INDUSTRIAL CREDIT IN LEBANON

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It remains to be said that the views are strictly the author's. He is therefore solely responsible for them as well as for any shortcomings or inaccuracies that the study may contain.

ABSTRACT

In the past two decades, Lebanese industry experienced a significant growth in both its contribution to the national income and in the number of people it engages. These developments have stimulated the increasing interest of both the public and the private sectors in industry. This study is an attempt at unveiling the implications of the shortage of industrial credit and the factors which have been responsible for it.

The evidence is clear that the supply of medium and long term credit falls short of the demand for it. The supply side has been studied by reference to the various existing credit institutions. The demand side of credit has been studied through first hand investigation carried in relation to five major industries namely: food, beverage, textile, cement, and metallic. The general conclusion was that short term credit is plentiful while medium and long term credit is in short supply.

The absence of specialized institutions apart from BCAIF, coupled with a mounting interest in industrialization, have led to the proposal of establishing a development bank. As far as industrial credit is concerned, there is very little

that can be said for the establishment of a new development bank, and the indications are that BCAIF can be conditioned to accommodate a rising demand for industrial credit. Once BCAIF's statutes are amended and made to agree with the government's industrial policy, when one is drawn, then it may be able to increase its resources significantly by floating bonds and by calling on regional and international financial institutions.

The government's role in industrial credit has been discussed with reference to the development bank project, the new draft banking legislation, and the need for fiscal reform to encourage the corporate form of enterprise which would in due course activate the Lebanese Stock Exchange.

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CHAPTER I

INDUSTRY IN LEBANON

A. STRUCTURE OF THE ECONOMY

The Lebanese economy is predominantly an economy of services. The services sectors contribute approximately two-thirds of the total national income of the country. Trade accounts for about half the income arising in the services sectors or one-third the aggregate national income. The other half is generated by tourism, international trade, insurance, banking, and allied financial activities. The agricultural sector leads the goods producing sectors with an 18 per cent share in the national income. The industrial sector follows with a contribution to the national income which has declined from 13.9 per cent in 1952 to 12.2 per cent in 1961. The IRFED Mission estimates a growth in the relative share of the industrial sector in the national income to about 16 per cent by 1975.[1] Table I shows the contribution of the various sectors to the national income during the years 1952-58 and 1961.

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[1]Privately secured from IRFED Mission - an economic mission which works in coordination with the Ministry of Planning in drawing up a plan for the economic development of Lebanon.

TABLE I

NATIONAL INCOME IN LEBANON
PERCENTAGE CONTRIBUTION 1952 to 1958 AND 1961

	1952	1953	1954	1955	1956	1957	1958	1961
Agriculture	19.4	18.9	17.9	16.0	16.0	15.8	16.5	18.5
Industry	13.9	13.8	13.2	12.7	12.9	12.6	13.7	12.2
Construction	4.3	4.0	4.8	4.4	3.5	2.7	2.9	3.9
Transportation and Communication	4.0	4.3	4.8	5.5	5.5	5.3	4.3	3.8
Commerce	29.9	29.5	29.0	29.6	28.9	31.2	27.5	26.7
Banking	4.5	4.4	4.5	5.1	5.7	6.1	7.0	6.1
Real Estate	8.8	8.7	8.9	8.4	9.2	9.2	11.7	10.8
Government	5.7	6.1	5.8	6.0	6.7	7.2	8.5	8.5
Services	9.5	10.5	10.7	12.0	11.3	9.9	7.9	10.1
TOTAL (rounded)	100	100	100	100	100	100	100	100

Source: Percentages calculated from Paul Klat, "The National Income of Lebanon", <u>Middle East Express</u>, No. 5 (April 2, 1962), p. 3.

In terms of the volume of employment it provides, agriculture stands out as the most important sector in the economy, engaging 51 per cent of the labor force, followed by industry with 20 per cent, and trade 18 per cent. Table II shows the breakdown of employment by sectors and Table III sets forth the IRFED Mission estimates of the distribution of employment as it will be by 1975.

TABLE II

LABOR FORCE IN LEBANON IN 1962

	Employers (000's)	Employees (000's)	Total (000's)	Percentage of Sector to Total
Agriculture	125	95	220	51
Industry	12	75	87	20
Commerce	26	53	79	18
Others (independent businessmen and professionals)	20	28	48	11
TOTAL	183	251	434 (1)	100
Government 1. Permanent Civil Servants			16	
2. Daily Workers			13	
TOTAL			29 (2)	
Total (all other daily workers)			117 (3)	
GRAND TOTAL (1)+(2)+(3)			580	

Source: <u>L'Orient</u>, December 1, 1962, p. 2.

TABLE III

EXPECTED GROWTH OF THE EMPLOYED LABOR FORCE ACCORDING TO MAIN SECTORS OF THE ECONOMY 1957 AND 1975 (In L.L.000's)

Sector	1957	1975	Percentage Increase
Agricultural	220	265	21
Manufacturing	54	101	87
Construction	33	42	27
Transport	24	39	58
Commercial	53	68	28
Miscellaneous	66	102	54
TOTAL	450	616	37

Source: IRFED Mission, Lebanon. See Paul Klat, "Small Industries in Lebanon", Middle East Express, No. 9 (April 30, 1962), p. 4.

Lebanon, which has an area of only 10,000 square kilometers, is poor in mineral resources. Aside from lime stone and some small deposits of iron ore in north central Lebanon, there is little to speak of. Electric power is in short supply in many areas and all the country's requirements of mineral oils and fuels are imported. The strategic geographic location of the country and its pleasant climate have contributed to the growth of tourism and trade. The people, realizing the paucity of their country's natural mineral resources have tended to steer economic activity in the direction of services. The pattern of social orientation, as reflected in the interest of the Lebanese to travel and migrate, has strengthened further the growth trend of the non-commodity sectors. The Lebanese emigrants, who are engaged in technical and professional services abroad, form an important source of foreign exchange to the country. Emigrants' remittances in 1960 amounted to L.L.75 million.[1]

The system of roads in Lebanon is adequate to serve the needs of a developing economy. The port of Beirut with its 106,600 square meters of free zone area and the modern international airport form together an efficient network connecting the country with international markets.

B. INDUSTRY: EVOLUTION AND STRUCTURE

Prior to World War I few factories existed and manufacturing was limited to handicrafts.[2] In the inter-war period, the mandatory authorities in Lebanon did not favour a policy of industrial growth, apparently in order not to jeopardize the position of French exports to Lebanon.

During the Second World War industrial growth was

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[1] Khalil Salem, "Lebanese Balance of Payments For 1960", Al-Raid al-Arabi, No. 19 (May 1962), pp. 11-14.

[2] Alexander Gibb and Partners, The Economic Development of Lebanon (1948), p. 128.

stimulated by the shortage of imports which was occasioned by the war conditions.[1] A further impetus to industrial growth was provided by the large expenditures on consumption by the allied armies stationed in the country. On the other hand, industry was handicapped by the patent shortage of raw materials and by the difficulty of renewing equipment and obtaining spare parts. Production under technically primitive conditions was profitable during the war and many of the manufacturing concerns succeeded in amortizing the costs of their plants in a short period of time.[2] In 1946-47, some renovation of capital equipment was induced by the increased foreign competition. Some of the industries which were built during the war collapsed in the face of the mounting competition of imported products. In the late forties, Lebanese industry was labouring under a heavy burden of overcapitalization which impaired its competitiveness.

In 1950 the chain of events carried an unhappy surprise to industry, namely the ending of the customs union with Syria. As a result, the local market which previously comprised Lebanon and Syria has now contracted.[3] On the other hand, the Korean War, which engaged a great number of factories in

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[1] Yusif A. Sayigh, Economic Development of Lebanon, Its Prospects and Problems (Baltimore: Johns Hopkins University, October 1955), p. 21.

[2] Gibb, op.cit., pp. 128-29.

[3] U.N., Department of Economic and Social Affairs, Economic Developments in the Middle East, 1945-54 (New York: U.N., 1955), p. 157.

Europe and the United States in the production of war goods gave a strong impetus to Lebanese industry by relieving it for some time from foreign competition.

A census of industry was undertaken in 1955 by the Ministry of National Economy with the technical assistance of the Economic Research Institute at the American University of Beirut. It covered 1861 establishments which engaged a total number of 35013 workers. Table IV shows the number of persons employed and the total value added by five major groups of industries.

TABLE IV

NUMBER OF PERSONS ENGAGED, AND VALUE ADDED BY INDUSTRY (SELECTED MAJOR GROUPS)

Industry	No. of Persons Engaged	Value Added (LL000's)
All Industries	35,013	154,879
Metal Mining, Stone Quarrying Clay and Sand Pits	779	1,604
Food Manufacturing, Except Beverages	6,468	36,270
Beverage Industries	1,040	8,024
Textiles	6,049	15,589
Petroleum Refineries, and Cement Manufacturing	1,825	22,727
TOTAL	16,161	84,214
Percentage of total to All Industries (Rounded)	46%	54%

Source: Ministry of National Economy, Industrial Census 1955.

The census revealed that there were 1031 establishments employing five to nine workers, 581 employing ten to twenty-four, 149 employing 25 to 49, 60 employing 50 to 99, and 40 employing 100 workers or more. The census excluded undertakings operating with less than five workers (employer included). The census further showed that 86.6 per cent of the establishments studied employed less than 25 workers. This reflects the prevalence of small-size family-type enterprises throughout the country.

The 1955 industrial census has been the only census ever undertaken. More recent figures relative to certain aspects of industrial activity are available, but these are mere projections as to the pattern of development in industry. Although the 1955 census is by now out of date, there seems to be no reason to believe that the conditions of Lebanese industry have changed substantially since then.

Besides the information which was supplied by the 1955 industrial census, there are some data, rough as they might be, related to capital formation in industry. The share of the public sector in industrial investment is rather small. Gross fixed capital formation comes primarily from private domestic savings which contribute a share of 80 per cent while 20 per cent comes from outside sources.[1] Apart from

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[1]Food and Agriculture Organization (FAO) of the United Nations, Lebanon (Rome: U.N., 1959), p. 25.

the tobacco monopoly the industrial sector in Lebanon is entirely a private sector. Capital formation in the industrial sector has shown a constant contribution of L.L.15 million per annum from 1951 to 1954. The figure declined to L.L.13 million in 1955 only to rise to L.L.24 million and L.L.27 million in 1956 and 1957 respectively.

One of the most striking features of Lebanese industry is the predominance of family firms. Family firms are deeply rooted in the pattern of business organization in Lebanon. Industry is mainly built around family firms which are only too often disguised in the corporate form. The partnership and individual proprietorship are the leading forms of organization of business in Lebanon, industry being no exception.[1] The number of corporations in the industrial sector is apparently growing at a faster pace than in other sectors. The strong desire to be independent and to act alone or only in association with a small group of friends or relatives explains in part the existence of only a limited number of corporations with a large group of shareholders.

Industry in Lebanon suffers from a shortage of skilled labour. The system of education has produced a relatively high level of literacy, "though of doubtful immediate value for purposes of fast economic growth."[2] From the point of

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[1]Yusif A. Sayigh, Entrepreneurs of Lebanon (Massachusetts: Harvard University Press, 1962), pp. 56-57.

[2]Ibid., p. 3.

view of economic development, one may consider the supply of scientists, engineers and economists to be much less adequate than that of lawyers and poets.[1] Labour, especially the unskilled, is cheap by western standards but its low productivity results in a relatively high per-unit cost of manufactured products.

The domestic market on the other hand is narrow, and competition in many lines is severe. The main reasons for the narrowness of the market are the small size of the population (which is less than two and a half million) and the relatively low per capita income. At the dollar rate prevailing at the end of 1961, the per capita income in Lebanon stood at about U.S.$ 420.[2] The maldistribution of income has limited what the non-rich classes can spend on consumption. There seems to be no indication that the gap in the distribution of income has been narrowing down in the post-war period.[3] Moreover, the wide variety of tastes among the population and the western habits which are widely spread have engendered a market preference to imported goods. The visible imports and exports amount to about 60 per cent of the total national

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[1] Ibid.

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

[3] FAO, op.cit., p. 15.

income, imports alone forming about 50 per cent. This is a very high percentage as compared with other countries such as the United States, Britain or even Norway where the corresponding import-to-income ratios are 3, 24, and 40 per cent respectively.[1]

Tariff protection on industrial products ranges up to sixty per cent. The latter rate amounts in effect to approximately 40 per cent only, as the tariff rate is applied on the so-called official rate of L.L.2.19 to the United States dollar rather than the average market rate of three pounds to the dollar.

The Lebanese economy is characterized principally by a minimum of government interference in, or control of, economic activity. "The Lebanese economy is as close to the classical 'laissez faire' model as one can expect in the modern world."[2] The country enjoys a liberal economic policy. Fiscal policy, for example, which affects saving and investment activity through taxation is apparently not oriented to any specific goal other than revenue collection to meet ordinary government expenditures. The budget is not yet utilized as a dynamic tool for stabilizing the internal price level or for the redistribution or rechannelling of income nor as a tool for economic development.[3]

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[1] _Ibid._, p. 2.

[2] _Ibid._, p. I-6.

[3] Elias Saba, "The Lebanese Budget", _Al-Raid al-Arabi_, No. 6 (April 1961), p. 17.

Government direct investment in industry is limited to the ownership of the tobacco monopoly and to a few electric power companies in the country. The state has exerted an influence on industrial development through a number of measures, of which the following may be worth a brief comment.

1. In 1953 the government set up an Industry Institute (now known as the Industrial Research Institute) with the cooperation of the Association of Lebanese Industrialists and the United States Government. The Institute's purpose is research, analysis and the setting of standards. A number of private concerns have utilized the services of the Institute, but the novelty of the idea of scientific business research in the country, and the costs involved have precluded the use of the Institute's services by industries on a wide scale.

2. In 1953 the government issued a decree preventing the import of second hand machinery. The decree aimed at limiting the import of inefficient, out of date equipment. But, as some have argued, second hand machines are not necessarily inefficient and, in certain instances, may help to reduce the costs of production. Some, on the other hand, expressed the fear that this decree may tend in the long run to suppress the small manufacturer leaving only the big who could afford buying new equipment.

3. A law was passed in 1954 aimed at encouraging the

establishment of new enterprises.[1] It exempted companies established during the five years following the issuance of the law from income tax for six years. The corporation exempted should be set up with a fully paid up capital of at least one million pounds, disbursing a minimum of L.L. 100,000 annually in wages and having as its object the introduction of an absolutely new product to the market. The effective term of the law has been extended as from 1959 for a further period of six years ending on the third of February 1965.[2]

4. Since the middle forties, a number of trade agreements have been concluded. Trade and payment agreements concluded with the Eastern Bloc were designed to promote Lebanese agricultural exports, whereas agreements with other countries were of the commercial treaty type providing for the most favoured nation treatment and reflecting the desire on the part of the contracting states to facilitate trade between themselves.

The existing General Arab Trade Agreement exempts from duty all agricultural and mineral goods and lowers by 25 per cent the tariff on industrial goods comprising at least 50 per cent local raw materials and labour.[3] In 1956,

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[1] Al-Jarida al-Rasmia, No. 6 (1954), p. 59.

[2] Middle East Express, No. 37 (November 12, 1962), p. 3.

[3] Burhan Dajani, L'Economie Libanaise et Arabe, IX, No. 71 (January 1959), p. 22.

it was decided to lower by 50 per cent the duty on certain industrial goods listed in supplementary schedules. The administrative barriers (such as quotas, licenses, and unofficial boycotts) have discounted the advantages of that agreement. Countries like Lebanon, applying very limited restrictions on international trade, can offer few concessions to other contracting parties.

Conclusions

From the preceding exposition one may conclude that industry in Lebanon suffers from a number of handicaps which include, among others, the narrowness of the market, paucity of raw materials, low per capita income and severe foreign competition. Industry, inspite of the numerous difficulties it has encountered, has succeeded in growing at a significant pace in the past two decades. The increasing experience acquired by industrialists and the promulgation of a number of government measures aiming at protecting local industry have given an impetus to industrial growth. The shortage of long term industrial credit, as will be demonstrated in the following chapter, stands out as another handicap to industrial development which deserves a special attention.

CHAPTER II

THE SUPPLY OF INDUSTRIAL CREDIT

The sources of supply of industrial credit may be grouped into three categories: trade credit, non-banking financial institutions, and commercial banks. The latter source will be discussed at some length as it plays a major role in industrial credit.

A. TRADE CREDIT

Trade credit is the least formal of all forms of financing, yet it has tended recently to become more formal with the increasing interest that foreign governments have shown in guaranteeing such credits. Trade credit has been most widely used by the growing manufacturing concerns which are in need of more machinery and equipment. In addition, established industries which depend on foreign raw material imports tend to use this source of credit extensively.

A significant volume of trade credit has been available from foreign suppliers. Local suppliers have seldom been a regular source of trade credit. Thus, in most cases, industries which depend on local credit have to accept the irregular accommodations of local suppliers. This has been the case with many small-size concerns in the food and beverage industries, whose credit standing is not known to foreign suppliers. Local wholesalers of imported raw materials substitute their credit standing for that of the local manufacturer, and obtain credit from foreign suppliers. These wholesalers pass on the credit accommodations they obtain to the manufacturer. The wholesaler ordinarily charges the manufacturer a higher interest rate than that which he pays to the supplier to cover his interest expenses plus a certain margin. On investigation trade credit was found to be contracted on a short term basis and is, in frequent cases, interest free. The terms of trade credit are significantly affected by the conditions of international competition.

In the last decade or so a number of governments in Europe and the United States set up agencies whose function was to guarantee medium term credit extended by machine and raw material manufacturers to industrialists in different parts of the world. Of the European countries Germany has done this on the largest scale. It has set up two institutions to extend medium and long term credit. The first is Kreditanstalt fur Wiederaufban (KFW), which was established in 1948 and has been under the joint control of the central bank and the government. Its original aim was to help German industry to recover from the Second World War. After 1950, it directed its efforts to credit which helps to finance

German sales. Since 1959 it has been extending credit for five to ten years to foreign industries importing German goods with the guarantee of the German government; funds at its disposal amount to D.M.5 billion. The second agency set up in Germany, Ausfuhrkredit (AG), was founded in 1952 by a consortium of big German banks interested in export financing up to four years. It has a capital of D.M.270 million and has a discount line at the central bank of D.M.500 million. All loans of KFW and AG are guaranteed by the German government.[1]

In France two governmental institutions guarantee credit granted to importers of French products though on a smaller scale than those of Germany. They are Hermes Deckung and Compagnie Francaise pour L'Assurance Credit.[2] The government in the United Kingdom provides similar services through the Export Credit Guarantee Department.

In Belgium, L'Office National du Ducroire guarantees export credit up to five years against political risks in the importing countries. The activities of the latter institution continued to be marginal and supplementary to an institution set up in 1959 by twenty Belgian banks engaged in financing exports. Funds at its disposal amount to

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[1] Le Commerce Du Levant (Beirut), August 18, 1962, p. 5.

[2] Ibid.

B.F.4750 million and credit is granted for a period up to five years. A committee representing various banking institutions and governmental ministries have set the conditions and terms of rediscounting such credit. In 1962 a new pool was created in Belgium with a B.F.7 billion capital to guarantee export credit up to five years.[1]

In 1958 the Middle East Industrial Development Project Corporation (MIDEC) was set up in Luxembourg with a cosmopolitan group of businessmen from the United States, Canada, and ten European countries. The aim was to develop new industries with emphasis on small ones, through private means on a strictly commercial basis. Its capital is one million Swiss francs and its basic function is to bring together Arab capitalists and Western corporations which are ready to accept a minority interest. "For its services, it will receive 5 per cent participation in the equity capital of any company in the establishment of which it has been instrumental."[2]

The Investment Guaranty Program in the United States, now administered by the Agency for International Development (AID)(formerly known as the International Cooperation Administration (ICA), was set up in 1948 to help European reconstruction programs after the war.[3] The program later expanded into underdeveloped countries. It remained as a program of limited

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[1] Ibid.

[2] Roy Karaoglan, An Arab Development Bank: Its Practical and Theoretical Feasibility, Unpublished M.A. Thesis (A.U.B., June 1958), pp. 71-72.

[3] Marina von Neumann Whitman, The United States Investment Guaranty Program and Private Foreign Investments (New Jersey: Princeton University, 1959), pp. 1-2.

insurance against certain non-business political risks, namely: convertibility, blockage, expropriation, and war damages. The American beneficiary of this program is charged an annual fee. The minimum average term of insurable loans is three years. Lebanon has not yet signed an agreement to make use of this program. Jordan, Sudan, and Tunisia have participated in the program. Lebanon, with a minimum of quantitative trade restrictions and with no limitations whatsoever on remittances of profits or repatriation of capital or transfer of exchange, does not have much to gain by subscribing to this program.

The Foreign Credit Insurance Association (FCIA) in the United States, founded in 1961, is the first organization to extend medium term accommodations to American exporters on a large scale basis. The FCIA has been writing short term export credit insurance (for transactions on terms up to six months) since February 1962. Exporters, though, can insure against credit and political risks up to five years. Exporters will be covered against the loss of 85 per cent of the financed portion of transactionswhether the loss is the result of credit or political risks. Credit risks include insolvency, as well as the buyer's failure to pay for any other reason. Political risks include such government restrictions as war, revolution, civil commotion, and expropriation. The FCIA is formed by private insurance companies at the suggestion of the United States government through the Export-Import Bank. It is an unincorporated association open to all responsible insurance companies. Its membership now numbers seventy-one companies.[1] The credit insurance policies are offered to exporters through agents of member companies. One can easily point out two salient benefits to exporters. In the first place, exporters will be in a better position to extend credit to overseas customers as a substantial portion of the risks involved are covered by insurance. In the second place, exporters will be able to obtain financing more readily from commercial banks and other financial institutions where their foreign claims are so insured.

Foreign exporters have acted so far as the main direct channel through which local industrialists obtained credit from foreign sources. Credit agencies provide or guarantee the credit extended by the exporter. The agencies may, as is the case in Germany, advance funds to the supplier as soon as the goods are supplied. Thus the agency may, in effect, be the ultimate source of credit to the Lebanese industrialist. The German agencies which provide such facilities have been satisfied with the indirect benefits accruing to the German economy from an expansion of exports.

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[1] International Commerce (Washington, D.C.), Vol. 68, No. 5, July 9, 1962, p. 51; and No. 5, July 16, 1962, p. 9.

Other similar agencies in most countries do charge the supplier a fee for such a service. In most countries, other than Germany, different agencies provide simply an insurance against certain risks but do not provide the financing; the funds continue to be provided by the supplier. Needless to say, the supplier could resort without difficulty to different financial institutions to obtain the necessary funds as his receivables are insured by the credit agency. Lebanese industrialists in general do not call directly on the foreign agencies to arrange for credit as they get such accommodations indirectly through their suppliers.

In conclusion, one may say that there are a number of foreign sources of credit to finance mostly the import of machinery on a medium term basis. Our findings show that asmall number of local industrialists have arranged to get credit through the above mentioned sources. The type of credit supplied by these various foreign agencies is subject to certain limitations which restrict its use by Lebanese industrialists. The credit extended in most cases is not interest free but rather bears interest like any other bank loan or advance. Moreover, many of those agencies are not interested in financing small purchases of equipment by foreign industrialists and considering that the majority of industries in Lebanon are small concerns one can realize that many Lebanese industries do not fall within the field of interest of the various institutions.

The greatest difficulty that faces local industrialists is one of providing a bank guarantee for the credit offered by the foreign institution. The inability to provide a bank guarantee by most industrialists is due to two main reasons. The first is that the guarantee has to be for a period equivalent to that for which the credit is extended, and local commercial banks hesitate to grant guarantees for a period exceeding one year. The second is that the bank's charges for guarantees are often high. An industrialist who can pay a fee on the guarantee, and whose credit worthiness is good enough for a bank guarantee, is hardly in need of any credit from abroad. Another limitation of foreign trade credit is that it is commonly granted for the import of machinery rather than raw materials which many industrialists need to finance. Thus only firms purchasing machinery can benefit from the trade credit of those agencies.

B. NON-BANKING FINANCIAL INSTITUTIONS

The only non-banking source of industrial credit that exists now in Lebanon is the Banque de Credit Agricole, Industriel et Foncier (to be identified hereafter as BCAIF). The major part of the following section will thus be devoted to BCAIF. Insurance companies and the stock exchange (or the

Bourse) will be discussed only in so far as they constitute potential sources of industrial credit.

1. BCAIF

BCAIF may well be regarded as the successor of an older institution known under the name of Societe de Credit Agricole et Industrielle du Liban (to be identified hereafter as SCAIL). SCAIL was established in 1937 for a duration terminating in 1964, when the Banque de Syrie et du Liban (to be identified hereafter as BSL) concession expires. The initial capital of SCAIL was L.L.100 thousand which was paid in full by the BSL. In 1944 the capital was increased to one million pounds and a minority interest was taken up by banks and individuals. SCAIL borrowed from the BSL at 5 per cent to 6 per cent interest and granted loans at 8.5 per cent per annum.[1] The loans granted by SCAIL rarely exceeded five years and amounted to a maximum of 25 per cent of the value of the mortgage supplied. The government made available to it, through a special agency set up at the Ministry of Finance, the sum of L.L.41 million, of which only L.L.21 million were used. The agency studied every loan application and allocated its loan portfolio in the following manner: 46 per cent to agriculture, 40 per cent

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[1]Talha Yaffi, "Industrial Credit in Lebanon", L'Economie Libanaise et Arabe, Vol. 6, No. 47 (September, 1956), pp. 14-30.

to industry, and 14 per cent to hotels. In 1950 SCAIL started charging the government account at the BSL with all loans which were granted with the government agency's approval, but which were not settled within 15 days after maturity.[1] In 1955 the bad debts increased sharply and the government in order to facilitate repayment issued a decree allowing borrowers a period of ten years to affect payment without interest.

In general, the loans of SCAIL were more available to the large industrial concerns, namely those which could provide a mortgage security equal to four times the loan, than to the smaller concerns. Many an industrial concern hesitates to give a first mortgage on its property, fearing that such action would impair its credit standing. Political pressures had a decisive influence on the credit policies of SCAIL and precluded it from pursuing sound credit practices. The majority of loans granted out of the funds provided by the government's agency proved to be bad debts. In 1953 the government stopped guaranteeing loans through SCAIL and since then the latter's operations were limited to liquidating outstanding claims.

The only role that the government assumes at present in the field of industrial credit is embodied in its equity participation in BCAIF and its guarantee of some of the loans

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[1] *Ibid*.

that the latter contracted with the BSL. BCAIF was set up in 1954, with a capital of L.L.5 million, for the express object of providing medium and long term credit. Fourty per cent of the capital was contributed by the government and 60 per cent by private interests. In the period between 1955 and the first quarter of 1963, the bank received a total amount of L.L.70 million in loans from the BSL under a government guarantee. These loans were contracted for a period of 40 years and carried interest at 2 per cent per annum. In 1960 BCAIF obtained a $5 million loan from the Development Loan Fund bearing an interest rate of 4.5 per cent per annum.[1] Its resources which amounted as of the first quarter of 1963 to L.L.70 million (excluding the initial capital of L.L.5 million) plus $5 million, have been allocated in this manner: L.L.20 million and $5 million to industry, L.L.40 million to agriculture and L.L.10 million to tourism.[2]

BCAIF grants loans for working capital purposes for a term not exceeding one year. The amount of short term loans,

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[1]The Development Loan Fund whose name has been changed to the Agency for International Development (AID), is a United States government corporation. It was founded on December 31, 1959 and its function is to provide capital for specific projects and programs which contribute to economic growth in underdeveloped countries.

[2]Information privately secured from BCAIF's management.

as provided in the statutes of the bank, are limited to half the net annual earnings of the establishment regardless of the value of security offered. The security could be a personal guarantee, a mortgage, or stocks and shares deposited as collateral. The bank does not draw a clear line of distinction between medium and long term loans. Only recently did the bank modify its regulations to permit granting medium term loans (running up to 8 years) to concerns with a paid up capital of half a million pounds or more on a non-mortgage basis.[1] Before this modification was introduced all concerns had to provide a mortgage as security and the loans were not allowed to exceed 25 per cent of the paid-up capital. The same percentage still applies to unsecured loans. The security offered instead of the mortgage could be a bank guarantee with some restrictions on the dividend policy and the balance sheet structure of the borrowing firm. Long term loans which exceed eight years and run for as long a period as twenty years have to be secured by a mortgage. The loan may not exceed 35 per cent of the market value of the mortgage with no ceiling on the amount of the loan granted. The interest charged on credit extended in Lebanese pounds is 5.5 per cent, while interest on credit extended in United States dollars goes up to 6.5 per cent. The indust-

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[1] Talha Yaffi, "Industrial Credit in Lebanon", <u>L'Economie Libanaise et Arabe</u>, No. 106 (June, 1962), pp. 9-14.

rial credit activities of BCAIF are summarized in Table V. The breakdown of industrial loans by district is presented in Table VI.

TABLE V

BCAIF'S INDUSTRIAL LOANS

Year	Number of Loans	Outstandings at the Year End (in L.L.000)
1955	22	980
1956	115	5,879
1957	197	10,618
1958	222	11,267
1959	346	17,022
1960	N.A.	26,012
1961	N.A.	29,700

Source: Ministry of National Economy, Bulletin Statistique Trimestriel, 4 eme Trimestre, 1957 and BCAIF's Annual Reports, 1959, 1960, 1961.

The approximately L.L.20 million and $5 million allocated by BCAIF to finance industrial credit fall considerably short of meeting the requirements of industry for credit even under the present terms and conditions applied by BCAIF. The volume of credit extended by BCAIF to industry is, as has been asserted by all the bankers interviewed, only a small fraction of the volume provided by commercial banks to local industry.

Thus, one may say that the role played by BCAIF in industrial financing is quite limited and meets only a minor part of the aggregate volume of credit demanded by industry.

TABLE VI

GEOGRAPHIC DISTRIBUTION OF BCAIF'S INDUSTRIAL LOANS AS AT THE END OF 1961

District	Outstandings (in L.L.000's)
Beirut and Mount Lebanon	17,853
Beka'	2,206
North Lebanon	8,608
South Lebanon	1,033
TOTAL	29,700

Source: BCAIF's Annual Report, 1962, p. 9.

2. Other Institutional Sources

a. Insurance Companies

The majority of insurance companies operating in Lebanon are branches of foreign companies. The law of January 1955, as amended by the law of February 1956, set certain restrictions on the use of insurance companies reserves. Insurance companies operating in Lebanon which transact business involving life, and old age insurance and savings plans have to keep 100 per cent of their reserves in the country. The Ministries of Finance and National Economy may reduce this requirement to 50 per cent. Insurance companies which undertake fire, car accident, industrial accident, civil commotions, and agricultural insurance have to maintain 40 per cent of the installments received on annual premiums in Lebanon. On transport insurance, the insurance companies should maintain 25 per cent of the premiums collected every year in the country.[1]

The great majority of insurance companies maintain the legal reserves stipulated by law in commercial banks on a demand or time deposit basis at 3 to 4.5 per cent interest. Only a few of the Lebanese and Arab companies invest in industrial stocks, such investments being insignificant in size. Although one may readily rule out insurance companies as a source of industrial credit in Lebanon, yet they stand as a potential source of funds to specialized credit institutions and to industrial banks and perhaps directly to industrial corporations if and when the securities market in Lebanon develops further.

b. The Stock Exchange

The Lebanese stock exchange (known customarily as the Bourse) was officially set up in 1920. The stocks dealt in were few partly due to the instability of the French franc

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[1] L'Economie Libanaise et Arab, Vol. 2, No. 96 (June, 1961), p. 11.

prior to its stabilization in 1926 and partly because the idea of having a stock exchange was altogether new. The authorities suspended the operations of the Bourse twice in 1943 and 1945. In 1945 it was reorganized by a decree and again in 1957 and 1959 by laws enacted by the parliament.[1] Other amendments followed in the summer of 1961.

The listing requirements for Lebanese securities are four: first, the capital of the company should be no less than half a million pounds; secondly, the company should have published financial statements for the preceding two years; thirdly, the company should also publish statements once every year; and, finally, the company's securities have to be issued to bearer and be fully paid up. A Lebanese company is defined by law as one that has 51 per cent of its shares held by Lebanese nationals. Foreign securities may be listed on the stock exchange but only by authorization from the Ministry of Finance. Foreign corporations listed on the stock exchanges of their own countries may be listed on the Beirut stock exchange. If no stock exchanges exist in the foreign companies' home countries then they may be accepted for listing provided their capital is no less than one million pounds. These companies must carry through a

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[1] Zuhayr Mikdashi and Ahmad Malak, "Capital Market in Lebanon", L'Economie Libanaise et Arabe, No. 96 (June, 1961), p. 12.

bank in Lebanon all financial transactions without any expense to the potential Lebanese stockholder. The statutes and policies of the company should be in accordance with the regulations of its mother country and not in conflict with the Lebanese commercial code.[1] There are thirty-six companies listed in the Bourse as of the end of the first quarter of 1963. Out of these there are seven industrial companies and five electricity companies. The industrial companies are manufacturers of cement, eternit, tobacco, wood, alcohol, beer, and sugar. The shares of these companies are not actively traded. Negotiable bonds on the other hand have never been issued by a Lebanese corporation.

In the year 1962 only the stocks of two industrial companies have been traded in the Bourse namely the cement and eternit shares. The average monthly transactions in these shares have been 762 shares and 169 shares for the cement and eternit respectively. The number of shares outstanding of the cement company totals 240,000 shares and that of the eternit 60,000 shares. This proves that the value of transactions is insignificant. The average monthly volume of transactions consummated in the Bourse does not exceed 24,680 shares with an average monthly value of less than L.L.2.5 million. Table VII below is reflective of the volume and value of shares traded in the Bourse in 1962.

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[1] Nadeem Shwayri, The Bourse of Beirut, Unpublished MBA Thesis (A.U.B., 1959), p. 44.

TABLE VII

VOLUME AND VALUE OF SHARES TRADED IN BEIRUT'S STOCK EXCHANGE IN THE YEAR 1962

No. of Shares Traded	Jan.	Feb.	March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Average
Lebanese Cement Co.	2892	1471	295	515	870	485	415	690	407	865	105	135	762
Eternit Company	335	935	60	-	465	120	-	35	15	35	35	-	169
Total of All Shares Listed	91592	26096	22520	14725	22320	25,875	22285	11197	16781	12482	14411	15882	24680
Total Value of Shares Traded (L.L.000's)	3931	3849	2910	1622	2670	1990	1829	1552	1926	1539	1612	3117	2379

Source: Computed from Le Commerce du Levant monthly issues, February 1962 up to January 1963, Nos. 18 to 29.

The stock exchange has not proved to be an important channel for mobilizing savings and directing them into industrial corporations. Many a corporation lists its shares in order to reinforce their collateral value in times of need. A company for example, which is closely held, may offer for sale some of its shares and then ask some of its shareholders to bid for them at a high price. The price of the share may stay at that high level as long as the number of shares traded is limited. The stock exchange is still underdeveloped. The shares listed are few, those traded are fewer. With its existing structure and size it cannot assume the role of an intermediary in raising funds to industry. The corporations law, the tax law and the stock exchange law form an interrelated subject which affects in many ways the growth of the stock exchange. The discussion of those aspects would take us too far afield. One may conclude that, although the Bourse of Beirut is playing no role in industrial credit at present, the potential role that it can play cannot be overemphasized. As more stocks are listed, as the habit of investing in securities develops, and as the speculative tendencies in the stock exchange are restrained, the stock exchange will become an effective source of debt capital for industry.

C. COMMERCIAL BANKS

The Lebanese commercial banking system comprises (as of February 1963), sixty accredited banks and twenty-five non-accredited banks.[1] This study will concentrate on the accredited banks. The non-accredited banks account only for an insignificant proportion of total banking activities in the country. Besides, it was found that none of the non-accredited banks engages in industrial medium or long term lending. The banking system as a source of industrial credit has been investigated by the use of a sequential sample. A random sample of twelve banks has been chosen from among the relatively large local and foreign banks. The managers of those banks were interviewed and the results were tabulated and analyzed. The sample was then expanded by four more banks chosen also at random. The data obtained conveyed substantially the same picture as the data derived from the initial sample. The sample was further expanded by four banks, raising the total number of the sample to twenty banks. The results confirmed the findings previously obtained. The random sample thus studied comprises twenty accredited banks, of which ten are Lebanese, two are non-Lebanese Arab, and eight are foreign. The

[1] Accredited banks are those banks whose guarantee is accepted by the Lebanese government, and are as such considered first class banks.

Lebanese and non-Lebanese Arab banks will be studied as one group, because their policies seem to be very much alike. Accordingly, the sample may be devided for the purpose of the discussion into two categories: that of local banks (Lebanese and non-Lebanese Arab banks totaling twelve in number) and that of foreign banks (American, French, and British totaling eight).

In the following sections we shall study the factors that have contributed to the increase in the supply of loanable funds by the banking system in general and of industrial credit in particular. The findings of the study point to a significant shortage of long term credit to industry. Medium term credit is more available, yet in the majority of cases it is not contracted on a medium term basis, but rather on a yearly renewable basis. Short term credit for periods of less than one year is in adequate supply.

1. Banking System's Equity as a Factor in the Supply of Bank Credit

Lebanon has experienced since the early 1950's a rapid and significant expansion in the number of commercial banking institutions. There are at present, aside from BCAIF, 60 accredited banks out of which 44 banks are incorporated in Lebanon. Out of the Lebanese incorporated banks there are 16 which have foreign participations. Besides, there are five branches of Arab banks and 11 branches of other foreign banks, namely: four French, three American, two British, one Italian and one Dutch. On the whole, much of the banking activities are still in the hands of foreign banks which command greater experience in the art of banking and have more extensive connections abroad than the local banks.

There has been a marked growth in the aggregate capital of commercial banks mainly due to a number of reasons: first, banks have increased considerably in number in the post-war period. Second, an increasing number of formerly unincorporated banks have been incorporated, simultaneously increasing their equity. Third, a number of local banks started opening branches in various towns in Lebanon. Along with that evolution an increase in the capitals of long-established banks has been effected. The aggregate authorized capital of all banks operating in Lebanon as of March 1961 was L.L.246 million as against L.L.52 million representing the initial capital of those banks.[1] This nearly five-fold growth is attributed, among other things, to the aforementioned reasons.

One of the factors which prompted banks to increase their equity was the rise of deposits. Banks tended to increase their equity in order to maintain a satisfactory

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[1] <u>L'Economie Libanaise et Arabe</u>, No. 93 (March, 1961), pp. 19-22.

ratio of networth to deposits. Many depositors may view any decline in this ratio as a threat to the safety of the bank. On the other hand, different types of credit are associated with different risks. Hence, in order to provide for possible losses, banks have been trying to increase their equity reserves. The growth of the equity of banks has increased their ability to extend more credit.

The commercial banks' operations are generally limited to the financing of short term trade transactions with maturities rarely exceeding a year. The absence of a full-fledged central bank has deprived banks from a significant source of liquid funds to which banks in other countries ordinarily have access in times of need. The present rediscounting facilities of the BSL are restricted to bills having a maturity not longer than three months if held by the Issue Department and six months if held by the Banking Department. The bills discounted should bear a minimum of two signatures other than that of the bank. Banks avoid resorting to the BSL for rediscounting purposes, except when in keen need, in order not to disclose the names of their clients to a competing bank.

Despite the fact that all accredited banks are organized as corporations and that many banks were established in recent years, only three banks (two Lebanese and one French) besides BCAIF have their shares listed in the stock exchange. In 1962 only the shares of the BSL, from among the shares of banks, were traded in the stock exchange averaging 1,110 shares per month.[1] The outstanding shares of the BSL amount to 300,000 shares. This proves that banks' shares, whether listed or not, are not actively traded but are rather very closely held.

2. Inflow of Foreign Funds as a Factor in the Supply of Bank Credit

1952 was a significant year in the history of banking in Lebanon. In that year the government put into effect a previous decision to abolish all exchange controls and to allow residents and non-residents alike to operate freely in the market.[2] This helped to attract to Lebanon substantial amounts of funds from neighbouring Arab countries. This trend has been given a strong impetus by the introduction of the Bank Secrecy Law in 1956.[3] This law was introduced in the hope that it will help banks operating in Lebanon to

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[1] Computed from Le Commerce du Levant monthly issues Nos. 18 to 29 (February, 1962 to January, 1963).

[2] Talha Yaffi, "A Case for Central Banking Reform in Lebanon", Middle East Economic Papers 1958 (Beirut: Economic Research Institute, A.U.B., 1958), pp. 99-101.

[3] Al-Jarida al-Rasmia, No. 36 (1956).

attract foreign deposits. This law gave banks the right to open coded bank accounts on their books but it prohibited banks from divulging, subject to severe penalties, any information regarding their clients' accounts. The consequence has been a tremendous flourishing of banking activities.[1] The social, economic, and political changes in neighbouring Arab countries and the relatively stable conditions in Lebanon have helped to attract to it a sizable part of the funds flowing out of certain countries in the region. The low taxes in Lebanon which are not very difficult to avoid and evade have helped to strengthen the trend of inflow of funds.[2] The Bank Secrecy Law has helped in the evasion of taxes, especially inheritance taxes.

One of the features of the Lebanese monetary policy is the government's effort to maintain high gold coverage, which has rightly or wrongly helped to inspire confidence in the Lebanese pound in particular and the economy in general. The ratio of gold to the total cover increased from 2 per cent in 1948 to a peak of 95 per cent at the end of 1963.[3] The above-mentioned factors have had a cumulative result in attracting deposits.[4] The increase

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[1]Paul Klat, "The National Income of Lebanon", op.cit.

[2]Issam Ashour, Al-Nakd Wal E'Eteman Fi Al-Bilad Al-Arabia (in Arabic), (Cairo: The Arab League, 1962), p. 164.

[3]FAO, op.cit., p. 14, and Le Commerce du Levant (January 19, 1963).

[4]Ashour, op.cit., p. 164.

in the flow of deposits has given the Lebanese pound the image of strength. On the other hand, the stability and appreciation of the Lebanese pound have helped to attract more deposits.

The figures published on banking activities, though little, show clearly the increase in aggregate deposits. Demand deposits in Lebanese pounds have risen, as Table VIII reveals, from L.L.219 million in 1953 to L.L.792 million in 1961, reflecting more than three-fold rise in less than ten years. Time deposits have risen at a quicker pace from L.L.19 million in 1953 to L.L.138 million in 1961, reflecting over a seven-fold increase in less than ten years. Deposits in foreign currency showed a considerable rise from L.L.54 million in 1954 (converted into Lebanese for the purpose of comparison) to L.L.452 million in 1961, that is over eight-fold rise in eight years.

The time and savings deposits in local currency have shown a remarkable rise. The percentage of time and savings deposits to demand deposits of the private sector have risen, as Table VIII reveals, from 8.7 per cent in 1953 to 17.4 per cent in 1961. This points to an increase in both absolute and relative terms of time and savings deposits.

In the opinion of the majority of banks interviewed, the inflow of foreign deposits has not helped directly in

TABLE VIII

THE GROWTH OF BANKS' PRIVATE DEPOSITS
FROM 1953 TO 1961
(L.L. Millions)

	1953	1954	1955	1956	1957	1958	1959	1960	1961
Demand Deposits	219	246	299	307	447	443	621	716	792
Time "	19	27	39	42	50	54	78	113	138
Foreign Currency Deposits	N.A.	54	72	82	115	136	165	369	452
Time Deposits & Savings Deposits/ Demand Deposits*	8.7%	11.0%	13.0%	13.7%	11.2%	12.2%	12.6%	15.8%	17.4%

Source: International Monetary Fund, International Financial Statistics, October 1962, Vol. 15, No. 10 (Washington, D.C.: IMF, 1962), pp. 182-183.

* Computations excluded Foreign Currency Deposits.

financing industry. Foreign deposits, however, through their competition with local deposits for investment outlets (namely, trade, consumer credit, and construction) may have helped to release sizable amounts of capital funds for investment in other sectors, including industry. Thus the growth of foreign deposits may have helped indirectly in financing industry.

A direct relationship exists between loans and deposits. The level of deposits depends to a significant extent on the amount of credit created by banks through the loans they extend or through the investments they make. To the extent that banks credit, the banking system, subject to certain limitations, can be said to determine the volume of deposits.[1] In the absence of published detailed bank balance sheets it is difficult to segregate interbank deposits from other private deposits. The practice of window-dressing in the consolidated statements of banks and the inability to determine the volume of interbank deposits and loans make it impossible to distinguish between primary and secondary deposits in the global figure that the available statistics provide.

The data on capital movements are perhaps the least reliable estimates in Lebanon's balance of payments. According to one estimate total private long term capital forms approximately 88 per cent of the total net capital imports for the period 1957-60.[2] Private long term capital

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[1] Roland I. Robinson, The Management of Bank Funds (New York: McGraw-Hill Book Company, Inc., 1951), p. 25.

[2] Computed from Table IX.

inflows have played an important role in the Lebanese economy in the post-war period. Much of the incoming capital is invested in real estate and in the construction of apartment buildings. The growth in the construction sector is believed to have slowed down in the late 1950's. On the other hand, the advent of a number of modern industries has attracted the interest of potential Arab investors who seek a certain degree of diversification to their investments. "There are already some signs of a lag in the growth of demand for certain categories of residential apartments (those renting between L.L.3000 and L.L.6000 a year) behind its growing supply."[1] Thus industry, among other investment outlets, may well have a greater chance to compete for inflowing private long term capital which may, after some time, start seeking opportunities for investment other than those of apartment buildings. Table IX presents some data on external capital movements in Lebanon.

3. Growth of Local Deposits as a Factor in the Supply of Bank Credit

The available figures on deposits do not make it possible to draw the line between local and foreign deposits. It is, however, reasonable to assume that, with the increase in per capita income, the spreading of the banking habit,

[1] Khalil Salem, "Lebanese Balance of Payments for 1960", *op.cit.*, pp. 11-14.

TABLE IX

EXTERNAL CAPITAL MOVEMENTS IN 1957 TO 1960
(In L.L. Millions)

	1957	1958	1959	1960
Net Inflow of Capital	190	144	165	258
a. Net Movement of Short Term Capital	+7	+14	+9	+42
b. Net Movement of Official Long Term Capital	+1	+ 7	+12	+11
c. Net Movement of Private Long Term Capital	+182	+137	+144	+205

Source: Khalil Salem, "Lebanese Balance of Payments for 1960", <u>op.cit</u>.

the growth of the middle class, and the general improvement in the standard of living, local deposits are likely to grow. The findings based on interviews with bankers confirm this view. Bankers believe that local deposits have been growing at a fast pace in the past few years because of the factors just listed.

Inspite of the increase in the percentage of time and savings deposits to demand deposits, as shown in Table VIII, demand deposits continue to constitute the main source of funds for the banking system. One of the reasons behind the paucity of savings and time deposits in general is that the Lebanese middle class has a high propensity to consume. The propensity to consume of the Lebanese is even higher than that of oil rich countries in the region.[1] The natural result of this feature is a low level of saving on the part of the middle class. On the other hand, the bulk of local demand deposits belong to the rich business community.[2] The business community and the rich prefer to keep their funds on a demand deposit basis rather than tying them up for a certain fixed period regardless of its length. The main reason for this attitude is that depositors are always on the lookout for outlets giving returns higher than the interest rates allowed by banks. Thus despite the growth in local deposits, banks continue to have the bulk of deposits on a demand basis which limits their capacity to expand their medium term lending activities.

One can finally say that the banking habit has been stimulated by the increase in the interest rate allowed on demand deposits, the increase in the number of banks, and their services and the growing familiarity with and confidence in the banking system. All this has led to an increase in local deposits. The changes in foreign currency deposits do not have a direct effect on the volume of money

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[1]Issam Ashour, op.cit., p. 71.

[2]Ibid.

(both currency and demand deposits). At present, the bulk of foreign currency deposits in Lebanon belong to non-residents and affect in no direct way either the currency in circulation or local demand deposits which together make up the money supply of the country.[1] No reliable figures are available on the sources of foreign exchange deposits nor on the amounts converted into local currency.

4. Factors in the Supply of Industrial Credit

a. Competing Outlets for Funds

Aside from the traditional outlets for bank funds in Lebanon, namely trade and to a limited extent short term agricultural and industrial lending, a number of other investment opportunities have arisen in the past few years. One of these outlets has been the real estate and construction sector. As a result the activity of the construction sector was matched by expansion in bank credit. Recently there has been certain indications of a lag in the growth of demand for apartment buildings which has in turn dampened the boom in that sector (also refer to Chapter II, C-2). It is, however, realized that the construction sector competes with industry as far as short term and medium term credit is concerned running for as long as three years. The

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[1] *Ibid.*, p. 145.

credit to the construction sector rarely exceeds three years and outstanding loans are usually liquidated as soon as the building approaches the completion stage. Banks confronted with a decline in demand for credit by the construction sector may try to go more into other sectors to employ idle funds. Among these sectors industry is no doubt a promising alternative.

Another outlet for bank funds is consumer credit. Consumer credit, though it dates back to the ancient ages, has been growing and expanding significantly in Lebanon only in the past decade. Commercial banks extend consumer credit by discounting installment papers, by providing advance lines against the collateral of consumer bills, or by granting loans directly to consumers. The financing of auto sales and household appliances has proved to be highly profitable to many banks. There are some banks, however, which do not finance consumer credit. Consumer credit, as suggested by many bankers, has become a principle item on the assets side of their balance sheets. Bankers do not believe that consumer credit has become a handicap to the extension of industrial credit. Their reason is mainly that there is an easy credit market at present and credit funds seeking investment are ample if safe outlets can be provided.

The fact that an easy market exists at present for loanable funds makes it difficult to conceive of a competition between short term and long term outlets. Nevertheless, banks prefer short term lending, other things being equal, at least because of the liquidity advantage such lending would provide. At present, under the conditions of severe competition for financing commercial transactions, a number of banks have started exploring other alternatives among which is industry. The ease with which banks could resort to the future central bank in case they become tight will determine, in part, to what extent could banks go into long term financing.

b. Criteria Affecting the Supply of Industrial Credit

The criteria set up as guides to banks in their lending activities differ from one bank to the other, though some banks share the same criteria. These criteria spring up from the profitability, safety and liquidity considerations which shape the banks' decisions. These considerations are in turn related to the maturity and yield, to the quality and diversification of various investments, and to the variety of loan outlets. In the following sections those factors that tend to have a bearing on industrial credit will be discussed. All the banks interviewed, with the exception of one local and another foreign bank, were able to break down and classify the criteria governing their industrial credit policies into three categories according to their relative importance.

The majority of the banks do not observe different criteria relative to industrial credit, as distinct from other lines of credit. The type of industry, which is a possible consideration in industrial lending, whether heavy, light, or otherwise seems to be of no concern to most banks. Only one local bank ranked the type of industry as a first criterion and another ranked it as third. In the case of short term loans it is easy to understand why do banks interest themselves in the liquidity of the client more than in his profitability. Their reason mainly is that the maturity of their short term loans is not long enough to warrant a study of a project and to assess its returns and success, since in case of difficulty they have to depend solely on the value of the current assets of their client. As regards medium and long term credit one notices, to a considerable degree, a lack of concern among bankers to a genuine analysis of the feasibility of one industry as compared to another. Many bankers believe that such studies should be conducted by industrialists as the banker's main concern should be solely the credit worthiness of the potential customer. This attitude would not be described as ideal since the success or failure of an industrial project may alter radically the credit worthiness of the client.

There are some criteria, however, which touch on industrial credit, though it is not solely related to it. The earning power reflects on the debtor's ability to repay long term loans. This factor has been given a second place of importance by one foreign bank and was ranked third by six local and three other foreign banks. The secondary role attached to earning power shows that banks care more about the wealth of their customers than the viability and returns of a specific project in need of credit. One of the local banks associated repayment ability with the size of earnings, net of withdrawals by owners. An industrial project for which credit is sought might be sound and might generate in time enough profits to repay the loan and the interest. Yet, the industrialist might be spending more than his earnings. Thus the earning power does not signify necessarily the ability to repay; so earnings are referred to as net after dividends or owners withdrawals.

One local banker stressed that he would never give credit to an industry which depends to a large extent on imported raw materials and foreign skills. He believes that imported raw materials should form a very small component of the total value of the product. But as local mineral resources are scanty, that banker suggests that industries which depend on local agricultural resources or on local labour skills are the ones capable of growth and are consequently considered for industrial credit.

The criteria of morality (integrity), networth, ability and experience, growth, friendship, years of relationship and the movement of the account are classified in Table X, since they are related to general lending activities and not specifically to the industrial sector. It has been noticed that the elements of friendship and relationship, though not classified as criteria, do play an important role in granting credit facilities. Many bankers refused to rank friendship among the criteria, apparently fearing that it may reflect unfavourably on the policy of their banks. One foreign banker stated that his bank is ready to go along and finance any industrial project up to a period of three years without conducting any analyses of feasibility or earning power provided that the loan is guaranteed by a foreign mother company or by a supplier of well-known standing. In other words, the bank would be delegating all responsibilities of analyses to the guarantor who endorses the loan for the local company.

The interest rate has not proved to be an important factor in the supply of industrial credit funds. Banks, it was found, would not go into financing industry solely to collect high interest charges on their credit facilities.

Interest is by no means a decisive factor that would influence banks' judgment as to financing industry rather than another sector. Maturity is a strong factor and a determining one in industrial credit. It will be referred to in greater detail, along with the security offered by the debtor, in the following section.

One can thus conclude that there is no clear line of distinction between the criteria related to industrial lending and those related to lending to other sectors of the economy. The criteria guiding banks in their commercial credit transactions are generally the same as those applicable to industry. Table X presents a classification of the criteria discussed.

c. The Supply of Short Term Credit[1]

All the twenty banks interviewed, with no exception, provide credit for the import of machinery and raw materials by industry. The local banks charge interest at rates ranging between 6 per cent and 10 per cent per annum, while foreign banks charge interest at rates ranging between 5 per cent and 9 per cent for the same type of credit.[2] The difference in the rates and the variation in the range is attributed

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[1]Short term credit in the sense used here is that which does not exceed one year.

[2]The maximum legal interest rate is 9 per cent per annum which is rarely observed and is evaded by collecting charges and commissions over and above the legal interest charged.

TABLE X

SOME OF THE CRITERIA THAT GUIDE BANKS IN THEIR LENDING POLICIES

(Ranked According to Importance)

Criteria and Ranks	No. of Local Banks	No. of Foreign Banks
Morality as First	6	4
Morality as Second	4	1
Morality as Third	1	1
Net Worth as First	4	3
Net Worth as Second	6	2
Net Worth as Third	1	1
Ability and Experience as Second	-	1
Growth as Third	-	1
Friendship as Third	1	-
Years of Relationship as Second	-	1
Movement of Account as First	1	-
Movement of Account as Second	3	-
Earning Power as Second	-	1
Earning Power as Third	6	3
Type of Industry as First	1	-
Type of Industry as Third	1	-
Banks which could not give a breakdown	1	1

in part, to the fact that some bankers include commissions and charges in the rates they charge while others do not. The majority of banks, however, charge rates in the higher brackets of the ranges given.

The deposit margin demanded by banks on opening letters of credit is affected mainly by the criteria of credit evaluation referred to earlier. Naturally, the lesser the risk the lower the margin. The margin on short term credit to finance the import of capital goods and raw materials ranges between zero and 50 per cent (of the value of the order) in local banks and between zero and 25 per cent in foreign banks. In most cases, the margin is required by banks as a proof of the liquidity of the customer and not of his solvency. An insolvent client would not be accommodated for his credit needs from the start. The margin is an extra guarantee against price fluctuations in case the customer delays payment or defaults.

Banks generally grant their customers clean advances for the import of machinery and raw materials.[1] Margins are mainly required when the customer is new and when the account is on a trial basis. Once the relationship is established clean advances would be provided. When a customer exhausts his clean advance line he has to provide additional collateral (such as a cash margin, a foreign

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[1] Clean advance is an overdraft credit accommodation not backed by any specific collateral or security other than the general assets of the borrower. The terms clean advance, overdraft, and clean facility are used interchangeably.

exchange deposit, or the assignment of stocks) to warrant further advances. The margin is only one factor in the overall credit risk picture and thus cannot be considered separately. The margin, besides being an additional element of security, is a non-interest bearing deposit. The bank can make use of the margin deposit over the period extending between the time the goods are ordered until they are put on board the ship, at which time the bank effects payment to the supplier.

The credit period ranges between three months and three years. In the case of raw materials imports the length of the credit period is ordinarily long enough to allow the industrialist time to turn the raw materials into final product and then into cash. The period of credit, though it may run for three years, is extended on a yearly basis renewable if conditions do not change. This is why it is classified as short term credit. The yearly renewal enables the bank to adjust the interest rate in case the market rate on loans changes.

Another type of credit extended to industrialists on a short term basis is in the form of trade bills discounted. The terms do not differ from those applying to the discount of commercial installment papers arising from the sales of merchants. The interest charged by local banks ranges between 6.5 per cent and 12 per cent as against 5 per cent to 9 per cent charged by foreign banks. The main reason for the difference in the ranges when compared to those applied to the import of raw materials and machinery is that small industrial firms can arrange to get lines for the discount of their bills at banks and not for the import of machinery or raw materials. The variation in the rates is partly attributed to the inclusion or exclusion of commissions charged and to the fact that the interest rate is a function of the credit worthiness of the client. The amount of the line, the size of the bank, and the intensity of competition are all factors in the rate of interest charged. The maturity for discount lines run from 3 to 24 months and rise to 36 months among foreign banks who have been actively discounting promissory notes of prime names among industrialists.

Many banks allow clean advances to the industrialists to pay for their operational expenses such as salaries and electricity bills. The rate of interest ranges between 7 per cent and 9 per cent. Such lines run for one year and are renewed if turnover, profit, and morality of the debtor continue to be in good standing. Commercial banks thus provide industrialists with credit for the import of raw materials and machinery, for the discount of trade papers, and for operational purposes. Table XI summarizes the findings on short term credit to industry.

TABLE XI

SHORT TERM CREDIT TO INDUSTRY
TYPES OF FACILITIES & TERMS

	Local Banks	Foreign Banks
Letters of Credit		
Interest Range	6-10%	5-9%
Margin	Up to 3 years	Up to 3 years
Maturity	0-50%	0-25%
Discounting Bills		
Interest Range	6.5-12%	5-9%
Maturity	3-24 months	3-36 months
Overdrafts for Operational Expenses		
Interest Range	7-9%	7-9%
Maturity	1 year	1 year

d. The Supply of Medium Term Credit[1]

None of the banks interviewed grants long term credit to Lebanese industry. There are a number of banks, however, that have been driven into long term industrial

[1]Medium term credit, in the sense used here, is that which runs for a period exceeding one year but which is less than five years. Long term credit is that which exceeds five years. The line of demarcation is difficult to draw between short term and medium term credit, considering that short term credit which runs for one year is renewed automatically every year or so. A situation of similar overlapping exists between medium and long term credit.

financing by the failure of the debtors to pay back their short term loans. A forced liquidation, many bankers believe, would, in most cases, lead to a redemption of only a fraction of the original loan. So bankers in such situations would extend the repayment schedules. + Banks cannot thus be considered as a source of long term funds.

There are two local banks out of a total of twelve interviewed and one foreign bank out of eight, which do not provide any medium term financing to industry. The rest of the banks provide such credit to industry if it is backed by a mortgage. The percentage advanced against the mortgage ranges from 30 per cent to 60 per cent in local banks and rises up to 70 per cent in foreign ones. Banks have different appraisal procedures in estimating the credit worthiness of their clients. Some banks base the percentage they advance on the market value, others on the market value discounted by a percentage and still very few reckon the percentage in terms of the realizable value in a forced sale. Two of the local banks exclude machinery when estimating the value of a factory. Such exclusion may reduce significantly the amount of the loan secured by a mortgage especially when the industry is highly mechanized.

The interest charged by local banks ranges between

6 per cent and 12 per cent compared with 6 per cent and 9 per cent charged by foreign banks. The high interest rate on loans against mortgages is mainly due to the period for which such a loan runs. Loans secured by mortgages have a maximum maturity of three years and five years in local and foreign banks respectively. These medium term loans are in the majority of cases renewable. This is not the ideal way for an industrialist to arrange for loans. An industrialist wants to calculate his costs including the cost of credit with accuracy. He has to have as many factors of those that affect his business accurately estimated or fixed to be able to ascertain his working and fixed capital needs over a period of time. The industrialist cannot have long range reliable plans when his sources of finance are uncertain and when his credit lines are on a yearly basis.

Banks differ in the way they allocate their loan portfolio. Some local banks allocate not more than 5 per cent of their total loan portfolios to loans against mortgages, while some foreign banks allocate not more than 10 per cent. The percentage rises to 30 per cent among some other local and foreign banks. All the eight foreign banks and six out of the twelve local banks interviewed ascertained that their industrial credit policy is not affected by the inefficient foreclosure procedures. The other six local banks expressed extreme concern about this issue and claimed that it is an important factor in the supply of industrial credit. Time consuming procedures in the event of default make it difficult to liquidate the mortgage within short time. Table XII summarizes the results arrived at relative to medium term credit.

TABLE XII

TERMS GOVERNING MEDIUM TERM CREDIT SECURED BY MORTGAGES

	Local Banks	Foreign Banks
No. of Banks that do not give this type of loans	2	1
Percentage of Mortgage's value advanced	30-60%	30-70%
No. of Banks that exclude machinery from Mortgage valuation	2	-
Interest Range	6-12%	6-9%
Maturity	3 years	5 years

Banks have different policies regarding the finance of raw materials and machinery. Three local and one foreign bank favour providing credit for the import of raw materials rather than machinery. Their reason is that machines are in many cases so highly specialized that it becomes impossible to sell them upon foreclosure when a customer defaults. One foreign bank stresses that the import of raw materials represents a lower degree of financial risk. For it shows that the firm has already made its arrangements to furnish enough capital to take care of its requirements for land, building, and machinery. Advocates of credit to machinery argue that machines might be imported to process and manufacture goods whose raw materials component is locally available. Thus, in case foreign supplies are cut, the industry will go on working with the locally provided raw materials. There are nine local and five foreign banks which have no preferance as between the financing of raw materials or machinery. They believe that when the criteria, on which credit is extended, are met the type of goods imported is of no concern to them.

Conclusion

Banks in Lebanon are accommodating adequately the short term credit needs of industrialists. They are only partially financing medium term requirements, while long term credit is almost unavailable at all. There is a shortage of long and medium term credit. The subject will be taken up again in the concluding chapter.

CHAPTER III

DEMAND FOR INDUSTRIAL CREDIT

This study concentrates on the credit aspects of the private sector of industry. The discussion will evolve around six major groups of industries, namely: food, beverage, textile, cement, metal mining, and steel and aluminum production. The first five groups engage jointly, according to the 1955 industrial census, about 46 per cent of the total labour force employed in industry and contribute about 54 per cent of the total value added by industry. The steel and aluminum industry was insignificant before 1955, and was thus excluded from that census. The growing contribution of this industry to employment and to the value added by the industrial sector was not represented in the percentages just cited. Naturally, the inclusion of the steel and aluminum industry would improve the percentages and thus the reliability of the sample. The close association between metal mining and steel and aluminum production makes it convenient to study them as one group under the label of metallic industry. Over and above the six industries investigated a small sample from a number of other industries has been covered to provide additional guides as to the general pattern of demand for industrial credit. The findings presented below, however, are related primarily to the six major industries which are believed to be highly representative of Lebanese industry.

The food industries covered by the sample included grain mill products, pastries, cakes, biscuits, sugar, chocolate, cocoa products, candy confectionary, vegetable oils, and edible fats. Under beverage, the sample covered liquors, arak, wines, beer, soft drinks, and carbonated waters. The textile industry in the sample comprised the spinning and weaving of cotton, silk, and wool. The cement industry in the sample included all types of cement, and eternit products factories. The metallic industry sample included iron mining plants, foundries, steel mills, and aluminum factories.

The term "networth" as used here refers to the present value, as of the last quarter of 1962, of the equity participations in industry.[1] Thus, it is not necessarily the same as either the authorized capital or as the paid up capital. The networth of the sampled firms under

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[1]The networth of two cement and eternit factories has been determined by multiplying the outstanding number of shares by the average market price of a share over 1962. The networth of all the remaining firms in various industries has been based on the management's estimates of the present value of the respective firms and on the estimates supplied by competitors and other trade sources. Where the estimates varied the lower estimate was the one considered.

study amounts to approximately L.L.359 million distributed as follows: food L.L.66 million, beverage L.L.34 million, textile L.L.70 million, cement L.L.126 million, metallic L.L.42 million, and miscellaneous industries L.L.21 million. The findings presented below are based on a sequential random sample chosen from every industry. The sample was increased successively till it was felt that the expansion of the sample was not having any more a significant bearing upon the results formerly obtained.

The majority of factories investigated were either family concerns or closely held companies rarely owned by more than a few people who, in most cases, are brought together by kinship or friendship ties.

A. DEBT VERSUS EQUITY FINANCING

Industry, like any other economic endeavor, requires capital to get established, grow, and prosper. Long term capital would be needed to finance such long term prospects as growth. Whether equity or debt funds will be raised depends on a number of considerations.

Industrial firms ordinarily prefer debt to equity funds in order to avoid bringing in new shareholders who would acquire voting privileges in the organization. The volume of additional funds required might be so large that the sale of new stocks or the acceptance of funds from new partners may result in a loss of control to the existing shareholders or owners. Thus, the desire to retain voting control by a particular group tends to influence the form of financing. In the larger incorporated industries which have a wide distribution of shares it would be to the interest of the controlling group to issue more stocks. The controlling group will strengthen its position by taking such a step, since it becomes difficult for an outsider to purchase a controlling interest in the corporation.

In Lebanon, a distinctive policy could be traced in the various industries studied, Almost all the industries, with very few exceptions, regarded the admission of new shareholders or partners through an increase in equity as a last resort. This policy is a reflection of the prevalence of the closely held type of ownership in Lebanese industry. Some firms expressed their willingness to take on loans bearing high interest rates in order to avoid bringing in new equity participants. The aversion to dilution of control continues to hold a high place in the financial policies of Lebanese industrial firms. There is always a tendency towards debt financing when the existing shareholders cannot supply the funds needed in a given situation from their own resources.

The absence of a bond market and of a developed capital market have put severe limitations on the availability of debt financing outside the banking system. The absence of debt instruments, other than the Egyptian Real Estate Bank bonds which are not actively traded, and the public's aversion to holding industrial securities have restricted debt financing to short term and in a small number of cases to medium term credit. The results of the study show that the maximum interest rate an industrialist can afford to pay on a loan is 9.5 per cent, while a ready demand for funds exists in the construction sector which offers an average rate of interest of 12 per cent with a mortgage as security.[1] This will naturally rule out industrial bonds as a competitive outlet for the community's savings.

The term "debt", as used in what follows includes short, medium and long term loans. The results of the study show that, in the food industry, firms accounting for 60 per cent of the total networth of the industry have a debt to networth ratio (referred to hereafter as the ratio) ranging between 10 and 40 per cent. Firms accounting for 25 per cent of the networth have a ratio ranging between 45 and 60 per cent. The remaining firms have a ratio

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[1]The average rate of 12 per cent has been obtained through interviews with a number of mortgage brokers during February 1963.

running as high as 100 per cent or a little more. The latter case is characteristic of the wheat grinding mills owners who finance their imports of wheat in large measure by drawing on their advance accounts at banks.

In the beverage industry firms accounting for around 80 per cent of the total networth of the industry have a ratio ranging between 10 and 15 per cent. Firms which account for 10 per cent of networth have a ratio reaching 25 per cent. The beverage industry manifests little need for credit accommodations mainly due to the high sales turnover they typically have, which enables most firms to repay their short term outstanding debts promptly. A number of soft drink firms have been able to amortize their yearly renewable debts in a couple of years out of profits. The smaller firms that manufacture "arak" rarely resort to banks. These establishments are contented with their existing methods of operation and have in the majority of cases no need for funds to renew equipment or to expand operations. Firms that manufacture "arak" account for no more than 10 per cent of the networth of the beverage industry.

In the textile industry, there is not a single firm which is completely out of debt. A number of large textile firms have gone into debt for the purpose of diversifying their product lines and renovating their equipment. Firms accounting for 75 per cent of the total networth of the industry have a ratio ranging between 30 and 50 per cent. A number of firms which account for 10 per cent of networth have a ratio of 150 per cent which shows a relatively low equity participation. The remaining firms in the textile industry who represent 15 per cent of the networth have a ratio of 60 per cent.

The debt-to-equity ratio in the cement industry is relatively low. Firms representing approximately 90 per cent of the total networth have a ratio ranging between 2 and 5 per cent. Firms accounting for the remaining net-worth have a ratio of 40 per cent. The relative profit-ability of the industry, the recent construction boom, and the great expenditures on rebuilding after the earthquake have contributed to a low debt-to-networth ratio in this industry.

In the metallic industry, firms representing 70 per cent of the networth of the industry have a ratio ranging between 40 and 65 per cent. The remaining firms in the same industry have a lower ratio.

Financial leverage is most feasible in industries which can afford to pay a fixed rate of interest on borrowed funds. Leverage is quite risky for a firm with highly fluc-tuating profits. Industries like cement, which have highly stable profits and which consequently can use leverage to advantage, are not in need of funds. Other industries, such as the food industry, whose profit experience is not stable as that of the cement industry have been using leverage quite intensively to avoid bringing in new equity participants.

B. FACTORS IN THE DEMAND FOR INDUSTRIAL CREDIT

In this section, we shall enquire into the terms of credit in so far as they determine the individual firm's demand for credit. The study will cover the interest rates, maturities, and type of security offered by the various industries along with estimates on the amounts of credit needed in industry.

1. Interest

The effective rate of interest charged by banks varies from one borrower to the other more than it does from one industry to the other. It was found that only one firm in the food industry whose wealthy shareholders have interests in various banking concerns, and another soft drink company whose loans are guaranteed by the mother foreign company, have been successful in contracting loans at 6 per cent interest. The remaining firms in both the food and beverage industries pay a rate higher than 6 per cent interest on the credit they obtain from banks. The average effective rate in the cement industry is approximately 6.5 per cent, whereas it reaches 8 per cent in the beverage and metallic industries and 9 per cent in the food and textile industries. As a matter of policy the minimum acceptable interest rate to banks on industrial loans as of the first quarter of 1963 does not fall below 6 per cent which is considered the prime rate for industry in the market. The 5.5 per cent rate is charged only by BCAIF and thus applies to the relatively small number of firms which have borrowed from it.

The maximum acceptable rate to the food and beverage industries on loans and advances goes up to 9.5 per cent and 8 per cent respectively which is the same as the rates actually charged. This relatively high rate may be explained, in part, by the fact that the majority of the firms in those industries are small concerns with limited resources. Large concerns in the same industries which are adequately capitalized and whose business is solicited and competed for by various banks, do not contract loans at rates exceeding the prime rate prevailing in the market. The maximum acceptable rate to textile firms is 9 per cent though the large textile mills are accommodated at rates much lower than this. The cement industry stands as an exception in that it is awarded generally the lowest rate in the market. The cement industry is one of the largest and most solidly established industries. The lines of credit granted by banks to this industry are extensive, yet such lines of credit are seldom utilized in any significant way. The main reason is that these industries are adequately capitalized and have generated enough profits over the years to build up substantial reserves to finance their expansion and renovation projects. The maximum acceptable rate to the cement industry is around 7 per cent. The metallic industries, on the other hand, do not enjoy a preferential rate as does the cement industry. The industrialists engaged in the latter industry acknowledge the fact that they are in a heavy type of industry which requires credit for long periods. To them the interest rate has always been high as compared with the rates charged by banks on credit extended to large firms in other industries. TAble XIII summarizes the previous findings.

TABLE XIII

TERMS OF CREDIT FOR SELECTED INDUSTRIES

	Food	Beverage	Textile	Cement	Metallic
Interest					
Range acceptable to Banks	9.5%	6-8%	7-9%	6.5%	6.5-8%
Maximum rate " to the industry	9.5%	8%	9%	7%	7.5%
Maturity					
Period acceptable to Banks	3mo.- 2 yrs.	1-2yrs.	3 yrs.	1 yr.	2-3 yrs.
Period demanded by industrialists	3mo.- 10 yrs.	2-5 yrs.	5 yrs.	1-3 yrs.	2-15 yrs.
Security					
Varies with the credit worthiness of the client, maturity, size of loan, and other factors.					

An acceptable rate of 9 per cent to a firm does not necessarily mean that the same firm is getting the credit it is seeking even though the minimum acceptable rate to the bank might fall within the range acceptable to the industry. The reason is that the acceptable rate and the rate at which credit is granted may not refer to the same firm but to two different firms in the same industry. What is acceptable to one firm might be way below what banks would charge on advances extended to that same firm. Another factor affecting interest rate is that a firm may be ready to contract loans at different rates depending on the maturities of the respective loans. On the whole, the rate of interest that any industry is willing to pay depends in the final analysis on its marginal efficiency of capital.

2. Maturity

Commercial banks are an important source of short term credit though it is by no means the only source. Trade credit comprises another main source of short term financing. Short term credit, which is customarily known as commercial credit to industry, is used for two main purposes. The first is to finance seasonal purchases and sales. In the majority of the food, beverage and textile industries a great concern has been expressed about seasonal short term credit. Enterprises in these industries need short term credit for a period of three to six months in order to finance the purchase of raw materials, processing, and selling so as to meet obligations when they fall due. The three above-mentioned industries also arrange for lines of credit to rediscount the bills generated by their sales or to get advances secured by the collateral of such bills.

A further need for short term credit arises, in certain cases, when industrialists advance funds on a seasonal basis to their suppliers. For example, the majority of industrialists in the sugar, canning, and vegetable oil business do provide such advances. The sugar industry provides funds to beet growers before they start planting and guarantees to buy all their produce at prices fixed in advance. The canning and oil industries provide similar facilities. Many industrialists do not have adequate financial resources to make such advances to suppliers a regular service to be provided by industrialists. Most industrialists, however, make a profit in providing these advances from the spread between the rate they charge the local suppliers on funds advanced to them and the interest rate they pay on borrowed funds from banks. Naturally, industrialists assume the risk of possible default by the suppliers.

The cement and metallic industries do not have a seasonal short term need for financing their raw material purchases. The cement factories have their own reserves. The same is true of the steel mills that operate mines.

In the case of steel mills that use scrap iron as raw materials they have to pay in cash for their supplies. The aluminum factories need short term credit occasionally when they import their raw material requirements namely: aluminum rods, bars, and sheets. Credit in the latter case is mostly extended by suppliers who ship the raw materials against the acceptance by the industrialist of a three to six months draft in which he promises settlement. Banks on the other hand often extend credit for the import of raw materials on a letter of credit basis. Industrialists prefer trade credit, whenever it is interest-free, to bank letters of credit.

The other main use of short term credit besides the financing of seasonal purchases and sales of industries, is to meet operating expenses. Industrialists in general, even the few ones who command ample capital resources, arrange for credit lines at banks to meet operating expenses. Operating expenses comprise salaries and wages, rents, electricity and other miscellaneous items. Most industries get these credit lines on a clean basis (no collateral security), the size of the line varies with the credit worthiness of the borrower. Such a credit line does not necessarily leave the industrialist in a debtor's position. In the peak season of sales some industrialists may be able to clear up their indebtedness and build up a credit balance in their accounts on which they would be allowed an interest return.

Our investigation has revealed that in 45 per cent of the cases studied the need for medium and long term credit is sought mostly for the purpose of renewing machinery and equipment. In 25 per cent of the cases credit is used to diversify the operations and the products of existing concerns. The latter situation applies mostly to the food and textile manufacturers. Those manufacturers assert that through the introduction of new products they would be able to reduce their overheads and to expand sales and profits. Many of these manufacturers can easily diversify their product lines by installing a few more machines. In 30 per cent of the cases, financing is needed to retire certain short term obligations contracted to meet medium and long term requirements. Such a need for working capital is acute in a number of firms that have overinvested in building and machinery at the expense of working capital. A continuing dependence on short term credit for working capital tends to convey an adverse picture of the firm's liquidity position when reviewed by banks.

The period of bank credit is typically a year for the cement firms, which mostly obtain the credit funds by discounting bills generated out of sales. The beverage firms have been getting advances up to two years on a renewable basis to modernize machinery. The food, textile, and metallic industries, which are in need of more medium and long term facilities, are getting credit for periods running up to three years on the understanding that the loans would be renewed at maturity.

In studying the credit needs of industrialists one finds that firms accounting for 40 per cent of the networth of the beverage industry are in need for credit running up to five years in order to renew and install machinery. Only one newly established firm in the cement industry is in need of credit lines running for three years, which it has already got in the form of trade credit from machine suppliers. In the textile industry the majority of the firms need credit to renew machinery and to install new ones for the production of new textile products. These industrialists expressed a need for loans not exceeding five years in term. The picture changes considerably in the food industry where the majority of firms are small with modest profit margins and reserves. The bulk of loans they need is for five to ten years period. In the metallic industry, the need of almost all the firms is for loans of about ten years maturity, with the exception of foundries which do not need loans exceeding a period of five years. The nature of the industry, the heavy investments involved, the long time it takes to process and produce the final product, all have given rise to the need for long term credit. The production cycle in this industry is relatively long and it is here where the need for long term credit is most acutely felt.

3. Security

With a few exceptional cases in the beverage industry, where the foreign mother companies offer their own personal guarantee, the majority of firms in all industries depend on what they can offer locally in terms of security or collateral. Credit lines guaranteed by mother companies are not taken as a sign of financial weakness for the local firm. The mother company outside Lebanon which may have control over the local subsidiary arranges with banks, while the local plant is under construction, to grant advances to the subsidiary with the mother company's guarantee. It should be noticed that certain firms may be willing to offer mortgages as security for long term credit but are not willing to offer the same type of security for short term credit. Thus, there is a direct relationship between the security offered and the maturity of the loan. The relationship is not as apparent between the security offered and the interest charged.

In the food industry firms accounting for 60 per cent of total networth insist on having clean credit lines with no security, the rest, especially the medium-sized and small firms, agree to offer personal guarantees and mortgages.

A number of beverage firms offer the guarantee of their mother companies, especially in the early stages of their life. The majority of soft drink firms are affiliates of foreign concerns which guarantee the local firms' credit. A number of alcoholic-beverag e firms offer mortgages as security, especially where the loaned funds are substantial and are contracted for a period longer than one year.

In the textile industry, the larger firms which account jointly for approximately 70 per cent of the networth of the industry do not offer any mortgage as security, except for loans which some of them obtained from BCAIF. Textile manufacturers get clean advances mostly because they are closely-held family concerns and the credit worthiness of the family as a whole is taken into consideration. Banks hesitate to accept chattel mortgage or machinery as a security because a great number of firms possess outmoded machines and because the resale value on forced sale is low.

In the cement industry, which is adequately capitalized and quite profitable, firms insist on clean advances. The main reason for this, besides the high credit worthiness of the concerns involved, is that the credit is required only for short term purposes.

In the metallic industry, all the firms are ready to offer mortgages as security provided the credit granted is for long periods of time. At present firms accounting for approximately 50 per cent of the total networth of the industry have mortgages on their factories.

4. Amount

The IRFED Mission has lately made certain estimates on the volume of credit needed by the various sectors of the economy over the five year plan period which stretches between 1964-1968. Although the figures might not be more than very rough estimates, yet they are an important attempt at quantifying the need of industry for credit. Table XIV shows these estimates.[1]

TABLE XIV

CREDIT NEEDED BY INDUSTRY 1964-1968

(In L.L. Million)

Sector	Object	Total	Beneficiary	Maturity
Industry	a. "Industrial Zoning"*	15	Jointly owned Corporations	Long term
	b. Financing Equipment	100	(Private and Public)	Medium term
		115		
Handicrafts	Financing Equipment	20	Private concerns	Medium term

* This category of credit is aimed at promoting the setting up of industries in specified localities outside the city of Beirut and is not limited to the financing of equipment.

[1] Privately secured from IRFED Mission.

The total amount of credit needed by industry over the five years amount to L.L.135 million, over and above the short term credit that might be needed by industry.[1] According to IRFED, the global amount is to be allocated in this manner:

Year	Financing New Enterprises	Financing Modernization	Total for Industry *	Handicrafts
1964	6	4	10	3
1965	9	6	15	3
1966	12	10	22	4
1967	15	10	25	5
1968	18	10	28	5
	60	40	100	20

* Excluding credit for zòning and handicrafts.

IRFED Mission further suggests that the Development Bank which, it proposes, will provide the financing to industry would try not to exceed the following ratios: A 60 per cent ratio of credit to equity of any industrial firm and a 40 per cent ratio to handicrafts concerns. The limited information available on the detailed calculations on which the estimates were built renders it difficult to go any further in analysis there.

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[1]Le Commerce du Levant (Monthly Issue), No. 32 (April 15, 1963), p. 30.

Conclusions

The demand for industrial credit is a function of many interrelated factors which vary in importance from one industry to the other. The influence of various demand determinants differ among various firms.

Industries in need of capital have a choice between equity or debt financing. Equity financing is used, generally, only when existing shareholders can raise among themselves enough funds to cover their needs. Debt as a source of finance is sought, though sometimes at a high cost, to prevent bringing in new shareholders who would acquire voting rights. When shareholders are unwilling or unable to provide additional equity capital they resort to debt financing. It is rare to find in Lebanon any industry which is absolutely out of debt. This study has revealed that the food, textile, and metallic industries depend more heavily on debt as a source of funds than the beverage and cement industries.

The interest rates, the maturity period, and the security to be provided are the more important factors in the demand of industrial credit. It was found that the cement industry does not need credit for a period exceeding three years. The period of credit rises to five years in both the beverage and textile industries while long term credit is only sought by two industries out of the five investigated, namely food and metallic industries. The food industry needs credit for a maximum period of ten years while the metallic industry needs credit for a period of fifteen years.

The type of security offered is connected closely to the maturity period of the loan, to its size, and to a much lesser extent to the interest rate charged. Mortgages are the main type of security offered on long term loans. Industries with a low ratio of debt to networth hesitate to contract loans on other than clean advance basis. There is however no direct relationship, in most cases, between the security offered and the interest rate charged. It is expected in cases where an industry offers a mortgage as security to ask for a lower interest charge than that charged on clean advances.

CHAPTER IV

INDUSTRIAL CREDIT IN PERSPECTIVE

A. THE CAPITAL REQUIREMENTS OF INDUSTRIAL DEVELOPMENT IN LEBANON

Capital financing is a significant factor in the industrial development of any country; Lebanon, as our findings show, is no exception in this respect. Although capital plays a significant role in industrial growth, it does not follow that the problem of finance is the only or even the most important problem facing industry in this country. Industrial development in Lebanon has been handicapped by a number of factors. One is the limited use of modern techniques of management. Another is the narrowness of the market. The small size of the population and relatively low per capita income are responsible for Lebanon's narrow domestic market. The severe competition of foreign products coupled with the absence of a rational tariff policy for the protection of industry have not helped industry in Lebanon. The size of the local market is to some extent conditioned by the element of taste of the population. The existence of a great diversity in tastes, as is the case in Lebanon, makes it difficult to have enterprises of an economical size. In the foreign markets, Lebanese products are competing severely for a foothold. The situation has been made difficult by the tariff and administrative barriers imposed in potential markets for Lebanese products. Industrial growth has been further retarded by the shortage of domestic sources of raw materials in commercial quantities and by the relative paucity of skilled labour.

The reasons for industrial capital shortage in Lebanon are many. An endeavor will be made to cover the main ones. The level of savings which is low and the character of financial institutions which exist in the country have been strong factors in the shortage of medium and long term capital. The absence of data on savings and consumption makes it difficult to give anything more than a rough explanation. For one thing, the level of savings is relatively low. On the whole, in Lebanon "people save less than one would expect them to and people in high income brackets save much less than they can."[1]

The absence of financial institutions other than commercial banks to channel savings has helped to shape the present pattern of investment by directing the deposits of the community into traditional trade outlets. The pro-

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[1] Yusif Sayigh, "Lebanon: Special Economic Problems Arising From a Special Structure", Middle East Economic Papers, 1957, p. 75.

blem of mobilizing savings is particularly serious where new forms of economic activity are involved, as in the expansion of industry in Lebanon. Savings tend to move within the sector in which they are generated. "In the course of economic development, industrial enterprise has come from many segments of the community (and chiefly from the merchants) in which capital and skill grew by slow accretion."[1] Many of the industrialists interviewed endorsed this view and asserted that they have expanded from trade into industry. The fact that the bulk of deposits in the banking system are on demand, coupled with the absence of a central bank which would rediscount bills for banks in financial stress, have led to a concentration of bank lending, for the major part, on the short term end of the market.

The underdeveloped Stock Exchange does not offer at present a significant source of capital funds for industry. This has helped to direct much of the long term capital funds into real estate investments rather than into other sectors of the economy. Moreover, the Lebanese progressive taxation system penalizes the corporation's profits and favours partnerships and single proprietorships. The tax is levied on the individual shares in the firm's income and/on the corpora-

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[1]William Diamond, Development Banks (Baltimore: Johns Hopkins Press, 1957), p. 14.

tion's global net profit. Under a progressive tax system this is likely to result in higher tax rates applied in the case of corporations than in the case of other forms of organization. The prospects of mobilizing private domestic savings for purposes of industrialization through a greater use of the corporate form of enterprise are thus handicapped by the present tax law.

It is worth stressing that "the investor's expectations of the returns he is likely to get on his investment are coloured not only by the purely economic factors of demand and costs but also by various political, social, and psychological elements that make up the environment in which he has to function."[1] The region has not enjoyed a substantial period of political stability, and this state of affairs has not been favourable to long term capital investments in industrial projects. The region as a whole is undergoing a critical evolution in its political and socio-economic structure. Lebanon, apparently cannot escape the repercussions of the revolutionary institutional changes taking place in neighbouring countries. These changes tend to have an impact on the movement and outlook of capital investment in Lebanon. The non-economic considerations, significant as they are, fall beyond the scope

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[1]The Indian Committee on Finance for the Private Sector, quoted in Ibid., p. 12.

of this study.

The government in Lebanon has never spelled out a well-defined economic policy. Economic activity in the country at present is considerably dependent on the initiative of the private sector. Moreover, the dearth of scientifically studied industrial projects by public or private research institutions has contributed to the reluctance of capital to flow into industry.

There is a clear dilemma in the situation. Banks apparently, among other suppliers of credit, are willing to accommodate only growing industries, whereas the industries' complaint has been that they cannot grow as long as there is a shortage of industrial credit.

B. POTENTIAL FOREIGN SOURCES OF INDUSTRIAL CREDIT

Potential foreign sources comprise foreign banking institutions and international financial organizations. A number of foreign banks have engaged in the financing of industrial credit by providing equity or loan funds. Bank of America recently established an international agency, under the name of Bamerical, which has for its object to grant loans to foreign industrialists and commercial corporations.[1] Bamerical shall engage mainly in equity participation. Its principal object is to acquire a minority

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[1] Middle East Express, No. 33 (October 5, 1962), p. 30.

share in the equity of industries with a majority voice in the board. The Bank, as it insists on a voice in the management which is disproportionate to its part ownership, counts on the fact that investors may rush to subscribe to an industrial company's shares mainly because of its participation. The Bank, through its international agency, shall be in a good position to determine with accuracy the credit needs of sponsored corporations and may further supply such corporations with credit funds. Bamerical, needless to say, would not participate in a company if its profit prospects are not bright. Among the implied prerequisites for such a participation is a willingness on the part of the majority shareholders to give control to the Bank. Lebanese industrialists with sound and economically feasible projects may approach such an institution for both equity and loan funds. There are a number of institutions similar to Bamerical in various European countries. Bamerical has been referred to here merely as an illustration of a source which has not yet been tapped by local industrialists.

The main international institution that supplies credit to private industrialists is the International Finance Corporation (IFC), which was established in 1956 as an affiliate of the World Bank. It is designed "to supplement the activities of the Bank by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas."[1] It does not invest in enterprises which are government owned or controlled, yet it may invest in enterprises having minority government participation. It further seeks investment in existing or in new industries. The Corporation provides financing in association with private investors without government guarantee and seeks to create investment opportunities by bringing together domestic and foreign investors and experienced management.[2] It also aims at stimulating the flow of private capital into productive investments in member countries. In 1960 IFC's Charter was amended to permit it to offer, in association with private investors, long term financing through equity or loans, whereas previously it could not make any equity investments.[3] The Corporation is also allowed under the same amendment to underwrite issues of shares or securitities prior to public sale, or on a standby basis. "It will help by joining with local institutions in sponsoring offerings of industrial securities to the general public and by making

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[1]The World Bank, IFC and IDA, _The World Bank, IFC and IDA Policies and Operations_ (Washington, D.C: IBRD, April 1962), p. 95.

[2]_Ibid._

[3]_Ibid._, p. 98.

investments on its own behalf."[1] It will thus assume a role which is complementary to that of the World Bank, the IFC supplying equity and loan capital and the World Bank offering long term loans only. Needless to say that IFC would participate only in enterprises having sound capital structures, promising profit prospects, and experienced management. In new enterprises established with IFC's help, the latter's contribution to the capital should always be less than 50 per cent of the total capital and should avoid exercising its voting rights except in compelling circumstances.[2] The Corporation should be assured that there are not enough private domestic funds seeking investment in the industry under reasonable conditions. The aim is to avoid competing with private enterprise in the field of industrial financing.

The usual IFC loan runs for fifteen years with serial maturities and bears a commitment fee of 1 per cent per annum on the unsettled (unpaid) portion of its investment (for both equity and loans) over and above the interest charged on the loan.[3] The interest charged is a function of the risk involved and recent loans to industries in Greece, Peru, and Pakistan carried a 7.5 per cent interest.[4]

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[1]Eugene Black, quoted in Middle East Express, No. 6 (April 9, 1962), p. 9.

[2]The World Bank, IFC, and IDA, op.cit., p. 99.

[3]Ibid., p. 100.

[4]IFC, 1961-62 Sixth Annual Report (Washington, D.C.; IFC, 1962), pp. 10-13.

IFC has successfully formed syndicates with a number of investment houses to underwrite issues of capital shares of industries. Despite the fact that its paid in capital, which was contributed by its 60 member countries, is around $97 million, yet it has seen to it that for every IFC dollar invested, some three or four more dollars from private channels have flowed into its projects.[1]

The IFC has not participated so far in the financing of any industrial project in Lebanon. Equity participations by IFC, no doubt, would stimulate the market for securities by inducing more people to invest their savings in corporate shares. The strict criteria of screening out projects applied by IFC will allow Lebanon to have the benefit of expert advice on the economic feasibility of industrial proposals. A number of Lebanese industrialists, however, have already sought financing from the IFC but their applications were turned down. Sound projects which are supported by adequate studies from the engineering, marketing, and financial points of view would not fail to attract IFC's interest. Heavy industry in Lebanon, such as the metallic industry, which is in need of more capital, skills, and experience than are locally available might be among the first to seek IFC's participation, whereas the limited

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[1]The World Bank, IFC and IDA, <u>op.cit</u>., p. 102.

capital requirements of the smaller industrial firms can be readily met from sources other than the IFC.

The Export-Import Bank of Washington (Eximbank) is an important potential foreign source of credit to industry. Eximbank is a United States Government-owned corporation which was established in 1934 with one billion dollars as capital paid in by the United States Treasury. Eximbank has a further line of credit from the treasury amounting to $6 billion which it can use on a revolving basis. In its turn, Eximbank "makes long term loans to finance the purchase of United States equipment, goods, and related services for projects undertaken by private enterprises or governments abroad."[1] Eximbank also provides funds and guarantees the payment of medium term commercial export credits extended by exporters, and in partnership with private insurance companies offers short and medium term (5 years) export credit insurance. Eximbank sponsored the formation of the Foreign Credit Insurance Association (FCIA), already discussed in Chapter II, to provide exporters with insurance on their credit sales overseas. The Bank assumes all political risks but shares the credit risks with FCIA on a 50-50 basis. The exporter

[1] Export-Import Bank of Washington, I (for the twelve months ended June 30, 1962), (Washington, D.C.: Eximbank, 1962).

is a co-insurer and must carry for his own account from 5 per cent to 15 per cent of the political risk and 15 per cent of the credit risk. Premium rates vary according to the risks in the country of the importer and the term of the credit. When a commercial bank is prepared to carry for its own account the short (18 months or less) maturities of the credit guarantee, Eximbank will issue to it, for a suitable fee, guarantees against political risk. On maturities exceeding 18 months the Bank will issue guarantees against both political and credit risks. The buyer of the United States goods has to make a cash payment between 10 and 20 per cent of the value of the goods while the exporter's participation should not fall below 15 per cent. The guarantees have been made assignable so that the commercial bank may sell the export paper to other financial institutions.[1] Eximbank has authorized loans for three projects in Lebanon.[2] Eximbank is evidently in-

[1] Ibid.

[2] Ibid., II. The three loans are the following: $3,175,000 to La Societe de Grands Hotels du Liban for the construction of Phoenicia Hotel, $124,300 to Salim Najjar and Company for the import of an aluminum extrusion press, and a certain amount to Haj Ali Zaatari and Bros. for the import of a citrus packing plant which expired unused. The loan for the first project was contracted in the middle of 1959 and runs for 18 years, with an interest charge of 5.75 per cent.

terested in larger projects which are supplemented by adequate feasibility studies. Lebanese industry may tap this source of credit in case it is in need of funds to finance its purchases of equipment and raw materials imported from the United States. Lebanese industrialists can get credit facilities through exporters from the United States or through their banks who may apply to Eximbank for credit.

Another foreign source of credit to local industry, which has been utilized by few industrialists so far besides BCAIF, is the Development Loan Fund (DLF), now known as the Agency for International Development (AID). The DLF was established as an independent United States Government-owned corporation in 1957. Its capital is $1.4 billion and provides guarantees as well as direct loans. This institution is particularly interested in financing the foreign exchange requirements of development projects and programs, more particularly the costs of goods and services of United States origin. The activities of DLF are not meant to compete with private investment capital or with either Eximbank or World Bank operations. Projects financed by it should be technically sound and should have a contribution towards the development of the underdeveloped country. Private industrial projects are eligible for financing from the DLF, and proposals which contribute to increased private investment and enterprise are apparently welcomed. Private industrialists are expected to provide a reasonable share of the total funds needed for a project. The terms and conditions of DLF loans are flexible; there is no fixed policy regarding interest rates, types of collateral, maturities, and others.[1] DLF in general offers a valuable service in financing sound industrial projects in underdeveloped countries. Lebanese industry may call on DLF's services not only to finance the purchase of machinery and raw materials but also to pay the salaries of foreign technicians employed in an industry. DLF has thus far granted loans to BCAIF and one aluminum mill in Lebanon. It is a promising source of foreign credit which has not yet been adequately tapped.

C. CONCLUSIONS

Lebanese industry, notwithstanding the problems it has been encountering, has reared an appreciable growth. It is no more thought of as a "poor relation" but has rather become a respected member of the Lebanese economy. A number of economic experts have emphasized the necessity of applying a crash industrialization program in the country, without necessarily having to develop the agricultural sec-

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[1] Development Loan Fund (Washington, D.C.: DLF, 1960), pp. 2-6.

torfirst. "It is industrialization... which gets money into the hands of the people, it creates consumer goods and supplies funds for people to buy these goods."[1] Other economists entertain a different view regarding the growth of Lebanese industry. They believe that no substantial progress could be achieved through the agricultural and industrial sectors of the Lebanese economy. "It is mainly on the growth of the services sectors that our future prosperity depends, and I am afraid that both in government and in business, only those who keep this in mind will succeed."[2] The writer is inclined to support the view that "even at the risk of some hardship to trade, certain viable industries ought to be encouraged for the purpose of training labour and developing skills and factory discipline and organizational qualities which are valuable and necessary."[3] Other proponents of this view stress the employment advantages of the industrial sector as compared to that of trade.

Industry in Lebanon deserves much more attention than it has received so far from the authorities. Its

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[1]William Voris, "Industrialization: The Basic Necessity", Middle East Forum, Vol. 38, No. 5 (May 1962), p. 23.

[2]Paul Klat, Middle East Forum, Vol. 38, No. 8 (October-November, 1962), p. 41.

[3]Yusif Sayigh, Economic Development of Lebanon - Its Prospects and Problems, op.cit., pp. 22-24.

moderate contribution to national income gives no reason for its neglect. Admittedly, the "country is too small to harbour a large scale modern industry,"[1] yet a well-defined industrial policy has become imperative. The Lebanese Government should study the problems that face existing industries in matters of organization, finance, and marketing and should formulate its plans accordingly. The tariff structure reflects no carefully designed economic policy and has resulted in the growth of a number of inefficient industries without stimulating competitive enterprise. Thus the tariff policy, trade agreements, tax exemptions, industrial licencing, concessions, credit policy and a host of related measures should be tied up closely and clearly to a definitive industrial policy. Whether certain industries should be encouraged more than others becomes a matter of detail.

The recent strong interest of the government in the economic development of the country, as signaled by the engagement of the IRFED Mission to draft a development plan for the country, gives an encouraging sign to those interested in industrial growth. It is hoped that the Mission will bring forward, among other recommendations,

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[1] Paul Klat, "Lebanese Prosperity Myth or Miracle", <u>Middle East Forum</u>, Vol. 37, No. 2 (February 1961), p. 13.

a specific industrial policy. Such an industrial policy would outline the proper use of the community's economic resources. This policy need in no way impair the private sector's initiative but would rather help to give it leads as to the government's future action in matters related to industry. "It is inherent in an underdeveloped economy that the risk attached to investment in local enterprises is high; private individuals cannot reasonably be expected either to assess the extent of these risks fairly, or to take it entirely on their own shoulders."[1]

Supplying credit is an integral part of any industrial policy. The Ministry of Planning is presently studying the establishment of a development bank which would provide credit to the different lagging sectors of the economy, including industry. Credit, it is important to repeat, would help industry yet one should observe the fact that industrial expansion is also hampered by factors more important sometimes than the financial aspects.

In Chapter II the various existing sources of supply of industrial credit were evaluated. It was found that there is an adequate supply of short term credit (up to one year), a limited supply of medium term credit (up to five years), and nearly a complete absence of long term

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[1] Edward Nevin, Capital Funds in Underdeveloped Countries (London: Macmillan and Company, Ltd., 1961), p. 75.

credit other than that extended by BCAIF. The various trade sources which provide mainly term credit for the import of machinery were discussed along with the factors which limit their use to a relatively small number of firms. The other sources of credit comprise BCAIF and the commercial banks. Commercial banks have continued to direct the bulk of their credit activity to the trade sector. Banks, motivated primarily by profit and liquidity considerations, have not played a significant role in medium and long term lending, although they manifested an active interest in extending short term credit to industry. BCAIF has extended credit to industry on medium and long term basis but has been handicapped by its relatively small resources. Studying the credit market of Lebanon, one develops the opinion that capital is not scarce but is rather used in ways not conducive to the growth of the commodity sectors of the economy.

In Chapter III, our analysis of the demand for credit revealed that there is a patent need for medium term credit in nearly all industries. Industry also needs long term credit though to a lesser extent. Short term credit, needless to say, is demanded by all industries.

The writer realizes that there is a shortage of medium and long term credit. It is true that banks do supply industry with credit with a two-year maturity, which is in the majority of cases renewable at maturity for a similar period; yet, credit is seldom granted on a medium term basis from the start. Private initiative in general and commercial banking in particular have not thus far been conducive to an improvement in the situation. The degree of risk inherent in industry is typically high, especially as compared with risks associated with trade. It is doubtful that the highly competitive character of the supply of investible funds in the trade sector would help to channel a sizeable portion of capital away from the trade sector and into the industrial sector. The shortage of medium and long term credit is not so much due to an overall capital shortage as to a lopsidedness in the capital market which favours trade and services.

The role that the government should play in providing industrial credit may be discussed in relation to the development bank project, to the new draft banking legislation, and lastly to the fiscal policy.

A law was passed in June 12, 1962 reorganizing the Ministry of Planning and providing in Article 32 for the creation of a National Bank for Development.[1] The proposed bank aims, among other things, at developing the industrial sector. Subsequently, on June 22, 1962, Mr. Debono of the

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[1] L'Orient (August 22, 1962), p. 2.

IRFED Mission submitted a project for the establishment of such a bank. In his project, Mr. Debono specified that the bank would have for its object the financing of the following activities: government public works, agricultural and fishing cooperatives, touristic ventures, housing projects, industry, handicrafts cooperatives, shipping enterprises, and banks which would advance medium term credit. It can be seen that industry is only one of many areas of interest to such a bank. Lately Mr. Jaffrezic, an economic expert, prepared another project for a development bank which is currently under discussion.

Through a brief evaluation of BCAIF'S role in industrial financing, we hope to cast further light on what should be done to accommodate better the industrial sector's need for credit.

BCAIF's policy of limiting short term loans to half the net annual earnings does not have much of an economic justification. A short term loan is by its nature self-liquidating as the principle and interest will be paid out of the proceeds of sales. Only a drastic fall in prices or a drastic cut in the sales volume may result in the inability of the borrower to repay his debt. Some industrialists argue that BCAIF is not providing an adequate supply of funds for working capital purposes. But BCAIF's main interest is in medium and long term lending activities. Should BCAIF decide to advance more short term loans which are already in plentiful supply, its long term lending operations, given its limited resources, will be necessarily weakened.[1]

The limited funds at the disposal of BCAIF have restricted the extension of its lending activities, The low interest rates it charges, although it is permitted to charge 2 per cent over what it pays, have put a limit on the interest it can pay on loans it may wish to contract with various agencies or institutions. On the other hand, one cannot help industry by charging higher rates of interest. Because of the joint public and private participation in the ownership of this institution there has always been apparently a conflict of interests. The private sector's shareholders favor higher rates in order to make more profits. A higher earning power, it is maintained, would give BCAIF a greater access to loans from other institutions, which would expand BCAIF's lending capacity. The government insists on lower rates for the purpose of helping industry keep down its costs. It is further maintained that BCAIF can afford to keep its rates low because the bulk of its resources are obtained

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[1]Suggested by Dr. Talha Yaffi, Managing Director of BCAIF.

under a government guarantee for a low interest charge.

Our study revealed that five local banks (out of twelve interviewed), and three foreign banks (out of eight) favoured an increase in the role of the government in industrial lending through the establishment of a development bank. The remaining banks did not express any specific view, with the exception of one foreign bank which did not regard Lebanon as a country with a promising industrial potential. The bankers who favour the establishment of a development bank believe that such a bank would take up the financing of long term debt while medium term credit will continue to be accommodated by them on a yearly renewable basis. The writer, in referring to the development bank, which the government is planning to set up, will limit the discussion to the industrial credit aspects of its activities.

The writer is of the opinion that the industrial credit activities of the new development bank could be taken care of by BCAIF. The latter's statutes could be amended in order to embody the government's industrial policy, which should be set up if a sincere interest is directed towards developing industry. The 40 per cent of the government in BCAIF's capital, coupled with the fact that the bulk of BCAIF's resources are government guaranteed, would give the government a definite say in implementing the same aims that it hopes to achieve by setting up a development bank. The fact that the resources of BCAIF are inadequate constitutes no justification for settting up almost a duplicate institution in so far as industrial credit is concerned.

What should be the policy relative to the interest on loans extended by BCAIF? The issue is definitely controversial. Those who argue for a lower rate than the market rate contend that the market rate tends to favour the concerns which can make higher profits than others and thus can pay a high interest rate. But profit making is not the only or the most important criterion of judging whether or not an industry is economically feasible from a social point of view. A labour-intensive industry or an industry that contributes to the development of a lagging geographic region in the country might rank higher in the government's scale of priorities than an industry promising higher profits but a lower contribution to employment or regional development. It is feared that many non-economic factors, such as politics, might intervene if a discriminatory interest policy is applied. In general, "industries to be established in Lebanon should not be expected to return profits which are much higher than the current rate of interest."[1] If BCAIF charges its

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[1]Edmond Asfour, "Industrial Development in Lebanon", <u>Middle East Economic Papers, 1955</u>, p. 5.

customers a lower rate of interest than the market rate, then it would put a limit on the rate of interest which it can afford to pay on funds it may wish to borrow from regional or international institutions. Those institutions ordinarily lend funds at the prevailing interest rates in the market. Kuwait, which is a potential source, with overseas foreign exchange holdings of Sterling Pound 240 million as of August 1962, has been able to achieve on the average an income of 5.75 per cent. The Kuwaiti funds are mostly invested in guilt edged securities.[1] This will provide us with an idea on the market interest rate acceptable to a potential lender such as Kuwait. The interest that BCAIF pays on funds it borrows will determine, in part, the interest that it will charge on lending to industrialists. As BCAIF is partly owned by private interests, private shareholders do expect a profit on their investment, though it may be unnecessary to make a return on government capital. Moreover, it is essential to acquire a record of profitability before BCAIF can aspire to active trading in its securities. "By providing capital on conditions commensurate with its cost and with the risks incurred, it can show by example that long term

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[1] Middle East Express, No. 25 (August 20, 1962), p. 19.

investment can be both sound and profitable."[1]

Should BCAIF charge the same rates as those charged by commercial banks, or rather the prevailing market rates, such a policy would undoubtedly hurt a number of existing industries and may discourage potential industries from ever starting. It is, therefore, recommended that a structure of interest rates be applied by BCAIF which would allow for different rates to be collected on loans to different industries. The interest rates applicable to various industries should be determined in the light of the industrial policy of the government. The government may subsidize BCAIF in compensation for the cut in interest rate charges which it will make for industries the government is keen at developing.

BCAIF should be allowed by its statutes to issue debt securities and to call on local and foreign sources of capital to expand its resources. The securities of BCAIF could become an attractive outlet for the funds of official and semi-official bodies as well as other private investors. BCAIF may start raising funds by floating short term notes and later long term bonds. Short term notes might be easier to float as the country has become familiar with the bills market especially after the substantial increase

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[1]William Diamond, op.cit., p. 84.

in instalment sales paper in the market. Commercial banks and insurance companies may well be among the first to be attracted into investing in BCAIF's notes.

Savings accounts at commercial banks have grown significantly in the early sixties. Much of these accounts can be considered as fixed. If a top limit is put on the size of any one saving account, as the draft banking law proposes, the individual bank would be assured of a better degree of diversification and thus of a lower risk of sudden withdrawals, than would have been the case where depositors are few in number with large balances. Banks are paying on the average an interest rate ranging between 3.5 and 4 per cent on savings accounts, while safe and profitable outlets for investment have become increasingly limited. BCAIF may start with L.L.1 million issue of bonds bearing an interest income of 5 per cent. The rate allowed may be slightly lower than the rate that BCAIF charges on its loans but slightly higher than the rates allowed by banks on savings accounts and also higher than the interest offered on interbank funds. BCAIF may then establish special funds (by maintaining suitable balances) with a number of securities dealers and commercial banks who are authorized to redeem at sight any bond presented for sale. The responsibility for pegging the market value of BCAIF's securities may as well be relegated to the prospective central bank. Such securities may be declared as eligible for rediscounting at the central bank or as collateral for loans by the central bank. The reputation achieved for a high liquidity of such bonds coupled with an attractive interest rate will enable BCAIF to go on floating more bonds. Once the bonds get to the hands of the public and are considered as liquid securities BCAIF could gradually lower the interest it is granting on such bonds and perhaps withdraw its (or the central bank's) pegging of the price. With a little of patience (perhaps a couple of years to achieve a record of marketability and confidence in the capital market) BCAIF may in time be able to dispose with government guaranteed loans.

Various suggestions and projects have been put forward, all centering around the idea of establishing an Arab Development Bank to finance various development projects in the Arab World, including industry, but none of them has been implemented. In those projects a major role has been attached to Arab oil-rich countries in supplying a sizeable portion of the capital resources needed for such a bank. Among those who submitted such projects for an Arab Development Bank were: Professor Said Himadeh of the American University of Beirut, the Arab League, and the late Deputy Emile Bustani.

Presently the main regional source of funds is Kuwait. The aim of the Kuwait Arab Development Fund is to help Arab countries in their development projects by loaning them capital. The Fund's capital was originally Kuwaiti Dinars (K.D.) 50 million, all of which was contributed by the government. The Fund may, under its statutes, borrow from the public and other sources and issue bonds.[1] Later the capital was increased to K.D. 100 million and a provision was added for a further possible increase to K.D. 150 million.[2] The Fund has already granted a number of loans to Sudan and Jordan under the guarantee of the respective governments. The Kuwait Company for Investment is another possible source of finance. Its capital is K.D. 15 million. It is equally shared by the government and the private sector.[3] It seeks investment outlets for its capital and its customers' deposits. BCAIF may consider these sources, among others, as likely sources of credit funds worth tapping.

The World Bank (IBRD) and its two affiliates, the International Finance Corporation (IFC) and the International Development Association (IDA), provide a number of

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[1] Al-Raid al-Arabi, No. 16 (February, 1962), p. 11.

[2] Middle East Express, No. 28 (September 10, 1962), p. 20.

[3] Al-Raid al-Arabi, No. 19 (May, 1962), p. 64.

credit services to industry. IFC, which provides both equity and loan funds to private industries and to development banks, has been previously discussed as a potential source of industrial credit. The World Bank restricts its lending activities to governments or to projects guaranteed by governments. BCAIF has to have the government's guarantee for any credit it seeks from the World Bank. The latter has recently participated in a number of growing industries in underdeveloped countries. The World Bank generally "disposes of its industrial shares whenever an enterprise becomes profitable and, therefore, capable of attracting more private capital."[1] The primary aim is to use the Bank's capital as a revolving fund. The IDA was founded late in 1961 with a total subscription of $912 million.[2] It finances development projects with no interest charges on credit extended save some service fees. IDA grants loans to countries with balance of payments difficulties. Lebanon which does not have such difficulties may not be able to contract easily any loans with IDA. The World Bank and IFC continue to stand out as important potential sources of industrial financing with considerable

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[1]IBRD, The Economic Development of Iraq (Baltimore: Johns Hopkins Press, 1952), p. 295.

[2]IDA, 1961-1962 Annual Report (Washington, D.C: World Bank, 1962), p. 11.

experience in financing development banks.

To conclude the writer believes that the government can, without considerable difficulty, implement its industrial credit policy through BCAIF and avoid the establishment of a new development bank. The government may go along and establish a development bank to cater to the needs of the other sectors of the economy. BCAIF's activities need in no way interfere with the activities of commercial banks. They may well help to increase banks' earnings as a result of "the indirect business accruing to them from the expansion of existing enterprises and the creation of new ones."[1] BCAIF should actively act as a catalyst for investment in industry. Furthermore, if BCAIF does issue securities of the type suggested above, these can be used by the banks as secondary reserves.

The draft Banking Legislation contained an article which draws a line of distinction between commercial and specialized banks. The Government is apparently interested in the growth of specialized banks which would lend on medium and long term basis. The main aim of this distinction is to insure the liquidity of the commercial banking system whose greater part of deposits is on a demand basis. Advocates of this view argue that the his-

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[1]William Diamond, op.cit., p. 46.

tory of commercial banks in Europe which have engaged in both short and long term lending shows that too many of them were involved in serious liquidity difficulties.

Some commercial bankers argue that the segregation is not necessary as banks seldom grant medium or long term loans. The absence of specialized institutions, however, is no justification for not providing the necessary legislation for encouraging their growth. Other bankers claim that such classification deprives commercial banks from lucrative investment outlets. The implication here is clear in that banks do engage at present in medium term lending. Bankers substantiate their views by stressing that no significant bank failures took place in the country in spite of the fact that a series of crises swept the whole region in the past years. They further claim that the cash reserves to be kept with the prospective central bank are a sufficient liquidity cushion.[1] This line of reasoning does not sound to be very convincing since the legal cash reserves can be only a minor source of liquidity to the banks.

The writer suggests that this problem could be handled as follows. A certain fixed percentage of the volume of savings and time deposits at banks will be assigned to other

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[1]Le Commerce du Levant (January 5, 1963), pp. 9-12.

than short term lending purposes, if banks so chose. Thus banks can go into medium term lending only if they have fixed or savings deposits and only up to a certain percentage of these deposits. Savings accounts, which have been growing significantly in the past few years, may give banks the opportunity to invest these funds in outlets with a maturity exceeding one year. Savings Accounts have nearly doubled between 1960 and 1962 as many bankers asserted. Savings deposits in Lebanon, contrary to other types of deposits, are largely held by Lebanese nationals. In conclusion one can say that there is no harm in providing legislation for the establishment of specialized institutions. But as these institutions may fail, especially at the start, in attracting a sizeable volume of fixed and savings deposits, it is suggested that commercial banks should continue to attract all types of deposits and be able to use them in other than short term investment subject, of course, to certain limitations.

The present tax law should be reformed to give a clear advantage to the corporate form of enterprise, which is a promising channel for mobilizing the community's savings towards investment in industry. The growth of corporations in both number and size is an essential prerequisite for any sizeable activation of the Stock Exchange. The fact that many industries cannot operate profitably except on a large scale is a strong point in favour of corporations. In an attempt to encourage corporate form of enterprise the government had exempted all dividends on corporations securities from taxation. It is suggested that the government should apply a flat rate on corporations' profit and maintain a progressive tax on other legal forms of business enterprise. The present income tax is applied in a progressive scale on incomes of all forms of enterprise. In time and as more ventures of the type that need large capital outlays are started the flat tax rate would act as a decisive incentive. For some time to come, however, one would expect the family-type enterprise to continue as the predominant form.

The Stock Exchange will take time to develop even though a great number of corporations might be established. The difficulty of developing the habit of investment in securities coupled with the possibility that many of the corporations will continue to be family-owned might retard the development of the Stock Exchange for some time to come. The floatation of public securities with pegged values, as was suggested above in connection with BCAIF, would certainly help to bring about more active trading in the Stock Exchange. Furthermore, the simplification of the long and laborious formalities attached to the formation of corporations in Lebanon is a vital step towards the encouragement of corporations. At present, a corporation to be formed requires the approval of its statutes by the government on authorization by a special decree from the Council of Ministers.[1]

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[1] Code de Commerce (Beirut: Librairies Antoine, 1955), Article 80, p. 44, as quoted in Ibid., p. 95.

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