الجمهورية اللبنانية
مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام

THE LEBANESE ECONOMY IN 1989

Republic of Lebanon
Office of the Minister of State for Administrative Reform
Center for Public Sector Projects and Studies
(C.P.S.P.S.)

Dr. Marwan Iskandar

January 22, 1990

THE LEBANESE ECONOMY IN 1989

More than six months of all-out hostilities in 1989 have caused extensive damages to the country's economic infrastructure, long work stoppages, dis-investment and capital flight, thus lending support to the view that this major setback has wiped out the economic gains of 1988 and may have thwarted economic recovery at its launching stage. In fact, neither the modest gains of 1988 nor the setback in 1989 have altered the basic features of Lebanon's economy which, for the past five years, has been in the throes of recession and monetary instability but has nevertheless retained its potentials for recovery.

(The budget deficit continued to grow in 1989; the size and rate of growth of public spending remained well above those of public revenues)

As in previous years, the Treasury's revenues in 1989 were but a small fraction of total expenditure. The shortfall as measured by the net increase in the internal debt in 1989 reached LL.. 493.6 billion.

In the last quarter of the year, the domestic debt increased by LL. 191.2 billion, compared with increases of LL. 78.6 billion, LL. 131.2 billion and LL. 92.6 billion in the first, second and third quarters respectively. The domestic debt outstanding reached LL. 898.8 billion by the end of 1989, up 121.8 percent on its end 1988 level.

(The banking sector remained the Treasury's main recourse to bridge the shortfall; a substantial portion of the sector's loanable funds are diverted away from private investment financing to be earmarked for inflationary deficit financing.)

Issues of Treasury bills, the main vehicle of budget deficit financing, increased by a net LL. 360.6 billion in 1989. In the fourth quarter of the year, net Treasury-bill issues amounted to LL. 149.7 billion, compared with LL. 91.9 billion, LL. 52.9 billion and LL. 66.1 billion in the first, second and third quarters respectively.

The total value of Treasury bills in circulation amounted to LL. 786.4 billion at the end of 1989, up 84.69 percent on the end 1988 total.

In 1989, commercial banks were still the main subscribers to the Treasury's debt instruments; they held 77.53 percent of T-bills outstanding at the end of the year, whereas the saving public held 18.50 percent of these bills and the central bank held 3.36 percent.

The volume of Treasury bills demanded by banking institutions and the saving public is not by necessity equal to the spending requirements of the Treasury. An increase in the demand for assets denominated in Lebanese pounds increases subscriptions to Treasury bills to a level which may exceed the funds the State needs to bridge the budgetary shortfall. That was the case in the past two years when exchange-rate expectations had led to sizable shifts of funds toward deposits and assets denominated in LL. This allowed the central bank to start phasing out its contribution to the financing of the budget deficit, the most inflationary portion of the public debt.

Still, the central bank's direct contribution to the public debt in 1989 amounted to LL. 189.8 billion all of which constitute subsidies on domestic sales of fuel products.

(Financing the budget deficit through issues of Treasury bills, while affording a measure of stability on the money and the currency markets in the short run, deprives the private sector of the resources it needs to finance investments.)

The modality of deficit financing is such that the private sector remains disadvantaged in its competition with the public sector for banks' resources, irrespective of exchange-rate expectations. Thus, when exchange-rate expectations favor the Lebanese pound subscriptions to Treasury bills surge and the volume of loanable funds left at the disposal of the private economy dwindle, and when exchange-rate expectations go against the Lebanese pound funds shift away from LL.-denominated deposits and the financing of private activity suffers as well.

(The relative size of the public sector in the economy continued to grow and the growing budget deficit continued to bloat the money base while private investment and production slackened.)

This has created a classic inflationary situation whereby high rates of monetary growth are unmatched by real economic growth.

In 1989 as in 1988 the rate of inflation as measured by the cost-of-living index subsided to the 30-40 percent level down from about 600 percent in 1987.

Prices in 1989 had moved up sharply following the collapse in the state of security, the blockade imposed on a large region in the country, and the disruption of important supply channels and of domestic production and trade.

The gradual return to normality in the third quarter of the year ironed out distortions in price structures and consumption patterns and led to a fall in the cost-of-living index for the month of July. The index decreased again in October as speculation in support of the Lebanese pound was encouraged by a truce agreed upon in the last week of September. An improvement in the pound's exchange value depresses the cost-of-living index because it reduces the equivalent in LL. of prices quoted in foreign exchange, it puts downward pressures on the prices of importables and hence on the price level in general, and it inevitably creates expectations of further exchange-rate improvement and price falls. Despite political turmoil, the pound held its ground in November and the cost-of-living index recorded an insignificant increase of less than one percent for that month.

In December, however, the pound shed nearly 13 percent of it U.S. dollar value following the government's decision to sanction pay settlements that were deemed excessive compared to the increase in the cost-of-living index in 1989. The index for the month moved up by nearly eight percent and the index for the year was up 40 percent.

(Inflation depresses real incomes and standards of living; the demand for imports falls due to both the income-effect and the price-effect—hat is the fall in the exchange value of the pound—, while export industries thrive due to the competitive edge afforded by lower domestic factor costs.)

This has, for the past three years, helped reduce the trade deficit and also led to the emergence of a balance of payments surplus.

The fundamental realities of the Lebanese economy thus remained unchanged over the past year and economic recovery in a backdrop of monetary stability will remain illusive in the absence of an acceptable political cure to the country's predicament.

In the meantime, political uncertainty will continue to restrain investment and the repatriation of capital and the economy will continue to operate well below capacity.

However, if not disrupted by a general breakdown in security, economic activity in 1990 is likely to create more jobs in all sectors of the economy and more particularly in export-oriented industries.

Barring a drastic fall in the currency's rate of exchange, the improvement in standards of living afforded by higher real wages in 1990 will strengthen the demand for imports. The results of price and product surveys conducted in 1989 suggest that imports may have regained their competitive advantage on the local market and that import-substitution, which had reached its limit when standards of living and purchasing power were at their lowest ebb in the second half of 1987 and early 1988, is currently being reversed. This process should continue in 1990 provided a modicum of political and monetary stability prevails.

الجمهورية اللبنانية
مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام

January 22 1990

Republic of Lebanon
Office of the Minister of State for Administrative Reform
Center for Public Sector Projects and Studies
(C.P.S.P.S.)