

A CENTRAL BANK FOR LEBANON

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## PREFACE

The object of this paper is to appraise and analyze the Monetary Convention of 1937 according to which the Banque de Syrie et du Liban (BSL) performs certain central banking functions in Lebanon, and to show the vital need for replacing BSL by a new national central bank at the expiration of the Convention in 1964.

This Convention which was issued and amended during the French Mandate thirty seven years ago is no longer suitable to meet the needs of the developing monetary and banking systems. This is due to the basic evolution of the Lebanese economy in particular and to the changes in the world situation in general.

The number of banks operating in Lebanon have increased from about fifteen in 1920 to more than eighty in 1961. Central banks have recently become increasingly important in promoting the interest of the public, executing the government's monetary policy and facilitating economic development. Almost all independent countries have established central banks of their own in order to ensure the evolution and progress of their monetary and banking systems and to encourage the growth of their economies.

Lebanon being an independent country whose government

seeks the welfare of the public and the development of the economy should take advantage of the expiration of the BSL Convention in 1964 and establish a new central bank whose main aim will be to promote the welfare of the people and protect their interest.

I would like to express my deep gratitude to my supervisor, Professor Paul J. Klat for his valuable and numerous comments and his helpful criticisms. Had it not been for his generous help and encouragement this work would not have been completed.

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## ABSTRACT

At present Lebanon has no central bank. Its Bank of Issue, the Banque de Syrie et du Liban (BSL), a French corporation which obtained certain prerogatives in accordance with the Monetary Convention of 1924 (later amended in 1937), performs some activities of a central bank in the country. As such, the BSL has a dual character; on the one hand, it is a commercial banking institution motivated by profit and the interest of its shareholders; and on the other it operates as a central bank whose objective is to safeguard the interest of the public and execute the government's monetary policy. This situation has led to certain weaknesses and defects which are detrimental to the development and evolution of the monetary and banking system in Lebanon.

The aim of this study is to appraise and analyze critically the present convention and functions of BSL; reveal its defects and weaknesses, and demonstrate the essential and vital need for establishing a new national central bank for Lebanon which will serve the interest of the Lebanese public and execute the government's policy efficiently.

This solution is so necessary in the light of the development and evolution of the Lebanese monetary and banking systems and the present BSL's convention and functions.

BSL being a commercial bank motivated by profit and the interest of its shareholders is not in a position to function as a central bank. This is because a central bank should be mainly motivated by the public welfare and not profit. Besides, there are certain basic objections to BSL's Convention and functions as a central bank which necessitate its replacement by a real national central bank.

Lebanon being an independent country should establish a central bank of its own which will operate and function in accordance with the public interest and seek the nation's welfare and development.

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## CHAPTER I

### THE MONETARY SYSTEM OF LEBANON - HISTORY AND EVOLUTION

#### I. Background

From the sixteenth till the beginning of the twentieth century Lebanon was under Ottoman rule and as such its monetary system was that of the Ottoman Empire. Gold, silver, nickel and copper coins were in circulation.

Beginning with 1880 and up to 1914, Ottoman Turkey was on a gold standard and the gold pound was the standard unit of account. The pound was equal to 102.083 grams of fine gold and was made divisible into 100 silver piasters.<sup>1</sup> In addition to metal coins, banknotes of the Imperial Ottoman Bank circulated during the latter part of the period and were covered by precious metal reserve one third of which was in gold. However, the banknotes were of little significance as most of the people were reluctant to use them.

#### 1. The Currency During the First World War

In 1914, Turkey entered the World War I allying herself with Germany; probably more than any of the belligerent nations, it found war financing a very difficult problem. It soon suspended the gold standard and resorted to its Allies

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1. Said Himadeh, Monetary and Banking System of Syria (Beirut: American Press, 1935), p. 25.

for financial assistance.<sup>1</sup> It obtained loans from Germany and Austria-Hungary amounting to 80,000,000 marks and 47,025,000 crowns respectively. The gold equivalent of these loans was deposited with the Reichsbank and the Austro-Hungarian Bank in the name of the Ottoman Public Debt Administration, and on this basis, Turkey was able to issue notes under the supervision of the Administration equal to the amount of the deposit.<sup>2</sup>

On June 13, 1915, a law was passed authorizing the issue of 6,583,094 Turkish pounds notes, the equivalent of the gold deposited with the two mentioned banks. The law stipulated that the notes should be legal tender and equal in value to gold. Later six more issues were made payable in gold to bearer; however, they were not secured directly by gold, but by German treasury notes of equal value.

During the war period these notes were exposed to sharp depreciation and fluctuation and 10 to 13 of them were exchanged for one gold pound. The people had great confidence in gold pounds and were suspicious of the banknotes. Even the Turkish Government itself was obliged to go into the market and buy gold at a premium in order to cover its remittances to Germany for munitions and to buy food supply in the interior where most peasants declined to honor paper.<sup>3</sup>

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1. The Turkish Government was unable to rely upon its Bank of Issue, The Ottoman Bank, since the Bank belonged to French and British interests.
  2. Himadeh, op.cit., pp. 34-42.
  3. G.B. Ravandal, Turkey - A Commercial and Industrial Handbook (Washington: Government Printing Office, 1936), pp. 203-209. See also Talha Yafi, The Monetary and Banking System of Lebanon with Special Reference to Monetary Reform (Wisconsin: Unpublished Ph.D. Thesis, 1959), pp. 4-10.

## 2. Franco-British Occupation of Lebanon

In September 1918, Turkey was defeated and the English and French forces occupied Syria and Lebanon. On November 2, 1918 the High Command of the British Army ordered the demonetizing of the Turkish paper currency and substituted for it the Egyptian pound.<sup>1</sup> But since the people's reaction towards paper money had not become any better, the Egyptian banknote was exchanged at a discount in terms of gold.

In accordance with the Treaty of San Remo of April 1920, Syria and Lebanon were put under the French Mandate. The French Administration soon found that it was quite expensive to buy Egyptian pounds in order to meet its expenditure in Syria and Lebanon. Consequently, the French High Commissioner canceled the declaration which decreed the Egyptian pound legal tender and issued by arrêté (No. 129, April 2, 1920) a new Lebano-Syrian paper currency based on the French franc and redeemable in checks on Paris. The same (arrêté) assigned to Banque de Syrie, a French company, the privilege of issuing the new currency notes. The new pound was made equivalent to 20 francs and divisible into 100 piasters.

## II. The Franco-Lebanese Monetary Conventions

### 1. The Monetary Convention of 1924

In order to legalize the Lebano-Syrian currency and

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1. The Egyptian pound was backed by Sterling assets and this made its use in Syria and Lebanon by the British army less expensive than the purchase of gold or foreign currencies.

confirm the status of the Banque de Syrie, negotiations took place between the two Governments of Syria and Greater Lebanon on the one hand, and the Banque de Syrie on the other.

On January 23, 1924, a convention was signed between the two parties and was approved by the French High Commissioner. According to this convention, the franc exchange standard was sanctioned and the Bank was granted a monopoly privilege of issuing notes for a period of fifteen years beginning April 1924. The notes were to be redeemable in checks on Paris at the rate of 20 French francs to one Lebanon-Syrian pound, and were to be the only legal tender money in the country. The Bank whose name became Banque de Syrie et du Grand Liban<sup>1</sup> was the official bank of the states and the custodian of governments funds.

As a safeguard of the note issue, articles 7 and 8 of the Convention stipulated that the issue department shall be independent from the commercial banking department and that the amount of the notes in circulation shall not exceed 25 million pounds and shall be fully covered by reserve as follows:<sup>2</sup>

- a. 45% gold and foreign government securities payable in gold.
- b. Short-term bonds issued by the French Government.
- c. Commercial paper consisting of foreign bills with two signatures, and domestic bills with three

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1. Later in 1939 its name became Banque de Syrie et du Liban; henceforth it will be referred to in this paper as BSL.

2. Himadeh, op.cit., p. 70.

signatures, the amount of which should not exceed seven per cent of the notes in circulation.

- d. Optional current deposit at the French Treasury; the amount of this and the commercial bills should not exceed 22 per cent of the total issue.

In return to the privilege of issuing notes the BSL had to pay annual percentages from the yields of the reserve to the governments of Syria and Lebanon.<sup>1</sup>

## 2. The Monetary Convention of 1937

Prior to the expiration of the 1924 Monetary Convention, a new one was signed on May 29th 1937 for a period of 25 years between the Government of Lebanon and the BSL. This Convention became effective as from April 1st 1939. It was based on the old 1924 Monetary Convention with some modifications. The BSL retained its privileged position of issuing notes and acting as the government fiscal agent. However, in the new convention no limits were set for issuing notes and the notes in circulation were to be covered by two kinds of reserves:<sup>2</sup>

1. An obligatory reserve which included:
  - a. A minimum of 10% in gold.

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1. The rates of these payments were progressive starting at 1% and reaching 50% of the profits on reserve according to the average daily circulation of the notes.
2. For details relating to the Monetary Convention of 1937 see Al Jarida Al Rasmiah (The Official Gazette), Beirut, May 28, 1937, No. 3468, pp. 1293-1305. Also Al Majmu'ah Al-Haditha Lilkawanin Al-Lubnaniah, eds., A. Barud, M. Saleh and S. Hatem, vol. VII (Beirut: Sader Press, 1954), section Money and Exchange.

- b. 25-26 per cent in francs deposited with the French Treasury in Paris bearing a minimum interest of 1.75 per cent.
  - c. An interest free loan of LL 250,000 to the Lebanese Government.
2. A Non-obligatory reserve which included:
- a. Commercial bills in Lebanese pounds with three signatures maturing within three months.
  - b. French Government bonds maturing within five years and similar ones maturing within two years provided the latter do not exceed 25 per cent of the total value of the bonds.
  - c. Demand deposits in francs at the French Treasury provided they should not exceed 6 per cent of the total note in circulation.
  - d. A loan of LL 1.5 million to the Lebanese Government for economic development.

Unlike the old one, the new Convention recognized the Lebanese currency as the only legal tender, standard of value and of deferred payments. It separated the Lebanese from the Syrian currency, although the two remained in circulation at par; and it assumed a minimum gold reserve. Also it recognized the right of the contracting government to all the gain arising from an increase in the value of gold reserve in terms of francs and imposed taxes and duties upon the BSL.

### 3. The Franc Fluctuations and the Monetary Convention of 1944

Ever since it was introduced in May 1920, the Lebano-Syrian pound was the permanent shadow of the French franc, fluctuating with it and depreciating with it. Obviously, such a situation was not to the interest of the Lebanese economy.

#### a. Franc Fluctuations

During the first month of its introduction in May 1920, the average rate of the Lebano-Syrian pound was 137 U.S. cents. Following the fluctuations of the franc it rose to 162 cents in July and dropped <sup>to</sup> 116 cents in December, and then rose again during 1921 reaching an average of 154 cents in December and an average of 183 cents in April 1922. After that it fell steadily with some fluctuations reaching an average of 92 cents in March 1924. These fluctuations continued till July 1926 when the franc was de facto stabilized in terms of gold.<sup>1</sup> This made Lebanon indirectly on a gold exchange standard, and its note which was equivalent to 20 francs became indirectly equivalent to 1310 milligrams of gold 900/1000 fine.

This stabilization remained for a period of ten years during which Lebanon had the advantage of a stable currency.

In October 1936 France abandoned the gold standard and once again the Lebano-Syrian pound started a cycle of depreciation and fluctuations following the franc. Between

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1. The de jure stabilization was not achieved until June 1928.



June 1937 and May 1938 the franc depreciated from 26 francs per U.S. dollar to 35.88 francs per U.S. dollar.<sup>1</sup>

The "Office des Changes" which had been set up in December 3, 1939 by the High Commissioner was made the sole operator of foreign exchange; all foreign exchange was ordered to be sold to this office. This enabled France to collect all the available foreign exchange by issuing Lebano-Syrian pounds against French bonds.

In June 1941 Lebanon and Syria were invaded by the allies and the value of the Lebano-Syrian pound was set at 883.125 per sterling. However, when the British withdrew, the "Office des Changes" was put under the control of the Free French Administration through the BSL. Later, due to British demand, the Office des Changes was ordered to sell sterling to residents without limitation against Lebanese pounds.

b. The Monetary Agreements of 1944

On January 24, 1944 a Monetary Agreement was signed between France, Britain, Lebanon and Syria in Damascus according to which the following parity in terms of sterling between the Lebano-Syrian pound and the French franc was to be maintained:<sup>2</sup>

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1. Yafi, op.cit., p. 20.

2. Republique Libanaise, Ministère de la Justice et des Affaires Etrangères et des Libanais D'outre-Mer, Recueil des Traites et Conventions Bilaterales (Beirut: Dar Al Hayat, 1951), p. 79.

LLS = FF 22.65

£ = FF 200

£ = LLS 8.83/100

The Convention stipulated further that no restriction on the purchase of sterling should be put upon the residents of Syria and Lebanon without the agreement of governments concerned.

The French Delegation promised to maintain the value of the franc assets covering the note issue of the BSL and those of the Office de Changes at the rates mentioned above even in case the franc were devalued.<sup>1</sup> Another promise was to restore the gold which was taken to France from BSL by the French Vichy government representatives, and in fact, the gold was soon restored.

On April 18th 1944 another agreement was made between the French Administration and the Governments of Syria and Lebanon according to which the management of the Office des Changes was to be transferred to the latter governments.<sup>2</sup> However, the actual transfer did not take place until 1948 when a new monetary agreement was signed between Lebanon and France; until that date the French remained in control of the Office des Changes. The Lebanese and Syrian nationals found it difficult to convert their franc balances into

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1. Lebanese Republic, Al Watha'ck wal Nusus (Documents and texts concerning the economic and financial relations between Syria and Lebanon, October 1943 - March 14, 1950), (Beirut, 1950), pp. 25-34.

2. Recueil Des Traites et Conventions Bilaterales, op.cit., p. 83.

foreign currencies due to the reluctance of French authorities to accept any such requests.

Exchange control, as set up by the Protocole of April 19th, 1944 was to be directed by three officials representing the French authorities, the Government of Lebanon and the Government of Syria. In addition there was a French general inspector who was assisted by Lebanese and Syrian agents.<sup>1</sup>

c. Misinterpretation of the 1944 Monetary Agreements

In accordance with the Catroux letter of January 24th, 1944, France paid BSL FF 287,229,729 following the devaluation of the franc in July 1945; and the value of the Lebano-Syrian pound was raised from FF 20 to FF 22.65.<sup>2</sup> Again on December 26th, 1945, the franc devalued from FF 200 to 480 to the sterling and France paid FF 16,600,246,810 for the note cover and FF 32,415,441 for privately held franc assets and the LLS was raised from FF 22.65 to 54.35. However, on January 10th, 1946 the French Government withdrew its promise and informed the Lebanese and Syrian Governments that it was no more responsible for any losses in the value of the francs in the note cover and deposits with BSL resulting from any new devaluation of the franc. Also the transfer of sterling was restricted on March 1946 by the Controle des Changes.

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1. Ibid., p. 84.

2. Payment was made in French Government bonds of 3 months maturity bearing one per cent interest.

The two Governments rejected the French claims and brought to the attention of the French Government that neither the spirit nor the letter of the Catroux promises justify such actions. The French Government replied by claiming that the Catroux promises were limited to the year 1945. The two Governments objected to such a false interpretation and insisted, rightfully so, that the French Government was under obligation of guaranteeing the value of the franc assets in the note cover due to any future franc devaluation.

When reading the Catroux letter one finds that the Lebanese and Syrian Governments were justified in their objections, as shown in the following two paragraphs:

"When the exchange rate between the French francs and sterling pound is changed the French Committee of National Liberation will take the necessary measures to keep and maintain constantly the sterling value of the French assets of BSL and those covering the note issue.

In case of new franc devaluation in relation to sterling, the French Committee of National Liberation will add to the franc assets until their total value converted in sterling at the new rate is equivalent to what it used to be when converted at the rate of 200 francs."<sup>1</sup>

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1. Gabriel Menassa, Plan de Reconstruction de L'Economie Libanaise et de Reforme de L'Etat (Beirut: Societe Libanaise d'Economie politique, 1948), pp. 487-488.

Regardless of all the efforts made by the two governments to convince the French Government the latter insisted that the promises applied only for the year 1945.

As a result of this disagreement, negotiation started in Paris between delegates of the Lebanese and Syrian Governments on one hand and the French Government on the other hand. After about five months the Lebanese Delegation and the French Government signed a separate agreement on the 24th of January 1948. The Syrian Delegation had withdrawn few days earlier.

The Syrian Government declared that the Agreement did not guarantee the Lebano-Syrian assets as agreed upon in the Catroux letter, nor did it provide enough scarce currency for Syria; that it put the country (Syria) under the obligation of importing from the French Union; and that it gave a de jure recognition to the concessions given to the French companies during the French Mandate.

Unlike the Syrian, the Lebanese Government found in the Agreement an adequate guarantee against the loss in the note cover which would result from the franc devaluation of January 25th, 1948, as it was not prepared to devalue its currency. In addition the Lebanese Government had no intention of withdrawing the concessions granted to the French companies and wanted to settle its problems with France on a friendly basis.<sup>1</sup>

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1. Al Majles al Niyabe - Minutes of the Lebanese Parliament (Beirut, February 4, 1948), pp. 474-492.

### III. The Franco-Lebanese Monetary Agreement of 1948

In addition to the monetary problems and the sterling guarantee of the Lebanese held franc assets, the monetary agreement of January 1948 deals with other unsettled Franco-Lebanese problems such as French concessionary companies and properties in Lebanon, commercial relations, transfer of capital and others. The Agreement provided for the liquidation of claims and counter claims existing between the two countries. In the following paragraphs the main provisions of the Agreements are discussed.<sup>1</sup>

#### 1. The Main Provisions

With regard to the Catroux letter of January 1944 relating to sterling guarantee of franc balances held by Lebanon (franc assets in the cover and franc assets with the Office des Changes) the 1948 Monetary Agreement offers a sterling guarantee for the exchange balances in the note cover for a period of ten years. These balances were to be released by annual installments. As for the non-guaranteed balances, they were made available for immediate use either for the purchase of goods from the French Union or for the purchase of certain European currencies.

The franc assets which were held by Lebanon (13 billion) were thus put into two different accounts, "The old No. 1 account" and "The old No. 2 account."

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1. For details on the Franco-Lebanese Monetary Agreement of 1948 see The Monetary Agreement Between Lebanon and France, 24 January, 1948 (Beirut, 1948), Recueil des Traites et Conventions Bilaterale, op. cit., pp. 111-129.

Old No. 1 account was credited with 8 billion and carried a sterling exchange guarantee for ten years. Debits from this account were to be made for the following:

- a. Payments to the French Government in compensation for its property in Lebanon.<sup>1</sup> Such payment was to be made in five annual payments beginning June 1949 and must be undertaken with a sterling exchange guarantee.
- b. To make available current exchange resources, annual releases should not exceed one-tenth of the actual amount credited to No. 1 account starting July 1st 1953 after the debt for the French Government is paid. Under special circumstances the two governments could agree on increasing the amounts released. Annual releases will be credited to a new No. 3 account.

In December 1953, 3 billion francs remained in No. 1 account. As annual releases were made, an insignificant amount remained at the end of the agreement in 1958. According to the new Monetary Agreement of 1959 this amount now enjoys a guaranteed exchange rate in terms of the U.S. dollar.<sup>2</sup>

Old No. 2 account which carried the unguaranteed franc balances amounting to FF 4 billion held by the Office des Changes to be debited by:

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1. The French property in Lebanon included the telephone system, broadcasting stations, military equipment and others estimated at LL 20 million.
  2. See Modification of the 1948 Monetary Agreement, p. 22.

- a. The value of European currencies which Lebanon purchases, besides the French franc, converted at official rates. This should not be more than half the total of No. 2 account in one year. The two governments were to agree upon the kind of European currencies and the dates of payments.
- b. What remains of No. 2 account during the first three years of the agreement were to be moved to No. 3 account. However, No. 2 account seems to have been liquidated before the end of the first year.<sup>1</sup>

No. 3 account was to be credited and debited according to the value of commercial transactions between the two countries.

Capital transfers from Lebanon to the French Union were to be free but transfers from the latter to the former should be carried through the French Exchange Control Office. Under special circumstances (for family needs, transfers of capital of Lebanese emigrants) such permissions were granted.

Prior concessions granted to French companies in Lebanon will not be changed unless agreed upon by the companies concerned and the Lebanese Government.

In cases where the export of some goods are subject to limitation due to the imposition of quantitative restrictions, the traditional trade relations between the two countries should be taken into consideration in determining

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1. Al Majles al Niyabe, op.cit., pp. 985-987.



the quotas. The French Government promises to facilitate the export of equipment to Lebanon.

The Controle des Changes which was set up in April 1944 is replaced by an agreement to promote good Franco-Lebanese relations.

Finally, Lebanese nationals who own securities of French companies in Lebanon were exempted from French taxes on interest and dividends of their securities.

## 2. Appraisal of the Franco-Lebanese Monetary Agreement of 1948

On studying the Franco-Lebanese Monetary Agreement of 1948 one finds that the Lebanese Government sacrificed part of its rights to settle its problems with France. The following points are the major criticisms of the Agreement.

First, by accepting the Agreement, Lebanon gave up its right to the sterling exchange guarantee of the franc balances in the Office des Changes which amounted to about FF 4 million. Such a right had been provided for by the January 1944 Monetary Convention.

Second, when the French franc devalued in January 1948 from 480 to 866 to the sterling, the franc assets belonging to Lebanon but not guaranteed in terms of sterling lost 55.4 per cent of their value. These assets were originally guaranteed against any franc devaluation according to the January 1944 Monetary Convention.

Third, the new agreement restricted the purchase of

European currencies to half account No. 2 between 1948-50 and to account No. 1 beginning July 1953. It did not provide foreign exchange for Lebanon during the period of 1950-53.<sup>1</sup>

Also Lebanon had to use the French francs for transactions with the French Union only and only half account No. 2 was exempted from such restrictions.

Fourth, the Monetary Agreement of 1948 did not provide for equal rights between Lebanon and France as far as the transfer of funds resulting from invisible trade was concerned. Transfers of funds from Lebanon to the French Union were allowed without limitations except that they should be made through approved medias, but transfers from the French Union to Lebanon had to be approved by the French Office des Changes.

Fifth, the provisions granting respect to all concessionary companies including BSL hindered the ability of the Lebanese Government to take measures altering the position of BSL in favor of an independent and effective monetary policy.

Sixth, Van Zeeland in his "Report to the Lebanese Government on the Franco-Lebanese Monetary Agreement of 1948" criticized the sterling guarantee and believed that a gold guarantee would have been more favorable to Lebanon.

### 3. Consequences of the Franco-Lebanese Monetary Agreement of 1948

One of the consequences of the Monetary Agreement of

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1. Zuhayr Mikdashi, The Monetary System of Lebanon (Beirut: Unpublished M.A. Thesis, 1956), p. 22.

1948 was the breaking of the Monetary Union between Syria and Lebanon, thus marking the parting of ways between the two countries whose currencies till that time had been legally interchangeable.<sup>1</sup>

The Monetary Agreement of 1948 provided the Lebanese currency with a separate status possessing its own cover and enjoying possibilities with respect to the use of French franc balances which the Syrian pound for the time being did not share. Soon Lebanon and Syria called in the other country's notes circulating in their respective territories. This withdrawal of notes resulted in a net Lebanese claim on Syria of LS 44,589,082 million which was paid by Syria between 1952-54.<sup>2</sup>

#### 4. Modification of the 1948 Franco-Lebanese Monetary Agreement in June 1959

In June 1959, the Monetary Agreement of 1948 was modified by the Lebanese and French Governments. The main points of the new agreement relate to the following:

- a. The remaining franc balances of the Lebanese Government in account No. 1 shall enjoy a guaranteed exchange rate in terms of the U.S. dollar, until these balances are used up.

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1. F.A.G. Keesing, The Monetary and Banking System of Lebanon, International Monetary Fund, Washington, D.C., 1953, p. 2. (Typescript)

2. See Al Watha'ck wal Nusus, opcit., pp. 61-66.

b. Both, the Lebanese and French governments have agreed to conclude a fiscal agreement in order to avoid double taxation.

Pending the conclusion of the negotiation with regard to the fiscal agreement, the French Government shall exempt Lebanese nationals who own securities of French companies operating in Lebanon from taxes on their dividends earned from these securities.

c. The Lebanese Government asked for a favorable treatment for the Lebanese emigrants with regard to the transfer of capital. However, it has been shown that the recent law of the French Controle des Changes is more liberal than the 1948 Monetary Agreement.

The following non-resident accounts are allowed to be transferred without limits to amount according to the French law:

- i. Transfer for journals' subscription
  - ii. Insurance and judicial costs
  - iii. Revenue transfer of all natures
  - iv. Inheritance
  - v. Repatriation of emigrant properties leaving the French zone for good.
- d. For allowances and living expenses for which the general regulations are more restrictive than the Monetary Agreement of 1948, the French Government raised the ceiling as follows:

- i. Monthly family allowances per person were raised from FF 25,000 to FF 55,000.
- ii. Monthly travelling allowances for the head of the family were raised from FF 45,000 to FF 90,000 and for every member of the family with him the amount was raised from FF 15,000 to FF 35,000.<sup>1</sup>

This agreement has been concluded in the hope that another agreement with wider scope will be negotiated which will settle all the financial and fiscal problems between France and Lebanon.

#### IV. The Lebanese Monetary Law of 1949

The severance of the pre-existing monetary ties between France and Lebanon paved the way for the Lebanese monetary law of May 24, 1949 which recognized the Lebanese currency, redefined the Lebanese pound in terms of gold and laid down new rules for the cover of the note circulation.<sup>2</sup>

##### 1. Main Provisions of the Monetary Law of 1949

- a. The Lebanese pound is the monetary unit and is equal to 405.512 milligrams of gold.<sup>3</sup>
- b. The BSL Issue Department is given the task of issuing Lebanese money of one pound and above

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1. The Franco-Lebanese Agreement of June 25, 1959 (Beirut, 1959) (Typescript) secured from the French Financial Attaché - the French Embassy.
2. Al Jarida Al Rasmiah (The Official Gazette), Beirut, June 1, 1949, No. 22, pp. 280-282.
3. This rate was accepted by the International Monetary Fund in September 1947.

while notes and coins of less than this value are to be issued by the Government Treasury. Both issues (BSL and the Treasury) are legal tender in the country.

- c. All bank notes in circulation issued by BSL Issue Department must be provided with a 100 per cent cover of which at least 50 per cent must be in gold and foreign exchange. The other 50 per cent must be in Government loans and securities, securities guaranteed by the government and commercial bills.

The exact proportions of each of the elements in the note cover were regulated by decree No. K/15105 of May 27th, 1949 which maintained that:

- a. A gold cover account must be opened which includes all the gold cover at the official rate prevailing. When gold (or foreign exchange) is purchased or sold at prices different from the official one, or if the official price is altered, the change in its value will be credited or debited to the Treasury of the Government in a special account and will bear no interest. The debit balance must not exceed the value of the gold cover.
- b. The value of the gold cover should be 10 per cent by December 1950, 20 per cent by December 1951 and 30 per cent by December 1953. Such an arrangement should take place only if it is

possible to obtain the necessary amounts of gold.

- c. The BSL and the Government will choose the foreign currencies to be kept in the cover which must include the guaranteed franc holdings of the cover of the Lebanese pound and other foreign exchange held by BSL and government bonds.
- d. When the BSL purchases or sells IBRD or foreign government securities the net profit from such transaction should be put in the note cover, however, any losses from such transactions should be borne by BSL alone.
- e. The other 50 per cent of the note cover will be composed of the following:
  - i. Bonds and advances issued by the government or guaranteed by it.
  - ii. Bills of exchange maturing within three months, carrying three signatures provided their amount does not exceed 15 per cent of the note in circulation.

## 2. Evaluation of the Monetary Law of 1949

- a. The main objective of the Lebanese Monetary Law was to recognize the independence of the Lebanese currency and to strengthen foreign and national confidence in its value.
- b. The law fixed the LL 1 at 405.512 milligrams of pure gold which represents an overvaluation

of the market rate by about one third. At present such a parity is of no significance as practically all transactions take place at the free rate of the exchange market.<sup>1</sup>

- c. The law allows the Treasury to issue gold coins but such an issue is of no practical significance since the state does not seem to carry such a practice for once it issues gold coins at official parity there will be a great demand for these coins, whose market value would be greater by one third of their face value.
- d. The law permits a certain degree of elasticity in the money supply since 50 per cent of the note cover could be kept in the forms of government loans and commercial bills. Thus the BSL can issue additional notes by moving eligible assets from its banking department to its issue department and this will increase the liquidity of its banking department which might not be in the interest of Lebanese monetary policy.<sup>2</sup>

## V. Recent Trends in the Monetary System of Lebanon

### 1. Trends in the Note Circulation

From 1939 to the end of 1945 the note circulation

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1. Yafi, op.cit., pp. 58-59, and Mikdashi, op.cit., p. 28.

2. This point will be further discussed in Chapter IV.



increased from LL 28 million to LL 171 million. Such an increase was caused by the monetary inflation during the war period.<sup>1</sup>

After the war period, when the Lebanese Government withdrew the Syrian notes from circulation in 1948 the note circulation increased from LL 162.5 million in January to LL 205 million in February. Then there was a tendency for the note circulation to decline due to business contraction and BSL was instructed to purchase gold and foreign exchange in order to prevent such a decline.

In 1951 as the Korean War started, the note circulation increased from LL 167 million in September 1949 to LL 215 million in June 1951 and as a peaceful agreement was reached in Korea, it declined to LL 199 million in June 1952.

In 1953 the Exchange Stabilization Fund started to purchase U.S. dollars in the open market and this led to an increase in the note circulation which reached LL 266 million at the end of 1955.

On December 1958 the note circulation increased to LL 399 million and it kept on increasing until it reached the level of LL 400 million in December 1959,<sup>2</sup> and LL 437 million in December 1960.<sup>3</sup>

Unlike the war period, the recent monetary expansion

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1. R. L., Bulletin Statistique Trimestriel (Beirut: Ministry of National Economy, 1950), vol. I, p. 4.

2. BSL, Exercice 1959 (Paris, 1960), p. 21.

3. Secured from the Ministry of National Economy, Lebanon.

in the past few years have been due mainly to the expanding and progressing business activities of the private sector in the country. The advances made to the private sector up to December 1958 were LL528 million compared to LL 94 million to the public sector and those advances of the private sector kept on increasing until they reached LL 649 in December 1959 while those of the public sector remained at the same level.<sup>1</sup>

## 2. Gold in the note cover

Due to the inflow of capital into the country, the monetary authorities have been able to purchase gold by foreign exchange and put it in the note cover. This have been particularly true after the issue of the Monetary Law of 1949 which stipulated that gold and foreign exchange should form at least 50 per cent of the note cover. The government have been always buying gold with the foreign exchange and thus gold have become the most important item in the note cover.

Gold increased from 2 per cent (3.17 million) of the note cover in 1948 to 95 per cent (252 million) in 1955 and then fell to 77.4 per cent (308 million) in 1958 due to the unlucky 1958 crisis and then it increased and reached a level of 85.5 per cent (392 million) in December 1959,<sup>2</sup> and 92 per cent in December 1960.<sup>3</sup>

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1. Exercise, op.cit., p. 22.

2. The Beirut Chamber of Commerce and Industry, Development of the Lebanese Economy, 1959 (Beirut: Chamber of Commerce, 1960), p. 133.

3. Al-Anwar (Beirut), January 10, 1961.

The rest of the note cover consists of government obligations. It should be noted here that when many countries (including France and England) devalued their currency in September 1949, Lebanon decided to maintain its parity and consequently to give up its link with sterling. The loss resulting from the depreciation of some of the foreign exchange elements of the note cover mainly French francs, had to be compensated by the Lebanese Government. Part of the French franc holdings were not covered by an exchange guarantee and another part was protected by a guarantee against a devaluation of the franc in terms of sterling, which in this case was not operative. In order to make up for the BSL the Government issued Treasury Bonds to an amount of LL 58.7 million in accordance with the provisions of decree No. 581 of December 8, 1949.<sup>1</sup>

### 3. The Exchange Rate

In July 1947 Lebanon joined the IMF and declared an official rate of the Lebanese pound to the dollar \$1 = LL 2.19. However, such a rate has been of little significance.

At present all exchange transactions are conducted at free market rates which were officially recognized in November 1948 for import and non-trade remittances. For a considerable portion of export transaction, the sale of 90 per cent of exchange proceeds in the free market was authorized.

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1. Keasing, op.cit., pp. 2-3.

The free rate was also authorized for 20 per cent of the local expenditures of foreign companies. In January 1952 all exchange receipts were made eligible for sale at the free rate and in May 1952, the use of the free rate was authorized for the local currency requirement of the foreign companies also.<sup>1</sup>

Now the use of the official rate is restricted to few government transactions. It serves as a basis for the calculation of import duties and the making of trade statistics and it is applied in accounting for Government income and expenditure in foreign currencies. The use of official rates by the customs authorities leads to the undervaluation of import goods prices in dollars and this means that foreign trade statistics have to be corrected before they can be used for an analysis of trade situation or the balance of payments.

The free rate since its official recognition in 1948 has fluctuated sharply till 1954 (See Table 1). Since then it has shown only minor fluctuations.

One can summarize the present position of the Lebanese monetary system as follows: The Lebanese pound has an official gold value which is not actually maintained and which has no practical significance. BSL continues to control the note issue according to the 1939 Monetary

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1. International Financial Statistics, vol. XIII (November, 1960), pp. 190-191.

Table I

ANNUAL AVERAGES OF THE EXCHANGE RATES FOR U.S. DOLLARS  
IN LEBANESE POUNDS - BEIRUT MARKET

<u>Year</u>	<u>Exchange Rate</u>
1937	1.26
1948	2.19
1950	3.47
1951	3.80
1952	3.66
1953	3.42
1954	3.22
1955	3.24
1956	3.20
1957	3.16
1958	3.17
1959	3.15
1960	3.15
1961	3.11 °

Source: International Financial Statistics XIV, 1961.

° Up to April 1961

Convention and the Monetary Law of 1949. The Government supervises the correct application of the rules governing the note issue but cannot interfere with any other aspect of BSL's activities which are independent from the government.

## CHAPTER II

### DEVELOPMENT OF THE BANKING SYSTEM IN LEBANON

#### I. Background

##### 1. Banking under the Ottoman rule

During the first half of the nineteenth century there were practically no real banking institutions in Syria and Lebanon. This was due to the fact that under the Ottoman Turkish rule, the circumstances of life militated against the creation of Turkish banks, the main obstacles being religion, improvidence, and lack of confidence in the state. In addition the acquisition of wealth was inevitably followed by hoarding and concealment in the form of cash, jewelry and gold.<sup>1</sup>

During the second half of the nineteenth century few banking houses were established and most of the loans and discounts were made by money lenders.

At the beginning of the twentieth century and before the outbreak of World War I, a significant increase in banking institutions took place. Foreign banks established branches in the large cities of Syria and Lebanon and native banks increased in number. This was followed by a marked

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1. Ravandal, op.cit., pp. 220-222.

development in the granting of credit facilities and a corresponding increase in foreign and domestic trade.

In spite of that, banking activities before the war were very small compared to the need of the country and the banks took little part in financing industrial institutions and were very conservative in extending credit to merchants.<sup>1</sup>

## 2. Banking under the French Mandate

During the war, banking activities were reduced to a minimum and as Turkey was defeated, several banks (belonging to the Central Powers) closed and ceased to operate.

Under the French Mandate, a marked development in commercial banking took place, and both foreign and national banking institutions increased in number. BSL which took over the monopoly of note issue and acted as the government fiscal agent became the most important single bank in the country.

Most of the commercial banking business was carried by foreign banks, the majority of which were French enterprises. Their operations were directed to finance mainly international trade, the finance of domestic trade being left to the national banks. As most of the foreign banks were branches of strong establishments, they commanded a large lending power and they rarely resorted to the Bank of Issue for help because they could always depend on their headquarters.

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1. Himadeh, op.cit., pp. 28-33.

Mortgage banking business, which was not practised before the World War I, developed and was carried by three mortgage companies.

The national banks had a small capital which enabled them to meet the ordinary needs of the local population and to finance domestic trade, but only few of them were in a position to finance international trade. On the whole they discounted their commercial bills with the foreign banks. The national banks differed from the foreign banks in that the former depended for their loans on their own resources and proceeds of discounted papers, while the latter depended upon deposits as the major part of their capital. The national banks dealt in commercial mortgage loans while the foreign commercial banks did not lend on real estate mortgage. A further difference between the business of the national and foreign banks was the fact that unlike the latter the former were not devoted to banking activities only, but also they engaged in several other business activities.<sup>1</sup> Besides the national banks there existed hundreds of private money-lenders who lent their own funds at a high rate of interest.

### 3. Banking in the Reign of Independence

After World War II Lebanon achieved its independence and soon it started to shape and modify its own economic

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1. Ibid., pp. 131-136.



features. The country's poverty in natural endowments forced the Lebanese population to take the role of middle-man for which the country's location and temperament were best suited. Thus, the government's policy was directed towards freedom of trade, travel and foreign exchange movements. This made Lebanon a carrier and an entreport for countries both in the Middle East and further east. Lebanon acquired the peculiar feature of a high proportion of income earned in the trade sector (which comprised internal trade, import-export, transit and re-export) namely, 28 per cent. The Lebanese merchants handle large quantities of goods, their own and other countries' both in two party and in triangular trade. Transit and export trade are directed towards the Fertile Crescent area, the Persian Gulf and countries further east. The Beirut port facilities such as the big Free Zone area and the construction of the Beirut International Airport have encouraged trade, transit and re-export.<sup>1</sup>

In such an atmosphere and under the above mentioned structure the banking system in Lebanon developed a great deal. The number of foreign and national banks multiplied rapidly. Foreign banks whose operations were limited to financing international trade became increasingly interested in financing domestic trade as well. Also national banks' operations in international trade increased sharply. Thus

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1. Yusif Sayigh, "Special Economic Problems Arising from a Special Structure," Middle East Economic Papers, 1957 (Beirut: Economic Research Institute, 1957), pp. 60-80.

both foreign and national banks came to finance international and domestic trade and both strive to receive demand deposits from customers and both types of banks compete in the market to conduct a larger share of the business activity. However, the foreign banks are at an advantage for being able to resort to their headquarters whenever they are in difficulties. Under the present banking system, the national banks turn to BSL as the Bank of last resort, but as will be shown in this chapter, they expect little help from BSL and always try not to resort to it.

## II. The Salient Features of the Banking System in Lebanon

### 1. Unregulated Banking Structure

The banking profession in Lebanon is entirely free and unregulated due to the absence of a commercial banking law and any other governmental control or supervision. Thus, any person, Lebanese or foreign, could engage in commercial banking in the same way as ordinary business without being subject to any requirement with regard to management, capital, reserve ratio, investments and annual reports. All banking transactions are considered as acts of commerce and any person or corporation carrying out such transactions are considered as merchants and have to register with the Chamber of Commerce.<sup>1</sup>

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1. Commercial Code (Legislative decree No. 304, April 7, 1943, Articles 6, 9 and 304-314).

Besides this, there is no regulation on the subject of banking except the Law of Banking Privacy which was issued in September 1956 with the aim of encouraging the inflow of capital into the country. Briefly, the law stipulated that all incorporated banks are strictly forbidden from revealing information about the funds of their customers to any person unless authorized by the concerned customer or his legal heirs.<sup>1</sup>

As a result of the unregulated banking system in the country, the private banks do their business the way they like and the government, except in periods of crisis, does not interfere in the banking activities and thus under normal conditions government's influence is almost negligible. Also, most of the banks do not publish regular detailed statistics about their business and this has led to the lack of data and figures which would show the precise position, solvency and liquidity of the banking institutions.<sup>2</sup> The foreign banks publish consolidated balance sheets which do not give details about their activities in Lebanon. Among the national banks very few publish any figures and these publications are usually irregular. It should be mentioned here that the Ministry of National Economy publishes information about banking loans, advances and deposits in its Bulletin Statis-

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1. For details about the Law of Banking Privacy, see Al-Jarida Al-Rasmiah, Beirut, September 15, 1956, No. 36, pp. 799-800.

2. For details see page 38.

tique Trimestriel and in the Monthly Bulletin of the Central Office of Statistics. However, this information is contributed by the banks on a voluntary basis and although they show some trends about the development in the banking system, the figures are inadequate for a detailed analysis of the banking institutions in particular and the economic conditions in general. Annual profits and losses accounts which are submitted for income tax purposes are reserved for the use of fiscal authorities.

Such are the most outstanding and prominent features of the Lebanese banking system which is established and operating in an atmosphere of complete freedom and liberty which is part of the general economic liberalism in the country. In spite of this the banking system enjoys a good reputation and the banking institutions have multiplied and developed rapidly in the past few years in accordance with the needs of the growing population and the expanding business activities of the country.

## 2. Banking Relationships

Unlike the more developed banking systems where banks try to help and cooperate with each other, there is a marked lack of coordination and harmony among the banking institutions in Lebanon which is due mainly to the absence of a central bank and the unavailability of call money and similar credit instruments.<sup>1</sup> Such a situation has induced

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1. Keesing, opcit., p. 12.

a high degree of individualism in the inter-banking relationship and deprived the Lebanese banking system of a strong and constructive element which would contribute to its development.

BSL which enjoys the sole right of note issue and is the depositor of government funds is looked upon by some banks (mostly national) as the lender of last resort. As no official rediscount rate exists, BSL is in a sole position to decide the quality of bills acceptable for rediscount and thus banks can never predict what kind of help they can receive from BSL. In addition many banks consider BSL, which is a commercial bank as well, a strong competitor and are reluctant to reveal the names of their customers to it.<sup>1</sup> But whenever these banks encounter serious difficulties they are obliged to turn to BSL. The national banks have a strong feeling that they are at a disadvantage to BSL and on the whole, they resent its status and the concessionary privileges which it enjoys. Foreign banks prefer to seek help from their headquarters where short term accommodations are arranged for them.

Such a situation hinders any sort of effective cooperation among the individual private banks who operate under fierce competition and it has induced several of them to try to be self-sufficient and to operate independently, leading to a noticeable lack of coordination in the banking system which is neither in the interest of the banking institutions

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1. Economic Research Institute, Business Legislation in Lebanon (Beirut, 1956), p. 28. (Mimeographed).

nor in favor of the economic and financial conditions in the country.

Also call money or similar short term intra-bank credits are absent and banks rarely negotiate bills with each other. This means that a money market in the real sense is practically lacking. Banks do not help each other to dovetail temporary liquid surpluses and deficiencies and funds seldom move from one bank to another.<sup>1</sup>

At present only two forms of organized and regular cooperation are practised among some of the banking institutions.

The first is the Clearing Service which was established in 1943 and is handled by BSL. This form of cooperation includes about twenty four banks half of which are foreign.

The second is the Credit Risk Office which is mainly a central register held by BSL in order to collect information about the amounts of credits offered by the participating banks to customers. The number of banks which joined this form of cooperation are less than twenty and at the beginning of its operation many of the national banks refused to join it on the basis that it enabled BSL to follow their operations and activities.<sup>2</sup> Besides these there is the Association of Banks which has been recently established with the purpose of bringing more cooperation among the banking institutions. All of these organizations comprise

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1. Keesing, op.cit., p. 13.

2. See next section, page .

a good number of banking institutions even though membership is not obligatory. The rest of the banks which have not joined these organizations remain to operate independently.

### 3. Banking Liquidity and Solvency

By banking liquidity is meant the ability of banks to meet requests for payment on demand or on short notice. Banking solvency on the other hand means that the value of a bank's assets are large enough to cover its liabilities excluding those of its owners.<sup>1</sup> Thus, while a bank might be liquid and is able to meet all payments demanded it does not necessarily follow that it is solvent.

After such a brief definition of banking liquidity and solvency, a discussion of these two aspects in the light of the Lebanese banking system is useful.

Due to the inadequate information available about the over all position of the banks in Lebanon it is very difficult to detect the liquidity and solvency of the banking system; however, there are certain factors at work in the system itself which have tended to decrease both liquidity and solvency of the Lebanese banks in general in spite of the fact that the capital reserve of some of them has reached a high level of 50 per cent.

Under serious political or any other sorts of crisis, the Lebanese citizens are inclined to withdraw their deposits immediately from the banks fearing the consequences of such

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1. Lester Chandler, The Economics of Money and Banking (New York: Harper and Bros., 1948), pp. 239-249.

crisis. Thus, in both the 1956 Suez crisis and in the 1958 Lebanese internal crisis, customers rushed to withdraw their deposits and in both crises several banks were in difficult positions to meet cash payment and BSL was instructed by the government to relieve the banks from their difficulties (mainly by rediscounting their trade bills).

In the past few years it was noticed that the liquidity of the Lebanese banks have declined and this is explained by the fact that as a result of the over crowding of banks and the fierce competition among them the interest on demand deposits tended to increase while interest on advances and discount tended to decrease. This led some of the banks to use a larger part of their loanable funds in order to receive a sufficient income and thus they decreased their reserve ratios. In addition another element has effected adversely the liquidity of the Lebanese banking system, namely, the sharp decrease in the liquidity of the Syrian banking system.<sup>1</sup> This is in view of the proximity of the Beirut and Damascus markets and taking into consideration that a great number of the banks in Lebanon have also branches in Syria.

Still other banks have engaged in speculative business and risky investments in order to obtain a higher income. This has weakened banking solvency and under an adequate commercial banking law such an investment would have been forbidden.

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1. Professor Paul Klat, Le Commerce du Levant (February 18th, 1956).



At present it is reported that since the beginning of 1960 several of the Lebanese banks have been faced with a marked lack of cash and as a result the rate of interest on cash at banks<sup>1</sup> have increased from 2 or 2.50 per cent to 3.50 or 4 per cent.<sup>2</sup>

As a safeguard of banking liquidity and solvency the Credit Risk Office, which was discussed in the previous section, was established in order to collect monthly information about the loans advanced to the customers by banks which joined the office and then study the credit worthiness of every borrower by comparing the total value of the loans advanced to him to his capital.

### III. The Banking Institutions in Lebanon

#### 1. Three Categories of Commercial Banks

The commercial banks in Lebanon are divided according to the Ministry of finance into three classes.

a. The accepted banks - or first class commercial banks whose guarantees is accepted by the government.

b. Non-accepted banks, or the second class commercial banks whose guarantee is not accepted by the government.

c. Discount houses - whose guarantee is not accepted by the government, and who are mostly owned by private individuals and operate mainly on discounting trade bills.

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1. These are cash which a bank deposit with another bank.

2. Emile Essa, Lesan Al-Hal (Beirut, December 21, 1960), p. 5.

There are about eighty three commercial banking institutions in Lebanon forty four of which are accepted; thus the first class commercial banks are almost more than half the total number of commercial banks in the country and they represent several nationalities. (See Table II)

Table II  
THE ACCEPTED COMMERCIAL BANKS IN LEBANON<sup>x</sup>

Name	Place of registration	Year of organization in Lebanon	Nominal capital (in million)
1. BSL	France	1919	FF 300
2. Credit Foncier d'Algerie et de Tunisie	France	1921	FF 765
3. Banque National pour le Commerce et l'Industrie Afrique	France	1927	FF 500
4. Banque Misr-Syrie-Liban	Lebanon	1929	LL 3
5. Compagnie Algerienne	France	1931	FF 1500
6. Banco di Roma	Italy	1936	LL 1000
7. Banque Tohme	Lebanon	1942	LL 1
8. Arab Bank	Jordan	1944	JD 3.5
9. Eastern Commercial Bank	Lebanon	1944	LL 1
10. British Bank of the Middle East	England	1946	£ 1
11. Rafidain Bank	Iraq	1948	ID 1
12. Banque Saradar	Lebanon	1948	LL 3

Table II (Contd.)

## THE ACCEPTED COMMERCIAL BANKS IN LEBANON

Name	Place of registration	Year of organization in Lebanon	Nominal capital (in million)
13. Banque Libanaise pour le Commerce	Lebanon	1950	LL 2
14. Banque Sabbagh	Lebanon	1950	LL 2
15. Banque G. Trade-Credit Loyonnais	Lebanon	1951	LL 1
16. Banque du Liban et d'Outre Mer	Lebanon	1951	LL 5
17. Federal Bank of Lebanon	Lebanon	1951	LL 7
18. Intra Bank	Lebanon	1951	LL 12
19. Banque Shartuni	Lebanon	1951	LL 2
20. The Saudi National Commercial Bank	Saudi Arabia	1952	LL 1
21. Banque Al-Ahli	Lebanon	1952	LL 5
22. Banque Belgo-Libanaise	Lebanon	1953	LL 5
23. Banque du Caire	UAR (Egypt)	1953	EE 0.5
24. Nederlandshe Handel Maa Tschappij	Holland	1954	OF 75.03
25. The Chase Manhattan Bank	U.S.A.	1955	\$ 150.00
26. The First National City Bank of New York	U.S.A.	1955	\$ 200.00
27. The Commercial Bank of Beirut	Lebanon	1955	LL 1.5
28. La Banque de Beyrouth et des pays Arabes	Lebanon	1956	LL 2

Table II (Contd.)

## THE ACCEPTED COMMERCIAL BANKS IN LEBANON

Name	Place of registration	Year of organization in Lebanon	Nominal capital (in million)
29. The Eastern Bank Ltd.	England	1956	£ 2
30. The Bank of America	U.S.A.	1956	\$ 250.00
31. Banque Sami Shukeir	Lebanon	1956	LL 1
32. Banque Fonciere Libanaise	Lebanon	1957	LL 2
33. Banque Joseph Lati & Fils	Lebanon	1957	LL 4
34. The Real Estate Bank of Lebanon	Lebanon	1957	LL 2
35. Banque Naayam	Lebanon	1958	LL 4
36. Banque Pharoan & Chiha	Lebanon	1958	LL 12
37. Beirut-Riyad Bank	Lebanon	1958	LL 25
38. Banque De Credit National	Lebanon	1958	LL 2
39. The Industrial Credit & Investment Company of Lebanon	Lebanon	1958	LL 15
40. Union National Bank	Lebanon	1959	LL 10
41. Bank of Lebanon and the Middle East	Lebanon	1959	LL 5
42. Lombard Bank	Lebanon	1959	LL 2
43. Middle East Banking Company	Lebanon	1959	LL 2
44. Banque de l'Economie Arabe	Lebanon	1960	LL 5

x Up to January 1961

Source: Ministry of Finance

The accepted banks do the major part of the banking business for they handle over 90 per cent of the banking activities in the country.<sup>1</sup> The rest is left for the non-accepted banks who are owned by Lebanese and Syrian nationals and to the discount houses which are owned mainly by Lebanese and are interested in discounting trade bills. Very few of the discount houses engage in advancing and accepting deposits. Besides these, several hundreds of money-lenders operate on their own at a very high rate of interest.

## 2. Functions of the Accepted Commercial Banks

Since the accepted banks are the heart of the banking business in Lebanon for they handle the largest volume of the banking activities, this section will be devoted to the functions of these banks.

The accepted banks engage in commercial banking activities whereby they receive deposits and lend money on short term. The rate of interest which they pay on demand deposit differ depending on the bank itself. On the whole the foreign banks pay about 3 per cent while the national banks offer a higher rate which reaches as high as 4 per cent. Time deposits do not appeal much to people even though the interest paid on them is usually higher than that on demand deposits. Thus, while demand deposits were LL 742 million in September 1959 time deposits were LL 72 million,<sup>2</sup> and by

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1. Yafi, op.cit., p. 78.

2. Lebanese Republic, Ministry of National Economy, Monthly Bulletin (Beirut: Central Office of Statistics, 1959), pp. 2-5.

December 1960 while demand deposits were LL 955 time deposits were LL 113.<sup>1</sup> In addition to the higher rate of interest, there are other factors which account for the large difference between demand deposits and time deposits such as the development of the use of checks among the Lebanese people, the rapid increase in the number of banks and the rise in the number and amount of loans advanced to businessmen.

The banks are interested in financing short term mercantile loans which are self liquidating such as discounts, advances on securities and overdrafts whose maturity is less than a year and are usually made against property or signature endorsements. These are the only forms of short term investments available in the banking functions and besides BSL none of the other banks hold Treasury papers. As a result of this situation, the banking system in Lebanon lacks short term investments of high liquidity which are easily marketable and rediscountable. Also the nonavailability of Treasury Bills in the monetary market deprives the Government and BSL from a potential instrument of open market operations which is so essential and vital in carrying out the Government's monetary policy.

The absence of Treasury Bills from the banking system is due to the fact that the Lebanese Treasury has been able in the last few years to accumulate budget surpluses and to

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1. Figures are secured from the Ministry of National Economy, Lebanon.

finance itself out of accrued savings deposited with BSL. Thus, the government has not yet experienced the need to turn to the banks for the financing of any short term cash requirements. Besides, the banks do not seem to be interested in holding government paper since the type of interest paid on it would not be attractive to them.<sup>1</sup>

As for the long term credit which is advanced beyond one year, the Lebanese banks do not engage in such a form of investment and they confine themselves to extending short-term credits to merchants and businessmen. This is because of the small amount of resources which they command and their lack of adequate experience in this field. The case is different with some of the foreign banks (non-Arab) who being branches of larger establishments, own larger resources and have acquired a much higher degree of experience and thus they are in a position to extend long-term loans beyond one year (some times up to five years) in order to finance several types of business in the fields of commerce, industry and others. Thus, these foreign banks fill a gap in the field of long-term investment which the national banks up to now have not been able to meet. It is hoped that some of the major national banks will be able to enter the business of long term investment in the near future.

The Lebanese banks deal in a further transaction, mainly gold and foreign exchange, which is due to the geo-

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1. Keesing, op.cit., p. 12.

graphic and strategic position of Lebanon. Beirut being a natural door to the Mediterranean and an intermediary between Europe and the Western Hemisphere on one hand and the Middle and Far East on the other hand, plays an important role as a gold trading center. In the past ten years the Lebanese banks made a good profit on gold and arbitrage transactions; however, profit and such types of transactions have been reduced to a small percentage, and the Lebanese banks have decreased their operations in that field.

#### The Non-Commercial Banking Institutions

In Lebanon there are only four non-commercial banking institutions and thus they represent a very small minority in capital and credit when compared to the commercial banks. (See Table III)

The two French non-commercial banks are the Compagnie Mediterranienne de Gestion et de Placement which is a subsidiary of the commercial bank Credit Foncier d'Algerie et de Tunisie and its main activity is to purchase shares of companies operating in Lebanon or outside; and the Monts de Piete Egyptiens which operate by offering advances against security goods, merchandise and precious metals. The activities of both of these companies are small and their scope of operations is quite narrow.

The other two non-commercial banks are Lebanese and they operate by offering medium and long-term credits to



Table III  
NON-COMMERCIAL BANKS IN LEBANON

Name	Place of organization	Year of operation in Lebanon	Nominal capital (in million)
1. Compagnie Mediterranienne de Gestion et de placement	France	1919	FF 6
2. Monte de piété Egyptiens	France	1934	FF 6.4
3. SCAIL (Société de Crédit Agricole et Industriel du Liban)	Lebanon	1939	LL 1
4. BCAIF (Banque de Crédit Agricole, Industriel et Foncier)	Lebanon	1954	LL 5

Source: Ministry of Finance, Lebanon  
Chamber of Commerce, Beirut

industry, agriculture and real estate and usually these loans are made against mortgage of real property.

The loans which SCAIL offers are subject to a rate of interest which ranges between 8 and 9 per cent. However, all loans which are guaranteed by the government are subject to a lower rate of interest.

BCAIF offers loans at a rate of interest of about 5 per cent. Out of its LL 5 million capital 40 per cent is subscribed by the government. In addition to this the govern-

ment has guaranteed a loan of LL 45 million advanced by BSL to BCAIF for forty years at 2 per cent interest. The government's objective in that is to encourage and help BCAIF in order that it acquires enough resources and facilities to offer long-term and medium loans to farmers and industrialists and thus enable them to get over their financial obstacles and solve the problems which hinder the development and progress of their business. This step has been found necessary in the light of the fact that the Lebanese commercial banks do not extend such types of loans and farmers and industrialists might not always be able to receive their desired loans from foreign banks. Lebanon whose 50 per cent of its population live on agriculture and whose industries are still in the early stages of development find it very essential that the necessary loans are extended for the development and evolution of both agriculture and industry.

#### IV. Banking Reform

##### 1. The need for reform

From what has been discussed in the previous sections it becomes very clear that the banking system in Lebanon is characterized by certain rigidities and imperfections which are due to the absence of a general banking law to regulate the banking system and the lack of a central bank to supervise and control the banking activities. Such a situation is detrimental to the application of a sound monetary policy.

The number of banks operating in the country has been increasing very rapidly; between 1957 and 1960 twenty three commercial banks have been established and the commercial banking institutions increased from 60 to 83 and the accepted commercial banks increased from 28 to 44 in number.<sup>1</sup> Thus the introduction of a general banking law becomes very essential for the development of the banking system and for the organization of the banking profession in Lebanon. Under the present existing legislation neither the government nor BSL supervises the development of the banking conditions or control the credit situation. The absence of banking rules as well as the lack of any means of interference on the part of the Government becomes a serious handicap which must be corrected if Lebanon is to enjoy a constantly developing and progressing banking system.

## 2. Suggestions for a Banking Law

The suggested banking law should be formed in such a special way so as to organize, supervise and control the banking system in the light of the present Lebanese conditions which have favoured the increase in the number of banks and led to a prosperous banking institutions. It should be noted here that for the perfect application and effectiveness of the banking law the creation of a central bank is quite necessary.<sup>2</sup> The following are the major points and provisions

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1. See Table III.

2. The role of the central bank in carrying out banking reform will be discussed in chapter V.

which should be included in a general banking law:

- a. At present any person, Lebanese or foreign can establish a banking institution and is considered like any merchant doing business. It is very essential that all banking institutions should be subjected to a license which will be granted according to a provision setting up the capital requirement for the proposed bank.
- b. At present some banks engage in risky investments to acquire higher returns in order to cover their expenses and to earn a larger amount of profit. Thus they are tempted to participate in investments whose liquidity and price stability are low. Accordingly, certain restrictions on banking activities should be made. Banks should not be allowed to extend medium term credit which would exceed a certain percentage of their total assets. Banks should restrict their loans on mortgages and real estate to a certain absolute minimum. No bank should be allowed to offer a credit to a customer beyond certain proportion of the bank's paid in capital and surplus. Banking institutions should not be allowed to invest more than a given percentage of their demand deposits in bonds or any other obligations. Also banks should not include real estate as part of their capital except their premises and this should not exceed a certain proportion of the surpluses and capital

of the bank. On the other hand some banking operations should be completely prohibited. Certain loans should not be allowed such as loans for purposes of speculation and term loans more than one year without collateral except under special permission of the director of the bank. Banks should not be allowed to deal in business other than banking and if a bank is permitted to run another business, this business must be kept separate and distinct from the banking business.<sup>1</sup>

- c. At present the banks are under no obligation to keep any reserve. The law should include an obligatory legal reserve requirement in the form of cash kept by the bank against its deposit liabilities.
- d. The banking law should offer the monetary authorities or the central bank all the possible facilities to supervise and audit all banking activities by examining their books and records and to obtain any information they deem necessary to see to it that the banking institution is not violating the provisions of the general banking law. Such safeguards for the audit and inspections of the banking institutions are vital in order to protect the

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1. Yafi, op.cit., pp. 244-245.

interests and properties of the depositors and shareholders.

- e. National banks should be required to issue balance sheets on their activities in the country while all foreign banks must issue distinct and separate balance sheets about their operation in Lebanon. Publication of all the balance sheets should be regular and annual. This provision is important due to the present lack of statistics and figures on the operation and position of banks in Lebanon. Once the banks are obliged to issue balance sheets one can have a clear picture of the overall situation of the banking system and the figures would provide the monetary authorities as well as observers with a useful instrument for analytical purposes.

## CHAPTER III

### THE BANQUE DE SYRIE ET DU LIBAN

As no real central bank exists in Lebanon, BSL which had obtained by concession certain privileges under the French Mandate and which were later reaffirmed by the Franco-Lebanese Monetary Agreement of 1948,<sup>1</sup> enjoys de facto certain central banking prerogatives.<sup>2</sup>

This chapter is devoted to a discussion and study of BSL. Section I deals with the organization, management and capital of BSL. In section II, the commercial banking department is discussed and analyzed, and section III is on the note issue department. Finally, some aspects of BSL, in its function as a central bank, are appraised.

It should be mentioned here that at present BSL functions in accordance with the provisions of the 1937 convention which expires in 1964.<sup>3</sup>

#### I. Organization and Administration of BSL

The BSL is a French corporation (Societe anonyme) which in 1919 replaced the Ottoman Bank in Syria and Lebanon and inherited its privileges in the two countries after the

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1. For the Franco-Lebanese Monetary Agreement of 1948 see chapter I.

2. Business Legislation, op.cit., p. 28.

3. The Monetary Convention of 1937 is discussed in chapter I.

French occupation. It was established for a period of 99 years and was constituted according to the French law, with its main office in Paris.

The commercial activities of the bank are defined in its Statutes, but the note issue department is governed by the Convention of 1937 and the Monetary Law of 1949.

According to its Statutes BSL's main objective is to promote and facilitate the economic development of Syria and Lebanon;<sup>1</sup> and in order to achieve such an aim it can engage in any type of banking activities, except in real estate transactions and mortgage loans.

The Convention of 1937,<sup>2</sup> which was concluded for 25 years (starting 1939), granted BSL the monopoly of note issue in Lebanon and the sole right to receive and hold Government deposits and thus BSL acts as the Government's bank.

In 1919 the capital of BSL (paid in) was ten million francs; however, this amount has been increased as the banking activities were expanded. In 1940 the capital of BSL reached 57 million francs and in 1949 it was increased to 300,000 million francs and since then it has been kept at that level.<sup>3</sup> The majority of its shares are owned by French and English capitalists and only a small percentage of shares (about 15 per cent) is owned by Syrian and Lebanese nationals.

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1. BSL Statutes, Article 3 (Paris, 1949).

2. This Convention was originally signed in 1924 for 15 years and was renewed for 25 years in 1937.

3. BSL, Exercise 1920, 1949, 1950, 1959.



The BSL is managed by a Board of Directors which includes eighteen members; the members of the Board are elected in the meeting of a general assembly. The Board of Directors elects a President, a Vice President and a General Managing Director. The meetings of the Board are held at the call of the President or at the request of half the members. Since the President and most of the Directors are not residing in Lebanon, great powers are instructed to the General Managing Director (Administrateur Directeur General) who acts as a representative of the President in guiding and supervising the policy of the bank. The practical execution of the bank's policy is carried out by the several managers of the branches in Syria and Lebanon. The shareholders have no direct and practical influence in the management of the bank and when they meet once a year for formal procedures, the recommendations of the Board of Directors are accepted and adopted without changes or modifications in the General Policy. The BSL submits to its shareholders a consolidated annual balance sheet which offers a picture of its banking affairs in Syria and Lebanon and France, but does not differentiate between the relations with the governments, other banks and with private customers. (See Table IV)

At present BSL has twelve branches in Syria and six in Lebanon; Beirut, Sidon, Tripoli, Baalbeck, Tyre and Zahleh,<sup>1</sup> the main branch among them being that of Beirut where the general management of the branches and the note issue department are situated.

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1. Ibid., p. 5.

Table IV  
BSL BALANCE SHEET FOR 1959<sup>x</sup>

Assets	FF Million	Liabilities	FF Million
Real Estate, installation and furniture	1700	Capital	300
		Legal Reserve premium	30
Shares and Bonds	1500	Premium Issue	14
		General Reserve	1600
		Reserve for Exchange Fluctuation	300
Cash and at Banks	11500	Special Reserve for Revaluation	1000
Treasury Obligations	11100	Immobile Reserve for Syria	2000
Advances and Debit Accounts	30900	Profits and Losses	10
		Reserve for Withdrawal of Notes	18
		Cheques Accounts	7200
		Public administration and current accounts	39400
Demand Accounts & others	200	Various Creditors	5900
		Bills outstanding	300
		Rediscount of Portfolio	200
Guarantee for 3rd party	2800	Dividends payable	100
		Demand accounts and others	100
		Guarantee for 3rd Party	2800
Funds available for pension and provident for personnel in Syria and Lebanon	100	Funds available for pension and provident for personnel in Syria and Lebanon	100
	<u>60100</u>		<u>60100</u>

Source: BSL Exercise 1959. x Approved by General Assembly.

## II. The Commercial Banking Department of BSL

Because of its statutory prerogatives (note issue and government's bank) BSL's Commercial Banking Department is considered to be the most important single and private bank operating in Lebanon. Had it not been for these privileges, BSL would have been a relatively small commercial bank. BSL's capital which was increased in 1949 to FF 300 million is equivalent to LL 1.700 million; out of the 44 accepted commercial banks operating in the country only seven Lebanese commercial banks have a capital below LL 2 million while none of the foreign banks have a capital below that level.<sup>1</sup> Thus it is clear that it is the privileged position of BSL which enabled it to become the most important commercial bank in Lebanon and to play a vital role in the commercial banking business providing certain central banking services such as the bank of last resort, and the center of the clearing office.

### 1. The Rule Governing the Operation of BSL's Commercial Banking Department

The operations of the commercial banking department are regulated and defined in BSL's Statute of which the following provisions are the most important:<sup>2</sup>

1. To discount all commercial papers including promissory notes made to order, drafts, bills of exchange and in general all credit instruments whose maturity does not exceed 180 days.

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1. For details see Table III Chapter II page 47.

2. BSL Statutes, op.cit.

2. To offer loans and advances on negotiable or non-negotiable obligations guaranteed by:
  - a) warrants, b) deposits of money or precious coinable metals, c) bills of lading to order or to bearer and d) deposits of government securities or other securities which are approved by the Board of Directors of the bank. However, the bank is not allowed to engage in mortgage security business proper.
3. To open current loan accounts bearing interest. The Board of Directors is given the task of determining the maximum of such accounts which could be extended to each person.
4. To accept and receive for safe keeping deposits of money, precious metals, securities, etc., and to open current and fixed deposits accounts.
5. To tender for and sell public and private debts issued in the form of negotiable securities and to carry out but only for the account of third parties the issue of all transferable securities and the receipt and delivery of all pledges and securities.
6. To carry out for individual persons or for the public or for private institutions the collection of bills or any cash or banking business that might be asked from it.
7. To issue, buy, sell and negotiate public securi-

ties, treasury bills, bills of exchange, letters of credit, and others.

8. To undertake trading activities in precious metals.
9. To carry out for the account of the government the cashing of public revenues and the payment of public expenses and in a general way to help the government in its financial undertakings.
10. To undertake in general all financial and banking business in Syria and Lebanon except that of land mortgage operations proper.

Article 3 embodies certain restrictive provisions upon the Commercial Banking Department during the concessionary period of BSL's Note Issue Department.<sup>1</sup>

1. All commercial papers which are eligible for discount must have at least two signatures accepted by the bank and bear a maximum duration of 120 days. If only one signature is presented, the other one might be replaced by one of the securities mentioned above in provision two.
2. At least half of the total amount of commercial papers payable in Syria and Lebanon must carry either three signatures or two signatures and one of the securities mentioned above in provision two.
3. Advances on securities besides those of the French Government and precious metals must not exceed 60

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1. Ibid.

per cent of the market value of such securities.

The foregoing provisions indicate that the banking business of the Commercial Banking Department of BSL is not restricted to banking and financial institutions only but also reaches the general public and no differentiation is made between the two.

In many respects the provisions governing the operation of the Commercial Banking Department of BSL do not differ from those of other commercial banks.

However, one can notice that the above stated provisions do not provide for credit facilities to finance medium and long term loans which would exceed 180 days. This results in a marked lack of such types of investments which are so essential to the Lebanese economy.<sup>1</sup> Normally one would have expected from BSL to fill the gap of medium and long term investments in Lebanese economy rather than participate in its creation and persistence specially when we take into consideration that BSL is the government fiscal agent and needs to operate for the interest of the public and its welfare. BSL does not extend medium and long term loans which are essential for development of the Lebanese economy. The fact which reveals itself is the BSL like any other private commercial bank is motivated by its own interest and profit and in carrying out banking activities it takes two factors into

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1. In chapter II section 2, it was mentioned that only few foreign banks engage in medium and long term loans (BSL not being one of them).

consideration; first, maximizing its profit and second, insuring an adequate solvency and liquidity of its commercial banking department.

## 2. Functions of the Commercial Banking Department of BSL

BSL has a larger volume of private demand deposits than any other commercial bank. This, as a matter of fact, has been one of the major complaints of the other commercial banks which consider BSL a strong competitor and feel that BSL which commands a smaller volume of capital than theirs have been able to attract a larger volume of private demand deposits and to enjoy an important position in the banking system simply because of its privileged position. In addition, the government deposits give it some significant amount of cash, thus enabling it to expand further its banking activities. It seems that more than 50 per cent of the present banking business done through BSL would not have been possible had it not been for the present prerogatives which it enjoys, as the bank of issue and the government's bank.

BSL does not publish nor release any separate figures on its private demand deposits and thus it is quite difficult for an observer to follow the trends of private demand deposits at BSL. However, it has been possible for the present writer to compute an estimate of private demand deposits at BSL.

Around 1951 it is estimated that about 38 per cent of the total private deposits were kept by BSL. This was due to the privileged position and prestige which it enjoyed as well

as to the small number of banks which were operating in the country at that time. After 1950 the number of banks established in Lebanon multiplied rapidly.<sup>1</sup> As a result of the increase in the number of banking institutions private deposits at BSL tended to decline specially as many of the commercial banks strove to attract private demand deposits by offering attractive rates of interest up to about 3 per cent. By 1955 only about 16 per cent of the total private deposits were held by BSL.<sup>2</sup> This percentage kept on declining steadily and out of the private demand deposits (which constituted 91 per cent of the private deposits) in 1959 BSL had 9 per cent.<sup>3</sup>

Unlike private demand deposits, government deposits at BSL have been increasing steadily at a sharp rate; from LL 69 million in 1952 they increased to LL 145 million in 1955 and kept on increasing to LL 247 million in 1960. This big amount of government deposit compensates BSL for its loss of private demand deposits in the past ten years.

In following the trends in the advances and discounts made through BSL one is again faced with unavailable information and figures which could be used for analytical purposes.

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1. Between 1950 and 1957 the number of banks almost doubled and between 1957 and 1960, twenty three commercial banking institutions were established in Lebanon.
  2. Mikdashi, op.cit., p. 91.
  3. The estimate about the private demand deposits at BSL was computed in the following way: From the International Financial Statistics, figures were obtained on government DEPosits with BSL. These were subtracted from the combined figures of government and private demand deposits published by BSL (for Lebanon) and thus getting approximate estimates on its private demand deposits in Lebanon.



It has been reported that around 1950 about two thirds of the total loans and discounts were undertaken by BSL; however, this large volume has also tended to decrease but at a mild and slow rate due to the increase of government deposits at BSL<sup>1</sup> and to the expansion of banking business and transactions which have been marked by a large increase in the credits and loans advanced in the money market.<sup>2</sup>

In concluding this section one can make the following remarks: First, in accordance with the rules governing its operation BSL is not allowed to deal in mortgage business. Second, BSL's statutes restrict its banking business to short term credit in the form of loans, discounts and overdrafts to merchants and thus do not make any available medium and long term credits, advances and facilities for periods extending beyond six months. Such a handicap as has been mentioned previously is not in the general interest of the Lebanese public and its welfare and development. Third, the banking activities of BSL when compared with 1950 have shown a significant decline which means that the share of BSL of the total banking activities have decreased due to the tremendous increase in the number of banks operating in the country; however, the fall in the amount of loans and discounts made through it have been less than the fall in the amount of its private demand deposits. Only government deposits with BSL have shown a significant increase creating a considerable

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1. Yafi, opcit., p.123.

2. See the increase of bank loans and discounts in table VI.

Table V

GOVERNMENT'S DEPOSITS AT BSL AND DEMAND DEPOSITS  
AT BANKS 1950-1960

(In LL Million)

Year	Government Deposits at BSL	Private Demand Deposits of Banks	Total Demand Deposits of Banks
1950	24 <sup>X</sup>	185	209.7
1951	31 <sup>X</sup>	221	253.1
1952	69	232	301.5
1953	105	219	324.4
1954	116	246	362.1
1955	145	299	444.0
1956	133	307	440.0
1957	104	447	551.0
1958	115	443	558.9
1959	157	621	778.1
1960	247	708	955 <sup>o</sup>

Sources: International Financial Statistics,  
1950-1961.

Bulletin Statistique Trimestriel,  
1950-1959.

X These figures are taken from Dr. Yafi's  
thesis.

o This figure is secured from the Ministry  
of National Economy, Lebanon.

cash at its disposal.

### III. The Note Issue Department of BSL

The Note Issue Department is distinct and independent from the Commercial Banking Department and has separate accounts for its activities concerning the issue and withdrawal of notes. It was established in 1919 by the French military authorities and was given recognition by the Conventions of 1924 and 1937. At present its activities are governed by the Convention of 1937 and the Monetary Law of 1949.

The Note Issue Department is granted the monopoly of issuing Lebanese banknotes which are legal tender in all the territories of the Lebanese Republic; however the issue of metallic and gold coins is restricted to the government authorities.

It should be mentioned here that in spite of the de-jure separation between the Note Issue Department and the Commercial Banking Department there exists a marked and close relationship between the two for the former is constantly affected by conditions taking place in the latter as will be shown in this section.

#### 1. Earnings of the Note Cover

The earnings of the note cover were set up by the Convention of 1937 and divided between the Government and BSL. However, in 1951 the Government gave up its legal right to share in these earnings because it was following

Table VI

## BANK LOANS AND DISCOUNTS 1948-1960

(In million LL)

Year	Total Bank Loans and Discounts
1948	223.6
1949	222.3
1950	280.2
1951	318.3
1952	356.0
1953	357.0
1954	402.0
1955	495.0
1956	513.0
1957	600.0
1958	613.0
1959	743.0
1960	996.0 <sup>x</sup>

Source: Bulletin Statistique Trimestriel.

x Secured from the Ministry of National Economy, Lebanon.

a monetary policy which aims at increasing the gold reserve in the note cover, and as the gold does not yield any earnings to the Note Issue Department those earnings declined a great deal and thus led the Government to abandon its share of it since it was responsible for this decline. (See table VII)

## 2. The Note Cover

In accordance with the Monetary Convention of 1937 the Lebanese pound was linked to the French franc. During World War II, the Lebanese pound was linked to the sterling and it was not until the enactment of the Lebanese Monetary Law of 1949 that the pound acquired a separate and distinct status.<sup>1</sup> This Law stipulated that a 100 per cent cover for the Lebanese pound should be maintained of which at least 50 per cent should be kept in gold and foreign exchange. Ever since the Law has been put in practice the Government has been constantly instructing BSL to buy gold in order to increase the gold reserve in the note cover, which thus increased from 2 per cent in 1948, the year before the issue of the Law to 92 per cent by the end of 1960 (see Table VIII). This tremendous increase in the gold reserve has been possible because the country has been enjoying annual surpluses in its balance of payments with which it has purchased gold.

Another interesting feature of table VIII is that since 1954 there has been no foreign currencies in the note cover. This is because BSL has been instructed by the Govern-

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1. For further details refer to chapter I, page .

Table VII

## GOVERNMENT EARNINGS OF THE NOTE ISSUE DEPARTMENT

Year	Amount in LL
1948	138.811
1949	70.175
1950	14.225
1951	-

Source: Bulletin Statistique Trimestriel

ment to buy gold with all the foreign exchange available in the cover. Thus at present there is only gold and a very small percentage of government obligations in the note cover. This shows the policy of the Government which aims at backing the Lebanese pound with the maximum amount of gold in order to surround it with confidence and strength.

### 3. Non Supervised Activities

BSL is under no obligation to buy or sell gold at fixed prices and its gold purchases are determined on an ad-hoc basis by the Stabilization Fund.<sup>1</sup> In December 1960 the Government instructed BSL to buy gold in order to increase further the percentage of gold reserve in the cover

1. The Stabilization Fund was established in 1949 and it provides a consultative framework between the Government and BSL.

Table VIII  
GOLD AND OTHER ELEMENTS IN THE NOTE COVER  
(In thousand pounds)

Year	Currency in Circu- lation	Gold	%	Foreign Exchange	%	Government Obligations	%
1948	185.000	3.707	2	123.573	67	57.720	31
1949	168.000	42.496	25	38.576	23	86.928	52
1950	196.000	70.345	36	27.655	14	98.000	50
1951	208.000	92.992	45	13.280	6	101.728	49
1952	200.000	109.179	55	-	-	90.821	45
1953	205.000	126.689	62	6.566	-	71.745	35
1954	242.000	218.534	90	-	-	23.466	10
1955	266.000	252.823	95	-	-	13.177	5
1956	333.000	264.102	79	-	-	68.898	21
1957	356.000	308.736	87	-	-	47.264	13
1958	399.000	308.736	77	-	-	90.264	23
1959	400.000	242.158	86	-	-	57.842	14
1960 <sup>x</sup>	437.000	399.000	92	-	-	32.000	8

Sources: Bulletin Statistique Trimestriel

BSL Exercise

Central Office of Statistics

x Secured from the Ministry of National Economy,  
Lebanon.

and BSL bought 500,033 ounce and the percentage of gold increased to 92 per cent. The gold was bought from the markets of London and Switzerland at \$35,79 per ounce and thus the BSL paid \$17,882 million or the equivalent of LL 56,239 million for the total amount of gold. If the same amount of gold had been bought from the Federal Bank of America at \$35,23 per ounce the whole deal would have cost LL 55.119 million and thus a sum of LL 1.119 million would have been saved.<sup>1</sup> The lack of adequate government control and supervision upon such transactions increases the costs of purchasing gold to cover the note.

There is a significant degree of flexibility in the circulation of notes due to the ability of BSL to transfer eligible assets (reserve de couverture) from the Banking Department to the Issue Department against the issue of bank notes which would enlarge its private cash funds. Thus the note circulation could be expanded beyond its size without any change in the rules governing the note cover and this means that the Government's ability to supervise the Issue Department does not equip it with any efficient means to carry out its monetary policy. The Government can only supervise the correct application of the rules governing the note issue but has no other rights whatsoever to interfere with any other aspect of the BSL's business.

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1. Raymond Edde, Al-Anwar (Beirut, January 13, 1961).  
--- Debate in the Lebanese Parliament, January 1961.



#### IV. Some Aspects of BSL as a Central Bank

BSL is not a central bank, but has obtained prerogatives which enable it to perform certain functions of central banking. The Convention of 1937 has given BSL the sole monopoly of note issue and the privilege of being the Government fiscal agent and as such BSL has a superior position and a special monetary role to play in the Lebanese banking system of which the rest of the private commercial banks are deprived. As the government bank, BSL keeps all the government deposits and since these are kept in the form of demand deposits in order to allow the government to draw from them at any time it wishes, the interest earned on these deposits is 1 per cent. This is considered to be a low rate of interest specially when it is compared to the rates offered by the other commercial banks in Lebanon.<sup>1</sup> In addition, all loans and advances to the government are made by BSL.

BSL's dual character in some respects as a central bank and in others as a commercial bank operating under the profit motive has a direct bearing on the functioning of the banking system in general and on BSL itself in particular. Thus the functions of central banking which BSL assumes are carried out only to a certain degree. Most foreign banks do not resort to BSL in times of need because they belong

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1. Most of the commercial banks in Lebanon pay 3 per cent on demand deposits.

to larger institutions and always seek help from their headquarters. Very few of them resort to and cooperate with BSL in periods of difficulties and those are the French-owned banks which find in BSL all the assistance and help they desire. Among the national banks (Arab-owned) only the larger ones are able either to resort to their main centers for aid or to refrain from seeking help by keeping an abundant amount of cash at their disposal. The rest of the national banks appeal to BSL for assistance in periods of crisis because they have no other choice.

BSL offers certain functions and services in its role as a central bank among which the following are worth mentioning:

BSL undertakes overdraft services which are extended for a period as long as 360 days; however, loans are subject to call after 45 days' notice. Such a treatment is inconvenient to bankers because they can never predict when BSL would call back the loans.

Another service is the rediscount facilities which are offered in accordance with the provisions governing its operation. It should be noted that the discount operations of BSL are of particular importance, because through this function BSL is expected to restrict or extend the supply of credit in the country. However, because BSL is a competitive institution, unlike central banks in general, it is unable to play this role efficiently. Just as many banks rediscount with it, it practises a certain degree of control

over the volume and quality of credit. Such a control is carried out by restricting the qualities of bills eligible for discount. The rediscounts to be eligible must carry three signatures and their maturity is up to 120 days when they are held in the Banking Department and 90 days when they are kept in the Issue Department and banks in general prefer this treatment with regard to rediscount of bills to overdrafts. This partly explains why rediscounting services by BSL to the commercial banks have increased a great deal.<sup>1</sup> Another reason for the increase in rediscounting services through BSL is due to the increase in government deposits in its bank. Table V shows that government deposits at BSL have increased from LL 69 million in 1952 to LL 157 million in 1959, to LL 247 million in 1960.

There is no official rediscount rate by which BSL must abide and this makes BSL the only judge of the quality of bills acceptable for rediscount. The trade bills are studied in each separate case and BSL is in a position of quoting rates according to the quality of the paper which is offered to it.

As a result, the private commercial banks can never know ahead of time what sort of assistance and aid BSL is willing and intending to provide them and this is one of the main complaints of the commercial banks which need to

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1. Yafi, op.cit., p. 126.

resort to BSL at certain difficult periods but are never sure of the type and kind of assistance they are likely to expect.

As Table IX shows, the discount rates have been lowered from 7 per cent in 1949 to about 6 per cent in 1953 and since then the rates have been fluctuating between 5 and 6 per cent. It is noticed that BSL does not change the discount rate in accordance with the public interest as a central bank would do because of its commercial status which forces it to operate under a profit motive. Thus the discount rates were higher in periods of crisis contrary to what they should have been. If BSL were a real central bank it would have lowered the discount rates during such periods in order to stimulate investment. Thus in 1956 a period of crisis the BSL discount rates were similar to those of 1955 while in fact they should have been lower to induce business activity which was showing signs of contraction. The same applies to 1958, a period of internal crisis where the discount rates were even higher than those of 1957 while in fact they should have been lower to prevent contraction in business and to stimulate expansion of credit.

Besides overdrafts and rediscount facilities BSL offers inter-clearing services and that is why many banks keep a significant amount of cash with it. Table X shows the tremendous increase in the clearing services which have taken place through BSL since the Beirut clearing office

Table IX

MONTHLY AVERAGE OF THE DISCOUNT RATE OF BSL FOR 3-SIGNATURE  
COMMERCIAL BILLS OF UP TO 90 DAYS' MATURITY (1949-1960)

Month	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
Jan.	7.00	n.a.	6.75	6.64	6.28	6.00	5.32	5.25	5.40	5.31	5.91	6.00
Feb.	7.00	6.97	6.70	6.23	6.23	5.99	5.20	5.23	5.31	5.47	5.83	6.08
March	7.00	6.84	6.58	6.59	6.13	5.70	5.14	5.26	5.36	5.70	5.92	5.98
April	6.90	6.83	6.57	6.50	6.19	5.62	5.21	5.30	5.25	5.44	5.79	5.98
May	7.00	6.85	6.72	6.67	6.25	5.45	5.14	5.20	5.26	5.45	5.89	6.03
June	6.80	6.85	6.58	6.39	5.97	5.63	5.14	5.26	5.20	5.62	6.02	5.90
July	6.90	6.65	6.66	6.38	6.13	5.52	5.16	5.33	5.17	5.61	6.06	5.71
August	6.90	6.69	n.a.	6.54	5.02	5.40	5.21	5.31	5.30	5.61	6.08	5.77
Sept.	6.80	6.77	n.a.	6.33	6.18	5.30	5.25	5.35	5.35	5.64	6.10	5.72
Oct.	6.90	6.76	6.57	6.35	6.09	5.32	5.20	5.23	5.36	5.70	6.14	5.70
Nov.	6.90	6.73	6.54	5.39	6.26	4.72	5.24	5.30	5.44	5.67	6.02	5.62
Dec.	6.90	6.75	6.56	6.58	6.11	5.11	5.26	5.13	5.38	5.75	6.02	5.68

Source: International Financial Statistics, 1950-1961.

N.B. Discount rates for January 1950, August and September 1951 are not available.

Table X  
 NUMBER AND VALUE OF CLEARINGS IN THE BEIRUT  
 CLEARING OFFICE  
 1943-1960

Year	Number	Value
1943	5.610	52.381
1944	6.934	64.697
1945	8.746	116.611
1946	7.886	90.971
1947	9.728	140.263
1948	15.778	261.737
1949	20.387	275.791
1950	27.328	363.925
1951	34.845	552.701
1952	46.763	722.064
1953	65.575	574.523
1954	101.360	639.506
1955	154.476	925.680
1956	220.592	1.221.850
1957	278.061	1.454.183
1958	285.221	1.369.735
1959	411.280	1.940.675
1960 <sup>x</sup>	536.351	2.227.720

Source: Bulletin Statistique Trimestriel.

x Secured from the Ministry of National Economy,  
 Lebanon.

started to function in 1943. However, because BSL can neither dictate nor manage the reserve of commercial banks it is not in a position to control the money supply in the country as a central bank would normally do and it exercises only a limited degree of control in that respect through the limitation of qualities of bills eligible for discount.

Chapter IV  
CRITICAL APPRAISAL OF THE BSL PRESENT CONVENTION  
AND FUNCTIONS

At present BSL's prerogatives which enable it to perform certain central banking functions are practiced in accordance with the Convention of 1924 (as amended in 1937) and the Lebanese Monetary Law of 1949.<sup>1</sup> The former granted BSL the monopoly of note issue and the privilege of being the government's bank and its fiscal agent. The latter laid down the rules governing the note cover.

No doubt, the above mentioned Convention was enacted and signed by the Lebanese Government in the belief that it will be beneficial for the monetary and economic development of the country and safeguard the evolution of the monetary and banking system. Thus BSL was granted a very special and important position in order to carry out and facilitate the achievements of the government's policy which aims at the welfare of the Lebanese public in general. However, after 37 years of experiences and tests there have developed strong beliefs and tendencies for replacing the 1937 Monetary Convention as it expires in 1964 by a new national central

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1. See chapter I for a summary of the main provisions of the 1937 Monetary Convention and the Lebanese Monetary Law of 1949.



bank which would serve the interest of the Lebanese public more efficiently. The BSL which is essentially a private commercial bank motivated primarily by profit and the interest of its shareholders is not in a position to operate as a real central bank whose main objective is the welfare of the public.

This chapter will be devoted to a critical appraisal of the BSL convention and functions in Lebanon and a demonstration of its inability to operate as a real central bank.

#### I. Weaknesses of the BSL Convention of 1924

There are major weaknesses which characterize the present BSL convention and dominate its operation and activities to the detriment of monetary policy in the country. This section will expose these weaknesses and appraise critically their effects and consequences.

##### 1. Obsolete in terms of Present Conditions

At present the first weakness of the BSL Convention is that in general it does not suit the present monetary conditions in Lebanon which have developed a great deal since the convention was declared. The monetary and banking conditions which were prevailing 35 years ago and according to which the convention was issued are very different from what they are at present. This is due to the basic evolution and development of the Lebanese economy in particular and to the changes in the world situation in general.

When BSL was first allowed to function in 1924 and later in 1939 as a central bank in addition to its commercial banking activities it was permitted to do so because of the vital need for a central bank which would guide and assist the development of banking activities and operations, provide for the issue of notes and their withdrawal from circulation, and finally act as the government bank and its fiscal agent in the country. At that time (1924 and later 1939) the Lebanese banking and monetary system was in its early stages of formation and development which required all sorts of technical assistance and services; thus the BSL convention was found to be an appropriate and suitable short-run solution as none of the national banks was in a position to assume such a serious role and as the government lacked the necessary experience to establish a national central bank. In 1924 when the first convention was signed there were practically no national banks operating in the country and when the same convention was renewed with some modification in 1937 none of the national banks was able to take over from BSL.<sup>1</sup> But now, things have changed a great deal and the Lebanese economy and its monetary system are different from what they used to be while the BSL's Convention and its structure and functions are still the same, as they were

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1. Lebanon at that time was under the French Mandatory system which favored the BSL convention and operation in the country.

in 1924. The number of banks operating in the country has increased from about fifteen in 1937 to more than eighty banks in 1961 and Lebanon has become the most important center for financial transactions in the area. Also the Lebanese monetary policy which was of no significance in the past has become an essential and vital weapon which could be directed towards the welfare of the public. Thus it is not in the interest of the Lebanese economy and its developing monetary and banking system to allow a commercial bank which is motivated by profit to function at the same time as a central bank. Such a situation has led BSL to compete at a comparative advantage with the other banks causing the lack of harmony and coordination in the banking system. The special position of BSL which was accepted at one time can no longer continue because the country needs a real central bank which will be motivated by the interest of the public, supervise and direct the activities of the banking institutions, and facilitate the development of the monetary and banking system.

2. The BSL Convention is Detrimental to the Application of Monetary Policy

Article 4 of the 1937 Convention stipulated that the Note Issue Department should be independent and separate from any other department of BSL.<sup>1</sup> However, no guarantee has been

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1. Al-Jarida Al Rasmiyah (The Official Gazette), op.cit., pp. 1294-1304.

enacted to ensure the effective application of this article and as a result there has always been close and noticeable relationship between the Banking Department on one hand and the Note Issue Department of BSL on the other hand and the latter has constantly been affected by the liquidity of the former. Thus whenever the Banking Department of BSL is short of cash, eligible assets move from the Banking Department to the Issue Department against the issue of additional notes which would increase the private liquidity of the BSL Banking Department. Thus BSL is in a position to expand the notes in circulation beyond its size in order to increase its private liquidity and therefore expand credit. Should this happen during an inflationary period when the government's policy aims at contracting credit the activity of BSL will hinder the application of the government's monetary policy and neutralize its effect.<sup>1</sup> In fact this implies that the monetary authorities cannot interfere effectively in the market in favor of the public interest since their efforts will be reduced by the BSL activity to increase its liquidity and expand credit to its customers and thus increase its profit. In more developed countries the governments count a great deal on their monetary policies in order to direct and stabilize the economy, and for the achievement of that

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1. For a detailed analysis on the ability of BSL to neutralize the government's budgetary policy refer to Yafi, op.cit., pp. 142-145.

aim they instruct their central banks to carry out certain activities in the money market. In Lebanon the case is quite different due to the present BSL Convention which deprives the country from the benefits and usefulness of an efficient and practical monetary policy.

### 3. The Lack of Control and Supervision

The Lebanese government could have prevented the BSL from carrying activities which are detrimental to its monetary policy had it not been for Article 22 of the 1937 Convention which stipulates that the government has no right whatsoever to interfere in the BSL's affairs besides its right to supervise the rules governing the note issue.<sup>1</sup> This lack of governmental control and supervision over BSL is an inherent weakness which dominates the convention and gives BSL a free hand in functioning and operating according to its own interest without any regard to the government's monetary policy and the current economic conditions in the country. It is quite amazing that the convention which granted BSL wide and important prerogatives should concomitantly deprive the government from practicing any sort of control upon BSL's business and operation. For in fact this means that the government has offered BSL a complete and absolute autonomy to take advantage of its privileges in the monetary and banking system and to do business in the

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1. Al-Jaridah Al-Rasmiah, op.cit., pp. 1295-1299.

best way that would accomplish the aims of its shareholders. A remedy for this situation becomes very urgent if the government should need to manifest its authority and interfere in the banking business to safeguard public interest.

## II. The BSL Functions in the Test

The primary criterion by which the functions of BSL are analyzed and judged is the fulfillment of its obligations and the execution of its services as a central bank operating in accordance with the Convention of 1937, which granted BSL some important aspects of a central bank.

### 1. BSL as the Bank of Issue

Among all its functions as a central bank BSL fulfills its obligation and performs its duties as the Bank of Issue, best. The Issue Department undertakes the issue of Lebanese banknotes as the Lebanese government deems it necessary. It is also confronted with the task of withdrawing notes from circulation which it conducts efficiently. This function of BSL is well achieved except that it has not kept the Issue Department separate from the Commercial Banking Department as was stipulated in Article 4 of the 1937 Convention.<sup>1</sup> In general BSL's particular services as the Bank of Issue have been of benefit to the country particularly at the early stages of development when the Conventions of 1924 and 1937

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1. See pages 82 and 83.

were signed. However, it should be mentioned that in return, BSL has gained and acquired some prestige among the other banking institutions due to the monopoly of note issue which it enjoys.

## 2. BSL as the Government's Bank and its Agent

BSL's prerogatives include its function as the government's bank and its fiscal agent and therefore all government deposits are kept with BSL. But these deposits which are kept in the form of demand deposits are treated at a disadvantage as far as the rate of interest paid on them is concerned; while all the other commercial banks pay a rate of interest of about 3 per cent on demand deposits BSL pays only 1 per cent on the government demand deposits. On the other hand, whenever the government obtains a loan from BSL it is charged a rate of interest ranging between 2 and 4 per cent. Although the Convention of 1937 allows the government to obtain loans from other commercial banks provided the terms of the loans are better than those offered by BSL, none of the other commercial banks are in a position to compete with the Bank of Issue and the Government's Bank and therefore all government loans are channeled through the BSL.

BSL is the fiscal and financial agent of the government; thus it provides certain services without any charges for the government such as payments to public branches and transfers of funds between Lebanon and the rest of the world.

These services have been beneficial to the government.

As the government's financial agent BSL is expected to operate in harmony and coordination with the government's monetary policy, but because it is motivated by profit and the interest of its shareholders it has not always been able to do so. This is because in periods of difficulties and crises BSL assumes its own private policy which safeguards the interest of its shareholders.

Thus during the Suez crisis which had direct bearing on the Lebanese economy, the government's policy aimed at curtailing the contracting tendencies in the economy by encouraging expenditure and the extension of credit, but BSL was inclined to follow another policy of contracting its credit in order to protect the interest of its shareholders, and this is indicated by its discount rates policy which instead of being lower in periods of crisis to prevent the shrinking of economic activity were increased significantly.<sup>1</sup>

The same applies to the Lebanese internal crisis of 1958 which led to a general slow-down and contraction in the economic activities in the country. The rate of investment and the extension of credit fell sharply and the whole position of the Lebanese economy was threatened. Again BSL assumed its own policy of contracting its credit to protect the interest of its shareholders. Available statistics show

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1. See Table IX.



that BSL instead of lowering its discount rates (as central banks usually do in periods of crisis to encourage the extension of credit) it raised them from 5.36 per cent in March 1957 to 5.75 per cent in 1958.<sup>1</sup> Such a policy which is followed by BSL in periods of economic fluctuation protects the interest of its shareholders and safeguards their funds and capital from any possible risks. This would have been accepted if BSL was a simple commercial bank with no other obligations; however, this is not the case for BSL operates as a central bank and therefore should take into consideration the government's monetary policy and the interest of the public. As a matter of fact BSL functions in favor of the banking system within narrow limits and that is when it rescues the banks which become short of cash in periods of crisis. In general, any monetary policy followed by the government cannot be very effective and fruitful as long as BSL, as a central bank, does not function in harmony with it. Here one feels the vital and urgent need for creating a new structure which would operate and function primarily and mainly for the public interest and in complete harmony with the government's policy. The chance for establishing a new structure is not far from reaching and only goodwill and intentions are needed.<sup>2</sup>

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1. International Financial Statistics, op.cit.

2. The chance for changing the present structure will come in 1964 when the BSL convention expires.

### 3. BSL as a Banker's Bank and Supervisor

As a bankers' bank BSL functions by offering rediscount and overdrafts services on one hand, and, by opening lines of credit to other banks on the other hand. However, such operations undertaken by BSL are quite limited in scope due to its dual character as a commercial bank doing business on a profit basis and as a bank which assumes certain central banking functions. Only some of the private commercial banks cooperate with BSL and seek to receive its help during periods of difficulties while the majority of the other banks refrain from seeking its assistance. As was mentioned earlier, the foreign banks prefer to resort to their headquarters for any sort of aid and the big national banks consider BSL a serious competitor and try to have the minimum relations with it.<sup>1</sup>

It is interesting to mention here that some of the national banks prefer to remain abundantly liquid rather than resort to BSL in difficult periods. Under such conditions BSL does not play a very significant role as a bankers' bank and it is not in a good position to control and supervise the activities of the banks in general as central banks do.

If BSL were not a private commercial bank motivated by profit and if its banking business were restricted to the banking institutions and the government only then BSL

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1. Business Legislation in Lebanon, op.cit., pp. 28-30.

would have been able to supervise the activities of the commercial banks and probably all of them would have considered it as the bank of last resort, and would have sought its help and assistance. But as long as BSL is a competitive institution it makes a great difference for the other banks which would always try to avoid resorting to it.

### III. Some additional objections to BSL

There are some basic objections to BSL which make its presence and functioning in the country undesirable. These objections, in addition to the above mentioned weaknesses and disadvantages of the Convention demonstrate the necessity of changing the present BSL Convention and structure altogether.

#### 1. BSL's Dual Character

As a commercial private bank operating under a profit motive and the interest of its shareholders BSL cannot play its role as a central bank whose main policy and aims are directed towards the interest and welfare of the public, and the cooperation and coordination with the government's fiscal and monetary policies particularly in periods of difficulties and crises.

The dual character of BSL as a commercial banking institution motivated by profit and as a bank pertaining certain central banking functions dictates upon BSL a

special policy which is not always in the public interest. This is because BSL is constantly inclined to maximize its profit and safeguard the investment of its shareholders. Therefore, it is bound to follow a policy which is different from that followed by the government whenever the interest of its shareholders and those of the public are in conflict. This means that the government and its "fiscal and monetary agent" do not always work in harmony particularly in periods of economic expansion and contraction, because while the government will be trying to expand credit in periods of economic contractions the BSL in order to safeguard the interest of its shareholders will be restricting credit. On the other hand while the government will be trying to restrict credit in inflationary periods, the BSL seeking the maximization of its profit will be expanding credit. Such a situation does not provide an adequate environment for the government to fight inflationary and deflationary tendencies in the economy.

Thus it becomes obvious that BSL lacks the basic and preliminary elements to act and operate as a central bank.

## 2. The BSL Represents foreign Interests

BSL was first established in 1919 by a French military decree and its 1924 and 1937 Conventions were signed during the French Mandatory period. At present it is a French corporation whose headquarters are in Paris. The position

of BSL as a central bank and a commercial bank, might have been accepted under the French Mandatory System as most of the economy was under French control, but in the period of independence this condition should not last any longer. Being a French corporation BSL represents French interest and therefore it might be tempted to follow certain policies in its capacity as a central bank which would be deleterious to the Lebanese economy. In other words, BSL could restrict or expand credit, increase or decrease the note in circulation in accordance with the interest of its shareholders. In addition, it has been noticed that in periods of crisis and difficulties it favors and assists quickly the French banking institutions while it might be reluctant to aid the other national banks which consider it the bank of last resort.

### 3. Some Results of the BSL's Prerogatives

The BSL's privileges and special position have led to serious consequences which are rooted in the Lebanese monetary and banking system. Chief among these are the lack of harmony and cooperation between the banking institutions as most of them consider BSL a dangerous competitor and try not to seek its help and assistance. Another consequence is the absence of effective and constant cooperation between the government on the one hand and the BSL on the other hand as far as the former's policy and the latter's interests are concerned. A further consequence which affects

the BSL itself is the fact that although the BSL commands a small capital it has been exercising a large volume of business activities which would not have been possible had it not been for its privileges and prerogatives.

#### IV. The Monetary Policy in Lebanon

This section is devoted to the study and appraisal of the Lebanese monetary policy whose application has been constantly affected by the BSL's structure and operations. Monetary policy which is a constructive and basic weapon used for the development and progress of the economy has not been utilized in Lebanon due to the absence of a real central bank.

##### 1. Problems and Obstacles facing the Formation of Monetary Policy

Among the main obstacles which hinder the formation of a sound monetary policy in Lebanon is the institutional framework of BSL. This is so because its dual character has deprived it from supervising and directing the business of the other commercial banks and has led some of those banks to refuse to cooperate with it. In as far as its banking business is concerned, BSL is free from any sort of governmental control and thus it is free to follow the policy which best serves the interest of its shareholders. This situation has prevented the government from acquiring the right and adequate central banking institution which

would be in a position to adopt and carry out its monetary policy in accordance with its endowed power and prestige in the banking system. BSL does not operate mainly for the public interest and has no control over the banking system and therefore it is not the right institution which could execute the government's monetary policy. As a matter of fact in periods of crisis BSL is inclined to operate contrary to the government's policy and reduces its effects.

In addition to the above mentioned obstacles there is a serious problem which must be taken into consideration in any study of the Lebanese monetary policy. This is the problem of unavailable statistics. At present the government does not possess any sufficient insight or adequate information about the essential aspects of the economy. The information which is usually collected and published by central banks in other countries is unavailable. With the exception of the information published on a voluntary basis in the "Bulletin Statistique Trimestriel" which gives monthly figures about banking conditions, there is no other statistical survey of the banking system. However, these figures are not of much use for analytical purposes as they consist of total deposits and total advances and discounts without any breakdown. Under this condition no clear picture of the Lebanese economy is provided and thus it becomes very difficult to form an appropriate economic and monetary policy based on exact and tangible information and figures. Thus a remedy for this situation is necessary and an effi-

cient solution is urged in the light of the development of the monetary and banking system in the country. If reform and constructive measures were not possible in the past, at present the government has at its disposal an extremely adequate and appropriate chance namely the expiration of the 1937 Monetary Convention in 1964 which will end the prerogatives and undesirable position of BSL. Such an opportunity should be utilized and a real central bank should be established.

## 2. Aims and Practical Application of Monetary Policy in Lebanon

After discussing the obstacles and difficulties facing the formation of a monetary policy in Lebanon it will be useful to go further and discuss the aims and objectives which the government tries to achieve in terms of monetary policy and how far it has been successful in carrying out its monetary policy in the general atmosphere of freedom and the absence of governmental control which characterize the Lebanese economy.<sup>1</sup>

Among the first objectives of the government is the guarantee of an adequate liquidity and solvency for the banking system in general so that in periods of crisis and difficulties the banking institutions do not find themselves short of cash. However, due to the obstacles which face the

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1. The Lebanese monetary policy is discussed in Keesing, op.cit., pp. 17-22, and Yafi, op.cit., pp. 146-149.



formation of monetary policy and due to the absence of a general banking law regulating the banks' reserves the government has not been able to achieve this aim fully, and whenever necessary it instructs BSL to rescue the needy banks. Actually most of the banks arrange on an individual basis to remain on the safe side with an adequate liquidity. However, the risky investment which some other banks undertake in order to increase their profit is definitely not in favor of banking liquidity and solvency.

Another aim of monetary policy is that of ensuring economic stability through the elimination of internal and external cyclical fluctuations. Lebanon which is essentially a free trade country has practically no business cycles of its own, and its ups and downs are imported from outside. The country deals in international trade to a great extent and thus it becomes vulnerable to international business cycles. Again, as was mentioned previously in this chapter the BSL does not follow a counter cyclical policy because it is motivated by profit. The achievement of economic stability in the country needs the determination of the government to achieve such a policy and the establishment of a new central banking organization which would work for its success.

A further aim of monetary policy is the stability of the exchange rate. At present the Lebanese pound has two rates, an official one which is of no practical significance and a free market rate which is used for all business trans-

actions. The government's policy aims at stabilizing the free market rate which is allowed to fluctuate only within small limits. In 1956 the government's policy was not to allow the dollar to fall below LL 3.20 and the exchange stabilization fund was instructed to buy dollars in the market whenever the dollar tended to fall below that rate. However, since 1957 the dollar rate has been fluctuating between LL 3.16 and LL.3.11.

A fourth aim of monetary policy is the development of the economy in general and for that aim the government has established a Development and Planning Board in order to study and advice the various programs which could improve the economic conditions in the country. So far the government has not actually used the monetary policy for economic development purposes and this seems to be due to the absence of practical and efficient means and instruments of monetary policy.

It is very likely that the government would have to resort to inflationary measures in order to carry out its economic development policy. This is because the government's deposits at BSL are not sufficient to finance all its programs and plans. Although inflation might achieve economic development such a policy should be resisted at present due to the lack of adequate means of controlling inflation and keeping it within reasonable limits.

From what have been discussed above one can see that

the government has not achieved the aims of monetary policy fully. This might be partly due to the fact that it is ill-equipped with the necessary measures and instruments of monetary policy and therefore is unable to achieve these aims efficiently. The solution for such a situation seems to lie in the obstacles facing the formation of monetary policy in Lebanon, chief among which is the necessity of establishing a real central bank which could supervise and control the monetary and banking system and act as an efficient monetary agent for the government's policy.

## Chapter V

### TOWARDS A CENTRAL BANK FOR LEBANON

This chapter is devoted to a study of the remedy for the undesirable situation which was created by the BSL's dual character in the monetary and banking system. This suggested remedy is mainly the establishment of a new national central bank which will operate and function in accordance with the public interest.

With that respect, it is worth mentioning two approaches to monetary and banking reform in Lebanon. The first is that of Mr. Keesing who believes that Lebanon should develop its statistical departments and should acquire a higher degree of statistical information before it undertakes measures of monetary reform. This approach is based on the belief that the country lacks accurate statistical information about the monetary and banking system and therefore it is not in a position at present to carry out effective monetary reform. The second approach is proposed by the Lebanese economists, Dr. Talha Yafi and Professor Paul J. Klat who believe that although the country lacks accurate statistical information about the monetary and banking system, the government should go ahead and carry out its schemes of monetary and banking reform which are so essential to the development of the country. This approach is based on the belief that monetary

reform could be achieved simultaneously with the gathering of statistical information and therefore Lebanon should not delay its plans of monetary reform until the development of statistical information for the latter could grow with the execution of the former.<sup>1</sup>

Section I of this chapter presents a manifestation of the urgent and vital need for a real central bank. Section II discusses the various proposals for the formation of a central bank which would replace the BSL in 1964. Section III deals with some of the organizational problems of the proposed central bank, and Section IV exposes its expected achievements.

### I. The Need for a National Central Bank

As was previously shown in this paper, Lebanon has no central bank of its own and its bank of issue, the BSL, which exercises some central banking functions is quite different from a real central bank. The BSL is a commercial bank motivated by profit and the interest of the shareholders, it engages in commercial business activities and competes with the other banks in the market. Also, it accepts deposits and grants advances and loans to private customers

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1. This approach is the normal procedure which has been adopted by other countries where monetary and banking reform have been carried out. It is interesting to note that decree Law 154 of July 1959 which created the Monetary and Banking Board visualized implicitly the second approach which is unquestionably the more logical and practical.

in addition to banks and the government. These functions of the BSL have led to a lack of cooperation and harmony among the banking institutions, created an unorganized money market and hindered the formation and application of an effective monetary policy and reduced its effect. Such results are obviously expected when the country lacks the adequate and proper central banking organization which brings about the desired harmony in the operation of the banking institutions, organize the money market and ensure the success of the government's monetary policy. Thus, the present situation must be corrected and the right solution is the establishment of a central bank whose motives and operations are different from those of the BSL.

Unlike the BSL, the new central bank must neither perform ordinary banking business nor compete with the other commercial banks. It must not accept interest bearing deposits or grant loans and advances to private customers. It must always be motivated by the public interest and must never be swayed by the profit motive. Its activity should not be like the commercial banks; to earn and seek profit for its shareholders, but to safeguard the stability of the monetary and credit system of the country.<sup>1</sup> Such a wide difference between the activities of the BSL and those of the proposed

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1. S.N. Sen, Central Banking in Underdeveloped Money Markets (Calcutta: Bookland Limited, 1952), pp. 1-12.

new central bank indicate the urge for the creation of the latter and the abolishment of the former.

The need for the creation of a new national Central Bank emerges from the belief that Lebanon is an independent country whose government is mainly concerned with the welfare of its citizens and the progress of the country. The BSL convention and functions have led to serious problems in the monetary and banking system which are detrimental to the interest of the public and the government's policy. Thus it becomes essential that a new central bank be established not only to remedy the defects created and left by BSL but also to work for the achievement of a better monetary and banking system in the country and to direct and protect the development of the economy in general.

In addition the Central Bank would bear good results by gathering important statistical information which are unavailable at present. Through its role as a director and supervisor of the commercial banks it would collect and publish figures and information on the conditions of the monetary and banking system which would enable the government to build up sound economic and monetary policies based on facts and not on estimates. It will also provide the financial experts with adequate figures for analytical and constructive purposes.

Besides the vital and essential need for the establishment of a Central Bank, it is worth stating a general

rule which has been adopted by almost all sovereign countries in the world today and which applies to the Lebanon as well. Basically Lebanon is an independent country and therefore its establishment of a national central bank is a "symbol of the country's economic independence",<sup>1</sup> and its ability to manifest its authority in the monetary and banking system and to play its role in the development of the economy without any foreign influence or pressure which might delay or hinder the achievement of its policy. This general rule is an acknowledged right which has been utilized by almost all countries and recently by many of the neighbouring Arab countries.<sup>2</sup>

## II. Alternative Proposals for the Establishment of a Central Bank in Lebanon

### I. The unsound Proposals

Among the first unsound proposals which have been suggested (probably by agents of BSL) is the prolongation of the present BSL convention with some modifications which would make it more acceptable to the government and the public opinion. Regardless of the arguments for or against this offer such a proposal should be ruled out completely

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1. Ibid., p. 5.

2. In the past ten years Egypt, Iraq and Syria have established central banks of their own.



because it will maintain and allow the organizational structure of the BSL to presume its functions in the country and this means the continuation of the BSL defects and disadvantages in the monetary and banking system. The main objection against BSL as a Central bank is the fact that it is a commercial bank operating for the interest of its shareholders and motivated by the maximization of its profit. No matter how the BSL convention of 1937 could be changed, altered and modified it will still retain the BSL's dual character which can never function in accordance with the public interest. If for no other reason that proposal should be rejected. The proponents of this proposal have tried to give some standing to their arguments by maintaining that BSL's experience and ability to run the Lebanese monetary affairs would not be available should the government decide to establish a new Central Bank. The answer to this argument is that first of all BSL's experience (which is not necessarily adequate because it has not performed a full and complete role of a central bank) is not indispensable for the establishment of a new Central Bank. The experience could be acquired by the Central Bank when it starts to operate and it should never stand as an obstacle for its creation particularly as the government could rely on Lebanese monetary experts and bankers who are familiar with the Lebanese monetary affairs. Besides, the government could make use of the BSL experience (if it deems it necessary) without the need of prolonging its convention and that is mainly

by attracting highly qualified personnel who are working for BSL at present, and induce them to work for the Central Bank by offering them better terms and salaries. Thus the government could make use of the BSL experience together with the knowledge of the Lebanese monetary experts. The experience of BSL in the Lebanese monetary affairs is of no significance to the country unless it is directed to serve the interest of the public and not those of its "shareholders."

Another proposal offered by those who oppose the establishment of a new national Central Bank, is the Lebanization of BSL which is in fact partial nationalization.<sup>1</sup> This plan implies that the government should own more than 50 per cent of the BSL stocks and thus command control upon its policy and activities. Thus the government would gain the experience offered by BSL and at the same time would supervise its activity. Again this suggestion is rejected on the ground that BSL would remain fundamentally a commercial bank motivated by profit and as such it cannot play its role as a Central Bank operating for the interest of the public. It is true that when the government has majority control it could nullify the profit motive, but then, of course, the other shareholders would want to beg out, since the bank would not be operating with the purpose of maximizing its

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1. Dr. T. Yafi who proposes the establishment of a Central Bank for Lebanon regards the Lebanization of BSL as a second alternative.

profit.

A third suggested possibility is the nationalization of BSL by the government. This suggestion although more acceptable than the first two is based on almost the same grounds, i.e., to make use of the BSL experience and avoid the complication of establishing a new central bank. However, since nationalization would retain BSL's dual character this suggestion is rejected. The government could nationalize only the Issue Department and thus eliminate BSL's dual character; but this means that the government is not able to establish a Central Bank of its own and therefore has to rely on BSL. In fact there is no need to nationalize BSL since the government can establish a new Central Bank of its own and provide it with the right and efficient persons to manage and direct its activity. Furthermore, it is not very difficult for the new Central Bank to acquire adequate experience once it starts to operate in the market. However, this suggestion remains to be the best among the unsound proposals.

## 2. The Sound and Logical Proposal

After rejecting the unsound proposals it becomes obvious that the establishment of a new Central Bank by the government is the most adequate and appropriate solution for the central banking problem in Lebanon. Such a step would end the BSL's prerogatives and defects. The new Central Bank will function in accordance with the govern-

ment's monetary policy and will be motivated by the public interest. All the arguments against the establishment of a national Central Bank focus on the assumption that the government cannot manage and direct the Central Bank efficiently and that, sooner or later it will be subjected to political pressures and governmental interferences which would hinder its proper operations. To those who do not trust the government's management of the Central Bank it should be said that at present there are efficient monetary experts whose services and advices could be of great help and value. The government could use those experts and give them a full hand in directing and managing the Central Bank and with their present knowledge and experience it is hoped that they will run the Central Bank efficiently particularly after they acquire enough practical experience. "Some people have been spreading rumors about the inability of the Lebanese to run and manage the new Central Bank... these rumors are against the public interest and should be fought severely."<sup>1</sup>

The other argument against the establishment of a national Central Bank is that it will be exposed to political pressures and government interferences. This problem could be overcome and avoided as much as possible by setting up

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1. Rafik Naja, Al-Tayar and Al-Talegraph (Beirut), January 2, 1961.

a separate management for the Central Bank which would make it independent from governmental interferences and away from all political pressures. The assumption that the Central Bank might be exposed to governmental interferences and political pressures is not something which cannot be overcome. It is expected of the monetary experts who will be in charge of the Central Bank to be conscious of their responsibility and to work with the sole aim of safeguarding the public interest and executing the government's policy. Again it should be emphasized that the choice of persons is very important. The Lebanese monetary experts who have handled the monetary problems so far efficiently should be induced to run the Central Bank by being paid high salaries and offered free hand in order to manage and direct the Central Bank efficiently.

### III. Some Organizational Problems of the Proposed Central Bank

Once the establishment of a new Central Bank is decided certain problems with regard to its ownership and organization would appear that would need adequate solutions.

#### 1. Ownership

With regard to its ownership it seems that there has been a tendency all over the world to shift the ownership of Central Banks from private to public. This is manifested by the fact that most of the Central Banks which originally

started operating as private commercial banks have been turned to the government and are now owned by it in order to operate solely and mainly for the public interest. At present only few countries have central banks which are privately owned (such as Union of South Africa, Switzerland and U.S.A.) and in general all the new established central banks are owned by the governments particularly in under-developed countries.<sup>1</sup>

For Lebanon it seems that a central bank owned by the government is the best alternative for it will operate mainly for the public interest and execute the government's monetary policy, with secondary concern to profit.<sup>2</sup>

## 2. Management and supervision

A central banking Board should be set up which would manage, direct and supervise the activities and policies of the Central Bank. Such a board would be also charged with the task of ensuring the necessary harmony and co-operation between the government's policy and the activities of the Central Bank. This will eliminate the problem of exposing the government and the Central Bank of following different policies. The Board should be provided with adequate autonomy to function in accordance with the

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1. For a study on the ownership of central banks see M.H. De Koch, Central Banking (London: Staples Press Limited, 1956), Chapter VIII.

2. The central banks in Egypt, Iraq and Syria are owned by the state.

circumstances of the current situation. The following are recommended to form the central banking Board:

1. The Minister of Finance (Chairman)
2. The Governor of the Central Bank (Chief Executive)
3. The Director General of the Ministry of Finance  
(Member)
4. A member of the Economic and Planning Board  
(Member)
5. A Lebanese Monetary Expert (Member)

Other members (if necessary) would be chosen from among university professors and highly qualified government officials who are specialized in the monetary field.<sup>1</sup> The Governor should be appointed by the Council of Ministers for a period of five years and should be responsible to the central banking Board.

All monetary decisions taken by the government should be subjected first to the recommendation of the Board. In that respect the Board should also advise the government on the monetary policy which it should follow. The Board should also be given freedom to decide upon the discount rate, the rate of interest and the reserve of the commercial banks and other measures which would direct the

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1. Dr. T. Yafi suggests that a university professor, an experienced person in the field of commercial banking, and an experienced person in the field of industry and commerce to be included in the central banking Board. See Yafi, op.cit., p. 227.

volume of credit and give the Central Bank a full control over the credit system in the country.

The capital of the Central Bank should be subscribed by the government and should be adequate to ensure the proper functioning of the Central Bank. To start with a sum of LL 5 million is recommended.<sup>1</sup>

#### IV. Expected Achievements of the National Central Bank

As a national Central Bank established in Lebanon for the first time, high hopes and expectations would be built upon its role and contribution to the welfare of the country.

##### 1. The Monetary and Banking System

In the monetary and banking system the Central Bank is expected to play a constructive role. As it will gain the respect and leadership of all the commercial banks, it will bring about the necessary harmony in their activities and coordination in their business. Through its power and prestige it will conduct and supervise the activities of the commercial banks and prevent them from delving into risky investments which would risk the deposits of their customers. In its function as a bank of last resort it will operate in periods of crisis in favor of the banking institutions and would rescue the needy ones without any

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1. This sum is suggested by the Economic and Planning Board.



hesitation by discounting their papers (provided, of course, they are acceptable papers) and thus provide them with the needed cash. This would safeguard the banking system from corruption and ensures one of the aims of monetary policy, namely the liquidity of the banking system. The Central Bank would offer discount services for the commercial banks and thus enable them to resort to it whenever they need to do so. It would offer loans and advances to the banks for periods extending as long as one year. Through its control of loans, discount rates and rates of interest it is expected to direct and supervise the credit system.

However, there are practical difficulties with that respect. Unlike more developed countries, the Central Bank in Lebanon cannot depend on indirect means (such as open market operations) in order to control the credit system in the country and this is due to the absence of an organized money market and the lack of treasury bills and government securities which could be used to affect the expansion or contraction of credit. It is true that the Central Bank could use the discount rate and the rate of interest to achieve its purpose in controlling credit but this alone does not seem to be sufficient. Therefore more effective direct and legal/<sup>means</sup>should be used. The Central Bank can act directly upon the amount of bank credit by varying the cash reserve of the commercial banks; it may be given the power of controlling the lending operation of the commercial banks by fixing certain ceilings on their lending activities which

will not only affect the quantity of bank credit but also its quality. Qualitative control would be used to channel financial resources into the developing sectors of the economy. Also the central bank may be given the power to control the interest rates paid by the banks on their deposits and the rates charged by them on loans and advances. This will enable the Central Bank to bring the lending activities of the commercial banks within its policy. Furthermore, it is very necessary that the central bank should have the right to audit, supervise and control the financial records of the commercial banks to have a full knowledge over their activities.

The new Central Bank will act as the government's fiscal and financial agent and thus it will direct the sales and purchases of government's securities whenever these are issued and made available to banks and the public. Also it will undertake financial deals on behalf of the government and would buy and sell foreign exchange, and would purchase gold to cover the notes. It will also take care of the reserves of the country in a way so as to protect the value of the Lebanese pound from serious fluctuations. It will handle and manage the government's deposits and will extend loans and credit for its necessary investment and expenditures. It is expected that all these activities will be carried out in accordance with the public interest and the government's monetary policy. These functions, the new

Central Bank would be able to carry out, since it would not be hindered by the interest of its "shareholders" and the maximization of its profits.

"As no organized money market can be worked effectively in the absence of a Central Bank"<sup>1</sup> the new national bank will facilitate the growth of a sound and organized money market and will encourage the growth and use of treasury bills in the future.

It is expected that the new Central Bank will assume the responsibility of eventually declaring a new par value to the Lebanese pound instead of the old official one, which was declared in 1947.<sup>2</sup> To achieve this, the Central Bank would have to refrain from interfering in the market for a couple of years in order to decide upon the new rate which will be officially recognized, declared and maintained. This actually means that the government should abandon its policy of purchasing gold to cover the notes for some time in order not to disturb and effect the rate of exchange. Once the new official rate of exchange is established the Central Bank would have to maintain it within the prescribed limits set by the I.M.F. and will acknowledge the full convertability of the Lebanese pound. This step will give Lebanon a more

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1. Sen, op.cit., p. 6.

2. The present official rate of the Lebanese pound is 405.512 milligrams of gold or LL 2.20 = 1 U.S. dollar. This rate was accepted by the I.M.F. in 1947.

important position and prestige as a financial center in the Middle East. In return, the government should be willing to lose gold sometimes in order to stabilize the new rate whenever it depreciates in terms of the dollar.

## 2. The Development of the Economy

Besides its primary duties in controlling the credit and regulating the activities of the commercial banks, it is expected from the Central Bank to play an important role in the field of economic development. This is because "a Central Bank operating in an underdeveloped country cannot confine its activities merely to the task of regulating the operation of commercial banks if it is to carry out its primary duties effectively."<sup>1</sup> One of the main conditions which restrict the operations of the Central Banks to regulating credit only is the availability of a medium and long term capital market catering to the needs of all classes of entrepreneurs whether they are engaged in agriculture, commerce or industry.<sup>2</sup> Due to the lack of sufficient medium and long term credit extended in the money market and particularly to agriculture and industry in Lebanon, the new Central Bank is expected to extend such forms of credit in order to encourage the development of agriculture and industry. Although it has been generally recognized that

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1. Sen, op.cit., p. 207.

2. Ibid., pp. 208-212.

in most of the underdeveloped countries Central Banks have been pushed to finance economic development through inflationary means such a tendency should be resisted in Lebanon and the Central Bank should extend loans to governments for development purposes only as far as they do not contribute to sharp inflationary tendencies. This is not only because the results of inflations are not in favor of a developing economy but also because inflation will affect the country's reserves and its exchange rate.

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