THE DEVELOPMENT OF LEBANON'S' FINANCIAL MARKETS

1 — INTRODUCTION

A — ECONOMIC BACKGROUND

The Lebanese economy's marked lopsidedness in favour of services has often been a source of concern among economists. The fact that the services sectors — including commerce, finance, transport and communications, and other services — generate over 60 per cent of the gross domestic product has been regarded as a point of weakness rendering the general level of economic activity in the country highly vulnerable to all the vicissitudes affecting these sectors, and deflecting the country's course of development from the path of sustainable and stable growth which is ordinarily identified with industrialization.

The general view which had been predominant until the mid-1960's, namely that Lebanon lacks the requisite conditions for industrialization on any substantial scale, has been greatly dimmed by the impressive growth of industrial output and exports, particularly since 1967. Somehow the oft-cited inhibiting factors — including the paucity of natural resources, the narrowness of the domestic market, the scarcity of long term capital, and the predominance of the mercantile spirit — have been outweighed by such positive factors as Lebanon's geographic proximity to the Arab markets ; the manifest initiative and enterprise of the Lebanese entrepreneur ; Lebanon's consistent adherence to liberal currency and trade systems and to a non-cumbersome tax system ; the availability of a highly adaptable and relatively cheap labour ; and other factors. Hence a significant shift of emphasis could be felt in favour of industrialization at the governmental as well as the private levels, of which the creation in 1973 of a separate Ministry of Industry and Petroleum was symptomatic.

Since the October 1973 Middle East war, however, a number of factors have emerged which tend to reassert the relative position of the services sectors in Lebanon, particularly finance. The soaring of oil prices and the concomitant increase in the financial resources of the Arab oil exporting countries, the improved prospects of peace and stability in the Middle East region, the swing to more liberal policies vis-a-vis foreign investments in such capital importing countries as Egypt and Syria, have all been significant developments which, in the long run, might have the effect of dampening the thrust for industrialization and bringing back into relief the role of Lebanon as a center of services in the region.

I do not mean to underestimate the prospects of further industrial growth in Lebanon. For it may well be argued that the rapid economic growth in the neighbouring Arab countries will tend to enhance the demand in these countries for Lebanese goods, including manufactures. Moreover, the industrialization of the Arab world will probably create new openings of complementarity in the industrial structures of the various Arab countries, including Lebanon (Incidentally a rehashed Arab Common Market might well be the vehicle for achieving this end in the future, and Lebanon may have to establish some kind of working association with it). Besides, there will necessarily be a considerable time lag before the ambitious policies and programs of the neighbouring Arab countries come to full fruition. In the meantime Lebanon's lead in certain areas of production may allow for further industrial growth or, in any case, for a sufficiently long period of readjustment. Nonetheless, a shift of relative emphasis back to services might be within sight.

Of the services sectors banking and finance will, by virtue of the budding financial boom in the Arab Middle East and by virtue of the existence of a fairly developed banking system in Lebanon, probably hold the greatest promise.

B — ECONOMIC IMPLICATIONS

Unquestionably there are immense benefits to be derived from the development of Lenanon's position as an international financial center. A thorough discussion of the conceivable benefits would take us too far afield. One may expect an enormous growth in the financial sector as existing financial institutions expand and new institutions are set up. A simultaneous growth in affiliated industries, such as telecommunications, is also bound to take place. A parallel growth is also foreseeable in countless areas of ancillary activities, including transportation and tourist accomodations, legal advice, publicity, public relations, and other services. The resulting contribution to national income, though hard to quantify, is anticipated to be substantial.

To all the direct benefits, one may add the indirect benefits that will accrue to the national economy from the anticipated existence of a sophisticated financial market within handy reach of both the Government and the private sector in Lebanon. Investment funds will be available in ampler supply to them, and a wide spectrum of advanced financial services will be readily accessible to them.

Notwithstanding all that can be said in support of the objective, however, the development of the country's position as an international financial center cannot be considered as an unqualified boon. There will be problems connected with monetary control as the domestic economy becomes more vulnerable to foreign capital movements, and also problems connected with the regulation and supervision of the functioning of the financial system as it assumes an increasingly intricate supra-national character.

As far as monetary policy is concerned the big problem will be to isolate the domestic market from the vicissitudes of international capital movements. The experience of the old-established centers, including London and Switzerland, suggests that very frequently this is not easy to achieve. The current floating of sterling and of the Swiss franc is particularly revealing in this respect. Thus it would be imperative, in any plan to promote Lebanon's role in international finance, to ensure that the monetary authorities are properly equipped with all the policy weapons they require to preserve an adequate measure of control over the general monetary conditions in the country at all times. The amendments to the Money and Credit Law promulgated in November 1973 did indeed confer upon the Central Bank very broad and effective powers. These will have to be kept under continuous review in the light of the changing situation.

The Central Bank has recently introduced a measure which is aimed at protecting the domestic economy from the disturbing effects of capital inflows. The banks have been prohibited from paying interest on their local currency liabilities to non-residents. This measure should be an effective one. Its application in Lebanon, however, will be handicapped by the fact that bank secrecy, which is rigorously observed, precludes any strict surveillance of the banks' compliance with the regulation, and by the fact that the distinction between resident and non-resident under the official definition in application is far from being foolproof.

C — THE APPROACH

It is axiomatic that, if Lebanon is to play an effective role in the burgeoning financial boom of the Middle East, it will have to develop a financial market with an international perspective. It is important to keep in mind that the question is largely one of perspective. It would be absurd to speak of a hard and fast dichotomy between the domestic and international markets in a country. Our reference to an international financial market should be construed simply as a reference to an orientation or a perspective.

Lebanon cannot and need not aspire to becoming **the** financial center of the Middle East, but rather **a** financial center

— hopefully a major one — in the region. The development of Lebanon's position as an international financial center does not preclude the advent of other financial centers in the region which may well evolve along complementary rather than competitive lines with Lebanon's. The following Swiss view is relevant to cite in this connection :

« Seeing matters in their true light, we find that there is no such thing as competition between financial centers, since as a matter of fact, they support each other. So there would be little sense in any attempt to compete with London as a financial center, quite apart from the fact that one cannot create centers of finance. They come into being if and when the pre-requisites for their existence are present. In the absence of these pre-requisites, even the most elaborately organized setup cannot lay the foundations for a financial center » (1).

In line with this view, we seek in this paper:

a — to delineate the main features of an international financial center that — though catering primarily to the Arab Middle East — lays no claim to exclusivity in the region.

b — to identify the conditions which provide a favourable climate for the development of such a center.

c — to explore the ways and means of promoting these conditions in Lebanon.

The discussion will be conducted in terms of the customary dichotomy between money and capital markets.

We shall concentrate in this paper on the structural and economic aspects affecting the development of Lebanon's role as an international center. Other aspects might be no less important, but they fall beyond the scope of this paper. These would include political and social stability, efficiency of the telecommunications system, access to all kinds of services, efficiency of the legal and judiciary system, and the standard of business ethics.

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(1) Max Ikle, *Switzerland : an International Banking and Finance center*, Dowden, Hutchinson, & Ross Inc., 1972, p. 2.