CONSUMER CREDIT IN LEBANON

by

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Submitted in partial fulfillment of the requirements
for the degree of Master of Business Administration
in the Business Administration Department of the
American University of Beirut
Beirut, Lebanon

May, 1962

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ACKNOWLEDGMENT

The writer wishes to express his sincere gratitude to Professor Salim Hoss, who has generously given of his advice and attention. His numerous and helpful comments and criticisms have greatly contributed towards improving the work both in argument and presentation.

Gratitude is also extended to business enterprises and officials of several financial institutions who provided the writer with information upon which this study is made. Furthermore, the writer is grateful to various friends who were most helpful in the various phases of this work.

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ABSTRACT

During the past five years sale on credit in Lebanon has expanded very rapidly. If consumer credit continues to grow at the same rate, it is bound before long to hit what may be regarded as a critical level relative to people's incomes. This study attempts to make a critical analysis and appraisal of consumer credit in Lebanon, with a view to pointing out the chief problems to which it has given birth.

This study opens with a brief survey of the history of consumer credit and its main sources of finance in a developed financial market. This is followed by a descriptive study of the various instalment plans in application in the Lebanese market, and by a brief account of the evolution of credit terms and the main sources that finance consumer credit. The true costs of credit to the consumers and the factors which are taken into consideration in evaluating the credit of a customer are analysed.

It is difficult to estimate the effective interest rate which the consumer pays on his instalment purchases because of the fact that, in addition to the interest charged, other costs of financing are added to the cash price and are amortized in the periodic payments. Moreover, there is frequently a substantial difference between the cash price and the credit price of an article. In most cases, the cost of credit is more than the legal rate but, dealers have their own ways and means to circumvent the law.

The effect of the expansion of consumer credit on the Lebanese economy is appraised through a study of the relationship between the growth of consumer credit and various economic variables.

The analysis leads to the conclusion that consumer credit has tended to increase consumption through the facilities it has provided. Increased consumption, on the one hand, tends to extend business activities, increase employment, and thus increase income. On the other hand, it would increase imports and thus decrease the country's foreign exchange balances.

Credit is usually extended freely during good times and curtailed during bad times. Consequently, consumers tend to increase their purchases during good times, and curtail them during bad times so as to repay outstanding debts. Consequently, consumer purchases tend to fluctuate over the business cycle in a manner that accentuates general economic instability.

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CHAPTER ONE

INTRODUCTION

The primary purpose of this study is to examine the various aspects of consumer credit in Lebanon, its growth during the post-war period, its sources, its actual application and the role it has been playing in the economy.

Consumer credit in Lebanon has significant implications from the point of view of individual consumers and firms as well as from the point of view of the general economy.

On the firm level consumer credit is increasingly becoming an important instrument of competition among business firms as well as among banks. It would be interesting to inquire into the terms and conditions under which consumer credit is extended and the interest rates that are charged in various market sectors. Some equity considerations will inevitably be brought up in the discussion of the terms of credit applied in Lebanon.

From the standpoint of the general economy, on the other hand, the significance of consumer credit can hardly be over emphasized. It is of interest to investigate the probable impact of the expansion of consumer credit experienced in the post-war period upon prices, upon investment and saving, and upon the economic development of the country.

This thesis is mostly based on data obtained from agents, dealers in consumer goods and from high-ranking officials of several financial institutions. The data were collected through a series of interviews and through a questionnaire.

However, since certain facts were not obtainable by these means, the officials in the Statistics Department of the Customs, and those in the Car Registration Department were approached, and they were kind enough to give some of the needed data.

Chapter II defines consumer credit and lists its main sources in a developed financial market, with particular reference to the U.S.A. This will help to place consumer credit activity in Lebanon in its proper perspective as it is described in Chapter III. Chapter IV discusses the roles of consumer credit in the Lebanese economy, especially from the point of view of its relationship to prices, savings, income, and banking policies. Finally, Chapter V presents a summary of this study and certain conclusions.

Although the study is supposed to cover the Lebanese market, the writer has to admit that the interviews made, and data collected were limited to the Beirut market. Beirut was taken because it is the main market in Lebanon in terms of the value of credit transactions, and because developments that have taken place in Beirut have apparently set the pattern for developments in other parts of the country.

The writer does not claim that the picture he draws of the consumer-credit market in Lebanon is either complete or infallible. It will be obvious that the data cited are no better than very rough approximations. No adequate statistical information or literature is available on the subject as it relates to Lebanon. The writer had thus to conduct his research by directly contacting people who are involved in some aspect or the other of consumer credit activity in Beirut.

Only a limited number of individuals have been interviewed, and these may not be strictly representative of the Lebanese market as a whole. This restriction was partly remedied by information obtained from other sources. Discussions with a number of people who are well acquainted with the subject was helpful. In addition, information secured from the Customs and from the Car Registration Department helped in arriving at aggregate estimates, rough as they might be, relative to certain sectors of the consumer-credit market.

CHAPTER TWO

NATURE AND SOURCES OF CONSUMER CREDIT IN A DEVELOPED FINANCIAL MARKET

A. Nature of Consumer Credit

There are two general methods of defining consumer credit: classifying it by the user or by the grantor of the credit. Neither definition is altogether clear. Definition of consumer credit by use runs into the logical difficulty of drawing a distinction between a producer and a consumer. Definition by agency which grants the credit overstates the total, in a country like the U.S., by one-fourth to one-third because there is no one agency that is purely a consumer credit agency.[1]

Consumer credit does not include: (1) Long-term credit used for the expansion or the replacement of productive equipment. (2) Shorter-term credit employed in expediting the production and the fabrication of goods or in facilitating their movement through channels of trade; (3) speculative credit.[2]

There is a strong tendency for people to regard the growth and

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[1] Thorsten Sellin, ed., The Annals of the American Academy of Political and Social Science, Consumer Credit, (Philadelphia: The American Academy of Political and Social Science, 1938), CLXLVI, 63.

[2] Ibid.

widespread use of consumer credit as a modern business development. It is quite true that most of our modern-day credit institutions are of recent origin, but consumer credit itself dates back to ancient times. The buying of goods to be paid for at some later date and the borrowing of money to be repaid sometime in the future are very old practices. There is much documentary evidence that consumer credit played an important role in ancient societies. Some of this evidence has been uncovered by archeologists and the Bible provides us with numerous references to credit practice, and to the behavior of debtors and creditors. Historians tell us of many early uses of consumer credit. Paul Einzig, an English monetary authority, points out that "credit existed on a fairly extensive scale long before the stage of money economy was reached."[3] He makes reference to the fact that in many primitive societies, with no trace of a medium of exchange, transactions involving credit in kind played an important part in the life of primitive communities. Even before the development of barter, credit existed because goods and services had different values to different individuals at various points in time. Typically, a creditor would loan seed to a debtor who would repay his debt out of the next harvested crop. Primitive man appears to have used credit for other reasons too. Rents for land and shelter were fixed in kind over long periods of time and loans were made so as to enable debtors to pay "ransom fines, tribute, bride money..." and to carry on trade.[4]

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[3] Paul Einzig, Primitive Money (London: Eyre and Spottiswoode, 1949), p. 372.

[4] Ibid., pp. 372-73.

B. Sources of Consumer Credit

In a developed financial market, such as that of the United States, the credit needs of consumers of small means are furnished by special institutions. These agencies include Pawn Shops, Industrial Banks, Consumers' Co-operatives, Government Agencies, Insurance Companies, Sales Finance Companies, Commercial Banks and Dealers in consumer goods. These are the institutions which cater to individuals of limited income who voluntarily or by compulsion go into debt to acquire the goods or to have the use of the services necessary for their subsistence, comfort and well being. Following is a brief description of the chief characteristics and functions of these various institutions as they are known in the United States.

1. Pawn Shops

The pawnbroker is a pledge lender, one who lends money against goods left in his possession as security. His customers usually include various classes of people. There is, first, the group of wealthy spendthrift people, who pawn their personal belongings rather than get a loan from their bank. Another group includes the demimonde, the gamblers, the owners of resorts and nightclubs persons of dubious professions, who invest their excess cash in valuables which may be easily liquidated when the need for them arises. These make up the most profitable part of the pawnbroker's business.[5] For, "contrary to popular

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[5] The Annals of the American Academy, op.cit., p. 150.

belief, it is not the borrowing of poor persons that makes pawn shop keepers prosper; the customers whose trade they fight to keep are the careless spenders among the rich."[6]

A third class is made up of the petty entrepreneurs, such as street peddlers, sandwich-stand operators, sweetshop owners, and the like, whose bank credit is worth little but who have something of value to pledge.

Still another group comprises the careless artisans who pawn their tools: newspapermen who pledge their cameras, railroad men who pledge their watches.

The fifth class includes the private citizen of small means who owns no particularly valuable jewelry, but who has a radio, a refrigerator, or other furniture, upon which he can obtain some money. At the very bottom are the poor, who might have something of value to pledge and who try to borrow a few pounds in order to keep alive.[7]

All these people have one thing in common, namely, for one reason or another, the pawn shop is the only place where they can borrow money. Whatever their reason for borrowing might be, the pledge lender affords these people credit they can get no where else. That is where the pawn shop fits into the picture.

Frequently the pawn broker arouses criticisms on account of the usurious rates at which he often collects interest and on account of the

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[6] Boyden Sparkes, "Is your watch at Simpson's?" Saturday Evening Post, February 27, 1937, p. 88.

[7] The Annals of the American Academy, op. cit., p. 150.

low valuation often placed upon the items pledged as security by the borrowers.

While the commercial bank acts as a wholesale dealer in credit, the pledge-lender is, as are most other consumer credit agencies, a retail merchant of credit. For the bank a loan of one thousand Lebanese pounds is a trifle; for the pawnbroker, it is substantial.

The pledge lender faces a problem peculiar to his business, namely, the appraisal of the pledge. He must be a trained man or must hire a trained and honest man, who is acquainted with all the countless types of merchandise daily offered as pledges. He must be able to evaluate quickly the forced-sale worth of the article and to adjust the loan accordingly. Over valuation would result in loss. Undervaluation, or refusal through ignorance, would involve loss of business. Appraisal is probably the greatest problem in the business.[8]

In Lebanon there are no pawn shops of the kind described above. There are shops that grant loans on the security of valuables as jewelery stores but these are not specialised for this type of business. A jewelery store acts as a pawnshop in the sense that you can pledge your jewelery and get a loan up to 50% or 60% of the value of the jewelery. There are also private lenders that grant loans on the security of automobiles. The business of these lenders would be discussed in Chapter III in detail.

2. Industrial Banks

The term industrial bank here has little to do with industry.

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[8] Ibid., p. 154.

An Industrial Bank is organized as a bank or company which specializes in small loans, dealing chiefly with people who are wage earners in industry, although its business is by no means confined to industrial people. Moreover, it is not to be confused with the term "industrial savings bank," which refers to savings facilities set up within a factory or a group of factories to administer the savings of employees.[9]

When the first industrial bank was organized in the United States, commercial banks generally made no small loans. The loan business of the commercial banker was directed mainly toward satisfying the borrowing needs of business men of established credit, and the requirements of other customers who possessed acceptable liquid security which could be pledged as collateral. As compared with the making of small loans, the commercial banker was a wholesaler of credit. Since small loans were difficult to obtain, except at much higher rates than commercial banks charged for larger loans, there was a need for specialized suppliers which could afford to furnish this type of loan at lower costs. The "industrial bank" evolved to meet this need.

The central idea of the industrial bank is that the borrower's character and earning power combined may provide a satisfactory form of security. In other words, of the "three C's" (Character, Capacity and Capital) which a commercial banker usually investigates in considering a loan to a given applicant, the stress is placed on the former two. It should be noted, however, that, except on collateral loans, industrial

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[9] Ibid., p. 142.

bankers usually require one or two endorsements. The endorsers frequently, though not always, possess all three of the commercial banker's requirements.

The chief problem of industrial banks in the United States today is competition--both for savings funds and for loan outlets. The industrial bank competes for savings funds with the savings departments of commercial banks, savings banks themselves, personal finance companies, government bonds, corporate bonds, and even with stocks and real estate. For borrowers, it competes with commercial banks, savings banks, small loan companies, and with the relatives and friends of potential borrowers.

The recent emergence and expansion of personal loan departments in many commercial banks undoubtedly has caused some concern among industrial bank managers as well as small loan companies, although to a lesser extent in the latter case. It is true that the industrial bank's business has increased since the introduction of personal loan departments in commercial banks and that the latter have helped to "educate" the public concerning small loans. Nevertheless, while each group of lenders is supposed to cater to a different class of customers, in practice they compete very often for the same customers.

Industrial banks operate under special laws. Their principal method of operation involves a plan unique in the field of bank loans. The first step in the making of an industrial loan is to discount its maturity value usually at the rate of six or seven percent. Also usually deducted is a two percent commission or service fee. At six percent discount on a $100 loan for a year the borrower would receive $92. An amortization plan is then set up. If the borrower can repay the amount of the loan at $2 per week, it would require 46 weeks to pay off the amount actually received and 50 weeks to pay the face amount of the note.[10]

The effective rate of interest on this loan is 17.39 percent per annum.[11] The making of the loan and its retirement by this periodical payment plan, however, is not the complete procedure. Most industrial banks invoke other instruments. Instead of repaying, as in the example above, the plan involves the accumulation of cash or other liquid assets at the rate mentioned, and then, when the savings equal the amount of the loan ($100 in the above case) using them to cancel the loan.

Some industrial banks and companies adopt a different procedure, using investment certificates. Such certificates are sold by the bank to the borrower on the instalment plan at the time of making the loan, and the certificate is pledged with the bank as security for the loan. When the certificate has been fully paid, it represents $100 of savings and may or may not be used to cancel the note, at the option of the borrower. If it is not so used it may be retained as an investment, in which case the loan must be paid by other means.[12]

> It is clear that industrial banks serve a useful purpose in offering credit facilities to the second or third stratum of borrowers. Their methods of operation encourage thrift

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[10] Ibid., p. 143.

[11] The average loan over the year is 92/2 = 46; 8/46 = 17.39 (See also, R.W. Pitman, "The Small Loan Business," American Economic Review, (March, 1931), XXI, 16.

[12] The Annals of the Am. Academy, op.cit., p. 144.

> and are, in a sense, educational. Although industrial bankers disclaim the existence of competition with other types of lenders, it is obvious that efforts are constantly under way to attract a wider circle of customers and that this expansion tends to attract some of those who are or were doing business with other lenders or have thought of doing so. While the plan of operation of industrial banks is different in its details from that of any other groups of lenders, it has proved through the years to be sound banking practice, and the business of industrial banks and companies, recently strengthened by the diversification in the types of loans, continues to grow steadily.[13]

C. Consumers' Co-operatives

With the emergence of consumers' as well as business men's need for credit a variety of money lending agencies grew up to supply needed loans at a price which would yield profit. Alongside the professional loan firms, there has developed a specialised form of co-operative, dealing only in credit. This co-operative has been known under the name "credit-union."

Historically the credit union was created for the purpose of making credit available for persons of modest means. As they developed they grew to serve another purpose and that was the promotion and encouragement of thrift. The facilities which the credit union, when properly run, offers makes it possible to the working man to manage his financial affairs in an orderly and intelligent manner. It is known that some of the difficulties that the American workingmen face are due to the

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[13] *Ibid.*, pp. 147-148.

failure to manage their finances properly. Partly because they have never known a different practice and partly through the lack of facilities, the working men simply live from pay day to pay day, spending all they make.[14]

For the credit union's healthy growth and ultimate survival there are three outstanding features which have to be commonly accepted.

> (1) The credit union must be organized within the limits of a well defined group of a certain minimum size, whose members are held together by some fairly close associational tie. The reason for this is obvious. As a savings society a credit union might accept money from anyone. But in making loans it must be in a position to know, or to find out with little trouble or expense, the credit standing of each applicant. This is not a difficult matter in a restricted group, and also this close association supplies the strongest moral pressure on the borrower to repay his loan.[15]

"(2) The credit union must be a co-operative enterprise, actuated by a true co-operative purpose of benefiting all its members, and must be owned, financed, and democratically operated by its members."[16] As a rule, the amount of shareholdings by any one member is limited. The danger of control by large shareholders is avoided by the provision that each member shall have one vote regardless of the size of his holdings.

"(3) The credit union, however, functions best if subject to periodic examination by an outside authority."[17]

Organized within a compact group, chartered and examined by a governmental authority, and owned and operated by the members themselves

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[14] Ibid., p. 156.

[15] Ibid., pp. 158-159.

[16] Ibid., p. 159.

[17] Ibid.

for their own mutual benefit, the credit union would rest on a foundation of sound principles.

In Lebanon there are no such credit unions. It is claimed that a co-operative credit system is the best method of providing loans to people who need them (small and medium income bracket). Credit to people in the large income bracket is not a problem, the problem is the small income group who suffers from want of credit or can get it at high rates of interest because credit to them is risky.

D. Government Agencies

Government agencies in the United States, whose activities affect the volume and structure of consumer credit are few in number, and the credit created under their operations is a small percentage of the estimated total advanced annually. As an example there is the Federal Housing Administration and the Electric Home and Farm Authority.[18]

The primary purpose of most of the lending activities of the government credit agencies was to make funds available to corporations or to individuals who were unable for a variety of reasons to obtain the necessary funds to finance certain desirable types of expenditures through the ordinary credit channels. This underlying purpose was the raison d'etre of the operations of the Federal Housing Administration and the Electric Home and Farm Authority.

The Federal Housing Administration is not a lending agency but

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[18] Ibid., p. 163.

operates as an insurance company. It insures payment on loans made by private lending institutions on homes and rental apartments.

The theory has been that, by providing government insurance against loss on home mortgage loans, more credit would be available for the financing of homes with lower down payments and longer maturities. This would make it possible for more people to buy or build homes.[19] This device has influenced the direction of a significant volume of private funds and has increased their flow into the channels of consumer credit.

Through the use of the government guarranty, generally lower interest rates on home mortgage loans have been achieved and a measure of uniformity in both interest rates and requirements for acceptable mortgages has been brought into the home mortgage market. A much higher degree of standardization of mortgage loan terms and lending plans exists now than previously.

As a result of these changes, the liquidity of home mortgage loans has been increased considerably and vast resources of the commercial banking and insurance companies have been brought into the mortgage market.[20]

> The Electric Home and Farm Authority handles only a limited volume of business but is nevertheless the one credit agency of the Federal Government operating strictly in the field of financing consumer credit. As generally set forth, the original purpose was to aid in the distribution, sale, and installation of electrical apparatus, through the provision of an economical financing service to the potential purchasers

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[19] Erwin W. Boehmler, Financial Institutions, (Illinois: Richard D. Unwin, Inc., 1956), p. 457.

[20] Ibid., pp. 458-460.

> of electrical equipment in the areas supplied with power by the Tennessee Valley Authority, thereby increasing the demand on the power lines of the Tennessee Valley Authority. From this limited beginning the program of the Authority has taken on a national aspect in that the corporation it will now sign contracts for the purchase of instalment paper with utilities or dealers selling electrical equipment approved by the Authority as to quality and price, in areas where the rate charged for electric power has been approved by the Authority.[21]

The operations of these two agencies have been credited with bringing a reduction in the financing charges for consumer credit. Also the credit insurance provided by the government under the Federal Housing Administration and the financing operations of the Electric Home and Farm Authority encourages "broader and easier" instalment credit through a lowering of credit standards and a lengthening of the credit terms beyond those which commercial practice regards as sound.

Even though government agencies advanced a small percentage of consumer credit, compared with the total of such credit, yet it is believed that they have influenced changes in credit standards, such as the reduction of the down payment required, and the lengthening of the terms of instalment credit.

E. Insurance Companies

Borrowing on life insurance policies constitutes an important means of obtaining funds with which to finance consumption. It is probable that such borrowing takes place, as a rule, only in times of emergency; for example, to meet the costs of a serious illness or to provide

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[21] The Annals of the American Academy, op.cit., p. 171.

for policy holders and their families in times of difficulty. It is usually during hard times that such borrowing becomes very important.

Borrowing on insurance policies differs in an important respect from ordinary borrowing. Whereas a person who borrows from a finance company or buys on credit from a merchant does not have security to cover the loans except what he acquires by them, an insurance borrower is in reality borrowing his own property, since the net reserves credited to him on the books of the companies are his own.

In Lebanon insurance companies practice this type of credit. They give loans to their policy holders at a lower rate of interest than the prevailing rate in the market. The Arabia Life Insurance Company gives loans to its policy holders up to 90% of the cash surrender value, at 6% interest which is below the prevailing rate of interest.[22]

F. Sales Finance Companies

The primary business of such companies in the United States is to buy instalment contracts from the dealers and make the collections. These companies expanded with the automobile industry. Because many would-be purchasers of automobiles demanded the privilege of buying on instalments, and because most automobile dealers had small capital resources which they could not afford to tie up in receivables, the sales finance companies were born and expanded. It is important to notice here that sales-finance companies do not lend money but instead discount papers

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[22] Information obtained from Mr. George Mansour, Production Manager and Chief Life Inspector, Arabia Insurance Co., Interview, February 26, 1960.

acquired by merchants and dealers.

It is customary for the sales-finance company to furnish its dealer-customers with conditional-sale contract forms and rate charts, and also to procure insurance in connection with the financing of instalment sales. The merchant makes his contract with the purchaser and then offers the "deal" to the finance company. If the deal is satisfactory to the finance company, it purchases the contract from the merchant.[23]

This discounting may or may not be on a recourse basis. If it is on a recourse basis the merchant assumes the risk of bad-debt loss and takes back from the finance company any unpaid paper. When it is on a nonrecourse basis the merchant is released from any liability and the finance company assumes the risk of bad debt losses. A third plan which is a combination of the two is also in practice. According to this plan the merchant and the credit agency share the credit losses with a limit being placed for one or the other.

These sales finance companies perform another important service besides the purchase of instalment papers, namely "wholesale financing" or "floor planning" which is the loaning of money to dealers to enable them to buy their stock in trade.

In Lebanon, discount houses and banks perform some of the functions of a sales finance company. This would be described in detail in Chapter III.

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[23]Boehmler, op.cit., p. 199.

G. Commercial Banks

Most banks at present, have a stake in instalment credit. Some commercial banks extend instalment-sale credit by way of discounting dealer paper, but many commercial banks also make direct instalment cash loans. Cash credit, as offered by commercial banks, usually comprises two types of loans: single payment loans and instalment loans. Each of these types of loans is made on either a secured or an unsecured basis, depending on the over-all quality of credit risk relative to the amount of the loan. The collateral pledged as security on these loans is usually in the form of securities, insurance policies, savings accounts, automobiles, and other personal property that may readily be converted into cash in the event of default by the debtor.

Banks were attracted to this field for two principal reasons: first, to provide income when commercial loans were at a low point; and second, as a means of improving their public relations. The banks have found that by meeting the credit needs of the average individual they build good will in the community.[24]

Once the banks became active in the field, their business grew faster than that of other lenders. This has been so because the rates quoted by them for instalment loans tend to be somewhat lower than those quoted by other credit agencies. Banks are in a unique position to extend a small loan service at a cheaper rate than other lenders because this is only one of several services and the operation of another unit does not

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[24] Ibid., p. 200.

increase their overhead to any great extent.[25]

H. Dealers in Consumer Goods

Charge accounts are now considered to be an integral part of retail business, and today it is extremely difficult for retail stores to secure an adequate volume of business unless they sell on credit. In most cases the major portion of the business is done on credit, and it is believed that a smaller volume of sales turnover would be enjoyed if cash and only cash transactions were required.

While charge accounts are truly a convenience in the making of purchases and give rise to a statement of the purchaser's expenses each month, they are far more than that in practical usage today. They are short term credit extensions to the buying public. Many credit executives believe that 65 percent of their charge customers use monthly accounts because they do not have available sufficient cash to make and to pay for the purchases which they have charged. They have organized their family budget and their family finances so that it is necessary for them to have credit for a current month's purchases in order to be able to obtain the rather necessary items they must have. The other 35 percent probably does not have the problem of actually paying for purchases but uses the accounts primarily as a convenience.[26]

Stores have been encouraging charge accounts on the ground that a charge customer buys more liberally than a cash customer. Charge

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[25] Ibid.

[26] The Annals of the American Academy, op.cit., p. 111.

accounts also offer merchants the opportunity to dispose of luxury merchandise that is not enjoyed by a strictly cash store.

There is no doubt that a charge account has some advantages to both buyer and seller. To the buyer the advantage is that he may possess merchandise in advance of the day when he will have the money to pay for it, and to the seller there is the advantage of personalized solicitation or direct mail circularizing through which he may place before his customers special articles the advertising of which would not carry the same appeal or receive as large a response because in this case the personal element plays its role.

Sometimes charge accounts are abused. Charge customers feel that they are entitled to more privileges than those who pay cash, while cash sales are more profitable if the expenses incurred in connection with charge sales are taken into consideration such as bookkeeping costs, bad debts, collection costs and others. In this respect, merchants have to bear a share of the blame because they give charge customers the feeling that they are the preferred patrons of the store.

Statistics in the United States reveal that charge customers return more merchandise, make more unjust complaints, and expect more "free" services than the average cash buyer, and, unfortunately for the latter, the charge customer usually gets what he sets out to attain.[27]

Lebanon lacks some of the above mentioned institutions. Institutions that finance consumer credit in Lebanon will be discussed in Chapter III.

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[27] Ibid., p. 112.

CHAPTER THREE

CONSUMER CREDIT AS APPLIED IN LEBANON

The information for this chapter was obtained mostly from dealers in selected consumer goods, discount houses and bankers.[1] The data were collected through a series of interviews.

A. The Legal Aspect of Instalment Sales

Where payments are to be made on instalment basis, the seller usually seeks to protect himself in the event of the buyer's failure to complete payment on the contract. Where real or personal property is sold, losses can be minimized by reserving the right to repossess such property. The Lebanese government issued on May 20, 1935 a law in which it regulated the sale of motor vehicles and of agricultural and industrial machines on instalments.[2] Article III of the law states that, in selling motor vehicles and agricultural and industrial machines, the title to the property shall be retained by the seller until full payment is made. Such an arrangement is known as a conditional sales contract. Lombank operates on the basis of this law.[3] Some dealers in the home appliances business

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[1]The names of people interviewed are tabulated and classified in the appendices attached to this chapter.

[2]Lebanon: Ministry of Justice, Modern Collection of Laws.

[3]Lombank is a division of Lombard which specializes in the financing of car sales, Lombard being an ordinary commercial bank.

sell on instalments under this arrangement.[4] Not all dealers sell under this arrangement because consumers are averse to entering into such arrangement which keep the title to the property sold with the dealer. Consequently, there developed the use of other types of arrangements which, though not provided for specifically in the law, are recognized by the Lebanese courts.

A popular arrangement provides for the transfer of title to the buyer, with the property subject to a lien or mortgage for the unpaid portion of the selling price. In case the buyer fails to pay in due time the seller has the right to confiscate and sell the property. The seller keeps out of the proceeds an amount equal to the unpaid balance of the price.[5]

There is a third method which is applied in practice, viz. the hire-purchase plan. Under this arrangement, the property may be considered as leased until the purchase price is fully paid, at which time title passes to the buyer. In the home appliances business, when a credit transaction takes place, sellers do not usually give a statement acknowledging that the article was purchased from their stores until full payment is made. Dealers regard this as a form of hire purchase arrangement.

B. Development of Credit Terms

This study will concentrate mostly on the instalment sale of cars and electric home appliances since apparently they are the lines

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[4]See Appendix IV to this chapter.

[5]In this case, the interest is charged on the cash sale price of the article from the date of the sales of the article to the consumer to the time of the settlement of the account.

that are associated with the bulk of consumer credit.[6]

1. Cars:

The fact that a law was passed in 1935 to regulate the sale of cars and of agricultural and industrial machines on the instalment plan indicates that this type of credit existed even before that year. The terms of instalment credit in application, however, have undergone a far-reaching evolution.

In the thirties, the down payment required was in most cases no less than 70% and the maximum maturity period was for six months. The rate of interest charged ranged in most cases between 10% and 12% flat[7] depending on the client and his relationship with the distributor. Thus the effective interest rate amounted to something like 19% to 23% per annum. By the early fifties, most car dealers had lowered the down payment they required to around 40% and had extended the maturity they allowed to twelve months. The interest charge was still flat as before. In the late fifties, beginning in 1958 or thereabout, the downpayment required had been lowered to around 33 1/3% on some brands and to 20% on others. The maturity was extended in some cases to 24 months.

Volkswagen, among others, extends instalment credit up to 30 months. Besides the change in the maturity period allowed, there has been a change in the manner of calculation of the interest charge. At present, some dealers calculate the interest at the rate of 1% per month

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[6]This is the belief of the majority of bankers and dealers whom the writer interviewed. See the appendix.

[7]That is, the interest was applied on the total amount for the whole period and not on the diminishing balance.

Generally

and this makes 12% per year; and some charge a 7% flat interest rate, which makes around 13% per annum. The car dealers who do business with Lombank charge 7% flat because Lombank itself charges this rate.[8]

These credit facilities have been possible, first, due to competition among car dealers and, second, due to the facilities car dealers are getting from the manufacturers. Sometimes the dealers are given one year to settle the price on an instalment basis. Moreover, agents and dealers have been willing to reduce the downpayment required because there is no great risk in car sales as cars are mortgaged to the seller and are insured against accidents. In other words, the value of the car is highly secure to the car dealer, whether the transaction is done according to the law of 1935 or under the mortgage arrangement. Car agents and distributors are pleased with the new credit facilities open to them because they believe that these credit facilities have contributed to their increased turnover by about 50 percent. In order to minimise bad debt losses, the dealer usually drafts an arrangement with the buyer which would ensure that the depreciated value of the car is at all times in excess of the unpaid balance. He also sees to it that the car sold is covered by a comprehensive policy. The insurance is sometimes done by the seller on behalf of the buyer.

The sale of cars on instalments has been facilitated with the coming of Lombank into the picture to finance the instalment sales of cars. Although there were agencies that finance car sales on instalment

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[8]Anglia, for example.

before, yet these concentrated mainly on financing commercial cars (taxis). The "Levant Motors," which is a finance company specialising in financing the sale of cars, is normally reluctant to finance the sale of private cars.[9] This is because it believes that the commercial car provides a higher security with the valuable red plate.*

Car dealers and distributors that were interviewed have reported that, on the whole, they have not had a bad experience with their clients. Most of them asserted that the rate of defaults amounts to only between 1% and 3% of instalment sales. The rate of default is slightly higher on large cars than on small cars, because some people buy the large cars as private cars for the purpose of using them as commercial cars, that is, for the purpose of either renting them out or using them illegally to carry passengers in the mountains. These people are usually sensitive to the government policy towards them. When the government is strict in applying the law against them, it becomes difficult for them, as their incomes consequently fall, to meet their obligations as they fall due. On the other hand, those with a regular income proved on the whole to be good clients.

There are instances when customers delay payment for one or two months, and these make up between 20% and 30% of the clients.[10] This usually happens due to a force majeure e.g. an accident that happens to the client or his family or an illness for which he did not budget.

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[9] Information is obtained from Mr. George Salameh, Partner, Levant Motors. Interviewed March 28, 1962.

[10] See Appendix I Group I-A.

***The red plate in Lebanon represents a licence for the commercial use of cars. Red plates command a relatively high price in the market because they are limited in number**

These clients do not pose a serious problem; they generally resume their regular payments once the mishap passes.

2. Home appliances:

Regarding the electric home appliances, the writer is limiting his study to refrigerators, washing machines, ranges, stoves, televisions and radios. These have been chosen because it is possible to get a rough estimate of the volume of their sales from the Customs statistics. Other small electric articles are lumped together in customs statistics, and it is not possible to break the total into components. Most of the furniture sold in Lebanon is produced locally and it is practically impossible to estimate the total annual sales.[11] (Manufacturers consider this information i.e. the volume of production per year, as confidential and they are not willing to divulge it). Thus, the writer had to limit himself to refrigerators, washing machines, ranges,

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[11] The sales figures of wooden and metal furniture and fixtures in 1955 were LL 11,427,000 and LL 3,206,000 respectively. These figures were obtained from American University of Beirut, Economic Research Institute, Industrial Census of Lebanon 1955 (Beirut: March 1958), pp. 95-99.

For 1959 and 1960 the writer was able to get the production figures for the wooden and metal furniture and fixtures:

	1959 in pieces	1960 in pieces
wooden furniture and fixtures	53,000	57,000
metal furniture and fixtures	150,000	140,000

These figures were obtained from the Ministry of National Economy, "Files of the Industry Section," (Beirut: May 1962).

The figures are in terms of heterogeneous units, and it is practically impossible to estimate the total sales value. Consequently, the writer has been unable to go further on his discussion of consumer credit in the furniture business.

stoves, televisions and radios because it was believed that the figures obtainable regarding their sales volume are more dependable than whatever estimates one might come out with about the other articles.

The sale on credit of the selected home appliances started around 1950 in Lebanon. At that time the maximum maturity period allowed was six months and the down payment required was no less than 50% of the price, and the interest was on the average 10% flat. Two or three years later the maturity was extended to 12 months, the down payment and the interest were kept as before. By 1957, the maturity had been in most cases extended to 15 months and the down payment lowered to 33 1/3%. During 1958, the year of the political crisis, sales on credit were reduced to a minimum because banks became more conservative in granting credit and dealers were more cautious than before. For it was extremely difficult to collect a debt from clients in the midst of the unhappy events of that year. In the middle of 1959, sales on credit resumed their previous position. In 1960, due to the severe competition among companies, many dealers accepted practically any amount as down payment provided the balance is paid in twelve months.

In 1961, Kettaneh, agent of General Electric, lowered his down payment requirement to 10% and 15%, and accepted instalments over twenty-four months at one percent a month. Other companies followed suit, and some of them, e.g. the Philco dealer started asking for no down payment, allowed instalments over twenty-four months, first twelve months free of interest. Once a leader takes a step the others generally follow suit with little delay. The leading sellers are the distributors of General

Electric, Westinghouse and Frigidaire.[12]

A word of caution is appropriate. Although the distributor sometimes claims that no interest is charged for the first twelve months, the price is often raised by about 5%. That is, the distributor sometimes adds 5% to the price in lieu of charging interest. In the final analysis all comes to the same thing.

Some dealers in other lines of business i.e. television and radio, do not show interest at all but they add sometimes as much as 20% to the price when they sell on credit. Some give credit up to 18 months and others up to 24 months. Many a dealer feels that it is in their interest not to give credit for more than one year, considering that the television set is usually guaranteed by the manufacturer for one year only. In case something happens to the television after one year, the dealer has to charge for it, and a misunderstanding might arise between the dealer and the customer, and then the customer might stop paying. They are, nevertheless, forced by competition to extend credit for more than one year.

Most of the dealers in home appliances who were interviewed emphasized that the new credit facilities have increased sales by more than 100% between 1959 and 1961. On the other hand, risk has increased and this is felt more by small dealers than by big dealers and agents. Big dealers sell mostly to small distributors and these in turn sell to the consumer. In the event of default, small dealers are subject to prosecution in accordance with the commercial law. This means that they have to pay their debts

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[12]The information is obtained from Messers Shbaclo, Kurani and Saad. See <u>Appendix</u> I, Group I.

when they fall due or else run the risk of being declared bankrupt. Consumers, in case of default, are not subject to bankruptcy proceedings and the maximum that a dealer can do is to repossess his merchandise.

Consumers are being attracted by the new terms of credit. Apparently the majority of them are not cost conscious; they think of the cost in terms of the downpayment only.[13] It seems that generally they do not try to figure out the real price they are required to pay or the effective rate of interest which they are charged. Consumers are being induced to buy by the easy terms of credit and are perhaps buying more than their incomes warrant. Eventually, many of them are bound to come into trouble with the distributor. Moreover, some of them, in figuring out what they can afford to pay out of their fixed income by way of instalments, do not provide for unexpected, inescapable expenditures. That is why small dealers are feeling the burden of easy credit terms more than big dealers. A small dealer[14] told the writer that the rate of default he is experiencing is more than 30%, whereas big dealers report that it is not more than 3%. An explanation to this phenomenon is that most of the small dealers are still new in the field of instalment selling, and so they have not yet got enough experience in appraising the credit-worthiness of people. They are more likely to commit errors than the more experienced large dealers. Suggestions that might lower the percentage of default will be discussed in Chapter V.

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[13]This is the impression of most of the dealers interviewed among them are Messers Chidiac, Saad, Chebli and Kurani.

[14]Mr. Anis Haddad, see Appendix I-Group I.

C. Sources of Consumer Credit

Consumer credit in Lebanon is financed mostly by dealers in consumer goods, discount houses and banks.

1. Retailers:

Dealers in consumer goods differ from discount houses or commercial banks in that they finance consumer credit directly. Consumers buy on account from the dealers and settle part or all of the debt usually at the end of the month when they cash their salaries or wages. To some persons, it is a convenient way to pay for their accumulated purchases at the end of the month, and to others it is a necessity because they do not have available cash to pay at the time of purchase.

Consumers buying on credit are usually well known to the retailer, and no interest is charged. There is sometimes a difference in the price between cash and account purchases, and the difference is something as high as 8% to 10% of the cash price. The difference, to be sure, boils down to an exorbitant rate considering that charge accounts have perhaps an average maturity of one month. Such difference, where it exists, could be considered as the interest charged. On the whole, the bad debt loss on charge accounts is insignificant because charge customers are usually well known to the retailers. Apparently most of the dealers have not had unfavorable experience with their customers. The bad debt rate is estimated at 2% to 5%. About 25 percent of customers, however, delay payment of their debts for at least one month, but eventually they pay.[15] No estimates of

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[15] The information is obtained from group II dealers in the appendix. II

the volume of charge account business are available, and it is exceedingly difficult to arrive at even rough estimates of such business by first hand research. Retailers selling on credit are practically innumerable and are reluctant to divulge any significant information about their business.

2. Discount houses:

Discount houses finance consumer credit in three ways; namely, first, by making direct loans to consumers; second, by discounting the consumers' instalment notes for retailers; and, third, by making advances against consumers' instalment notes. They lend money up to one year to consumers whom they know, and to those who have more or less a secure income. The security required in such cases is usually the signature of the borrower plus the signature of someone who is well known to the lender or is well known in the market. The interest rate that discount houses charge is between 9% and 10% flat,[16] which is equivalent to an effective rate of approximately 17% to 19% per annum, depending upon the client.

Why do consumers borrow money since they can buy most of their needs on credit? Sometimes they borrow not to buy commodities but to pay medical expenses or school fees or to travel or to meet other unusual expenditures. Sometimes they borrow to buy commodities, either because they know that the difference between the cash and credit price including the interest and other charges amounts to more than what it costs to

[16] Information is obtained from Group III-A interviewee. See appendix III to the present chapter. The calculation of interest would be shown in a later section in this chapter.

borrow money from a discount house, or because they have used their credit with the dealer and can not buy any more on account from him. Discount houses assert that they have not had a bad experience with such clients except that sometimes they delay payment for a while.

In 1960 a new finance agency, Lombank, came into existence. Lombank specialises in financing the sale of private and commercial cars. It relieves the car dealers from the possibility of bad debt loss. When a customer goes to an agent to buy a car, the agent takes all the necessary information about the client as to the place of work, salary, status and other details.[17] The agent passes the information to the bank which, in the light of further investigation, may either accept or reject to finance the credit extended to the client in question. In case the bank accepts, the instalment notes are made to the order of the bank and the agent is paid their discounted values. In order that the bank may finance the transaction, the downpayment should be no less than 33 1/3% of the price and the car must be insured by a comprehensive policy. The bank finances instalment credit up to 24 months in the case of new cars and from 15 to 18 months in the case of used cars, provided the latter are not more than two years old. The interest rate Lombank charges is 7% flat, equivalent to approximately 13% per annum.[18]

Lombank has served a useful purpose by relieving the car dealers from the worry of debt collections, and thus made it possible for them to

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[17] A form of the information sheet is presented in Appendix V to this chapter.

[18] Information is obtained from Mr. Camelery of Lombank.

concentrate on stronger sales programs and efficient service which are among the main factors that lead to increased sales. To the agent, an instalment sale would be equivalent to a cash sale because the transaction with Lombank is done on a non-recourse basis.

The second method in which discount houses finance consumer credit is by discounting for retailers consumers' instalment notes. There are several reasons why retailers (and sometimes wholesalers) resort to discount houses, even though the latter generally collect higher charges than commercial banks. Following are the chief two reasons:

First, it may be that a retailer has used his line of credit with the bank, and he still needs to borrow more money. Under the circumstances he might resort to the discount house.

Second, there are several facilities that the discount house offers to his clients, which the bank does not offer:

a) At the time of the maturity of the note, if the customer does not have the full amount to settle it and he is rated among the good clients, the discount house may take what the customer has and accept another note for the balance. A bank does not normally do such things.

b) Discount houses frequently give their customers loans against uncovered, post-dated cheques for a short time e.g. three or four days. This happens when a merchant is in need of cash, and the bank has not yet credited his account with the amount of the bills discounted. Banks usually credit the account after two or three days from the date instalment notes are discounted. During that period the merchant would give the discount house a post-dated cheque against which he takes cash, and at the due date of the cheque his account would be credited in the bank and the discount house would cash the cheque. Even though post-dated cheques are not allowed in the Lebanese law[19], they are in practice used in the manner just described on the basis of mutual confidence between the maker and the payee.

c) Some commercial banks are usually reluctant to discount commercial papers for more than 120 days whereas discount houses discount papers up to one year.

These are some of the reasons why merchants resort to discount houses even though they are charged a higher rate of interest than they are charged by commercial banks.

Discount houses classify their customers into five groups:

The first comprises the big merchants who have a sound reputation in the market. These resort to discount houses when they have already used their line of credit at the bank, and they still need more money.

The second comprises the merchants that do not have access to big banks because they are not well established, and do not have enough assets.

The third comprises the property owners. They come and mortgage their property against a certain sum. These are not considered as very good customers because frequently they can not pay before they sell the property, and they often press for an increase in the mortgage.

The fourth comprises employees who sometimes need money in anticipation of their monthly slaries and sometimes borrow for a period of several months.

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[19]Article 425 of the Lebanese Commercial Law states that a cheque should be paid on sight even if it is post-dated.

The fifth comprises the commercial car owners who mortgage their cars with the red plate against a certain sum of money.

Discount houses finance consumer credit indirectly through the first and second groups by discounting consumer bills for them or by giving them advances against such bills, and directly through the fourth group as they give loans to the individual himself. Clients of the first group are charged 10% to 12% interest. Those in the second group are charged 13% to 15% interest and those in the fourth group 18% to 20% interest. Owners of discount houses believe that they finance between 20% and 25% of the total institutional consumer credit.[20]

3. Commercial Banks:

Commercial banks are the major financiers of consumer credit. They operate either by discounting consumers' promissory notes or by making advances against them. In the case of discount, the interest rate ranges between 7% and 9%.[21] The interest is charged on the face value of the note for the exact period of time covered. Besides the interest rate banks charge a collection fee which varies between 50 Lebanese piasters and five Lebanese pounds per bill depending upon the value and the location of the consumer-debtor.

The principle in commercial banking in Lebanon is allegedly not to accept bills or notes having a maturity longer than four months.[22]

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[20] Information is obtained from Group III-A. Interviewees. See Appendix III.

[21] See Appendix III, Group III.

[22] Mr. George Murad, Asst. Manager, Bank of the Arab Economy, interviewed March 29, 1962.

But some banks do accept bills having a maturity up to eight months.[23] Banks usually discount bills and notes to merchants who are considered to be solvent and safe. It is practically always the case that a discount client has a deposit account at the bank so that in case a bill is not paid it would be charged to his account. Some bankers believe that consumers' bills are highly secure and liquid. The risk of default attaching to consumers' bills and notes is not usually considered great, as the relatively small amount of consumers' notes and bills ensures a rather wide distribution of the risk.

Banks also finance consumer credit by advancing to retailers a certain percentage which varies between 40% and 80%[24] of the face value of the bills. Bankers prefer to make advances against bills because they feel that they are more secured when they give a certain percentage of the bills only. While most banks do not discount bills for more than four months, they accept bills as collateral having a maturity period of over one year.[25] In cases of advances some bankers compound the interest monthly[26] and some quarterly.[27] It was impossible to know the exact volume of consumer credit that banks finance, but it can be said that they finance the largest share of consumer credit.

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[23]For example Bank of the Arab Economy.

[24]See Appendix III, Group III.

[25]For example Bank Beirut Riyad.

[26]For example Bank of the Arab Economy.

[27]For example Bank Beirut Riyad.

D. Costs of Instalment Credit

The real costs of instalment selling include the interest charge, plus the difference between the cash and the credit price plus all the other charges that are sometimes added, such as insurance and collection fees etc.

In an attempt to make their rates comparable with the usual bank interest, instalment sellers have adopted the policy of stating their rates in the form of "interest" but in a way that does not reveal the "true interest" as the purchaser is prone to figure it. The possibility of disguising the true costs is greater, indeed, in instalment selling than in ordinary bank credit. In the case of ordinary commercial credit a small change in the rate of discount is enough to draw the attention of the client, first, because of the magnitude of the transactions involved and, second, because the business borrower is more likely to be of the calculating type than a consumer. One would suppose that a rational consumer would try to weight out the rise in costs in the term of finance charges against the relative desirability of the consumer good in question as between the present and the future. The evidence is that the average consumer in Lebanon is not of that calculating type. The implication is that, with some limits, the demand for consumer durable goods is generally inelastic in respect to decreases of finance charges.

It is interesting to point out some of the methods used by dealers to disguise the true amount of finance charges. One way is to charge interest on the cash price of the article even though a certain percentage of the price is paid down on the purchase.

Another method is to charge a flat interest rate on the balance for the whole period without taking into consideration the diminution in the balance as instalments are paid. The interest charge may be quoted as 7 percent on the unpaid balance of the price at the time of sale, but the effective rate charged would be considerably higher. To illustrate, suppose the unpaid balance is payable by twelve monthly instalments. The average outstanding debt over the twelve-month period is equivalent to a little over half the amount of the debt. More accurately, the average outstanding debt would be equal to P $\left(\frac{n+1}{2n}\right)$, where n represents the number of instalments needed to discharge the debt and P the amount of the debt. Hence, an instalment account repaid in 12 payments means that the debtor has full use of the principle amount for an average of $6\frac{1}{2}$ months. Clearly, this explains the need for computing the true interest rate on instalment purchases. In as much as the debtor has full use of the creditor's principle for slightly more than one half of the total instalment period, it may be surmised that the true interest rate is approximately twice the nominal rate. The constant ratio method formula for computing the true interest rate is:[28]

$$R = \frac{r(2n)}{(n+1)}$$

R = true interest rate per annum

r = nominal interest rate per annum

n = number of instalments to discharge the debt.

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[28] This formula was developed by T.N. Beckman and is used in his Credits and Collection in Theory and Practice, (6th ed.; New York: McGraw-Hill Book Co., Inc., 1955), p. 98.

To illustrate the application of this formula, assume the purchase of a new refrigerator for LL 1750. Suppose that the buyer paid LL 250.- as downpayment and agreed to pay the balance of LL 1500.- by 12 instalments, the rate of interest charged being 7% flat. The true interest rate can be figured out as follows:

$$R = \frac{7\%\ (2x12)}{12 + 1} = \frac{7\% \times 24}{13} = \frac{168}{13} = 12.92\%$$

Sometimes besides the interest rate charged, instalment sellers add other charges as insurance, collection fees, service fees and the like. Over and above that there is often a difference between the cash and the credit price. To demonstrate, let us consider a case where a refrigerator that can be bought for LL 1150.- for cash has been sold for LL 1200.- on instalments for 12 months with interest at 1% per month. In this case the buyer would be paying besides the LL 78.- interest $(1200 \times \frac{12}{100} \times \frac{6\frac{1}{2}}{12})$ a sum of LL 50.- which represents the difference between the cash and the credit price. The total charge to the buyer would be LL 128.-. The formula for computing the true interest rate is:[29]

$$R = \frac{2 \times m \times I}{p(n + 1)}$$

R = annual simple interest rate

I = L.L. cost of the credit

m = number of payment periods in a year

n = number of payments scheduled

p = net amount of credit advanced (principal)

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[29] Boehmler, op.cit., p. 209.

Application of the formula would give the following interest rate:

$$R = \frac{2 \times 12 \times 128}{1150(12 + 1)} = \frac{24 \times 128}{1150 \times 13} = 20.5\%$$

From the above examples it is shown clearly that the true interest rate is almost double the nominal rate. Very many consumers are not aware of the real cost. If one watches the trend of development he will find that the true costs have been decreasing and not increasing. This could be attributed to two main factors among which are, first, the keen competition among instalment sellers and, second, the public is becoming more educated on the cost aspect of the credit they incur.[30]

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[30]The legal provision affecting the limit to the interest rate that might be charged vary according to the type of transactions involved.

Article 101 of the Lebanese Mortgage Law states that in real estate mortgages the rate of interest should not exceed 12%.

There is no law governing the interest rate on purely commercial transactions, i.e. on transactions concluded between two businessmen (See Court Action No. 154, February 14, 1950). Collection of Court Precedents, VI, p. 44.

Article 257 of the Lebanese Commercial Law states that the legal interest rate is 9%. This is supposed to apply to consumer credit.

Article 662 of the Lebanese Penalty Law, states that any person who charges implicitly or explicitly a higher interest rate than the legal rate, i.e. 9% would be subject to a fine up to half the principal and to imprisonment of not more than one year, or to either penalty.

Dealers have their own ways to circumvent the law. The methods discussed in the text illustrate this fact. According to lawyers interviewed, the legal validity of these methods has never been challenged by consumer-debtors before the courts.

E. Considerations in Evaluating the Credit of a Customer

Since there are no credit agencies to which dealers can refer for information about prospective customers, dealers have to depend upon their own judgment. Here experience and investigation play a dominant role. As was pointed out before, the lack of experience is one of the reasons why small and new dealers are having a higher rate of default than the larger, well-established dealers. Those new and small dealers have not yet acquired the skill of judging people, and their main concern is to increase their sales, either because part of their stock has been acquired on credit and they need money to settle their debts, and/or because they believe that by increasing sales they will increase their profits.

Most dealers and specially the large ones[31] assert that they care more for the quality than for the quantity of their customers. They worry mainly about the integrity and reputation of their customers as well as their ability to pay. Some agents have said that many a time they advise their prospective customers to buy the article which is within their financial ability and to abstain from buying things which are beyond their ability to pay. If the customer insists on buying what the dealer thinks is beyond his ability to pay, he would be asked to get another signature as guarranty. The guarantor should be a business man or a person who is well-known to the dealer.

How do dealers judge the financial position of the prospective customer? They inquire about the customer's place of work and about his

[31]For example, agents of General Electric, Westinghouse, Frigidaire and Philco.

salary. Also, they try in their own ways to figure out his monthly expenses such as rent, tuition fees, and the like so that they can estimate how much he can afford to set aside from his income to pay for the article that he wants to buy. Some dealers depend to a great extent on the first impression they get about the customer. They get this impression from talking to him and from the way he asks about the price and terms of credit. How accurate are they in their estimate it is difficult to say, but the relatively low rate of default experienced by many of them indicates that they have been doing quite well. What is keeping the dealers happy about the credit sales notwithstanding all the risk involved is the high profit margin, which ranges between 20% and 25% of the cost.[32] If we add to this the true high interest rate charged, which ranges between 15% and 20%, it becomes obvious that merchants are quite safe even with a relatively high rate of default.

Dealers in the car business are not liable to as great risk as those in the home appliances field. A car remains under mortgage to the seller until the buyer settles the price, while in the case of home appliances the title passes to the buyer as soon as he obtains possession of the article. There is as yet no law that regulates the instalment sale of home appliances as there is in the case of cars.

It is not the wish of the writer to give the impression that cars and home appliances are the only commodities that are being sold on instalment. On the contrary, with few exceptions, all types of

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[32] Ibid.

articles can be purchased on credit. The total sales figures of the other lines of merchandise were unobtainable. As was indicated before, it was practically impossible to get the sales figures of furnitures. The terms differ with the different companies. For example, the Sabti Furniture Company, does not have a fixed percentage for downpayment as long as the account is settled in twelve months.[33] Boutagy asks for no downpayment, maturity over two years. Mr. Sabti has said that the installment sale has increased his sales but, new comers into the furniture business have reduced his share of the market. Thus, in the final analysis his sales have not increased. Due to the credit-sale system Boutagy company has increased its sales by 25% and enlarged its production capacity by 5% only.[34] This proves that they were working under capacity so that the 25% increase in sale led to an expansion of 5% only.

Since the two lines of merchandise under consideration here, i.e. cars and home appliances, account for no less than 60%[35] of the credit business in the market, and since it is difficult to estimate the credit volume of other lines due to lack of statistics, the writer will try to estimate the volume of aggregate credit sales in the market on the basis of the sales figures of cars and home appliances.

F. The Volume of Consumer Credited in Selected Fields

To figure out the importance of consumer credit and its role in

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[33] Mr. Alfred Sabti, see appendix I-Group I.

[34] Mr. Farid Asfour, see appendix I-Group I.

[35] Most of the bankers and dealers interviewed have said that the credit sale of cars and home appliances constitute from 60% to 65% of the consumer credit market.

the economy an estimate of its volume is an essential matter. Due to the lack of statistics the writer concentrated on the two types of articles chosen, namely cars and home appliances. Through the research carried out, the writer has formed an idea, crude as it is, about the market share of these two lines of articles. The procedure here is to find the total number of private tourist cars that were sold for the last five years, plus the volume of home appliances that were sold and then estimate the credit sector of these sales.

To find the value of cars sold it is necessary to separate them into two categories: big size (mostly American) and small size (mostly European), because the percentage of credit sales and the average price of each category differ in each case.

TABLE I

THE NUMBER OF BIG AND SMALL PRIVATE CARS SOLD IN LEBANON DURING THE PERIOD 1957-61

Year	Big cars	Small cars	Total
1957	1064	2876	3940
1958	835	2641	3476
1959	932	4245	5177
1960	2050	6823	8873
1961	2831	7303	10134

Source: For the years 1957, 1958 and 1959 Piere Nasrallah, Le Credit A Moyen Terme Au Liban, (Paris: Librairie Generale De Droit et De Jurisprudence, 1961), p. 155.
For the years 1960 and 1961, R. Tabbakh, "Immatriculations De Vehicles Neufs Au Liban En 1961," Le Commerce Du Levant, February 28, 1962.

It is estimated that the average price of the small car is LL 6000.- and that of the big car is LL 11500.-.[36] According to this estimate the value of big and small cars sold during the period would be as in Table II.

TABLE II

THE VALUE OF BIG AND SMALL PRIVATE CARS SOLD
IN LEBANON DURING THE PERIOD 1957-61

Year	Value of big cars LL	Value of small cars LL	Total LL
1957	12,236,000	17,256,000	29,492,000
1958	9,602,500	15,846,000	25,448,500
1959	10,718,000	25,470,000	36,188,000
1960	23,494,500	40,938,000	64,432,500
1961	32,556,500	43,818,000	76,374,500

The majority of the car dealers interviewed have revealed the fact that 90% of the small cars and 70% of the big cars are sold on credit. According to this estimate the value of cars sold on credit would be as follows:

	LL
1957	24,095,600
1958	20,983,150
1959	30,425,600
1960	53,290,350
1961	62,225,750

[36]Pierre Nasrallah, Le Credit A Moyen Terme Au Liban, (Paris: Librairie Generale De Droit et De Jurisprudence, 1961), p. 156.

In order to be able to analyse the above figures critically it is preferable to tabulate them in such a form that the needed information could be extracted easily.

TABLE III

THE NUMBER AND VALUE OF PRIVATE TOURIST CARS SOLD ON CREDIT IN LEBANON DURING THE PERIOD 1957-1961

Year	No. of cars	Percent increase in relation to 1957	Credit sale value LL	Percent increase
1957	3940	--	24,095,600	--
1958	3476	(11.8%)	20,983,150	(12.9%)
1959	5177	31.4%	30,425,600	26.2%
1960	8873	125.2%	53,290,350	121.2%
1961	10134	157.2%	62,225,750	157.8%

In this table, 1957 is taken as a base year since it was comparatively speaking a normal year. The year 1958 was an abnormal year due to the political crisis that took place. The sales in 1959 showed an increase of 26.2% over that of 1957, although Lebanon in that year was still recovering from the crisis of 1958. The year 1960 showed a high increase and that is 121.2% over that of 1957 and in 1961 the increase was 157.8% over that of 1957. In other words, the volume is rising sharply.

The above information applies to the new car market. In this connection one cannot ignore the important market for used cars. It was impossible to get the exact sales volume of used cars because the exact monthly registrations are not available.

It is estimated that in 1961,75 used cars were registered daily and out of these 40 were private tourist cars. Considering that the registration department works 280 days per year, one can say that around 11200 used private tourist cars were registered per year; 25% of these are estimated to be under two years old.[37] This is important since the practice is not to sell on credit or finance cars that are older than two years.[38] The number of cars sold which are below two years old are in the neighbourhood of 2800 per year. Around 70% of these are sold on credit.[39] It follows that the used private tourist cars sold on credit are perhaps 1960 cars. These are divided in the proportion of 20% to 80% between big and small size cars, i.e. about 392 big cars and 1568 small ones. On the assumption that the big car loses 30% and the small one 25% in two years[40] the estimated sales value is LL 8000.- and LL 4500.- for used big and small cars respectively. Accordingly, the estimated credit value of used cars would come up to LL 10,192,000. Adding the credit sales of new cars to the credit sales of used cars, we get roughly a total of LL 72,415,720 for car credit sales in 1961.

Having estimated the total car credit market there remains the other line of merchandise under study, viz. that of home appliances. Figures regarding the sales volume of these articles were impossible to

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[37] Information is obtained from Mr. Salim Mroueh, Secretary, Registration Dept. of Cars and Machines, Ministry of Interior. Interviewed April 3, 1962.

[38] Mr. Tony Camelery, op.cit.

[39] This was the estimate of around 80% of the car dealers interviewed.

[40] This estimate was suggested by Mr. Salim Mroueh of the Car Registration Department.

get from the dealers. The latter refused to reveal any figures and home appliances are not, as are cars, registered on sale.

The solution for this problem was to find the quantity imported for a number of years and take their average as the annual consumption. The annual Customs statistical abstract is not of much help since it groups different articles under one heading. The writer, through the help of some of his friends in the Customs, obtained the market value of the home appliances in question for four years as shown in Table IV.

TABLE IV

MARKET VALUE OF HOME APPLIANCES IMPORTED
DURING THE PERIOD 1958-1961

Name of article	1958 LL	1959 LL	1960 LL	1961 LL
Refrigerators	11,175,050	12,006,347	21,706,885	28,420,000
Radios	7,816,500	10,884,900	19,484,700	21,210,000
Televisions	-	6,030,000	13,752,000	19,200,000
Washing machines and ranges and stoves	831,102	702,928	2,692,818	3,231,381
Total	19,822,652	29,620,175	57,636,403	72,061,381

Source: Republic of Lebanon, Files of the Statistics Department, Customs.

Because of the political crisis that marked 1958, the figures for that year cannot be considered as dependable. Moreover, television had not started by that time. The figures in the years 1959, 1960 and 1961 suggest an average consumption of LL 53,100,000 per year of the articles listed in Table IV. The sales volume of these articles may be expected to rise further in the future, first, due to the new credit facilities and, second, due to the electrification of the rural districts of Lebanon.

Due to the new credit facilities described at the beginning of this chapter many families are keeping their old refrigerators or radios or washing machines in the summer resorts and buying new ones for regular use in town. Moreover, inhabitants of districts where electricity power is being newly provided are finding it easy to buy most of the articles mentioned. One may also expect a continuous increase in replacement demand. Obsolescence, however, tends to precipitate the replacement of such articles a few years before the expiration of their useful life. The trend of sales may therefore, be expected to keep on rising sharply. Credit is granted on approximately 90% of the total sales of home appliances.[41] Hence the credit sales volume of the articles under consideration was roughly estimated at LL 47,790,000.

Most of the banks interviewed expressed the opinion that credit granted on cars and home appliances constitute about 60 to 65 percent of total instalment credit in the market. It has been estimated that the credit sales of cars and home appliances add up to LL 120,205,720. One may, therefore, presume that total instalments were roughly LL 200,-000,000 in 1961.

C. Summary and Conclusions

The Lebanese government issued in 1935 a law in which it organized

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[41] See appendix I attached to this chapter.

the sale of motor vehicles and of agricultural and industrial machines on instalments. The arrangement provided for under this law is of the nature of a conditional sales contract. Some dealers sell on instalment under this arrangement and others sell under different arrangements which, though not provided for in the law, are recognized by the Lebanese Courts. One of these arrangements provides for the transfer of title to the buyer, with the property subject to a lien or mortgage for the unpaid portion of the selling price. Under another arrangement the property may be considered as leased until the purchase price is fully paid at which time title passes to the buyer. This arrangement may be identified as the hire-purchase plan.

The fact that a law was passed in 1935 to regulate the sale of cars and of agricultural and industrial machinery on the instalment plan indicates that the sale of cars on instalment existed even before that year. The terms of instalment credit in application, however, have undergone a far-reaching evolution. The sale on credit of home appliances started around 1950 in Lebanon. The terms of credit have undergone great changes. At present some distributors advertise that no interest is chargeable for the first twelve months but, instead, they add sometimes as much as 5% to the cash price. In the final analysis all comes to the same thing.

In the car business, credit facilities have increased sales by about 50% and in the home appliances by about 100%. Apparently, the majority of the customers are not cost conscious; they think of the cost in terms of the downpayment only, and this is one of the reasons why they were attracted by the new terms of credit.

Consumer credit in Lebanon is financed mostly by dealers in consumer goods, discount houses and commercial banks. Dealers in consumer goods finance consumer credit directly while discount houses finance consumer credit in three ways: First, by making direct loans to consumers; second, by discounting consumers' instalment notes of retailers; and third, by making advances against consumers' instalment notes. Commercial banks finance the largest share of consumer credit. They operate either by discounting consumers' promissory notes or by making advances against them.

It is not easy for the ordinary consumer to figure out the true cost of his instalment purchase. There are several methods by which the instalment sellers try to disguise the true costs. These methods were discussed in detail in the body of the chapter. In other words, the real cost is always higher than the nominal interest rate which instalment sellers purport to charge. Moreover, the burden of the cost is not easily felt because the total cost of instalment selling is divided into a large number of small payments.

In evaluating the credit of a customer dealers have to depend upon their own judgment since there are no agencies to refer to for information. It seems that large dealers have had a more favorable experience in collecting their debts than small dealers because apparently they are the more experienced.

It seems that car dealers are not liable to as great risk as those in the home appliances field. This is so because there is no law yet that regulates the instalment sale of home appliances as is the case with cars.

The sales figures of cars and home appliances were taken as a basis for estimating the volume of consumer credit in the market. The total credit sales of private cars (new and used) plus home appliances amounted to LL 120,205,720 in 1961. This figure is estimated to represent 60% of the consumer credit market. On this basis, the total consumer credit sales are estimated to be around LL 200,000,000.- in 1961. The amount of charge-account sales is excluded from this figure since this is impossible to estimate with any measure of accuracy.

APPENDIX I

Group I

Home-appliance Dealers Interviewed

Name	Position	Date Started Selling on Credit	Maturity Period	Interest Charged	Down Payment	Rate of Default	% of Credit Sales to Total Sales	% of Delayed Customers
Mr. G. Abdul Nour	Chief Acc. Admiral	1955	24 months	3/4% a month	25%	None	90%	20%
" F. Asfour	Manager, Boutagy	1955	" "	10% on balance	none	2%	90%	25%
" G. Bashur	Inspector, Philco	1950	" "	Free for 1st year then 1% per month	No	3%	90%	25%
" C. Chebli	Sales Manager Kelvinator	1954	" "	No Int. but adds 20% on price	20%	3%	90%	20%
" A. Chidiac	Sales Manager, Soc. d'exp., industriel et commercial	1959	" "	9% flat	20%	7%	80%	40%
" R. Faroun	Agent, Frigidaire	1950	" "	1% a month	20%	2%	90%	25%
" A. Haddad	Retailer in H.A.	1959	12 months	No. int. but adds 20% on price	Any down payment	30%	93%	40%
" F. Hammawi	Inspector, Gen.Elec.	1950	24 "	1% a month	Bet.10% and 15%	3%	90%	20%
" E. Khoury	Agent, Zenith Radios & T.V.	1945	18 "	No Int. but adds 20% on price	15%	3%	80%	30%
" K. Kurani	Retailer in H.A.	1959	24 "	1% a month	no fixed %	2%	70%	20%

Name	Position	Rate Started Selling on Credit	Maturity Period	Interest Charged	Down Payment	Rate of Default	% of Credit Sales to Total Sales	% of Delayed Customers
Mr. J. Rebeiz	Carpet Dealer	1952	Max.1 year	Adds to price	Depends	1%	60%	15%
" T. Saad	Manager, Saad Co. Retailer in H.A.	1950	24 months	1% a month	Any down payment	5%	95%	30%
" A. Sabti	Owner, Sabti Co.	1957	12 "	9% on bal.	Not fixed	5%	60%	25%
" A. Shabaclo	Sales Manager Westinghouse	1950	24 "	5% flat	Between 10% & 20%	2%	93%	25%
" R. Tarabo.	Owner Tarabo Stores	1956	24 "	1% a month	4%	2%	100%	25%

C A R   D E A L E R S

Group 1 - A

Name	Position	Rate Started Selling on Credit	Maturity Period	Interest Charged	Down Payment	Rate of Default	% of Credit Sales to Total Sales	% of Delayed Customers
" G. Abdul Nour	Chief Acc., Ford	1955	24 months	1% a month	40%	8%	75%	30%
" E. Choucair	Salesman, Volks	1953	30 "	"	20%	2%	90%	20%
" N. Jabbour	Distr.Chrys.& Plym.	1928	24 months	"	30%	none	60%	25%
" A. Labban	Sales Manager Simca	1948	24 "	7% flat	33.1/3%	3%	95%	35%
" E. Naman	Agent, Anglia	1960	24 "	7% flat	"	3%	93%	20%
" M. Rasamni	Bus. Mang. Taunus	1959	24 "	1% a month	20%	5%	90%	20%
" T. Saad	Agent, Porche	1959	12 "	"	33.1/3%	none	60%	20%
" A. Salameh	Manager, Dodge	1957	24 "	"	50%	1%	60%	25%
" M. Zantout	Salesman, Opel	1953	24 months	"	33.1/3%	1%	90%	25%

APPENDIX II

Group II

Other Dealers in Consumer Goods Interviewed

Name	Position	% of credit sale to cash sale	Average credit period	% of bad debt	% of delayed customers
Mr. G. Bikhazi	Owner, Bikhazi stores, Sidani St.	90%	30 days	2%	25%
Mr. I. Fattouh	Partner, Super-Market, Makhoul St.	80%	30 days	3%	20%
Mr. N. Ghulam	Owner, Ghulam store	70%	30 days	5%	30%
Mr. G. Harmoush	Owner, Harmoush Store, Mazra't	95%	30 days	4%	30%
Mr. E. Lati	Partner, Lati Store, L'azariet	75%	30 days	3%	25%
Mr. A. Nalbendian	Owner, Nalbendian Store, Burg Hammud	90%	30 days	3%	30%
Mr. N. Rubeiz	Owner, Rubeiz Store, Makhoul St.	95%	30 days	5%	25%
Mr. A. Sifri	Owner, Sifri Stores	90%	30 days	4%	25%
Mr. R. Sifri	Owner, Sifri Store, Sadat St.	90%	30 days	5%	30%
Mr. G. Younis	Partner, Co-operative, Ashrafiet	85%	30 days	3%	25%

APPENDIX III

GROUP III

Bankers Interviewed.

Name	Position	How they ext. cons. credit	% of adv.	Int. Charg.	Coll. Fees per bill	Int. They Pay	Max. Maturity they accept
Mr. Abu Jawdeh	Branch Manager, Banque Libannaise pour le Commerce	Disc. & Adv.	40-80%	6-9%	2 LL.	3-5%	4 months
" Abu Khadra	Officer, Lombard	" "	60-70%	7-9%	1 LL	$5\frac{1}{2}$%	6 "
" N. Abi Saab	Chief Exc. Dept., Jordan National Bank	" "	50-70%	7-9%	1 LL	3-5%	4 "
" C. Baz	Cont., Bank Al-Ahli	" "	50-70%	$5\frac{1}{2}$-9%	$\frac{1}{2}$-1 LL	3-4%	4 "
" S. Bischara	Asst., Mang., Arab Bank.	" "	50-65%	6-8%	$\frac{1}{2}$-1 LL	$2\frac{1}{2}$-$3\frac{1}{2}$%	4 "
" O. Daouk	Chief de Ser., Bank Trad.	" "	30-65%	$5\frac{1}{2}$-9%	LL2-4 per 1000	3-4%	6 "
" R. Genadry	Asst. Manager, British Bank	" "	60-70%	7-8%	75 p.L.	3-4%	4 "
" M. Jabbour	Gen. Controller, Bank Beirut & the Arab Countries	" "	40-70%	7-9%	1 LL	3-5%	6 months
" L. Jammal	Ec. & Fin. Advisor, Commercial Bank.	Disc. & Adv.	50-80%	8%	"	3-4%	4 "
" M. Kanafani	Controller, Bank Beirut-Riyad	" "	70-75%	7-9%	"	4-5%	4 "
" I. Lati	Owner, Lati Bank	" "	50-70%	9-12%	"	4-5%	6 "
" R. Morcos	Rel. Officer, Eastern Bank	" "	60-70%	7-9%	"	3-4%	6 "
" G. Murad	Asst. Manager, Bank of the Arab Economy	" "	75%	9%	65-100 p.L.	3-5%	8 "
" A.K. Rayyis	Asst. Manager, Intra	" "	50-60%	$7\frac{1}{2}$-9%	$\frac{1}{2}$ LL	$2\frac{1}{2}$-$4\frac{1}{2}$%	6 "
" A. Salameh	Manager, Bank Tohmeh	" "	50-70%	9-12%	1-5 LL	$3\frac{1}{2}$-$4\frac{1}{2}$%	4 "
" K. Sanbar	Asst. Manager, 1st Nat. City Bank	" "	50-70%	7%	1-$1\frac{1}{2}$ LL	$3\frac{1}{2}$-$4\frac{1}{2}$%	4 "
" E. Talhame	Pers. Officer, Chase Manh. Bank.	" "	50-70%	6-8%	1-$1\frac{1}{2}$ LL	3-4%	4 "

GROUP III - A

Owners of Disc. & Finance Houses

Name	Position	How they ext. cons. credit	% of adv.	Int. Charg.	Coll. Fees per bill	Int. they Pay	Max. Maturity they accept
Mr. T. Camelery	Cr. Off. Lombard	Dir. Fin.		7% flat			24 months
" F. Fernaini	Owner, Dis. H.	Dis., Dir. Fin. & Adv.	60-70%	9-10% flat	2 LL	5%	24 "
" J. Karam	Owner, Disc. House.	"	50-60%	9-10% flat	2 LL	5%	One yr.
" G. Salameh	Partner, Lev. Motors	Dir. Fin. Comm. cars		1% per month			3 yrs.

APPENDIX IV

عقد بيع بالوعده

CONTRAT DE VENTE A CREDIT

فيما بين الموقعين ادناه

السيد Name of seller ______

والسيد Name of buyer ______

المقيم في Residence of buyer ______

فريق ثاني

قد تم وتقرر ما يأتي :

باع الفريق الاول من الفريق الثاني الذي قبل مشترى الادوات الآتية :

The former party agreed to sell the latter the following:

______

______

بيعاً بالدين لمواعيد معينة على ان تبقى الادوات المذكورة ملكاً للبائع الى ان يتم دفع ثمنها الآتي بيانه وقدره ______

On credit for specified periods of time provided the articles concerned will be considered as the property of the seller until full payment of the price which amounts to:

اتفق الفريقان على دفعه اقساطاً بالمواعيد المعينة فيما يلي

The two parties have agreed on settlement of the price by instalments to be paid on the following dates:

تحرر بها ______ سند ______ مؤرخة في اليوم ______ من شهر ______ سنة الف وتسعماية ______

	استحقاق Maturity Date	قيمة الكمبيالات (بالاحرف) Value of the notes in (letters)	ل. ل. L.L.
	المدفوع نقداً Cash Payment	ليرات لبنانية Lebanese Pounds	
١	1	»	
٢	2	»	
٣	3	»	
٤	4	»	
٥	5	»	
٦	6	»	
٧	7	»	
٨	8	»	
٩	9	»	
١٠	10	»	
١١	11	»	
١٢	12	»	
١٣	13	»	
١٤	14	»	
١٥	15	»	
١٦	16	»	
١٧	17	»	
١٨	18	»	
١٩	19	»	
٢٠	20	»	
٢١	21	»	
٢٢	22	»	
٢٣	23	»	
٢٤	24	»	

APPENDIX IV

عقد بيع بالوعده

CONTRAT DE VENTE A CREDIT

فيما بين الموقعين ادناه

السيد ______________________ Name of seller

والسيد ______________________ Name of buyer

المقيم في ______________________ Residence of buyer

فريق ثاني

قد تم وتقرر ما يأتي :

باع الفريق الاول من الفريق الثاني الذي قبل مشترى الادوات الآتية : The former party agreed to sell the latter the following:

____

____

بيعاً بالدين لمواعيد معينة على ان تبقى الادوات المذكورة ملكا للبائع الى ان يتم دفع ثمنها الآتي بيانه وقدره ______

On credit for specified periods of time provided the articles concerned will be considered as the property of the seller until full payment of the price which amounts to:

اتفق الفريقان على دفعه اقساطاً بالمواعيد المعينة فيما يلي

The two parties have agreed on settlement of the price by installments to be paid on the following dates:

تحرر بها ______ سند ______ مؤرخة في اليوم ______ من شهر ______ سنة الف وتسعماية ______

	الاستحقاق Maturity Date المدفوع نقداً Cash Payment	قيمة الكمبيالات (بالاحرف) Value of the notes in (letters) ليرات لبنانية Lebanese Pounds	ل. ل.
١	1	»	
٢	2	»	
٣	3	»	
٤	4	»	
٥	5	»	
٦	6	»	
٧	7	»	
٨	8	»	
٩	9	»	
١٠	10	»	
١١	11	»	
١٢	12	»	
١٣	13	»	
١٤	14	»	
١٥	15	»	
١٦	16	»	
١٧	17	»	
١٨	18	»	
١٩	19	»	
٢٠	20	»	
٢١	21	»	
٢٢	22	»	
٢٣	23	»	
٢٤	24	»	

APPENDIX V

A/C No.

شركة لومبنك لبنان ش. م. ل.

LOMBANK LEBANON S.A.L.

DEALERS PRELIMINARY PROPOSAL FORM TO LOMBANK

PHOENICIA STREET, P. O. BOX 4825 — BEIRUT
TELEPHONE 250380 (5 lines)

Dealer's Name .... اسم البائع .... 19....

Address .... العنوان

Tel. .... رقم الهاتف PN. No. .... / ....

ترفض شركة لومبنك رفضاً باتاً تمويل هذه المعاملة اذا كان للمشتري معاملة ثانية لديها .

THIS PROPOSAL WILL BE REFUSED IF THE PURCHASER HAS AN EXISTING OUTSTANDING CREDIT SALE AGREEMENT WITH LOMBANK.

PURCHASER المشتري

Full Name .... الاسم الكامل

Permanent Address .... العنوان

Tel. .... رقم الهاتف

State Owner or Tenant .... ملاّك / مستأجر

Passport No. .... رقم جواز السفر Identity Card No. .... رقم الهوية

Nationality .... الجنسية Age .... العمر

Married or Single .... متزوج / اعزب No. of Dependants .... عدد الافراد الذين يعيلهم

Occupation (Give Full Details) .... المهنة (بالتفصيل)

Name and Address of Employers .... اسم وعنوان رب العمل

Length Service .... مدة الخدمة Other Source of Income? .... هل من موارد دخل اخرى ؟

Owner of Property? .... هل هو ملاك ؟

Name of Bankers .... اسم البنوك التي يتعامل معها

Name and Description of Goods .... ماركة وأوصاف السيارة

Maker's Type or Model No. .... نوع ورقم الموديل

Description of Body .... وصف الكاروسيري

Private or Taxi? .... خصوصية او عمومية ؟

H.P. or C.C. .... قوة المحرك (عدد الاحصنة)

Petrol or C.I. .... بنزين / مازوت

Chassis or Serial No. .... رقم الشاسي

Engine N. .... رقم المحرك

Registration No. .... رقم اللوحة

New or Second Hand .... جديدة او مستعملة

Details of Accessories .... تفاصيل عن قطع التبديل

SCHEDULE — تفاصيل

Cash Price of Goods		ثمن السيارة نقداً
Accessories		قطع تبديل
Insurance		التأمين
Total		المجموع
Deposit		المبلغ المودع
Amount to be Financed		القيمة المطلوبة
Interest and Commission %		الفائدة والعمولة ٪
Balance Due (Total Value of Promissory Notes)		الرصيد المستحق (مجموع قيمة السندات)

Payable by .... Monthly — تدفع بموجب .... سنداً شهرياً

Instalments of L.L. .... each — قيمة السند الواحد ل.ل. ....

Commencing .... 19 — تبتديء في ١٩

PARTICULARS OF GUARANTOR — معلومات عن الكفيل

Full Name .... الاسم الكامل

Permanent Address .... العنوان

Married or Single .... Age .... العمر .... متزوج / اعزب

Occupation (Give Full Particulars) .... (المهنة بالتفصيل)

Length of Service .... مدة الخدمة

Name of Bankers .... اسم البنوك التي يتعامل معها

FOR OFFICE USE ONLY — للاستعمال الداخلي

CHAPTER FOUR

THE ROLES OF CONSUMER CREDIT IN THE LEBANESE ECONOMY

The roles of consumer credit in the Lebanese economy are discussed in this chapter by reference to the effects of consumer credit on the various sectors of the economy. Attention will be centered on the relationship between consumer credit on the one hand and banking activity and such economic variables as prices, income, and savings on the other.

A. Consumer Credit and the Banking Industry

Commercial banks in Lebanon were slow in adopting the practice of financing consumer credit. Not before the middle fifties have they entered this field, and then only under the pressure of competition. Previously most banks did not accept to discount promissory notes for more than six months, but recently they have been accepting to discount notes with longer maturity periods in the interest of protecting their business from competition. In adopting the policy that consumer credit financing is sound and in aggressively seeking customers who sell on credit to consumers, banks have gradually become one of the chief sources of consumer credit. Much to their good fortune they have been successful in developing the patronage of a large customer group which exhibited stability and a relatively low degree of risk.[1]

[1] This was the opinion expressed by most of the bankers who were interviewed.

Normally banks do not give loans directly to individuals for consumption purposes. Bankers help consumers indirectly by extending credit to retailers, who in turn would accommodate the consumers with credit. As has been pointed out in the previous chapter, banks either discount the consumers' notes for retailers or advance credit to them on the security of the consumers' notes. Banks accept bills that have a maturity of even two years as a collateral for advancing funds and sometimes they discount them.[2] If a bank advances the retailer an amount equal to 75% of the face of a note which has to run for two years, this would be equivalent to lending to the retailer the whole face value for 1½ years. Banks also perform the service of collecting consumers' notes on behalf of dealers.

1. Implications with respect to liquidity:

By accepting bills of long maturity bankers are open to the criticism that financing instalment sales is a misuse of bank credit in that it will, when practised on a significantly large scale, impair the liquidity of the banks.

To evaluate this criticism we must be clear as to the nature of banking credit and the significance of banking liquidity. Liquidity refers to the rapidity with which the banks' assets can be converted into cash with little or no loss in value.[3]

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[2]For example Banque Libanaise Pour le Commerce does that.

[3]Erwin W. Boehmler, Financial Institutions, (Illinois: Richard D. Irwin, Inc., 1956), p. 95.

It has been said that commercial banks simply transfer for a time unemployed or underemployed funds from the owners to others who are in a position to make use of them over a short period of time and make profit over and above the interest they pay. Such a statement would be correct if the banks limited themselves to lending only the amounts of currency deposited with them. This was as a matter of fact the practice at an early stage of the development of banks, but it would be misleading to make such a statement about modern banks. The amount of loans and discounts carried by the banks in modern societies is several times greater than their cash reserves. By granting credit, i.e. by allowing their borrowers to draw sight drafts on them in excess of the actual amount of cash held, banks create new purchasing power which, so far as it is accepted in general circulation, has much the same effect on the purchasing power represented by metallic or paper money.[4]

Short-maturity loans are considered to be an essential ingredient of bank liquidity. Many would even include the short-maturity feature in the very definition of commercial bank credit. The length of maturity is indeed important because the balancing of receipts and payments by banks is simplest when the maturities are short. The longer some maturities run, the more room there is for discrepancy in the duration of the accommodations provided by the banks and the more difficult is a coordination of receipts and expenditures. The more remote the maturity period is, the less is the bank able to foresee future cash flows or to control them.

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[4]Edwing R.A. Seligman, The Economics of Instalment Selling, (New York: Harper and Brothers Publishers, 1927), I, 313.

As a result, the danger that a bank will find it difficult to honour its depositors' sight drafts in due course becomes greater.

As far as Lebanon is concerned the lengthening of the loans average maturity period of a bank implies a loss of liquidity to the bank which might be of special import considering the absence of a developed market for commercial papers and of short-term government securities. There is in Lebanon little of the near-money type of assets which can be used by banks as secondary reserves. Moreover, there is no central bank that stands ready to serve as a lender of last resort for the commercial banks according to a well-defined policy.[5]

Consequently, the banks' liquidity position depends very much on the maturity structure of their discounts and advances. Banks grant short-term loans to businessmen, but actually these are long term loans in the sense that most of them are renewed at the maturity date. The writer is therefore inclined to argue that the growth of consumer credit has had some impact on the liquidity position of banks. It has probably induced longer-term notes into the note portfolios of banks, thereby, leading to some weakening of the banks' liquidity position.

2. Implications with respect to safety:

Safety refers to the ability of the bank to meet all its obligations if it is given sufficient time to liquidate its assets.[6]

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[5]Talha Yaffi, "A Case for Central Banking Reform in Lebanon," Middle East Economic Papers, 1958, p. 103.

[6]Lecture by Prof. Issam Ashour, Prof. in the Bus. Adm. Dept., A.U.B. March 19, 1960.

Commercial banks make money by putting the funds at their disposal to work. But the problem of banks is to make profit without imperiling their safety. "The art of commercial banking is solving this conflict: that of being safe and yet profitable."[7] Financing of consumer credit does not seem to jeopardize the safety of banks in any particular way as long as the general economic conditions in the country are favorable. If business conditions continue to be prosperous, there would be little cause for worry. The loans granted to business men on the basis of consumer notes would create new purchasing power, which tends to stimulate business activity in the economy.

The stimulus given to business activity by the increase in bank loans in Lebanon tends to manifest itself more in a rise in the volume of trade rather than in an expansion of industrial production. This is because, as a matter of fact, instalment credit is mainly allowed on the sale of imported rather than locally produced goods. Expansion of trade means a greater turnover and probably greater profits. As long as the credit is not misused by businessmen, and as long as businessmen are making profits over and above the interest charged by the banks, they would presumably be able to settle their accounts at the maturity date. In this sense credit would be safe. On the other hand, if traders take advantage of the relatively easy access they have to the banks' credit facilities and expand their business activities beyond their financial

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[7] Roland I. Robinson, The Management of Bank Funds, (New York: McGraw-Hill Book Company, Inc., 1951), p. 3.

abilities, then difficulties might arise. Cases of this kind are not hard to find (the recent insolvency of Tremplin is still fresh in mind).* Trouble of a different kind might arise as banks keep on relaxing their terms of credit. Most retailers deal with more than one bank, and with each they open a line of credit.[8] This has driven many a businessman to extravagance in their personal lives and precipitated their eventual insolvency. Bankruptcies have inflicted heavy losses on banks, to the detriment of their safety.

Furthermore, if banks grant credit facilities freely to businessmen, the latter in turn tend to relax their credit terms to consumers. There is the danger that consumers might be induced by the easy terms of credit to buy more than their incomes warrant. As a result the rate of default on the part of consumers might increase and cause financial embarassment to retailers as well as to banks.

In view of all the foregoing considerations, there seems to be a tendency for any significant expansion of consumer credit to imperil the safety of banks in Lebanon

3. Implications with respect to profitability:

Profitability is the ability of the bank to earn money for its owners. One of the chief sources of income to banks is the interest they charge. The appendix to Chapter III shows that there is an average difference of 3½% to 4% between the interest charged and that paid by

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[8] Although there is an office of Central Des Risques in Lebanon, which is supposed to supply banks with credit information about customers; it is not functioning efficiently for mainly two reasons: (1) It applies where loans exceed LL 50,000. (2) Not all banks are members.

*Tremplin was a retail store specialised in credit sales in Beirut. It was declared bankrupt in May 1962. Apparently the main reason for its failure was over-expansion of credit.

banks. Besides the interest rate banks charge a collection fee ranging between 50 piasters and 5 Lebanese pounds per bill discounted.

Moreover, some bankers believe that consumer credit has more than doubled the volume of their business and thus increased their profits.[9] Furthermore, instalment selling has acquainted many of the consumers with the banking activities. Consumer, by going to the banks to pay their notes, have become aware of the services which the banks offer and have thus become potential customers. Some bankers have said that consumer credit was one of the factors in the increase of the banks' customers.[10] The expansion of business activities and the increased number of customers have led apparently to increased profits.

There are no reliable figures to substantiate this hypothesis. One may, however, form a rough idea about the trend of profits in the banking sector by observing the size of the banking industry and its contribution to the national income.

As may be noted from Table V below the increase in national income has been continuous throughout the period, except for 1958, when Because of civil disturbances economic activity in most sectors dropped considerably.[11]

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[9]For example Bank Trad.

[10]For example the British Bank.

[11]The figures in Table V for 1925 to 1958 are the estimates presented by the United Nations, whereas the figures for 1961 are tentative estimates presented by Mr. Paul J. Klat).

TABLE V

THE CONTRIBUTION OF THE BANKING SECTOR TO THE NATIONAL INCOME OF LEBANON 1952-1958 and 1961
(At current factor prices)
in LL millions

	1952	1953	1954	1955	1956	1957	1958	1961
National income	1,115	1,168	1,256	1,374	1,417	1,503	1,325	1,789
Contribution of the banking sector	50	51	57	70	80	91	93	110
Percentage contribution of the banking sector	4.4	4.4	4.5	5.1	5.6	6.0	7.0	6.2

Source: Paul J. Klat, "The National Income of Lebanon," Middle East Express, No. 5, April 2, 1962.

> Over the period, the total increase of national income has been in the order of 60 percent, or roughly 6 percent a year. When adjusted to take into account price movements (the wholesale price index in 1952 was 111% and 106% in 1961), the national income figures would show an overall increase during the period of over 70% or roughly 7 percent increase a year.[12]

Table V shows that the banking sector's contribution to the national income has been growing at even a higher rate, as the percentage of national income arising in the banking sector increased from about 4.4 percent in 1952 to about 6.2 percent in 1961. Unlike most other sectors, the banking sector was not much affected by the disturbances of 1958. Even though there was a decline in the national income in that year, the share of income arising in the banking sector continued to rise.

[12] Paul J. Klat, "The National Income of Lebanon," Middle East Express, No. 5, April 2, 1962, p. 2.

In further evidence of the profitability of banking in Lebanon, one may refer to the increase in the number of banks operating in the country. The number of banks of "real importance" operating in Lebanon is reported to have increased during the past decade from 12 to over 50.[13] There are at present about sixty-one banking establishments,[14] and some of these have started new branches in various parts of the country during the period under review. These banks represent a number of nationalities. There are six French banks, three American, three British, and banks from Iraq, Italy, Holland, Jordan, Saudi Arabia, Egypt, Belgium, and Japan etc.[15]

Banks have expanded their activities and increased in number during the past decade. There are several factors that led to this expansion such as the free exchange market, the relative stability of the exchange rate, and the introduction of the Bank Secrecy Law in 1956. The growth of consumer credit might have well been an important factor in the expansion of banking activities.

In conclusion we can say that banks have helped to expand the volume of consumer credit. On the other hand, the expansion of consumer credit had a reciprocal effect on banks; namely, it played a role in the expansion of banking activities. Banks have been able to attract more customers by granting new credit facilities and to change the conservative attitude of people toward themselves.

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[13] Ibid.

[14] Malek F. Chehab, "Aspects Financiers Et Bancaires de la Conjoncture Economique Libanaise 1960," The Economy of Lebanon and the Arab World, October 1960, p. 13.

[15] Klat, op.cit.

B. Consumer Credit and the National Income

In Chapter III of this study, the volume of consumer credit was estimated to be around LL 200,000,000 in 1961.* On the other hand, the National Income for 1961 was roughly estimated to be LL 1789 millions.[16] On the basis of these figures the ratio of consumer credit to the national income is about 11%. If the stock of instalment debt outstanding is equal to 11% of current national income, it is assumed implicitly that each income recipient is in debt by an amount approximately equal to more than one eighth of his individual income. Since 1959, the National Income is estimated to have grown at an average rate of 7 percent per year while consumer debt has grown at an average annual rate of 50 percent.[17] Extrapolating these rates consumer debt which is now equal to about 11% of personal income will equal about 26% in four-years time if it continues to expand at the present rate.[18] At some point in the foreseeable future, and of course before the high ratio is reached, consumers will be so deeply immersed in debt that they will consider further increases in the ratio of debt to income to be intolerable.

Analysis of the effect of consumer credit on the national income will be attempted in what follows in terms of the impact of consumer credit on the volume and pattern of consumption and saving.

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[16] Ibid., p. 1.

[17] See Tables III and IV in Chapter III.

[18] If the National Income and instalment sale continue to grow at their present rates it is estimated that the national income would be about LL 2270 millions and the instalment credit would be about 600 millions.

***The assumption is that the bulk of instalment credit is granted for a period of two years.**

1. Implications with respect to volume and pattern of consumption and saving.

Consumer credit has encouraged consumption through the facilities that it has granted. Tables III and IV of Chapter III point to the increased sale of selected consumer goods. Moreover, it made it possible for the low-income group to acquire luxury articles which, in the absence of instalment credit, would be accessible only to the high income group.[19] The contribution of the increased consumption to national income would have been obvious if the consumer goods were manufactured locally. For, then, an increase in consumption would lead to increase in production as long as there are unemployed resources in the economy, and thus to higher levels of employment and income.

Lebanon, however, is an importing country and an increase in consumption leads to an increase in imports. Table VI shows the relative effect of the increase in the imports of consumer goods on the total imports.

TABLE VI

LEBANON: THE VOLUME OF IMPORT
1958-1960

(in millions of pounds)

	1958	1959	1960
Total imports cif.	676	821	1051
Sales of new cars	25.5	36	64.5
Imports of home appliances*	20.0	30	58.0
	45.5	66	122.5

Source: Import figures, International Monetary Fund, International Financial Statistics, Vol. XV, Number 4, April 1962, p. 180.
*Cars and home appliances figures, as in Chapter III.
*Home appliances include the items reported in Chapter III.

[19] One would find television antennas even on the cottages in the poverty structure Nahr district in the vicinity of Beirut.

The years 1958, 1959 and 1960 were taken only because the writer was not able to get the import value of home appliances prior to the year 1958. While over the three-year period, 1958-1960, the total imports have increased by 55%, the imports of the consumer goods in question have increased by about 170%. This shows that the import of consumer goods have increased at a rate which is about triple that of the total imports. One may well infer that consumers might have been a significant factor in the increased importation of durable consumer goods and in the overall increase in imports.

The probable influence of consumer credit on savings is of importance to the country in the sense that the economic progress of society depends to a large extent upon the accumulation of capital. A distinction must be made between individual savings and national savings. Whereas individual savings may take the form of any instrument of credit that entitles the individual to wealth, national savings can include only the actual tangible wealth itself, and possibly claims on foreigners. An individual may put his savings into the form of mortgage on land; from the point of view of the community, the increase of mortgages does not imply an increase of social wealth. Hence the claims of certain individuals and the obligations of others cancel out in the process of consolidation. The savings of society must embody themselves in the actual tangible wealth that is accumulated for future use.[20]

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[20] Seligman, op.cit., p. 271.

The question to be asked now is: does instalment selling encourage or discourage savings? In fact, there are two aspects of the influence of instalment selling on savings. The first, has to do with the individual's desire to save and the second with his ability to save.

With regard the desire to save, does not the mere possession of something which has long been wanted, and which could be secured through instalment sales redouble the exertion on the part of the individual for the mere prospect of ultimate ownership? If the prospect will make a man work harder in order to own a commodity which is worth having, it would at the same time increase his income. Also, many women have joined the working force in order to increase the family income and enjoy the possession of desirable commodities and partly increase savings. If income increases more than the increase in expenditure, savings would increase. Otherwise, it may remain the same or be reduced.

There is another side to this subject and that is the capacity to save. If the commodity is used for productive purposes in the sense of increasing the money income of the individual, then a part of the income may be devoted to increased saving. But, the commodities studied here are consumptive and not productive. Consumer durable goods purchased for consumption purposes often call for additional expenditures over and above the periodic payments of principal and interest. The ownership of a private car, for instance, is associated with spending on maintenance and gasoline. A refrigerator or a washing machine would increase the electricity bill. With a given income, durable goods thus tend to reduce the individual's capacity to save.

Consumer credit may have increased consumption at the expense of saving. Theoretically, given the size of income, if consumption increases saving decreases. In view of the lack of accurate and detailed statistics of national savings and credit it is difficult to determine the impact of the increased consumer credit on national savings. On the other hand, consumer credit may induce individual savings in another respect. If consumers desire to possess an article which they can not pay for in cash they will exert an extra effort to increase their income to buy it. Savings is a part of income, and if income increases savings might increase depending on whether the increase in income is more or less than the increase in expenditure.

2. Effect on prices:

Before discussing the effect of consumer credit on prices it is appropriate to show the changes in the cost of living during the past years, and the changes in the money supply.

TABLE VII

LEBANON: THE COST-OF-LIVING INDEX
1953-1960

1953	1954	1955	1956	1957	1958	1959	1960
100	95	96	102	109	114	118	122

Note: 1953 is taken as a base year.

Source: International Monetary Fund, International Financial Statistics, Volume XV, Number 4, April 1962, p. 180.

TABLE VIII

LEBANON: MONEY SUPPLY AND CREDIT
1953-1960

(in millions of LL)

	1953	1954	1955	1956	1957	1958	1959	1960
Money	414	478	555	627	790	827	997	1115
Currency	195	232	255	320	343	384	378	399
Demand Dep.	219	246	300	307	447	443	621	716
Credit to the private sector	270	345	454	482	602	585	709	1002

Source: International Monetary Fund, International Financial Statistics, Volume XV, Number 4, April 1962, p. 180.

The moderate rise in prices as shown in Table VII indicates that the Lebanese economy has been experiencing mild inflation. Table VIII shows that the supply of money has increased by LL 701 millions or about 170 percent, during the period 1953-1960. On the other hand, the volume of banks credit to the private sector has expanded by about LL 732 millions or about 270 percent during the same period. The expansion of credit over the 1953-1960 period, was apparently a major factor in the monetary expansion experienced during that period. Given the fact that the increase in money supply was a cause of inflation, one may attribute to the growth of credit, and to a significant extent to the growth of consumer credit, much of the responsibility for the sharp rise in prices witnessed during the period under review.

As regards the articles included in this study, the tendency for their prices to increase has been at least in part, counteracted by a number of factors:

First, competition; with the introduction of new brands in the market and the increased number of dealers, competition was inevitable. There is rarely a brand of car or electric appliance which can not be found on the Beirut market. Competition took several forms, competition in service, in credit facilities and in price.

Second, as many a dealer has asserted, inventions and improvements have exerted a downward pressure on prices in the producing countries. Manufacturers have reduced their prices, and consequently the cost to the dealer is reduced.

Third, instalment sales have increased the volume of sales, apparently giving rise to a tendency for the dealers' overhead per unit to decline. Thereby, making it possible for the dealers to reduce their prices, or to refrain from increasing their prices substantially with increased demand, without sacrific in profit.

Fourth, the fall in exchange rate have helped to reduce the cost to the importers.

In conclusion, the extension of credit has influenced prices but not as supposed to be because the supply is not limited. Lebanon is following a free economic policy and so it can import as much as it needs with no restriction.

C. Consumer Credit and Economic Stability

Consumer credit in Lebanon appears to be used largely to finance durable goods.[21] If the demand for the services of durable goods is a function of the level of income and of credit facilities granted, one can imagine an equilibrium stock of consumer durable goods corresponding to each income level and credit supply. Changes in income, and in terms of credit might lead to fluctuation in the demand for the services of durable goods and thus to changes in the general demand.

There are other points[22] which explain how consumer credit serve to intensify instability in the demand for consumer durable goods and in the aggregate demand generally. Although the following observation relate specifically to the United States they appear to be equally relevant to the conditions in Lebanon.

1. The attitudes of consumer borrowers toward incurring debt to buy durable goods may shift in a destabilizing fashion during the business cycle. As long as consumers expect a continuous flow of income they buy on instalments, and they are likely to cut their purchases sharply once they expect a cut or a decrease in income.

2. Instalment sellers tend to ease credit terms during good times and curtail them during bad times. Thus, sales transactions tend to fluctuate accordingly. A remarkable decrease in demand at the beginning of a recession period might lead to severe depression instead of having

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[21]Chapter III of this study shows that out of the total LL 200,-000,000 of instalment credit outstanding at the end of 1961, 36 percent was incurred for the purchase of automobiles (new and used), 24 percent for home appliances, and the remaining 40 percent, were miscellaneous articles.

[22]Warren L. Smith, "Consumer Instalment Credit," American Economic Review, Vol. XXXXVII, 1957, pp. 970-72.

a mild one.

3. Required repayment of outstanding debt shrink the consumer purchasing power during a period of declining activity. That this can be a heavy burden is attested by the fact that payments on instalment debt in 1961 were estimated at about LL 200 millions or about 11 percent of the national income. To the extent that repayments cause reductions in current expenditures, there is little reason to expect this effect to be especially concentrated on durable goods. That is the depressive effects of repayments are likely to be more generalized than the stimulative effects of credit extensions.[23] Of course, repayments may not cause a fully equivalent contraction in spending. Current saving may be reduced below what it would be in the absence of the need to repay or past accumulations of assets may be liquidated to obtain the necessary funds.

4. If consumers are overburdened with debt at a time when income falls sharply and are in consequence forced to default, the solvency of financial institutions may be imperiled with disastrous effects on the economy. Commercial banks have moved more and more deeply into the consumer credit field in recent years. They now supply directly or indirectly (via loans and discounts to consumer dealers) the majority of the credit made available to consumers. The commercial banking system has become more vulnerable to declines in the quality and the resulting losses on consumer loans. However, delinquencies, repossessions, and losses on

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[23] Actually, of course, credit extensions may have effects on expenditures for nondurable goods and services. For example, if credit were not available to a consumer to buy a television set, he might buy the set anyway and curtail his spending on nondurable items. Nevertheless, it seems likely that the effects are fairly concentrated on durable goods.

consumer loans have been low up till now.[24]

A consideration of the various effects of consumer credit on stability leads to the conclusion that it is not a device which enables consumers indefinitely to buy more than they could buy for cash. During the period while credit is in process of expansion, consumers can buy more than they could for cash. But when credit is in the process of contraction consumers can not buy as much as they could if they had no debts to pay and were able to use their incomes to make cash purchases. This expansion and contraction of consumer credit makes for economic instability.

D. Consumer Credit and the Individual Consumer

Different motivating forces influence the individual consumer to use his credit. In most cases the motivating interest may be one of the following reasons: (1) because of a desire to raise his standard of living or to increase his enjoyment, (2) because of the convenience offered by the use of credit, (3) because of necessity.[25]

Primarily the individual uses credit as a means of increasing the satisfaction which he can obtain from life. Credit enables the individual to have and enjoy things now, rather than postpone purchase and use of these things until an indefinite future time. By the use of credit he is able to obtain the use and service at present and defer payment until

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[24] This was the impression of the most of the bankers interviewed.

[25] Cole and Hancock, Consumer and Commercial Credit Management, (Illinois: Richard D. Irwin, Inc.), 1960, p. 11.

the future. The alternative would be for him to accumulate funds, through saving in order to be able to buy the article desired.

Because the individual can use credit as a means of payment rather than having to save and accumulate funds, the range of goods which are available for his choice is increased. There are certain commodities which have a high unit value and would be difficult for the individual to accumulate cash in advance to pay for them immediately. One of these is a car. In the development of our modern economy there has been added to the customary scale of living a number of other commodities of this same type. If this credit device were not available to the individual consumer, very few of the lower and middle income groups would be able to use and enjoy these commodities. Once an individual has made the purchase he is more or less impelled to make regular payment by the terms of the contract he has signed. Were he not under contract and instead were attempting to save in advance of the purchase, it is rather doubtful if he would be able to accumulate the necessary funds. It is more likely that day-to-day temptations would arise and he would spend his income in what might be called "non-lasting" purchases.

Another important reason for using credit is simply convenience. This explains the use of charge accounts. Many people prefer to buy on account although they have cash on hand. They find it more convenient to ask the storekeeper to charge their account than to carry the cash. Also when they have a charge account at the store any member of the family may be sent to the store without worrying about the cash. It may also facilitate the process of household budgeting to have the merchant assume part of the responsibility for keeping the household accounts.

A third reason why many people use credit can be described as necessity. Many a time an individual is faced by an emergency for which he has not budgeted: birth, death, sickness, and similar events which demand a large immediate sum. Not having a reserve sufficient for the occasion, the individual is pressed by what he regards as an emergency to secure a loan or to use his credit for goods and services.

Having analysed the reasons for which a consumer uses credit it is appropriate to say a word about whether the consumer is wise or unwise in using the credit. The use of credit often imposes a cost. Instalment buying carries charges with it and places the cost of the credit directly upon the buyer. Charge account credit, frequently, means trading at stores which may have sometime a slightly higher price than would be available if the purchase were made at a strictly cash store. The only criterion by which we can judge whether the individual has been wise or not in using credit is his own judgment. If he actually knows what it is costing him, and if he still buys on credit, and if he feels that the additional satisfaction obtained by the use of credit is greater than the cost of credit, then we must conclude that it has been a good bargain from his standpoint. As was suggested before the individual should be fully informed as to the charges which he will have to pay, and if then his decision is in favor of making a credit purchase, no one should interfere with his freedom of choice since we are living in a society in which the individual enjoys the freedom of choice.

On the other side, credit is, apparently, an easy way to purchase and it is necessary for the individual using credit to make two calculations as to future circumstances. "First, the future enjoyment he will obtain from the things he is getting now, and second, the future difficulties he will suffer from the necessity of having to make payment at some time in the future."[26]

"There is a natural tendency to exaggerate the pleasures of the present and to minimize the difficulties of the future."[27] Individuals have an optimistic view that it will be quite easy to make payment in the future. He also thinks that his income will increase, and he will find it easier to pay them, than it would be now. Also, we all are inclined to feel that present pleasures are better than postponed pleasures. For that reason we are anxious to have the thing we are considering purchasing and it seems that it will be quite easy to pay when the time comes.

There is also a great difficulty in calculating the cost of credit. These costs are usually concealed. Credit is offered by the seller in order to increase his volume of sales and so he attempts to quote the cost of credit in such a way as to make it appear as small as possible. The calculations are difficult for the customer and often are beyond his mathematical ability.

There are some errors and abuses in the use of consumer credit. These may be on the part of the buyer as well as on the part of the seller.

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[26] Ibid., p. 56.

[27] Ibid., p. 57.

It is not a good judgment to criticize the entire credit mechanism because occasionally some individuals misuse it.

E. Summary and Conclusion

The effect of consumer credit on the banking industry was discussed from the points of view of liquidity, safety and profitability. From the liquidity point of view some banks are discounting or advancing against relatively long term notes. This practice tends to impair the liquidity of the bank. Banks, however, have been granting long term loans indirectly even before consumer credit was introduced on this large scale. If banks keep on relaxing their terms of credit they might impair their safety. The easiness of credit might drive many businessmen to extravagance in their personal lives and precipitate their eventual insolvency. Bankruptcies inflict heavy losses on banks and thus impair their safety.

Consumer credit seems to be one of the factors that have helped in expanding banking activities, and increasing banks' customers and thus added to the banks' profits.

Consumer credit may have increased consumption at the expense of national savings. Increased consumption might be an incentive to consumers to work hard in order to earn enough money to buy the articles desired. Moreover, greater consumption might lead to greater sales turnover, and thus to expansion in the business activities. Instalment selling induces people to exert more effort, thus increase their income, and at the same time, greater possibility of increasing their savings.

During the past four years credit have expanded and the cost of living have increased. Normally, the expansion of credit would increase the demand and with a given supply prices would rise. In Lebanon the expansion of credit has affected prices but not as supposed to be because there were other factors that worked in the opposite direction.

Credit usually permits the borrower to make purchases which he might not be able to make at that time without credit. If credit is extended freely during good times and then the credit grantors curtail the terms and press collection of outstanding debts during bad times, there is a tendency for buyers to curtail purchases. So, consumers increase their purchases during good times and curtail them during bad times, so as to repay outstanding debts. It seems that many forms of credit have this characteristic and there is nothing about consumer credit which makes it a worse performer or a better one than other forms of credit. The over-buying in good times made possible by consumer credit must be paid for by under-buying in bad times. Thus consumer purchases fluctuate over various phases of the business cycle and thus leads to economic instability.

An individual consumer uses credit for several reasons either to raise his standard of living, or because of convenience, or because of necessity. The criterion against which we can judge whether the consumer is wise or unwise in using his credit is his own judgment. If he actually knows what it is costing him, and if he still buys on credit, and if he feels that the additional satisfaction obtained by the use of credit is greater than the cost of credit, then we must conclude that it has been a good bargain from his standpoint.

CHAPTER FIVE

CONCLUSIONS

A. Summary

Consumer credit is a system of retail trading which is in essence an extension of credit to consumers, under some form of contract by which the consumer agrees to make partial payments at stated intervals over a period of months or even years.

Contrary to the belief of some people, the use of consumer credit is not a modern business development. The buying of goods to be paid for at some later date is an old practice. There is much documentary evidence that consumer credit played an important role in ancient societies. Some of this evidence has been uncovered by the archeologists, and the Bible provides us with numerous references to credit practices, and to the behavior of debtors and creditors. Historians tell us of many early uses of consumer credit. Paul Einzig, an English monetary authority, makes reference to the fact that in many primitive societies, with no trace of a medium of exchange, transactions involving credit in kind played an important part in the life of primitive communities.

In a developed financial market, such as that of the United States, the credit needs of consumers of small means are met by several types of credit agencies. These agencies include pawn shops, industrial banks, consumers' co-operatives, government agencies, insurance companies, commercial banks and dealers in consumer goods.

Lebanon lacks some of the institutions mentioned above. Institutions that finance consumer credit in Lebanon are dealers in consumer goods, discount houses and commercial banks. Dealers in consumer goods finance consumer credit directly, while discount houses finance consumer credit in three ways, first, by making direct loans to consumers; second, by discounting consumers' instalment notes held by retailers; and, third, by making advances against consumers' instalment notes. Commercial banks finance the largest share of consumer credit. They finance it either by discounting consumers' promissory notes or by making advances against them.

There are several instalment plans in practice in Lebanon; namely, first, the conditional sales contract; secondly, the mortgage arrangement which provides for the transfer of title to the buyer, with the property subject to a lien for the unpaid selling price; thirdly, the hire-purchase plan, under which the property may be considered as leased until the purchase price is fully paid, at which time title passes to the buyer. There is a law that was passed in 1935 which organizes credit sales under the former arrangement. The latter two arrangements, though not provided for in the law, are recognized by the Lebanese courts.

The fact that a law was passed in 1935 to regulate the sale of cars and of agricultural and industrial machinery on the instalment plan indicates that the sale of cars on instalment was practiced even before 1935. The terms of instalment credit in application, however, have undergone a far-reaching evolution. The sale on credit of home appliances started around 1950 in Lebanon. The present terms of credit have undergone great changes. Sometimes distributors advertise that no interest is charged for the first twelve months, but what happens is that they sometimes add 5% to the price in lieu of charging interest. In the final analysis it all comes to the same thing.

In the car business, credit facilities have increased sales by about 50% and in the home appliances by about 100%. Apparently, the majority of the customers are not cost conscious; they tend to think of the cost in terms of the downpayment only. This is one of the reasons why consumers are attracted by the new terms of credit.

It is difficult to estimate the pure interest rate which the consumer pays on his instalment buying because of the fact that, in addition to the charges added, the costs of financing are included in the payments made, and are amortized by the periodic payments. In general, the gross cost of the credit usually ranges between 12% and 30% per annum.

In evaluating the credit of a customer, dealers have to depend upon their own judgment since there are no credit agencies to refer to. It seems that large dealers have succeeded in this field more than small dealers probably because they are more experienced.

The sales figures of cars and home appliances were taken as a basis for determining the volume of consumer credit in the market. The total credit sales of private cars (new and used) plus home appliances (refrigerators, radios, television sets, washing machines, ranges and stoves), amounted to around LL 120,205,720 in 1961. This figure is estimated to represent 60% of the consumer credit market. On this basis, the total consumer credit market is estimated to be around LL 200,000,000 in 1961.

The growth of consumer credit has probably induced long term notes into the note portfolios of banks, thereby leading to some weakening of the banks' liquidity position. The banks' safety is likely to be jeopardized if traders take advantage of the relatively easy access they have to the banks' credit facilities and expand their business activities beyond their financial abilities. But as long as the credit is not misused by businessmen, and as long as businessmen are making profits over and above the interest charged by banks, they would presumably be able to settle their accounts at the maturity date; and in this sense granting credit would be safe. Moreover, consumer credit has played an important role in the expansion of banking activities, and thus have contributed to the increase of its profits.

Consumer credit has probably encouraged consumption through the facilities it has granted. Increased consumption has increased imports, and thus resulted in a loss of foreign balances. Two propositions, however, may be advanced in this connection. On the one hand, there might have been an increased incentive for consumers to work hard in order to earn enough money to buy the articles desired. Moreover, greater consumption might lead to greater sales turnover, and thus to expansion in business activities. On the other hand, if consumption increases, national savings out of a given level of national income decrease. Individual savings, however, might even increase if consumer credit induces people to exert greater effort to earn a greater income.

It was found that during the past four or five years prices have risen and consumer credit has expanded. Normally, the extension of credit increases demand, and with a given supply prices tend to rise. In Lebanon, this may not be the case because of the relatively free import policy applied by the government, and because, as previously indicated, other factors have been at work which generated a downward pressure on prices.

Instalment sellers usually tend to ease credit conditions during upswings and tighten them during downswings because of changes in their attitude toward the risks of consumer loans. Consequently, consumers increase their purchases during good times and curtail them during bad times. The over-buying in good times made possible by consumer credit must be paid for by underbuying in bad times. The fluctuation in purchases over the various phases in the business cycle, is a factor contributing to general instability in the economy.

An individual consumer uses credit for several reasons, either to increase his satisfaction in life, or as a convenience, or as a necessity. There is no uniform standard against which an individual can be judged as to whether he was wise or unwise in using credit. The criterion is his own judgment. If he actually knows what it is costing him, and if he still buys on credit, and if he feels that the additional satisfaction obtained by the use of credit is greater than the cost of credit, then we may conclude that it has been a good bargain from his standpoint.

B. Conclusions

It would be appropriate at this stage to restate our principal conclusions on the basis of which some policy recommendations may be made.

1. In comparison to developed financial markets, Lebanon lacks a variety of credit agencies. The presence of some of them would, on the one hand, relieve commercial banks from a good part of long-term financing and make it possible for them to concentrate on loans of short maturity. Short-term credit constitutes a significant element of liquidity for banks in Lebanon. On the other hand, it would relieve consumers from paying exorbitant rates of interest. The institutions needed should be in a position to extend loans of sufficiently long maturities to finance the instalment purchases of consumers.

Among the agencies that would be appropriate for extending such a kind of credit are industrial banks and consumer co-operatives.

The term industrial bank refer to an organization which would specialize in small loans to wage earners. Since it is difficult to get small loans from the existing credit institutions, and if obtainable it is at a relatively high rate of interest, there is an obvious need for specialized suppliers who could afford to furnish this type of loan at lower costs.

The same object can be achieved by the establishment of what may be identified as consumers' cooperatives. It would be advisable for the co-operative to be organized by a group whose members know one another well. The reason for this is that, in making loans, the co-operative must be in a position to know or find out with little trouble the credit standing of each applicant. Moreover, a close association among members generates a moral pressure on the borrower to repay his loan, and thus the risk of loss would be decreased to a minimum.

The emergence of such institutions would decrease the costs to consumers, increase their purchasing power, and spare the dealers the risk of bad debt losses.

2. Lebanon lacks credit rating agencies which are supposed to supply businessmen with credit information about consumers. Also, the responsibilities and authorities of the "Central Des Risques" which is operated by the Banque de Syrie et du Liban may be reconsidered with a view to enhancing its effectiveness.

The establishment of credit rating agencies would in all likelihood play an effective role in reducing the bad debt losses which many of the small instalment dealers have been painfully suffering. Also it would enable merchants stimulate their sales by broadening and promoting their credit activity.

More effective use can also be made of the "Central Des Risques" office, and this can be achieved if the government takes such measures as, for example, forcing them to supply correctly all the information needed. Alternatively, the initiative for such organized action may well come voluntarily from the Bankers' Association. One of the measures which may have to be considered in order to improve the effectiveness of the "Central Des Risques" is relative to the minimum size of loans about which the member banks are obligated to submit information. At present, only credit exceeding LL 50,000 has to be brought to the attention of the "Central Des Risques," which in turn would bring same to the attention of the member banks. It seems to the writer that the present limit leaves out a good part of the consumer credit accommodated by banks in Lebanon.[1]

Once banks are able to get the right information about the credit standing of their prospective customers they would be in a better position to decide whether to grant them credit or not. If this system is applied properly, it becomes difficult for businessmen to borrow more than they are worth, and thus the risk of default is minimized.

3. Consumer credit has encouraged consumption of durable goods. The contribution of the increased consumption to national income would have been obvious if the consumer goods were manufactured locally. Lebanon, however, is an importing country and a major part of the increased consumption tends to take the form of increased imports, leading to a widened gap between the country's international revenues and expenditures on income account.

Moreover, manufacturers abroad are committing their agents in Beirut to a minimum figure of sales per year. Those dealers who fail to discharge their obligation run the risk of losing their agency. This practice is compelling some agents to import more than the market can bear under normal conditions. In order to be able to sell the quantity required, dealers have had to extend the period of credit, to lower the downpayment, and sometimes to pass the downpayment required. Some-

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[1]The Bankers' Association has decided to introduce some reforms aimed at making the "Central Des Risques," a more reliable source of credit information about borrowers. See "Experts are asking for organization of instalment sales," Al Kifah Daily, Beirut: May 25, 1962, p. 5.

times agents have had to sell regardless of the terms of credit in order to keep the agency. This is believed to have been the most significant factor in the economic crisis experienced in the first half of 1962 as well as in previous economic crises.[2]

4. Apparently consumers are not fully aware of the true cost of instalment purchases. They are attracted to this kind of business partly because they are not cost conscious and they tend to think of the cost in terms of the downpayment only. If consumer credit continues to grow at the rate witnessed in the past few years, it is bound to pass the safety level in relation to individuals' incomes. The rate of default on the part of consumers might increase as a result and cause financial embarrassment to retailers as well as to banks.

Any attempt to deal with this problem should include an effort to make consumers fully conscious of the burden of their debts. This of course presupposes full disclosure by dealers of the true costs of instalment credit.

A useful lesson may be learned in this connection from the experience of the United States. Senator Paul H. Douglas of the United States has put before the Senate a "full disclosure" bill requiring that the vendors to tell their credit customers in plain terms the full cost of credit they are granted. In other words, the dealer would be required under the proposed bill to write down for the customer before the credit transaction is completed the delivered price of the article, the amount

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[2] Ibid.

of the downpayment, the difference between these two figures, itemized charges not connected to the credit, the total amount to be financed, the finance charge, and the percentage of this charge expressed as a simple annual rate on the outstanding unpaid balance. A customer who is not supplied with complete information could sue the merchant for twice the credit charge plus attorney and court costs. Any retailer who violates the law would be subject to a $5000 fine plus a year in jail.[3]

It seems to the writer that some such action is needed in Lebanon. It is believed that most consumers would refrain from making excessive expenditures if fully informed as to how much credit purchases are costing them.

It should be noted in closing that the writer was mainly concerned in this study with showing the problems that have arisen out of consumer credit practices and their implications on the economy. The solution to some of these problems, however, involves ramifications whose treatment fall beyond the scope of this paper. It should be clear by now that the problems connected with consumer credit cannot be discussed in isolation of over-all problems related to banking, trade policy, public policy as regards the role of the government in economic life, and the like.

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[3]"Truth in Lending, Bill Argued," Business Week, July 22, 1961, p. 32.

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