# THE DEVELOPMENT OF FINANCIAL MARKET IN LEBANON WITH REFERENCE TO NON BANKING SECTOR

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By

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APPROVAL OF RESEARCH TOPIC

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TITLE OF RESEARCH TOPIC: THE DEVELOPMENT OF FINANCIAL MARKET IN LEBANON WITH REFERENCE TO NON BANKING SECTOR.

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## Chapter 1

# INTRODUCTION

Prior to 1975-76 War, there was a growing feeling among observers of the Lebanese economic scene, that the Lebanese capital market should be substantially developed. This they believed would be an important step toward the development of the national economy.

### Statement of the purpose

The role of financial institutions in enhancing economic development derives its importance from the fact that they facilitate the efficient accumulation of capital which is an important factor in the economic development.[1] They enable the channelling of savings which are collected from a wide range of different sources, into the most productive uses, and stimulate the desire to save and invest among many individuals. In Lebanon, despite the narrowness of the capital market the Lebanese economy has witnessed a remarkable growth during the sixties and early seventies, a growth, which to a large extent was induced by the relative political and financial stability prevailing during that period. However it is believed that this growth would have been greater had the capital market been more properly developed.

### Statement of the problem

Indeed while the financial market was able to attract substantial amounts of savings the effective utilization and the adequate allocation of these funds could have been greatly improved upon. The absence of an

[1] Shanti Tangri and Peter Gray, Capital Accumulation and Economic Development (Boston, D.C.: Health and Company, 1967), pp. 16-17.

adequate number of financial instruments available to investors has resulted in heavy investments, of short-term funds, in foreign exchange balance and real estate speculation. In addition the narrowness of the financial institutions structure has also tended to deter other than short-term investments. The securities market lacked a supply of attractive funds on the one hand, and individual and institutional buying power on the other.

So the Lebanese financial market has suffered from two major weaknesses: (1) The inefficiency of some of the existing financial institutions, and (2) the limited availability of financial instruments to savers.

From the financial authorities side, the role of these authorities in the development of the Lebanese capital market may be described as reluctant and basically passive in the pre 1975-76 period. However this role has become more active after the year 1977, particularly in the last three years when major steps were taken to maintain a relatively stable financial environment in the face of difficult economic and political conditions. However, the major financial problems are still found.

The research is designed to study three major particular questions:

1)- To what extent has the financial market been developed in Lebanon, and what is the magnitude of its operations.

2)- How successful have the financial markets been in achieving the financial intermediation in the country.

3)- What can, as a matter of fact be done to improve the operations of these institutions, in case they are not operating on the maximum level of efficiency.

## Performance objectives

The insufficient development of the Lebanese capital market has limited any benefits the country may have derived from the flow of oil funds;

Beirut acts mainly as a transitory center. Still no substantial attempts were made to cope with the existing issues pertaining to evolution of the Lebanese capital market, though a number of recommendations had been made. In the past three years, however there has been again a renewed interest in promoting the capital market, and a certain measures have either been put into effect or have been proposed as will be discussed later. The issue of developing the Lebanese financial market remains an important one.

The author of this study attempted to achieve the following performance objectives:

1)- First, to discuss the adequacy of various existing financial institutions in terms of their operations. Then,

2)- to evaluate the comparative degrees of success or failure of financial institutions in meeting the financial needs of the community, and finally;

3) to develop suggestions for improvements in consolidating the working and operation of financial institution in Lebanon.

## Methodology

In his research processing, the writer has depended on various informative resources to cover a sufficient part of the problem. He depended on financial and economic books, many interviews, periodicals, newspapers, government publications, ... etc. The research has included all the financial aspects from the 60's, up to the end of 1983, if the information is available. The major missing link in information is found in years 75-76 and the latest 1982, affected by the war. However the writer covered this defeciency by using different resources as he mentioned. Finally, the writer depended mainly on the Bank of Lebanon reports to reach the exact numbers, because financial reports submitted by some private institutions differed slightly from the figures submitted by official agencies.

## Organization of study

The first segment of the study shows the important connections between financial intermediation and economic growth. It also, analyzes some of the characteristics of the financial markets in both developed and developing countries. Then it describes the role of the Central Bank in the capital market. A brief overview of Lebanese economic and financial system is also provided in the first segment of the study. The second segment is divided into two portions. The first portion deals with the public financial sector in Lebanon, so it traces the performance and discuss the problems facing the public security market, international Bond issue, national institute for the guarantee of investments. The second portion deals with the private financial sector in Lebanon, it traces the performance and discuss the problems facing the private security market ( The Bourse), Insurance companies, the banking sector (briefly), and finance companies.

Finally, the last segment evaluates the functioning of the Lebanese capital market, both at the level of institutions and instruments, and suggests the necessary measures to further develop it.

Chapter 2

# PRESENTATION AND ANALYSIS OF RESULTS

## I - Nature and Scope of Financial Markets

### A. The important connections between Financial intermediation and economic growth

The financial system is one of the most important components of any nation's economy. It provides essential services without which a modern economy could not function.[1] Financial institutions collect savings from a wide range of different sources and allocate these funds to where they can be used most profitably through productive investment.

The nature of the connections between economic development and financial growth has received great attention from a large number of economists who expressed a wide variety of opinions on this subject. John Gurley and Edward Show, in discussing this relationship, arrived to the conclusion that a country's economic growth is contingent upon its financial structure.[2] The structure and performance of financial institutions, in a certain economy, may act as either a stimulating or a retarding agent, and either help or hinder the efficiency of the mobilization and allocation of capital. They stressed the fact that economics, with limited and narrow financial institutions, usually offer only one financial asset, i.e., money. Such underdeveloped financial structures limit the full use of financial incentives to savers and do not allow for the suitable investments of private

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[1]Peter Rose and Donald Fraser, Financial Institutions ( Plano, Texas: Business publications, Inc., Sec. edition 1985), PP. 6-7

[2]John Gurley and Edward Shaw, Money in a Theory of Finance (Washington, D.C.: The Brookings Institutions, 1960), PP. 46-55.

investors, since by having money as their only financial asset they restrict spending to current income, thus inhibiting the efficient specialization of investments and repressing economic development.

They concluded their study by stating that commercial banks are only one type of financial institutions and that money is only one of an array of financial assets. Thus, in order for a developing country to achieve development in real terms, its financial arrangement must be changed, in such a way, as to allow for greater diversification both at the level of institutions and instruments.

Hugh Patrick, in studying the relationship between financial arrangements and economic growth, conceived a variety of relationships between the two.[3] He first introduced the "demand-Following" phenomenon which states that the creation of financial institutions and related services is in response to the demand for these services by different savers and investors in the real economy. In this case, the evolutionary development of the financial system is a continuing consequence of the prevasive, sweeping process of economic development.

Another type of relationship is the so-called "supply-leading phenomenon, i.e., the creation of financial institutions and the supply of their financial assets, liabilities, and related financial services in advance of demand for them. This approach, as hugh stated, is not a necessary precondition for economic development, but rather presents an important opportunity to induce real growth by financial means.

Finally he looked at the relationship from a somewhat different approach: The relationship between the stock of financial assets and liabilities to the real capital stock. He outlined three major ways in which

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[3] Hugh Patrick, "Financial Development and Economic Growth in underdeveloped countries". Economic Development and Cultural Change 14 (January 1966) : PP. 174-178.

the financial structure can influence economic development. First, financial institutions can encourage the efficient allocation of capital by bringing about changes in its ownership and composition. Second, they can encourage the more efficient allocation of new instruments to more productive uses, by intermediation between savers and investors. Third, they can induce the rate of capital accumulation by offering greater incentives to save, invest, and work.

Raymond Goldsmith studied the effect that the financial structure of a certain country has on its economic growth. He found out that it may be best investigated from the point of view of both the total volume and allocation of savings and investments.[4] He stressed the idea that the availability of different types of financial institutions, in a developed financial market, has the property of seperating the functions of savings and investments, thus, increasing the availability of savings and the volume and efficiency of investments, and raising the ratio of capital formation to national product. Indeed, with the availability of financial instruments, household and other economic units are freed from the so-called indissoluble tie between their savings and investments. That is, savers do not have to spend their savings directly on small investment projects, but rather they will be able to invest them in financial instruments which will produce some returns. Meanwhile borrowers of the funds, through the issuance of financial instruments, will use the vast amounts of collected funds to carry on large scale investment projects. Indeed, the volume of savings needed for many production services, if they are to operate at minimum cost, is far greater from the amounts of savings done by a single economic unit, such large investments, being important for a country's economic growth,

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[4] Raymond Goldsmith, Financial Structure and Development (New Haven: Yale University Press, 1969), PP. 391-401.

cannot be done without the help of either the government, which usually has an important amount of resources collected through taxation, or voluntarily through the use of financial instruments which transfer savings from a large number of savers to a small number of investors who are willing to undertake large investment projects. Moreover, the existance of a developed financial market, particularly the one that is not limited to the issuance of fiduciary money, but rather possesses diversified financial instruments, will have a tendency of equalizing the marginal yields of different investments on capital expenditure. Thereby, helping to increase the share of capital expenditure made by business enterprises on large projects and decrease the share of small projects undertaken by households. The existance of developed financial institutions will contribute to the efficient allocation of collected funds among alternative uses. This is because financial institutions have the capability of financing different types of capital differing in form, durability, and industry.

Another economist, U Tun Wai, argued that there are three major ways through which developed financial intermediaries enhance the development process: (1) by the increase in the volume of collected savings, (2) by the better and more efficient allocation of funds, and (3) by the redistribution of benefits of larger returns on capital investments.[5] Financial intermediaries of developing countries are not developed in the sense that they do not provide the savers with adequate choice of financial instruments. Hence, investment opportunities are basically limited to currency, gold, or consumer goods. Both currency and gold are considered non-productive investments. Moreover the accumulation of savings in the form of consumer goods though may seem beneficial to the economy, nevertheless is

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[5] U Tun Wai, Financial Intermediaries and National Savings in Developing Countries (New York: Praeger Publishers Inc., 1972), pp. 31-33.

inconvenient. As a result, the volume of savings and the efficiency of investments, in these countries, will be very low. On the other hand, the existance of well-developed money and capital markets induces savers to save more by broadening their choice of saving between different financial assets which are marketable, safe, and interest bearing. He also stressed the idea that developed financial intermediaries encourage the more efficient allocation of funds between different competing uses, because of the fact that they offer different return on different financial instruments. Lastly,the so-called social distribution of savings results in a distribution of wealth, because people who did not receive any return on their savings, when they were in the form of goods or currency, are now able to share in the returns on investments by obtaining interest on their savings.

Edward shaw, in a lator work, emphasized the critical role of the financial sector in fostering economic growth and called for the financial deeping and liberation of the "sluggish" financial sectors of the developing countries, as a condition, to enhance economic development.[6] Financial deeping, i.e., the growth of financial assets at a faster pace than the rate of growth in the real sector, will result in a higher domestic savings-to-income ratio in both the private and public sectors. Moreover the growth of Financial institutions and the diversification of financial assets permit greater accessibility to financial instruments which guarantees maximum utility, at the least cost. Financial deeping, however, cannot be achieved without the financial liberation of the economy from the conservative and repressive policies adhered to by most of the developing countries. This will enhance the efficiency of the financial sector to mobilize and allocate total savings among competing investment outlets.

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[6]Edward Shaw, Financial Deeping in Economic Growth(New York: Oxford University Press, 1973), pp. 7-12.

The relationship between banking and economic development was treated by Rando Cameron. To him, banks can play a dual role, either to promote the economy or else to weaken it, depending on how effectively they perform their three traditional functions: (1) acting as intermediaries, (2) creating and providing means of payment, and (3) acting as entrepreneurs.[7] As intermediaries, they may act vigorously to collect vast amounts of funds which would be allocated to entrepreneurs for various investments projects, or they may fail to play this role, and thus loose the funds that might have been invested in development projects. As creaters and suppliers of the means of payment these institutions may redirect real resources into more productive activities or, and as a result of government actions or pressure or even private corruption, they may cause some problems in the economy such as inflation or recession. Finally as potential entrepreneurs, they may either undertake intelligent investment decissions which will provide them with important returns and, at the same time develop the economy, or else waste the important resources that are at their disposal in nonproductive projects. He concluded by saving that although the role of banking might be proper for the development of the economy, nevertheless, its positive effect may be offset by other factors such as unfavorable resource endowment, government policies, and social and political factors.

Thus the significance of financial markets (institutions and instruments) to a country's economic development is self-evident. In the first place, these markets play an important role in mobilizing savings and directing them into development outlets. The second point follows closely from this. It is frequently asserted that such a role is not played fully, or else discharged inefficiently in developing countries. In the case of

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[7]Rando Cameron, <u>Banking and Economic Development, Some lessons of History</u> (New York: Oxford University Press. 1972), PP. 7-8.

Lebanon which depends greatly on the trade and services sectors, there exist important shortcomings in the structure of its financial market, which tend to impede the process of industrialization and, thus, weaken the rate of economic growth. Hence an important condition for the further development of the Lebanese economy would be to develop the local capital market.

## B. Financial Markets in Developed Countries

Financial markets as have been developed in industrialized countries, comprise a complex of institutions and mechanisms whereby short-, medium-, and long-term funds are pooled and made available to the different sectors of the economy, and where instruments that are already outstanding are transferred.[8] Financial markets may be divided into money and capital markets.

### 1. The Money Market

The money market, which is mainly dominated by both the commercial banks and the Central Bank, refers to operations in short-term debt instruments, i.e., instruments without maturity not exceeding one year. These instruments are characterized by their marketability, a property that enables them to act as an ideal medium to fulfill the needs for liquidity and, at the same time, to produce some profits. The main debt instruments that are usually traded on this market are: treasury bills, bankers acceptances, certificates of deposites, and commercial bills.

#### (a) Treasury Bills

Being government obligations, they are the safest short-term debt instruments available to investors. Their maturity is usually between three

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[8] Herbert Dougall, Capital Markets and Institutions (New Jersey: Prentice Hall Inc., 1975), p. 5.

months and one year. Whereas their primary market is a periodical sale by the treasury, their secondary market, which is usually active consists of selling the bills at a discount with the difference between the selling price and the maturity value functioning as an implicit yield to the lender.[9]

(b) Certificates of Deposits

These are short-term debt instruments issued by banks for a certain period and a given maturity. Their secondary market, being active, makes it feasible for banks to undertake relatively long term financing.With the Development of CDs, banks could obtain funds not only by liquidation of their assets ( such as by selling treasury Bills) but also by selling certificates of deposits.[10]

(c) Bankers Acceptances

These are commercial credit instruments whereby a bank adds its good name and reputation to the promissory note of the borrower, thereby,making it more secure and trustworthy, and consequently more marketable than would be otherwise. When the bank accepts the draft, it thus becomes a promissory note of the bank and could then be resold, at a discount, in the secondary market.

(d) Commercial Papers

These are promissory notes of companies with good financial standing and solid credit worthiness. They carry interest which is paid along with

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[9] Dudley Lucket, Money and Banking (New York: McGraw Hill Book Company, 1976). P. 117.

[10] Peter Rose and Donald Fraser Financial Institutions, op. cit., pp. 93-94.

the principal at maturity. Their maturity is usually short, i.e., between three and six months, and hence their secondary market is not active.[11]

2- The Capital Market

Whereas the money market deals with short-term funds the capital market is basically concerned with longer-term commitments on the part of the lender and longer-term needs on the part of the borrower. It comprises specialized markets for corporate bonds and stocks, mortgages, government securities, and term-loans. In addition, it involves the participation of a wide number of institutions such as commercial banks, specialized or long-term credit banks, investment banks, investment companies, insurance companies, and pension funds. There are two important functions of the capital market: (1) the raising of new capital in the form of shares and debentures, and (2) the trading in already issued securities. While the first function is obviously much more important from the point of view of economic growth, the second function is also of considerable importance. These two functions are performed in, what has been called, the primary and secondary markets respectively.

(a) The primary market

The primary market is the market through which funds flow into newly issued securities. It deals with the selling of new securities when they are first introduced by the issuers. This is done in one of two ways: (1) directly, i.e., when the non financial issures, the final users of the funds, place their securities with the investors who are the ultimate acquires of the securities, without the help of investment banks, or (2)

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[11]Edward Reed, Richard Cotter, Edward Gill, and Richard Smith, Commercial Banking (New Jersey: Prentice Hall Inc., 1976), p. 182.

indirectly, i.e., through the assistance of an investment bank that underwrites (manages) the new issues. That is, it takes the full responsibility of distributing all or part of the new issues agreed upon between the issuer and the investment bank. It buys the issues at a discounted price and sells them to different investors, thereby making some profits. The advantage of this method lies in the fact that it assures the proper and efficient distribution of the issues as well as the quick acquiring of funds on the part of the issuer.

(b) The Secondary Market

The secondary market, i.e., the market for second-hand securities, is the place where, once issued, new securities can be traded, and where their prices are freely and competitively determined. It is usually organized in a two-way auction market for trading in securities. Buyers and sellers of securities deal in the market through brokers, Brokers representing the buyers compete among themselves to buy the requested securities at the lowest possible price. At the same time, brokers representing the sellers compete among themselves to sell their securities at the highest possible price. A transaction takes place once an agreement on a certain price is reached.

The existence of a secondary market is necessary to support and develop the primary market. Its role is to: first, ensure the marketability of the permanent or long-term securities. The disposition to acquire newly issued securities depends, to some extent, on the possibility of liquidating or transferring them on the secondary market easily, economically, and without great loss in their value. Second to make available funds necessary for the development of the economy. These funds may not be secured in the absence of a developed secondary market.

Finally the markets for financial assets have experienced immense institutional changes in recent years due to unstable economic conditions. Not only managers of Financial intermediareis but also managers of nonfinancial are learning such formerly esoteric financial practice as hedging a comitment for future loans.[12]

C. Financial Markets in Developing Contries

Financial markets, in many developing countries, are still in the early stage of Development and thus suffer from weakness both at the level of institutions and instruments. The institutional structure, while containing basic organizations, is not mature as is the case in Develop countries. There are not innumerable types of credit institutions often financing each other, i.e., commercial banks financing the operations of investment banks which in turn will help in financing of newly established corporations. In addition, there is a lack of a large number of highly differentiated near money assets such as deposit accounts, saving certificates, commercial bills, treasury bills, and certificate of deposits. Similarly, long-term financial assets such as stocks, bonds. Treasury bonds, and international bonds are either non-existent, or do not occupy an important position. The inadequacy of available short-, and long-term financial instruments reflects the basic fact that savings in these countries( oil-producing countries being excluded) are generally at relatively low levels. Apart from the shortage of funds, which is mainly attributed to their weak financial structure, the low per-capita income, and the high propensity to consume.[13] Another feature of many developing countries is the inappropiate distribution of available funds among various types of investments.

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[12]Robert Auerback, Financial Markets and Institutions (New York: MacMillan Publishing, Inc., 1983) PP, 367.

[13]Hisham Bsat, "The Arab Bourses: Establishment, Development, and Characteristics." Paper submitted to a seminar held by the Arab Central Bankers in Amman, June 1978, P. 2.

A large portion of funds, for example, is invested in developed countries where safety, liquidity, and higher returns are secured. Indeed the insistance of local investors on safety has tended, in the absence of well organized financial markets, to divert their savings into real estate investments, and comparable forms of investments.

Further, the two markets in Developing countries i.e., the money and capital markets, overlap significantly. This is mainly attributed to the fact that institutional specialization, in these markets, does not strictly correspond to the two markets, since there exists a number of institutions operating in both markets.[14] Moreover, these markets are most often dominated by the commercial Banks whose role varies from country to another depending. In part, on the dominance of the government in the economic system.[15] They furnish a substantial part of the external capital required by newly established or expanding industries. This is usually done through the supply of short-term loans which are rolled-over at maturity. As such, the commercial banks in developing countries take over the role of the investment banks which are usually supposed to finance the operations of corporations through the underwriting of newly issued stocks and bonds.

In most developing countries, the commercial banks are complemented by institutions designed to provide medium-and long-term credit to some sectors of the economy such as industry, agriculture, and construction. These institutions, which are usually supported by the government, engage to some extent, in direct equity subscription and private placements.

Securities markets, in most developing countries are dominated by the trading in government securities. The stock exchanges, on the other

[14] Samir Makdissi, Financial Policy and Economic Growth: The Lebanese Experience (New York, Columbia University Press, 1979), p. 40.

[15] Samir Makdissi, "The Arab Financial Systems: Role and Characteristics", Le Commerce du Levant ( 21 January 1981)P. 18.

hand are not developed, they are characterized by: (1) a limited number of listed shares, (2) a concentrated buying power. (3) a low daily turnover and (4) price instability.

Finally, it is worth mentioning that, the development of the financial markets in developing countries has been hindered by social, political, and other factors.

D. The Role of the Central Banks in the Capital Market.

Although the Central Bank has its greatest direct influence in the short-term money market, some discussions of it services are pertinent to our study, on several grounds: (1) this Institution acts as a fiscal agent for the government and plays an important role in the marketing of government securities (2) its credit policy has an important impact on the prices and the yields of long term securities, and (3) it can play an importnat role in broadening the capital market. The first two functions of the central bank are well known, however, the role that the central bank can play to develop the capital market is more relevant to this work, and thus requires more elaboration. Indeed the Central Bank is the only institution that can help to promote the capital's market operations. This is because it has both the resources and the responsibility for undertaking risks implicit in increasing the liquidity of investments within a country, something that cannot be expected from private institutions. There are a several ways through which a Central Bank can encourage the establishment of a capital market among which are: first, cooperating with the government to set up securities exchange office to deal with the sales and purchase of securities, secondly, offering rediscount facilities for the purchase of government securities, so that investors will find it possible for them to liquidate their investments at minimum or no loss, thirdly, imposing the inclusion of government bonds, in the banks legal reserve requirements, and fourthly, by adopting a set of monetary policy measures to assure the solvency as well as the proper functioning of the financial system.

E. The Lebanese Economic and Financial Systems: A brief overview

1. General Economic Background

Lebanon which occupies a strategic and geographic position, possesses limited natural resources but highly educated manpower. Its national economy has traditionally been open to the world economy. It was partly a result of these characteristics that the country developed into an important center for trade and finance. The trade and services sectors have thus assumed an important position in national economic activity. Their share in total G.D.P. accounted for more than sixty percent in the years preceding the year 1975-76.[16] Furthermore despite the substantial war, these sectors withstood, better than other sectors in the economy, the impact of the crisis. In contrast, the industrial and agricultural sectors, which accounted for around 14 and 9 percent, respectively, of total G.D.P. in the early seventies,[17] have suffered greatly from the events. We must not forget here that the Lebanese economic losses affected by 1975-76 war estimated to be about 16.3 billion L.L ( table 1-1), not to mention the human suffering, the social dislocation, and family seperation that remain beyond estimation or compare.[18]

There has been great concern, in the early seventies, over the major dependence of the Lebanese economy on the trade and services sector which make it vulnerable to changing factors, both political and economic.[19]

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[16] Bank of Lebanon, Annual Report 1975-1978.

[17] Ibid.

[18] Raymond Mallat, 70 Years of Money Muddling in Lebanon (Lebanon, printed by Alephy Beirut, 1977), p. 242-243.

[19] Salim Hoss, The Development of Lebanon's Financial Market (Beirut: Societe Technopress Moderne S.A.L., 1974). P. 4.

However despite the war of 1975-76 and the non-settlement of the political crises as yet, the Lebanese economic performance has been relatively vigorous. In part due to the enterprising spirit of Lebanese, many of whom sought work outside particularly in the Arab-Gulf regions. The remittances they have been sending back along with the resumption of trade and other financial institutions activities have helped generate a relatively strong balance of payment performance and permitted the Lebanese pound to maintain a strong position, the depreciation which occured in 1980 and early 1981 not withstanding.

Considering the external sector, Lebanon has always maintained a simple and liberal exchange system based on a floating exchange rate. There have been no restrictions regarding capital transfers. This characteristic stands in contrast with the exchange systems of a number of neighbouring countries which maintain exchange controls, a pegged exchange rate, and which accord the public sector a dominant role in economic development.[20]

2. The Financial System

The Lebanese financial sector is not sufficiently developed. It is characterized by institutional narrowness which resulted in shortage of specialized types of credit and severe limitedness of financial instruments. It is dominated by the commercial banks which are playing an important role in the country's economic recovery. They attract most of the Lebanese savings, which are mostly short-term in nature, and use the preceeds to finance short-term foreign trade or medium-term loans disguished in the form of short-term credit which are rolled-over at maturity. There is a limited number of specialized (medium-and long-term credit) banks. These institutions have been faced by a number of obstacles partly stemming from

[20] Makdissi, Financial Policy and Economic Growth: The Lebanese Experience, op. cit., p. 25.

their law of enactment which imposed many restrictions on their operations and made it easier for the commercial banks to compete with them. Further the hostilities which took place during 1975-76 have also contributed to the weakenning of the functioning of these banks.

With respect to Central Bank, since its establishment in 1969, the Bank of Lebanon has moved gradually to increase its effectiveness in monitoring and orienting monetary variables and in regulating the activities of the Banking system. The total assets of the Bank of Lebanon increased from L.L. 9506 million at the end of 1980 to L.L 11,896 millions at the end of 1981, or by around 20 percent. The increase was mainly in gold and foreign currencies which rose by 22 percent and constituted around 74 percent of total assets at the end of 1981[2] (table 1-2). This policy was mainly to halt the depreciation of the Lebanese pound which dropped its value dramatically specially after 1980.

There is no secondary market, as yet, in Lebanon to help in the creation of and the trading in short-term financial instruments, however the authorities are working towards the creation of a discount house. On the other hand, the Bourse, i.e., the securities exchange office is not developed. It is characterized by the sharp fluctuations in the price and volume of traded shares. Finally, there are no investment banks, as yet, in the economy to finance the operations of existing corporations.

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[21] Marwan Iskandar and Elias Baroudi, The Lebanese Economy in 1981-82 (Lebanon, Beirut: Printed by Aleph Oct., 1982) PP. 134-137.

Table 1-1

War Estimate of Economic Losses (75-76)

| Capital Destruction | In Billions L.L |
| --- | --- |
| 1) Capital sector | 1.350 |
| 2) Private sector | 4.200 |
| 3) Stocks | 2.000 |
| Subtotals | 7.550 |
| <u>Opportunity Losses</u> | |
| 1) N N P decline | 7.000 |
| 2) N N P growth forgone | 1.800 |
| Subtotals | 8.800 |
| T O T A L | 16.350 |

Source: Raymond Mallat, 70 years of Money Muddling in Lebanon.

Table 1-2

Bank of Lebanon Position as at Dec. 31, 1981
(With comparative Figures for 1980)

(In Billion LL)

| Assets | As at 30/6/80 | As at 31/12/80 | As at 30/6 /81 | As at 31 /12/81 |
|---|---|---|---|---|
| Gold and Foreign Currencies | 7,621 | 7,185 | 7,405 | 8,770 |
| Credit to the Public Sector | 668 | 1,954 | 2,211 | 1,991 |
| Credit to the Private Sector | 119 | 129 | 135 | 149 |
| Credit to Commercial Banks | 49 | 60 | 126 | 124 |
| Fixed Assets | 23 | 26 | 26 | 26 |
| Unclassified Assets | 56 | 152 | 94 | 836 |
| Total Assets | 8,536 | 9,506 | 9,997 | 11,896 |
| Liabilities | | | | |
| Currency in circulation | 3,928 | 4,220 | 4,726 | 4,888 |
| Commercial Banks Demand Deposits | 2,120 | 1,961 | 2,036 | 2,249 |
| Demand Deposits of specialized Banks | 6 | 4 | 6 | 6 |
| Private Sector Deposits | 13 | 14 | 16 | 17 |
| Engagements to the Public Sector | 1,674 | 2,052 | 2,216 | 2,974 |
| Foreign Engagements | 70 | 81 | 96 | 103 |
| Capital and Reserves | 370 | 370 | 494 | 493 |
| Unclassified liabilities | 355 | 804 | 407 | 1,166 |
| Total Liabilities | 8,536 | 9,506 | 9,997 | 11,896 |

Source: Bank of Lebanon 1982

## II - The Lebanese Financial Institutions

The present chapter has two aims: the first is to discuss, in detail, the major financial institutions operating in Lebanon, of the public and private sectors; the second is to assess their contribution to the further development of the Lebanese capital market.

### (1) The public sector

#### A - The public Security Market

With the continuing Governmental budgetary surplus, and the moderate increase in the banking system's liquidity in the years preceding the 1975-76 war, the need for the issuance of government securities, on a large scale, seemed uncalled for. However the situation changed completely after the war years; the government experienced a sharp decline in its revenue, coupled with an increase in its expenditure resulting from the growth of its public commitments. At the same time, and due to the decline of the commercial banks lending opportunities, the banking system witnessed growth in liquidity. All these developments led to substantial increase in the amount of government securities issued.

Table 2.1 shows the amount; the maturity; and the interest rates offered on the different types of government securities issued over the period 1967-1983. The years 1967-1972 saw the issuance of limited amounts of three-month treasury bills, no treasury bonds were issued. These were the amount of L.L. 40 million in 1967 at an average interest rate of 3.5 percent, L.L. 35 million in 1968 at an average interest rate of 5.5 percent, L.L. 80 million in 1969 at an average interest rate of 6 percent. No treasury bills were issued in 1970, but in 1971 and 1972, a total amount of LL 44 million and L.L 40 million of treasury bills were issued with average interest rates of 3.0 and 4.5 percent respectively.

During 1973-1976 there was no issuance of government securities, only redemption of outstanding issues. In the following four years 1977-1980, the issuance of government securities witnessed a noticeable change. The total amount of issued securities rose sharply in 1977, compared to the amount issued over the period 1967-1972. It amounted to L.L. 527.40 million, of which L.L 227.40 were three-month treasury bills, and LL 300 million were medium term treasury bonds of maturity ranging between one and five years. In 1978, a total amount of L.L. 3,024.60 million was issued of which L.L 2,949.50 million were in the form of three-month treasury bills and L.L. 75.10 million were in the form of five-year treasury bonds. During 1979 a total amount of L.L. 2,132.25 million was issued of which L.L 1672 million were three- and six month treasury bills, and L.L. 460.55 million were in the form of medium-term bonds with maturity ranging between one and five years. In 1980, only three-and six-month treasury bills, of total L.L. 3961 million, were issued. During 1981, the amount of treasury bills issued increased sharply. A total amount of L.L. 11,067 million was issued of which L.L 9,564 million were in the form of three-month treasury bills and L.L. 1,031 million were in the form of six-month treasury bills, and L.L 472 million were in the form of one-year bonds. During 1982, the huge increased in treasury bills continue. A total amount of LL 24,936 million was issued of which L.L 21898 million were in the form of three-month treasury bills and L.L 2384 million were in the form of six-month treasury bills, and L.L. 654 million were in the form of one-year bonds. In 1983, the amount of government securities issed rose to L.L 37,603 million of which L.L 25,820 million were in the form of three-month treasury bills and L.L 5240 million were in the form of six month treasury bills and L.L 5,923 million were in the form of one year bond, and LL620 million were in the form of medium term bonds with maturity ranging between two and five years. So, we can notice two major fluctuations in the issuing of government securities: the first occured in year 1978, when the amount issued rose from L.L 527 million in year 1977 to L.L. 3,024 million in 1978. The second fluctuation started in year 1981, when the amount issued rose from L.L 3961 million in year 1980 to L.L 11067 million in year 1981. This situation is still continuing now.

Also another point appears here, the three-month treasury bills account for more than 50 percent of the total government securities issued from the year 1967 till 1983 (except for the year 1977).

Issuing more government securities is the major policy of the Lebanese government, to decrease the budget deficit. So the effect of government securities appeared mostly after the Lebanese civil war (75-76), when most of the Arabic financial aid stopped. In addition to its effect on the budget deficit these securities played a great role in the Lebanese economy to decrease inflation through controlling liquidity.[1]

The interest rates carried by these securities showed an increasing trend during these years. The interest rates offered on treasury bills increased from an average of 3:00 percent in 1977 to 15.00 percent during1982. Finally these rates decreased in 1983 to the average of 9.5 percent but it raised again to around 14.00 percent in the year 1984 (table 2.2).

By interviewing Mr. Elie Noujaim,[2] he related the increasing amount in issuing government securities to four basic aspects: the budget deficit ( which is increasing year after year), the worsening economic and poli-

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[1]Dr. Ali Al-Khalil, "Financial situations", An-Naher (Beirut), 22 June 1981, Section: Financial Survey (in Arabic).

[2]Elie Noujaim, Director of the economic and statistical division in the Bank of Lebanon, (Based on a personal interview held on Jan. 4, 1985).

tical situation, the fall in collected revenues of various governmental sectors and the huge inflation, Mr. Noujaim predicts also that the interest rates of government securities will remain high because of two reasons: (1) to encourage the commercial banks to sell more securities, taking into consideration that these banks are using the dollar market widely after the falling of the Lebanese pound monetory value. (2)the rise of interest rates in the local and foreign markets.

The public debt is the sum of accumulated domestic and foreign debt. The external component of the debt was around 200 million dollars in 1981 and has barely altered since then. The domestic debt stood at L.L. 6892 million in 1981 and L.L 14031 million in 1982. At end 1983, the domestic debt had risen by another 50.83 percent to L.L 21163 million of which 25.07 percent was borrowing from the Bank of Lebanon and 74.93 percent was treasury bills in circulation ( table 2.3).

Government securities have been, mainly, held by three institutions: the commercial banks, the social security fund, and the deposit Insurance fund. The commercial banks holdings are not exempt from tax, however since 1979, government securities of six-month maturity and above, have been accepted as part of the 15 percent reserve requirement imposed on commercial banks.[3] In addition, the social security system's interest earnings from holding government securities are tax exempt. Other institutions have not, as yet, become holders of government securities on any important scale. This has been,mainly, the result of the low-- until recently-- yields offered on these instruments, compared to alternative investment outlets. Moreover with the exception of the employees of the Bank of Lebanon, the non-institutional public have only recently become holders of government

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[3]Circulars No. 220 and 234 of the Bank of Lebanon, dated February 24 and May 26, 1979, respectively.

securities. The policy of the financial authorities is, however, to encourage the public to hold treasury bills.

There is no secondary market, as yet, for the trading in government securities. However, according to articles 7 and 64 of the government decree regulating the functions of the Bourse, all government securities must be traded on the Bourse floor. In fact, some tradings took place during 1969-1971, however, no government securities were exchanged on the Bourse, afterwards. It is believed, however, that with the creation of the new discount house, the market for these securities will expand.[4]

The authorities concerned intend to continue the issue of government securities during 1980's, with the purpose of controlling the banking system's liquidity as well as to finance emerging budgetary deficits. The interest paid on these issues could also be increased. The authorities are also considering selling government securities to the non-institutional public on a larger scale.

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4 See Chapter three.

Table 2.1

Government Securities issued 1967-1983

(Millions of Lebanese Pounds)

| Type | 1967 | | 1968 | | 1969 | | 1971 | | 1972 | | 1977 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Interest Rate | Amount | Interest Rate | Amount | Interest Rate | Amount | Interest Rate | Amount | Interest Rate | Amount | Interest Rate |
| Three-month Bills | 40 | 3.50 | 35 | 5.50 | 80 | 6.0 | 44 | 3.0 | 40 | 4.5 | 227.40 | 3.00 |
| S i x-month Bills | - | - | - | - | - | - | - | - | - | - | - | - |
| One year Bonds | - | - | - | - | - | - | - | - | - | - | 138.15 | 3.60 |
| Two year Bonds | - | - | - | - | - | - | - | - | - | - | 111.85 | 4.30 |
| Three year Bonds | - | - | - | - | - | - | - | - | - | - | 50.00 | 4.25 |
| Five year Bonds | - | - | - | - | - | - | - | - | - | - | - | - |
| T O T A L | 40 | | 35 | | 80 | | 44 | | 40 | | 527.40 | |

Source: Bank of Lebanon, Quarterly Bulletine, 80-83.

Table 2.1 - Continued

(Millions of Lebanese Pounds)

| | 1978 | | 1979 | | 1980 | | 1981 | | 1982 | | 1983 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Interest Rate | Amount | Interest Rate | Amount | Interest Rate | Amount | Interest Rate | Amount | Interest Rate | Amount | Interest Rate |
| Three-month Bills | 2,949.50 | 2.61 | 1,441.00 | 3.19 | 3,254.00 | 9.00 | 9,564.00 | 13.3 | 21,898.00 | 14.2 | 25,820.00 | 9.5 |
| Six -month Bills | - | - | 231.15 | 3.19 | 707.00 | 4.50 | 1,031.00 | 13,46 | 2,384 | 13.44 | 5,240.00 | 10 |
| One year Bonds | - | - | 93.- | 4.84 | - | - | 472.00 | - | 654 | - | 5,923.00 | 10.125 |
| Two year Bonds | - | - | 160.05 | 5.86 | - | - | - | - | - | - | 554.- | - |
| Three year Bonds | - | - | 141.05 | - | - | - | - | - | - | - | - | - |
| Five year Bonds | 75.10 | 6.50 | 66.00 | 7.06 | - | - | - | - | - | - | 66.00 | - |
| T O T A L | 3,024.60 | | 2,132.25 | | 3,961.00 | | 11,067.00 | | 24,936.00 | | 37,603.00 | |

Source: Bank of Lebanon, Quarterly Bulletins, 80-83.

Table 2.2

Interest rates on 3 month treasury bills

1981-1983

(in percent)

| | 1981 | 1982 | 1983 |
|---|---|---|---|
| January | 11.50 | 14.00 | 10.00 |
| February | 11.50 | 14.00 & 15.00 | 9.50 |
| March | 11.50 | 15.00 | 9.50 & 10.00 |
| April | 13.00 | 15.00 | 10.00 & 9.75 |
| May | 14.00 | 15.00 | 9.75 & 10.00 |
| June | 14.00 | 15.00 | 9.25 & 9.00 |
| July | 14.00 | 15.00 | 9.00 & 8.75 |
| August | 14.00 | 15.00 | 8.75,900 & 9.25 |
| September | 14.00 | 15.00 | 9.25 & 9.50 |
| October | 14.00 | 13.50 & 13.00 | 9.50 & 9.75 |
| November | 14.00 | 12.50 & 12.00 | 9.75 |
| December | 14.00 | 11.50, 10.50 & 10.00 | 9.75 |

Source: Bank of Lebanon, Annual Reports 1981, 1982 & 1983)

Table 2.3

Components of Public debt of Lebanese Government (1979-1983)

(Millions of L.L)

| | Government Securities (1) | Borrowing from the Bank of Lebanon (2) | Domestic Debt ( 1+2 ) | External Debt (4) | Public Debt ( 3+4 ) |
|---|---|---|---|---|---|
| 1979<br>% of DD | 1,166<br>43.9% | 1,487<br>56.1% | 2653<br>100% | 303 | 2956 |
| 1980<br>% of DD | 2476<br>56% | 1,952<br>44% | 4428<br>100% | 859 | 5287 |
| 1981<br>% of DD | 4910<br>71% | 1982<br>29% | 6892<br>100% | 1039 | 7931 |
| 1982<br>% of DD | 12279<br>87.5% | 1752<br>12.5% | 14031<br>100% | 1039 | 15070 |
| 1983<br>% of DD | 15856<br>74.9% | 5307<br>25.1% | 21.163<br>100% | 1039 | 22,202 |

Source: Bank of Lebanon, Annual Reports ( 80 - 83 )

B - International Bond issue

These are medium-term bonds issued by foreign borrowers upon their borrowing from the local commercial banks. The number of these issues has not been significant in the past since the Bank of Lebanon discouraged their placement. The Bank seemed to have been obsessed with two main considerations so as to resist the placement of these issues. First, it did not wish to internationalize the Lebanese pound (through the availability of Lebanese pound denominated paper abroad) fearing that it will become vulnerable to speculative activity in the foreign financial markets. Second, it believed that the relatively long-maturity of these issues-- an average of seven years-- might cause liquidity problems for the bond purchasing banks.[5]

C - The National Social Security Fund

This is a semipublic organization established in 1967 to offer retirement and family compensation, as well as medical care. It is of considerable importance to the Lebanese capital market because of the long-term nature of its funds.

Table 2.4 shows the total deposits of the Social Security Fund with both the Bank of Lebanon and the commercial banks over the period 1971-1983. As apparent from the table, the total deposite experienced a continuous growth, during the period 1971-1978; thus, increasing from L.L. 96 million at the end of 1971 to L.L 520 million at the end of 1978.However, in the last five years, i.e., 1979-1983, these deposits decreased by around 35 percent, to reach L.L 341 million at the end of 1983.

The decrease in the fund's total deposits is, mainly, attributed to the drop in government and employee contribution after, and as a result of,

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[5]Hoss, The Development of Lebanon's Financial Market, op.cit., p.43.

the 1975-1976 War.

The role of the Social Security fund in the public securities market did not assume any important scale before the year 1977. As of end of 1977, the fund subscribed a total of L.L 58 million in government securities. The amount rose to L.L 72 million at the end of 1978, and it experienced a continuous growth, to reach L.L 1,492 million at the end of 1983 (Table 2.5).

D - The National Deposit Insurance Fund

The National Deposit Insurance Fund was established on May 9, 1967. Its main purpose is to insure all deposits, of a single depositor ( both resident and nonresident), denominated in Lebanese pounds up to L.L30,000. Its capital is subscribed by both the government and the operating commercial banks. Upon its establishment, a bank is required to subscribe L.L 100,000 to the capital of the fund, an equal amount is also subscribed by the government. Consequently, the capital of the fund is subject to change as a new banks are established, or as operating banks are dissolved. The resources of this institution may be deposited, interest free, with the bank of Lebanon. They may be used to purchase government securities, and state-guaranteed obligations. The participation of this institution in the public securities market has not been significant.

Table 2.4

Total Deposits of the Social Security Fund

With both the Bank of Lebanon and Commercial banks, 1971 - 1983

(Millions of Lebanese Pounds)

| | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank of Lebanon | 4 | 7 | 5 | 14 | 17 | 16 | 17 | 63 | 11 | 7 | 7 | 6 | 9 |
| Commercial banks | 92 | 165 | 248 | 328 | 377 | 379 | 433 | 457 | 495 | 456 | 378 | 390 | 332 |
| Total | 96 | 172 | 253 | 342 | 394 | 395 | 450 | 520 | 506 | 463 | 385 | 396 | 341 |

Source: Bank of Lebanon, Quarterly Bulletins 79-83.

Table 2.5

Distribution of Treasury bills among subscribers

1977-1983

( in millions of pounds and in percent )

| Years | Financial Institutions | | Public Institutions | | Total | |
|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % |
| 1977 | - | - | 58 | - | - | - |
| 1978 | 745 | 91 | 72 | 9 | 817.00 | 100 |
| 1979 | 116 | 41 | 165 | 59 | 281.00 | 100 |
| 1980 | 2,076 | 84 | 400 | 16 | 2,476.00 | 100 |
| 1981 | 4,142 | 84 | 768 | 16 | 4,910.00 | 100 |
| 1982 | 11,254 | 92 | 1025 | 8 | 12,279.00 | 100 |
| 1983 | 14,364 | 90.6 | 1492 | 9.4 | 15,856.00 | 100 |

Source: Bank of Lebanon, Annual Reports 80-83

E - The National Institute for the Guarantee of Investments.

The National Institute for the guarantee of Investments was established in the year 1977. The basic objective of the NIGI is to guarantee, for a premium, new investments made after the effective date of Legislative Decree No.3 setting up the institute. The term "guarantee" is used to distinguish NIGI's coverage of specific political risks from the insurance of commercial risks handled by private insurance companies in Lebanon.

In 1981, Lebanon's National Institute for the Guarantee of investment appeared to be starting to come into its own in helping to encourage new investment. An analysis of the policies underwritten by NIGI until the end of October shows that 108 companies have resorted to the institute to cover investments in Lebanon against war risk. This in itself was a remarkable development. In April 1980, only 17 policies were issued, and some 20 others were under review, and the value of investments covered by these policies totalled L.L 75 million. By November 1981, investments covered by the institute amounted to L.L 433 million.[6]

F - Conclusions

In assessing, briefly, the contribution of the aforementioned institutions to the development of the local capital market, the following may be noted :

1) The issuance of government securities, though assumed a minor scale prior to 1977, nevertheless, has shown major improvements during the last five years. If this continues, it will help, greatly, the development of the capital market.

2) The role of both the Social Security Fund, and the Deposit Insurance Fund has not been active, despite the fact that the two institutions

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[6] Iskandar & Baroudi, The Lebanese economy in 1981-82, op.cit. p.157-159.

have acquired some government securities in the last four years. Indeed these institutions possess substantial amounts of funds which, if invested in the securities market will contribute to its development.

## (2) The Private Sector

### A – The Private Securities Market

The Lebanese private securities market is not, as yet developed as is the case in industrialized countries. Its development is hindered by many factors, among which are the following:[1]

1) The Bourse (stock-exchange office), which is supposed to be the most important institution in the market, suffers from many weaknesses (see the section on the Bourse below).

2) There are no investment banks, as yet, in Lebanon to help in the marketing of newly issued securities.

3) Most of the Lebanese corporations are small in size and narrowly owned. The owners, who are usually single families or family groups, excersise close control over their corporations. The fear of loss of control or possible disclosure of sensitive information on their financial operations, prevents them from placing their shares to be traded on the market.

4) There is lack of protection of the investors welfare on the part of the authorities concerned. This reveals itself in the absence of any supervision over the published financial statements supplied by the different corporations. Indeed, the auditing profession as well as the disclosure standards are not regulated in Lebanon.

5) The weaks publicity offered by the Bourse's committee on the Bourse's operations had rendered the Lebanese investors unfamiliar with the functionning of the securities market.

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[1] Hisham Bsat, " The Arab Bourses: Establishment, Development, and characteristics". op. cit. pp. 8-10. Also Nasim Saliba, "Development prospects of the Lebanese financial markets", The Arab Economist, May 1979, pp. 7-10.

6) The continuous supply of commercial banks overdrafts and lines of credit to existing corporations allows them to expand their business without having to resort to the securities market.

7) The listed securities on the Bourse are not only very few in number compared to the number of registered corporations in Lebanon, but also represent few sectors of the economy. There has been no listed securities of banks, insurance companies, hotels or air and sea transportation.

8) The presence of foreign financial firms representatives ~~has added to the weakenning of the local securities market. These insti~~tutions have acted as intermediaries between local investors and foreign markets, thereby, encouraging the outflow of local funds.

## The Bourse[2]

The Bourse, a quasi-public entity, was established in July 1920. Its main role is to act as an intermediary for dealing in gold, foreign exchange, as well as financial assets. It has been reorganized several times since its establishment and some improvements concerning matters of law were introduced in both 1978 and 1980.

All banks operating in Lebanon, as well as corporations with a capital of at least L.L 500,000 and above are automatically registered as members of the Bourse: However a very small number of these members actually place their shares to be traded on the Bourse. It is estimated that out of 1500 Lebanese and foreign companies operating in Lebanon, 45 companies place their shares on the Bourse and only 15 of them have their shares on the Bourse and only 15 of them have their shares regularly traded in 1982. There are around fifteen brokers, mostly individuals, operating on

[2] The information of the Bourse, is privately secured from the Bourse's authorities.

the Bourse. The regulations of the Bourse do not allow the number of participating brokers to exceed 32. Brokers represent their clients (buyers and sellers) for brokerage fee equivalent to 5 per thousand of the transactional value of listed corporations shares. Similarly the Bourse itself charges a fee of 2 per thousand on every transaction, so as to cover its costs. In addition, each broker should submit, annually to the Bourse, a colleteral of value not less than L.L 100,000 against any legal claims from their clients. Furthermore, all listed corporation as well as brokers, have to pay each an annual subscription of L.L 2000 and L.L 200 respectively.

Prices of newly accepted shares are not allowed to fluctuate by more than 10 percent of the previous closing prices, similarly, brokers are not allowed to sell or buy, in a single order, more than 100 shares of L.L 200 each. The above two regulations were introduced during the early 1960's in response to the severe speculative activity that took place on the Bourse during that period.

## Operations on the Bourse, 1964 - 1984

A review of operations on the Bourse, in the last two decades, reveals that the market has been, basically, speculative and disorderly. This manifest itself by the small number of transactions, the erratic fluctuations in prices, and the small number of listed shares. This is mainly attributable to the weak control exercised by the Bourse on trading operations;[3] the smallness of the Bourse, and the general shortcomings of the securities market ( as discussed earlier). In addition, the events of 1975-1976, and the prevailing security conditions have had adverse effect on the Bourse.[4] Finally, we must not forget, that the government has stopped the

[3]Some tradings take place off the Bourse floor.

[4]Trading activity dropped sharply during the period.

implementation of the decree 120 (April 1983), which permits the Bourse to control the exchange monetary market in addition to the stock market.

All these reasons were more realistic and powerful than Mr. Antoine Al-Khawaja optimistic seen for the future operations of the Bourse.Mr. Al-Khawaja has predicted a good days for the Bourse, depending upon the great confidence of the Lebanese and Arabic investor in the Bourse, in addition to the continuous work of the Bourse to change the domestic capital into large projects controlled by many groups and not monopolistic one.[5]

Table 2.6, shows the total number of stocks exchanged and their total value during the period 1964-1984. The peak of trading activity was reached in 1964 when 857,000 stocks worth L.L 81 million were traded. Following that year, severe speculation in trading activity took place leading to great loss on the part of many small investors and to the shying away of many local and foreign investors. As a result, and due to other factors: The Intra Bank crisis of 1966, the Arab-Israeli War of 1967, and the local disturbances of 1969, the trading activity dropped in subsequent years to reach a minimum of 26,000 stocks, worth L.L 2 million, in 1969.

The picture, somewhat, changed in the following years. During 1970-72, both the number and the total value of exchanged-stocks increased:The number of exchanged-stocks increased by over three folds, while their total value quadrupted. This may be attributed to the general improvement of the business climate in the country, the inflow of capital into the country as a result of the drop in interest rates abroad, and the relative political stability prevailing in the country during that period. In 1973 and 1974, the number of exchanged-stocks dropped to reach 285000 stocks in

[5]Antoine Al-Khawaja (President of The Bourse), "Beirut Bourse," Al-Liwa (Beirut), 28 January 1983, Section: Bourse Survey, p. 5. (In Arabic).

1974. However, the total value of exchanged-stocks increased in 1973 to reach L.L 52 million then declined to reach L.L 50 million in 1974.

The period 1975-1978 witnessed a sharp drop in trading activity.The intermittent closing of the Bourse and the hostilities prevailing in the country during this period have contributed to the slow-down of the Bourse's operations. The operations were restored in early 1979, with a twice weekly trading sessions, increased to three weekly sessions afterwards.As apparent, however, from the table, the number of exchanged stocks has dropped to its minimum level after 1979. During 1980 when only 19,000 stocks were exchanged. This situation continued in the years 1981-82 to reach its worst level in the years 1983-84, when inconsiderable amounts have been exchanged only.

By interviewing Mr. Elie Khwaja, he said that after the year 1982 the few 15 companies that were operating in the Bourse, stopped most of their operations, and the control of stock companies by specific groups in addition to the political situation prevent the entrance of new companies to the Bourse. Mr. Khawaja predicted that the bad situation of the Bourse will not change except by two things: (1) a powerful change in the Lebanese economic and financial situation, (2) the permission for the Bourse to control the Exchange monetory market by settlement of the Decree 120 from the government.[6]

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[6]Elie Khwaja, Director of the Bourse (Based on a personal interview held on January 10, 1985.)

Table 2.6

Operations on the Bourse 1964-1984

| Year | Number of exchanged stocks | Total Value of exchanged Stocks (Millions of LL) |
|---|---|---|
| 1964 | 857,000 | 81 |
| 1965 | 368,000 | 29 |
| 1966 | 191,000 | 14 |
| 1967 | 152,000 | 8 |
| 1968 | 41,000 | 5 |
| 1969 | 26,000 | 2 |
| 1970 | 101,000 | 10 |
| 1971 | 127,000 | 14 |
| 1972 | 387,000 | 43 |
| 1973 | 350,000 | 52 |
| 1974 | 285,000 | 50 |
| 1979 | 90,000 | 0.012 |
| 1980 | 19,000 | 0.002 |
| 1981 | 7,037 | 0.652 |
| 1982 | 33,485 | 2.570 |
| 1983 | inconsiderable | 0 |
| 1984 | inconsiderable | 0 |

Source: The Bourse of Beirut, Year 64-84.

B - <u>Insurance Companies</u>

The insurance industry paved its way into the market during the second half of the 20th century. In 1965 thirteen local insurance companies were working in the Lebanese market in addition to a great number of foreign companies. From 1966 up to the early seventies the number of insurance companies increased to more than 100 (Lebanese and non Lebanese).

Nevertheless, the growth of the insurance sector has been beset by a number of problems which may be outlined as follows:

(1) The density of insurance companies operating in Lebanon, relative to its population, is high compared to other countries of the world.

(2) Fierce competition: particularly among small companies, and the newcomers. Premium-hungry companies driven by fast profit and survival motives have resorted to blind competition, and have in some cases undercut premiums to levels at which their reserves were rendered insufficient.[7-8]

(3) High turnover of insurance companies (see Discussion below)

(4) Segmented market: The bulk of the business is in the hands of twelve leading companies. (See Discussion below)

(5) Lack of specialized management: Many of the small companies suffer from inadequate and unspecialized management and professional skills.

(6) Services not properly adopted to the local market: the disorganized growth of the industry has inhibited to some extent the ability of many companies, to provide services strictly adopted to the requirements to the Lebanese market.

(7) Inadequate state control: government control and regulation of the

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[7] Iskander & Baroudi, The Lebanese Economy in 1981-1982, <u>op.cit.</u>, P. 150.

[8] By Law, the insurance companies are forced to reserve L.L500,000, and this amount was doubled in November 1983 to reach one million.

insurance sector has been minimal to date. The insurance law which was introduced in 1962 has not been modified in parallel to the rapid growth and development of the industry.

(8) Many people, due to several factors such as, relegion, background and mentality don't like to enter into contracts with insurance companies.

Since the early seventies, the insurance industry in Lebanon has been characterized by a rapid growth in the number of insurance companies and a high turnover among registered companies.

At the end of the year 1968 the number of registered insurance companies was 86 company (12 national, and 74 foreign), of which 12 companies were active. The entry and withdrawl of foreign and national companies into and out of the industry continued during the period 1969 to 1980,38 companies withdraw from the market during this period, while 59 new companies were established (table 2.7). At the end of 1980 the number of registered companies was 104 company. (40 national and 64 foreign). Parallel to this growth the number of active companies increases from 12 in the period between 1968 and 1971, to 19 companies in 1974, 30 in 1978 and 40 by 1980. In the year 1981, 32 insurance companies withdraw from the market (most of it were foreign companies), then five companies entered the market, while three companies withdraw. In 1983 there were 74 insurance companies operating in Lebanon, these companies were divided into thirty two foreign insurance companies and fourty two national ones, most of these companies write all kinds of general insurance (table 2.7).

In view of the large number of insurance companies operating in the country, one would expect the productivity of the insurance sector to be high; however, this has not been the case. For example, fire insurance, which would be an important source of premium income, is very little utilized by Lebanese businessmen or hom owners.

Table 2.8 gives a view of the insurance companies premium collected in Lebanon in general insurance, comprising insurance, operations effected in all fields except life insurance, over the 1970-1983. Between 1970 and 1974, premiums collected increased by more than 120 percent, i.e.,from L.L 34 million in 1970 to L.L 75.7 million in 1974, reflecting the overall improvement in the business climate prevailing during those years. The data for the years 1975-1976 are not available; however, it is believed that the premiums collected during the two war years were very low. The trend, once more, changed in subsequent years, i.e., 1977-1980. The total premium collected increased by around 140 percent over this period, i.e., from L.L 45 million in 1977 to L.L 107.8 million in 1980. Between 1980 and 1983 premiums collected increased by more than 100 percent, i.e., from L.L 107.8 million in 1980 to L.L 215.8 million in 1983.

According to life insurance companies, before 1979 the data was not available; however it is believed that premiums collected during these years are inconsiderable for the life insurance sector. However the life insurance sector started to appear after year 1979, to reach a premium collection of L.L 78 million in 1983 which represents around 25 percent of the total collected premiums (table 2.8).

Premiums collected by insurance companies in Lebanon increased in the year 1983 by 28 percent over 1982 figures. But like previous years the figures showed a continued concentration of business in the hands of the top 12 companies, who took nearly 50% of the business.
From table 2.9, we can notice that the top 12 firms accounted for around 50 percent of the total premiums in the non-life business sector, through the years 1980, 81, 82 and 83, when the total number of insurance companies exceeds 70 companies.

As in previous years national companies received the lion's share of the premiums. Bankers Assurances was again the leading company, with receipts of L.L 17.15 million, followed by L'Union Nationale with LL 15.04 million. The third biggest and top foreign company was L'Union des assurances de Paris with premiums totalling L.L 10.70 millions.[9] Close behind was the compagnie dé Assurances et de Réassurances with L.L 10.22 million ( table 2.9 ).

In interviewing Mr. Mahmoud Awkal,[10] he mentioned many problems facing insurance companies today, specially the density of insurance companies operating in Lebanon and what results from this in the form of fierce competetion effecting the large and small companies negatively. He stressed also on the narrowness of the investment market for the premium funds collected by insurance companies, specially when the real estate projects become a risky one in Lebanon. Finally Mr. Awkal predictes that the insurance industry will continue growing on the basis that commercial banks obliged their customers to insure all their contracts.

Although all insurance policies denominated in Lebanese pounds and 50 percent of foreign contracts are, by law, required to be invested in lebanon, the absence of a developed securities market has resulted in heavy investments in real estate, foreign securities, and foreign exchange. The flow of investment resources through the insurance sector to Lebanese corporations and the government has been minimal.[11]

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[9] Marwan Iskandar, "Insurance premiums grow but business remains in few hands", An-Nahar Arab Report and memo, volume 8 no.8 March 5 1983.

[10] Mahmmoud Awkal, Department manager of the Societé Arabo-Europeéne D'Assurances et de Réassurances (Based on a personal interview hold on Jan. 14, 1985).

[11] Salim Hoss, The Development of Lebanon's Financial Market, op. cit., pp. 37-38.

Table 2.7

Turnover of Insurance Companies Between 1968-1983

| Year | No. of New companies | No. of companies Withdrew | No. of companies | | |
|---|---|---|---|---|---|
| | | | National | Foreign | Total |
| 1968 | 3 | 12 | 12 | 74 | 86 |
| 1969 | 2 | 3 | 12 | 73 | 85 |
| 1970 | 3 | 4 | 12 | 72 | 84 |
| 1971 | 4 | 3 | 12 | 73 | 85 |
| 1972 | 6 | 2 | 15 | 74 | 89 |
| 1973 | 5 | 7 | 16 | 71 | 87 |
| 1974 | 9 | 6 | 19 | 71 | 90 |
| 1975 | 8 | 1 | 24 | 73 | 97 |
| 1976 | - | - | 24 | 73 | 97 |
| 1977 | 2 | 3 | 26 | 71 | 96 |
| 1978 | 4 | 2 | 30 | 68 | 98 |
| 1979 | 3 | - | 32 | 69 | 101 |
| 1980 | 10 | 7 | 40 | 64 | 104 |
| 1981 | 0 | 32 | 40 | 32 | 72 |
| 1982 | 5 | 0 | 43 | 34 | 77 |
| 1983 | 0 | 3 | 42 | 32 | 74 |

Source: Association des companies d'Assurance du Liban, 68-83.

Table 2.8

Total Premiums collected, 1970-1983
(Millions of Lebanese pounds)

| Year | Premium collected by non-life ins. co, | Premiums collected by life insurance co |
|---|---|---|
| 1970 | 34 | N.A. |
| 1971 | 39 | - |
| 1972 | 45.4 | - |
| 1973 | 53.2 | - |
| 1974 | 75.7 | - |
| 1975 | N.A. | - |
| 1976 | N.A. | - |
| 1977 | 45 | - |
| 1978 | 67 | - |
| 1979 | 95.3 | 26.3 |
| 1980 | 107.8 | 37 |
| 1981 | 141.3 | 46.9 |
| 1982 | 168.3 | 59.7 |
| 1983 | 215.8 | 78 |

Source: Association des compagnies d'Assurance du Liban, year 70-83

Table 2.9

Net Premium collected by the twelwe leading
Insurance companies in Lebanon in the Non-Life Branches
( in thousands L.L)

| Company | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|
| 1) Bankers Assurances | 9,250 | 11,900 | 14,118 | 17,146 |
| 2) L'Union Nationale | 9,600 | 10,200 | 14,010 | 15,036 |
| 3) Union des Assurances de Paris | 10,150 | 10,600 | 10,841 | 10,699 |
| 4) Compagnie d'Assurances et de Reassurances du Liban et du Monde Arabe | 4,450 | 5,600 | 7,455 | 10,215 |
| 5) La Libano-Swisse Compagnie d'Assurances | 4,700 | 6,200 | 7,444 | 8,265 |
| 6) Societe Arabo-Europeene d'Assurances et de Re-assurances | 3,400 | 4,900 | 5,526 | 7,883 |
| 7) St. Paul Fire and Marine Ins. Co., | 5,900 | 6,200 | 5,585 | 6,968 |
| 8) Societe Nationale d'Assuran. | 3,850 | 4,900 | 5,660 | 6,586 |
| 9) La phenicienne,Compagnie d'Assurances et de Reassu-rances | 1,800 | 2,300 | 5,501 | 6,585 |
| 10) Al Nisr Ins. Co., | 4,250 | 5,300 | 6,923 | 6,423 |
| 11) Commercial Assurances | 2,100 | 3,400 | 4,333 | 6,125 |
| 12) American life Ins. Comp. | NA | NA | 4,429 | 5,884 |
| Total Premiums of 12 Co. | 59,450 | 71,500 | 91,825 | 107,815 |
| Total Premiums collected by all non-life Ins. Co., | 107,800 | 141,300 | 168,300 | 215,800 |

Source: Association des compagnies d'Assurance du Liban, Year 80-83

## C - The Banking Sector

The present chapter has two aims: the first is to discuss briefly, the main features of two important banking institutions operating in Lebanon: The commercial and the medium-and long-term credit banks; the second is to asses their contribution to the further development of the Lebanese capital market.

### (1) The Commercial Banks

There has been a significant change in the structure of the commercial banks operating in Lebanon as a result of the events of 1975-76. For while in the pre war years the influence of foreign banks subsidiaries was greater, the post war period witnessed a better performance of both Lebanese and joint Lebanese-Arab banks.

The banking sector currently consists of 91 banks. The existing banks are divided as follows:[12] 48 Lebanese banks, 15 joint Lebanese-foreign banks, 13 foreign banks, 5 Arab banks, and 10 joint Lebanese-Arab banks.

The existing banks vary in terms of their capital, assets, deposits, and number of branches. There exist, on the one hand, small family-owned Lebanese banks and, on the other, branches or subsidiaries of large foreign and Arab Banks.

With the exception of the Intra Bank crisis of 1966 which resulted in the liquidation of some of the existing weak banks and a ban on the establishment of new banks, the Lebanese banking sector witnessed a steady growth in the last decades. Indeed the banking sector has withstood, better than other sectors in the economy, the problems resulting from the 1975-76 war. This is reflected in the tremendous increase in the banking sector's total assets, deposits and number of bank's branches after the war.

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[12]Source: Association of Banks in Lebanon, Annual reports 1970-1983 (Beirut: Association of Banks in Lebanon).

Table 2.10 below gives some idea of the development of the banking system over time. As a result of ban that was imposed, effective 1967, on the establishment of new banks, the number of banks operating in the economy remained constant during the period 1970-77. However and due to the removal of the ban, effective July 1977 the number of operating banks increased from 76 banks at the end of 1977 to 82 banks at the end of 1980. Finally, the number of banks increased to reach 91 banks at the end of 1982, and this number remained constant in the years 1983-84 because the government stopped the license of banks.

The total number of commercial banks branches showed a gradual growth during the period 1970-74, increasing from 275 branches at the end of 1970 to 298 branches at the end of 1974. However in the post war years the number of branches experienced a sharp increase, growing from 298 branches at the end of 1974 to around 400 branches at the end of 1979. Indeed the destruction of Beirut's commercial center where most of the banks main branches were located, along with the effective division of the country into different parts forced many banks to open new branches in many parts of the country so as to meet the demand of their customers.

The total assets of the banking sector also grew throughout the last thirteen years at an annual rate of about 25 percent. It increased from LL 5,046 million at the end of 1970 to L.L 37,197million at the end of 1980, to reach L.L 78496 million at the end of 1983, Moreover the average size of banks, represented by assets per bank, also increased during this period. This increase was more than twelve-folds: from L.L 70 milllion at the end of 1970 to L.L 863 million at the end of 1983.

## Composition of credit

Table 2.11 presents the distribution of commercial banks credit facilities according to channels of economic activities. Such classifications, though not a very accurate one, can be considered as a general indicator of the main outlets of credit in the economy. The table above shows that about 50 percent of total outstanding amounts during 1970-1983 was in the form of short term credit directed to the trade and services sectors. Furthermore, around 35 percent of total commercial banks credit was directed to three sectors: agriculture, industry, and construction. These sectors, as one might expect, require longer-term financing. In consequence, it may be said that the commercial banks have been engaged in medium-term lending disguished in the form of short-term credit which are rolled-over at maturity; thus competing with other capital market institutions namely, the medium- and long term credit banks. This, however has tended to delay the development of the local capital market.

Table 2.10

Commercial Banks Data, 1970-1983

(Millions of L.L)

| Years | Number of Banks | Number of Branches | Assets | Assets Bank |
|---|---|---|---|---|
| 1970 | 72 | 275 | 3,046 | 70 |
| 1971 | 74 | 292 | 6,327 | 86 |
| 1972 | 74 | 293 | 7,604 | 103 |
| 1973 | 74 | 294 | 9,700 | 131 |
| 1974 | 76 | 298 | 12,314 | 162 |
| 1975 | 76 | 243 | 13,489 | 177 |
| 1976 | 75 | 369 | 13,849 | 185 |
| 1977 | 76 | 395 | 17,298 | 228 |
| 1978 | 77 | 400 | 20,461 | 266 |
| 1979 | 78 | 402 | 27,021 | 346 |
| 1980 | 82 | N.A | 37,197 | 454 |
| 1981 | 84 | N.A | 52,981 | 631 |
| 1982 | 91 | N.A | 61,718 | 678 |
| 1983 | 91 | N.A | 78,496 | 863 |

Source: Association of Banks in Lebanon, Balance Sheets of the Banks ( year 70-83 )

Table 2.11

Percentage Breakdown of Commercial Banks claims on Private Sector

( 1970-1983 )

| Year | Agri-culture | Industry | Cons-truction | Trade & Services | Fin. Instit. | Other | Total |
|---|---|---|---|---|---|---|---|
| 1970 | 5 | 17 | 12 | 54 | 3 | 9 | 100 |
| 1971 | 5 | 17 | 11 | 54 | 3 | 12 | 100 |
| 1972 | 4 | 16 | 11 | 54 | 5 | 9 | 100 |
| 1973 | 3 | 16 | 11 | 52 | 6 | 12 | 100 |
| 1974 | 2 | 18 | 10 | 51 | 4 | 15 | 100 |
| 1975 | 3 | 20 | 11 | 51 | 4 | 9 | 100 |
| 1976 | 3 | 20 | 12 | 56 | 4 | 10 | 100 |
| 1977 | 2 | 20 | 10 | 52 | 5 | 12 | 100 |
| 1978 | 2 | 17 | 11 | 48 | 3 | 19 | 100 |
| 1979 | 2 | 17 | 12 | 52 | 3 | 14 | 100 |
| 1980 | 2 | 17 | 10 | 53 | 2 | 15 | 100 |
| 1981 | 3 | 17 | 11 | 54 | 2 | 13 | 100 |
| 1982 | 3 | 17 | 12 | 52 | 4 | 12 | 100 |
| 1983 | 2 | 16 | 13 | 49 | 3 | 17 | 100 |

Source: Bank of Lebanon, Quarterly Bulletins 79-84

(2) - The medium - and long-term credit (Specialized) Banks

These institutions are of greater importance to the capital market than the commercial banks mainly because they specialize in longer-term operations. In Lebanon, they exist both, private and quasi-public specialyzed Banks.

The role of these institutions in the Lebanese capital market has not been successful for many reasons among which are: first, the restrictions imposed by their law of enactment which rendered their functionning somewhat difficult, second, the competition of commercial banks which, in practice, engage in medium-term lending, and third, the events of 1975-76which made it difficult for them to function properly or to make use of the fiscal advantages offered to them.

An Evaluation of law 22/67 governing the Medium- and long-term credit Banks, shows that this law was enacted in 1967 in response to the Intra Bank crisis of 1966 and with the aim of encouraging the specialization in longer-term financing operations within the economy. The law offered the long-term credit banks certain fiscal advantages, including tax exemption for the first seven years of operations on the revenue generated from their domestic lending, and the removal of 0.2 percent stamp tax on their debt instruments.

Medium- and long-term credit (specialized) Banks operating in Lebanon

As mentioned earlier there are two types of long-term credit banks operating in Lebanon: private and quasi-public specialized banks.

Private specialized Banks

The following may be listed:

1) The Finance Bank: It was established in 1960 under the name of "the Lebanese Real Estate bank". In 1972 its name was changed to "The Fi-

nance Bank" and it began operating under the provisions of the law 22/67.

2) The investment and Finance Bank (I.N.F.I): It was established in 1973 under the provisions of the law 22/67. The majority of its capital is owned by foreign financial institutions with a 35 percent share being owned by the local commercial banks. Its objective, as any other long-term credit bank, is to carry out operations involving long term loans and investment projects, such as purchases of bonds, and the issue of medium- and long-term guarantees.

3) The union Bank: this bank operated only for three years, beginning 1974, after which it closed down.

4) The bank of Near East: It was established in 1974 by a group comprising banks and insurance companies and is principally concerned with the provision of mortagage finance to individual home buyers and with conducting limited amounts of term-lending domestically.

## Quasi - Public Specialized Banks

These banks have generally, been more active than previous ones mainly because of the substantial support that the government had offered them. There are at present four quasi-public specialized banks operating in Lebanon. These are:

1) The National Bank for Industrial and tourist development:[13] its establishment in 1973 was in response to the growing need for term-lending in both the industrial and tourist sectors. Its capital was set at L.L60 million with 51 percent public ownership and 49 percent private ownership.

2) The agriculture, Industrial and Real Estate Bank: It was established in 1954, and was supposed to accumulate its resources through the de-

[13] Abdul Rahman Tayyarah, "The National Bank for Industrial and Tourist Development", An-Nahar (Beirut) 5 November 1979. Section: Banking Survey (in Arabic).

posits of the commercial banks and government's funds. During the period 1955-1967, it supplied many loans to both industry and tourism projects, however, its credit to agriculture was insignificant. In 1967 a year after the Intra Bank collapse, it was given the major role of acting as a liquidator for a number of weak banks operating during that period. It has been, since then, transformed into a commercial bank.

3) The National Bank for Agricultural Development: towards the end of May 1977, a decree was issued establishing the National Bank for agricultural development with a capital of L.L 50 million being wholly subscribed by the government. It is supposed to take over the role assumed by the AIRECB. It is to accept deposits with a minimum maturity of 18 months and can borrow from the domestic market an amount equivalent to six times the subscribed capital.

4) The Housing Bank:[14] A legislative decree establishing the Housing Bank was issued on January 15, 1977. Its capital of L.L 50 million is subscribed by three parties: the National Social Security Fund, the Ministry of Finance, and the private sector. The resources of the Housing bank could be augmented by borrowing from the Government a maximum of L.L. 50 million at concessionary interest rates, during the first five years of its operations. In addition, the Bank can borrow from both the public and the private sectors an amount equivalent to six times its capital. It began operation in 1979 by approving 215 loans totaling L.L 19 million.

This bank is still, however, facing some difficulties in mobilizing deposits from the private sector.

D - <u>Finance Companies</u>

On January 12, 1981, the Bank of Lebanon approved the establishment

[14]Source: Bank of Lebanon. Also Flado Khlat,"The Housing Bank", An-Nahar (Beirut) 5 November 1979, Section: Banking Survey, P. 5. (in Arabic).

of the Lebanese Finance company which has yet to be operative. The main function of this institution are the following:[15]

a) improve the primary market and create a secondary market for government securities.

b) Act as an investment bank by underwriting newly issued private and public debt instruments

c) Act as a secondary market for money debt instruments such as bankers acceptances, commercial bills and certificates of deposits

d) Improve and expand both the interbank and the exchange markets.

The Bank of Lebanon will be expected to grant the company privileged access for rediscounting government securities with a minimum maturity of three years. Such access will be unlimited, but subject to the provisions of the law of Money and credit and the monetory policy of the Bank of Lebanon. Furthermore, the commercial banks will be expected to provide lines of credit to the company. These will be however, secured by government securities, certificates of deposits and other negotiable financial assets.

E - Conclusions

In assessing, briefly, the contribution of the aforementioned institutions to the development of the local capital market, the following may be noted:

1) The role of the Bourse has not been satisfactory for many reasons among which are: the narrowness of the securities market, the inefficiency of the Bourse, the competition of the commercial banks and the foreign Borrowers, the absence of investment banks, and the 1975-76 War and the prevaling security situation.

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[15] International Finance Corporation, Lebanon Discount House, Draft Project Proposal for Potential Shareholders. (Washington D.C.: International Finance Corporation, 1979), pp 21-22.

2) Insurance companies, operating in Lebanon, have not as yet,become important participants in the capital market, however, thier role is expected to be greater, once the latter developed.

3) The contribution of both the commercial banks and the medium-and long-term credit banks to the development of the capital market could have been greater, had it not been for the short maturity of the commercial banks deposits, and the unnecessary restrictions imposed by law No. 22/67 on the operations of the long-term credit banks. The competition between the two types of banks and the 1975-76 events have further aggravated the problem.

4) The operations of the Lebanese finance company involve a mixture of the operations of an investment bank, a stock exchange office, and a discount house. By performing the functions of both a discount house and an investment bank, the company will be contributing much to the development of both the capital and money markets. However considering the company's role as a secondary market for government securities, it should be noted that this role conflicts with the traditional role played by the Bourse.

# Chapter 3

# CONCLUSIONS, RECOMMENDATION AND SUMMARY

## CONCLUSION

### An Examination of Developments So Far

It is, undoubtedly, a difficult task to broaden the capital market in a country that is, constantly, affected with economic instability and political turmoil. Machinery, in the form of financial institutions and systems, might be created, but it certainly could not be operated under proper conditions. When reckless fiscal and monetary policies result in soaring inflation, the development of a proper capital market is retarded; savings are best invested in real estate or in foreign exchange balances abroad. Investors will not accept the threat of capital loss resulting from placing their savings in a bank for a relatively long period, when they know that the real return could be negative. Thus, although the institutional environment for a broad capital market may be perfectly structured, it will not function properly, since it cannot attract the funds of savers.

Pre 1963, the year of enactment of the Law of Money and Credit, there was, practically, no law governing the activities of the banking sector, save for the Secrecy Law of 1956.[1] The existing Monetary Law of 1947 did not regulate monetary and banking activities except for regulations relating to the currency issue. Banking activity was considered an act of commerce and was, thus subject to the Commercial Code of 1943 that regulated

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[1] This law states that the managers and employees of banks are forbidden to give any information concerning the names and the amount of holdings of clients.

all commercial activity in the country.[2] The Law of Money and Credit set forth the regulatory framework for the monetary system by establishing a Central Bank ( Bank of Lebanon), and initiating a set of laws regulating the operations of the different financial institutions existing in the country. It reflected an attempt by the authorities to lay the regulatory framework for the banking and other financial operations without impinging undully on the important role played by the private sector in the economy.[3]

The Bank of Lebanon was, established in 1964 replacing Banque de Syrie et du Liban which assumed, until then, the de-facto role of the Central Bank with only very limited Central Banking activities. The role of the Bank, as defined by the Law of Money and Credit, is to safeguard the stability of the Lebanese currency, ensure a basis for economic and social progress, and to supervise the activities of the different financial institutions. The power of the Bank in terms of credit extension and monetary policy was somewhat limited. Its role in the capital market,which is represented by its engagement in open-market operations, was subject to strict limits. The Bank was authorized to buy or discount obligations issued or guaranteed by the state, provided their maturities do not exceed 90 days, and their total value does not exceed the Bank's capital of general reserves. The Bank, could however buy or sell private and public securities (Not for the account of the Ministry of Finance).[4] These restrictions, were removed during 1973 when major amendments were introduced to the Law of Money and Credit.

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[2]Antoine Asseily, Central Banking in Lebanon (Beirut: Khayyat Publishers, 1967), pp. 31-32.

[3]Makdissi, Financial Policy and Economic Growth: The Lebanese Experience, op. cit., pp. 51-52.

[4]Article 100 of the Law of Money and Credit.

During 1964, the Bourse witnessed severe speculative activity which lead to great loss on the part of many investors, and to sharp decline in the volume of transacted shares. This problem, which was mainly the result of the weakness and inefficiency of the Bourse: the narrowness of the securities market; and the weak control exercised on the financial information supplied by the different corporations, was not tackled properly by the authorities who imposed two mere regulations on the operations of the Bourse. The first required that prices of traded shares should not vary by more than ten percent of the previous closing price. The second required that no single order, of more than L.L 20,000, can be transacted.

The above two regulations had little, if any, effect on improving the situation of the Bourse which has since then witnessed a continuing drop in the number of traded shares. This is mainly attributed to the fact that the core of the problem, i.e., the inefficiency of the Bourse; the little control it exercises over trading operations; and the narrowness of securities market, were not properly tackled.

The Intra Bank crisis of 1966 set a demarcation line in time between a period of passiveness on the part of the monetary authorities and the beginning of a period of awareness of the importance of financial policy. The crisis, which was the result of a sharp decline in the banking system's total liquidity,[5] put great pressure on the authorities to cope with its short- and long-term consequences.

With respect to the immediate, or short-term, problems resulting from the crisis, namely, the lack of sufficient liquidity for the banking system, the authorities helped the existing banks by offering them credit facilities. It was further agreed that the Intra Bank should be split into

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[5]For a review of this crisis, see Emile Ghattas, Lebanon's Financial Crisis in 1966: A Systemic Approach", Middle East Journal 25 (Winter 1971): 31-48.

two institutions: an investment company known as Intra Investment Company, and a small bank being a subsidiary of the Intra Investment Company and known as Bank Al-Mashrek.

The long-term, and more important, consequences of the Intra Bank crisis, i.e., the safety and the proper functionning of the banking system, were met as follows:[6]

1) Some of the weak banks that were facing financial problems were totally liquidated and put under the supervision of a newly created Superior Banking Commission which was given special powers to take over the weak banks.

2) Two other important bodies were created to supervise banking operations. The first was the Banking Control Commission whose function is to supervise, control, and make sure that banks are functionning within the limits of the Law of Money and Credit. That is, it exercises pressure on commercial banks to keep an adequate balance between the maturity structure of deposits and investments. The other, newly established, institution was the National Deposit Insurance Fund which acts as an insurance company for deposits denominated in Lebanese pounds. It guarantees individual deposits not greater than L.L 30,000 in a single bank.

3) The enactment of Law number 22/67 provided for the establishment of medium-and long-term credit banks. The Law has been an important step towards the promotion of the Lebanese capital market, because it set forth the basis for the creation of financial institutions that engage in term-financing. However, despite the fact that the law was enacted in 1967, six years passed before the first long-term credit bank was established in 1973. This is in part due to the fact that the law suffers

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[6]Makdisi, Financial Policy and Economic Growth: The Lebanese Experience, op. cit., pp. 53-54.

from any loopholes related mainly to the restrictions it imposes on the operations of the long-term credit banks which make it difficult for them to function properly. No serious attempts however, have yet been made by the authorities to amend this law.

4) A five year ban, beginning May 1967, was imposed on the establishment of new commercial banks. The authorities felt that the Lebanese financial market was saturated with commercial banks and a ban would be important for the safety of the financial system.

Ten years later, in 1973, the authorities attempted to amend some of the restrictions in the Law of Money and Credit in order to give the Central Bank more authority and greater flexibility in its monetary policy and to enable it to play a more effective role in the capital market. Some of the important amendments may be classified as follows:[7]

1) Commercial banks were, henceforth, required to deposit with the Bank a certain ratio of their assets as special minimum reserves. This ratio is to be specified by the Bank.[8]

2) The Bank was, henceforth, able to use different types of credit controls to influence the direction of credit to different sectors of the economy.

3) Government or government-guaranteed debt instruments would, henceforth, qualify as part of reserve assets up to a proportion of deposits to be specified by the Bank.[9]

4) The maturity of publicly held securities that the Bank could buy or discount was increased from 90 to 180 days.[10] In addition, the bank

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[7] Makdisi, Financial Policy and Economic Growth: The Lebanese Experience, op.cit., pp. 54-56.

[8] Article 76 as amended.

[9] Article 79 as amended.

[10] Article 106 as amended.

was, henceforth, allowed to purchase foreign governments' or international organizations' debt instruments with any maturity; and to discount or re-discount commercial bills denominated in foreign exchange with six months maturity.[11]

6) Government and government-guaranteed obligations could, henceforth, be traded on the Bourse.

The two war years, 1975-1976, witnessed the absence of any institutional or financial measures being adopted by the authorities. However, with the cessation of hostilities in November 1976, the Bank of Lebanon took three important measures to assure the solvency of the banking system. The first was to hold, in abeyance, the reserve requirement on commercial banks' deposits. The second was to allow the commercial Banks to retain pretax profits of 1975-1976. The third was to provide easy credit to banks having liquidity problems.[12]

Other important measures were, further, undertaken. The moratorium on licensing new commercial banks, that had been imposed in 1967, was lifted effective as of July 2, 1977; the number of commercial banks operating in the country, thus, increased to reach 82 banks as of end of 1980. Equally important, was the establishment of the Housing Bank ( long-term credit bank) in 1977. On March of the same year, a decree was enacted establishing a banking free zone where all non-residents' foreign currency deposits are exempt from reserve requirements; premiums for deposit insurance; and the 10 percent withholding tax.[13] Despite the fact that this measure was aimed at encouraging the inflow of non-residents funds into the country, the prevailing unsettled political and security situation in the country tended to hinder such development.

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[11] Bank of Lebanon, Annual Report, 1975-1978 (Beirut: Bank of Lebanon, 1979), pp. 52-63

[12] Decree No. 77 of 2/6/77.

[13] Decree No. 29 of 5/2/77.

Towards the end of 1979, the Bureau of Economic Policy Coordination was created. Its role is to coordinate fiscal, monetary,and development policy measures in the light of general national objectives including the curbing of inflationary pressures; and the promotion of a sound financial policy as a basis for economic reconstruction and development. It has worked, since its establishment, on several economic issues including a proposal to float government securities to the non-institutional public as a step towards mobilizing domestic savings and the development of the securities market. Equally important, an attempt has been made to reconsile monetary and fiscal objectives by limiting the extent to which emerging budgetary deficits could be financed by the Bank of Lebanon. The objective here was to lessen, to the extent possible, the monetary impact of budgetary deficits.

Apart from the above, the Bank of Lebanon and a group of commercial banks have worked together, since 1979, to create a Lebanese discount house known by the name of the Lebanese Finance Company. It is yet to be operative; and it is expected to have a tremendous effect on both the local money and capital markets.

Finally by looking at the experience of the Lebanese capital market, during the period under study, one can recall seven important events that had major imprints on the development of this market. These are: first, the enactment of the Law of Money and Credit in 1963 which provided for the establishment of the Bank of Lebanon and regulated banking activity, save for the Commercial code of 1943 which treated banking as an act of commerce. Second, the Beirut Bourse crisis of 1964 resulting from severe speculative activity which led to significant losses to small investors and to a shying away by the mass of public investors from the stock exchange market for a long period; thus, weakenning the contribution of the Bourse to the development of the capital market. Third, the Intra Bank crisis of 1966 which led to the liquidation of some banks; the setting of the Banking Control Commission; the establishment of the Deposit Insurance Fund; and the imposition of a five year ban (extended to ten years, ending in 1977) on the establishment of new banks. Fourth, the enactment of Law 22/67, providing for the creation of medium- and long-term credit banks, in 1967. Fifth, the creation of the National Social Security Fund in 1967. Sixth, the major amendments to the Law of Money and Credit in 1973 which gave the Bank of Lebanon more powers and greater flexibility in its monetary policy and enabled it to undertake more appropriate measures to develop the local capital market. Finally, the 1975-76 war and its impact on the structure and performance of the different financial institutions in the capital market.[14]

## Commercial Banks

Theoretically speaking, the role of these institutions in the capital market involves: (1) supplying funds to investment banks underwriting newly issued securities; (2) acquiring public bonds through open market operations; and (3) engaging in medium-term lending disguised in the form of short-term credit.

In Lebanon, the picture is, somewhat, different. With the absence of investment banks, the commercial banks no longer play their complementary role as suppliers of funds to investment banks, but rather supply funds directly to corporations. This process has tended to hinder or at least delay the development of the Lebanese securities market. To illustrate, corporations which are in need for capital, do not borrow through the issuance of stocks or bonds, but rather borrow directly from the commercial banks; thus, no new stocks or bonds are being made available for

[14] The 1975-76 events have affected adversely the operations of the medium- and long-term credit banks, the insurance companies, and the Bourse; the operations of the commercial banks were less affected. For details, refer to chapter two.

the public.

Apart from the above, commercial banks operating in Lebanon compete with the medium- and long-term credit banks by supplying medium-term credit under the guise of short-term advances which are rolled over at maturity. This tends to impede the functionning of the medium- and long-term credit banks which face great difficulty in mobilizing deposits because of the restrictions imposed by their law of enactment.

Another feature of the commercial banks, operating in Lebanon, is the short maturity of their deposits. It is estimated that around 95 percent of all deposits at commercial banks during the period 1970-1980, were demand and savings deposits.[15] Moreover, it is also estimated that over 97 percent of total deposits, including time deposits, had a maturity not exceeding three months. The nature of these deposits reflects the propensity of Lebanese savers for short-term investments and quick returns. However, it also presents an obstacle for the proper development of the Lebanese capital market since the commercial banks account for the largest part of Lebanese savings.

Finally, apart from deposits, the commercial banks do not offer other money market instruments. There has been virtually, no certificates of deposits or bankers' acceptances. The reason behind this phenomenon has partly been the result of: (1) the propensity of Lebanese savers for short-term investments; (2) the presence of a 10 percent withholding tax on income derived from these instruments in comparison with tax exemption on savings deposits; and (3) the lack of a secondary money market, the development of which is descussed below.

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[15] In Lebanon, the distinction between savings and demand deposits is (apart from the fact that savings deposits while not subject to prior notice may not be withdrawn by check)in the fact that the interest earned by savings deposits is higher than that earned by demand deposits. Moreover, the interest income arising from demand deposits is subject to a ten percent tax while that of savings deposits is exempt.

## The Beirut Bourse

The Lebanese stock exchange which is supposed to be the most important and efficient institution in the capital market is not very popular among the Lebanese public. This is a result of the continuous flactuations in both the prices and number of daily traded stocks and bonds. Indeed, the narrowness of the Lebanese Securities market; the weak control exercised by the Bourse over operations taking place on its floor; the competition of foreign borrowers; the availability of bank overdrafts and lines of credits; and finally the weak publicity offered by the Bourse, have all contributed to the diminishing role played by the Bourse in the Lebanese capital market. Furthermore, the Government itself did not attempt seriously, in the last two decades, to try to cope with the problems facing this institution, except in the year 1964 when two regulations were imposed to lessen the speculative activity that occured during that year.

The development of the Lebanese capital market is directly related to the development of the Bourse ( the reverse is also, somewhat, true). Consequently, in order to promote the development of the capital market, it would be necessary to improve the conditions of the Bourse, as well as the securities market. Measures to promote the operations of the Bourse will be discussed at a later stage in this chapter.

## The Medium - and Long-Term Credit Banks

The role of these institutions, in the Lebanese capital market, has not been impressive. The main problems facing them stem from mainly two factors: (1) their inability to raise enough funds for their operations; and (2) the competition of the commercial banks which rendered their proper functionning somewhat difficult. Both factors originate from loopholes existing in the law governing their operations. In addition, the events of 1975-76 have worked to impede their development mainly because they prevented these banks from benefiting from some of the fiscal advantages provided by their law of enactment; and discouraged savers from depositing their funds, for, relatively, long periods, in these banks.

Obviously, the prospects of the medium- and long-term credit banks will depend, largely, on introducing certain amendments to the law governning their operations.

### Insurance Companies

Insurance companies, operating in Lebanon, assumed a more important role, in the economy, during the early seventies. However, this role, somewhat, diminished after the 1975-1976 war years when many companies had to close down. Their role in the securities has not been significant: Their shares are not listed on the Bourse; their equity investments are minimal and their holding of government securities is limited.

The number of insurance companies, operating in Lebanon, is still large when compared to the population of the country.[16] Thus, the entry of new companies into the insurance field should be regulated in such a way as to encourage the establishment of strong and efficient companies that will benefit the insured.

### The Social Security Fund

This institution, as already discussed, possesses substantial amount of funds which are either deposited with commercial banks or used to buy government securities. They can play a significant role in the capital market if the latter could be properly developed.

## RECOMMENDATIONS

The examination of the first part leads to the conclusion that in order to develop the Lebanese capital market, the fulfillment of two important prerequisites would be required:

[16] Hoss, op. cit., pp. 37-38.

1) Promoting the functionning of three important institutions, namely the commercial banks, the medium- and long-term credit banks, and the Bourse.

2) Creating various types of debt instruments adapted to the requirements of different types of savers.

(a) Institutions

The Lebanese capital market cannot thrive without the existence of an adequate amount of funds supplied by the local commercial banks to assist the different institutions of the market and, in particular, the new Finance Company to underwrite new debt instruments. To improve the effectiveness of the existing commercial banks in promoting the capital market the following measures are suggested:

1) Regulations should be set to encourage existing corporations to borrow through the securities market rather than to borrow directly from the existing commercial banks through the guise of rolled-over short-term credit. In other words, borrowing through the issuance of new stocks and bonds should be stimulated.

2) The roll over financing should be discouraged to allow the medium -and long-term credit banks to undertake their designed role, which is the advancing medium and long-term credits to the different sectors of the economy. Needless to say, the short-term nature of commercial banks credit renders business projects vulnerable to liquidity crisis. For although, some Lebanese firms and business men might have benefited from the rollover of commercial banks' debt; nevertheless, they were uncertain concerning the reliability of extended financing to expand their business.[17]

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[17] Makdisi, Financial Policy and Economic Growth: The Lebanese Experience, op. cit., p. 46.

3) A withholding tax on interest income arising from short-term deposits should be introduced to induce the longer-term deposits. For instance, a certain fee may be charged on early withdrawals of savings deposits. Moreover, interest offered on demand deposits may be abandoned. These two measures might help increasing the maturity of the available funds at the commercial banks which may be used to finance the operations of other capital market institutions.

The second, and more important, institution in the capital market that requires major improvements is the Bourse. To promote the functionning of the Bourse and, more generally, the securities market, the following measures may be considered:

1) The tax system applicable to profits of Lebanese corporations should be amended so as to eliminate discrimination against large corporations with many shareholders. To illustrate, the present tax system,being of the progressive type imposed on individuals, has tended to discourage the formation of large corporations. This is because large corporations with many shareholders incur more taxes than small family-owned corporations, resulting in lesser dividends being distributed to their shareholders.

2) The difference between the so-called open and closed companies should be clarified. For while an open company permits the entrance(subcription) of many shareholders, the closed company allows the subcription of few shareholders. In Lebanon, however, some of the companies declaring their openness allow only few to subscribe. Thus, measures should be taken to encourage the establishment of open companies and discourage the closed ones.[18]

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[18] Bourse of Beirut, "The Development of the Lebanese Securities Market", Beirut, 1980 (in Arabic), pp. 4-5.

3) The poor information and control regarding the shares of listed companies have deterred would be investors from buying such shares. Full trading information must be made available, on a daily basis, on all listed securities. This would include full reporting on a transaction by transaction basis, reflecting the prices and the number of traded securities. A control commission should be set to monitor all financial information supplied by different corporations.[19] This will, of course, encourage investors to participate in the operations at the Bourse.

4) A unified auditing and disclosure procedure should be adopted in Lebanon to facilitate the comparison between the financial statements of different companies.

5) Measures should be taken which would require different corporations, operating in Lebanon, to provide periodic reports concerning their financial position; their operations; and their future plans.

6) The government and its different agencies ( the Electricity company, the Telephone Company and, the municipalities) can encourage the operations of the Bourse by issuing securities which may be conducted on the Bourse.[20] Later, and when investors become more familiar with the operations of the Bourse, as a result of their dealings in listed government securities, they will be encouraged to trade in private corporations' securities.

The problems facing the medium- and long-term credit banks originate, mostly, from restrictions imposed by their law of enactment. To develop the operations of these banks, the law should be amended along the following lines:[21]

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[19] Bsat, op. cit., pp. 16-17.

[20] Beirut Bourse, op. cit., p. 6.

[21] Hoss, op.cit., pp. 33-36. See also Fouad Abi Saleh, op.cit. pp.7-8.

1) The minimum maturity of the private (non-bank) savers' deposits and that of institutions that these banks are allowed to accept, should be decreased to one year and six months, respectively. This will allow these banks to have better cash-flow positions and greater flexibility in terms of their lending operations.

2) Greater freedom should be granted to these banks regarding their operations in the money market.

3) They should be permitted to discount their certificates of deposits at any time so as to allow these banks to have better cash-flow positions.

4) The long-term banks did not benefit from their entitled seven years tax exemption, beginning 1973. This is mainly attributed to the events of 1975-76 which made it very difficult for these banks to operate efficiently. It is, thus, recommended that the tax exemption period be extended.

5) Allowing these banks to engage in investments and merchant banking.

6) The collateral demanded by these banks against granted loans should be decreased so as to allow various sectors of the economy to benefit from the funds available at these banks.

(b) <u>Instruments</u>

The Lebanese and foreign investors have been always faced with limited choice of short-, medium- or long-term debt instruments. They have, thus, been obliged to assume foreign exchange risks implicit in investments abroad or invest in real estate and foreign financial instruments. The reasons behind this shortage in available debt instruments have already been discussed throughout this study. Hence, the following section will concentrate on measures which might help cope with this problem. These are the following:

1) Creating a secondary money market which will facilitate the issuance of and the trading in short-term debt instruments. This would be taken care of by the Finance Company.

2) Promoting the operations of the Bourse and, more generally, those of the securities market.

3) Amending the present tax legislation. Indeed, there presently exist two fiscal obstacles in the Lebanese tax legislation, as related to the taxation of financial instruments, which impede the attainment of a developed financial market: the withholding tax on movable capital and the stamp duty. The withholding tax, of which the earnings of savings accounts government securities, and certificates of deposits and bonds of long-term credit banks are exempted, is imposed on certain financial instruments such as commercial banks' time deposits, commercial papers, bankers' acceptances and bonds of corporations. As a consequence, the market for these instruments has not developed. On the other hand, the stamp duty applied to all financial instruments seems to discriminate against short-term debt instruments; since, the shorter the maturity, of the instrument, is the greater will be the burden borne by the owner. Consequently, the market for short-term debt instruments has been distorted.

Thus, two fiscal measures may be considered to correct the situation: the first would be to abolish the withholding tax on movable capital; and the second is to amend the stamp duty so as to avoid discrimination against some of the short-term debt instruments.

## SUMMARY

Despite the narrowness of the capital market, the Lebanese economy has witnessed a remarkable growth during the sixties and early seventies; a growth which, to a large extent, was induced by the relative political and financial stability prevailing during that period. However, it is believed that this growth would have been greater, had the capital market been more properly developed. Indeed, while the financial market was able to attract substantial amounts of savings, the effective utilization and the adequate allocation of these funds could have been greatly improved upon. The absence of an adequate number of financial instruments available to investors, has resulted in heavy investments, of short-term funds, in foreign exchange balances and real estate speculation. In addition, the narrowness of the institutional structure -- commercial banks being the dominant institutions-- has also tended to detter other than short-term investments. The securities market lacked a supply of attractive funds, on the one hand, and individual and institutional buying power, on the other.

The commercial banks, which are characterized by the short maturity of their liabilities, and their dominance are credit suppliers, furnished a substantial part of the external capital required by established industries. This was in the form of short-term advances which were rolled-over at maturity. The roll-over of loans is, however, viewed as an unreliable source of funds to industries. It encourages the borrower to continue operations with a dangerously unbalanced capital structure and with minimum of equity funds, thus, rendering investment projects increasingly vulnerable to liquidity crisis. Indeed, the absence of adequate term financing seems to have acted as a constraint on the expansion of plant capacity.[22]

The role of the medium-and long-term credit banks has not been, on the other hand, satisfactory in meeting the demand for the financing of some projects requiring term-loans such as housing, agriculture, and tourism. Some of the problems they faced have stemed from their law of enactment.

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[22] Makdisi, Financial Policy and Economic Growth: The Lebanese Experience, op. cit., p. 46.

Apart from the aforementioned, the 1975-76 war has imposed major financial constraints on both the private and public sectors. In the first place, the substantial damages incurred by many economic units require large sums of term credits which could not be augmented without the presence of a developed long-term credit institutions. Moreover, the growing governmental budgetary deficits emerging after the war could have been more satisfactorily met with the existence of a developed securities market.

With all of the above in mind, the importance of broadening the local capital market is obvious. However, and as discussed earlier in this study the role of the financial authorities has not been -- until recent years-- active in coping with the different problems facing the local capital market. The authorities seemed to initiate reforms only after crisis had arisen; the Intra Bank crisis is one example. Further, while in certain cases, e.g., the Bourse, and Law No. 22/67, it had become apparent that reforms are needed, they seemed to hesitate in undertaking them.

In recent years, however, the position of the financial authorities has changed. They have taken a number of measures which are expected to have beneficial effects on the development of the capital market. Among them are: the establishment of two new specialized banks; the creation of a banking free zone; and the proposed establishment of a finance company.

If the Lebanese capital market is to be developed, the financial authorities should play an even more active role in the near future. This would include the broadening of the securities market and the strengthening of the existing financial institutions. To achieve the first objective, a number of steps should be considered. This includes: (1) reducing the impediments to the issuance of new financial instruments; (2) encouraging the banking system to issue different types of financial instruments to meet the needs of a wider range of savers; and (3) tightening of financial regulations and supervision on financial intermediaries and corporations to protect the interests of investors.

To achieve the second objective, i.e., the strengthening of some of the existing financial institutions a set of measures should be adopted. For instance, fiscal measures should be considered as an incentive to increase the maturity of the commercial banks' deposits. Moreover, the competition between the commercial banks and the medium-and long-term credit banks should be minimized.

The Bourse, on the other hand, should be granted more powers to control, effectively, all trading activity taking place on its floor; and to prevent all forms of speculative activity that might occur.

The law governing the operations of the medium- and long-term credit banks should be, further, changed so as to allow these institutions to mobilize greater amounts of deposits; and to operate efficiently in the local capital market.

Finally, other insitutions such as insurance companies, the Social Security Fund, and the Deposit Insurance Fund, should be encouraged to participate, more effectively, in the securities market.

To conclude, the development of the Lebanese capital market should receive greater concern in the future. A developed capital market will enable both Lebanese and foreign investors to invest a good part of their funds in income-earning assets which will channel a large portion of the savings to the uses most needed. It will, further, help the Bank of Lebanon to use, more efficiently, its monetary policy tools. The development of the capital market will induce banks to reduce their excess liquidity; it will also help to curb real estate and foreign exchange speculation,as well as to support, when the need arises, governmental budgetary operations.

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