LONG TERM CREDIT IN LEBANON

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PREFACE

Credit has been called the life blood of modern economic society. If supplied in sufficient quantity and used efficiently, credit is a mighty weapon for improving the lot of people and raising their living standards. Lebanon's credit facilities are fairly well developed, but are geared entirely to commercial needs -- a fact which partly explains the inadequacy of specialized credit institutions, and the ensuing unavailability of medium and long term credit. Lebanon's problem is, therefore, to render medium and long term credit more readily available to the productive sectors of the economy. The present dissertation is an attempt to analyse what has so far been done in this field and to suggest remedies for possible future improvements.

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ABSTRACT

Trade has been Lebanon's traditional activity for a long time. The country's favorable geographical location and the temperament of its people have made Lebanon a services and trading center for countries in both East and West. Moreover, Lebanon being a small country with meagre natural resources, its industry and agriculture cannot at best be too significant. Generally, the Lebanese seem to prefer to invest their money in commercial undertakings, where the turnover is quick and profits high, and are often reluctant to invest in productive ventures, which are on the whole considered secondary fields of investment. This attitude is typically Lebanese, and any attempt on the part of the government to change it basically may lead to unfavorable consequences in the whole economy. However, it is necessary for political and social as well as for economic reasons to encourage agriculture and industry, irrespective of their economic effectiveness and relative productivity. Such an encouragement will lead to a more balanced sectorial growth and will result in greater employment opportunities and in a better distribution of income not only among the various classes of the community but also among the various districts in the country.

Unfortunately, the Government has so far done little to foster agriculture and industry. There has never been any overall general policy of assistance or protection, nor has there been any serious attempt to meet particular problems in either sector. An obvious case in point is the provision of medium and long têrm capital for production and the establishment of the necessary specialized credit institutions which normally channel available investment capital into agricultural and industrial pursuits. Until recently the few specialized credit institutions that existed suffered from serious limitations, and consequently the credit facilities that could be provided were far short of needs. The creation of the Agricultural Industrial and Real Estate Credit Bank has been undoubtedly a welcome step. The Bank will do much to reduce the need for institutional medium and long term credit; the volume of credit it has already extended is quite impressive. However, the Bank seems to be hindered by some limitations which must be remedied if its role in contributing to the development of the productive sectors of the economy is to be adequately performed.

While the creation of a specialized credit institution may go a long way towards reducing the urgent need for medium and long term credit, it certainly is not enough to surmount the major handicaps that characterize the Lebanese credit situation. However, taken together with other suggested remedies regarding commercial banks, savings institutions, the capital market, credit cooperatives, and supervised agricultural credit, it may become adequate to meeting present requirements of reform and may ultimately lead to a more balanced growth of the country in the future.

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CHAPTER I

INTRODUCTION

Any brief survey of the Lebanese economy will reveal two striking features which generally characterize its structure and distinguish it from the other economies of the region. One feature is the relatively high level of per capita income which Lebanon enjoys. According to the only estimates available,[1] the total Lebanese national income in 1950 was LL 1,026 million. On the basis of the population estimate of 1,280,000, the per capita income would be about LL 800, which at market rates of exchange then prevailing would amount to $250 per annum. This per capita income level is substantially higher than anywhere else in either Asia or Africa with the exception of Israel and the Union of South Africa.[2] The breakdown of the Lebanese national income into its various components, brings out the second striking feature of the Lebanese economy namely, that Lebanon is a country of services and not of production, and that the bulk of the Lebanese national income is derived not from agriculture or industry, but from trade and other services. The singularly high proportion of income earned in the trade

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1. A.Y. Badre, "The National Income of Lebanon", Middle East Economic Papers, 1956, Economic Research Institute, American University of Beirut, (Beirut: Dar El Kitab, 1957), p. 31.

2. *Ibid.*, p. 31 n.

sector, i.e., 30 per cent, is higher than anywhere else in the world since in most other countries the proportion ranges between 8 and 18 per cent.[1] There are very few countries where the production of services is greater than the production of goods, and of such countries Lebanon is the only one where around two thirds of the total value of production relates to services and only one third to goods.[2] This preponderance of services' over goods' production does not seem to be a haphazard occurrence. Lebanon is a small country, poor in its natural resources, perhaps the poorest in the whole region. Therefore, at best, its industry and agriculture cannot be too extensive. The people seem to have had few alternatives to being traders, intermediaries and middlemen for which occupations they appear, besides, to be well suited by tradition, temperament, and by their country's location. Lebanon's location on the eastern coast of the Mediterranean is very favorable for international trade, and the channelling, for centuries, of a substantial part of Middle Eastern commercial and financial operations through Lebanon has created an experienced class of businessmen, entrepreneurs and bankers. Their world-wide transactions have been facilitated by links with Lebanese emigrants, many of whom have established themselves in both Americas and along the

1. Y.A. Sayigh, Economic Development of Lebanon - Its prospects and Problems, mimeographed, (October 1955), p. 11.

2. See A.Y. Badre, op.cit., p. 34.

coast of Africa. This favorable geographical location coupled with the Lebanese love of liberty and freedom and their world outlook,[1] might be the fundamental factors which explain Lebanon's two peculiar features. The Lebanese love of freedom and strong appreciation of personal liberty manifest themselves in their choice of freedom of trade and foreign exchange transactions. International trade policy is at present characterized by an almost complete lack of intervention on the part of the Government, and trade is practically without control or restriction; the same spirit of liberalism prevails over the foreign exchange policy, with no control whatsoever imposed on either the sale or the purchase of foreign exchange. These are all reflections of the deeply rooted desire for personal liberty. Needless to say that these policies have been of tremendous help in furthering the growth of trade and of services connected with it. The adventuresomeness of the Lebanese and their world outlook, as reflected in migration, have also assisted in the establishment of commercial and financial links all over the world, which have constituted a source not only of capital but also of technical skill and know-how. All this has made Lebanon an intermediary and an entrepot for countries in both West and East.

Trade, as was just pointed out, has been Lebanon's traditional activity for a long time. For this reason and for

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1. Love of freedom and world outlook have been singled out as the two 'refugee traits' of the 'mountainous character of Lebanon'. See A.Y. Badre, op.cit., p. 35.

the fact that turnover in trade is relatively quick and profits high, the Lebanese in general seem to prefer to invest their money in commercial undertakings. To them, agriculture and industry are secondary fields of investment. This mentality appears to be typically Lebanese, and it may be a mistake to attempt to alter it basically. Lebanon's economic vocation has been for centuries in commerce, and not in production, and to try to force artificially new directions on investments could be detrimental to the whole economy.[1] However, it seems necessary for political as well as for economic reasons to encourage agriculture and industry, irrespective of their economic effectiveness and relative productivity. It is true that Lebanon's economy had successfully withstood and overcome difficulties originating from the loss of Palestine market and from the reduction of business with Syria, but the growing economic nationalism within the Middle Eastern countries may prove to be a great impediment for further expansion of middleman and commercial services which Lebanon renders to the Arab countries. If only for this reason, not to mention the social reasons, i.e., providing additional employment, and securing a better distribution of the national income among the various peoples and regions of the country, more attention must be paid to the encouragement of industry and agriculture.

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1. P.J. Klat, "The Future of Economic Development in the Arab World", Middle East Economic Papers, 1956, Economic Research Institute, American University of Beirut (Beirut: Dar El Kitab, 1957), p. 62.

Prior to 1948 Palestine was Lebanon's best customer, taking in most of Lebanon's vegetable products which were not easily marketable elsewhere. As a consequence of the Palestine War and the ensuing boycott of Israel, this market was lost. In March 1950 the customs union between Lebanon and Syria was abruptly terminated by the latter. In terminating the union Syria was motivated by the desire to establish protective tariffs, to which free trading Lebanon did not agree, and to make Syrian trade independent of Lebanese channels. A large part of Syria's trade, under pressure from the Government, was diverted through the as yet undeveloped port of Latakia. Syria also discouraged the use of Lebanese financial and commercial intermediaries and restricted travel of its nationals to Lebanon. While both countries suffered from adjustment to new conditions, the Lebanese economy, largely geared to servicing its Syrian hinterland, was the more vulnerable of the two and lost more heavily. With these past difficulties still vividly recalled, and with even Jordan now trying to reduce its dependence on the expensive Beirut transit by shifting some of its trade to Aqaba, Lebanon may find it advantageous to slightly alter its basic economic policy with greater emphasis given to the encouragement of the commodity-producing sectors.

The encouragement of agriculture and industry, however, should not be at the expense of other sectors, and especially of the trade sector. The aim should be to bring the levels of income in agriculture and industry closer to that in trade and services, by pulling commodity production upwards rather than by pushing services production downwards. Despite the limited potentialities of the industrial and agricultural sectors, income arising in these two sectors, could no doubt be raised without reducing the absolute income of the trade sector. National income will grow in absolute terms and the income of the commodity-producing sectors will also grow. But its growth will be both absolute and relative, while that of the income of the trade sector will only be absolute. The result will be a gradual removal of the existing lopsidedness in sectoral shares, after which the rate of growth of the whole economy can rise faster since the main limitation - the relative smallness of the commodity-producing sectors - will have been removed.[1]

Unfortunately, however, the Government has so far done little to foster agriculture and industry. There has never been any overall general policy of assistance or protection, nor has there been any serious attempt to meet particular problems in either sector. An obvious case in point is the provision of medium and long term capital for production and the establishment of adequate specialized credit institutions. Such specialized credit institutions have been, until recently, practically non-existent, and long term credit, consequently, unavailable. Under the Turkish regime, since Lebanon was an

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1. Y.A. Sayigh, <u>op.cit.</u>, p. 55.

Independent Sanjaq, it should not make use of the credit facilities of the Agricultural Bank of Turkey, and therefore the only sources of credit were the landowners and professional money-lenders, who provided most of the credit available for the agricultural population at very high rates of interest. Lebanese industry then was too small to receive any attention from the Turkish Government. Under the mandate, there was nothing successfully attempted to correct the situation. A deliberate action was taken to encourage industry and agriculture through the establishment of a small specialized credit institution known as SCAIL (Société de Crédit Agricole et Industriel du Liban), and when it was established in 1939, it was hoped that long term credit would be made available at reasonable terms, but it was soon realized that the rigid requirement of mortgages and the political favoratism which governed SCAIL's lending policy left those who needed credit most outside the scope of its operations. It was not until late in 1954, when the Lebanese Government cooperated in the establishment of BCAIF (Banque de Crédit Agricole, Industriel et Fonçier) that it made its first real effort to financially assist agriculture and industry. Before that date, the few facilities that existed for industrial and agricultural credit suffered from serious limitations. Aside than SCAIL and BCAIF, which constitute the major source of investment capital in Lebanon, there are no other significant non-commercial banks presently in operation.

At one time a couple of banks attempted to issue long term loans but they soon ceased their long term credit operations and now operate as commercial banks. Under such circumstances, a considerable volume of credit, as expected, is extended outside the banking system by landowners, merchants and professional money-lenders, who in their turn rely on regular bank credit. Most of this non-institutional credit is extended in the agricultural sector of the economy and is a reflection partly of the inadequacy of credit institutions and partly of the poor credit risk of the borrowers. Credits of this type generally carry high, usurious rates of interest.

It is only normal to have the credit facilities in Lebanon exclusively geared to commercial needs. This is both a reflection of the trade-bias in the economy and a probable cause of it. Because Lebanon has always been basically a trading country, its financial institutions find it more profitable to deal with short-term commercial credit activities, and therefore activities that require long term credit cannot emerge and develop, which in turn has certainly helped to accentuate trade. This unbalanced growth in Lebanon's financial institutions has left agricultural, industrial and real estate credit far from being adequate.

Apart from the inadequacy of long term credit which is mainly due to the non-existence of specialized credit institutions, the set-up of Lebanon's credit facilities still lacks essential features, which in developed economies help considerably in pooling savings funds and channelling them into agricultural, industrial and real estate undertakings. To begin with, regular commercial banks, which in developed countries generally constitute a source of long term credit, do not in Lebanon undertake the issue of loans on longer than short term basis. The present structure of the Lebanese banking system does not permit the commercial banks to issue such loans. Also, the banking institutions are unequally distributed with most of the banks concentrated in Beirut, and very few in the other towns and rural areas. This places the less important urban centers and the rural areas at a disadvantage, and the people who need credit can only resort to borrowing from landlords or money-lenders at high rates of interest. The non-existence of banking institutions in such places has also forced savings that might exist to be hoarded. Although there is some evidence that savings in the form of hoards has declined, nevertheless, it is still believed that the deeply ingrained habit of putting savings into hoards of precious metals and currency is still widely common in the rural areas.

Secondly, savings institutions are non-existent. There are no special savings banks in Lebanon to pool savings funds, and with exception of a couple of banks who recently introduced certain savings devices, commercial banks do not generally consider it worth while to make any effort to attract savings deposits. This is best reflected in the small ratio of savings deposits to total deposits. Also, postal savings systems which normally encourage saving among people of middle and low income groups, do not exist; and savings in the form of insurance are reported to be insignificant.

Thirdly, credit cooperatives, which usually constitute an important source of agricultural credit through the provision of a channel for farmers' savings and a way to mobilize capital for agricultural development, can practically be considered non-existent in Lebanon. The Government promulgated various legislations for the purpose of spreading the cooperative movement in Lebanon. However, such legislation have had no effect whatsoever on stimulating the formation of cooperatives. It seems that the farmers have not yet become accustomed to pooling their efforts and cooperating in various ways to overcome the disadvantages to which they are exposed as individual producers. The social structure and low saving capacity of most rural areas in Lebanon, do not help to overcome the sectarian and individualistic tendencies that presently impede the formation and spread of cooperative movements.

Finally, capital markets in most developed economies serve as means for mobilizing long term capital funds. Lebanon's capital market is small and unorganized, and therefore cannot perform the expected role of pooling capital for long term investment. A measure has been recently taken by the government to organize the set-up of the Beirut stock exchange (bourse) which will certainly encourage dealings in stocks, make company formation more desirable, and help in the pooling of capital for long term investment. However, company formation will be still handicapped by the people's general indifference toward incorporation. The Lebanese businessmen are established individualists and the predominant type of business organization is, therefore, the private or family form.

The adverse effect of these social traits and institutional deficiencies, and especially the inadequacy of present financial institutions must not be minimized. Experience shows that in many countries the growth and accumulation of capital have been practically parallel to the spread of adequate savings and specialized credit institutions. It is said[1] that Lebanon's problem is not so much one of getting new capital; Lebanon appears to have at present a great deal of floating capital, partly coming from local savings, and partly imported. The real problem is that of channelling available funds into agriculture and industry. Lebanese capitalists prefer to invest their money in commercial undertakings, and are usually reluctant to invest in productive pursuits. It is therefore of paramount importance for the government to overcome this reluctance which not only limits the participation of private capital in industry and agriculture, but also makes it practically impossible for the banking system to find funds for investment in medium and long term ventures. The purpose of this dissertation is to analyze what has so far been done in this field and to make recommendations for possible future developments.

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1. See P. Klat, op.cit., p. 61.

CHAPTER II

BACKGROUND OF THE LEBANESE MONETARY AND BANKING SYSTEM

A study of the background of the Lebanese monetary and banking system cannot extend very far back into history because Lebanon has only recently acquired its independence. Prior to the First World War Lebanon[1] was under Turkish jurisdiction and formed an integral part of the Ottoman Empire. As such, it had no independent monetary system or banking organization. Between 1880 and 1914 the currency was based on gold, and the Turkish gold pound was the monetary unit. Currency notes were issued by the Imperial Ottoman Bank, but were not widely circulated in Lebanon. When, in November 1918, Syria and Lebanon were occupied by the British and French armies, the first immediate step adopted by the occupation authorities was to demonetize the Turkish banknote and to declare the Egyptian paper pound as legal tender. The Egyptian pound remained in circulation for two years and thus replaced the Turkish banknote as the legal paper currency. The Turkish subsidiary coins, however, are reported to have stayed in use till the late twenties.

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1. Lebanon which was then a "Sanjaq" excluded the cities of Beirut, Tripoli, and Sidon. During the French Mandate the small Sanjaq was expanded to include the above cities as well as the Biqaa', and became known as "Greater Lebanon". See Royal Institute of International Affairs, The Middle East, 2nd ed., London, 1954, pp. 468-470.

On April 1, 1920, when Lebanon was declared a French Mandate, the French High Commissioner established by decree a new monetary unit, the Syrian pound, and the circulation of the Egyptian paper pound as legal tender was abolished. The Syrian pound, whose value was fixed at 20 French francs was made on January 1, 1921, the sole legal tender.[1] The right of issue was granted to the Banque de Syrie,[2] (hereafter referred to as BSL), which was a subsidiary of the Imperial Ottoman Bank. The Syrian pound was made divisible into 100 piasters; it was to be covered mainly by French assets, and to be redeemable in cheques drawn on Paris.

The privilege of note issue granted to the BSL by the military decree of 1920 was later confirmed in 1924 by a convention, signed on January 23, between the Governments of Syria and Lebanon on the one side, and the BSL on the other. This privilege was to last for fifteen years. It was also agreed that the BSL would function as an official bank of the States under the French Mandate. The monetary unit became the Lebanese-Syrian pound; its par value remained fixed at 20 French francs, and the provisions of its cover remained essentially unchanged. It was specified that two different

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1. See Said Himadeh, ed. <u>Economic Organization of Syria</u>, (Beirut, American Press, 1936), p. 264.

2. In 1924 the Banque de Syrie changed its name to Banque de Syrie et du Grand Liban, and in 1939 to Banque de Syrie et du Liban - BSL.

series of banknotes would be issued, one bearing the inscriptions "Grand Liban" and the other "Syrie". However, it was also agreed that the two series would circulate without distinction in the two countries and would be legal tender in either one. Currency reserves were to be held jointly in the name of the two countries.[1]

Before the termination of the 1924 convention, negotiations between the governments of the Syrian and Lebanese Republics and the BSL culminated in two separate, though identical conventions (one for Syria and one for Lebanon). The conventions were to last for twenty five years, starting April 1, 1939, (as compared with 15 years for the previous conventions), and expiring in 1964. Among other things, the 1939 conventions provided for the gradual detachment of the Syrian and Lebanese note circulations from each other. However, the 1939 conventions still preserved most of the essential features of their predecessors.[2]

From the time it was issued in May 1920 onward, the Lebanese-Syrian banknote, being redeemable in franc exchange, had to follow the numerous fluctuations in the value of the French franc. The successive devaluations of the franc portrays the instability of the Lebanese-Syrian pound which was, until 1948, almost entirely backed by French franc assets.

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1. For further details on the convention see Said Himadeh, Monetary and Banking System of Syria, (Beirut, American Press, 1935), pp. 69-72.

2. For further details see Zuhair Mikdashi, The Monetary System of Lebanon, unpublished M.A. Thesis (Beirut, American University, 1956), pp. 3-5.

In 1939 a system of exchange control was organized and an Exchange Office was set up to buy and sell foreign currencies. In November 1941, three months after the occupation of Lebanon and Syria by the Allied forces, the Lebanese-Syrian pound was linked to sterling. The purchase price of the sterling pound was fixed at LSL 8.83, which left the existing franc quotation unchanged at Ffr. 20/LSL. The purchase prices of other currencies were fixed according to their equivalents in sterling in the London exchange market. On the 25th of January 1944 a monetary agreement (Catroux Convention) was signed between Great Britain and France, and was followed by a similar agreement between France, Lebanon and Syria, signed in Damascus on the 9th of February 1944. This agreement specified that a guaranteed parity in terms of sterling between the Lebanese-Syrian pound on one hand, and the French franc should be maintained. In other words, it was in effect a sterling guarantee of Lebanese held francs assets in the note cover and those of the Exchange Office. From August 1941 until March 1946 the Lebanese-Syrian pound was freely convertible into sterling. During this period, it had been reported that about LSL 700 million were transferred to the sterling area or served to import goods and gold into Lebanon and Syria.[1] On the basis of its new sterling parity the Lebanese-Syrian pound did not follow the French franc devaluations of 1944 and 1945. When the franc devalued from Ffr. 176 to 200 per sterling and

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1. See Joseph Naggear, "Le Problème Monetaire du Liban" in Les Conferences du Cénacle, Ed. Michel Asmar, IV, No. 5-6, Beirut, May 25, 1950), p. 112.

Ffr. 200 to 480 per sterling respectively, the official franc quotation in Lebanon was successively raised to Ffr. 22.65/LSL and Ffr. 54.35/LSL. This was in conformity with Catroux letter of January 25th, 1944. In July 1947, the International Monetary Fund accepted the rate of LSL 2.194 to the dollar as the official par values of both the Lebanese and the Syrian pound. This rate corresponded, at the parity of LSL 8.83/£, with the then existing dollar-sterling cross rate of $ 4.03/£ . In January 1946, however, France notified Lebanon that it would not be responsible for any further devaluations of the franc. After prolonged negotiations, the two countries came to an agreement, signed on January 24, 1948, i.e., one day before the new devaluation of the franc, which was intended to replace the Catroux Convention of 1944. Following this devaluation, the prevailing rates between the Lebanese and the sterling pounds were maintained, while the rate with the franc was raised to Ffr. 97.83/LSL.

The Franco-Lebanese Agreement of 1948, unless negotiated again or extended, will expire in 1958. This agreement is not only concerned with monetary problems. It provides also *inter alia* for the liquidation of financial claims and counter-claims existing between the two countries, and for the settlement of several issues connected with French concessionary companies in Lebanon, commercial relations, capital transfers, and exchange control.

One of the main provisions of the agreement was that the franc assets of the Lebanese branch of BSL, outstanding at the date of agreement (around Ffr. 14 billion), were to be divided into an "Old No. 1 Account" and an "Old No. 2 Account". The No. 1 Account, representing the cover for the note issue, was credited with approximately Ffr. 9 billion, and carries a ten-year sterling exchange guarantee. It was supposed to be drawn upon for the following purposes:

a) to repay France for the value of French Government property sold to Lebanon estimated at LL 20 million, in five equal annual installments of LL 4 million starting in June 1949;

b) to provide current foreign exchange with the proviso that annual releases would not exceed one-tenth of the original amount, beginning in 1953.

The No. 2 Account of approximately Ffr. 5 billion was to be debited with the value of goods purchased from France and of purchases of certain European currencies, other than French francs, converted at official exchange rates.

Within less than a year after the signature of the agreement the No. 2 Account was entirely used up and, because of the adverse Lebanese balance of payments with France, inroads were also made into the No. 1 Account which was supposed to have been blocked until 1953, and then released by annual installments. Up to the end of 1955 the outstanding value of No. 1 Account was Ffr. 3.33 billion, i.e., a decrease of 63% from the original Ffr. 9 billion.

Of the other main provisions of the agreement was a new recognition of the privileges extended to BSL; in fact Lebanon, in the agreement, pledged itself not to alter the terms of the concessions of the French companies operating in Lebanon except by way of contract and in the framework of existing legislation.

This monetary agreement produced several important consequences:[1]

First, the Lebanese promise not to introduce any alterations in the concessions of French companies, confirmed, amongst other things, the 1939 convention with the BSL which, as a result, continued to exercise its privileges.

Secondly, since the French-Lebanese agreement was not, at that time, accompanied by a similar agreement between France and Syria, it designated the parting of the ways between Syria and Lebanon, whose currencies till that time had been legally interchangeable and factually identical. The Lebanese currency now assumed a separate status - it possessed its own cover, and enjoyed possibilities with respect to the use of French franc balances which the Syrian pound, for the time being, did not share. It is true that Syria concluded a monetary agreement with France in February 1949. However, this agreement did not contain a clause committing Syria to change concessions of French companies only "by way

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1. F. Keesing, <u>The Monetary and Banking System of Lebanon</u> - mimeographed, (May 10, 1955).

of contract and in the framework of existing legislation." Lebanon and Syria both called in the other country's notes circulating in their respective territories. This withdrawal resulted in a net Lebanese claim on Syria of LS 45 million. Syria repaid this debt in five installments between 1952 and the end of 1954.

Finally, the severance of the pre-existing close monetary ties between France and Lebanon paved the way for a new monetary law, namely, the monetary law of May 24, 1949. This law reorganized the Lebanese currency by laying down new rules for the cover of the note circulation, and by re-defining the Lebanese pound in terms of gold. The notes in circulation were to be covered up to a minimum of 50% by gold and foreign currencies, and the balance by government bonds and advances to the government or guaranteed by it; however, up to 15% of the issue could be held in commercial bills maturing within 90 days and bearing three signatures.[1] The Lebanese pound was made equal to 405.512 milligrammes of pure gold,[2] representing the parity of US$ 1 = LL 2.19.

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1. The monetary law of 1949 does not say that a minimum of 50 per cent of the note cover shall consist of gold and foreign currencies, but in practice the law seems to be applied as if these words were specified in its text. For further details about the requirements to be fulfilled by the various elements of the note cover, see Decree No. 15105 of May 27, 1949.

2. This official gold value is not actually maintained and is of very little practical significance.

In compliance with this legislation and the desire of Lebanon to assert the independence of the Lebanese currency vis-à-vis the French franc assets - which previously represented most of its backing - BSL has engaged in large-scale gold purchases both on the Beirut market and abroad, and kept simultaneously reducing the proportion of foreign assets until they disappeared completely from the note cover.[1] All of BSL's foreign assets (mainly French Francs) are today held in its banking department.

When many countries devalued their currencies, in September 1949, Lebanon decided to stick to its old parity of US$1 = LL 2.19. The Lebanese Government, therefore, had to bear the loss resulting from the depreciation of certain foreign assets of the note cover, mainly French francs. This loss was made good by the issuance of Treasury Bonds to the amount of LL 58.7 million.[2]

Meanwhile, the Lebanese Government had officially recognized the open currency market which had been previously operating.[3] From that time on, an increasing part of foreign

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1. While gold has increased both absolutely and relatively from a low point of 2% of the note cover in January 1948 to a high point of 87.3% of the note cover in April 1957, foreign exchange has steadily declined from a high point of 97 per cent in January 1948 until it disappeared completely from the note cover after March 1952. (Foreign exchange later had a temporary reappearance in the last four months of 1953).

2. Decree No. 581 of December 8, 1949.

3. Decree No. 13532 of November 2, 1948.

exchange transactions was being legally negotiated. The Exchange Office soon stopped making currencies available at their official rates for import purposes, and in 1949 restrictions forcing private exporters to sell part (10%) of their proceeds in the official market were abolished. At present, there are no restrictions on the making of current and capital payments. The only transactions conducted at the official rate, through the Exchange Office are the payments to Lebanese diplomatic missions abroad. The assets of the Exchange Office are held for the Government by the BSL. Foreign currencies received by the Government (mainly from the oil companies operating in Lebanon) are passed to the BSL against Lebanese pounds converted at the official rate and credited to the Government current account.

The parity of the Lebanese pound ($1 = LL 2.194) established when Lebanon joined the IMF in 1947 has not been changed since. However, with the gradual liberalization of foreign exchange controls, this official exchange rate has become purely theoretical. The free rate, since 1953 has shown remarkable stability.[1]

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1. The dollar stood at around LL 3.55 in mid-1948, dropped to an average of about LL 3.26 in 1949, increased to an average of LL 3.47 in 1950 and of LL 3.73 in 1951, and since November 1953 has fluctuated around the level of LL 3.23. It should be mentioned in this connection that the Stabilization Fund, set up in October 1949 to provide a consultative framework between the Government and the BSL, has made it a rule since the summer of 1953, that dollars shall be bought by the BSL in the free market whenever the price of the dollar falls to LL 3.20. There is no corresponding rule about the sale of dollars at a certain rate.

CHAPTER III

CHARACTERISTICS OF THE LEBANESE BANKING SYSTEM

Although the Lebanese banking system is fairly developed, it still lacks some of the characteristics common to most advanced banking systems in the world. It was therefore found appropriate, before launching into a discussion of the present position of the central bank and of the commercial banks in Lebanon, to point out briefly some of these deficiencies, namely those connected with the lack of banking legislation, and of banking statistics, with the 'individualistic' aspect of the banking system, its liquidity and solvency, the non-existence of savings institutions, and finally the predominance of commercial credit.

1. Banking Legislation

With the exception of the Banking Secrecy Law of September 3, 1956,[1] which is the first law that makes the Lebanese

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1. Published in Al Jarida Al Rasmia (The Official Gazette), No. 36, Sept. 5, 1956 and put into effect two months later, this law was introduced in the hope that it will help Lebanese banks to attract foreign deposits. "Though the importance of such action should not be overestimated, it may at the same time be stated that the official establishment of banking secrecy would constitute a small sacrifice on the part of the Lebanese authorities. Since international capital movements are entirely free and uncontrolled, anybody preferring to avoid the chances of official scrutiny is at liberty to keep his funds in such places as to make them inaccessible to government investigation. Even if the authorities should force the banks to disclose information about their depositors, therefore,

banking system subject to certain regulations, there is no specific legislation concerning banks in Lebanon; the banking profession is entirely free and unregulated. Banking and exchange operations are considered by law as mere acts of commerce[1] and are consequently regulated by the Commercial Code. Any person or corporation, whether Lebanese or foreign, can operate a bank and will be considered as a merchant.[2] Thus all banks are only subject to provisions referring to merchants generally. There are, however, few specific provisions pertaining to the contractual aspects of certain banking operations namely those relating to deposits.[3] Apart from the aforesaid provisions, nothing else concerning the subject of banking is presently in existence. There is no legal reserve requirements, no legal maximum rates of interest on deposits or on other credit instruments, and above all there is no central banking institution invested with the power of regulating the volume of money in circulation. The absence of banking legislation has made government supervision on banking practices almost non-existent. Private banks go about

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they are not likely to discover much that might be of interest to them. Under those conditions, the official recognition of banking secrecy .... may serve to dispel fears or misunderstandings on the part of depositors that might otherwise arise". F. Keesing, op.cit., p. 34.

1. Commercial Code (Legislative decree No. 304 of April 7th 1943), Article 6.

2. Ibid., Article 9.

3. Ibid., Articles 307-314.

their business as they choose. Although BSL, as will be pointed out later, enjoys certain banking privileges, the government has no right to supervise its business activities. The need to interfere may not have been particularly strong in the past, but the legal authority to do so, should the need arise in the future, is lacking. A good proof of this occurred in November 1956 when, as a result of the Suez crisis, there was a great rush on banks. As most of these banks kept relatively little cash reserves, the situation of some of them soon became precarious. In the absence of a central bank to extend the needed rediscount facilities, the government had to order a considerable increase in the note issue in order to relieve the pressure on banks.[1] This situation may not have evolved, or may have evolved to a considerably smaller degree, had banks been forced by law to keep an adequate cash reserves against demand deposits, and to abide by other safety measures which the government may have thought useful to impose.

2. Banking Statistics

Another important deficiency is the lack of banking statistics. It is clear that no monetary policy is possible as long as the Lebanese Government does not have at its disposal the detailed information about economic conditions in general and the banking conditions in particular.

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1. This is shown by the increase in note circulation from LL 309 million to LL 349 million in October and November 1956. In January 1957, however, with the return to more normal conditions, deposits started to return to banks and consequently the note issue gradually declined to LL 328 million in April 1957.

To begin with, due to the special position of the BSL, the statistical information which in many countries is collected and published by the central bank, is practically unavailable in Lebanon. Secondly, banks submit to the Lebanese authorities, each year, a balance sheet and a profit and loss account, drawn up in accordance with rules fixed by the Minister of Finance, for tax purposes only. The significance of this information such collected for an understanding of the monetary and banking system is practically nil. Moreover, banks are not obliged to communicate monthly a statement of their assets and liabilities or a statement of their cash position.

The only data presently available are the monthly figures published by the Ministry of Finance on bank loans (advances and discounts) and deposits, without any sub-division or breakdown.[1] This information is contributed to the Ministry by the banks on voluntary basis. No doubt, these figures provide some general information on banking developments, but they are not adequate for any detailed analysis. Foreign banks publish their balance sheets in such a way as to make it impossible to distinguish the business they perform in Lebanon from their business elsewhere.

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1. Reference is here made to Ministry of National Economy, Bulletin Statistique Trimestriel which reported in mid-1956 total bank loans and total deposits at LL 538 million and LL 516 million respectively. At the same time currency in circulation was LL 286 million.

There is no doubt at all that clearly detailed and up-to-date figures about banking conditions are of paramount importance for any future government action in the field of monetary policy, and must be collected together with more complete information on the balance of payments, the national income, and government finances.[1]

3. 'Individualistic' Aspect of the Banking System

Due to certain peculiarities, which will be presently discussed the Lebanese banking system shows a lack of homogeneity and coordination, and is characterized by a high degree of individualism.

It is reported[2] that banks seldom negotiate bills with each other, and call money or similar intra-banks short term credits do not exist. This means that a money market is practically non-existent. Banks do not help each other dovetail temporary liquidity surpluses or deficiencies, and very few funds move from bank to bank. Many local banks are un-

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1. Some attempts in those directions have been undertaken by the Economic Research Institute of the American University of Beirut and UNRWA. However, since most of the basic quantitative data are scanty, studies such as balance of payments and national income estimates cannot be considered, as was realized by those who conducted them, as more than "rough estimates that might be useful in reflecting directions rather than magnitudes." A. Badre, "The National Income of Lebanon," op.cit., p. 1.

2. Economic Research Institute, Business Legislation in Lebanon, mimeographed, (Beirut, American University, 1956) p. 41.

willing to call on other banks for help, if and when they encounter difficulties, since they consider doing so a sign of weakness. As to their relationship with the BSL, which will be discussed later, some of the local banks do not wish to benefit from BSL's facilities, since they consider the latter as a competitor. On the other hand, most foreign banks do not need BSL because they can easily arrange short-term financing with their home offices abroad.

Apart from the non-existence of a money market, and in view of the fact that there is no central bank in Lebanon, all relationships which normally take place between the central bank and the private banks can be considered, for all practical purposes, as insignificant in Lebanon.

Cooperation among banks in Lebanon is still far from being adequate. Only two types of organized cooperation among banks exist, namely, the check clearing service, and the credit risk office. The former is handled by the BSL and comprises nine foreign and ten local banks. The latter is a central register held by the BSL which collects information about the amounts of credit granted by the participating banks to various customers. It has been joined by nine foreign and eight local banks. For the rest of the banks, no organized cooperation among them exist, and all attempts have so far failed. In June 1954, three Lebanese banks, the Intra Bank, the Federal Bank of Lebanon, and the Banque Libanaise pour le Commerce thought of forming an association of Lebanese Bankers.

This attempt failed when Intra Bank withdrew at the last moment. Early in 1956 some foreign banks also attempted to form a bankers' association, but so far nothing has materialized.

From all this, it follows that there is a lack of harmony and mutual help between banks in Lebanon. The consequences of such a characteristic became evident in November 1956, when the few banks that were in difficulty could not find ready help with the other banks. As shown earlier, the crisis was finally averted by government intervention. However, it is clear that closer cooperation between banks could have, from the beginning, prevented the occurrence of any liquidity crisis.

4. Liquidity and Solvency of the Banking System

Liquidity and solvency are two difficult, though separate,[1] aims which banks must keep in mind. Liquidity of a bank is usually defined as its ability to exchange its

1. The following example will indicate why liquidity and solvency must, for analytical purposes, be separated: "A bank may not be able to acquire cash quickly enough to meet demands upon it for payment on short notice or without any notice at all, even though the value of its assets would be considerably greater than its liabilities to non-owners if it had ample time in which to sell the assets. On the other hand, an insolvent bank - one whose deposits and bank note liabilities exceed the value of its assets -- may continue to operate for a long time if it is not subjected to heavy demands for payment." See L.V. Chandler, The Economics of Money and Banking, (New York, Harper and Brothers, 1948) p. 196.

assets for money fast enough to meet the demands upon it for payment. "Complete liquidity would require that the banks assets (except for those representing capital and surplus) be entirely in cash. If earning assets were to be held instead of cash, then they should be such assets as would be converted into cash within the shortest possible period."[1] If a bank begins to lose part of its cash reserves due to deposit withdrawals, the fact that its assets would mature within a few weeks would soon restore its reserves or decrease its liabilities, either of which will make the bank able to pay its creditors upon demand.

A bank is solvent when the value of its assets is at least great enough to cover all its liabilities except those to its owners; it is insolvent when the value of its assets is insufficient to cover all the non-owner claims against it.[2] It is true that a bank may be able to function for some time after the value of its assets has declined below its liabilities to its creditors; however, such insolvency is undesirable because if the bank's condition becomes known or suspected, this will likely lead to immediate demands on the bank for payment and therefore to losses to depositors and other creditors.

Since no adequate statistical data are available, the liquidity and solvency of the Lebanese banking system can be

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1. E.S. Klise, Money and Banking, (Ohio, South-Western Publishing Co., 1955), p. 305.

2. L.V. Chandler, op.cit., p. 196.

only assessed in general terms. However, from the available information the following two conclusions may be drawn. First, if difficulties should ever arise, the organization of the Lebanese banking system does not seem to be such as to guarantee that these difficulties will be taken care of smoothly. Secondly, it is probable that the position of the Lebanese banking system has deteriorated in the last few years.

The fact is that at present commercial banks are never sure, when faced with a rush by depositors asking for payment in legal tender, about the help they may get from the BSL. Moreover, there have been recently signs of overcrowding and complaints among banks about severe competition. The considerable increase in the number of banking institutions operating in Lebanon has reduced the profits of banks, and as a result, the Lebanese banking system may be confronted with serious problems of liquidity and solvency.

Generally an individual bank must be liquid enough to meet the demands by its customers for currency, and to make payments of adverse clearing balances to other banks. To meet these payments, a bank in Lebanon usually resorts to several sources of funds. First of all, it uses currency from its own vaults, or draws on its deposit balances with other commercial banks, including BSL. The next step, in case the bank is a foreign one, is to call on funds from its head office or other branches outside the country, or from correspondent banks outside Lebanon. Finally, if these sources are not adequate to ensure the necessary liquidity, then the bank secures the necessary funds by selling its assets to and borrowing from BSL. A sale of bank's assets may, however, prove burdensome, as happened in November 1956, when other banks also face demands for cash payments. In such cases, borrowing from BSL, in its capacity as bank of issue, is the ultimate source of liquidity.

One important factor must be finally mentioned. Taking into consideration the propinquity of the Beirut and Damascus markets and the fact that several of the banks which operate in Lebanon have branches in Syria, and vice versa, it is probable that the liquidity of one banking system may affect that of the other. Since the liquidity of the Syrian banking system is reported to have been increasing,[1] one would then be justified in believing that the liquidity of the Lebanese banks has been affected in the same direction. It must be

1. The liquidity of the Syrian banking system can be assessed because the Syrian authorities obtain detailed banking statistics and are better informed about their banking conditions than the Lebanese. Defined as the ratio of cash to demand deposits, the liquidity of the Syrian banking system has increased from 12 per cent in December 1954 to 19 per cent in December 1955, and to as high as 26 per cent in August 1956. For figures on Cash and demand deposits, see Syrian Republic, General Monthly Bulletin of Current Statistics, November-December 1956, p. 25.

noted, however, that the competitive rise in interest rates on deposits in Lebanon may have induced Lebanese banks to use a large portion of their loanable funds in order to have a sufficient income leaving them with relatively little cash reserves. These reserves are reported to have dropped to 30 per cent.

As to the solvency of the banking system, if one takes into account the high interest paid by some banks in order to attract deposits, one will be led to conclude that bankers are tempted to invest in speculative assets with higher returns in order to acquire sufficient profits, as a result of which their solvency will be negatively affected. Moreover, there is no regulations in Lebanon which forbid commercial banks from holding common stocks, real estates, inadequately secured mortgages or highly questionable short term papers. In fact, there is no limitation on the proportion of assets that may be held in any form, thus providing a temptation to bankers to invest in assets of questionable safety.

If banks' capital accounts are large relative to their assets, creditors enjoy a large degree of safety, whereas if capital accounts are small, a decline in assets values will endanger creditors. Hence, the solvency of banks does not only depend on the stability of the value of their assets, but also on the size of their capital accounts. Since some Lebanese banks have small capital creditors as a result may be endangered.

Mention has already been made of the Credit Risk Office which was created by BSL in agreement with the Government in 1953 as an attempt to increase the safety and the solvency of the Lebanese banking system. Since it is the responsibility of the Credit Risk Office to collect monthly information about the amounts of credit granted by the participating banks to their customers, the banks would then be able to estimate the creditworthiness of every customer. The fact that the office records only loans of over LL 50,000 limits the scope of its activities; bankers consider, and rightly so, that the small borrowers are equally, if not more, dangerous than big borrowers. Moreover, very few banks, as previously stated, have so far joined this organization.

To conclude, while the Lebanese Government, like all other governments, cannot under all circumstances guarantee the liquidity and solvency of its banking system, there are no reasons why in principle it should not be able to take precautionary measures as safeguards against possible emergencies.

5. <u>Nonexistence of Savings Institutions</u>

Another outstanding characteristic of the Lebanese banking system is the virtual nonexistence of savings institutions. There are no savings banks in Lebanon to pool savings for capital investments, and the regular commercial banks do not consider it worthwhile to make a particular effort to attract savings deposits. Postal savings systems, which in developed countries are designed to mobilize capital and to encourage thrift among middle and low income groups, do not exist;[1] and savings in the form of insurance are negligible.[2] This does not necessarily mean that savings do not accrue, but rather that they do not take institutional form. In fact, net investments in Lebanon were estimated in 1950 at LL 150 million.[3] There is no doubt that part of these investments was contributed by foreign capital imports (including emigrants' remittances) which in 1951 totalled LL 70 million.[4] The balance must have been therefore provided from internal savings. These savings are invested directly,

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1. It must be mentioned that the Lebanese Government called upon a United Nations expert who submitted a project of postal savings in Lebanon early in 1955. However, nothing has been heard about the project since then.

2. It is reported that the fifty insurance companies (four of which are Lebanese) operating in Lebanon are not interested in domestic investments. Most of these companies invest the bulk of their resources in more developed economies. However, some of them claim that they contribute to domestic capital investment by depositing part of their funds on a time basis with commercial banks at 3% interest per annum. See T. Yaffi, "Industrial Credit in Lebanon". Chamber of Commerce & Industry of Beirut, The Economy of Lebanon and the Arab World, September 1956, p. 20.

3. A.Y. Badre, "Le Revenu National Au Liban" in L'Economie Libanaise et le Progrès Social, Les Orientales, Beirut 1955), p. 27.

4. Edward Fei and Paul Klat, The Balance of Payments of Lebanon, 1951 and 1952. (The Economic Research Institute, American University of Beirut, 1954), p. 5.

not through the intermediary of institutions or a capital market. Actually the latter, if considered primarily as a market for mobilizing long term investment capital, does not exist. The Beirut stock exchange (Bourse), with its existing set-up which limits its scope of action to local corporations only,[1] cannot serve as a means of pooling capital for long term investments. A further handicap for the development of long term capital lending is the fact that the predominant type of business organization in Lebanon is private or family ownership. It is reported that there are only around 100 joint stock companies, out of which only 25 are listed in the Bourse.[2] Mention must be made, however, of a measure which has recently been taken to modernize and organize the regulations and set-up of the Beirut stock exchange.[3] This will no doubt make dealings in company stocks more regularized and easier, and therefore will make company formation more desirable.

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1. Stocks and bonds of a company cannot be quoted unless 51% of them are held by Lebanese nationals. However, some of the actively trade companies are French companies controlled by French nationals, like the Port de Beyrouth, D.H.P., Radio-Orient, BSL Fonçière de Syrie, Electricité d'Alep, and Compagnie Générale du Levant.

2. T. Yaffi, <u>op.cit.</u>, p. 19.

3. The Stock Exchange Law of February 2, 1957. For details see <u>Al-Jarida Al Rasmia</u>, No. 6, February 6, 1957, p. 104.

Lebanese still generally prefer types of investments which are tangible and visible and over which they can exercise some personal control. It is mainly for this reason that real estate is the favored field of long-term investment. Capital is inclined to flow into speculative channels where high profits are expected and often obtained. Lebanese merchants are versatile, and as such are known to shift easily from commodity to commodity and to withhold stocks for long periods in anticipation of price increases, rather than to aim at large, quick turnover with moderate profits. In the past the habit of putting savings into hoards of precious metals or even currency has been deeply ingrained. There is however, some evidence, not susceptible to statistical measurement, that the relative importance of savings in the form of hoards has declined in the postwar period as opportunities for profitable investment has grown.

It may be useful to make two observations here. First, people in the high income brackets save much less than would be expected. It has been said that "the wealthy people, those who could afford to save, have a natural tendency of rivaling each other in conspicuous consumption. The number of cadillacs in the Arab countries is phenomenal! Millions are spent every year on luxury imports, foreign travel or the building of palatial residences. A foreign visitor to Cairo, Beirut, Damascus or Baghdad is invariably struck by this stupendous exhibition of wealth alongside squalor and poverty. Most of the income, thus squandered, is lost to the economic circuit of production primarily through import leakages and this is probably where exploitation of the masses by the more-often-than-not idle few shows its ugliest face."[1]

The second observation is that the proportion of savings held abroad has been recently increasing. This is reflected by the fact that holdings of gold and foreign exchange have increased over the past five years.[2] This has unfavorable consequences which extend beyond the immediate loss of some investment in one year; the loss means a reduction in income for the coming year and therefore, a shrinkage in the absolute investable part of that year's income, and so on.[3]

The above mentioned points may help to draw the following conclusions, namely, that while Lebanon cannot complain about not having enough investment, 'personal' savings institutions and devices are still lacking in Lebanon. Savings deposits have recently shown a tendency to increase, but are still relatively small (see table below). With the exception of few local banks who have already introduced certain savings devices, the other banks, and particularly the foreign, do not seem to consider it worthwhile to make any effort to attract time deposits.

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1. P. Klat, "The Future of Economic Development in the Arab World", op.cit., p. 59.

2. Gold and foreign exchange holdings have increased from $50.8 million in 1950 to $90.8 million in 1956. See International Monetary Fund, International Financial Statistics, February 1957, pp. 154-155.

3. Y.A. Sayigh, op.cit., p. 50.

DEMAND AND TIME DEPOSITS FOR THE PRINCIPAL BANKS

IN LEBANON (LL 1,000)

As at the end of	Time Deposits	Demand Deposits	Total
1950	5,514	209,667	215,181
1951	6,205	253,092	259,297
1952	11,766	301,456	313,222
1953	19,049	324,371	343,420
1954	26,699	362,058	388,757
1955	39,301	443,969	483,270
1956 (Sept.)	43,455	473,054	516,509

Source: Ministry of National Economy, Bulletin Statistique Trimestriel, 2nd quarter of 1956, p. 42.

6. Predominance of Commercial Credit

The present structure of the Lebanese banking system does not permit the commercial banks to undertake the issue of loans on longer than short term basis. Commercial credit, as is evident from the predominance of commercial banks operating in Lebanon, is the main form of credit which is adequately available. In the absence of proper medium and long-term credit businessmen depend on short-term credits which are sometimes renewable. The main instruments of short-term credit are overdrafts, discounts, documentary credits, and advances on securities, all of which do not exceed the period of one year. While overdrafts, which are extended for one year subject to renewal, may solve the problem of merchants, they are hardly adequate for farmers and manufacturers who require time to get their product on the market, and completely unsuitable for financing expansion and investment. Moreover, the short-term credit facilities are open only to some of the large firms. Small business including artisans, still depend very largely on local money lenders, and a large proportion of farmers have to turn to grain merchants or landlords when in need of personal credit.

It is an established fact that commercial banks in almost all countries, in order to maintain a high degree of liquidity and solvency, limit the majority of their operations to the extension of short-term credit facilities. However, most commercial banks are expected to, and quite often do, invest a substantial portion of their funds in medium loans extending to five years or more; and some are even required by law, as is the case in Latin America, to invest at least ten per cent of their demand deposits in time credits. There are several factors which, in developed countries, enable commercial banks and encourage them to extend long term loans. Such factors are mostly non-existent in the Lebanese banking system.[1]

To begin with, commercial banks in developed economies have large capital resources; and their time deposits are becoming as important as demand deposits. This enables such banks, since they do not have to maintain a high degree of liquidity, to invest part of their funds in term loans. In Lebanon, however, capital is not as abundant as it is in developed economies. The

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1. T. Yaffi, op.cit., pp. 16-17.

volume of time deposits to demand deposits is very low. Consequently, some Lebanese commercial banks depend exclusively on demand deposits for their operations and cannot, therefore, encourage the expansion of term loans and run the risk of low liquidity.

A second factor which enables commercial banks to extend long term loans is the fact that they can rely on the discounting facilities made available by the central bank. Such facilities assist the banks in securing an adequate degree of liquidity. However, the absence of a central bank in Lebanon renders it difficult for the commercial banks operating in Lebanon to resort to similar discounting facilities as are available in developed countries. The BSL provides the local banks with some discounting facilities, but since BSL is basically a commercial institution operating to maximize its profits, it is motivated by commercial returns rather than by public interest. The BSL, because of its own commercial benefit, cannot discourage discounting facilities during prosperity and encourage such facilities during depression.[1] Furthermore, BSL cannot, by law, discount bills other than those for

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1. This was apparent in what took place during the period between the end of 1952 and the end of 1953. While economic activity was high, the deposits in the BSL reached LL 79 million; but when the depression fell, these deposits contracted to LL 59 million. The same thing happened during the first three months of 1956 when the money in circulation increased by LL 10 million, and the whole sale prices and the cost of living indices rose as a result of the increase, in government expenditure, following upon the flood in Tripoli in December 1955 and the earthquake in March 1956.

short term mercantile credit. In other words, it does not discount bills whose maturity exceeds 120 days, whereas most central banks deal in commercial bills with maturities ranging up to 270 days or a year.

A third factor which encourages commercial banks in some developed countries to extend term loans is the fact that these banks can in general rely on specialized credit information services to look into the financial and credit standing of the different enterprises before actually granting them the loans. In Lebanon, the lack of reliable balance sheet and profit and loss statements makes it difficult for commercial banks to grant term loans. Such loans, in the absence of specialized credit information services, can only be made on the basis of mortgage credit. It is reported that a small amount of mortgaged loans is extended in Lebanon; but, on the whole, commercial banks are not interested in such types of credit; and mortgage banking is still far from being developed.[1]

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1. Mortgage banking in Lebanon was largely represented by the local branches of two French mortgage corporations, the "Crédit Fonçier d'Algérie et de Tunisie", and the "Société Nouvelle de la Compagnie Algérienne de Crédit et de Banque." Facilitated by the progress of cadastral surveying, and some settlement and registrations of rights on real estate, both operated for some time as mortgage credit establishments; but the commercial character of the country soon opened before them the possibility of the more lucrative business of exchange and discount. In 1936 the Crédit Fonçier ceased its credit mortgage operations, and the Compagnie Algérienne soon followed suit. Both now operate as commercial banks.

Finally, a considerable number of the important commercial banks operating in Lebanon are foreign. Since these banks can always depend on their principal centers abroad to increase their liquidity when the need arises, they are then capable of extending term credit facilities if they so desire. However, foreign banks are known not to be particularly keen about participating in such types of credit. The foreign banks have always been interested in financing Lebanon's international trade relations, leaving internal trade to local banks. It is true that over the last decade, these differences between foreign and local banking have tended to become less pronounced, and now both participate in international and local financing. Nevertheless, foreign banks, as all others, are interested in immediate profits, and it did not take them too long to realize that the mercantile sector is the most lucrative.

CHAPTER IV

COMMERCIAL BANKING INSTITUTIONS

After the preceding description of the major characteristics of the Lebanese banking system in general terms, this chapter endeavours to present a discussion of the commercial banking institutions as potential sources of long term credit. The chapter is divided into two main sections: the first describes the position of the BSL in the light of its legal provisions and its activities both as a central bank and a commercial bank and the second is devoted to a discussion of the position of the private commercial banks.

A. Banque de Syrie et du Liban

In view of the prerogatives it has been granted by its Convention with the Lebanese Government of 1924, BSL is in a position to perform various roles and to exercise a large control over the Lebanese banking system. Apart from being the most important commercial bank, BSL is a Bank of Issue, a Government Bank, and a Bankers' Bank. These various functions of BSL will be presently discussed separately. However, it must be mentioned at the outset that it is difficult to arrive at a clear picture of the methods followed by BSL in performing these diverse functions, or to draw a line of distinction between its transactions as a central bank and as a commercial bank.

1. Bank of Issue

BSL is a French corporation with headquarters in Paris. It was established on January 2, 1919 when it took over from the Anglo-French owned Ottoman Bank all its agencies and privileges in Lebanon. Its present status is based on the Convention of 1924 (as amended in 1937), which, unless renewed, will expire in 1964.

According to the terms of the 1924 Convention, BSL has the sole right of note issue in Lebanon. BSL consists of an Issue Department and a separate administration which is sometimes called the Banking Department and in which all business not affecting the note issue is concentrated. In accordance with Article 4 of its statutes, BSL's Issue Department is to be distinct and absolutely independent from any other section of the bank. It has separate accounts for all operations of issue and withdrawal of notes. In actual fact, however, the Issue and the Banking Departments are not absolutely independent. Since BSL is free to move eligible assets ("réserve de couverture") from one department to the other, the Issue Department is readily affected by conditions prevailing in the Banking Department and vice versa.

The Convention also provides that the earnings of the note issue, i.e., the gains from the fiduciary reserve, be divided between BSL and the Lebanese Government. In other words, in return for the right of note issue, BSL was obliged to pay an annual fee to the Government. However, the Lebanese

Government has recently waived its right to share in the note cover earnings; this decision was probably motivated by the fact that non-earning assets and mainly gold have been increasing in the note cover, which is believed to have considerably reduced the gains of the Issue Department from the note cover.

As a potential source of long term credit, BSL is greatly handicapped by the fact that the Issue Department is not permitted by law to discount bills whose maturity exceeds four months. This means that BSL is able and willing to discount and rediscount bills that are restricted to short term mercantile credit only. As a consequence of such a limitation, most other banks refuse to handle other than short term credit facilities, since such facilities could not be rediscounted by BSL.

2. Government Bank

Apart from having the sole right of note issue, BSL has the sole right to receive and hold government deposits, and as such acts as the government's bank and its fiscal agent. The government deposits with BSL have been steadily increasing over the past years, and now constitute a very significant portion of the total amount of deposits outstanding with the Lebanese banking system. Practically all government deposits with BSL are demand deposits in order to make it possible for the government to draw any amount any time it has to meet its current expenditures. These deposits receive a rate of interest which is considered to be low in comparison with the rates of interest offered by the other commercial banks.[1]

The Convention also provides that all advances to the Lebanese Government or public agencies should be provided by BSL unless the government can get those advances at better terms from other banks. It is obvious, however, that with the special privileges which BSL enjoys (i.e. as the note issuer and the holder of government deposits) the other banks are in no position to compete with it. The advances which the government has so far obtained from BSL consist mainly of loans to municipalities, to private electric companies (with government guarantees), to the Telephone Authority and other semi-public institutions. The rates charged by BSL on these loans vary from 2½ to 4 percent per annum. It is interesting to remember in this connection that the government, while paying a 4 percent interest on some

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1. It is provided by law that government deposits with BSL should receive a rate of interest which is 2 percent less than the official discount rate of the Banque de France. Since the discount rate of the latter has been on the average 3 percent, the interest therefore earned on government deposits is 1 percent, while other commercial banks in Lebanon are reported to give as much as 3 percent on demand deposits. The law is now under parliamentary reconsideration; the Finance Committee has already decided to dissociate the rate paid by BSL on government deposits from the rate of the Banque de France; it is likely that Parliament will follow suit.

of its loans, earns 1 percent only on its deposits. The following table shows government deposits with BSL and BSL advances (including the holding of government bonds) to the Government since 1950.

TABLE 1

DEPOSITS OF AND ADVANCES TO THE GOVERNMENT

(L.L. Million)

End of	Deposits (a)	Advances (b)
1950	24.3	n.a.
1951	31.8	n.a.
1952	69.2	85
1953	108	78
1954	115.5	94
1955	144.9	87
1956	n.a.	89

SOURCE: (a) Zuhair Mikdashi, *op.cit.*, p. 80.
(b) Privately secured from the Ministry of Finance.

On the assumption that government deposits with BSL provide a potential source of long term credit, the fact that these deposits have been increasing and constitute today 28 percent of total deposits, may be taken as an indication that BSL's capacity to extend long term credit has recently considerably improved. However, it must be remembered that most of these deposits, as mentioned earlier, are demand deposits, which greatly reduces BSL's ability to finance term loans.

3. <u>Bankers' Bank</u>

As already indicated, BSL enjoys two prerogatives which normally belong to a central bank, namely, the right to receive government deposits, and the ability to increase the liquidity of its banking department at no cost to itself by shifting some of its assets to its issue department. Aside from enjoying these two prerogatives, BSL is furthermore in a position to act as a bankers' bank and in particular as a lender of last resort.

There are two ways by which BSL can act as a bankers' bank. One is by rediscounting trade bills; and the other by opening lines of credit to the other banks.[1] Despite the fact that the former way is more oftenly resorted to than the latter, most banks are still reluctant to use BSL's rediscounting

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1. It is reported that BSL has for the past few years adopted a third device known as borrowing <u>en pension</u>, which is simply a sale of bonds or bills under a re-purchase agreement. The bank needing funds, sells trade bills to BSL and receives the latter's check in payment. The period of advance is seven days subject to extension on a seven-day basis. After the lapse of the agreed period the bank will repurchase the trade bills from BSL. See Zuhair Mikdashi, <u>op.cit.</u>, p. 85.

facilities for several reasons. The most important of these reasons is the fact that BSL does not publish an official discount rate. What BSL usually does is to judge the quality of each trade bill separately, and therefore to quote different discount rates which vary with the quality of trade bills that are offered to it. As a result, most private banks are not always sure of the assistance BSL may be willing to extend to them, and in many cases, particularly when they have no agreement with BSL concerning rediscount facilities, banks will have to open negotiations with BSL whenever the need for such facilities arises.

A second reason is that while there are a few private banks which cooperate with and seem to obtain from BSL the kind of assistance they need, there are other banks which are often loath to use BSL's rediscounting facilities. These banks do not show any willingness to rely on assistance from BSL because they consider the latter a competitor to which they do not wish to communicate the names of their customers. To most local banks, reliance on BSL's assistance is also a loss of prestige. This might explain two facts which can be reconciled in one, namely, that the chief customers of BSL are generally the French owned or French controlled banks, and that most local banks prefer to remain highly liquid rather than use BSL's credit facilities. It is important, in this respect, to bear in mind that the objective of maintaining high liquidity, as previously noted, renders it arduous for local banks to be of any assistance in so far as extending term loans is concerned.

Regarding trade bills it must be mentioned that to be eligible for rediscount, their maturity period should not exceed three months, and that they are discounted at rates varying between 3 and 3.5 percent per annum. In discounting these papers BSL is purely guided by commercial motives; it contributes to credit expansion by lowering the discount rate in periods of high economic activity, and curtails credit by raising the discount rate in periods of low economic activity. Needless to say, such a discount rate policy is the opposite of the policy normally pursued by central banks.

The second way by which BSL can act as a bankers' bank, i.e., opening lines of credit to commercial banks, consists of giving the banks an unsecured open account subject to overdraft up to a certain maximum point. Repayment, which is agreed upon by contract, is usually after one year. However, BSL has generally the right to call in its loans with a 45-day notice. As a consequence, commercial banks are forced to lend for a shorter period, a factor which greatly limits their capacity to extend long term loans. It has already been stated that while such facilities, i.e., overdrafts, may help merchants solve their problems, they are hardly adequate for farmers and manufacturers, and completely unsuitable for financing expansion and investment.

Aside from the above mentioned two functions, BSL performs one other important function of a bankers' bank. Due to the fact that all agreed banks keep deposits with BSL for clearing purposes, BSL is in a position to act as the clearing agency of the Lebanese banking system. However, since there is no law which requires banks to maintain a certain percentage of their demand deposits as cash reserves, BSL has no jurisdiction to lay down nor to control the cash reserve requirements of commercial banks.

4. Commercial Bank

In addition to being a bankers' bank, a government bank, and a bank of issue, BSL also engages in private banking activities, and is the most important private bank in Lebanon. In accordance with Article 3 of its statutes, the principal purpose of BSL is to promote the economic development of Syria and Lebanon. To that end, BSL carries out various types of banking services, but is not permitted to engage in real estate transactions and mortgage loans. However, the latter provision has not been strictly adhered to, since it is reported that BSL sometimes issues long term loans against mortgages.[1] As specified in Article 3 of its by-laws, BSL's services to the public are restricted to the following:

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1. It is claimed by some banks that the Sisters of Charity Building and the two Jesuits' buildings at Ashrafiah & Jamhour were financed by BSL. See M.F. Abcarius and P.W. Dakarian, Notes on the Lebanese Credit System (Agriculture and Industry), mimeographed, p. 6.

1. To discount all commercial papers and credit instruments whose maturity does not exceed 180 days.
2. To grant loans to financially autonomous public institutions.
3. To discount and grant loans or advances guaranteed by warrants, deposits of money or precious metals, bills of lading, and deposits of government securities approved by the Council of Administration of the Bank.
4. To receive deposits of money, precious metals, securities and other financial papers; and to open current and fixed deposit accounts.
5. To undertake the collection and payment of all kinds of financial papers; and to carry commission operations for individuals or for public or private establishments.
6. To issue, purchase, sell, and negotiate public securities, financial papers, treasury bills of exchange, letters of credit, drafts and checks.
7. To open current loan accounts of a duration not exceeding one year for credit worthy persons.
8. To raise loans for the account of third parties.
9. To trade in precious metals.
10. To cash public revenues and to pay public expenses, and in general to help the local government in its financial operations.

Almost all of the above provisions are similar to those of commercial banks. These provisions reveal one striking feature of BSL's commercial credit activities, namely, that they are almost exclusively concentrated on financing short term mercantile credit not exceeding 180 days in the form of direct loans, discounts and overdrafts. BSL is fundamentally a commercial bank, and therefore it is only normal that it limits its activities to the more lucrative business of the mercantile sector. Like all other commercial banks, BSL is prompted by profit motives. Therefore, to be able to compete with the other banks, BSL cannot encourage discounting facilities during depressions and discourage such facilities during prosperity. The following table, which shows the monthly averages of the discount rates of BSL for three-signature commercial bills of up to 90 days' maturity indicates very clearly that BSL does not follow any anticyclical policy.

During the year 1951, when economic activity was high and trade was expanding, BSL discount rate declined from 6.75 in January to 6.54 in November. And when economic activity was at its lowest in November 1953, BSL discount rate went up to 6.26 while in June of the same year it was as low as 5.97, despite the fact that the government urged BSL to expand its credit facilities.

Although these variations in the discount rates are minor, they are enough to point out that BSL does not usually pursue any policy in the interest of the public if such policy

Table 2

BSL Discount Rates

	1950	1951	1952	1953	1954	1955	1956
January	----	6.75	6.64	6.28	6.00	5.32	5.25
February	6.97	6.70	6.83	6.23	5.99	5.20	5.23
March	6.84	6.85	6.59	6.13	5.70	5.14	5.26
April	6.83	6.57	6.50	6.19	5.62	5.12	5.30
May	6.85	6.72	6.67	6.25	5.45	5.14	5.29
June	6.85	6.58	6.39	5.97	5.63	5.14	5.26
July	6.65	6.66	6.38	6.13	5.52	5.16	5.33
August	6.69	----	6.54	6.02	5.40	5.21	5.31
September	5.77	----	6.33	6.18	5.30	5.25	5.35
October	6.76	6.57	6.35	6.09	5.32	5.20	5.23
November	6.73	6.54	6.39	6.26	4.72	5.24	5.30
December	6.75	6.56	6.58	6.11	5.11	5.26	5.13

Source: International Monetary Fund, International Financial Statistics.

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happens to conflict with its profit motives and competitive power.

Like any other banking institution, BSL's capacity to participate in extending long term credit facilities depends, to a considerable extent, on the size of its capital. When it was established on January 2, 1919, BSL's capital was FFr. 10 million. Since then it has been increasing and it now amounts to FFr. 300 million entirely paid up. Despite this increase, BSL's capital is still considered to be small, specially when taken in relation to its volume of business. According to the 1955 balance sheet,[1] BSL's capital, including various visible reserves amounted to around FFr. 845 million. BSL's loans and advances in 1955 amounted to Ffr. 24,187 million, i.e., around 30 times its own capital plus reserves; and its deposits and creditors for the same year amounted to Ffr. 53,646 million, i.e., 64 times its own capital plus reserves. However, it must be borne in mind, as reported,[2] that hidden reserves are quite considerable in size; and BSL's annual profits are probably much more than what its published profit and loss account shows. Nevertheless, in spite of these possible hidden reserves, and in view of its volume of business, BSL's capital may be considered quite small, a factor which debilitates its potential to finance long term credit.

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1. See Assemblée Générale Ordinaire, Banque de Syrie et du Liban, Exercise 1955, June 27, 1956.

2. See F. Keesing, op.cit., p. 8.

B. The Commercial Banks

In almost all developed countries of the world, commercial banks are expected to, and very often do, provide a substantial amount of long term financing. As such, commercial banks constitute an important source of long term credit. In the light of this fact, the position of the commercial banks operating in Lebanon will be presently analyzed.

Despite the fact that various factors have tended to slow down the continued growth of Lebanon as a financial and commercial center, the number of commercial banking establishments in the country has been increasing very rapidly during the past few years. Thriving on the complete freedom in the domestic trade and exchange market, and on the entirely unregulated and free banking profession; and attracted by the overall commercial aspect which seemed to afford many lucrative opportunities, numerous banks have been established in Lebanon. It is reported that there were 12 banks of real importance operating in the Lebanese market in 1953. Less than two years later, this number had risen to at least 20, including 11 foreign banks, and 9 local banks each having a paid-up capital of at least LL 2 million. At present, according to the classification of the Ministry of Finance,[1] there are 27 accredited banks in Lebanon, out of which 13 are locally in-

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1. The Ministry of Finance classifies banks into three types - accredited banks (banque agrée), non-accredited banks, and discount houses (banquiers).

corporated and 14 are foreign. Accredited banks are first class banks whose guarantee is accepted by the Lebanese Government. Most of these banks are owned or controlled by foreign banking establishments. Non-accredited banks are only five in number, out of which one is foreign. In view of the fact that their banking operations are not significant, these banks are considered second class banks. Discount houses, i.e., the third type of commercial banks, are around thirty in number. Their exclusive function is to discount or purchase bills offered in the market. However, there are few of them who receive deposits and make advances. Discount houses, which are all privately owned, get their loanable funds from their capital, time deposits of friends, and to a large extent from commercial banks.

The activities of the commercial banks mainly concentrate around financing internal trade transactions as well as foreign trade deals. These deals involve merchandise trade, gold movement, or mere foreign exchange transactions. In these operations, the commercial banks are not alone; for, there are numerous money-dealers who do large business from small, insignificant, one-room offices. Both, the money dealers and the discount houses, have made of Beirut a brisk money market, which has been developing with the growth of the Lebanese banking system to a degree that it now has become of a considerable size and world-fame.

It has already been mentioned in the previous chapter that the present structure of the Lebanese banking system does not permit the commercial banks to undertake the issue of loans on longer than short term basis. The factors, which in developed countries enable commercial banks to provide long term credit facilities, are still virtually nonexistent in Lebanon. This does not mean, however, that Lebanon's credit facilities are not well developed or adequate. Commercial credit, as is reflected in the continuous growth and spread of commercial banks, is adequately available, but agricultural, industrial, and real estate credit and banking are very much short of needs.

In a country where trade has been for centuries the traditional vocation, it is only normal to have most of the credit facilities geared exclusively to commercial needs. Of the 27 main banks which are presently in operation, practically none handle long term loans as a significant part of their business. The information available on the subject is too inadequate to allow a definite assessment of the share of each sector in the total credit made available by banking institutions. For instance, there is no way of knowing exactly what part of the total banking credit of LL 575 million (advances and discounts) at the end of September 1956, accrues to each of industry, agriculture and real estate. However, savings deposits which are the natural source of long term credit from banks represented, in September 1956, around 8 per cent of total deposits and only 7 per cent of total outstanding credit. It is also more difficult to make any significant estimate of long term loans advanced by non-institutional sources such as merchants, money lenders, landlords or relatives and friends.

1. Agricultural Credit

The only reliable information available that might throw some light on the role which commercial banking institutions and individuals play in extending long term loans for agriculture is a sample survey covering 146 villages conducted in the South Beka' in 1953.[1] It is evident that this survey which covers villages in a relatively poor district cannot be taken as representative of the whole country. The sample nevertheless gives an interesting picture of the distribution of loans among the different sources and the interest rates charged by each. The results of the survey, given in the following table, show that about 51 per cent of all loans come from banks, 43 per cent from money lenders, 4 per cent from landlords and about 2 per cent from relatives and friends. Average rates of interest are reported to range between 24 per cent and 8.8 per cent, the highest rates being on loans from landlords and the lowest on loans from relatives and friends. One of the major sources

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1. See Economic Research Institute, American University of Beirut, "Report on Agricultural Credit in Lebanon", Proceedings of the Agricultural Credit Conference of October 1953, (Beirut 1953 - Mimeographed), p. 11.

of loans, according to the survey, is the "Other Banks". It is said, however, that the role of "Other Banks" is probably not typical of other parts of the country; and in fact some of the "Other Banks" could be easily called money lenders without stretching the definition too far. This point is supported by comparing the average rates of interest they charge with those charged by other sources. Since landlords are also private money lenders the conclusion seems to be that private persons or money lenders are by far the larger source of agricultural credit in this area.[1]

This survey reveals certain aspects of the agricultural credit extended by commercial banks and non-institutional sources which need be mentioned at this point. To begin with, it is clear from the findings of the survey that the real problem is one of excessive interest rates. As already indicated above, about half the credit available to the rural communities comes from non-institutional sources, i.e., money lenders and landlords who, on the average, charge interest of 24 per cent and above. Even the credit available from banks is not cheap. The South Beka' survey reveals that only 20 per cent of the bank credit comes from official institutions and, therefore, bears a small interest charge (about 7 per cent); the balance comes from private banks and bankers whose interest charges average 18.5 per cent. In actual fact, there is little difference between these private bankers and the ordinary money lenders.

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1. Ibid., p. 11.

TABLE 3

SOURCES OF AGRICULTURAL CREDIT

SAMPLE OF 146 FARMS IN VILLAGES IN SOUTH BEKA', 1953

Source	No. of Loans	Value LL1000	% of Total Loans	Average Rate of Interest %
Official Banks	24	56.7	11.5	6.9 (1)
Other Banks	42	195.9	40.0	18.5
Money Lenders	90	210.9	43.1	22.4 (2)
Landlords	5	18.1	3.7	24.0 (2)
Relative & Friends	17	8.1	1.7	3.3
	178	489.7	100.0	-----

Source: Economic Research Institute, American University of Beirut, "Report on Agricultural Credit In Lebanon", op.cit., p. 11.

(1) This includes the official interest rate of 5 per cent and a few additional charges that the debtor has to meet.

(2) Cases were reported where the interest rates were high above this average.

Together they supply over 90 per cent of available credit at rates close to 20 per cent per annum.[1] The fact that the bulk of the outstanding loans is supplied by non-institutional sources is a definite indication of the failure of official institutions to meet satisfactory the local demand for credit.

Secondly, it is generally believed that the well-to-do farmers, because of the better security they can offer and of the greater influence they can wield, are able to obtain larger loans and much better terms than is available to small farmers. The loans advanced to the latter group by provincial banks and money lenders carry an interest rate of over 18 per cent, and are often given against the signature of well-to-do guarantors or in exchange for an I.O.U. that can be collected at harvest time. Money lenders and small banks have also been known to advance loans against crop liens when the farmer has some other forms of wealth such as animals, machinery or real estate. Landless peasants, on the other hand, are rarely offered a loan, and if they are then it is often as a means by which the landlord could tie them to the land through permanent indebtedness to him.

Finally, the majority of the loans advanced to farmers by banks and money lenders are of modest dimensions; they are mostly one-year loans of which a large number is seasonal. In most cases, these annual loans are renewed in whole or in part

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1. P. Klat, "Rural Indebtedness in Lebanon and Possible measures for its Alleviation". A paper presented in the Second Regional Meeting on Agricultural Credit, Beirut, November 1954.

from year to year, so that in fact they tend to become medium term loans. However, the risk to the farmer that the one-year loans may not be renewed except at more onerous terms often discourages him from using the loan for development purposes that might take years before showing results. The tendency is therefore for these short term loans to be used for financing current needs of the farm. But since these loans are seldom paid out of current income they tend to be renewed for another year at whatever conditions seem less burdensome. The result is that these loans become medium term in their duration but only short term in their function.[1] For this reason it is probable that long term credit which could be used for development purposes generally comes from non-institutional sources rather than from banking institutions.

2. Industrial Credit

There is no information available which can reveal the extent of the participation of commercial banks in extending long term loans for industry. It is true that very few commercial banks, as mentioned earlier, handle industrial credit as a significant part of their business. Nevertheless, it is believed that many commercial banks extend short term credit facilities which are renewable and which may in effect serve as medium and long term loans. For instance, if an industrialist

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1. Economic Research Institute, American University of Beirut, "Report on Agricultural Credit in Lebanon", op.cit., p. 13.

can get a loan for one year, and if the bank gives him a good guarantee that the loan will be renewed, then the loan can be considered, for practical purposes, a long or medium term loan.

In order to find out whether commercial banks extend such renewable short term loans, and if they do, at what terms and to what extent, a small survey was conducted. A sample of 68 industrial establishments was randomly chosen, and was stratified according to type of industry and to size of establishment. The sample was limited to those establishments in which factors of production are directly employed in manufacturing specific physical goods, and an equal number of large and small establishments was selected, i.e., 34 of each. The size of the establishment was based upon the number of workers employed. The average number of workers in large establishments ranged from 463 to 55, being highest in textiles and lowest in cement industry; while the average number of workers in small establishments ranged from 21 to 10, being highest in textiles and lowest in both food and beverages and printing and paper industries. The following table shows the distribution of the sample by type of industry and size of establishment.

The following establishments were interviewed with the intention of knowing the following:-

1. Whether they get any loans from commercial banks?
2. At what rates of interest?
3. For what periods? and

TABLE 4

DISTRIBUTION OF STRATIFIED SAMPLE BY TYPE OF INDUSTRY AND SIZE OF ESTABLISHMENT

INDUSTRY	SMALL	LARGE	TOTAL
Textiles	7	7	14
Food & Beverages	6	6	12
Furniture and Carpentry	5	5	10
Printing and Paper	6	4	10
Cement and Tiles	5	4	9
Mechanics	3	5	8
Shoe and Tannery	2	3	5
TOTAL	34	34	68

4. Whether the loans are renewable or not?

In cases where the establishments reported that they do not get any loans, they were asked --

5. Whether they do so, because they do not need the capital, or because the commercial banks do not give them the needed capital.

It can in no way be claimed that the findings of this small sample can be taken as representative of the overall position of commercial banks; the sample is too small to warrant making any generalizations as to the participation, if any, of commercial banks in extending term loans for industry. However, the survey gives an interesting contrast between the conditions facing small and large establishments with respect to availability and terms of credit facilities of commercial banks. Of the 34 small establishments, only 9 take loans from commercial banks and 25 do not; while in the case of the large establishments the situation is completely the opposite - 25 take loans from commercial banks and 7 do not.[1] It is interesting to note that of the 25 small plants which did not take any credit facilities from banks, 22 said that they were not in need of such facilities and only 3 said that they could not get the needed credit from banks. The 7 large plants were all not in need of banks' credit facilities. The interest rates paid by small plants ranged from 5 to 12 per cent, and averaged around 8.5 per cent; while the interest rates paid by large plants ranged from 5 to 8.5 per cent, and averaged to 6.5 per cent. Loans to small plants can in no way be considered long or medium term loans; with the exception of two plants which got non-renewable loans for a six-month period, all other loans were of a maximum duration of three months, and only one of which was renewable. Loans given to large establishments were for longer periods, but they still were, if not in function then in duration, far from being long or medium term loans. Six large establishments got loans up

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1. Two of the 34 large establishments of the sample refused to give any information.

to a maximum of three months, eleven up to six months, and seven up to one year. Of the first group, three could renew their loans; of the second group, seven could renew their loans; and of the third, only four could do so.

Taking the findings of the survey together, it was found that 50 per cent of the sample, i.e., 34 establishments, needed credit and could get it from commercial banks; 29 establishments did not need credit; and 3 needed credit but could not get it. The average interest rate paid amounted to around 7 per cent. Of all the sample, only four establishments got renewable one-year loans, seven got renewable half-year loans, and four got renewable three-month loans. It is apparent, therefore, that the credit facilities received are virtually all of the mercantile type. Apart from the fact that 34 establishments did not get any loans from commercial banks, most of the facilities made available by such banks to industry are, both in function and duration, short-term commercial credits which are inadequate and unsuitable for expansion and investment. It is true that practically all the 50 percent of the sample which did not get any credit facilities said that they did not need such facilities, but this should not be taken to mean that there is no need for credit. It is mostly the small establishments which showed no exigency for credit. Once these establishments expand and become large, their need for credit will increase, and it is very probable that it is the limited availability of long term capital which is essential for development and investment which is hindering the expansion and growth of these small industries.

CHAPTER V

SPECIALIZED CREDIT INSTITUTIONS

A. General Background of the Credit Situation

The establishment of specialized credit institutions dates back to the Turkish regime, when the need for agricultural credit was so highly felt that the State founded in 1887 the Agricultural Bank of Turkey, with the aim of making advances to farmers for agricultural purposes. This was the only agricultural bank in all the Turkish Empire. In Syria the bank had over fifteen branches or agencies distributed in the various districts or wilayats. The capital of these branches amounted in 1914 to about $2.5 million and was allocated among the various districts in proportion to the amount of the tithes paid.[1] In other words, the operations of the bank, which consisted of the issue of medium term loans, and in few cases of short term seasonal loans, were limited to the amount collected in taxes from each district. This limitation clearly points out that the Agricultural Bank was uncapable of meeting the whole demand for credit. Anyway, since Lebanon was then an Independent Sanjaq collecting its own taxes, it did not contribute towards the capital of the Bank, and consequently, it did not benefit from its credit facilities.

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1. S. Himadeh, op.cit., p. 32.

The situation remained unchanged until February 8, 1919, when all the agencies of the Agricultural Bank were suspended and later (from 1923 to 1928) reorganized by the Mandatory power into five state agricultural banks, one of which in Lebanon.[1] The Lebanese Bank was organized in 1926, and during that year it advanced loans amounting to around LS 170,000 at a low rate of 1 per cent. Repayment was to be made in 1927, but the engagements were prolonged on the ground that the crops in that year were bad; new loans, amounting to LS 142,000, were granted to the debtors in 1928 on the same conditions as in 1926. Due to the successive prolongations which were later granted, and to the fact that most loans were not recoverable in a regular manner, the Bank, in effect, suspended its loan operations in 1931.[2]

In order to help farmers secure long term credit, the Lebanese Government issued in 1930 a decree supplementing that of 1922 on mortgage credit and regulating mortgage banking.[3] Attracted by the protection which the new law granted to mortgage companies, the "Societe Nouvelle de la Compagnie Algerienne de Credit et de Banque" established a branch in Lebanon, and the "Credit Fonçier d'Algerie et de Tunisie" expanded its mortgage activities which it had started a couple

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1. The other four banks were one in the state of Syria, the state of Alaouites, the State of Jebel ud-Druze, and the Sanjaq of Alexandretta.

2. S. Himadeh, <u>op.cit.</u>, p. 253.

3. Decrees No. 3290 of September 23, 1930 and No. 1329 of March 20, 1922.

of years earlier. These two banks did not, however, appreciably extend their operations to rural areas, because of the greater risk that followed from the falling prices of agricultural products during the thirties. The government agreed in 1930 to guarantee the loans granted to farmers by these two banks and to bear part of the interest charge. But despite these encouragements the "Crédit Fonçier" ceased its long term mortgage operations in 1936 and the "Compagnie Algérienne" followed suit in 1939, in favor of the discount and exchange business which yielded larger profits.

Under such circumstances, the only sources of credit left to the agricultural population were the merchants, landowners and professional money lenders. These creditors advanced loans, which were mostly short term or intermediate, at very high interest rates, not only to secure maximum profits but also to cover possible losses. The creditors were aware of two facts. First, that the recovery of loans from defaulters may be very difficult; and second, that quite a large proportion of their debtors were likely to default. For both these reasons they considered themselves justified in charging high, usurious rates which ran as high as 40 per cent. Consequently, the debtors who repaid their loans suffered burdensome interest rates because of those who defaulted.

Lebanese industry prior to the First World War was practically inexistent. Only 10 to 15 per cent of the population depended on industry and handicraft, and the existing industrial activity followed the handicraft and domestic systems.[1] Most of the handicraft workers like cobblers, tailors, carpenters, and metal workers, were centered in cities. The domestic industries were scattered throughout the rural areas, and produced a diversity of manufactured products ranging from silk and woolen cloth to lace, carpet, wine and araq. On the whole, Lebanese industry before the First World War was generally small in size and characterized by a very limited use of machinery. In both the handicraft and domestic industries, machinery, in the strict sense, did not exist. The tools used were very rudimentary and most of the factories lacked proper equipment; even the most developed of these, the silk-spinning industry, employed no modern machinery. There were many factors which were responsible for the perpetuation of such primitive methods of production. Chief among these factors were: First, the failure of the legal and administrative system to provide sufficient security for native investors and therefore, the lack of capital investment; and second, the political troubles and intrigues, along with the inefficiency of the financial administration which did not encourage foreigners in the investment of their capital;[2] with

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1. George Hakim, "Industry", Economic Organization of Syria, S.B. Himadeh, ed., (Beirut: American Press, 1936), p. 119.

2. Mr. Nsouli, "Lebanese Heritage from Handicraft to Industry", Les Conferences du Cenacle, Vol.VII, Beirut, April 16, 1953, p. 76.

the lack of investment capital, Lebanese industry remained undeveloped, too small to attract the attention of the government, and consequently it could never hope to, and never did, receive much official assistance.

In the main, the development of industry in Lebanon is of recent date. The conditions in which Lebanon found itself after the First World War had a tremendous effect in shaping and transforming the industrial life of the country. When the war ended it became essential to build anew, and the post-war development was characterized by two new tendencies - a gradual disappearance of traditional industries, and a growth of modern factory production. These two aspects may be considered as one general movement to replace the handicraft and domestic systems by the more mechanized factory system.[1] However, little progress had been made when the workd was plunged into the Second World War. With the exception of few measures that were taken to aid industrial development, Lebanese industry generally remained unassisted, and investment capital was still lacking. With the outbreak of the Second World War, Lebanese industry found new opportunities for further expansion. The sharp curtailment of foreign imports, coupled with an increase in demand for local products brought about by the presence of allied forces, led to further developments in Lebanese indus-

1. George Hakim, _op.cit._, p. 123.

tries. Also, the Western powers, during the war years, deliberately encouraged the development of industries to replace foreign commodities blocked from the Middle East by the restrictions on sea communications.[1] Since then, and inspite of the various handicaps which the Lebanese economy had to cope with, i.e., the political situation between 1941 and 1944 in Lebanon which enervated all opportunities for industrial development, and the termination of the customs union between Syria and Lebanon in 1950 through which Lebanon lost one of its primary markets, Lebanese industry has been witnessing an unprecedented growth.[2]

This very brief survey of the development of the Lebanese industry is intended to disclose one very significant fact, namely, that the Lebanese industry has in general been deprived of any government or foreign financial assistance. The establishment of most of the industries existing at present in the country, is practically all due to private

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1. Alfred Bonné, State and Economics in the Middle East, (London: Kegan Paul, French, Trubner and Co. Ltd., 1948), p. 302.

2. This rapid growth is indicated by the reported increase in the number of industrial establishments from 400 in 1930 to 900 in 1939 (N. Nsouli, op.cit., p. 78); in a survey of Lebanese industry conducted by the Ministry of National Economy in 1950, industrial establishments excluding concessions, public utilities and handicrafts, were about 1285 in number; and according to the preliminary findings of the Industrial Census of 1955, conducted jointly by the Ministry of National Economy and the Economic Research Institute, the number of establishments increased to 2100. It is worthwhile to mention in this respect that capital invested in industry is reported to have increased from LL 117 million in 1950 to LL 232 million in 1956 (Chamber of Commerce and Industry of Beirut, The Economy of Lebanon and the Arab World, No. 54, April 1957, p. 44).

initiative. The work done in this field without government assistance is really outstanding. Under the Turkish regime, so-called Lebanese industry was too small to receive any attention from the rulers; the Mandatory powers did not undertake any deliberate measure to help promote industrial development; and the Lebanese government has not done much in way of financially assisting industry, for until late in 1954, when BCAIF was constituted, few facilities existed for industrial credit and such facilities as did exist suffered from serious limitations. When SCAIL was established in 1939, it was hoped that industry would obtain a measure of assistance, but it soon became evident that the rigid requirement of mortgages to cover for loans left industry outside the scope of the operations of SCAIL.

Aside than SCAIL and BCAIF, which constitute the major source of long term credit in Lebanon, there are two other non-commercial banks which are not as significant, and therefore would only be very briefly mentioned. These two banks are French companies with a very small capital. One is the Companie Mediterraneene de Placement et de Gestion established in 1919 as a subsidiary of the Credit Fonçier d'Algérie et de Tunisie, with a capital of Ffr. 6 million. As an investment bank, its operations consist mainly of buying shares of corporations established in Lebanon or abroad. The other is the Monts de Piété Egyptiens, a small French company established in 1934 with a capital of Ffr. 6.4 million. Its activities consist in giving advances against the security of movable goods or merchandise. The operations of these two companies are very limited in scope.

There is still another bank which could be a likely source of credit for industry. It is the Banque Nationale pour le Commerce et l'Industrie, which at one time attempted to issue long and medium term loans for industrial development. However, since most of its funds were obtained on short term, it had to abandon the idea of extending term loans, and is at present, like all other banks operating in Lebanon, interested in quick turn-over which assures attractive profits and a relatively high degree of liquidity.

B. SCAIL (Société de Crédit Agricole et Industriel du Liban)

1. Formation

The insufficiency of credit for industry and agriculture led the Lebanese Government to consider seriously the possibility of creating a specialized credit institution to finance agriculture and industry. In 1937 an agreement was concluded between the government and BSL, whereby the latter sponsored the creation of a society which would undertake the issue of agricultural and industrial long and medium term loans for development. SCAIL was established for a period of 25 years, starting in 1939 and ending with the concessionary period of BSL in 1964. Its original capital of LL 100,000, totally subscribed by BSL, was gradually increased until in 1944 it became LL 1 million held as to 51 per cent by BSL and 49 per cent by the Banque Nationale pour le Commerce et l'Industrie, and a few local bankers and capitalists. In November 1942 after negotiating with BSL and SCAIL, the Government concluded an agreement with the latter for a period of five years under the terms of which the Government undertook to guarantee agricultural term loans. Since these loans were to be guaranteed by the government, it was also decided to set up at the Ministry of Finance a specialized Government Agency known as the Agricultural, Industrial and Hotel Credit Service, whose function was to study and approve all guaranteed loans. It was later decided by the Government and SCAIL to extend the period of the 1942 agreement, as from December 1945, for ten more years.

2. Operations

Aside from the guaranteed loans which were made available through the Government Agency, SCAIL had its own capital and could usually obtain secured overdraft facilities from BSL and other commercial banks. This made it possible for SCAIL to operate in two ways, which will now be separately discussed, i.e., through the government agency and directly.

(a) Through the Government Agency

In accordance with the 1942 agreement between the government and SCAIL, the latter was granted through the Government Agency a loan of LL 5 million at an interest rate of 5 per cent. No specifications were made as to how much of these funds should be allotted to agriculture and how much to industry and hotel keeping. Since the 1942 agreement was signed for a period of five years, all loans extended by SCAIL were not to exceed that period. Consequently, all SCAIL's credit facilities were limited to the extension of medium term loans not exceeding five years.

In December 1945, a new agreement was reached between the Government and SCAIL, whereby the period of the previous agreement was prolonged for ten years ending in December 1955, and the LL 5 million accredited to the account of SCAIL were increased to LL 15 million. This guaranteed amount was set aside by SCAIL for the issue of loans through the Government Agency, in the proportion of LL 7 million to agriculture and LL 8 million to industry and hotel keeping. It was later realized that most of the industries applying for loans were in the nature of small handicrafts which could not satisfy the conditions laid down for obtaining loans. Such conditions required that loans must be made against mortgages, that mortgagers must be sole owners, and that the land mortgaged must have been surveyed. It was, therefore, decided in September 1947 to vary the distribution set out above, and instead, LL 8.5 million were appropriated to agriculture and LL 6.5 million to industry and hotel keeping.

Recoveries which had not been used in new loans, and which amounted to around LL 6 million, were granted to SCAIL by the government in May 1950. Out of this new loan, LL 4.5 million were to be extended to agriculture and LL 1.5 million to industry and hotels. Thus, the total of all guaranteed loans made available to SCAIL through the Government Agency became LL 21 million. These government guaranteed loans could theoretically range between one and ten years, but in fact, they were mainly medium term loans ranging from three to five years. Such a strong limitation on the term of the loans issued was inevitable because the agreement with SCAIL was for a period of ten years, and therefore all loans had to fall within the term of the agreement. This meant that as the date (December 1955) when the agreement expired approached, the maturity period of the loans extended by SCAIL had to be reduced from year to year. Interest was charged at the rate of 4.57 per cent per annum of which a part went to the government and a part to BSL. In addition a charge of 1 per cent was made to cover investigation expenses.

All the loans extended through the Government Agency were guaranteed by the Ministry of Finance. Once the loans were investigated and approved by the Government Agency they were paid and collected through SCAIL, but the latter did not take any responsibility whatsoever. When a loan was not paid in due time, and as soon as SCAIL was convinced that it could not collect the loan, it transferred the file to the Ministry of Finance, which would then pay the debt to SCAIL and take its place as creditor. It was primarily for this reason that the Government Agency used to inspect loan applications very carefully in order to determine the security and make sure of the recovery of each individual application. In this respect, the procedures for obtaining a loan from SCAIL were considered to be burdensome, and its operating methods ineffective. When received, applications used to be scrutinized by the Government Agency, and if found satisfactory, they were referred to the Ministry of Agriculture or the Department of Industry or Tourism, as the case may be, to be examined as to the necessity and utility of the project. The applications were then returned to the Ministry of Finance where a committee consisting of a representative of the Ministry of Finance and either an agricultural expert from the Ministry of Agriculture, or an engineer from the Ministry of Public Works, with a high official of the Ministry of Finance serving as chairman, would visit the locality and decide on the priority of the loans. On the report of this committee, the Director of the Finance Ministry would decide on the amounts and terms of the loans, and would then submit all the applications to the Minister of Finance who would, in turn, take them to the Prime Minister for approval. Once the loan is granted, the government still had the right to supervise the way the loan was spent. Every borrower was asked to submit a statement to the government describing in detail the purpose and method of spending the loan and the borrower's locality could be inspected to check the truth of the statement. Whenever the loan was used for a purpose other than that for which it was granted, it became immediately due and the rate of interest was raised to 9 per cent.

Aside than the burdensomeness of the procedure for obtaining loans, which had certainly led many borrowers to forego SCAIL's credit facilities and to pay a much higher price for credit from non-institutional sources, SCAIL's lending policy was generally governed by the availability of formal securities in the form of mortgages. All loans were made against mortgages only, and the loan could not exceed $\frac{1}{4}$ of the value of the mortgaged property as determined at valuation. Since SCAIL's valuation of the land was usually very conservatively made, the loan was in effect limited to 1/5 of the value of the property. Needless to say, such a type of security requirement proved to be a major factor in determining who could benefit from SCAIL's facilities. Under such conditions, small farmers who could not offer that degree of security and tenant farmers who owned no land, could never obtain any loans from SCAIL, and therefore loans were made available to those who needed them least or those who could help themselves most, namely, those who could provide a mortgage security equal, at least, to four times the loan. It must be also mentioned that SCAIL's lending policy was considerably governed by political favoritism, and as a result, most loans were made for political rather than for economic reasons.

The activities of SCAIL through the Government Agency formed at the time an important source of long term credit. However, the volume of credit made available by SCAIL was not stable; nor did it follow a clear trend, as would be evident from comparing the loans extended each year.

TABLE 1

LOANS AND ADVANCES BY SCAIL (1948 - 1952)

Through Government Agency

(in LL Million)

YEAR	AGRICULTURE	INDUSTRY	HOTELS	TOTAL
1948	5.40	4.05	1.58	11.03
1949	3.88	3.40	1.15	8.43
1950	2.44	2.34	1.15	5.94
1951	2.93	1.68	1.38	5.99
1952	4.13	1.45	1.38	6.96

Source: Annual Reports of SCAIL for 1948-1952; Annual Reports for later years were not available. These figures are only approximations because figures in SCAIL's Annual Reports are based on monthly averages.

The limitation set by the requirement that all loans whether for short or long terms should be secured by a first mortgage on an immovable property, not to mention that the maximum amount of an agricultural loan guaranteed by the government was limited to LL 5,000, had in fact frustrated the purpose of long-term loans which SCAIL alone was in a position to advance.

When the agreement with SCAIL expired in 1955, it was reported that all the guaranteed loans (LL 21 million) made available through the Government Agency had been lent to the public. Agriculture had the largest share; and then industry, where the loans very seldon exceeded LL 100,000.[1] The following table shows the distribution of these guaranteed loans among agriculture, industry and hotel keeping.

TABLE 2

TOTAL OF LOANS AVAILABLE TO AND USED BY SCAIL THROUGH GOVERNMENT AGENCY

	LL. Million	Percentage
Agriculture	9.7	46%
Industry	8.5	40.5%
Hotels	2.8	13.5%
	21.0	100.0%

Source: T. Yaffi, op.cit., p. 24.

As a result of the government's decision in 1953 to establish an Agricultural, Industrial and Real Estate Bank, and of the expiration of the agreement with SCAIL in 1955, the operations of SCAIL through the government Agency were first greatly reduced and later abrogated. At present SCAIL operates only directly. It is important to mention in this respect that around LL 8 million of the total guaranteed loans

1. T. Yaffi, op.cit., p. 24.

available to SCAIL through the Government Agency had not been recovered when the agreement with SCAIL expired. And since the government could not collect these loans, it passed a law in 1956 whereby all debtors were given a period of ten years during which all loans should be recovered.

(b) Direct Operations

Apart from its operations through the Government Agency which were made possible by the availability of government guaranteed loans, SCAIL had its own funds and could thus operate directly. In addition to its capital, SCAIL was able to obtain credit facilities from BSL and from other large commercial banks. These facilities, which were mainly in the form of secured overdrafts, served to finance the direct operations of SCAIL. In its direct operations SCAIL followed, to a considerable extent, the same procedure as in its operations through the Government Agency. In actual fact, SCAIL had applied this operational method before it had entered into agreement with the government.[1]

The total amount of loanable funds which was at the disposal of SCAIL for its direct loan operations was estimated to be around LL 7 million.[2] The distribution of these funds among the various sectors is shown in the following table.

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1. M.F. Abcarius and P.W. Dakarian, op.cit., p. 9.

2. T. Yaffi, op.cit., p. 22.

TABLE 3

DIRECT LOAN OPERATIONS OF SCAIL (1948-1952)

(in LL Million)

YEAR	AGRICULTURE	INDUSTRY	HOTELS	TOTAL
1948	2.23	0.55	0.16	2.94
1949	1.86	0.82	0.15	2.83
1950	2.72	2.40	0.60	5.72
1951	3.55	2.45	0.64	6.64
1952	3.08	2.07	0.63	5.78

Source: Annual Reports of SCAIL for 1948-1952; Annual Reports for later years were not available. These figures are only approximations because figures in SCAIL's Annual Reports are based on monthly averages.

When the government started to consider the establishment of a new specialized credit institution, the direct operations of SCAIL began to decline, and since BCAIF started operating in June 1955 the amount of loanable funds previously available to SCAIL was greatly reduced to an extent that its present operations are insignificantly small.

Interest was charged at the rate of 8.5 per cent, of which approximately 1 per cent was paid to the government as income tax, while SCAIL had to pay 5 per cent on loans it contracted from the commercial banks. The majority of the loans issued by SCAIL varied between five and seven years. The amount of the loan was statutorily restricted to 25 per cent of the estimated market value of the mortgaged property. It is reported, however, that the valuations made by SCAIL were mostly based on the forced sales value of the property, which very often amounted to one half of its estimated market value. In actual fact, therefore, loans granted by SCAIL did not exceed 12.5 per cent of the market price of the property hypothecated in guarantee of the loan.[1] Both, the amount of security required and the conservative procedure of valuating the mortgaged property, were undoubtedly undue handicaps to the availability of credit. It is important to mention, however, that while a sizeable portion of the loans extended through the Government Agency, as previously noted, were not recovered, only few loans of the total extended directly by SCAIL defaulted.

3. Summary

This brief discourse of the activities and operational methods of SCAIL, through the Government Agency and directly, points out (not to mention the political influence which considerably determined the issue of loans) two predominant peculiarities which served as major obstacles to the success of SCAIL and even led to its failure. First was the limited availability of credits to agriculture, industry and hotel keeping. This limited availability was mainly due to SCAIL's

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1. M.F. Abcarius and P.W. Dakarian, op.cit., p. 10.

lending policy which was wholly governed by the availability of securities in the form of mortgages. While the purpose of the loan in most developed countries is usually the governing factor in institutional lending, it was rarely taken into consideration by SCAIL. Thus small borrowers, who could not provide the required mortgaged security and who were therefore in urgent need for financial assistance, were incapable of using SCAIL's credit facilities. The second peculiarity is the ineffectiveness of SCAIL's organization and operating methods. Its operations were not very flexible and the procedure for obtaining a loan was slow and complicated to an extent that borrowers preferred to resort to non-institutional sources even if they had to pay, as was often the case, a much higher price for the needed credit.

The above mentioned shortcomings, and the severe public criticism of SCAIL's operations led the Lebanese Government to consider the establishment of a new and autonomous specialized credit institution. In 1953, the government called upon the advice of the International Bank for Reconstruction and Development (IBRD) in helping to set up the coveted Agricultural, Industrial and Real Estate Bank. The IBRD sent an expert who, after surveying the Lebanese credit situation, suggested that two separate banks be formed - one for agriculture and one for industry and tourism. It was understood that had the Lebanese Government formed the two banks as suggested, IBRD would have been willing to contribute to their capital. However, on July

16, 1954, the Lebanese Government passed a law[1] establishing an Agricultural, Industrial and Real Estate Bank (BCAIF), which meant that the government found it more appropriate to establish one bank with three distinct departments to finance agriculture, industry and hotels.

C. BCAIF (Banque de Credit Agricole, Industriel et Foncier)

BCAIF is a public company established for a period of forty years for the purpose of extending agricultural, industrial and real estate term credit. Its capital is LL 5 million, of which LL 2 million is subscribed by the government, and the remaining LL 3 million are floated in shares of LL 50 each. In addition to its capital contributions, the government has provided BCAIF with a LL 25 million guaranteed loan at 2 per cent interest, of which BCAIF cannot use more than LL 10 million each year.

The Bank consists of three distinct sections - one section is for agriculture through which the Bank is required to extend 40 per cent of its loan portfolio, another section is for industry through which another 40 per cent should be extended, and the third is for real estate through which the remaining 20 per cent of the loans should be extended.[2] Loans

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1. Law of July 16, 1954 was followed by Presidential Decree No. 6807, Al Jarida Al Rasmia, No. 44, October 27, 1954, which permitted the establishment of the said bank as a public company for a period of forty years.

2. Law of July 16, 1954, Art. 9.

can be made as short term loans for not more than one year, medium term loans up to eight years, or long term loans up to 20 years.[1] All short term loans can be granted against a real property mortgage, a hypothecation, securities or a personal guarantee of two persons aside than the signature of the borrower; while medium and long term loans can only be granted against a mortgage on real property.[2] Short term loans should be primarily used, in agriculture, to purchase seeds and fertilizers, to pay wages and to repair agricultural buildings, and in industry and hotels and other establishments in the tourist trade, to renew and purchase equipment and to buy raw materials essential for production. The amount of short term loans cannot exceed, irrespective of the value of the security given, half the net earnings of the establishment, while it is possible for short term loans granted to cooperatives to amount to up to two-thirds of the estimated net earnings.[3] Medium term loans are extended to individuals, companies and agricultural cooperatives and societies, to finance the improvement and development of projects. Long term loans are granted to individuals and companies, for the development of land resources, and the development of the overall agricultural situation, and the development of industrial projects and tourist trade. The amounts of both medium and long term loans are

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1. Regulation supplemental to Law of July 16, 1954, Arts. 1, 3 and 4.
2. _Ibid._, Art. 1.
3. _Ibid._, Art. 2.

limited to 35 per cent of the real market value of the mortgaged property.[1] Agricultural loans are subject to further limitations - individual short term loans are limited to LL 6,000, medium loans to LL 30,000, and long term loans to LL 60,000; short and medium term loans to cooperatives are limited to LL 60,000 and LL 150,000 respectively.[2] There is no such limitation concerning industrial and real estate loans.

The rate of interest charged by BCAIF on all loans is 5 per cent, and for cooperatives the rate is 4.5 per cent; both rates are subject to moderate changes from term to term.[3] All loans which are not recovered in due time are subject to a raise of 2 per cent in the interest rate. In cases where a loan is used for a purpose other than that for which it was granted, BCAIF has the right to cancel it and it becomes immediately due.

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1. *Ibid.*, Art. 6.
2. *Ibid.*, Art. 7.
3. *Ibid.*, Art. 9. This article states that the rate of interest charged by BCAIF must not exceed the rate charged by BSL on its guaranteed loan to BCAIF by more than 3 per cent and 2.5 per cent in the case of cooperatives. Since the rate charged by BSL is 2 per cent, BCAIF's rates become 5 and 4.5 per cent respectively.

The management of BCAIF is assured by a Board of Directors composed of twelve members including the Director General, four of which are appointed by the Government and the remaining eight are elected by the shareholders.

1. Activities

As previously mentioned, BCAIF was created in July 1954 and started its operations on June 1, 1955. However, it was until September 1, 1955 that it actually started extending credit facilities.[1] Therefore any evaluation of the role BCAIF has so far performed must be made in the light of the fact that it has been operating for less than two years. It was found appropriate, in discussing the activities of BCAIF, to deal with the loans extended to each sector separately, i.e., agricultural loans, industrial loans, and real estate loans. The discussion will be based on the figures for the years 1955 and 1956. It must be stated that all the 1955 figures here reported are those of the last four months of the year only, since the Bank actually started its credit operations in September of 1955.

(a) Agricultural Loans

In extending its agricultural loans, BCAIF has given special attention to the plantation, irrigation and protection of fruit trees, olives, grapes and citrus, and to poultry

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1. BCAIF, Annual Report for 1955, (Beirut: Dar El Funoun, 1956), p. 7.

breeding, all of which are main agricultural products either locally consumed or exported. It is worthwhile to mention that the Bank's lending policy has been mainly geared towards assisting small farmers. This policy is reflected by the fact that most of the agricultural loans, as reported, were extended to small farmers.[1] The Bank has also shown willingness to help farmers through agricultural cooperatives which were given special privileges. However, only one such cooperative has applied for a loan and was granted a short term loan of LL 60,000.[2]

In 1955, the number of agricultural loans extended by BCAIF was 370, and amounted to LL 3.5 million, or approximately 72 per cent of the total loans extended by BCAIF during that period. In 1956, the number of agricultural loans was 1178, totalling LL 7.7 million, or 47 per cent of the total loans extended by BCAIF. This makes the total number of agricultural loans so far extended equal to 1548, for a value of LL 11.2 million; thus the average agricultural loan was LL 7,235. The following table gives the number and value of agricultural loans distributed among the various districts.

Most of the agricultural loans extended were medium term loans not exceeding eight years. While around 87 per cent of the agricultural loans during 1955 were medium term,

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1. BCAIF, <u>op.cit.</u>, p. 9.

2. <u>Ibid.</u>, p. 10.

TABLE 4

NUMBER AND AMOUNT OF AGRICULTURAL LOANS, BY DISTRICT

District	1955 (1) Number of Loans	1955 (1) Amount (LL)	1956 (2) Number of Loans	1956 (2) Amount (LL)
Beirut & Mt. Leb.	159	1,389,300	433	2,550,515
Beka'	84	880,375	313	2,126,021
North Lebanon	81	618,050	238	1,444,815
South Lebanon	46	603,100	194	1,588,560
TOTAL	370	3,490,825	1,178	7,709,911

Source: (1) BCAIF, 1955 Annual Report.

(2) Privately secured from Mr. T. Yaffi, Head of the Industrial and Real Estate Section of BCAIF.

only 4 per cent were for short term and 9 per cent for long term. Approximately the same proportion holds for 1956, as the medium term loans amounted to 88 per cent, while the short term loans were only 5 per cent and the long term loans 7 per cent. Table 5 gives the proportional distribution of agricultural loans among short, medium, and long term loans.

Taking into consideration the rigid requirement of two signatures other than the borrower's for personal guarantees, and the limitation of individual agricultural loans to a maximum of LL 60,000 (irrespective of the value of the security), and cooperative loans to LL 150,000, BCAIF's agricultural loans can be regarded as quite impressive. During 16 months BCAIF has extended more agricultural loans than SCAIL did during all the period of its operation. However, the activities that are expected to be performed by a bank like BCAIF in the agricultural sector, are still far from being adequate. This question will be dealt with in a later chapter.

TABLE 5

AGRICULTURAL LOANS, BY TYPE

	1955		1956	
	Amount LL	Percentage	Amount LL	Percentage
Short Term	140,700	4.0%	397,200	5.2%
Medium Term	3,045,125	87.2%	6,755,411	87.6%
Long Term	305,000	8.8%	557,300	7.2%
TOTAL	3,490,825	100.0%	7,709,911	100,0%

Source: Privately secured from Mr. T. Yaffi, Head of the Industrial and Real Estate Section.

(b) Industrial Loans

Industrial loans, as those for agriculture, must not exceed 40 per cent of the loanable funds of the Bank. In both years, however, industrial loans did not amount to that limit, and particularly during 1955, industrial loans were much less than those of agriculture. While agricultural loans amounted to LL 3.5 million in 1955 and LL 7.7 million in 1956, industrial loans were less than LL 1 million and around LL 5.9 million in 1955 and 1956 respectively.

The majority of the loans were extended to such industries as vegetable oil, textiles, tiles, olive oil, hides and skins, rubber tires, shoes, paper and cardboard, foundries, refrigerators, and air conditioners. The number of these loans was equal to 22 during 1955, and to 115 during 1956. This makes the total number of industrial loans so far extended by BCAIF equal to 137, for a total value of LL 6.9 million, and the average industrial loan equal to LL 50,062. Most of these loans (around two-thirds) were extended to the Beirut and Mt. Lebanon district. Table 6 classifies the number and amount of these loans according to districts.

TABLE 6

NUMBER AND AMOUNT OF INDUSTRIAL LOANS, BY DISTRICT

	1955		1956	
District	Number of Loans	Amount (LL)	Number of Loans	Amount (LL)
Beirut & Mt. Leb.	19	939,400	68	3,876,070
Beka'	-	-	11	199,600
North Lebanon	2	31,000	29	1,634,600
South Lebanon	1	10,000	7	168,300
TOTAL	22	980,400	115	5,878,570

Source: Privately secured from Mr. T. Yaffi, Head of the Industrial and Real Estate Section.

The provision pertaining to limiting the amount of individual short term loans to half the net yearly income of the establishment has certainly reduced the demand for such loans to an extent that only an insignificant portion of the loans extended were short term. It is reported,[1] however, that the Bank is considering the possibility of amending this provision, so that the amount of short term loans extended to industry would be reasonably increased. There are no provisions which distinguish clearly between medium and long term loans. The only distinction made is that medium term loans can be extended up to eight years, and long term loans up to twenty. Nevertheless, it can be generally stated that all medium loans are those needed to renew, modernize or buy machinery to expand the plant capacity, while long term loans are those needed for heavy expenditures on plant equipment, which can be profitable if amortised on a long run basis. Both types of loans require a real property mortgage and the maximum amount is limited to 35 per cent of the real market value of the mortgaged property. This forms the only limiting factor, and unlike agricultural loans, there is no other limitation to the amount of medium and long term loans extended to industry. Table 7 gives the proportional distribution of industrial loans among short, medium and long term loans.

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1. *Ibid.*, p. 10.

TABLE 7

INDUSTRIAL LOANS, BY TYPE

	1955 (1)		1956 (2)	
	Amount (LL)	Percentage	Amount (LL)	Percentage
Short Term	300,000	30.6%	290,500	4.9%
Medium Term	429,400	43.8%	2,855,100	48.6%
Long Term	251,000	25.6%	2,732,970	46.5%
TOTAL	980,400	100.0%	5,878,570	100.0%

Source: (1) BCAIF, 1955 Annual Report.

(2) Privately obtained from Mr. T. Yaffi, Head of the Industrial and Real Estate Section.

It can be easily seen from the above table that while medium and long term loans have been increasing both absolutely and relatively, short term loans have instead decreased both absolutely and relatively. From around 30 per cent in 1955, short term loans have decreased to less than 5 per cent in 1956. The Bank has not as yet amended the provision which limits the amount of a short term loan to half the net yearly income, and therefore, the 1957 figures are expected to still be the same. Medium term loans in 1956 were seven times, and long term loans eleven times what they respectively were in 1955. Relatively, medium term loans have increased by 5 per cent and long term loans by 20 per cent.

(c) Real Estate Loans

In accordance with its statutes, BCAIF is required to extend 20 per cent of its loanable funds to the real estate sector. What has actually been extended, however, amounted to 7.7 per cent of the total loans extended in 1955, and to around 16 per cent in 1956. Taking into consideration that real estate loans are restricted, by law, to hotels and other establishments of the tourist trade, it will be expected, at least in a country like Lebanon where summer resorts are a major attraction to tourists, that more loans will be extended and utilized in this field. During 1955 only 15 loans of a total value of LL 379,000 were extended; and during 1956, 54 loans of a total value of LL 2.6 million were extended. Therefore, the total number of real estate loans so far extended by BCAIF is 69 for a total value of around LL 3 million, making the average real estate loan equal to LL 43,636. As shown in the following table, more than two-thirds of these loans went to the Beirut and Mt. Lebanon district.

As is the case with industrial short term loans, the provision which limits such loans to half the net yearly income of the establishment, has been an impediment to the availability of real estate short term loans. It is primarily due to this reason that no such loans were extended during 1955, and during 1956 only 7.6 per cent of the real estate loans were short term. The situation is not expected to be any better in 1957. Medium

TABLE 8

NUMBER AND AMOUNT OF REAL ESTATE LOANS, BY DISTRICT

District	1955 Number of Loans	1955 Amount (LL)	1956 Number of Loans	1956 Amount (LL)
Beirut & Mt. Leb.	10	256,000	38	2,236,000
Beka'	3	63,000	9	190,000
North Lebanon	1	30,000	6	171,700
South Lebanon	1	30,000	1	34,000
	15	379,000	54	2,631,700

Source: Privately obtained from Mr. T. Yaffi, Head of the Industrial and Real Estate Section.

term loans have absolutely increased from LL 60,000 in 1955 to LL 204,125 in 1956, but have relatively decreased from 17.4 per cent to 7.8 per cent in 1955 and 1956 respectively. Thus, the majority of the real estate loans are long term; in 1955 such loans amounted to 82.6 per cent, and in 1956 they were up to 84.6 per cent of the total real estate loans. Table 9 gives the amounts and percentages of real estate short, medium, and long term loans.

2. Summary

It is as yet early, at this stage where BCAIF has only been operating for less than two years, to pass any judgment

TABLE 9

REAL ESTATE LOANS, BY TYPE

	1955 (1)		1956 (2)	
	Amount (LL)	Percentage	Amount (LL)	Percentage
Short term	-	-	200,000	7.6%
Medium term	66,000	17.4%	204,125	7.8%
Long term	313,000	82.6%	2,227,575	84.6%
	379,000	100.0%	2,631,700	100.0%

Source: (1) BCAIF, 1955 Annual Report.

(2) Privately obtained from Mr. T. Yaffi, Head of the Industrial and Real Estate Section.

on its credit operations; and it is not warrantable, with the available information about BCAIF, to say whether its activities have been adequate or not. However, it has been observed by many, among whom the Bank's Board of Directors, that the Bank suffers from some structural weaknesses and provisional limitations; and that if the Bank is to perform the desired role in developing the agricultural, industrial and real estate sectors of the economy, some necessary changes and basic amendments must be made.

BCAIF is the only source of term credit presently in existence, and as such it should be the institution to which most industrialists and farmers must look for an expansion of institutional credit. Already, the Bank has exhibited a potential to remove some of the major handicaps that characterize the Lebanese credit situation. In spite of its structural weaknesses and provisional limitations, which will be dealt with later, BCAIF has proved to be an important source of institutional credit as is reflected in the volume of credit it has already extended. In less than a year and a half, from September 1, 1955 till December 31, 1956, BCAIF has extended 1,754 loans of a total value of LL 21.07 million. Table 10 shows the share of each sector of the number and amount of these loans.

TABLE 10

NUMBER AND AMOUNT OF TOTAL LOANS, BY SECTOR
until end of 1956

	Number	Amount (LL)	Amount expressed as % of total
Agriculture	1,548	11,200,736	53.2%
Industry	137	6,858,970	32.5%
Real Estate	69	3,010,700	14.3%
	1,754	21,070,406	100.0%

Source: Based on figures from Tables 4, 6, and 8.

Agriculture which is expected to receive 40 per cent of the total loans, received instead around 53 per cent. This

TABLE 11

TYPE OF LOANS, BY SECTOR

Until end of 1956

(in LL)

	Short Term	Medium Term	Long Term	Total
Agriculture	557,900	9,800,536	862,300	11,200,736
Industry	590,500	3,284,500	2,983,970	6,858,970
Real Estate	200,000	270,125	2,540,575	3,010,700
TOTAL	1,328,400	13,355,161	6,386,845	21,070,406
Expressed as % of total	6.3%	63.4%	30.3%	100.0%

Source: Based on figures from tables 5, 7, and 9.

can be partially explained by the fact that in 1956, instead of using only the LL 4 million[1] annually allocated for agriculture out of the LL 25 million loan with BSL, BCAIF was permitted[2] to draw on an additional LL 3 million. Industrial loans amounted to 32.5 per cent and real estate loans to 14.3 per cent, while as required by law they should have amounted to 40 per cent and

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1. Since BCAIF is permitted to draw annually a maximum of LL 10 million out of the loan with BSL, and since the law fixes the share of agriculture at 40 per cent, then the annual share of agriculture loans is LL 4 million.

2. Law of June 7, 1956.

20 per cent respectively.

Expressed according to type, the total loans extended until the end of 1956 were in the main medium term loans. Out of the total of LL 21 million, around LL 13.4 million or 63.4 per cent were medium term loans. Short and long term loans amounted to LL 1.3 million and LL 6.4 million, or 6.3 per cent and 30.3 per cent of the total respectively. The above table classifies the type of loans extended according to sector.

CHAPTER VI

SUMMARY AND RECOMMENDATIONS

It is proposed in this chapter to suggest remedies and make recommendations regarding a possible improvement in the Lebanese banking system so as to render long and medium term credit more readily available to industry, agriculture, and real estate. The remedies suggested pertain to commercial banks, savings institutions, the capital market, credit cooperatives, supervised agricultural credit, and specialized credit institutions.

A. Commercial Banks

Due to the inadequacies and limiting factors from which the Lebanese banking system suffers, commercial banks are not encouraged and sometimes even not permitted to handle long term credit as a significant part of their operations. Some of these limiting factors have been previously discussed; however, it may be appropriate, before making any recommendations, to recapitulate some of them in a brief fashion.

1. In view of the fact that there is no central bank in Lebanon, commercial banks are deprived of, or cannot rely on, the discounting facilities normally made available by central institutions. These facilities usually assist

banks in maintaining an adequate degree of liquidity, and therefore enable them to undertake the issue of loans on longer than short term basis. It is true that BSL provides local banks with some discounting facilities, but such facilities are limited by law to short term mercantile credit. Moreover, some private banks are not always sure of the facilities that BSL may be willing to extent to them, and others are often unwilling to use BSL's rediscounting facilities since BSL to them is a competitor and reliance on it may result in a loss of prestige. For these reasons, most private banks have always shown a preference to remain highly liquid rather than to use BSL's credit facilities; and the desire for high liquidity renders it difficult for banks to tie their funds for long periods of time.

2. Commercial banks in Lebanon, unlike those in developed economies, generally have small capital resources; and their time deposits, although generally on the increase, amount to only 8 per cent of total deposits. Consequently, as banks have to depend almost exclusively on demand deposits for their operations, they are unable to undertake long term financing. One of the factors which has contributed to this deficiency is the indifferent attitude of commercial banks toward attracting savings deposits; only very few banks have recently introduced effective savings devices.

3. The nonexistence of any specialized credit information services is an important factor which often discourages banks from extending long term credit facilities. Moreover, as most business establishments do not keep adequate financial statements to enable banks to satisfactorily appraise their credit standing, banks are naturally loath to engage themselves in long ventures. It is true that in the absence of specialized credit information services long term loans could be granted as mortgaged loans; however, some of the banks' experiences in this type of credit were not favorable, and mortgage banking is still completely undeveloped.

4. However, since more than half the accredited commercial banks presently operating in Lebanon are foreign and since these banks can often arrange with their home offices to increase their liquidity when the need arises, there should be, _prima facie_, at least possibilities of long term credit financing. However, foreign banks do not seem to be particularly interested in such types of credit. Their interest has always been geared towards financing Lebanon's international trade, leaving local finances to Lebanese banks. These differences between foreign and local banking have tended to diminish over the past years; nevertheless, foreign banks are interested in quick profits and prefer to channel most of their business to the mercantile

sector, which in Lebanon is unquestionably the most lucrative.

In the light of the above factors, a few remedies may be suggested. Foremost among these remedies is the establishment of a central bank. For as long as there is no central bank on whose discounting facilities and assistance banks can rely, the capacity of such banks to participate in extending long term loans will remain limited. Secondly, commercial banks should attempt more deliberately to attract savings deposits either by raising the interest offered on time deposits or by introducing effective savings schemes. Thirdly, specialized credit information services ought to be established and business concerns should be encouraged to keep regular balance sheets and profit and loss accounts, and any other financial statements which banks may require.

It cannot be claimed that commercial banks will, as a result of these remedies, extend all the presently required long term credit. They cannot be expected to, their essential function being to service mercantile needs. However, these remedies will undoubtedly help to surmount some of the obstacles that at present hinder commercial banks from devoting a small portion of their loanable funds to long term investments.

B. Savings Institutions

Despite the fact that Lebanon enjoys a substantially higher per capita income than anywhere else in the region, the level of savings is considered to be relatively low.[1] This can be primarily attributable, as far as financial institutions are concerned, to two main factors:

1. The nonexistence of savings institutions and particularly of postal savings systems.

2. The disinterestedness of commercial banks in attracting savings deposits.

In the absence of savings institutions in Lebanon, commercial banks have become the only financial institutions capable of mobilizing savings funds. Commercial banks, however, are mainly interested in mercantile credit, and limit their activities to Beirut and the other urban centers. For these reasons it is believed that a significant part of savings, particularly in the rural areas, still goes into idle hoards of precious metals and currency, or into real estate which is undoubtedly at present the most favored field of long term investment. Had there been adequate savings institutions to pool savings funds, it is possible that some of these funds would have been channelled into agricultural

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1. This, as cautioned previously, should not be taken to mean that savings do not accrue; but rather that they are invested directly and not through the intermediary of institutions.

and industrial ventures. Not only do most savings now go into idle hoards; a good part is squandered on conspicuous consumption or is held abroad.

It is essential, therefore, to suggest certain measures which will encourage the expansion of institutional savings. First, a government savings bank must be created which will undertake to pool savings funds and to grant long term loans. It will be appropriate, if the bank were to achieve the desired purpose, that it be equipped with moveable sections whose functions will be to collect savings funds from rural areas. The government should be willing also to offer reasonable interest rates on deposits with the bank, and to guarantee all loans granted by it. In order not to compete with commercial banks, it would be advisable for the bank only to extend long term credit and to finance ventures which commercial banks are not interested in.

Second, most developed countries have established postal savings systems which are designed to mobilize capital in areas where financial institutions are lacking, and to encourage saving among middle and low income groups. It may be good to establish such a system in Lebanon. This would involve certain preliminary steps which must be accomplished before the system could be established, such as a study of the present set up of the postal system and the possibility of its expansion and reorganization; and the training of officials needed for running it. It must be mentioned in this respect, that some of these preliminary studies have been completed and a draft law for the establishment of postal savings institution was submitted to Parliament early in 1957.

Third, commercial banks must be encouraged by the government to establish branches in rural areas; and since the main purpose of these branches should be the mobilization of savings, these banks should have special savings departments. It may also be a worthwhile attempt for the government to issue bonds to be sold to the public through these banks.

C. Capital Market

Capital markets in developed countries serve as means for mobilizing long term investment capital. If primarily considered as such, Lebanon's capital market does not exist. The Beirut stock exchange (Bourse) is unorganized, and since its scope of action is limited to local corporations only, it is too small to perform the expected role of pooling capital for long term investment. A developed capital market calls for the existence of well established corporations. If long term capital were to be mobilized, it is essential to have readily marketable bonds and stocks of corporations with good standing. There are very few corporations in Lebanon whose securities could be readily marketable, and the presence of many small business firms is a clear feature of the Lebanese economy. It is said,[1] that Lebanese businessmen, by and large, are established individualists. There is an abundance of proverbs playing up the wisdom and superiority of 'making business alone'. In these circumstances, the corporation has had to grow slowly. The consequences in fragmentation and shortage of finance, in wasteful duplication, in inability to finance research, in the limitation of the life of firms to the lifetime of their owners, are too familiar for elaboration. Mention must be made, however, of a measure[2] which has been recently taken by the government to modernize and organize the regulations and set-up of the Bourse which will undoubtedly encourage dealings in stocks and bonds, and make company formation more attractive to capitalists.

There is one additional important factor which may be regarded as a hindrance to the formation of joint stock companies. This factor is taxation. Corporations, like individuals, are taxed progressively on their distributed net profits. This is a striking peculiarity of the tax law in Lebanon, since in most countries a proportional rate rather than a progressive rate is imposed on corporate profits.

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1. Y. Sayigh, op.cit., p. 50.

2. See footnote 3 on page 35.

Progressive taxation on corporations clearly discriminates against large capitalization as the rates are made to increase progressively with profits irrespective of the capital used to acquire these profits. Progressiveness can be justified only in personal taxes, and should not therefore be used in the case of corporations. It is believed that an amendment which will impose proportional instead of progressive rates on companies will go a long way towards encouraging future incorporations. It may also be useful to generally reduce the present income taxation rates. It is reported,[1] in this connection, that although these rates are not high when compared with rates in other countries, the government, under pressure from various trade and producers' organizations, is considering reducing the rates especially on the higher income brackets in the hope of encouraging local investment and the inflow of foreign capital.

These tax amendments, coupled with the recent attempt to modernize the Bourse, will undoubtedly help to overcome the indifference of the Lebanese toward incorporation, which is a basic handicap to the development of long term capital lending in Lebanon.

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1. Economic Research Institute, Business Legislation in Lebanon, p. 50.

D. Credit Cooperatives

It is frequently claimed that a cooperative credit system is the best method of providing agricultural loans to the people who need them most -- the small and medium farmers. Agricultural credit to large and medium land-owners is not a major problem, for these people either do not need credit or have access to existing credit institutions; they seem to be the only people who in general obtain credit commensurate with their needs and at reasonable terms. The problem is the small farmers who suffer from want of credit or can get it only at exorbitant rates of interest. Small farmers are, more often than not, typified by certain features such as the small size of their land, their huge number, the wide scatter of their farms, and the small size of their average loans, all of which make credit to them risky and expensive. In order to overcome the risks involved, a close personal contact and knowledge should exist between lender and borrower. This can be achieved by some form of organization amongst the farmers whereby their credit needs are aggregated and dealt with on a group basis. The ideal and most successful form of organization is the cooperative credit society which is perhaps the only way of facilitating the access to credit to small farmers.

1. Legislative Privileges

In order to spread the cooperative movement throughout Lebanon, the Lebanese Government promulgated a decree[1] which laid down the principles and regulations for agricultural cooperatives. The outstanding features of this law are that it permitted the formation of cooperative societies with either limited or unlimited liability;[2] it limited the types of loans granted by cooperative societies to short and medium term loans, of maximum durations of twelve months and five years respectively;[3] and it specified that the acceptable forms of security for short term loans could either be personal guarantee, deposit of valuables, shares and bonds, or the mortgage of real estate, while medium term loans could be only secured by a first class real estate or bond mortgage.[4] The Government also issued a decree[5] in 1942, the aim of which was to encourage the formation of cooperative societies by giving them special privileges. It exempted all cooperatives from the payment of registration

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1. Legislative Decree No. 121 of November 19, 1941.

2. Ibid., Article 8.

3. Ibid., Articles 36 and 37.

4. Ibid., Articles 38 and 39.

5. Legislative Decree No. 215 of November 17, 1942.

fees, all fees chargeable upon the formation of such societies, all legal fees on cases brought by them for the recovery of debts due, as well as all taxes due on buildings belonging to the cooperatives. Furthermore, cooperative societies were granted reductions on all products sold directly by the Ministry of agriculture and on the fees charged by government for chemical analysis. Members of cooperative societies were also exempted from the payment of all fees for the registration of mortgages they give as a security against loans granted by the cooperatives.[1]

Unfortunately, these legislations have had little effect on stimulating the formation of cooperative societies in Lebanon. At present, credit cooperatives can, for all practical purposes, be considered nonexistent. The only active credit cooperative (which is in fact a multi-purpose cooperative) in Lebanon has too small a capital to enable it to make sizeable loans; and it was established in 1936 long

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1. Economic Research Institute, American University of Beirut, "Report on Agricultural Credit in Lebanon", op.cit., p. 15. For additional privileges granted to cooperatives, see also Boulos Boulos, Agricultural Cooperation and its Advantages, Ministry of Agriculture, Lebanese Republic, (Department of Administrative Affairs, undated), pp. 14-15.

before the above legislations were enacted.[1] Certainly, the supervision and technical assistance advanced by the cooperative to its members helped to improve the financial standing of both the cooperative and its members, but the credit function of the cooperative, due to the low saving capacity of the members themselves, could not at best be of any significance; and members are usually reluctant to make use of credit obtained from outside at a high rate of interest and against promissory notes signed jointly by members. It is reported that only around half the farmers of the village became members of the cooperative, and that the majority of them belong to a religious sect and a political party the ideals of which lend themselves more easily to cooperation. The cooperative attempted to, but failed to establish four branches in neighboring villages.[2]

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1. Reference is here made to the cooperative of Ubaydiyeh; the factors that led to its success were the personal effort of the founder, and the characteristics of the village of Ubaydiyah itself which is a small socially well-knit village having about 400 farmers who intensively cultivate the small plots they own. For further information about the cooperative see Economic Research Institute, "Report on Agricultural Credit in Lebanon", *op.cit.*, p. 15.

2. *Ibid.*, p. 16.

2. Obstacles

It must have become evident from the above, that the cooperative movement does not seem to have struck firm root in Lebanon. It is appropriate, therefore, to consider some of the factors that presently impede its formation and spread. To begin with, the rural areas in Lebanon, as in other underdeveloped countries, are conservative and slow in adopting any new ways; they are even fatalistic and unwilling to believe that any movement on their part is apt to improve their lot. Secondly, an attitude of mistrust and suspicion prevails among the rural people, as a consequence of which they have grown to be cautious of any movement even if the improvement of their standards of living may be the only motive behind such a movement. Because of this suspicion and mistrust, farmers have tended to become individualistic in outlook -- an attitude which prevents people from pooling their efforts and cooperating together in various ways to overcome the disadvantages which confronts them as individual farmers. Thirdly, the low saving capacity of most rural areas, i.e., the lack of funds at the disposal of the prospective members of the cooperative societies is a major impediment to the formation and spread of the movement. This impediment can be surmounted either by proceeding slowly and relying on the small savings of the members or by guaranteed government loans or both. Finally, the resistance of moneylenders and other creditors who are benefiting from the weak bargaining position of the farmers is a factor which hinders the formation of cooperatives. Banks are also against the cooperative movement because they are opposed to any acts which will separate agricultural credit from industrial credit due to their interest in controlling the large scale agricultural loans and thus keeping it tied to industrial loans.

3. Remedies

These obstacles suggest that there is no one single method for the successful promotion of the cooperative movement in Lebanon. So far, active credit cooperatives, if any, in Lebanon have been the result of individual efforts of responsible people who have seen and felt the benefits of cooperative societies. In other countries, governments perform the main role in acquainting the people with cooperatives and their advantages. It may be recommended for Lebanon to adopt a policy, between these two types of extreme cases, which will combine both individual effort and government sponsorship. Few measures, which help to create a favorable climate for the promotion of cooperatives, must be mentioned in this respect. One important factor for the success of the cooperative movement is to let the people feel that the movement is their own and for their own benefits rather than have the movement dictated on them. Unless the people themselves become interested in the movement, it is most likely to fail. A second factor is government participation. While governments very often play an active role in promoting cooperative movements, the Lebanese Government's participation in this field has been very insignificant. The government has not yet been able to identify the special problem involved in making adequate credit available to the small farmer. "The imagination required for the formulation of a credit program, which is admittedly risky, which requires a technology of administration that is new, which has as its problem not ordinary commercial banking objectives but rather the economic enhancement of poor farmers, has yet to be provided."[1] It is therefore, recommended that the Government should attempt to participate more actively in the encouragement of cooperatives. It must be emphasized, however, that the role of the Government must be limited to the creation of a sound, independent cooperative movement, and that government sponsorship be a temporary measure which must be slowly discontinued as the movement becomes more and more capable of standing on its own feet.

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1. A.Y. Badre, "Summary Statement of Facts Pertaining to Agricultural Credit in the Middle East", Economic Research Institute, <u>Agricultural Credit Conference</u>, p. 7.

A third factor is rousing the public interest. The Government or the leaders of the cooperative movement can do much in way of acquainting the public with the aims, principles, and advantages of the movement through an extensive propaganda campaign. It is extremely important to make people aware of the achievements of the movement and thus win their interest and public support.

It is appropriate to mention, at this point, that cooperative credit associations can be both single purpose credit societies or multi-purpose societies, i.e., with credit as one of a number of services that the cooperative performs. Under conditions where credit cooperatives have a large volume of loans, they should be single purpose associations specializing in loan extension. On the other hand, where the volume of loans is small a multi-purpose cooperative which provides marketing and purchasing services as well as credit may be a more efficient and effective type of organization. It is recommended, therefore, that the multi-purpose type of cooperatives be encouraged in Lebanon, since at present the available volume of loanable capital is small.

4. <u>Advantages</u>

The significance of the above measures must not be minimized if credit cooperatives are to be promoted in Lebanon. The promotion of cooperatives is undoubtedly necessary, particularly when considered in the light of their numerous advantages. The first of these advantages is that cooperatives group farmers on a legal footing as a result of which the security they can offer is strengthened. By assuming joint liability, farmers put themselves in a position whereby they are enabled to borrow, as a group, from credit institutions, and as individuals, from their cooperative. The second advantage is that cooperative societies make possible the extension of credit at reasonable rates of interest; rates usually charged to members are moderate. Furthermore, if a farmer proves to be creditworthy, he can get the needed credit without paying any commission charges. A third advantage is that cooperatives provide a good channel for farmers' savings which at present take the form of idle hoards. Cooperative societies would encourage savings and thus increase the supply of loanable capital. Likewise such societies discourage unnecessary consumption habits. Cooperative societies, therefore, are probably the best way to mobilize domestic capital in rural areas for agricultural development. Finally, cooperatives enable the small farmers, the tenant, and the share cropper who are usually unable to offer any significant security to obtain the needed credit provided they possess a good character and are capable of using the loans in a productive manner.

Cooperative credit is necessary for the proper functioning of agricultural production. Farmers need varying amounts of capital and consumer goods throughout the year, and the provision for this need, when at all within the possibility of the farmers themselves, requires the existence of idle funds during a substantial part of the time; hence the need for credit. Credit may be looked upon from two angles -- first, the power of an individual to borrow; and second, the amount borrowed or the actual loan. The ability of the farmer to borrow is a reflection of his creditworthiness; and probably too, of the amount of his savings. In some situations there is a tendency for consumption to outrun production, and therefore no savings can accumulate; while in other situations capital goods are available but the means of mobilizing them are very inadequate. This makes for under-use of resources, waste and economic retardation.[1]

In addition to the regular uses of credit, cooperative credit is also an instrument of social policy. It may be a vehicle for altering land use patterns, for promoting the growth of family farms and alleviating other tenure

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1. V.W. Johnson & E.C. Johnson, Farm Credit Activities in Selected Countries with Reference to Credit Programs for Underdeveloped Areas, (Beirut, 1954 - mimeographed), p. 70.

problems, and for other like purposes. Great benefits can arise from credit properly so used. That there are risks inherent in the use of credit for economic reform should be apparent, but these can be assumed with adequate safeguards. One of these safeguards is supervised credit.

E. Supervised Credit

Systems of supervised credit have been set up in many countries to help low income farmers who are not usually capable of borrowing from credit institutions but who with credit and technical assistance in planning and operating their farms can make substantial economic progress. Supervision in relation to credit is broader than loan servicing. As the term is used in supervised credit, it involves the usual extension of loans and, in addition, educational activities in assisting the farmer in planning his farm business and operating the farm effectively. It means working with the farmer in improving farm practices and making plans which will increase productivity of the farm; such as analyzing the crops to be grown, determining the productive capacity of the farm and the economic soundness of the proposed operations. All these studies provide the basis for determining the amount of the loan and whether or not a loan can be approved. In fact, loans should be based on the capacity to repay rather than the physical security only.[1] The economic soundness of any loan must be determined primarily in the light of its impact on the production of the borrower. It is true that some lending will always be needed to help farmers during temporary difficulties due to harvest failures or any other cause beyond their control. In the long run, however, an increase in agricultural indebtedness will be justified only if it is capable of raising the output of farmers in such a way that they will have an ample margin for repayment of their loans. For instance, institutional credit on reasonable terms can hardly replace non-institutional credit at usurious rates of interest unless the borrowers can at the same time be made more creditworthy by ensuring that the proceeds of loans are really used to improve production. Thus, what is needed is a system of supervised credit which will in effect combine lending with agricultural extension or educational work.

Supervised credit may be organized under programs calling for direct loans to farmers by the government, for loans through cooperatives or for a combination of direct

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1. Food and Agricultural Organization of the United Nations, <u>Report on the Technical Meeting on Agricultural Credit for the Arab States Near East</u>, (Rome, December 1954), p. 22.

and cooperative loans. It is preferable, in so far as possible, to operate the supervised credit program through cooperatives, particularly in connection with short term loans.[1] However, since virtually no such cooperatives exist in Lebanon, any supervised credit program can only be operated through BCAIF, since the latter is the only specialized credit institution presently in operation. But BCAIF is, at present, far from being equipped to handle any credit supervision. As a result, supervision of loans has remained practically absent. It certainly is absent in the sense of helping the farmer to become a proper credit risk, but it is also absent to a large extent even in the form of inspecting adherence to the loan contract.

That the present agricultural credit situation in Lebanon calls for establishing a system of supervised credit should be apparent. A few suggestions, in this connection, may be necessary. In view of the technical educational features of a supervised crédit program which requires training courses for supervision, educational programs for farmers, the program is costly and therefore it is better to be first established in a few selected areas representative of different types of farming. Such pilot projects are

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1. Ibid., p. 23.

extremely beneficial since they can offer practical experience and demonstrate the organization and operation of a supervised credit program. It should be emphasized, however, that the technical educational and social services provided by a program of supervised credit should not be covered by the rate of interest on loans, but should be considered as a public service to be financed by the government.[1] If BCAIF, for instance, were to operate the supervised credit program, the charges for the services thus rendered should not be reflected in a higher rate of interest but should be covered by the government.

Secondly, the Lebanese Government should give due consideration to the possibility of establishing supervisors' training programs. Since Lebanon has had no experience in this field it may be advisable for the government to rely on getting technical assistance from foreign sources, either through calling on the advice of technical and administrative experts from abroad, or through sending qualified employees for training abroad. The establishment of local training activities may, nevertheless, be attempted to make use of the facilities and skills that are already available.

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1. Ibid., p. 23.

Thirdly, a program of supervised credit should be conceived as one aspect of community planning and development, and be coupled with broader programs of rural reconstruction and development. In most cases, such a program may also serve as a first step for cooperative development.

F. Specialized Credit Institutions

The unbalanced growth in Lebanon's financial institutions, credit facilities of which are well developed but are geared almost exclusively to commercial needs, has left Lebanon, until recently, without any specialized credit institution to adequately handle long term credit for agriculture, industry, and real estate. SCAIL was established in 1939, and it was hoped, since it was then the only specialized credit institution, that long term credit would be made more available. However, SCAIL suffered from serious limitations, i.e., rigid requirement of mortgages and political favoritism, which left small farmers, who could not offer the required degree of security or who had no political backing, outside the scope of its operations. BCAIF has been functioning for less than two years and it is yet early to pass any judgement on its performance. The volume of credit so far extended, as shown in the previous chapter, is quite impressive, and the Bank has already exhibited a potential to get rid of the major impediments that characterize the Lebanese credit situation. It has been observed, however, that BCAIF is handicapped by some weaknesses and limitations, both provisional and structural; and if it is to perform the coveted role in contributing to the development of the agricultural, industrial and real estate sectors of the economy, some basic changes and amendments are deemed necessary. It is the purpose of this section to discuss these provisional limitations and structural weaknesses, and to suggest possible remedies for their alleviation.

1. Provisional Limitations

The limitations of the provisions pertaining to agricultural, industrial, and real estate loans will be separately discussed.

a. Agricultural Loans

Agricultural short term loans can be granted against a real property mortgage, a hypothecation, securities or a personal guarantee of two persons aside than the signature of the borrower. Agricultural medium and long term loans can only be granted against a mortgage on real property, and are limited to 35 per cent of the real market value of the mortgaged property. Aside from these requirements, agricultural loans are subject to further limitations -

short term loans are limited to LL 6,000, medium term loans to LL 30,000, and long term loans to LL 60,000. Agricultural cooperatives are given, in this respect, special privileges - short term loans to cooperatives are limited to LL 60,000, and medium term loans to LL 150,000, but only one cooperative has taken advantage of such a privilege.

It is true that agricultural loans are risky and therefore call for rigid requirements, which can be economically justified; nevertheless, some of the above provisions are too exacting and it may be advisable to consider their amendment. To begin with, the requirement of two signatures other than the borrower's for personal guarantees may not necessarily be required in all cases. One signature (in addition to the signature of the borrower) may be quite adequate if the borrower is of a good financial standing. This requirement would have been more flexible if left to the discretion of the Bank to decide, depending on the borrowers' creditworthiness, whether one or two signatures should be required. This provision may partially explain the fact that only 4 per cent and 5.2 per cent of the agricultural loans extended during 1955 and 1956 respectively were short term loans. Secondly, the ceiling limitation of the amounts of agricultural loans, particularly in the case of medium and long term loans, may not be required. Agricultural loans should be secured, and the restriction of medium and long term loans to 35 per cent of the market value of the mortgaged property is quite adequate and reasonable, and does not necessitate any further limitations. Therefore, it may be advisable to abolish the provision which limits the amounts of agricultural medium and long term loans to LL 30,000 and LL 60,000 respectively.

b. Industrial Loans

Short term loans to industry, like those to agriculture, can also be granted against a real property mortgage, a hypothecation, securities or a personal guarantee of two persons aside from the signature of the borrower; and irrespective of the value of the security given, the amount of a short term loan cannot exceed half the net earnings of the establishment. There are no provisions which distinguish clearly between medium and long term loans. Like those to agriculture, both of these loans also require a real property mortgage and the maximum amount is limited to 35 per cent of the real value of the mortgaged property. This, however, forms the only limiting factor, and unlike agricultural loans, there is no ceiling limitation to the amount of medium and long term loans extended to industry.

Again, the requirement of two signatures other than the borrower's for personal guarantees is not always necessary.

It is easier for the Bank, with regard to industry, to know more about the financial standing of the borrower, and therefore it should be left to the judgement of the Bank to require either one or two signatures depending on the case under consideration. It may be argued, on the other hand, that since establishments do not keep adequate financial statements about their situation, it is not easy to depict the real financial standing of the borrower, and therefore two signatures are better be required.

The provision pertaining to limiting the amount of individual short term loans to half the net yearly income of the establishment can hardly be justified. This provision, as reflected by the amount of short term loans extended by BCAIF, has certainly reduced the demand for such loans to a degree that only an insignificant portion (around 5 per cent) of the loans extended were short term. It is important, therefore, that this provision be amended and made flexible so that the amount of short term loans extended to industry would be reasonably increased. It is reported that the Bank has been considering the possibility of amending this provision.

Although the provisions for medium and long term loans may be considered quite reasonable, it may still be worthwhile to consider few possible suggestions for the amendment of these provisions.[1]

1. Medium and long term loans can only be extended for the investment in fixed capital equipment, and cannot be used for working or operating capital purposes. In most cases, industrial establishments may have invested a considerable part of their capital in plant equipment, and consequently may find themselves short of working capital which undoubtedly will limit their operations. It may be argued that industrial establishments can resort to commercial banks when they need loans for working or operating capital purposes, but as shown previously, very few establishments are provided with such credit facilities. Therefore, it may be necessary to suggest an amendment to this provision so that medium and long term loans can be extended for working capital purposes, if only to the establishments which have in the past over-invested in plant equipment.

2. There are no provisions in the law designed to help establishments settle their old standing loans.[2] If the purpose of BCAIF is to assist small and large establish-

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1. Most of these suggestions were made by Lebanese industrialists who are dissatisfied with the above provisions. See T. Yaffi, op.cit., p. 27.

2. Article 8 of Law of July 16, 1954 is applicable only to debtors of SCAIL, and states that no loans to persons with outstanding debts are permitted unless at least 65 percent of the loan has been paid to SCAIL. It is evident that such a provision does not encourage debtors of SCAIL to borrow from BCAIF.

ments alike, provisions should be made in the law to permit the small establishments to consolidate or retire their old debts. Unless such facilities are provided, establishments, which due to the unavailability of reasonable term credits had to borrow at high rates of interest, can hardly expect to make a reasonable rate of return on their investment as long as a good part of their income is taken up by the high debt burden of the interest payments.

3. A third possible suggestion is related to the requirement of a real property mortgage. It is often proposed that BCAIF should attempt to extend what may be called "soft loans", i.e., unsecured medium and long term loans which will be primarily based on the creditworthiness and reputation of the establishment. Some industrial concerns depend, for meeting part of their credit needs, on the overdraft facilities of commercial banks. Any medium or long term loan from BCAIF would mean the mortgage of their plants or any of their real estate holdings which will weaken their creditworthiness with the commercial banks and consequently reduce the credit facilities which were previously made available to them. While such an argument may be valid, one would still question the fact whether it is advisable at present to extend unsecured medium and long term credits to industrial establishments in Lebanon. Very few establishments keep proper balance sheets and profit and loss statements,

and consequently their financial standing cannot be accurately assessed. Moreover, most unsecured loans in developed economies are granted to corporations only. It need not be repeated that corporations are still unpopular in Lebanon, and not until they become more numerous will it be possible to consider the extension of unsecured medium and long term loans.

c. Real Estate Loans

The provisions concerning real estate loans are similar to those of the industrial loans. In the case of short term loans, two signatures are required other than the borrower's for personal guarantees, and the loan cannot exceed half the net yearly income of the establishment; while medium and long term loans require a real property mortgage and the amount of the loan is limited to 35 per cent of market value of the mortgaged property. These provisions have had the same consequences for real estate loans as for industrial loans. The provision which limits short term loans to half the net yearly income of the establishment has been an impediment to the availability of real estate short term loans. It is primarily due to this reason that no such loans were extended during 1955, and during 1956 only 7.6 per cent of the loans were short term. The suggestions given with regard to the possible amendment of provisions of industrial loans, can be taken to apply to provisions of real estate loans as well.

Real estate loans, as defined by BCAIF's provisions, are restricted to hotels and other establishments of the tourist trade. This totally negates real estate loans which are normally extended to people with fixed and moderate incomes to enable them to purchase or build their own houses. And since practically all commercial banks have not shown any interest in handling these types of loans, medium and long term real estate loans at reasonable rates of interest have remained virtually non-existent. It is very important, therefore, to either amend the provisions restricting real estate loans to hotels and other establishments of the tourist trade, or to create a new and separate real estate bank which will specialize in extending medium and long term loans to middle class people who want to buy or build their houses. It may not be advisable, with the present structure of BCAIF, to amend the provisions of real estate loans. The creation of a specialized institution to handle such type of loans may be more appropriate. It is worthwhile to mention, in this respect, that a proposal for the establishment of the said institution has already been drafted.[1]

2. Structural Weaknesses

When the Lebanese Government was considering the establishment of BCAIF, it called upon the IBRD for advice. The latter, after surveying the Lebanese credit situation, recommended that two separate banks be formed - one for agriculture and one for industry and tourism - and showed a willingness to contribute to the capital of the latter, if formed as recommended. The Lebanese Government, however, decided to establish one bank which would finance at the same time agriculture, industry and hotels. In so doing, the government was mainly motivated by two factors - one was to minimize administrative costs, and the second was the realization that the government would not be able to attract enough private capital to a separate agricultural bank. Both these reasons do not appear sufficient to justify the establishment of one bank instead of two. The present structure of BCAIF, as a result of this decision, is often criticized as having basic deficiencies which prevent it from performing an adequate and meaningful role in the development of agriculture, industry and real estate. Moreover, banking principles, and past experiences in this

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1. See T. Yaffi and N. Saadeh, "A Proposed law for the Establishment of the Lebanese Real Estate Bank", Chamber of Commerce and Industry of Beirut, The Economy of Lebanon and the Arab World, September 1956, pp. 31-38.

field, neither justify nor support the present set-up of the Bank. There are many reasons which render undesirable the combination of the three different credit activities in one institution.[1]

1. Handling the different types of credit activities requires varying techniques and experience. The policy regarding the extension of loans, the ascertainment of their safety and of the types of security required, are necessarily different in each of the three types of credits and therefore cannot be administered efficiently by one institution.

2. While the industrial bank may need only one center, the agricultural bank requires many branches to be located in rural areas, if it is to perform its functions adequately. As long as no separate agricultural bank is created the possibility of establishing these branches would always remain slight.

3. The risk involved in agricultural credit exceeds that of either industrial or real estate credit, and therefore it will be difficult to increase the working capital of the Bank by attracting private capital or by relying on capital from international institutions, as long as the three types of credits are handled by the same institution.

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1. Some of these reasons were given in a document prepared by the Lebanese Development and Planning Board.

4. The capacity of the Bank to cater to the needs of small farmers will undoubtedly be weakened if it is to operate in three fields of credit. The small farmers need and deserve to be given special attention, and the Bank, with its present structure, will definitely fail to do so.

Aside from the above factors which call for the separation of the credit operations of the Bank, the experience which some countries have had in establishing their specialized credit institutions, seems to point to the same conclusion. Having created first an industrial and agricultural bank, Iraq soon found out that such a bank could not perform its credit operations adequately. The Iraqi Government, as a result, had to separate industrail credit from agricultural credit, and to create an independent bank for each. In Iran, the Government had the same experience - its attempt to combine agricultural and industrial loan operations failed, and now the industrial and agricultural bank limits its activities to agricultural credit only. In Lebanon itself, SCAIL's experiences in this field are very significant. One major cause of SCAIL's failure is probably the fact that it attempted to finance at the same time agriculture, industry, and real estate.

Based on the above factors and experiences, and in view of the fact that a suggestion has already been made to create a separate real estate bank, a recommendation to separate BCAIF into two banks, one for agriculture and one for industry and tourism, may prove to be very appropriate. In so doing, the government will remove the major structural impediment from which the Bank suffers.

One major problem which the government had to face in creating BCAIF was the lack of interest of private capital to participate in such a venture. Had it not been for the Government's participation, the Bank could not have been formed. It was only when the Government subscribed to 40 per cent (LL 2 million) of the capital and guaranteed a BSL loan of LL 25 million at 2 per cent interest to the Bank, that private capital became interested in joining. If BCAIF is separated into two banks, enough capital will probably be attracted to the industrial bank to enable it to operate without the Government's financial support, because of the high returns in industry in recent years. The real difficulty will be with the agricultural bank. However, since the Government has already contributed LL 2 million of the capital of BCAIF, and since Government financial assistance will no longer be needed by the industrial bank, all the Government's contribution to BCAIF can be diverted to the agricultural bank. The LL 2 million may not be enough to constitute all of the capital of the agricultural bank, but together with (say) LL 10 million of guaranteed loan from BSL it certainly will be enough to enable the bank to undertake a substantial amount of activity.

Establishing two separate banks will not only solve the problem of attracting capital, it will also enable the banks, particularly the agricultural one, to perform also certain essential activities which could not be developed under the present set-up of BCAIF. The agricultural bank would be able to pay more attention to the needs of small farmers, and may become capable of establishing a supervised credit system. It may also attempt to work out with the farmer on his farm the best application of credits, and in effect it will combine lending with agricultural extension services. For this task the bank will need credit supervisors well trained not only in credit techniques and problems, but also in agricultural methods. The supervisors will advise farmers on a program of improvement and will help them to seek greater efficiency to use new methods, fertilizers, and improved seeds. Furthermore, the bank may be able to perform additional extra-banking functions such as purchasing and selling seeds, insecticides, and machinery, purchasing land, and importing agricultural equipment.

Taken separately, each one of the above described remedies may appear inadequate to meeting present requirements. However, they constitute together a program of reform which, if carried out with vision and determination, may go a long way towards reducing the urgent need for medium and long term credit in the productive sectors of the economy. Such a reduction is probably one of the best guarantees of a more balanced growth of the country in the future.

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