Economic Dislocation and Recovery in Lebanon

Sena Eken, Paul Cashin, S. Nuri Erbaş, Jose Martelino, and Adnan Mazarei



INTERNATIONAL MONETARY FUND

Washington DC February 1995



Contents

		Page
Prefa	ace	vii
ı	Introduction	i
н	Some Economic Consequences of the Civil War	3
	Consequences of the War for Output	3
	How Fast Can Lebanon Recover?	6
	Does It Matter for Growth What Type of Capital Was Lost?	9
Ш	Impact of the War on Budgetary Performance, Structural	
	Weaknesses of the Budget, and Reform Measures	П
	Overview of Fiscal Performance During and After the War	11
	Structural Weaknesses of the Budget Measures to Address the Structural Weaknesses	15 17
	ivicasures to Address the Structural Weakinesses	17
IV	Currency Substitution and Dollarizațion	19
	Origins and Extent of Dollarization	19
	Capital Flight and Repatriation	20
	Advantages and Disadvantages of Dollarization Policies to Achieve, and Consequences of, De-Dollarization	22 23
	Toncies to Acineve, and Consequences of, De-Donarization	23
V	Estimating Money Demand in Lebanon	25
	Dollarization and the Definition of Money	25
	Behavior of Velocity	25
	Specifications of Money Demand Unit Root Tests for Stationarity	26 27
	Money Demand: Cointegration Results and Policy Implications	28
	Conclusions	30
	_ \ _/	
VI	Exchange Rate Developments and Their Relationship to Inflation	32
`\	Evolution of the Exchange Rate	32
	Long-Term Relationship Between Exchange Rate Movements and Inflation	36
	Short-Term Dynamics of Inflation and the Exchange Rate and the	50
	Two-Way Relationship Between Them	40
Text	t Tables	
Sect	ion	
11/	1. Measures of GDP	4
	2. Population and GDP	5

	3. Convergence of Actual to Steady-State Real Per Capita Incomes	9
Ш	4. Summary of Public Sector Operations (In billions of Lebanese pounds)	12
	5. Summary of Public Sector Operations (In percent of GDP)	13
	6. Summary of Public Sector Operations (In percent of total)	14
	7. Fiscal Indicators for Selected Middle Eastern Countries	16
IV	8. Currency Substitution	20
	9. Average Inflation Tax	23
V	10. Phillips-Perron Tests for Stationarity, 1964–93	28
VΙ	11. Exchange Rate Indices and Inflation	33
	12. Legal Minimum Wages	36
	13. Regressions of the Differential Between Lebanese and U.S.	
	Inflation Rates on Changes in the LL/US\$ Exchange Rate	38
	14. Dickey-Fuller Unit Root Tests, 1951–93	38
	15. Johansen Cointegration Test, 1975–93	39
	16. Dickey-Fuller Unit Root Tests, 1989–92	39
	17. Johansen Cointegration Test, 1989–92	40
Cha	rts	
Sect	ion	
П	1. GDP and Population Indices	6
••	2. Per Capita Real GDP, 1964–2010	7
Ш	3. GDP and Fiscal Performance	11
ΪV	4. Currency Substitution and Dollarization	21
• •	5. Dollarization and Exchange Rate Movements	21
	6. Real and Nominal Cross-Border Deposits	21
	7. Cross-Border Deposits (As percent of foreign exchange reserves	
	minus gold)	22
	8. Cross-Border Deposits (As percent of M2, including foreign	
	currency deposits)	22
V	9. Velocity of Monetary Aggregates	26
	10. Monetary Aggregates	26
	11. Composition of Total Liquidity	27
VI	12. Volatility of the Lebanese Pound/U.S. Dollar Exchange Rate	34
	13. Real and Nominal Effective Exchange Rates, 1964–93	35
	14. Real and Nominal Effective Exchange Rates, 1989–93	35
	15. Lebanon and Selected Other Countries: Nominal Effective	
	Exchange Rates	36
	16. Lebanon and Selected Other Countries: Real Effective Exchange Rates	37
	17. Price Level and Exchange Rates, 1951–80	37
	18. Price Level and Exchange Rates, 1975–93	37
	19. Price Level and Exchange Rates, 1989–94	38
Арр	endices	
i	Exchange and Trade System	42
NH -	Statistical Tables	44
``	A1. Selected Social, Economic, and Financial Indicators	44
	A2. Selected Indicators of Sectoral Economic Activity	46
	A3. Consumer Price Indices	46
	A4. Summary of Central Government Operations	47
•	A5. Treasury Bills in Circulation	48
	A6. Bank of Lebanon Balance Sheet	49
	A7. Commercial Banks' Balance Sheet	50
	A8. Monetary Survey	51

A9.	Factors Affecting Lebanese Pound Component of Domestic Liquidity	51		
A10.	Distribution of Residents' Monetary Assets	52		
A11.	Commercial Banks' Claims on Private Sector Classified by			
	Economic Activity	52		
A12.	Discounts and Yields on Three-Month Treasury Bills	53		
A13.	Commercial Bank Interest Rates on Lebanese			
	Pound Transactions, 1989–94	54		
A14.	Summary of the Balance of Payments	55		
A15.	Composition of Industrial Exports	56		
A16.	Destination of Exports	56		
A17.	Source of Imports	57		
A18.	Exchange Rate of the Lebanese Pound	58		
A19.	Nominal and Real Effective Exchange Rates of the Lebanese Pound	- 59		
Bibliography				

The following symbols have been used throughout this paper:

- ... to indicate that data are not available;
- to indicate that the figure is zero or less than half the final digit shown, or that the item does not exist;
- between years or months (e.g., 1991–92 or January–June) to indicate the years or months covered, including the beginning and ending years or months;
- / between years (e.g., 1991/92) to indicate a crop or fiscal (financial) year.

"Billion" means a thousand million.

Minor discrepancies between constituent figures and totals are due to rounding.

The term "country," as used in this paper, does not in all cases refer to a territorial entity that is a state as understood by international law and practice; the term also covers some territorial entities that are not states, but for which statistical data are maintained and provided internationally on a separate and independent basis.