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LEBANESE AMERICAN UNIVERSITY

LEBANESE EXTERNAL DEBT 1985-1995

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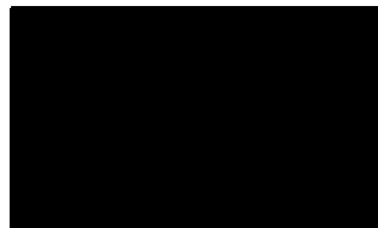

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Chapter I

Introduction

1.1 Purpose of the Study

The main purpose of this study is to analyze debt figures of the Lebanese Economy. It Concentrates on external debt by examining it, overlooking its changes over the years (trend), and analyzing it by considering its relation to major economic aggregates (GDP, Exports of goods and services, International reserves,....)

Also, the study deals with the comparison of the Lebanese debt figures with other emerging economies' figures to recognize our debt burden along with other countries.

1.2 Need for the Study

It is an attempt to reorganize economic data and figures in a way to follow up changes concerning external debt, analyze the changes, and know the consequence of high external debt. Therefore, the need to look at figures in a different manner, through different perspectives, necessitates the formulation of this study.

1.3 Methodology

The sources used to gather data were Banque du Liban (BDL) yearly reports, BDL monthly bulletins, monthly economic journals, World Debt Tables (WDT), International Monetary Fund (IMF) and World Bank (WB) reports. Also, books relating to external debt were used. The data used in this project for chapter II were mainly secondary data from economic books. Also, for chapter III and chapter IV the data were secondary from BDL reports and ministry of finance. Data were separated into two classes, class I including 1985-1992 period, and class II including 1993-1995 period.

Data were compared and analyzed according to these two periods. The research is a basic theoretical research that considers secondary data analysis a prime source of information. In short, this research methodology consists of the following steps:

-stating figures (secondary data)

-analyzing and comparing figures

-statement of the problem

-consequences of the problem

-recommendations

1.4 Limitation of the Study

During this study many problems were faced comprising the following:

-Non existence of real statistics concerning external debt figures before the year 1992.

-Difference in statistics between World Bank figures and BDL/ministry of finance figures.

-Unavailability of real definite figures before year 1989 concerning external debt, thus, necessitating the study through the years 1989 until 1995.

"It is important to note that in the year 1993 a new program to calculate external debt has been set under control of UNCTAD and it was issued by Ministry of Finance and BDL.

1.5 Construction of the Study

Chapter 1 starts with a general introduction stating the purpose, need, methodology, and limitations of the study. Chapter II represents a review of literature where debt is defined; it, also, shows its causes and its origin and development throughout recent history prior to World War II, post World War II, and recent era. Then Mexico is presented as a case study. Chapter III is an overview of the Lebanese economy where major economic indicators and economic aggregates are stated, concentrating on internal and external debt development in the second part of the chapter. Chapter IV constitutes the research analysis where external debt figures and data are analyzed, overlooked, and compared to other nations' figures. WB and IMF suggested policy reforms are presented in this chapter along with the implementation of reform in Lebanon. Finally, chapter V draws people's attention to the consequence of

high public debt levels by presenting solutions adopted worldwide to eliminate public debt, and stating local solutions to reduce the Lebanese debt burden, and eventually, the conclusion.

Chapter II

Literature Review

2.1 Debt Definition

A debt is a legal claim that someone holds against someone else. The claim may be of many kinds IOUs, loan agreements, or bonds of various sorts. The national debt is the sum total of all the outstanding bonds, bills, and notes issued by the treasury to individuals and institutions who have lent the government their money. Being more, public debt is divided into marketable and non marketable issues[1]. Marketable issues are traded and are available to all buyers. They include bills, notes, and bonds. The main difference between them is one of maturity.

Non marketable issues can be held only by the initial buyer and are offered to various groups. Mainly they are designed to be held by trust funds of the federal government, but special issues are also provided to state, local government and foreign governments. Also, they can be held by individuals as saving bonds[2].

2.2 Causes of Indebtedness

Discussing debt necessitates stating the underlying causes of indebtedness. Debt exists because borrowers want funds that they don't immediately possess. Governments are no exception. A government that seeks to borrow does so because its tax revenues are not sufficient to finance all the expenditures that it has budgeted. Why not raise taxes? The main reason is that taxing is often a politically unpopular means of raising money, and hence most of the time causes

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[1] Richard A Musgrave, Peggy B. Musgrave, Public Finance in Theory and Practice, 5th ed.(McGraw -Hill Inc.,Singapore), 1989, p.546.
[2] Ibid, p. 547.

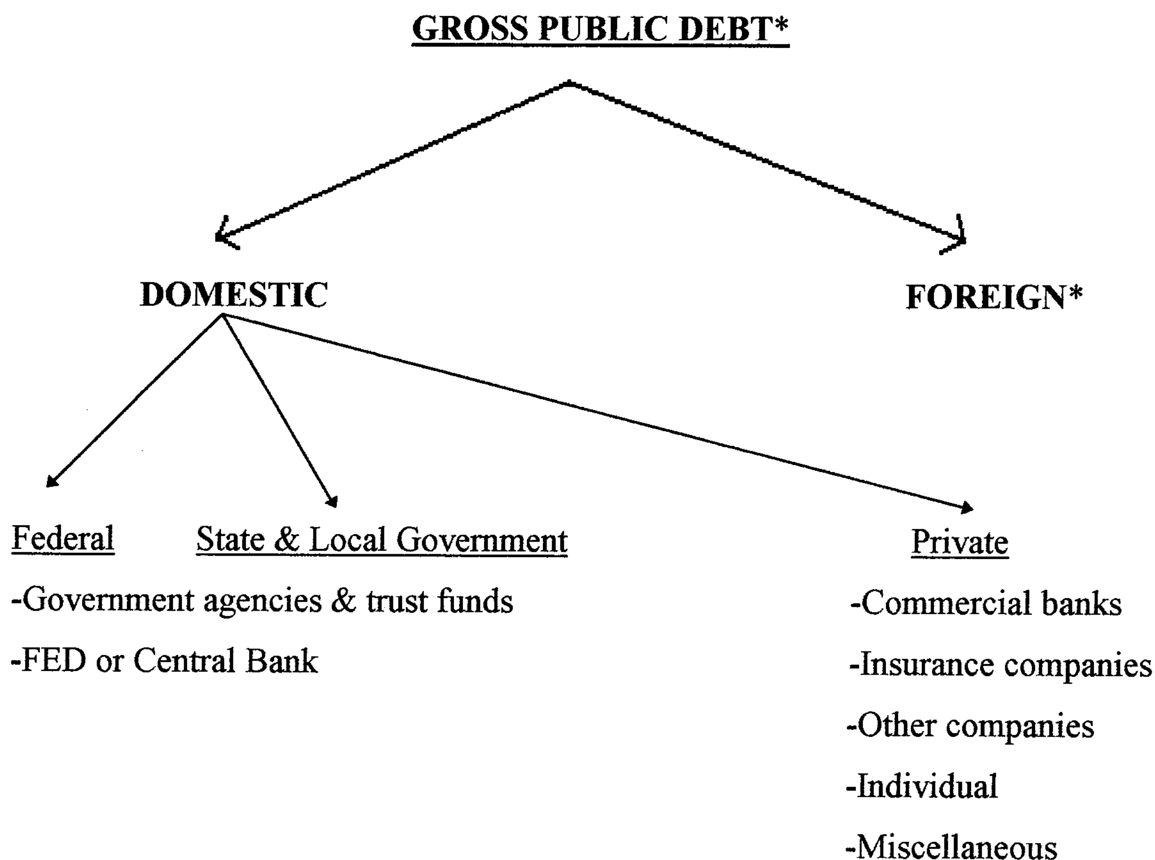

Figure 2.1: Gross Public Debt as distributed by type of Holder[3]

*It is important to note that net public debt is Gross debt less any debt held by Federal agencies.

*Foreign or External debt is the debt owned by foreigners, including: central banks, ordinary foreign banks, foreign companies, institutions and individuals.

social friction[4]. Approaching a country's indebtedness, it clearly seems to stem from the following sources:

i-A deteriorating balance of trade due to depressed commodity price, depressed demand for exports or rise in import prices.

ii-Increased liquidity in the international market which encouraged banks to increase their market for loans.

[3] Robert Heilbroner and Peter Bernstein, The Debt and The Deficit, 1st ed., (W.W. Norton & Co. Inc., N.Y.), 1988, p. 32.
[4] Ibid, p. 490.

iii-Reduced availability of grants and concessionary aids.

iv-The appearance of large fiscal deficits created by the need to counteract the economic contractions, in other words due to capital-intensive growth policies.

v-Development strategies high dependence on imported energy.

vi-High dependence on imported foodstuff.

vii-External borrowing to finance recurrent expenditures.

viii- Decline in domestic saving rates.

ix-Failure of the government to progressively tax elite to raise revenues.

In other words one can say that borrowing can play a useful role in the creation of physical and human capital[5] .

2.3 Historical Perspectives

Foreign debt and financial instability are not new. History is full with debt bubbles that have grown and burst. According to economic analysts external debt has always been an instrument with both, a potential for economic development and a risk of financial strain. A historical perspective on nations' debt development is necessary as it makes one aware of what has happened and what is going on now-around in the new world order where the world has become a cosmic village.

2.3.1 Prior to World War II

Foreign investment played an important role in the economic development of many nations even in the nineteenth century. During the nineteenth century the United States defaulted on foreign loans. The level of US Foreign indebtedness

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[5] Ibid, p. 59.

was estimated at 40 percent of GNP throughout the 1830s[6]. Estimates of the foreign indebtedness of USA at that time in relation to the size of the economy incurring the debt are very similar to the debt levels of many twentieth century developing countries. For the United States foreign debt fell to 24 percent of GNP in 1869, reaching 20 percent in 1899, 18 percent in 1914 and 8.5 percent in 1929[7].

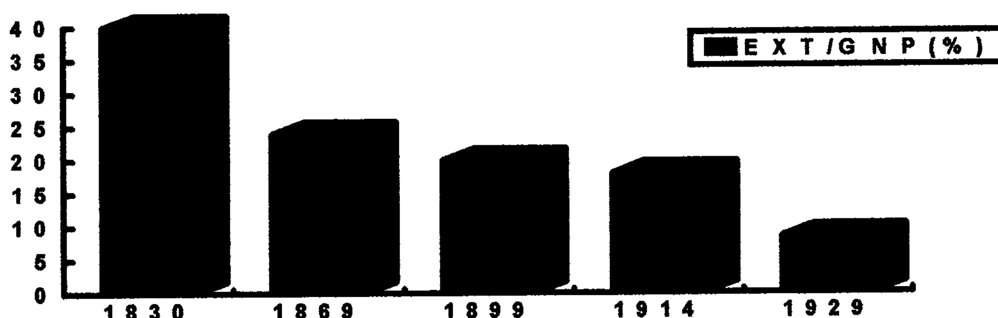

Figure 2.2: USA, EXT/GNP Trend

Foreign loans to the Unites States in the 1800s were not without risks. It is well known that there were periods in which American states defaulted on foreign loans in sizable numbers; large borrowings by American states for canal and railroad construction in the 1830s were defaulted in 1841 and 1842 as the price of cotton collapsed and foreign exchange was not available to make debt payments[8].

Canada, Australia, and New Zealand are additional examples of successful development; these countries were even more dependent on foreign investment inflows than the United States.

Regarding Canada, net foreign debt reached 114 percent of Canadian GNP in 1900, 111 percent in 1910 and 88 percent in 1920[9]. Up to 1914 Australia and New Zealand had together received about $ 2,435 millions in foreign investment

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[6] Robert Henriques Girling, Multinational Institutions and the Third World, (Greenwood Press, Inc., Connecticut), 1985, p. 21.
[7] Lawrence G. Franco & Marlin J. Seiber, Developing Country Debt, (Pergamon Press Inc., N.Y.), 1979, p.3.
[8] Robert Henriques Girling, Multinational Institutions and the Third World, (Greenwood Press, Inc., Connecticut), 1985, p.21.

which represented about $400 of external debt per person; the comparable figure for Canada in 1914 was about $500 per person[10]. These figures are higher than those of the United States, as they indicate a greater dependence on foreign capital inflows. One should keep in mind that such figures can not be compared to the current economies of the non-oil developing countries because, these countries were sparsely populated lands with huge amounts of underutilized natural resources; therefore, development strategies would be expected to be more capital-intensive for these countries. From this point of view, it is not surprising that relative to output, external capital was larger for these countries in the early twentieth century than for the developing nations in the last quarter of this century.

Experience prior to World War I indicates that, in an expanding world economy, foreign lending is both remunerative to the creditor and productive to the borrower, eventhough there are clearly risks to be faced and, sometimes, repayment may be tardy or partial, still there are tremendous gains to be made by both sides over the long haul.

After the build-up of foreign lending in the 1920s, the economic depression and sharp decline in world trade in the early 1930s resulted in widespread defaults by Latin American and Eastern European nations. By January 1932, defaults on a total of $2.6 billion had already occurred[11]. In 1931, estimated debt service costs for principal and interest payments were running at approximately one-third of government revenues in Latin America. As a proportion of export earnings, debt-service costs rose sharply from 1930. This was primarily due to the decline in prices of commodities exported by these nations as coffee, sugar, tin, etc.

It has been said, "In a period of falling prices, the burden of debts and accrued interests is much greater in terms of commodities or services than was originally intended, and the debtors in effect are repaying much more than the

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[9] Lawrence & Seiber, p.3.
[10] Kenwood & Lauyheed, Growth of International Economy, p. 42.
[11] Ibid, p. 52.

value they received"[12]. So, the key elements in the series of defaults by developing countries in the early 1930s were the following:

i- Collapse in world trade

ii- Decline in prices of their exports

iii-Unavailability of foreign currency to meet foreign debt payments

2.3.2 Post-World War II Era

From 1946 to about 1950, great efforts to reconstruct the European economy were done, hence, that period was called the reconstruction period. Between 1946 and 1950, the Western European nations received $16.4 billion in public grants and $14.4 in public loans[13]. During the same period, countries outside Europe and North America received $5.5 billion in public grants and $3.0 billion in public loans[14]. To be more specific, from 1945 till 1950, the net public indebtedness of the developing nations rose only slightly from $1.8 billion to $2.1 billion. In comparison, the net public indebtedness of the European countries increased very rapidly, rising from $3.6 billion in 1945 to $12.3 billion in 1950[15]. Repayments more or less offset new loans through 1955, when debt was $11.7 billion. European indebtedness never became worrisome as it leveled off after years of sharp growth (1947-1950), until it was essentially repaid in the early 1960s. The European economy required a ten-year of capital injection from 1945 to 1955 and then was able to achieve self-sustained growth. This growth was combined with both inflation and large concessionary grants in the 1950s to reduce the burden of payments. After 1955, the role of foreign public grants and loans became quite small and was replaced by domestic saving and private direct investment from the United States.

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[12] Lawrence & Seiber. p. 8.

[13] Ibid, p. 10

[14] Ibid, p. 10.

[15] Ibid, p. 11.

A second period of growth and development from the early 1950s until 1970s, was marked by a tremendous growth in world trade and world income together with increasing emphasis on using public capital for the development of Asian, African, and Latin American countries. During the 20 years from 1953 to 1973, the developing nations received $75 billion in public grants and $81.1 billion in public loans from the developed nations[16].

World trade increased from $75.7 billion in 1953 to $524.2 billion in 1973. A lot of factors were combined together to create a generation of growth and development in the world economy during this period and they include:

i-availability of low income energy.

ii-a stable international political order.

iii-liberalization of trade and the expansion of markets.

iv-unhindered flow of public capital to developing nations and private capital to Europe.

During this period, the indebtedness of the developing nations increased substantially, from $2.1 billion in 1950 to $121.0 billion in 1975 in outstanding developing countries debt. However, for a variety of reasons, it was not a fact that indebtedness was a serious pervasive problem since incomes, exports and prices were rising in the early 1970s. This resulted in reducing the real burden of debt on the developing nations and enabling them to raise the living standards, invest and repay past loans. So, the international financial system had evolved to a point where countries facing repayment difficulties could work together with the lenders and the international institutions to resolve problems in a mutually satisfactory way. Between 1956 and 1973, about 15 developing nations faced debt-repayment difficulties that were serious enough to lead to multilateral renegotiations of debt

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[16] Kenwood & Lougheed, p. 64.

payments[17] . The causes of these difficulties were generally related to problems specific to particular countries, such as excessive short-term indebtedness, sharp trade deterioration, insufficient export earnings, and other particular factors.

Obviously, after World War II public indebtedness in the Third World rose slowly but steadily through 1960s, from $2.1 billion in 1950 to $21.6 billion by 1961. Throughout the 1960s it grew up by an average of 17 percent per year, reaching $60.9* billion in 1969. This was followed by an explosive growth in the late 1970s and early 1980s. By the end of 1983 the world bank estimated Third World debt to be $810 billion, nearly 12 times more the 1969 level. (See Figure 2.3).

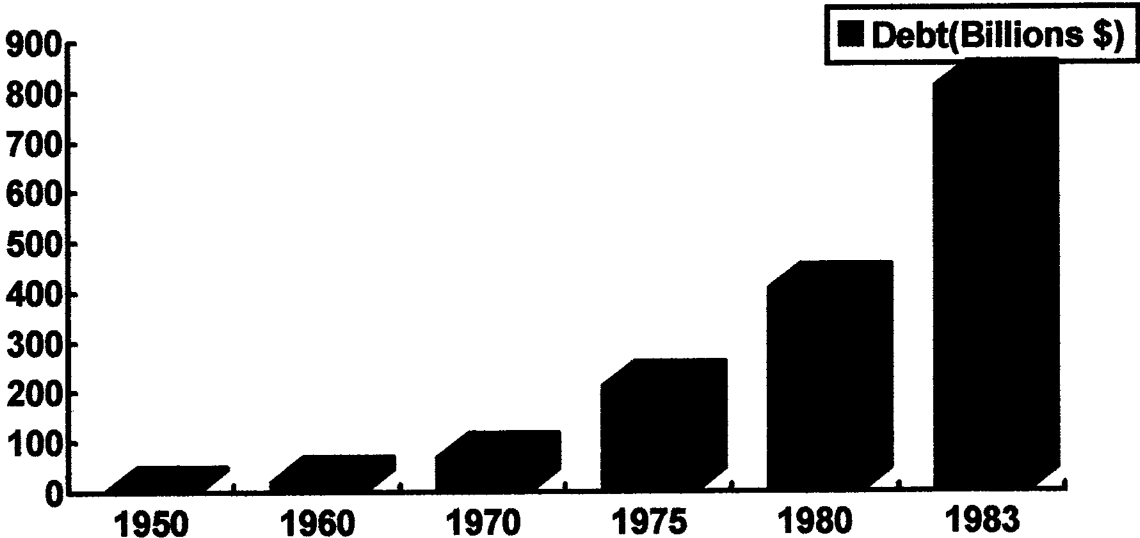

Figure 2.3: Developing World Debt (World Debt Tables)

[17] Kenwood & Lougheed," Growth of International Economy," p. 59.

* (A word of caution- these data are statistic, and different definitions of debt were used at different times)

2.3.3 Recent Era

The discussion of this era focuses on the years from 1982 until 1993. In the mid-1980s, comments of people concerning debt strategy were the followings: First, alarm that total debt was rising; and, second, frustration that banks were not lending new money to the debtor countries. This implied that banks were not doing their part to solve the problem. Of course, the more the banks lent, the more the debt totals would rise, so rising debt could be considered either a favorable or unfavorable sign.

The researcher will limit his discussion to the 17 heavily indebted countries, HD-17.

Table 2.2 Gross external debt.1989-93(Millions of dollars)

Country	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
17 heavily indebted countries												
Argentina	43.634	45.919	48.859	50.946	52.450	58.458	58.741	65.257	62.234	65.397	67.770	74.473
Bolivia	3.328	4.069	4.317	4.805	5.575	5.836	4.902	4.136	4.278	4.076	4.220	4.412
Brazil	92.961	98.341	105.419	106.121	113.705	123.837	115.712	111.373	116.417	117.350	121.063	132.749
Chile	17.315	17.928	19.737	20.384	21.144	21.489	19.582	18.032	19.227	17.947	19.134	20.637
Colombia	10.306	11.412	12.039	14.245	15.362	17.008	16.994	16.878	17.231	17.337	17.197	17.173
Costa Rica	3.646	4.188	3.992	4.401	4.576	4.721	4.545	4.603	3.772	4.049	3.965	3.872
Cote d'Ivoire	8.945	8.843	8.565	9.638	10.548	12.575	12.574	14.056	16.622	17.559	17.988	19.145
Ecuador	7.705	.595	8.305	8.702	9.334	10.474	10.746	11.317	12.109	12.468	12.280	14.110
Jamaica	2.846	3.445	3.585	4.089	4.216	4.733	4.569	4.573	4.663	4.516	4.393	4.279
Mexico	86.081	92.974	94.830	96.867	100.889	109.469	99.213	93.838	106.026	115.362	113.423	118.028
Morocco	12.535	13.399	14.219	16.526	17.907	20.796	21.026	21.639	23.531	21.567	21.599	21.430
Nigeria	12.954	18.540	18.536	19.550	23.403	30.655	31.246	31.997	34.537	34.436	30.998	32.531
Peru	10.712	11.343	12.157	12.884	14.888	17.491	18.245	18.583	20.069	20.719	20.293	20.328
Philippines	24.412	24.211	24.357	26.639	28.206	29.784	29.009	28.719	30.612	32.454	32.101	35.269
Uruguay	2.647	3.292	3.271	3.919	3.906	4.299	3.821	5.246	5.850	6.149	6.659	7.259
Venezuela	32.158	38.303	36.886	35.334	34.340	34.569	34.738	32.377	33.170	34.122	34.774	37.464
Yugoslavia	19.900	20.477	19.644	22.251	21.501	22.470	21.176	19.072	17.837	16.471	16.294	11.314
SUBTOTAL	392.085	424.279	438.717	457.301	481.950	528.664	506.839	501.696	528.185	541.979	547.151	574.273

Sources: World Bank, World Debt tables (WDT), various years.

Considering debt trends between 1982 and 1993, the following can be detected: Nominal debt for HD-17 rose by 46.4 percent over the period 1982-93 or by 4.2 percent annually. Referring to Table 2.2, debt declined during 1988-89, thus, reflecting debt-equity conversions and discounted buybacks. Over the period 1989-93, nominal debt rose by about 14 percent which is lower than 1982-87which

was around 34 percent. This moderate debt buildup after 1989 was due to internal transfer burden by which increased debt went mainly to private sector. If World inflation, is taken into account , real external debt for HD-17 rose substantially less than nominal debt (Table 2.3).

Table 2.3 Gross external debt-deflated, 1982-1993 (million of dollars)

country	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Nominal Ext. Debt												
HD -17	392.085	424.279	438.747	457.301	481.950	528.664	506.839	501.696	528.185	541.979	547.151	574.273
Deflated by US Wholesale prices, cte 1982												
HD -17	392.085	419.089	423.002	443.125	480.957	513.817	473.604	446.823	454.136	565.171	466.716	482.668

Sources IMF, International Financial Statistics (IFS)

Over the period, 1982-93, real external debt rose by 23.1 percent, or by 1.9 percent annually. To analyze the debt problem of the HD-17 over the period 1982-93 necessitates the study of the following ratios trends:

a-Ratio of external debt (gross debt minus reserves)* to exports of goods and nonfactor services(Table 2.4)

Table 2.4 Net external debt/export of goods and services, (percentage)

country	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
HD -17	290.4	311.8	278.4	298.8	**384.4**	368.1	312.8	276.1	252.1	255.0	231.8	225.3

Sources: IMF, International Financial Statistics(IFS)

For HD-17 countries, this ratio rose from 290 percent in 1982 to a peak of 384.4 percent in 1986, then it declined to 225 percent by 1993 (table 2.4). The peak in 1986 was due to the fall in oil prices to the oil exporters and to the erosion of exports association with domestic price stabilization programs for other HD-17 countries. This ratio improved a lot in the period between 1989-93 due to the recovery of export earnings combined with a build up in reserves that fully offset

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* International reserves: Sum of a country's monetary authority's holding of SDRs, its reserve position in the IMF, its holding of FX, and its holdings of gold. (Gold is excluded from reserves in the above table).

out rise in debt. The end result was to leave net debt/exports ratio in 1993 far below their peak in 1986 and substantially below their starting point in 1982 as well.

b-The ratio of net external debt to gross national product, an alternative measure of debt burden(Table 2.5).

Table 2.5 Net external debt/GNP*, (percentage)

country	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
HD- 17	41.5	52.2	51.5	54.6	59.7	**66.9**	57.6	54.4	46.9	43.9	42.4	42.5

Sources: IMF, International Financial Statistics(IFS)

According to Table 2.5, there was a jump in the relative debt burden from 1982 to 1983, a plateau for three years, reaching a peak in 1987. Modulate reduction in 1988-89 and a brisk improvement in 1990-93 brought the ratio back down to 42 percent by the end of 1993.

c-The ratio of Net interest payments to exports of goods and non factor services provided a measure of the relative debt burden. This ratio is different than debt-service ratio, which is the ratio of interest plus principal to export earnings. Net interest payments/export is superior to debt-service ratio, since repayment of principal is not an economic burden, as it is merely an exchange of one asset(resources) for another-a reduction in liability; nor was principal repayment a cash-flow burden for most of the major troubled debtor countries in the 1980s. Interest to export ratio may be the best indicator of the relative debt burden since it captures the price of the stock of debt-the interest payment.

* GNP figures are World bank estimates that use the current exchange rate to convert domestic currency GNP into dollar Values.

Table 2.6 Net interest payments/exports of goods and services(%)

country	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	199
HD- 17	29.8	28.7	26.0	25.0	25.2	25.4	25.1	19.4	15.8	14.3	10.5	10.9

Sources: IMF, International Financial Statistics(IFS)

During 1980s, interest rates fell substantially; thus, LIBOR fell from an average of 11.2 percent in 1982-84 to 7.9 percent in 1985-90, 5.9 percent in 1991, 3.8 percent in 1992 until it reached 3.25 percent in 1993[18].

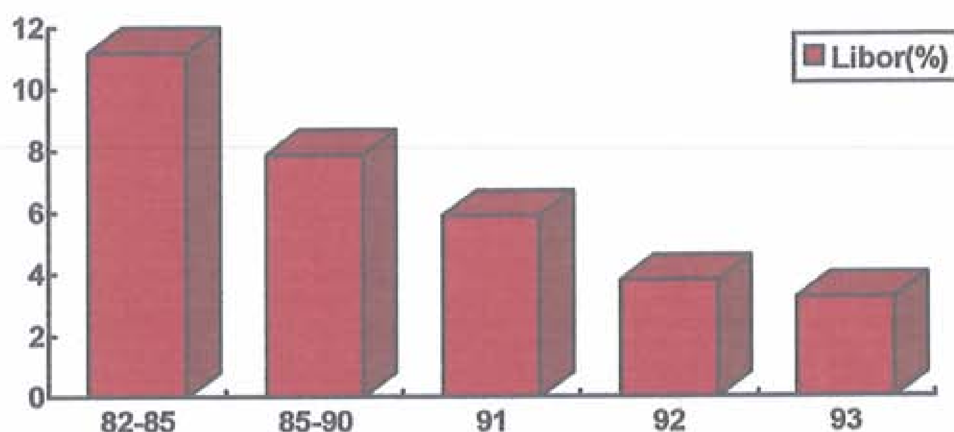

Figure 2.4: Interest rate changes

Although not all debt is at variable interest, there was enough responsiveness in the falling interest-rate price of debt; that for the HD-17 countries the ratio of net interest to export fell from 30 percent in 1980 to a plateau of 25 percent in 1984-88 reaching 11 percent in 1993 (Table 2.6).

Figure 2.5 summarizes the trends for the external debt burden of the HD-17 countries. Major improvements can be detected according to the three debt

[18] William R. Cline, International Debt Reexamined, (Institute for International Economics, N.Y.), 1995, p. 50.

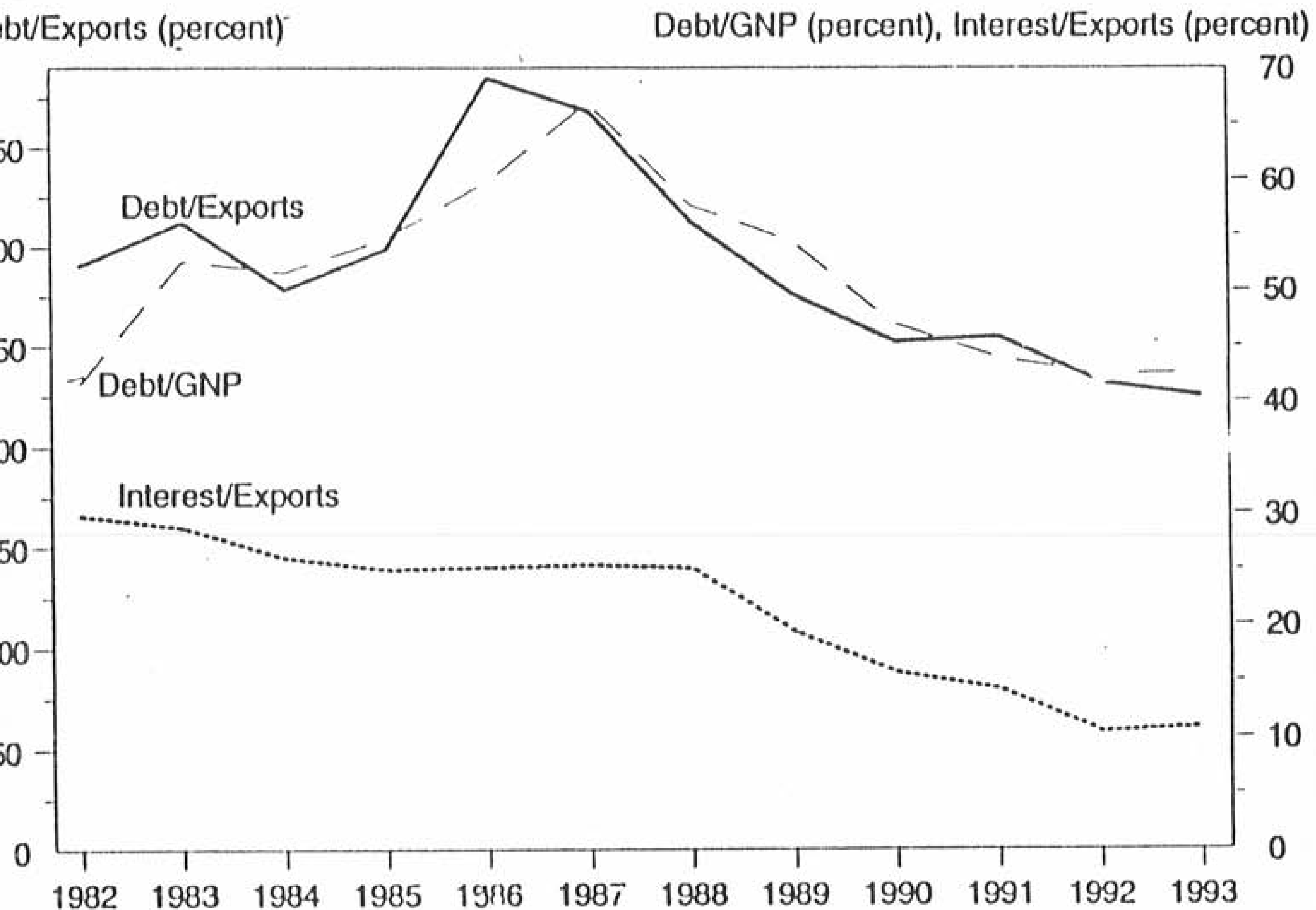

Figure 2.5: 17 Heavily indebted countries, 1982-93

2.4 Debt Theory

A question asked frequently why anyone would lend to a foreign country considering there is no tangible collateral as in domestic loans.

Reasons sight that countries insist in preserving their credit reputation for own self interest, because of welfare gains obtained through the use of foreign borrowing for "consumption smoothing" across. Also lenders' evaluation of the debtor countries point of indifference between retaining future access to consumption smoothing and the windfall gain from repudiating existing debt plays an important role. Strategists develop a model of sovereign lending that relies on asset seizure, export blockage, and loss of terms-of-trade gains as the sovereign incentive that replaces tangible collateral.

Many issues affected and shaped the debt theory as the paradox raised by many economist that lending should not take place for developmental reasons, because the time profile would involve solely lending at first and repayment subsequently, and there would be no incentive to keep paying in the second phase. Other economists oppose such hypothesis and suggested the missing elements which are countries' honor or pride, countries' expectations of lower risk premiums and wider market opportunities through full commitment to integration into international financial system[19].

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[19] Ibid, p.11.

2.5 Case Study "Mexico"

The first foreign loan extended to Mexico was from the English firm B.A. Goldschmidt and Co. for 3.2 million pounds in 1824[20]. Between 1888 and 1911, Mexico's foreign debt increased by more than 800 percent. Most foreign loans were used for national defense and government administrative expenses. During 1910s and 1920s, few loans were obtained and most of them to avoid default on foreign debt and several agreements were reached between the Mexican government and the foreign banks to reschedule the existing debt. In 1945 Mexico obtained its first post-war foreign loan for 20 million dollars from US Export-Import Bank, and, in 1947, it was granted a 22.5 million dollar loan from IMF; also, the world Bank extended three loans to Mexico for electrification projects, totaling 80 million dollars between 1946 and 1952[21]. Being 2.5 billion dollars in 1954, external debt continued rising reaching around 5 billion dollars in 1967, 6.3 billion in 1970(during which 80 cents of every dollar obtained from foreign loans was used to service the external debt), 11 billion dollars in 1974, and around 30 billions in 1979[22]. External debt continued to increase reaching 86 billion dollars in 1982, in other words, the crisis broke with Mexico being unable to meet its cash payments due.

Thus, the Mexican government announced on 18 August 1982 that it had insufficient funds to service external debts and declared a three-month moratorium on all interest and principal payments, a 70 percent devaluation, and a nationalization of its private banks[23]. Analysts agreed that the crisis was simply due to the sudden drop in oil prices and the country's overambitious investment

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[20] Antonio Gorge, Gorge Salazar-Carillo & Rene P. Higonnet, Foreign Debt and Latin American Economic Development, (Pergamon Press Inc., N.Y.), 1983, p. 139.
[21] Ibid, p. 140.
[22] Ibid, p. 142.

program of the 1970s. However, the causes were more fundamental, as they were rooted in the three-legged economic strategy that dates to the 1960s, which comprised briefly:

i-A shift from domestic food production to export of fruits, vegetables and live-stock, which meant massive imports of grains.

ii-Industrial sector focus on production of goods for the middle and upper-income groups (which implied limited demand, since the majority of the populations are poor)

iii-Oil dependency, which soared from 10 percent of total exports in 1970 to 73 percent by 1982, creating a dangerous dependence on a single commodity.

Let one not forget to add up capital flight at the late 70's, during which wealthy Mexicans came to view their economy as fundamentally unstable, due to balance-of-payments deficits and ever increasing infusions of foreign capital to finance the deficits. Therefore, they rushed to find safe heavens for their dollars in U.S real-estate or banks, which were offering the highest interest rate ever. Table 2.7 includes major economic indicators for Mexico during 1980's and 1990'S.

Table 2.7 Economic indicators for Mexico, 1980-93(billions of dollars)

	80	82	83	84	85	86	87	88	89	90	91	92	93
EDT[a]	57.3	86.0	93.0	94.8	26.9	100.9	109.5	99.2	93.8	106.0	115.4	113.4	118.0
GNP	188.1	-	-	-	-	121.7	133.3	164.4	198.2	236.3	279.8	319.7	332.0
XGS[b]	22.0	26.0	27.0	30.0	27.4	28.3	35.5	39.9	47.2	53.9	56.8	60.3	60.9
MGS	33.1	-	-	-	-	31.1	33.1	44.5	53.5	63.5	72.7	86.1	90.0
RES[c]	4.2	-	-	-	-	6.7	13.7	6.3	6.7	10.2	18.1	19.2	25.3

Source: World Bank, World debt tables (WDT), 1994-1995.

[23] Girling, p. 38.

a- EDT= Gross external debt

b- XGS, MGS= Exports and Imports of goods, nonfactor services.

c- RES= International reserves, include SDRS, reserve position in IMF, FX holding and holdings of gold (value at year end London prices).

As seen in (Table 2.7), EDT doubled during the 80's to reach 106.0 billions in 1990; 118 billion dollars in 93, which is the most recent data available. One is dealing with large and frightening numbers, but we can not evaluate the true debt burden without analyzing debt indicators during the 80's and 90's.

Table 2.8 Debt indicators for Mexico 1980-93 (percentage)

	80	82	83	84	85	86	87	88	89	90	91	92	93
EDT/XGS	258.1	-	-	-	-	**356.1**	308.7	248.9	198.9	196.7	203.2	188.0	**184.0**
EDT/GNP	30.5	-	-	-	-	**82.9**	82.1	60.3	47.3	44.9	41.2	35.5	35.0
INT/XGS[a]	27.3	-	-	-	-	**29.6**	23.5	21.9	19.7	13.8	14.7	12.7	10
TDS/XGS[b]	**49.3**	-	-	-	-	45.7	39.1	38.8	33.0	21.3	24.2	34.4	32.0
INT/GNP	3.2	-	-	-	-	**6.9**	6.2	5.3	4.7	3.1	3.0	2.4	2.0
RES/EDT[c]	7.3	-	-	-	-	6.6	12.5	6.4	7.2	9.6	15.6	16.9	**21.4**

Source: World Banks, World debt tables (WDT), 1994-95.

a- INT/XGS= interest ratio,total interest payments on accrual basis to exports of goods and services.

b- TDS/XGS= Debt service ratio, total interest payments plus principal repayments to exports of goods and service.

c- RES/EDT= international reserves to total external debt.

The debt indicators for Mexico (Table 2.8) show steady improvements since 1986, when debt/exports ratio peaked at 356.1 percent with the collapse in oil prices and exports earnings. After 1986, other major debt indicators showed improvements due to structural changes in the Mexican economy as a whole and particularly in debt strategy. In 1986, Mexico joined the General Agreement on Tariffs and Trade (GATT), thereby signaling a new open-trade strategy. Privatization was the other main area of structural reform, by which hundreds of

state firms were sold off. Among the most important were the telephone company, the state airlines, and the banks (Reprivatization of banks a decade later revived the private sector's willingness to invest in Mexico's growth).

Since 1983, Mexico has been trying to overcome the debt problem. Thus, in 1983 Mexico secured rescheduling of $23 billion in bank debt over 8 years at 1 7/8 percentage points spread above LIBOR[24]. In 1985 it rescheduled $48 billion dollars over 14 years and narrowed the spread to 1 1/4 percent under the multiyear rescheduling agreement (MYRA). Then in 1987, rescheduled $54 billion at 20 years naturities, 13/16 spread above LIBOR[25]. However, the real change in Mexican strategy took place in December 1988 when new president Carlos Salinas de Gortari took office. His new administration's debt policy involved the following:

i-Reduce the value of existing debt to be closer to its secondary market price.
ii-Assure multiyear access to new loans.
iii-Reduce the ratio of external debt to GNP.
iv-Reduce net transfer of resource from its existing level of 5% of GDP by enough to permit a return to sustained growth.

By 1991-92 the Mexican economy entered into a new phase. The debt problem had been partly resolved, inflation sharply reduced, and economic growth restored.

[24] Cline, p. 297.
[25] Ibid, p. 297.

Chapter III

Overview of the Lebanese Economy

3.1 Background of the Lebanese Economy

Lebanon, occupying a strategic place on the east coast of the Mediterranean between the three continents, was a bridge linking East and West and a cross-road through which foreign trade passed; also, one should not forget the capital Beirut, where major financial institutions were located to provide trade services, investments, and developing projects in the Arab World. Therefore, Lebanon has a long tradition of free trade and investment policies, with free market pricing for most goods and services and an unrestricted exchange and trade system. Today, the regional scene is different; alternative financial and commercial centers, such as Bahrain and Dubai, have emerged in the region. Many neighboring countries have established their own harbor facilities and contacts with international trading and financial centers. Lots of challenges are facing the Lebanese Government which is trying to enhance foreign investment in the economy and assure no legal restrictions to setting up and operating any kind of private business in Lebanon.

3.1.1 Prior to 1993

Lebanon has developed into a prosperous, lower middle-income country by the mid-70s. During 1960-69, economic growth averaged 5 percent per year and then accelerated to 9 percent per year in the period 1970-75[26]. The main source of growth at that time was the service sector, in particular, tourism, banking, insurance and free port activities. The banking sector (aided by a stable and liberal

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[26] "Lebanon survey", The Economist (Feb. 24, 1996) p. 12.

regime, a freely convertible currency, favorable regulations and skilled management) led Lebanon to serve as the financial center for the Middle East. Although smaller in size (in contribution to GNP) than the services sector, the export-oriented agricultural and manufacturing sectors also grew contributing to overall growth of income. Per capita GNP was estimated at US $ 2,070 in 1974, just prior to the outbreak of conflict in April 1975. Fifteen years later, per capita GNP decreased to reach U.S. $820, while income distribution worsened[27]. According to United Nations' estimates damages to infrastructure amounted U.S. $ 25 billion, with none of the principal sectors emerging from the conflict unharmed[28]. After years of war, in the late eighties and the beginning of nineties, the production development deteriorated and declined due to the following:

i-unavailability of adequate infrastructure.
ii-absence of skilled labor.
iii-obsolescent stock of capital.

These factors affected also trade, hotels, health, and education services, thus they added up to the decline in economic growth to reach (-40%) and (-10%) in the years 1989 and 1990 respectively. Also, the confidence in and credibility of the Lebanese pound and economic stability has begun eroding since 1983. The shift in authority from the government to non-official entities after 1982, gave rise to a parallel economy that severely hampered the government ability to collect revenues and taxes. This decline in government revenues and the growing expenditure on public services led to a large and rapidly growing budget deficit, reaching all time high about (90%) during 1988 and 1989. (See Table 3.1)

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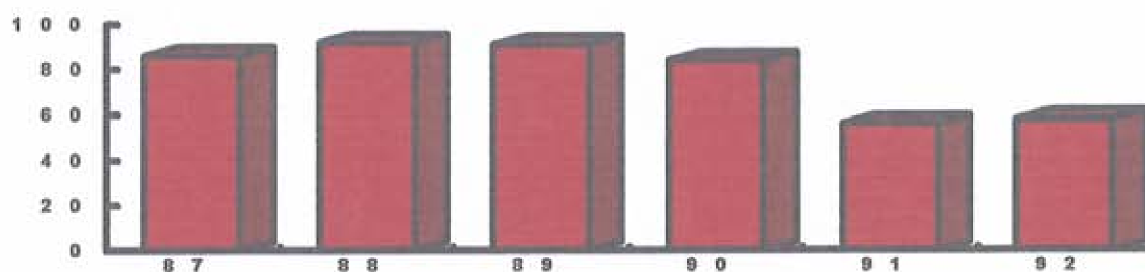
(27) Ibid, p. 12.
(28) Offering Circular, "The Lebanese Republic," (William Lea & Co., London) 1995, p. 15.

Table 3.1 Budget Expenditures:1987-1992 (billions of LBP)

Prior To 1992	87	88	89	90	91	92
Revenues	20.0	21.4	45.9	126.4	522.2	1030.9
Indirect taxes including customs duties	0.7	1.2	3.6	3.7	131.5	430.2
Direct and other revenues	19.3	20.2	42.3	122.7	390.7	600.7
Expenditures	143.5	275.8	511.4	797.1	1.196.2	2436.4
Salary and wages	20.6	61.6	96.9	215.1	370.0	660.1
Domestic interest	23.5	78.8	151.3	203.5	203.5	453.9
Others	94.3	116.9	230.5	342.5	461.7	1009.0
Capital expenditures	5.1	18.5	32.7	33.1	161.0	313.9
Deficit	123.5	254.4	465.5	667.7	674.0	1405.5
Deficit (percent of expenditures)	86%	92%	91%	84%	56%	58%



Source: Ministry of Finance/BDL

The above figure demonstrates that budgets prior to 1992 were always running at a deficit reaching 92 percent of expenditures in 1988, decreasing to 56 percent in 1991, and reaching 58 percent in 1992. Because of large fiscal deficit, the government continued to inject Lebanese Pound liquidity into the economy (see table 3.2), putting more pressure on LBP thus, driving iinflation up to reach 70% at the end of 1990.

Table 3.2 Money Supply (liquidity) 1984-1992 (Billions of LBP)

	85	86	87	88	89	90	91	92
Currency in Circulation	10.3	14.7	39.2	116.2	192.4	332.9	484.6	789.0
Sight Deposits in LBP	9.9	15.6	29.7	66.6	94.8	117.0	204.8	401.4
Money (M1)	20.2	30.3	68.9	182.8	287.2	449.9	689.4	1199.
Other Deposits in LBP	61.4	74.8	87.2	365.0	660.9	819.0	1461.1	3195.
(M2)	81.6	105.1	156.1	547.8	948.1	1268.9	2150.5	4394.
Deposits in Foreign Currency	38.9	222.8	1334.6	1643.6	1534.5	2584.6	3387.4	7474.
Total liquidity (M3)	120.5	327.9	1490.7	2191.4	2482.6	3853.5	5538.5	11869
Yearly changes in (M_3) percentage	56%	172%	355%	47%	13%	55%	44%	114%

Source: Ministry of Finance / BDL

Table 3.1 sets forth the liquidity of the Republic on the 31st December for each of the above years. One can detect that liquidity increased rapidly and reached its peak in 1987 (355%) as a result of the decrease in government revenues(inability to collect taxes), government printing money to cover its expenditures, political instability, infra-structure demolition after years of war, increase in government public expenditures; all were accompanied by high inflationary rates. The problem continued with large incorporating budget deficit in subsequent years 1991-92 (see Table 3.1). This lead to a vicious and continuous circle of budget deficit, that necessitates liquidity injection into the economy by either printing money, issuing T-bills or external borrowing; thus, increasing money supply to reach 114% at 1992 (see table 3.2).

One must not forget that Lebanese trade balance has always been at a deficit since 1985(see Figure 3.2), and Balance of Payments surplus was due to large capital inflows from Lebanese emigrants which helped BDL and Lebanese commercial banks to maintain their foreign currency reserves over and after the war period. The cycle of deficit financing, dollarization, outflows of capital, i.e.,

all these factors led to escalating inflation and exchange rate depreciation with the value of the Lebanese pound reaching 2530/USD in September 1992[29].

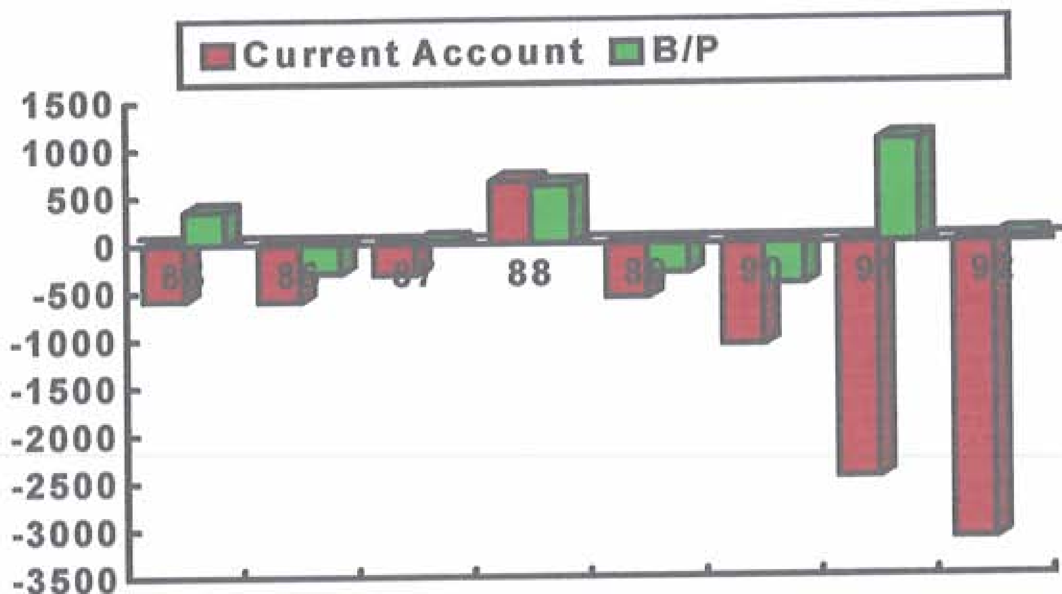


Figure 3.2 Balance of Payment and Trade Balance (Millions of USD)

At the end of 1992 the Lebanese Economy was facing the following problems:

-Galloping inflation

-Low productivity

-Infrastructure demolition

-Huge borrowing

-LBP depreciation

-Lack of investment opportunities

-Large fiscal deficit

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[29] BDL, Yearly Report, 1992. p. 61.

3.1.2 The period 1993 - 1995

By the end of 1992, the new government at that time was confronted with the challenge of reconstruction and the need to plan for the future while coping with the legacy of the past. In order to do so, it was necessary to reinforce the private sector activity, thereby rendering it the main engine for growth. The Government at that time, had 3 main principals:

i-Achieve prosperity and income increase level.

ii-Recapture Lebanon past role.

iii-Create a wide middle-class.

To reach these principals, the Government focused on the following short-term objectives:

i-Creation of a legal, financial, and economic environment.

ii-Redistribution and increase in income.

iii-Creation of an acceptable inflationary environment.

iv-Reduction of the fiscal deficit.

Due to the people's confidence in the new Government at the end of 1992 with its head figure Rafic Hariri, sizable inflow of capital and substantial shift from foreign denominated assets to LBP denominated assets was highly detected. Thus, in the last quarter, alone, in the year 1992, foreign reserves increased by almost US $1 billions and LBP appreciated from 2530/USD to reach 1838/USD at the end of 1992, 1711/USD in 1993, 1647/USD in 1994 and 1589/USD in 1995 (See figure 3.3); therefore, reflecting the exchange rate stability that the Lebanese economy has been longing for.

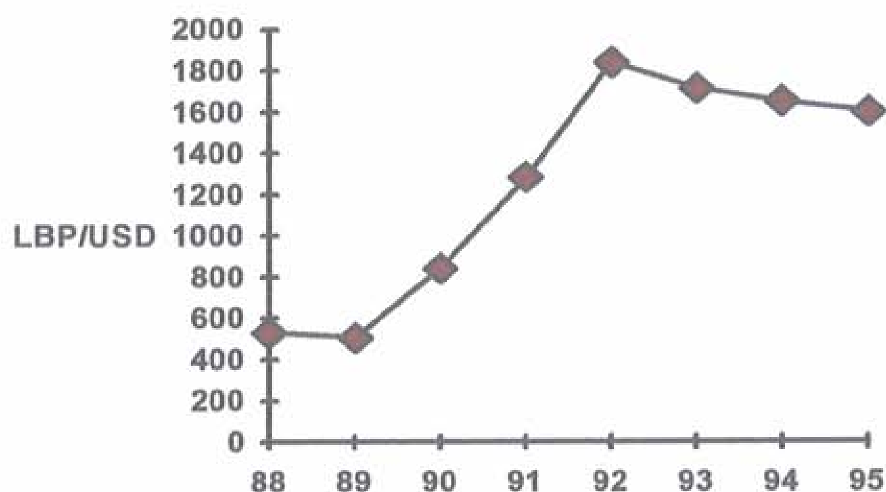

Figure 3.3 LBP/USD Exchange Rate(BDL Figures)

After, the New Government gained authority throughout the country, it moved to improve public sector finance, introducing measures aimed at containing and reducing the drain on public resources, through public expenditure control and enhancement of revenues' collection. Such a policy led to a fiscal deficit reduction to reach (37%), (56%) and (44%) in 1993, 1994 and 1995. (See Table 3.3 that summarizes Fiscal Budget changes since 1987)

Table 3.3 Fiscal Budget 1987-1995 (Billions of LBP)

	87	88	89	90	91	92	93	94	95
Revenues	20	21.4	45.9	126.4	522.2	1030.9	1854	2242	3150
Expenditures	143.5	275.8	511.4	794.1	1196.2	2436.4	2957	5089	5630
Deficit	**123.5**	**254.4**	**465.5**	**667.7**	**674.0**	**1405.5**	**1103**	**2846**	**2480**
Deficit(% Expenditures)	86	92	91	84	56	58	37	56	44
Revenue(%Expenditures)	14	8	9	16	44	42	63	44	56

Source: BDL / Ministry of finance

Regarding balance of payment, it was almost US $ 1.2 billion in surplus in 1993; US$ 1.13 billions in 1994; US.$ 256 millions in 1995; accompanied by a rise in central bank reserves of over US.$ 450 million in 1993; U.S.$ 1.861 million in 1994 and US.$ 591.1 million in 1995[30]. This surplus was not due to trade, as trade balance has always been running at a deficit that reached US.$ 3,536 million in 1993 (due to imports increase as a result of economic activity and reconstruction), US.$ 4,802 million in 1994 and US.$ 5,898 million in November 1995. Figure 3.4 sets forth the increase in net foreign reserves by BDL due to balance of payments surplus as a result of capital inflows to Lebanon.

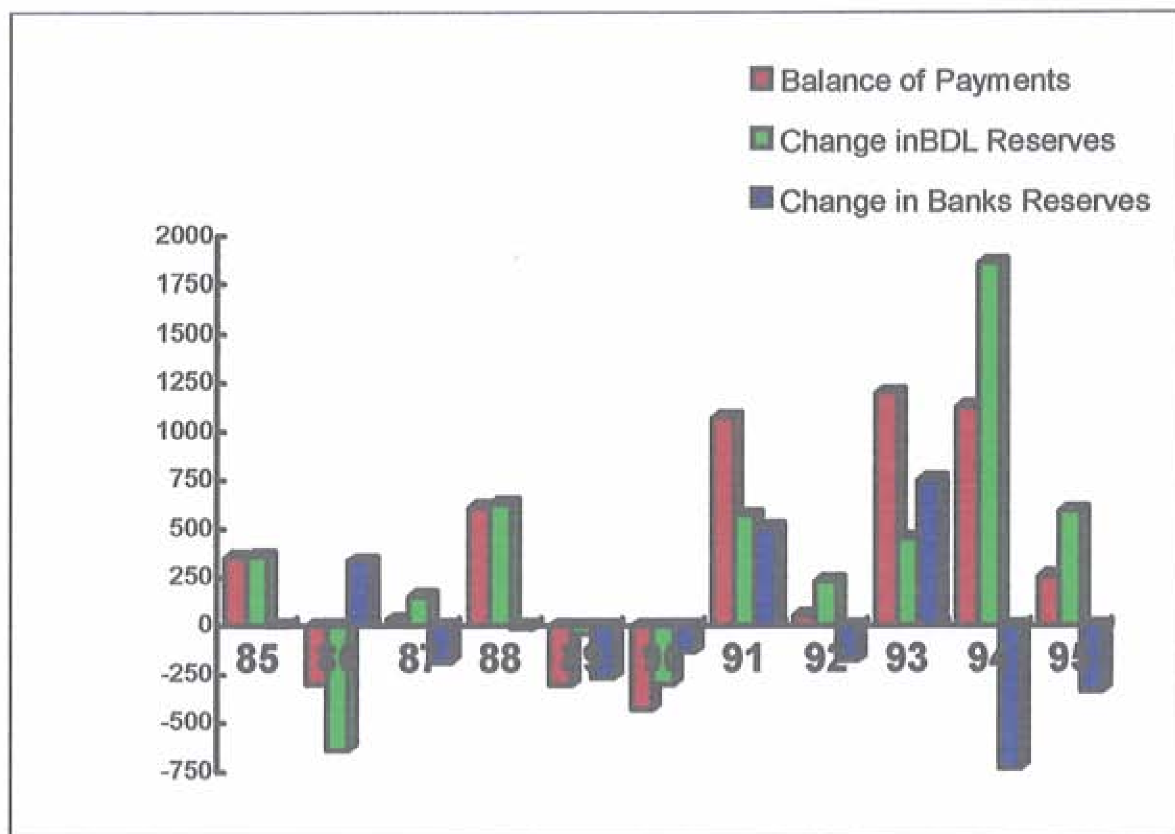

Figure 3.4: Changes in Reserves of BDL and Commercial banks(BDL-figures)

(30) BDL/Ministry of Finance Statistics.

In the year 1995, the GNP real growth rate was around 10 percent with an inflation rate of 10%, (LBP vs. USD 1598). Finally, the productivity of the Lebanese in terms of GDP, shows encouraging levels, as real GDP growth rate in 1995 was about 7 percent, which can be considered outstanding even if compared to first world countries. A look at GDP development since 1989 shows that sharp growth in GDP can be detected in the years 1993-94-95 thus revealing major changes in the Lebanese Economy.(Figure 3.5)

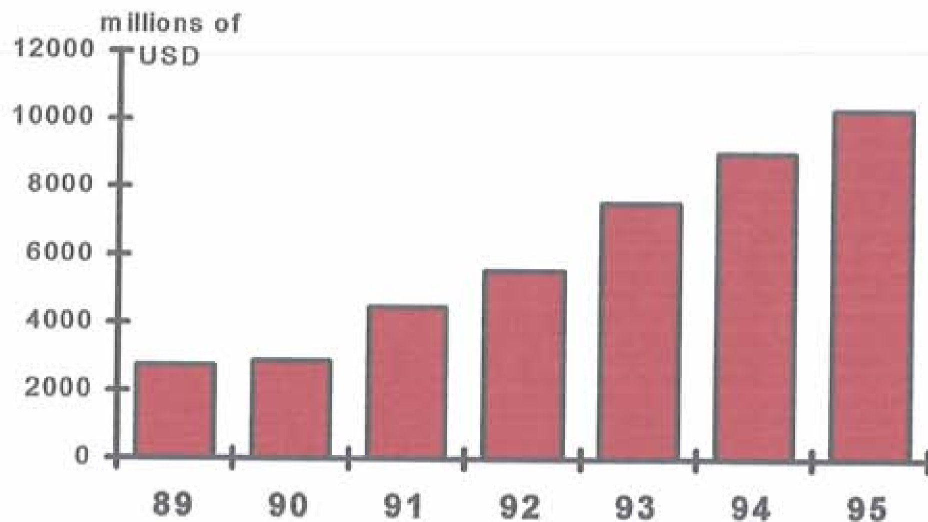

Figure 3.5 GDP Over Years 1989-1995

3.2 Public Debt

Upon examining Lebanon recent economic history, the fiscal budget is always at a deficit, in other words, government revenues are not offsetting government expenditures. This means that new sources of financing must be found by the Government to finance its projects development, infrastructure build up and rehabilitation of major sectors in the economy. The Government resorted to **borrow internally and externally.** By borrowing money, the government is a debtor, and the legal claims that others hold against it is public debt. Public debt is distributed, as stated before, by type of holder to include internal (domestic) and external (foreign) debt.

Table 3.4 Public Debt 1987-1995 (billions of Lebanese Pounds)

	87	88	89	90	91	92	93	94	95
Domestics Debt	193.6	521.5	982.8	1590.3	2639.3	5069.9	6374.4	9323.1	11997.3
External Debt									
- millions USD	553.5	449.5	517.3	543.9	576.9	247.7	326.8	771.8	1289.8
- billions LBP		238.2	261.2	458.0	738.4	455.3	559.2	1271.2	2061.1
Total Debt		759.7	1244	2048.3	3377.7	5525.2	6933.6	10594.3	14058.4
Debt growth per year(%)			63.7	64.7	64.9	63.6	25.5	52.8	32.7

Source: BDL/Ministry of Finance

Table 3.6 shows that total debt in December 1995 was about LBP 14,058 billions, and if public sector deposits at BDL which is around LBP 2,701.4 billions at the end of 1995 is taken into account, then, net total debt (total public debt minus public sector deposits) will be around LBP 11,357 billions. Upon examining figure 3.6, one can detect that moving debt since 1988 was always

upward sloping with yearly growth rate ranging between 35 to 65 percent. This debt as stated before comprises both internal and external debt.

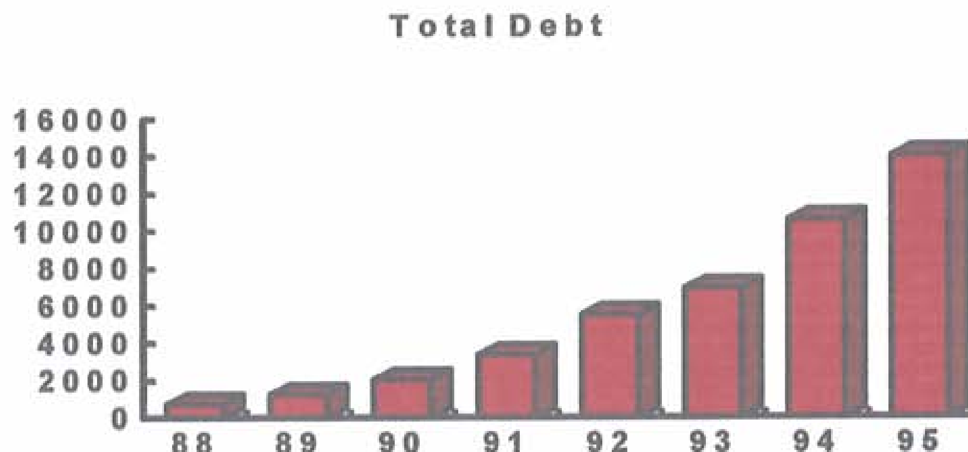

Figure 3.6 Public Debt (Billions of LBP)

3.2.1 Domestic Debt

It is the claims that **nationals** hold against the Lebanese Government in the form of:

-BDL loans to treasury

-BDL loans to public entities and Treasury

-T-Bills Portfolio held by BDL

-Commercial Bank's loans in the form of T-bills and others

-Non-Banking system T-bills held by citizens

Domestic debt remained to be the major component of public debt, as it ranged from 69 to 92 percent of total debt throughout the last nine years (figure 3.7). In 1990, domestic debt was about LBP 1,590.3 billion, LBP 5,070.8 billion in 1992 reaching LBP 11,997.3 billions in 1995(Table3.5) thus, emphasizing the government tendency to internal borrowing.

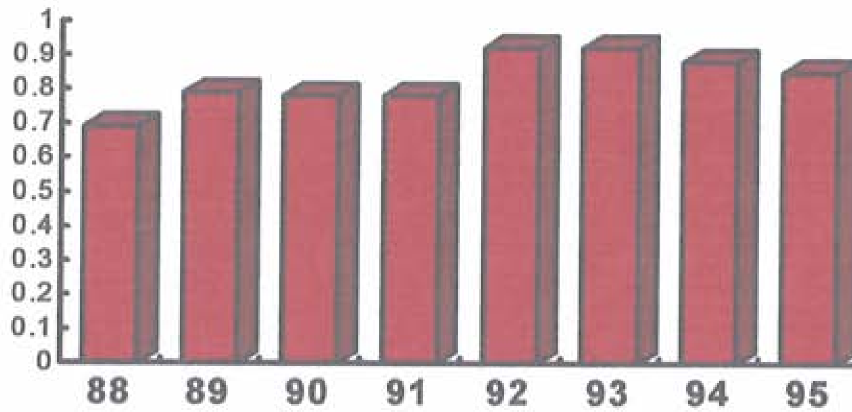

Figure 3.7 Domestic debt/Total debt (%)

Table 3.5 sets forth domestic debt constituents by type of holder and their development since 1987.

Table 3.5 Domestic Debt: 1987-1995 (billions of LBP)

	87	88	89	90	91	92	93	94	95
1.1 Central Bank	131.2	111.6	221.6	636.2	370.1	442.6	765.1	106.4	102.8
- Loans to treasury	63.4	90.5	189.8	551.6	289.9	283.2	292.3	-	-
- Loans to public Entities	1.6	4.6	5.3	8.4	9.3	16.7	54.4	77.7	102.8
- T-bills portfolio	66.3	16.5	26.5	76.2	71.0	142.7	418.4	27.7	-
1.2 Banks	51.9	326.4	611.0	767.1	1543.2	3717.2	4440.6	7276.4	8545.1
- T- bills	50.5	325.8	609.8	759.8	1536.2	3701.6	4437.3	7272.3	8488.6
- other loans	1.4	0.5	1.3	7.3	7.0	15.6	3.3	4.1	56.5
1.3 Non- Banking T- bills	10.4	83.5	150.1	187.0	726	911.0	1168.7	1940.3	3349.9
Domestic Debt	193.5	521.5	982.7	1590.3	2639.2	5070.8	6374.4	9323.1	11997.3
Yearly increase (%)		169%	88.4%	61.8%	66.0%	92.1%	25.7%	46.3%	28.7%

Source: BDL/Ministry of Finance

By analyzing domestic debt by type of holder, one can detect from the figure below (figure 3.8) that BDL contribution to finance the deficit reached around 40% in the year 1990 due to decrease in Commercial Banks and Non-Banking sector contribution. In the subsequent years, BDL contribution decreased to be negligible (1.2%) and (0.9%) in the year 1994 and 1995 (Figure 3.8/See Table 3.6) and that was due to the general stability that contributed to the development of T-bills market that encouraged commercial banks and non-banking sector to subscribe, contributing to 98% and 99% of total domestic debt in the years 1994 and 1995.

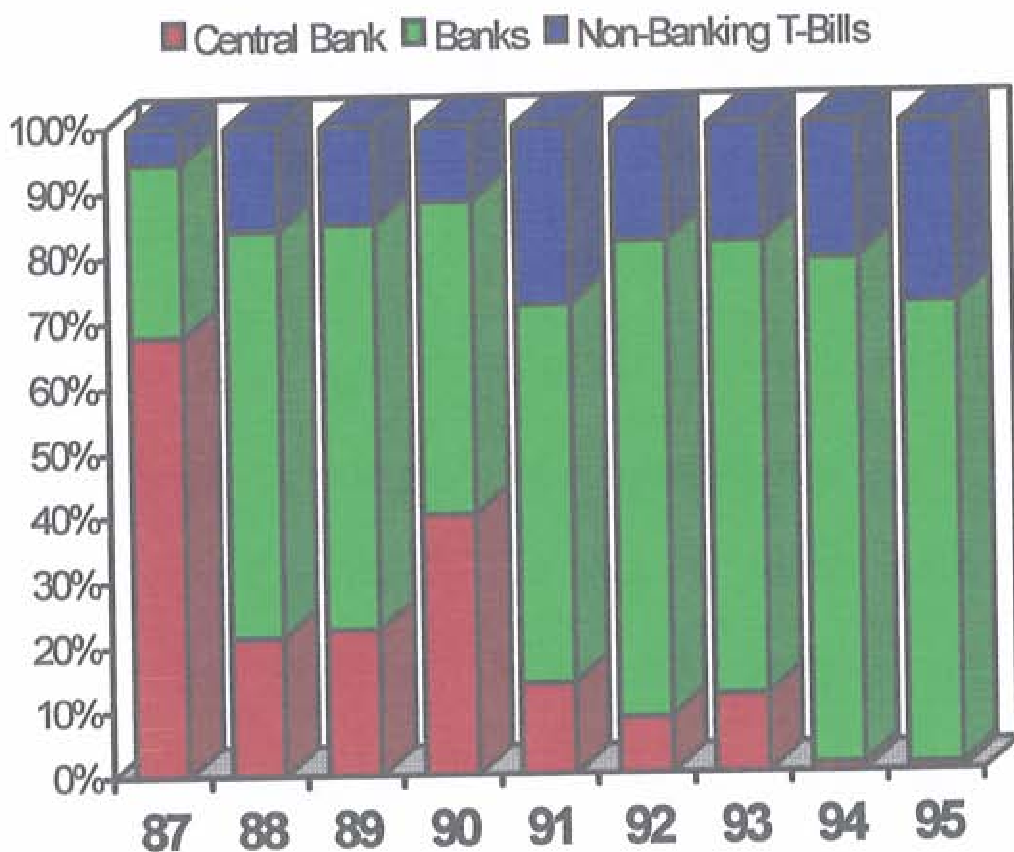

Figure 3.8 Domestic Debt By Type of Holder(% of Total)

In quick look at the above figure, one can realize the increase of commercial banks' and citizens' share in total debt as reaching the years 1994 and 1995 thus, relieving BDL from subscription in T-bills and from giving direct loans to public entities, hence reducing inflationary pressure on the Lebanese currency.

Table 3.6 Domestic Debt By Type of Holder(percentage)

	87	88	89	90	91	92	93	94	95
1.1 Central Bank	67.8	21.4	22.6	40.0	14.0	8.7	12.0	1.2	0.9
- Loans to treasury	32.7	17.4	19.4	34.7	11.0	5.6	4.6	-	-
- Loans to public Entities	0.8	0.9	0.5	0.5	0.4	0.3	0.9	0.8	0.9
- T-bills portfolio	34.3	6.1	2.7	4.8	2.6	2.8	6.5	0.3	-
1.2 Banks	26.8	62.6	62.2	48.2	58.5	73.3	69.7	78.0	71.2
- T- bills	26.1	62.5	62.1	47.8	58.2	73.0	69.6	78.0	70.0
- other loans	0.7	0.1	0.1	0.4	0.3	0.3	0.-	0.-	0.5
1.3 Non- Banking T- bills	5.4	16.0	15.2	11.8	27.5	18.0	18.3	20.8	27.5
Domestic Debt	100	100	100	100	100	100	100	100	100

Source: BDL/Ministry of Finance

The development of T-bills market can be linked to many factors:

i- Exchanging market stability and the difference in interest rate between Lebanese pound and other foreign currencies. Interest rate of 3-months T-bills reached 19 percent and 25 percent in 6-months, thus, creating a major incentive for subscriptions.

ii- Using open market operation or selling T-bills by auction aiming that T-bills interest rate be determined by supply and demand.

iii- Issuing 2 years T-bills with interest reaching 18.5 per cent, and this reflects a kind of monetary stability and a desire for medium-term investment.

iv- Tendency of non-residents and particularly Arabs to subscribe.

When analyzing domestic debt constituents (Figure 3.9) one would notice that loans to treasury and loans to public entities showed a major decrease between the years 1987 and 1993, while T-bills showed an increase during the same period to dominate domestic debt constituents.

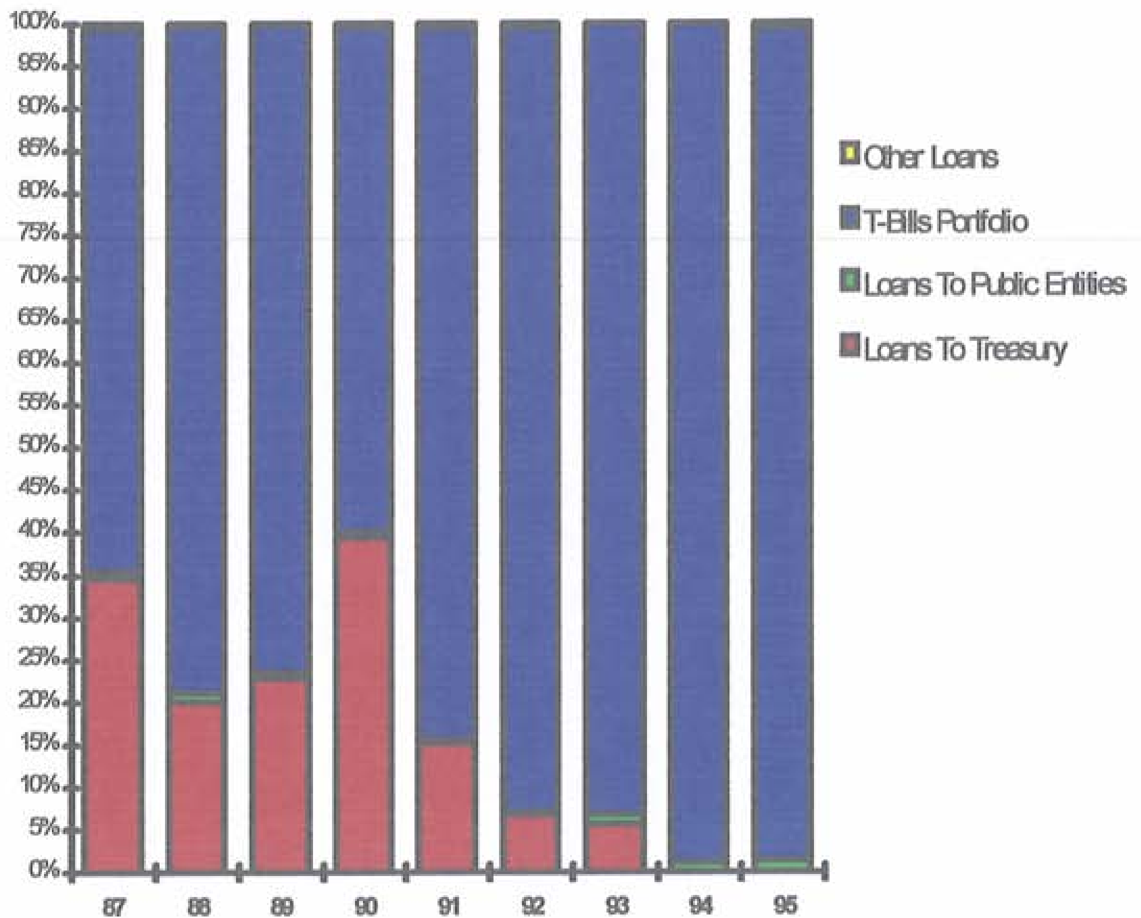

Figure 3.9 Domestic Debt Constituents(%)

It is important to mention that the high interest on T-bills encouraged banks and non-banking system to subscribe and to enforce the trust in LBP, even if such

high interest payments led to increase domestic debt interest from LBP 453.9 billion in 1992 to LBP 754 billion in 1993. By December 1994, domestic debt reached LBP 9323.1 billion after being LBP 6374.4 billion in 1993. T-bills portfolio reached more than 99 percent of total domestic debt in 1994(Figure 3.9). Commercial Banks contributed to 78 percent of outstanding T-bills, and around 21 percent held by non-banking system.(Table 3.6). Also in 1994, 3-months T-bills portfolio, depressed sharply from LBP 598 billion in 1993 to LBP 266 billion in 1994. 6-month T-bills showed no change while 12-month and 24-month T-bills portfolio increased by 39 percent and 51 percent respectively during 1994[31]. Subscribers preference to 12-month and 24-month T-bills was linked to stabilization of exchange rate and the political situation. Even though interest rate on T-bills was reduced in 1994 in comparison with 1993 figures, domestic debt interest payment increased from LBP 754 billion to LBP 1472 billion reflecting the increase in size of T-bills.

Finally, domestic debt reached LBP 11997.3 billion in 1995 with a 28.7 percent annual growth against 46.3 percent in 1994 (Table 3.5). The increase in internal debt in 1995 has resulted from continued fiscal deficit and from higher interest rates on T-bills in the period between May and September, which witnessed political speculations over presidential elections.

3.2.2 External (Foreign) Debt

External (Foreign) debt is debt owned by foreigners, including central banks, ordinary foreign banks, foreign companies, institutions and individuals. In other words, it means notes, debentures, bonds or other similar securities of the republic held by foreigners, with a stated maturity of more than one year from the date of their issue.(See Figure 2.1)

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(31) BDL, Yearly report, 1995. p. 72..

Inspite of the worse monetary and financial situation during the recent past years, Lebanon dependence on foreign borrowing remained limited, and that was a reason for being optimistic about Lebanon's ability to develop and prosper. According to the Ministry of Finance and the Council for Development and Construction (CDR), external debt during the 1980s didn't exceed US $400 million, and World Bank reports showed that external debt was around 8 percent of GDP in December 1991, which is a low ratio if compared to other neighboring and industrial countries. World Bank statistics showed that external debt was US $404.9 million in 1987; it decreased to US $386.6 million in 1988; then increased to US $447.8 million in 1991. It is important to mention that these numbers include national government debt and not public guaranteed debt.

Table 3.7 External Debt: 1987-1995 (millions of U.S dollars)

	87	88	89	90	91	92	93	94	95
External Debt	553.0	449.5	517.3	543.9	576.9	247.7	326.8	771.8	1289.8
Yearly growth (%)		(18.7)	15.1	5.1	6.1	(57.1)	31.9	136.2	67.1

Source: Ministry of Finance / BDL

***It is important to note that in 1993 a new program to calculate external debt has been set under the control of UNCTAD and it was issued by Ministry of Finance/CDR.**

At the end of 1991, external debt indicators were not yet considered dangerous, but risks must be anticipated and accounted for in case Lebanon external indebtedness increased. From this point of view, one must be sure that these loans must be used in productive sectors assuring increase in GDP to be able to pay back interests and principals in time without affecting economic activity and letting the people carry the debt burden. Table 3.7 shows that during 1992 external debt reached US$ 247.7 million and US$ 326.8 million in 1993, i.e, 32 percent increase (It is important to note that before 1993, debt figures were primary World Bank statistics). In 1994 external debt increased by 136.2 percent to reach US $

771.8 million of which US $400 million Bonds issued by the Lebanese Republic in October 1994, in bearer form, in denominations of US$ 1,000, US$ 10,000, and US$ 100,000 due in 3 years. This was the first time an Arabian country tried to borrow from international financial markets by Eurobonds.

During 1995, external debt increased by 67.1 percent to reach US $1289.8 million, including the proceeds of Eurobonds US $300 million, 9.125 percent bonds 2000 in bearer form, in denominations of US$ 10,000, US$ 100,000, and US$ 1,000,000 each with coupons for payment of interest attached. The net proceeds of the issue of the bonds, estimated around US$ 296,575,000 will be used by the Republic for the following purposes[32] :

-Renewal of infrastructure including the construction of roads and highways.
-Construction of an electricity generation plant in the southern suburbs of Beirut.
-Implementation of central market place.
-Improvement of public transportation and traffic planning and organization activities.
-Undertaking of infrastructure and reconstruction work in damaged areas and villages to help the relocation of displaced persons.

In general, chapter III showed an overview of the Lebanese Economy by stressing on two periods: Recent economic history including the years from high 80's to 1992, and the second period including years 1992 to 1995. The choice of 1992 as the separation line was due to the major changes that occurred at the end

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(32) Official Gazette,(Special Appendix No. 3), 19th Jan. 1995.

of that year in terms of economic and political events. Major indicators of the economy were stated in numbers and figures (Balance of Payments, Fiscal Budget, Trade Balance, GNP and Exchange-rate) showing year to year changes. Also, one should not forget the debt (external and internal) resulting from fiscal budget deficit and its high effect on economic performance, enhancing it if managed properly, or deteriorating it if ill-managed. External debt figures, in the second half of the chapter were frightening according to some people and normal to others. One should keep in mind, that numbers alone are not good indicators; they need to be analyzed, overlooked, and compared to other economic aggregate for one to be able to judge. All this would take place in the next chapter where debt indicators are analyzed to show the degree of external debt burden.

Chapter IV

Research Analysis

4.1 Major Ratios Studied

a- Ratio of external debt to exports of goods and nonfactor services*: EDT/XGS.

b- Ratio of external debt to gross domestic product: EDT/GDP.

c- Ratio of interest payments on EDT to exports of goods and nonfactor services: INT/XGS, also called interest service ratio. It is perhaps the best indicator of the relative debt burden as it captures not only the stock of debt but also its price- the interest rate(33).

d- Ratio of interest on EDT to GDP: INT/GDP.

e- Ratio of international reserves to external debt: RES/EDT.

External Debt Analysis

a-EDT/XGS

Table 4.1: EDT/XGS, Period 1987--1995 (millions of USD)

LEBANON	87	88	89	90	91	92	93	94	95
EDT	553.0	449.5	517.3	543.9	576.9	247.7	327	771	1289.8
XGS	504	638	500	511	530	631	676	819	824
EDT/XGS (%)	109.7	70.5	103.5	106.4	108.8	39.3	48.4	94.1	156.5

* Nonfactor services include insurance, freight, travel and transportation.

(33) William R. Cline, International Debt Reexamined, (Institute for International Economics, N.Y.), 1995, p. 50.

Figure 4.1 sets forth the trends in the ratio EDT/XGS

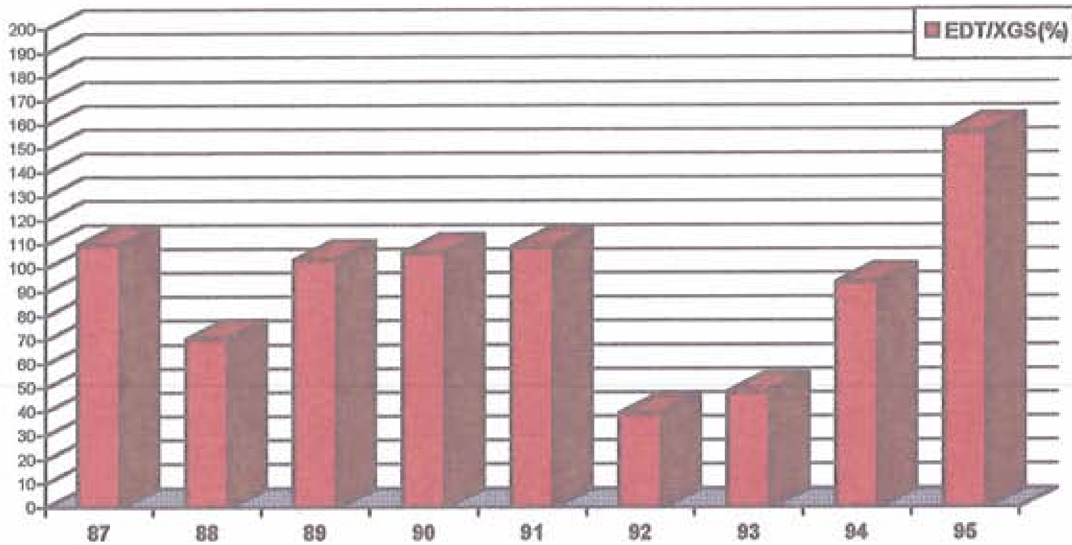

Figure 4.1

As detected from above, EDT/XGS was the lowest in 1992, and it started increasing to reach 48 percent in 1993, to 94 percent in 1994, and ending at a peak of 156 percent in December 1995. The major increase after 1992 was due to the heavy external borrowing by the government to finance the renewal of infrastructure and various construction projects. Lebanon EDT/XGS ratio was 156 percent at peak, which if compared to HD-17 countries 384.4 percent at peak (table 2.3) and Mexico 356.1 percent (table 2.7) is considered a low and non- frightening ratio. Eventually, eventhough EDT/XGS ratio is far above 1987 and 1992 ratios, it is still within acceptable range as long as Lebanon is enchancing and renewing infrastructure which in turn encourage production and hence exports.

b-EDT/GDP

Table 4.2: GDP* (millions USD), EDT/GDP(percentage)

	89	90	91	92	93	94	95
GDP	2,714	2,838	4,452	5,542	7,537	9,000	10,300
EDT/GDP(%)	19.0	19.2	13.0	4.5	4.3	8.6	12.5

Source: World Bank figures

According to table 4.2, after high levels in 1989 and 1990 due to war, with all major sectors of the economy undermined, with negative real growth rates (-42.2) percent and (-13.4) percent for the years 1989 and 1990 respectively, EDT/GDP showed a dramatic decrease from 19.2 percent in 1990 to 13.0 percent in 1991; 4.5 percent in 1992 and 4.3 percent in 1993, thus, reflecting the sharp recovery in the economy in 1991, where real GDP rose by almost 40 percent in 1991, 4.5 percent in 1992, and around 8 percent in 1993 and 1994. The ratio increased to reach 8.6 percent in 1994 and 12.5 percent in 1995. The increase in 1994 and 1995 was not due to decrease in GDP (as real GDP growth rate was around 8 percent during the stated years[*]) but due to

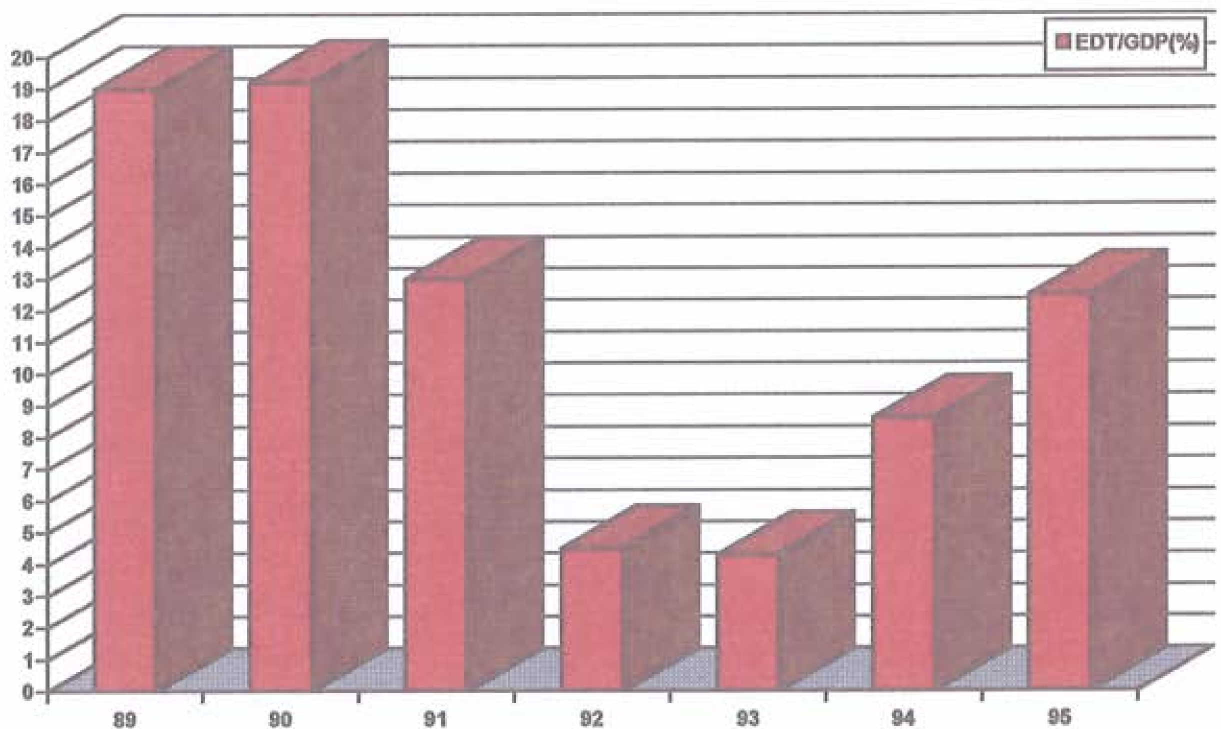

Figure 4.2 EDT/GDP (1989-1995)

[*]World Bank Figures

increase in foreign borrowing to finance reconstruction projects. Average external debt to GNP for several emerging countries classified by the World Bank within Lebanon's category stood at 47.7 percent on average in 1993, thus, reflecting the solvency of the Lebanese economy. If one considers total debt to GDP which is about 70 percent at end of 1995, such a ratio is still within safe range (acceptable rates are between 60 and 70 percent in industrial countries and may reach 100 percent in small countries like Lebanon)[34].

c-INT/XGS

Table 4.3: Interest payment on EDT (millions of USD), INT/XGS(%)

Lebanon	87	88	89	90	91	92	93	94	95
INT	27	35	33	32	41	N/A	24	31	71
XGS	504	638	500	511	530	631	676	819	824
INT/XGS (%)	5.4	5.5	6.7	6.3	7.7	N/A	3.6	3.8	8.7

Source: BDL Figures

INT/XGS provided a good measure of the relative debt burden. It has been said that, "principal repayment is not an economic burden, as it is merely an exchange of one asset (resources) for another -a reduction in liability- nor was it a cash-flow burden for most of the major troubled debtor countries is 1980's". So, in other words, the real economic burden is interest or the price of debt.

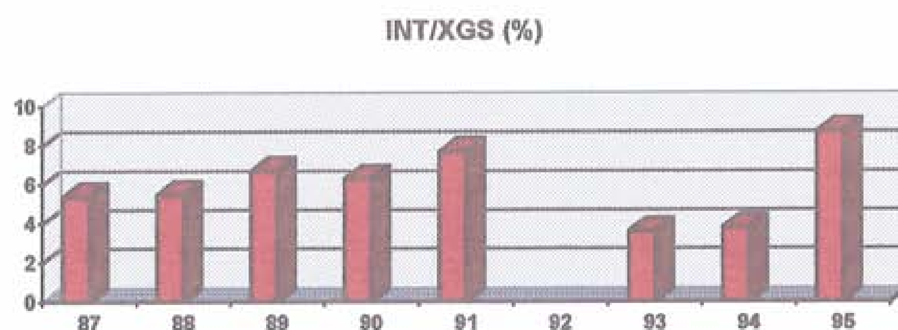

Figure 4.3: INT/XGS(%) 1987-1995

[34] Abd Alkarim Alkhalil, <u>The Indicator (in Arabic)</u>, June 1st, 1995. p. 94.

$$\text{Effective Rate (discount)} = \left(1 + \frac{40}{1000-40}\right)^{12/3} - 1$$

$$= 17.7\%$$

Discount Interest (If multiple bills)

$$\text{Effective Rate} = \left[\left(\frac{FV}{amt}\right)^{1/nm} - 1 \right] m$$

Where:

F= Face Value of the Loan
amt = Amount Received
m = # of bills
n = # of years

Attention: Mr. Rafic Sharafeddine

The following will be summarizing how to find the Effective Annual Rate for overdrafts and discounted bills:

Definitions:

Nominal rate: is the quoted rate or stated rate.
Effective Annual Rate (EAR): The rate that would have produced the final compounded value under annual compounding rather than compounding at interest frequency.

Regular or simple interest on overdrafts

$$\text{Effective Rate} = \left(1+\frac{i_{NOM}}{m}\right)^{m} - 1$$

Where
m=# of interest frequencies or compounding periods per year.
I_{NOM}= stated interest

Example: If we are charging 14% all overdrafts with interest frequency posted monthly, then:

$$\text{Effective Rate} = \left(1+\frac{14\%}{12}\right)^{12} - 1$$

$$=14.9\%$$

Discount Interest (If one Bill)

Interest that is calculated on the face amount of a loan but it is deducted in advance.

$$\text{Effective Rate (discount)} = \left(1+\frac{\text{interest}}{\text{Face Value-Int}}\right)^{m} - 1$$

Where
m=# of Periods per year

If you borrow USD 1,000 at a rate 12%, for 4 months, discount interest.

Effective Rate (discount)= $\left(1+\frac{40}{1000-40}\right) - 1$

$=17.7\%$

Discount Interest (If multiple bills)

Face Value = Amount Received$\left(1+\frac{K}{m}\right)^{nm}$

Then:

Effective Rate = $\left[\left(\frac{FV}{amt}\right)^{1/nm} - 1\right] m$

Where
F= Face Value of the Loan
amt = Amount Received
m = # of bills
n = # of years

INT/XGS is the percentage used to service interest from each dollar earned from exports. Examining recent Lebanese economic history INT/XGS reaches the peak (8.7 percent) in 1995 and if compared to the HD-17 countries peak 29.8 percent at 1993, and Mexico minimum ratio 10 percent at 1993, it is a non-frightening figure as our peak figure is below HD-17 countries peak by around 21 percent. Interest payment until now is not dangerous as it is until this moment not rescheduled and according to ex-finance minister, "There is no one dollar earned as a result of borrowing that has not been paid". Also, to refresh others' memory, all proceeds from external borrowing as said before in chapter 3 are used to finance investment projects (infrastructure, utilities, etc.,....)

d-INT/GDP

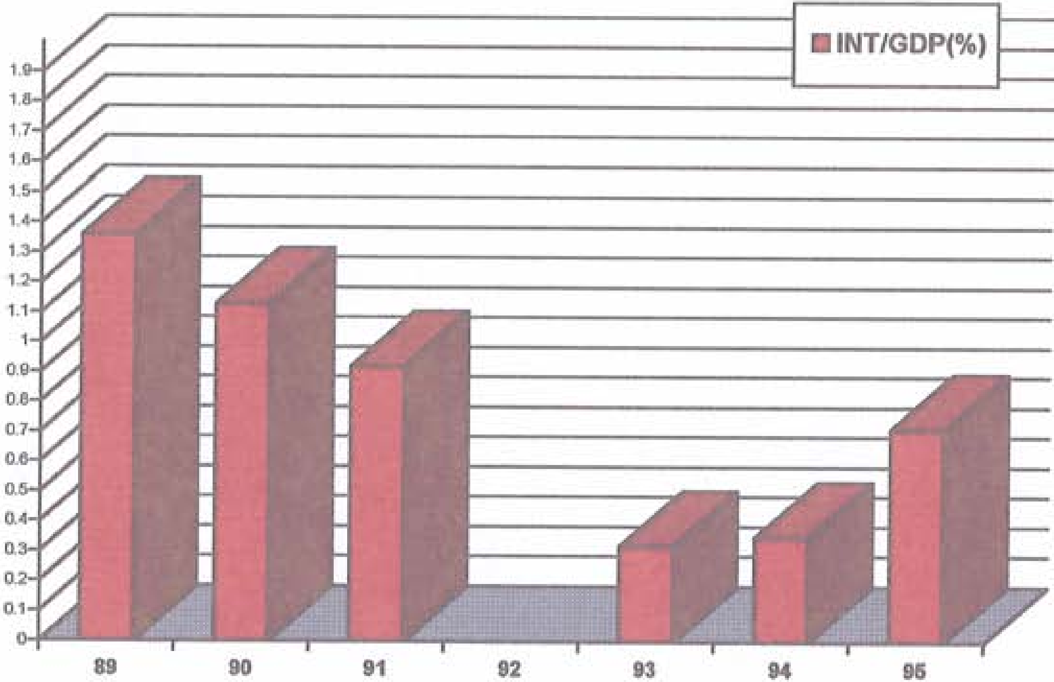

Figure 4.4: INT/GDP(%) 1989-1995

INT/GDP or in other words, the percentage of nation's output that is used to service debt interests. During 1995 INT/GDP was around 0.68 percent if compared to Mexico INT/GNP (peak 6.9 percent in 1986 and minimum 2.3 at 1993) one can be sure that no interest payment burden is reached yet. In 1989 INT/GDP was around 1.2 percent, then fell substantially reaching 0.92 percent

in 1991, 0.34 percent 1994, reflecting GDP real growth 38.2 percent in 1991; 4.5 percent in 1992 and around 8 percent in 1993 and 1994. The slight rise in INT/GDP ratio during 1994 and 1995 to reach 0.71 percent, could be interpreted as a positive sign due to Government paying accrued interests from past years and current interest earned due to Government borrowing from international financial market to offset the fiscal budget deficit and to finance infrastructure reconstruction.

e-RSE/EDT

Table 4.4: Reserves* (millions of USD); RES/EDT

LEBANON	89	90	91	92	93	94	95
RES	4,894	4,177	4,497	4,514	5,074	6,277	6,312
EDT	517.3	543.9	576.9	247.7	327	771	1,289.8
RES/EDT(%)	950	770	780	1,820	1,550	810	490

Source: BDL figures

Reserves are the governments holdings of foreign currency used to finance public imports expenditures, to repay back foreign borrowings and finally, as a support to our national currency LBP. In 1989 reserves constituted around 9 times EDT; they rose up sharply reaching 18.2 times EDT in 1992 due to decrease in EDT; then they fell abruptly reaching 8.1 times in 1994, and 4.9 times in 1995. Even if this ratio is falling, it is not considered as an alarm, since (RES/EDT=490 percent) in 1995 if compared to other emerging economics as Mexico (highest ratio RES/EDT=0.21 for 1993), we are better than Mexico by 20 times, taking into account that we are comparing our least measures with their most favorite recent ratio; in other words, comparing our lowest levels of RES/EDT with Mexico lowest levels show that Lebanon is better by 76 times

* Reserves: Net amount of Foreign currency, gold and other reserves of BDL, excluding foreign currency deposits of banks and other financial institutions with BDL.

according to (RES/EDT) debt indicator. So, the Lebanese economy is still holding destructive weapons to meet foreign obligations, and one of these weapons is RESERVES held at BDL.

INT/XGS(%)
EDT/GDP(%)
INT/GDP(%)

Figure 4.5

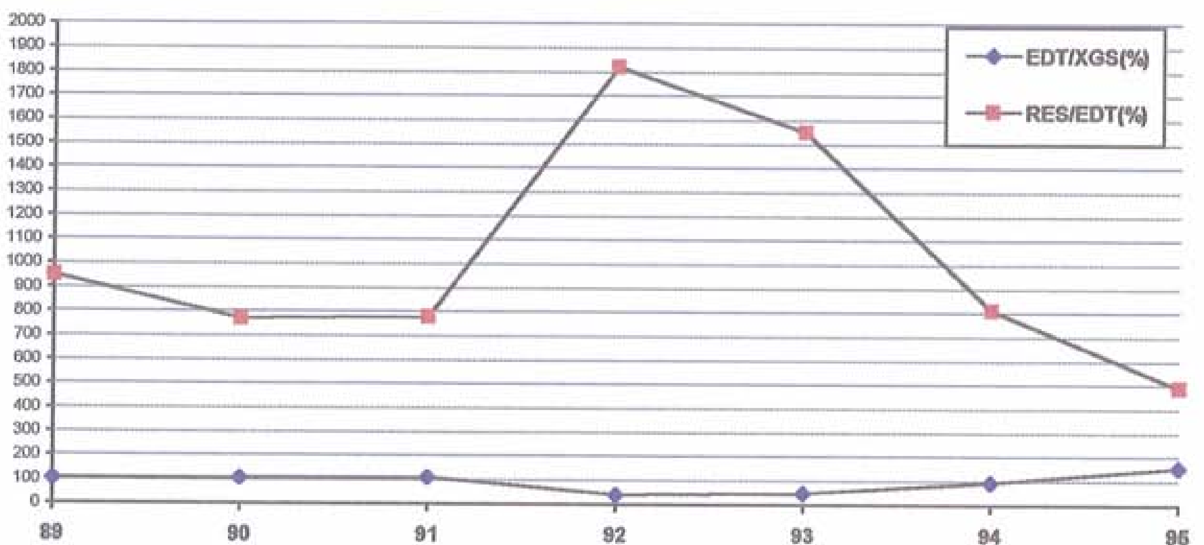

Figure 4.6

Eventually, figure 4.5 summarizes the trends for the external debt burden of Lebanon. Under the three measures INT/GDP, EDT/GDP, and INT/XGS improvements could be detected as trends are sloping downwards and reaching the year 1994 far below 1989 levels. Major changes took place during 1995 that affected INT/XGS and INT/GDP debt indicators negatively. In 1995, the Government increased its external borrowing, and part of interests accrued from past years on external debt was paid. All these factors inflated interest figures, thus, affecting INT/XGS and INT/GDP debt indicators. Under EDT/XGS and RES/EDT measures the trends look pessimistic, and non-improving trends are clearly seen upon the above figure 4.6. However, if the numbers behind the trends and the frightening look-like levels at the end of 1995 are examined thoroughly, everyone could be sure that these levels are far below dangerous levels if compared to emerging economies like Lebanese economy. Trend analysis for the debt burden of Lebanon show improvements when measured by certain indicators and show deteriorations when measured by others; even if deteriorating, the levels are still acceptable and far from being frightening or dangerous.

4.3-Suggested Policy Reforms by WB and IMF

The World Bank having the reputation of being the world's preeminent development agency, without doubt, has provided a financial life line between the advanced capitalist countries and numerous countries in the third world. Although it promotes developments, the WB is primarily a commercial institution, not an aid agency. The WB is the sister institution to the IMF. While the IMF lends to countries with essentially short-term, balance of payments needs, the WB finances long-term development projects that span from 10 to 25 years. Both institutions WB and IMF suggest stabilization

programs and Policy reforms to developing nations. The coming pages will set forth the suggested Policy reforms by WB and IMF for Lebanon:

1- Continue to Liberalize and Simplify the Trade Regime

Lebanon remains a highly open economy, and the Government has thus far successfully resisted projectionist pressures to raise tariffs. Average tariffs are 10% and relatively few items are subject to trade restrictions[35]. Nevertheless, there are a number of trade Policy issues still on the agenda- harmonization, simplification and continuous liberalization; and the Ministry of Finance is in the midst of an effort to harmonize the tariff code to be consistent with international norms. Thus, if Lebanon hopes to play a role as an entrepot and coordinator of internationally-based production, a uniform, low level tariff regime is an essential precondition, and establishing large free zones which will have important demonstration effects for the rest of the economy, is a basic need[36].

2- Develop Long-Term Savings

Although capital inflows have been an important source of financing for the Lebanese economy, domestic savings will have to play an increasingly important role in the future if the credit crunch facing the private sector is to be resolved. An important reason for banks' reluctance to lend longer term to the private sector is the absence of longer term savings in the economy. Some banks are beginning to issue longer term certificate of deposit (Byblos Bank), 2 years maturity. However, an important opportunity to develop long-term savings through mandatory private pension funds has not been explored; so, the passage of legislation to enable the emergence of competing private pension

[35] BDL, Yearly Report, 1994, p. 68.
[36] IMF, Lebanon: Economic Recovery, Stabilization, and Macroeconomics Policies, August, 1994, P.28.

funds would play a major role in the development of Lebanon's capital markets[37].

3- Achieving Macroeconomics Stability and Establishing Competitive Conditions

The ability of the Government to maintain macroeconomics stability depends on its ability to close the fiscal deficit. Without improving in raising revenues, the Government should not take the macroeconomics risks of reducing tariffs. Addressing the fiscal problem requires actions on several fronts[38]:

- Acceleration of the planned introduction of a General Sales Tax (GST).
- Improvement of tax administration and consolidation the tax base by eliminating exemptions.
- Reorientation of public sector investment toward factor creation. This would require a shift in Government portfolio of assets through the privatization of assets and activities that would liberate a large stock of resources to enable the Government to invest in the upgrading of human capital and institutions, as well as reduce the burden of public sector investment in future budgets.

4- Improving Public Administration

Fundamental restructuring of the civil service is necessary. One cannot run indefinitely a public administration that is characterized by an inefficient core surrounded by islands of efficiency. Longer term measures would have to tackle the upgrading and rationalization of staff, reorganizing the structures of public administration, and streamlining administrative procedures[39]. This

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[37] Ibid, p. 52.
[38] World Bank, Lebanon: Financial Policy for Stabilization, Reconstruction, and Development, Washington, 1994, p. 39.
[39] Ibid, p. 45.

requires a clear view of the role of the Government and appropriate choice of management systems and technology.

5- Privatization

Linked to the above suggested reform (improving public administration) policy, privatization of commercially oriented enterprises can be a major instrument for improving efficiency in many economies. In Lebanon, the environment -characterized by shortages of financial and human resources in the public sector- provides a favorable basis for realizing the benefits of privatization. Several assets and projects (the tobacco enterprise, the airline, the oil refineries, the establishment of industrial parks, and others) could be privatized without much complication. Other privatization, such as infrastructure services, may require the establishment of explicit, transparent, and credible regulatory arrangements. What is needed is a comprehensive revision of the assets, services, and functions that could be privatized and a systematic approach to privatization. Some services which would have to remain the responsibility of the public sector could be contracted to the private sector; thus, the effect would not also be only improving efficiency in service provision, but also allowing the Government to focus on its core functions.

6- Developing a Competitive and Responsive Financial System

Attaining high rates of growth requires a flexible financial system, capable of mobilizing large amounts of resources and allocating them to the private sector at low costs and in wide variety of term and conditions. Currently, the financial system is allocating most of its resources to the public sector, and the resources provided to the private sector are concentrated on a small number of borrowers at extremely short term maturities. Therefore,

the responsiveness of the financial system according to WB would have to address three main issues[40] :

- Three aspects of the institutional setting have to be strengthened: these include the legal structure for debt collection and mechanisms to enforce them, enhancing the information network (reliability of financial statements) and including banking regulation-supervision capacity.

- The banking system lacks the skills to lend money prudently in modern market as well as to provide financial services required by a globalized economy. Expansion of lending requires the upgrading of credit evaluation skills. Three actions are to be undertaken[41]. One, training efforts could be intensified (the Association of Bankers could play a major role in this initiative). Two, accounting and auditing systems should be strengthened, which would be reinforced by regulations or legistlations on disclosure of financial information. Three, competition could be enhanced by reducing Government borrowing and developing capital markets.

- The supply of domestic long term savings is grossly inadequate for financing a sustained and rapid rate of economic growth. Actions in the following areas would improve domestic savings mobilization: **(a)** The stock exchange should be developed by creating the regulatory framework and related institutions (establishment of a supervisory institution along the lines of US security and Exchange Commission should be considered). **(b)** The supply of long term funds could be increased through the reform and privatization of the pension system, and the development of mutual funds and the life insurance industry. **(c)** Finally, market solutions to the problem of long-term credit should not be undercut by subsidized and Government

[40] Ibid, p. 59.
[41] Ibid, p. 62.

sponsored specialized financial institutions. The specialized financial institutions should be privatized, eliminated, or converted into a single apex institution lending to other financial institutions, rather than directly to retail clients.

Table 4.5 sets forth Policy areas, policy objectives, short-term and medium-term actions suggested by IMF and WB in order to maintain macroeconomics stability and competitive conditions.

Table 4.5: Maintaining Macroeconomics Stability and Competitive Conditions

Policy Area	Policy Objective	Short Term Actions	Medium Term Actions
Fiscal Policy	Achieve macroeconomics stability by cutting the fiscal deficit	• Tap private sector in financing and implementing Government investment projects	• Privatization of public assets and enterprises • Private provision of public services and selected Government functions
Monetary and Exchange Rate Policy	Ensure consistence in current policies	• Liberalize interest rates and allow flexibility in exchange rate adjustments to respond to market forces • Develop indirect monetary control instruments	• Consider adopting a currency board
Taxation Policy	Enhance revenues without creating distortions	• Improve tax administration	• Design and implement a broad based sales tax Eliminate some of the tax holidays
Trade Policy	Simplify and liberalize trade regime	• Reduce number of tariff rates • Convert nomenclature to international convention • Align customs exchange rate to market rate. • Streamline customs administration and procedures.	• Eliminate import and exports licensing requirements except for special items such as drugs and firearms.

4.4 Implementation of Reform in Lebanon

The first policy objective to follow by the Government in the process of reform was price stability. The short term actions taken by the Government at that time (Nov. 1992) to reach price stability were:

i-High interest rate, leading to increase saving and reducing investment spending and consumption, thus, reducing inflation.

ii-Financing the deficit through T-bills and not through direct borrowing from BDL (Figure 3.9). Whereby by the year 1993, loans to treasury decreased to reach 4.6 percent of total domestic debt and become negligible in 1994 and 1995 after being 34.7 percent and 11 percent in years 1990 and 1991 respectively (Table 3.6), thus, reducing inflationary pressures. The Government was successful as inflationary rate reached 10-12% in years 1994 and 1995 after being 70-80% in the years 1989-90-91 and 1992[42]. Also, the local and universal trust given to the new Government at that time (with prime minister Rafic Hariri as the head figure) helped to regain the confidence in Lebanese pound and Lebanese economy.

Concerning monetary policy, the Government objective was to ensure consistence in current policies through ***keeping the spread between interest on LBP deposits and interest on USD deposits high*** in an attempt to:

- Decrease dollarization
- Attract foreign currency to Lebanon
- Increase the demand on LBP, which in turn leads to appreciation of LBP against other currencies.

[42]BDL yearly report 1995, p. 43.

In an attempt to develop a direct Monetary control over foreign exchange rate, ***a managed-floating exchange rate was followed by BDL***, which means buying and selling domestic or foreign currency to reduce volatility of the currency fluctuation. Such a short-term action was highly successful where BDL interferes in exchange rate market as a buyer or seller, to maintain a parity between LBP and other foreign currencies. The Hariri Government resignation and the South crisis (due to Israeli attacks) are perfect examples of the wise policy followed by BDL concerning x-rate fluctuation. Today, most major countries do not maintain fixed parities with the dollar; they allow their currency to float and they intervene whenever markets become "disorderly". Lebanon is one of those countries, through which by following such policy, it was able to reinforce the LBP, make it appreciate against the dollar and other foreign currencies, and decrease the dollarization of the economy. So, the two-legged short term actions followed by BDL (high interest rate on LBP and managed floating exchange rate) showed their effectiveness even though they were not suggested by IMF and the World Bank.

In an attempt to encourage investment and capital inflow, the financial authorities have been following a policy that comprised the following:

•***Amendment of Financial institutions income tax***, which was reduced from a range of 26-30 percent to 10 percent flat.

•***Amendment of Personal income taxes range*** between 0 percent and 10 percent range depending on income bracket.

Such a policy Lowering Income Taxes is expected to encourage reporting of profits and therefore, to increase revenues.

Concerning trade, the Government introduced the following regulations:

- Subjected imports to ad-valorem taxes
- Imposed additional port fees and charges which are moderate
- Introduced numerous exemptions applying to 40-50 percent of all imports, particularly food and raw material imports.
- Abolished the customs dollar and started collecting duties according to current exchange rates (the customs dollar was previously valued at 800 LBP).

It is well known that the Lebanon is included in the EC's (European Community) system of preference, and not a member of the GATT; joining the GATT under the current situation has many advantages and disadvantages. Under GATT, Lebanon will enjoy provisions and exemptions given to developing countries to benefit from economic support and other forms of aid and support. But under GATT Lebanon will prohibit customs duties and favor utilization of sales tax and value added tax. Although such taxes are regressive in nature, the compensation comes from ease of collection, less chances for corruption and less expensive bureaucracy. The major disadvantage faced will be a major loss of state revenues "the custom duties", which counted for about 40-50 percent of total revenues.

Consequence 2: High debt service costs can have the effect of ***reducing Government services***. Severe reduction of government services that comes with high levels of debt service eventually takes a heavy toll on the economy and its citizens; moreover, depending on which services are scaled back, the overall system can become highly regressive.

Consequence 3: Higher debt raises the government's real financing costs; a development that tends to ***raise the level of interest rates in the economy as a whole***. The public, when faced with ever-increasing supplies of government debts, needs the inducement of higher returns if it is to continue to hold the debt willingly. Two primary effects of higher real interest rates on the economy are as follows:

i) Raising the cost of servicing the existing stock of debt.

ii) They can spell over onto other interest rates in the economy and increase the required rate of return on capital investment. Thereby, reducing capital formation.

Consequence 4: With high levels of public sector debt, the government implicitly negotiates ever-larger ***involuntary intergenerational exchanges*** through its debt-management policies[43]. The existence of the debt means implicitly that older generation (the predominant holders of the debt) takes the younger generation hostage, in that the government is committed to using future taxation of the younger generation to service and/or reduce the debt. The net result is that the existence of a high level of public sector debt creates a political problem of losers and gainers from monetary and fiscal policy changes that would not exist in an economy with less debt.

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[43] Richard G. Harris & John Richards, Paying Our Way, (C.D. Howe Institute: Toronto), 1994, p. 8.

Consequence 5: High debt levels make the treasury encounters difficulty in selling its T-bills at auction. In such cases, the treasury must ***resort to Central Bank credit***, effectively monetizing much of the debt with inflationary consequences. A second problem encountered is that average maturity of the public debt becomes shorter and shorter; this normally happens because the public becomes increasingly concerned about inflation or devaluation and, therefore, prefers the short end of the maturity spectrum. In short, the actual consequences of high debt would most likely result in monetization of the debt and, consequently, a shutdown of the government's access to capital markets.

Consequence 6: Debt can function as a device for ensuring political commitment. Political economy emphasizes that debt issued by one government constitutes a ***binding constraint on future governments***; public debt can, therefore, serve as a commitment device in the game between incumbent governments and opposition parties. By running up a large public sector debt, a current government can constrain financially any subsequent government.

5.2 Worldwide Practices to Eliminate High Debt

Many nations, throughout history fell in the trap of high public debts. These nations eliminated high-debt levels in a way that best suited their economic circumstances. Practices followed in an attempt to eliminate high-public-debt levels are the followings:

a- ***Default or repudiation,*** by defaulting on either principal or interest, forcing lenders to absorb large write-downs on these loans.

b- ***High inflation*** which reduces the real value of the debt. This alternative eliminates domestic debt and not external debt (debt held in currencies other than the currency of origin). A high inflation rate causes real debt to fall to less than its initial value at fixed nominal interest rates. Germany's case after World War I is the best example.

c- ***A period of high economic growth*** faster than the rate of growth of the debt.

d- ***Sale of government assets,*** in other words debt reduction achieved as a result of privatization.

e- ***Imposition of one-time extraordinary capital levy***, that is, a one-time tax levied on wealth holders in the aim of reducing the public debt.

f- ***Budget surpluses created through tax increases and expenditure cuts***; through which the government will be able to pay interests and principal by money resulting from budget surplus.

5.3 Recommendations

To reduce external debt, the government needs money which cannot be found unless having fiscal budget surpluses. Reaching budget surplus necessitates the implementation of the following steps:

A- Cutting expenses

B- Increasing revenues

A- Cutting expenses

i-Refrain from issuing Lebanese Government T- bills in amount of proceeds greater than needed. This can decrease the huge proceeds of T-bills blocked and not used by the government in the central Bank. Giving an idea about the amount of unused proceeds, it reached LBP 3,300 Billion at the end of July 1994[44]. Let us not forget the cost of borrowing -the interest- and its effect on increasing expenditures.

ii-Reform in public administration. It has been estimated that the dismissal of 20 to 30 percent of public employees that don't fit in their jobs, reduces expenditures by around $ 300 million[45].

B- Increasing Revenues

i-Enhance and re-enforce tax collecting administrations so that the following can be done:

- eliminate tax exemptions
- collect accrued taxes and duties from past years
- increase the supply of building permits
- be quick in collecting building permits penalties and penalties on public assets

ii-Implementation of a tax reform by introducing a generalized sales tax and a value-added tax; even if such taxes are regressive in nature, the

[44] Awad, Barakat, A way for Treatment, The Indicator(in Arabic), No. 222, Nov. 1994, p. 71.
[45] Marwan, Iskandar, The Lebanese Economy, (Reaidy Press), 1995, p. 84.

compensation comes from ease of collection, less chances for corruption and less expensive bureaucracy.

iii-Privatization of some public utilities. This will reduce the burden of debt and provide better services in terms of quality and price to the citizen. Build, operate, and transfer (BOT) arrangements are recommended for immediate and outright privatization if capacity expansion is needed. It should be noted that the Lebanese government has chosen the BOT approach for the Arab Highway and Cellular phones.

iv-Sale of Government's Assets, for example:

- The Credit Libanais a successful, profitable, and well run commercial bank with the largest network of branches in Lebanon (40) is owned by the central bank. This situation contradicts the role and functions of the central bank and the government, so, why not privatized. If this move is realized, the government could receive US $ 80 million.
- Selling of real estate in Beirut at the Manara area.
- Selling of the rail-roads and their associated assets and real estates.
- Selling of the Government shares with INTRA.

v-Investment inflows must be stimulated. One of the effective ways is represented by the activation of the Beirut financial market and the launching of a selected number of issues for financing major projects. Delays whether in activating the market or planning for launching these issues are harming economic prospects in the country.

Ultimately, a further research is recommended that would investigate and analyze the effect of both internal and external debt, considering them in relation to GNP, reserves, export of goods and services, and other economic indicators. Such a study would lead to an overall concept of all the Government outstanding debt.

5.4 Conclusion

The Lebanese economy is suffering from many troubles that can be linked to the large budget defecit (44%-1995), increased trade balance deficit (3262 millions USD at end of 1995) and large amounts of debt to GDP (70% of GDP for year 1995.) All this coupled with the peace process that is taking place in the Middle East, mean that Lebanon has to prepare itself as a developed and compatible country to face the new Middle Eastern community. Therefore, many challenges are facing the Lebanese economy represented by the following:

A) The need to curb government borrowing, which increased in 1995 by 32.7 percent including external debt that increased by 67 percent.

B) The deficit of the budget which hovered around 50 percent in 1995, remains high and needs to be reduced significantly. The budget proposal for 1996 projects a deficit of 37 percent which, however, requires rigorous policies during the year.

C) As peace prospects improved and international challenges for joining the world trade organization escalated, Lebanon faced the need to improve the organization and activity of its financial market. Newly issued regulations for organizing the working of the stock exchange are not sufficient to bring

about the result. Lebanon still lacks an active investment banking community which is still in the process of mushrooming.

D) The General federation of labor asked for a number of demands in January 1996, including quasi-political policy changes as well as a 76 percent increase in wages and benefits; the Government accepted a number of social demonds and put aside the question of wages and benefits to negotiation between employers and employees; also, one should not forget the definite conviction, even with employees, that wage demands are exaggerated.

At the end, the sole question is back again. Can the Lebanese government increase its revenues, reorganize its public administrations, reduce the bureaucracy and re-establish itself as a modern government that fit the new world order. Our economic indicators leave us with the hope for a better future, when compared to other countries' figures. It is true that we have a large debt to GDP levels but, it is not hopeless, since large economies throughout the history showed similar and much greater figures. Concerning budget deficit, people should overlook it from a positive point of view, a budget for reconstruction where major economic institutions are undermined and need reconstruction, even the human capital.

Finally, the current period necessitates the appearance of such numbers and figures for a country like Lebanon, that lacks oil, gold and other precious metals, but armed with human resources, geographical location and a dominating incentive for a better life.

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