banking statistics and the enactment of banking legislation. They suggest that, in the meantime, the Board should:

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1. Draft bill of March 8th, 1956.

First, study the financial and monetary conditions of the country.

Second, advise the Minister of Finance on a general monetary policy compatible with the economic requirements of the country.

Third, make recommendations to the Minister of Finance concerning the ordinary budget and the present fiscal system in order to bring them more in harmony with the new monetary policy.

Fourth, draft the necessary legislation for the creation of a national central bank.

Fifth, draft a general banking legislation which would delimit commercial banking activities and impose safety requirements.

Sixth, train the employees who will be eventually responsible for the management of the Central Bank.

Seventh, supervise the Issue Department of BSL and all other central banking activities of the latter until the national central bank is created.

Eighth, supervise the implementation of the banking law.

The author endorses this latter view, i.e. that the establishment of a Money and Credit Board need not wait until banking statistics are collected and general banking legislation enacted. Mr. Keesing was apparently afraid that the early formation of the Board might make the latter adopt policies based on inaccurate data. This danger might be reduced if the Board refrains from embarking on a definite monetary policy until it has adequate tools of action. A proper selection of members may further reduce this danger.

It is worthwhile noting in this respect that it is of the utmost importance to assure a measure of autonomy to the Board. Although the monetary function is of public interest, it is not necessary for a number of reasons, that it should be directly entrusted to the State: First, "independence of the monetary authorities vis-à-vis the political power tends to guarantee the objectivity of diagnostics that they may be led to formulate on the economic situation of the country, as well as the disinterestedness in the initiatives they take in view of influencing this situation".[1] Second, the activities of a Central Bank call for some specialization which is not present in the political and administrative departments of the State. Third, the autonomy of a Central Bank permits some flexibility and the adaptation of the Bank's operations to a changing economy.[2]

The independence of the monetary authorities vis-à-vis the public authorities cannot, however, be absolute as the latter have the right of amending the law. It may be found advisable to retain a certain measure of governmental control

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1. Republique Syrienne, Statut Organique... Exposé de Motifs, op.cit., 4.

over the policy and actions of the Central Bank, while leaving the latter, with a great deal of freedom. A friendly and honest cooperation between the monetary authorities and the public authorities is always advantageous in so far as the latter can determine the budget, fiscal, commercial and other policies relating to the economic life of the nation. All these policies are interlinked and dependent upon each other, and cooperation between the two authorities is essential to assure the successful functioning of the economy.

In conclusion, it should be stated that the successful working of the Money and Credit Board cannot be assured by means of legislation only, "it is a product of years of experience and of growth of sound conventions". Efficient central banking management depends upon the persons more than on "any legal formula".[1] In general, it can be said that "central banking is not a science; nor is it an art, rather it is a craft. Science seeks facts and basic laws; art seeks beauty and perfection. Central banking tries to produce a serviceable commodity-economic stability."[2]

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1. Sen, S.N., <u>op.cit.</u>, 241-242.

2. E.A. Goldenwiser, <u>American Monetary Policy</u>, (McGraw-Hill, N.Y., 1951), 1.

APPENDIX I

COMPOSITION OF THE NOTE COVER

End of	Gold	%	Foreign Exchange	%	Total	% of Gov't Oblig.	Differences in Exchange Rates Covered by the State	Advances for Exchange of Syrian Notes	Other Elements in L.L.	Notes in Circulation (Million)
1948 Jan.	5,087,486	2	157,162,514	97	162,250,000	1			250,000	162.5
Feb.	5,087,486	2	189,662,514	92	194,750,000	6			10,250,000	205
March	5,087,486	2	143,662,514	73	148,750,000	25		49,000,000	250,000	198
April	5,087,486	2	135,662,514	71	140,750,000	27		49,000,000	250,000	190
May	5,087,486	2	137,162,514	72	142,250,000	26		49,000,000	250,000	191.5
June	5,087,486	2	136,662,514	73	141,750,000	25		44,500,000	250,000	186.5
July	5,087,486	2	133,662,514	73	138,750,000	25		44,500,000	250,000	183.5
Aug.	5,087,486	2	131,162,514	72	136,250,000	26		44,500,000	250,000	181
Sept.	5,087,486	2	130,162,514	72	135,250,000	26		44,500,000	250,000	180
Oct.	5,087,486	2	131,073,432	72	136,160,918	26		44,589,082	250,000	181
Nov.	5,087,486	2	125,573,432	69	130,660,918	29		44,589,082	6,250,000	181.5
Dec.	5,087,486	2	123,573,432	67	128,660,918	31		44,589,082	11,750,000	185
1949 Jan.	5,087,486	2	122,688,018.5	67	127,775,504.5	31		44,589,082	11,635,413.5	184
Feb.	5,087,486	2	115,194,253	63	120,281,739	35		44,589,082	17,629,179	182.5
March	5,087,486	2	110,694,253	61	115,781,739	37		44,589,082	21,629,179	182
April	5,087,486	2	106,389,412	59	111,476,898	39		44,589,082	22,934,020	179
May	5,087,486	2	97,889,412	57	102,976,898	41		44,589,082	24,434,020	172
June	5,087,486	2	90,389,412	54	95,476,898	44		44,589,082	27,934,020	168
July	12,963,126	8	80,428,821	48	93,391,941	44		44,589,082	29,018,971	167
Aug.	20,086,069	12	75,304,791	46	95,390,860	42		44,589,082	24,020,058	164
Sept.	29,912,493	18	43,826,150	27	73,738,648	55		44,589,082	45,672,275	164
Oct.	31,259,700	19	40,826,150	25	72,085,850	56		44,589,082	47,325,068	164
Nov.	36,101,047	22	39,826,150	24	75,927,197	54		44,589,082	43,983,721	164.5
Dec.	42,496,027	25	38,576,150	23	81,072,177	52		44,589,082	42,338,741	168
1950 Jan.	42,496,027	25	35,076,150	21	77,572,177	54		44,589,082	45,838,741	168
Feb.	50,360,305	30	31,509,456	18	81,869,761	52		44,589,082	44,041,157	170.5
March	55,342,024	31	31,509,456	18	86,851,580	51		44,589,082	45,559,438	177
April	70,344,811	40	28,009,456	16	98,354,267	44		44,589,082	35,056,651	178
May	70,344,811	40	28,009,456	16	98,354,267	44		44,589,082	35,056,651	178
June	70,344,811	39	24,555,812	14	94,900,623	47		44,589,082	40,510,295	180
July	70,344,811	39	24,555,812	13	94,900,623	48		44,589,082	43,510,295	183
Aug.	70,344,811	37	23,305,812	12	93,650,623	51		44,589,082	50,760,295	189
Sept.	70,344,811	36	23,305,812	12	93,650,623	52		44,589,082	54,760,295	193
Oct.	70,344,811	36	23,305,812	12	93,650,623	52		44,589,082	54,760,295	193
Nov.	70,344,811	37	23,305,812	12	93,650,623	51	53,510,000	44,589,082	250,295	192
Dec.	70,344,811	36	27,655,189	14	98,000,000	50	53,161,000	44,589,082	250,000	196
1951 Jan.	72,746,631	37	26,753,369	13	99,500,000	50	54,661,000	44,589,082	250,000	199
Feb.	72,746,631	36	28,153,369	14	101,500,000	50	56,661,000	44,589,082	250,000	203
March	72,746,631	35	31,753,369	15	104,500,000	50	56,661,000	44,589,082	3,250,000	209
April	78,350,961	37	26,149,039	13	104,500,000	50	56,661,000	44,589,000	3,250,000	209
May	80,323,446	38	25,176,554	12	105,500,000	50	56,661,000	44,589,000	4,250,000	211
June	81,329,146	38	24,170,854	12	105,500,000	50	56,661,000	44,589,000	4,250,000	211
July	81,329,146	39	23,670,854	11	105,500,000	50	56,661,000	44,589,000	3,750,000	210
Aug.	89,291,727	42	15,708,273	8	105,571,403	50	56,661,000	44,589,000	3,750,000	210
Sept.	92,991,799	44	13,279,604	6	105,271,403	50	56,661,000	44,589,000	2,478,597	210
Oct.	92,991,799	44	13,279,604	6	105,271,403	50	56,661,000	44,589,000	3,478,597	211
Nov.	92,991,799	45	13,279,604	6	105,271,403	49	56,661,000	44,589,000	478,597	208
Dec.	92,991,799	45	13,279,604	6	105,271,403	49	55,208,000	44,589,000	1,931,597	208
1952 Jan.	96,348,942	46	9,765,137	5	106,114,079	49	55,208,000	44,589,000	2,088,921	208
Feb.	96,348,942	46	9,765,137	5	106,114,079	49	55,208,000	44,589,000	5,088,921	211
March	96,348,942	49	9,765,137	5	106,114,079	46	46,008,000	44,589,000	288,921	197
April	96,777,803	49	7,260,441	4	104,038,244	47	48,080,000	44,589,000	292,756	197
May	101,846,093	52	939,803	1	102,785,896	47	47,208,000	44,589,000	417,104	195
June	101,846,093	52			101,846,093	48	48,308,000	44,589,000	256,907	195
July	101,846,093	52			101,846,093	48	49,308,000	44,589,000	256,907	196
Aug.	101,846,093	51			101,846,093	49	53,308,000	44,589,000	256,907	200
Sept.	101,846,093	51			101,846,093	49	54,308,000	44,589,000	256,907	201
Oct.	101,846,093	50			101,846,093	50	55,208,000	44,589,000	1,356,907	203
Nov.	101,846,093	51			101,846,093	49	53,308,000	44,589,000	256,907	200
Dec.	109,178,605	55			109,178,605	45	54,901,000	35,670,000	250,000	200
1953 Jan.	111,714,008	56			111,714,008	44	51,360,000	35,670,000	255,000	199
Feb.	114,245,261	58			114,245,261	42	47,830,000	35,670,000	254,344	198
March	117,961,771	60			117,961,771	40	44,114,000	35,670,000	253,834	198
April	123,125,967	62			123,125,967	38	47,867,000	26,753,449	253,584	198
May	123,125,967	63			123,125,967	37	45,867,000	26,753,449	253,584	196
June	124,357,027	63			124,357,027	37	44,636,000	26,753,449	253,524	196
July	124,357,027	63			124,357,027	37	44,636,000	26,753,449	253,524	196
Aug.	124,357,027	62			124,357,027	38	47,636,000	26,753,449	253,524	199
Sept.	126,688,900	63	6,566,187	3	133,255,087	34	42,740,000	17,835,633	251,464	203
Oct.	126,688,900	62	6,566,187	3	133,255,087	35	53,657,000	17,835,633	252,280	205
Nov.	126,688,900	63	6,566,187	3	133,255,087	34	51,657,000	17,835,633	252,280	203
Dec.	126,688,900	62	6,566,187	3	133,255,087	35	53,657,000	17,835,633	252,280	205
1954 Jan.	138,226,147	67			138,226,147	33	48,687,000	17,835,633	251,220	205
Feb.	149,663,147	73			149,663,147	27	38,250,000	17,835,633	251,250	206
March	160,894,448	77			160,894,448	23	29,019,000	17,835,633	250,919	208
April	160,894,448	77			160,894,448	23	31,019,000	17,835,633	250,919	210
May	162,163,448	75			162,163,448	25	43,667,000	8,917,816	251,736	215
June	162,163,448	74			162,163,448	26	47,667,000	8,917,816	251,736	219
July	162,163,448	73			162,163,448	27	50,667,000	8,917,816	251,736	222
Aug.	162,163,448	70			162,163,448	30	59,667,000	8,917,816	251,736	231
Sept.	162,163,448	69			162,163,448	31	64,667,000	8,917,816	251,736	236
Oct.	204,437,997	85			204,437,997	15	36,307,000		255,003	241
Nov.	218,534,090	90			218,534,090	10	23,207,000		258,910	242
Dec.	218,534,090	90			218,534,090	10	23,207,000		258,910	242
1955 Jan.	218,534,090	90			218,534,090	10	23,207,000		258,910	242
Feb.	218,534,090	90			218,534,090	10	23,207,000		258,910	242
March	218,534,090	90			218,534,090	10	24,207,000		258,910	243
April	218,534,090	89			218,534,090	11	27,207,000		258,910	246
May	218,534,090	88			218,534,090	12	30,207,000		258,910	249
June	230,027,827	91			230,027,827	9	21,714,000		258,173	252
July	230,027,827	91			230,027,827	9	21,714,000		258,173	252
Aug.	230,027,827	90			230,027,827	10	24,714,000		258,173	255
Sept.	230,027,827	87			230,027,827	13	33,714,000		258,173	264
Oct.	230,027,827	86			230,027,827	14	35,714,000		258,173	266
Nov.	230,027,827	86			230,027,827	14	37,714,000		258,173	268
Dec.	252,822,976	95			252,822,976	5	12,924,000		258,024	266

APPENDIX 2

THE TREASURY BONDS

At the signing of the 1948 Monetary Agreement with France, the Lebanese held franc assets were divided into two accounts, the Old No. 1 Account (about FF 9 billion) guaranteed in terms of sterling, and the Old No. 2 Account (about FF 4 billion) without any guarantee. As the Lebanese Government refused to devalue following the franc devaluations of 1948 (see Table 1 - Chapter I), it had to give its own guarantee for the discrepancy that arose in the unguaranteed franc assets as a result of the devaluation of the franc.[1] This is how a new account called "Government Guarantee" - which produced interest - was opened in the note cover of November 17th, 1948. When the Lebanese Government refused to devalue after the sterling devaluation of September 19th, 1949,[2] the loss on the sterling guaranteed franc was covered by debiting the account "Government Guarantee". In November 1950, this account changed name and became "differences in exchange rates covered by the State". This new entry in the note cover was composed of Treasury bonds whose issue - it is claimed - was made to "materialize the debt of the State

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1. On the 26th of September 1949, the Office des Changes announced that the Lebanese pound is not going to devalue. <u>BEF</u>, No. 14, <u>op.cit.</u>

2. Interview with Mr. Roger Canac, Technical Manager of the Issue Department of BSL.

towards the Issue Department of BSL."[1]

Decree No. 581 of December 8th, 1949, gave the Minister of Finance the right to issue Treasury bonds of one year maturity at 1% interest p.a. and of two years maturity at 1.5% interest p.a. Although nominally they have a maturity of one or two years, they are amortized at the rate of 3% annually only. The remaining have to be renewed. Their value per unit ranged between LL 500,000 and LL 1000. The original amount issued in November 1950 was LL 58,732,493 of which LL 44,636,000 were one year bonds and LL 14,096,000 were two year bonds.[2] As Syria started paying her debt on October 1st, 1952, additional amounts had to be issued. The total issue of Treasury bonds to make up for the loss in the Syrian debt amounted to LL 19 million. The total amount of Treasury bonds that were issued by the Ministry of Finance amounted therefore to LL 77.7 million. In view of reducing the interest charge on the Treasury bonds, the Ministry of Finance converted all the two year maturity bonds into one year bonds in 1955. Table 1 gives the out-

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1. These words are those of Mr. Oughourlian from BSL.

2. <u>Al Majles Al Niyabeh</u>, (December 22nd, 1951), 1206. All of the Treasury bonds are held by BSL as nobody wants to hold them owing to their very low yield and their illiquidity since only 3% of their amount will be amortized in any year.

standing amount of Treasury bonds at different dates as well as the yearly amortizations and interest charge.

TABLE 1

TREASURY BONDS, THEIR AMORTIZATION AND THE INTEREST CHARGE

(LL 1000)

End of	Treasury Bonds [1]	Yearly Amortizations	Interest Charge
1949			740 [2]
Nov. 1950	58,732.5	3,250 [3]	
1951			
Dec. 1952	56,914	1,762 [4]	629 [4]
Dec. 1953	61,742	2,400 [5]	1,500 [5]
Dec. 1954	66,112	2,792 [5]	
Jan. 1955	69,362	9,862	749
Jan. 1956	57,200	2,100 [3]*	584 [3]*

* Estimates

Sources: (1) Ministry of Finance.

(2) Interest on the account "Government Guarantee", Bulletin Statistique Trimestriel, 1950.

(3) Ministry of Finance, Fathlakat (Budget Bill, 1956), 39; in 1955, LL 6,612,000 were amortized in addition to the 3% yearly requirement.

(4) Al Majles Al Niyabeh, (December 22nd,1951), 1206. The interest charge comprises two parts:

- LL 320,000 for until 31/12/1951 and -
- LL 309,000 for until 3/ 6/1952.

(5) Al Majles Al Niyabeh, (October 11th, 1955), 25.

It was difficult to gather detailed information on Treasury bonds from one single source, we had therefore to rely on different sources to form Table 1. Table 1 shows that out of the total number of Treasury bonds which were issued, viz. LL 77.7 million, over LL 20 million were amortized and the outstanding amount of Treasury bonds at the end of January was LL 57.2. It is to be noted that the amount of Treasury bonds had been increasing during the period 1952-1954 as Syria was paying her debt. Lebanon had then to issue Treasury bonds to make up for the loss on the Syrian debt. Though the Syrian debt was completely paid up by October 1954, we witness an increase in the volume of Treasury bonds in January 1955. The reason is that it took some time for BSL to pass on the account to the Issue Department.

The total amount of interest that was paid on Treasury bonds until the end of 1955 (including interest on "Government Guarantee") was LL 3,618,000. Many writers consider that the payment of interest is unfounded while in the belief of BSL that Treasury bonds - as in any other country - do and should earn interest. It is of great moment to investigate this problem a little more closely.

In looking at the origin of the Treasury bonds, we find that they are a bookkeeping entry in the registers of BSL. Before their issue there was the "Government Guarantee" account which was also a bookkeeping entry. These Treasury bonds do not represent an actual advance of funds on the part of BSL. A bank is usually paid interest because it deprives itself from its own liquidity in favour of a borrower. The liquidity of BSL was not affected when the Lebanese Government refused to devalue along with the franc and sterling devaluations. It is worthwhile noting that other countries faced with the same circumstances as Lebanon issued non-interest bearing Treasury bonds. This is the case of Syria who issued interest free bonds to make good the loss in her franc assets of the note cover.[1] France also did not pay interest on the Treasury bonds it issued on December 7th, 1931, to make up for the loss on the sterling reserves of the note cover as the sterling devalued on the 21st of December 1931. The loss, although partly covered by the State, was shared to a small extent by the Bank of France which was then like BSL a private company.[2] Although BSL should not be asked to share in the loss of the note cover, it is unjustifiable that the payment of interest be continued.

Some writers argue that the payment of interest on Treasury bonds incites the government to settle rapidly the amount outstanding against it and to replace it with tangible assets such as gold or foreign exchange which have the confidence

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1. Legislative Decree No. 87 of March 28th, 1953, Art. 35, par. 3.

2. The loss on the sterling assets of the franc cover which was borne by the French Government was FF 2,342,371,604.76 André Boca, La Caisse Autonome d'Amortissement, (Librairie du Recueil Sirey - France: June 1953), 57-58.

of the public. This is, however, very doubtful. Other writers contend that, since the Issue Department of BSL is not covering its operation expenses as it has been increasing the gold cover at the request of the Lebanese Government, it ought to have some earning assets - mainly Treasury bonds - to cover these expenses. It should be noted, however, that the Convention of 1937 with BSL does not require the Lebanese Government to ensure the Issue Department a certain income.

On several occasions, some members of the Parliamentary Financial Committee have stated that the payment of interest on the Treasury bonds is unwarranted as it is not based on sound principles.[1] Others believe that the government ought to fulfil its financial obligation since it pledged itself to pay interest on the Treasury bonds by Decree No. 581. The whole question is still open, and preoccupies both the official and non official circles.

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1. Al Majles Al Niyabeh, (January 11th, 1955), 25.

APPENDIX 3

SETTLEMENT OF THE SYRIAN DEBT [1]

The total amount of Syrian pounds which were withdrawn from circulation in Lebanon by the Issue Department of BSL under governmental instructions was about LL 49 million on the 2nd of February 1948. After the transfer of Lebanese pounds then circulating in Syria - viz. LL 4,474,540 - was made to Lebanon, the total amount outstanding in Lebanon at the end of June 1948 was LS 44,589,082. For every Syrian pound in possession of the Issue Department of BSL, the latter issued one Lebanese pound.

On July 8th, 1949, an agreement between the Lebanese Government and the Syrian Government was signed at Shtura. This agreement provided that Syria would pay Lebanon her debt out of the French francs covering the LS 44.6 million. This payment was to be made in accordance with the Franco-Syrian Monetary Agreement of February 7th, 1949, after allowing for the successive devaluations of the franc until July 1949 i.e. the date of the signature of the agreement. These francs were to be transferred to the Lebanese Old Account No. 1 as soon as the French Parliament approved the Franco-Syrian Agreement of February 7th, 1949.

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1. The following study relies on:

   - Lebanese Republic, Documents and Texts... op.cit. 64-66.
   - Syrian Republic, Ministry of Foreign Affairs, Al Watha'ik Wal Nusus, Documents and Texts concerning the Economic Relations between Syria and Lebanon, (Syrian Republic Press, March 1950), 25.

The amount of French francs that Syria had to pay Lebanon in virtue of the Lebano-Syrian agreement of July 1949 can be shown in the following manner:

1. Before the franc devaluation of January 25th, 1948, the countervalue of Syrian pounds in French francs was LS 44 589 082 x FF 54.35 = 2,423,416,606.70 at the rate of exchange of LS 1 = FF 54.35.

2. According to the Franco-Syrian Monetary Agreement of 1949, 68.75% of the francs in the note cover of the Syrian debt (viz. FF 1,666,063,014.26) were guaranteed in terms of sterling; the non guaranteed balance was FF 757,353,592.44.

3. After the successive franc devaluations of January 26th, 1948; October 17th, 1948 and April 27th, 1949, the franc lost 55.3% of its value in terms of sterling.[1] The guaranteed part in the cover of the Syrian debt increased in amount so as to maintain its value in terms of sterling. It became
$$\frac{1,666,063,014.26 \times 1,097}{480} = \text{FF } 3,807,648,180.50.$$

4. The non guaranteed francs did not change in amount although their value depreciated by 55.3% in terms of sterling. The francs that Lebanon would have received at the signing of the Lebano-Syrian agreement of July 8th, 1949 were FF 4,565,001,772.94.

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1. The sterling which was worth FF 490 before January 25th, 1948 was worth as much as FF 1,097 on April 27th, 1949.

However, Syria did not pay Lebanon as it had agreed to do and the latter country had to sustain a considerable loss on the franc assets of the Syrian debt as a result of the sterling and franc devaluations of September 1949. On the 4th of January 1952, another agreement was reached by which Syria accepted to pay Lebanon in five semi-annual instalments starting the 1st of October 1952 the sum of FF 4,078,123,735.17. This sum was computed in the following manner:

1. As the sterling pound devalued by 30.5% in terms of the dollar on September 19th, 1949, and as the French franc on the same day devalued by 20% only, the franc appreciated in terms of sterling.[1]
2. Since FF 3,807,648,170.50 were to be guaranteed in terms of sterling, and since the French franc had appreciated in terms of sterling, a certain sum was to be deducted from the above amount so as to keep its countervalue constant in terms of sterling. The deduction had to be: $\frac{3,807,648,180.50 \times (1,097-980)}{1,097} =$ 506,702,860.23.
3. In contradiction with the principles agreed upon on the 8th of July 1949, Syria calculated the deduction on the basis of all the franc cover in the Syrian debt,

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1. The sterling which was worth FF 1,097 before September 19th, 1949 became worth FF 980 after that date.

although a certain portion of these francs was not to be kept constant in terms of sterling. The non-sterling guaranteed portion of the francs should follow the value of the franc whether the latter appreciates in terms of sterling or depreciates. Their amount had to be kept constant. The computation of the deduction was done as follows by Syria:

$$\frac{4,565,001,772.94 \times (1,097-980)}{1,097} = \text{FF } 486,878,037.77$$

The Lebanese Government, therefore, accepted a loss of FF 80,775,177.54 over and above the losses it had sustained on the guaranteed and non guaranteed franc assets of the Syrian debt as a result of the franc and sterling devaluations. For each Syrian pound, Lebanon got FF 111.11 while the official rate of the Syrian pound at the time of the settlement of the Syrian debt to Lebanon was FF 159.70. The total loss that Lebanon had sustained was:

$$44,589,082\ (159.70-111.11) = \text{FF } 2,167,029,385.$$

To make up for the loss on the Syrian debt, Lebanon had to issue about LL 19 million worth of Treasury Bonds.[1] The issue of these bonds was gradual and coincided with the payments of the five semi-annual instalments.

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1. L'Orient, (May 7th, 1952), 2.

Some writers argue that had Lebanon disposed of these Syrian notes - in the free market or by the purchase of Syrian goods - before the successive devaluations of the franc and the sterling devaluation of September 1949, losses on the franc assets of the Syrian debt would have been minimized.

APPENDIX 4

RATIO OF LIABILITIES TO ASSETS FOR CERTAIN LEBANESE BANKS

Formula:

1 - Total assets = total liabilities + capital account

2 - Total liabilities are deposits of customers, government bodies and banks, rediscounts and notes.

3 - Capital account includes capital stocks, surplus, undistributed profits and reserves.

The ratios between total liabilities and total assets determine the percentage of bank assets for which bankers owe to others (viz. depositors).

Source : Albert Gailord Hart, Money Debt and Economic Activity. (Prentice Hall, New York 1948), 36.

INTRA BANK

1952	$\frac{17\ 346\ 608.15}{23\ 965\ 791.70}$	= 72.38
1953	$\frac{14\ 538\ 878.92}{22\ 978\ 625.63}$	= 63.71
1954	$\frac{14\ 920\ 470.79}{28\ 805\ 538.38}$	= 51.79

BANQUE MISR SYRIE LIBAN

1950	$\frac{23\ 611\ 804.46}{25\ 893\ 523.83}$	= 91.19
1951	$\frac{25\ 068\ 995.12}{28\ 144\ 790.01}$	= 89.07
1952	$\frac{36\ 282\ 080.24}{40\ 773\ 938.50}$	= 88.98
1954	$\frac{54\ 700\ 763.62}{58\ 787\ 965.03}$	= 93.05

BANQUE BELGO-LIBANAISE

1954	$\frac{17\ 094\ 428.66}{19\ 147\ 966.97}$ =	89.27

BANQUE DU LIBAN ET D'OUTRE MER

1953	$\frac{5\ 186\ 459.52}{20\ 286\ 599.30}$ =	50.42

BANQUE LIBANAISE POUR LE COMMERCE

1953	$\frac{7\ 228\ 958.52}{15\ 548\ 924.26}$ =	46.49
1954	$\frac{13\ 846\ 652.24}{34\ 307\ 543.94}$ =	40.36

BANQUE AL AHLI

1954	$\frac{25\ 137\ 183.00}{30\ 274\ 611.44}$ =	83.03
1955	$\frac{35\ 617\ 809.85}{40\ 987\ 111.44}$ =	86.90

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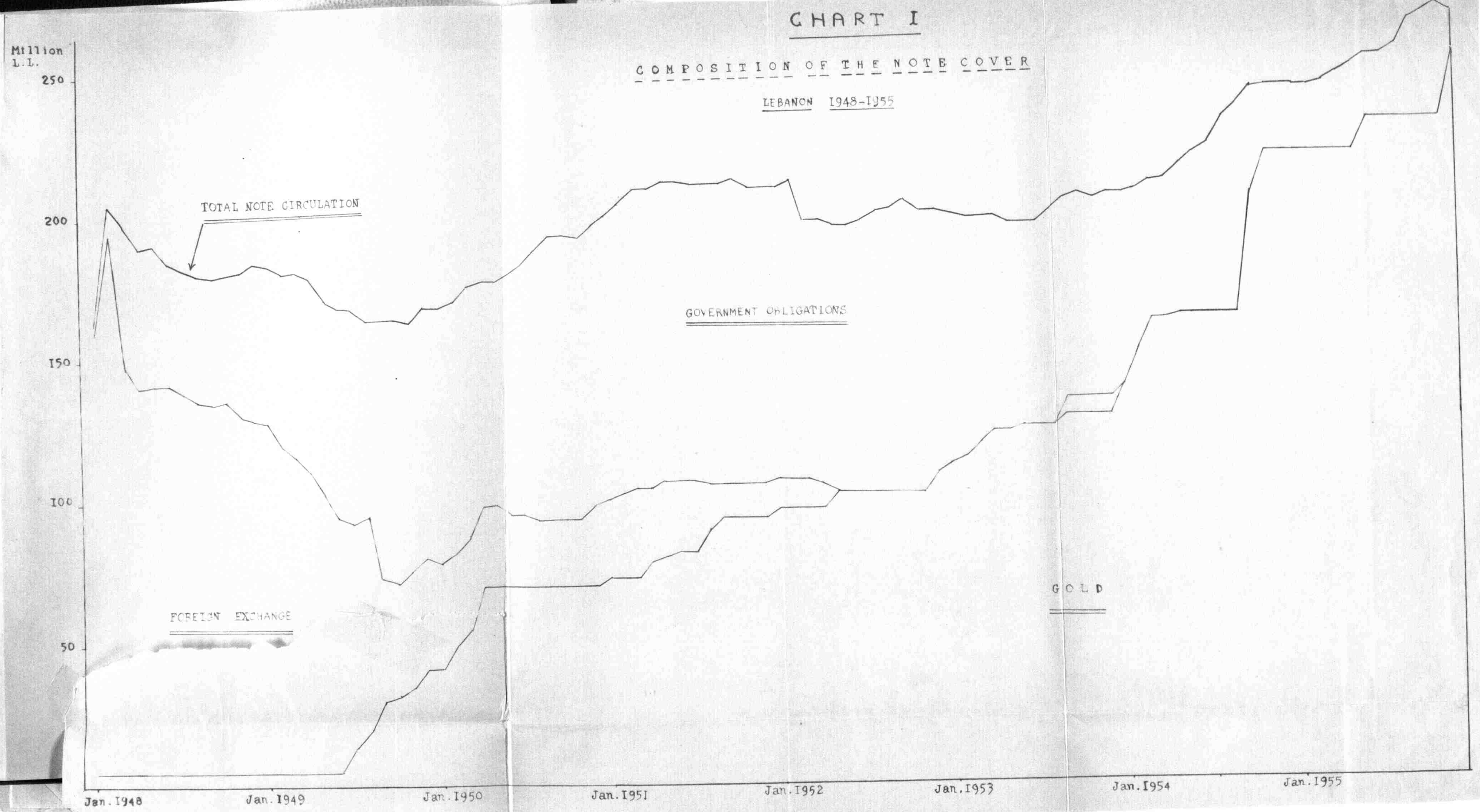

CHART I
COMPOSITION OF THE NOTE COVER
LEBANON 1948-1955
Million L.L.
250
200
150
100
50
TOTAL NOTE CIRCULATION
GOVERNMENT OBLIGATIONS
FOREIGN EXCHANGE
GOLD
Jan. 1948
Jan. 1949
Jan. 1950
Jan. 1951
Jan. 1952
Jan. 1953
Jan. 1954
Jan. 1955