

The 1999 Budget Law

A brief presentation

The newly formed Government aims to establish a modern economic and financial system that will ensure high rates of economic growth, which will, in turn, improve the population's standards of living. These medium-term goals will require an efficient management of the budget system by containing expenditures, improving collection of revenues, and modernizing the tax system thereby decreasing the budget deficit and the level of public debt. These fiscal targets will necessitate to be accompanied by monetary stability embodied by a stable exchange rate and a low rate of inflation.

The five-year fiscal reform plan

It is in this frame of mind that the newly formed Government is approaching the challenge of redressing the fiscal situation in the country. Indeed, the expansionary fiscal policy that has characterized the past few years has led to unsustainable levels of budget deficits, which have in turn resulted in rapidly ascending public debt levels. Reversing this trend will not be an easy task and will require a number of choices over the next few years. The Government is fully cognizant that this objective cannot possibly happen overnight and requires medium-term fiscal planning. Therefore, fiscal reform in Lebanon will be based on a five-year plan and Budget 1999 constitutes the cornerstone of this program. The primary objectives of the five-year fiscal reform program include a sustained decline in budget deficit levels commensurate to international standards accompanied by stabilizing debt to GDP ratios. The major strategies used to achieve the broad targets of the five-year fiscal reform plan are summarized below:

1. **Modernizing and adjusting the tax system:** Within this strategy, priority is awarded to the introduction of a VAT and the application of a global income tax. In addition, the Ministry of Finance is continuing to reinforce its audit and collection proceedings together with a simplification of tax procedures.
2. **Privatizing public entities and increasing the role of the private sector** in the economy through awarding some infrastructure projects to the private sector. It is important to note that proceeds from privatization will be used to write off public debt.
3. **Reducing public expenditures and reorganizing the public sector:** This strategy relies on a reconsideration of the role of the public sector through administrative reform and will ultimately result in a rationalization of expenditures.
4. **Restructuring public debt** and improving its management through establishing a debt management unit at the MOF.

Overview of 1999 Budget Law

I. Introduction

The 1999 Budget Law estimates an overall budget deficit of LL 3,405 billion with total expenditure appropriations amounting to LL 8,395 billion and total revenues reaching LL 4,990 billion. This target is in line with the Government's overall strategy of containing public expenditures and reducing the overall deficit and also constitutes the first step towards the five-year fiscal adjustment program. The deficit to expenditure ratio is projected to amount to 40% and the primary balance will register a surplus of LL 495 billion.

II. Headlines of 1999 Budget Law

The 1999 Budget Law focused on the following major headlines:

1. *1999 Budget Law* aims at decreasing the deficit by 4 percentage points compared to 1998 deficit. In absolute terms, the 1999 budget deficit amounts to LL 3,405 billion equivalent to 40% of expenditures (versus 44% achieved in 1998).
2. 1999 Budget Law projects a *primary or non-interest surplus* of LL 495 billion.
3. *Budgeted expenditures* for 1999 amount to LL 8,395 billion. This budgeted level of expenditures represents an achievement since it underlies a decline of expenditures, when the increase in wages and salaries ratified by Parliament in 1998 is excluded.
4. *Budgeted revenues* for 1999 amount to LL 4,990 billion. This figure excludes municipalities' share of taxes, which amounts to the vicinity of LL 400 billion. In comparison, actual revenues for 1998 amounted to LL 4,161 billion if we exclude municipalities' share of LL 280 billion. Total revenues, including municipalities' share, for 1998 summed up to LL 4,441 billion whereas they are estimated to amount to LL 5,390 billion in 1999.
5. *Payments of previous years' arrears*, amounting to LBP 1,130 billion, will be tackled by issuing special treasury bills to be discounted at banks and traded in the secondary market. It is expected that the beneficiaries of these bonds will use them to repay their borrowings from the banks (especially hospitals and contractors).

III. Economic context of the 1999 Budget Law

The preparation of Budget 1999 was accompanied by some rigidities related to two major factors, namely the prevailing economic condition in the country and the heavy burden of a non-discretionary expenditure bill:

1. *Prevailing economic condition*: The post-war reconstruction period was accompanied by an expansionary fiscal policy that led to the following:
 - a. High level of total deficit: 51% of expenditures and 18% of GDP in 1996, 59% of expenditures and 24% of GDP in 1997, and 44% of expenditures and 14% of GDP in 1998.

- b. High and increasing level of net public debt: From 39% of GDP in 1993 to 105% of GDP in 1998 (and 110% of GDP if we add arrears due till end 1998 amounting to LBP 1,130 billion).

In addition, for the past three years, the economy has been witnessing slowing rates of real GDP growth as well as rising unemployment rates.

2. *Non-discretionary expenditure bill*: The maneuvering of 1999 Budget Law is limited by some expenditure rigidities summarized below:
 - a. The large “personnel cost” appended by a ratified raise in wages and salaries for public sector employees as of 1999.
 - b. The extremely large debt service bill accompanied by an increase in of LL 700 billion for 1999, which renders the total debt service bill to around LL 3,900 billion.
 - c. Deferred payments amounting to LBP 1,130 billion, broken down into appropriation bills, hospitalization bills, and contractors’ bills.

IV. A Closer Look at 1999 Budget Expenditures:

One of the major objectives of 1999 Budget Law is to contain expenditures. However, given the large debt service and wages and salaries bills, the Government is left with little room for maneuvering. Nonetheless, major efforts were undertaken to find windows of opportunities for curtailing current expenditures without affecting capital and project expenditures. The Government succeeded in reaching a level of capital expenditures that is 20 percent, or LL 148 billion, greater than the previous year’s level (following a reallocation of certain transfers from current to capital expenditures, budgeted capital expenditures for 1998 have increased to LL 750 billion whereas budgeted capital expenditures for 1999 are equivalent to LL 898 billion).

Total budget expenditures for 1999 are equivalent to LL 8,395 billion broken down as follows:

1. Debt service amounting to LL 3,900 billion constitutes 46% of total budget expenditures.
2. Other current expenditures amounting to LL 3,596 billion, a major part of which constitutes the personnel cost bill.

It is important to note that the debt service bill together with the public sector labor cost bill constitute more than 80% of total expenditures, which leaves little room for maneuvering.

3. Capital expenditures amount to LBP 898 billion, representing more than 10% of 1999 budgeted expenditures whereas they constituted around 7.5% of 1998 budgeted expenditures.
4. The remaining part of 1999 budgeted expenditures will be dedicated for operational purposes of the administration.

In order to contain expenditures and to attain a budget deficit amounting to 40% of expenditures, the following measures were taken:

1. Tightening of current expenditures for all public agencies.
2. Elimination of special indemnities related to emergency conditions for the armed forces.

V. A Closer Look at 1999 Budget Revenues:

The Ministry of Finance is pursuing ongoing efforts to invigorate revenue collection and to further widen the taxpayer base, which has already been expanded from 63,000 taxpayers (in early 1997) to 94,000 (as of mid May 1999). This 50% increase in the number of taxpayers was due to two reasons, namely the ongoing taxpayer survey that has resulted in the discovery of 21,400 hidden taxpayers, and the registration of 10,000 newly established businesses.

In addition, Budget 1999 contains new revenue sources that constitute the first step toward achieving a comprehensive tax reform project.

Budgeted revenues for 1999 amount to LBP 4,990 billion and represent an absolute increase of LBP 840 billion or a 20% rise when compared to 1998. It is worth noting that municipal revenues were not counted as part of budget revenues and will be considered in a separate account as part of treasury revenues.

The extensive increase in revenues is due to the main following reasons:

1. Increasing rates and progressiveness of income taxes on wages and salaries: maximum rate was augmented from 10% to 20% characterized by additional progressiveness in brackets.
2. Increasing rates and progressiveness of income taxes on industrial, commercial, and non-commercial professions: maximum rate was augmented from 10% to 21% characterized by additional progressiveness in brackets.
3. Increasing flat rates of corporate taxes on profits from 10% to 15%.
4. Increasing flat rates of tax on income derived from movable capital from 5% to 10%.
5. Increasing flat rates of corporate dividends from 5% to 10%.
6. Increasing rates and progressiveness of inheritance tax rates: maximum rate was augmented from 10% to 16% characterized by additional progressiveness in brackets.
7. Increasing rates and progressiveness of built property taxes: maximum rate was augmented from 10% to 13% characterized by additional progressiveness in brackets.
8. Increase customs duties on certain luxury items such as fur coats, perfumes, leather clothing, jewelry, and wrist-watches.
9. Increase in the gasoline excise tax amounting to an additional LBP 2,000 per 20 liters.

10. Increase customs duties on tobacco and products from 6% to 90%.
11. Increase in some fees and charges such as airport landing fees, airport parking fees, etc...

It is important to note here that the following revenue measures constitute additional revenues over-and-above 1999 Budget Revenues:

- Additional fees on cellular phone calls amounting to US\$ 0.04 per minute (went into effect)
- Shoreline violation fees (special law under preparation)

Moreover, Budget 1999 included some tax incentives, intended to encourage investment and private sector initiative in certain productive sectors, such as the following:

1. Decrease in real estate registration fees by 15% for the period extending from budget ratification to 4 months thereafter. As a result, and during this particular period of time, real estate registration fees will amount to 5.1% instead of 6%.
2. Additional real estate registration fees imposed on foreigners and amounting to 10%, will be suspended until end 1999.
3. Fixed telephone line membership fees were decreased by 60% (in order to encourage further memberships).