

1998 Budget Report

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CHAPTER I

INTRODUCTION

At the end of 1992, the Government took on a mammoth task in its attempt to revive and transform the Lebanese economy from a war-torn economy to a thriving, normal post-war economy able to adjust to the numerous developments in the regional and international economies. Indeed, the Government attempted to raise the living standards of the Lebanese population by rejuvenating the economic cycle, enhancing the incentives for higher investment and rebuilding the damaged infrastructure, while simultaneously pursuing disinflationary and price stabilization policies.

Since 1992, the Government's economic recovery program rested on the dual, and sometimes conflicting task of economic revival and stabilization. The adopted framework aimed to rehabilitate the country's damaged infrastructure, replenish the depleted capital stock, reinstate traditional public services and social programs and provide a conducive environment for the return of the expatriate Lebanese community, while pursuing exchange rate stability and disinflationary policies. To a great extent, this strategy has been successful. As the Government-led reconstruction program got underway and with the normalization of the economic environment, real economic growth averaged 5.7% (1992-97). At the same time, the foreign exchange rate stabilized, the inflation rate was reduced to single digits (from over 120%), interest rates gradually declined (since 1995) and substantial gross foreign reserves have been accumulated. Also, the banking sector thrived as deposits and loans to both the private and the public sector multiplied.

All through, the government has always acknowledged and mentioned in the various budget reports that the main challenge to its economic program lies in the area of fiscal policy. Having embarked on an ambitious post-war economic revival program and with no forthcoming international aid, the Government naturally ran budget deficits financed mainly through domestic borrowing. It is essential to note that the years of turmoil significantly reduced the State's ability to collect revenues and by 1992 the Revenue Department at the Ministry of Finance and other departments that are in charge of collecting taxes and fees were severely handicapped. Moreover, real per capita income in 1990 was only about one third of its level in 1975. Thus, raising tax revenue would have excessively burdened all segments of the Lebanese population and would have slowed down growth and impeded the economic revival program. Although revenues increased by four folds from 1992 to 1997, sharp increases in both capital and current expenditures, resulted in fiscal deficits and debt accumulation.

Here, it is important to mention that total expenditure, between 1993 and 1997 totaled L.L. 33,300 billion. After including the debt service payments associated with each expenditure item, total expenditure - from the Budget and foreign loans - was divided as follows:

- 16% towards servicing the balance of the debt incurred prior to 1993.
- 51% on social services, education, health and security, including salaries and wages, as well as transfer payments to public sector employees.
- 26% towards capital expenditure.
- 7% on miscellaneous administrative outlays.

Today, the fiscal stance continues to represent a formidable challenge. The Government, therefore, is proposing for 1998 a strict and realistic budget which entails a front loaded fiscal adjustment that aims to ameliorate the debt dynamics and allow for a soft landing of the economy. One encouraging development that bodes well for adhering to the 1998 budget is the growing consensus in the country on the need to address the fiscal deficit issue and to strengthen fiscal policy in a significant and durable manner. This is an important development and a pivotal factor in any deficit reduction scheme. Indeed, unless all the segments of the Lebanese society approach this issue in a responsible and mature fashion, the budget deficit and the debt situation will remain unresolved.

CHAPTER II

RECENT ECONOMIC DEVELOPMENTS

By 1992, the Lebanese economy was devastated due to seventeen years of civil strife and was faced with a number of serious predicaments. The country witnessed heavy migration of skilled labor and extensive capital flight. At the same time, the public finance situation deteriorated due to the lack of Government authority in the country and the consequent inability to collect the due revenues while continuing to provide a minimum level of public services. The resulting budget deficits were primarily financed through monetization which increased liquidity and led to massive pressures on the Lebanese Lira, high and increasing rates of inflation, and rising dollarization.

Since October 1992, the Government has strived to, and succeeded in restoring macroeconomic stability, curbing inflation, and reversing the trend of exchange rate depreciation of the Lebanese Lira as the Lebanese people regained confidence in their national currency and the future of the Lebanese economy.

It is against this background that this section briefly sheds light on the macroeconomic position in the country. The analysis encompasses an overview of the actual economic and financial performance of 1996 and 1997 followed by a synopsis of the 1998 Budget. The section is divided into the following seven parts:

Part 1: Movements in Gross Domestic Product

Part 2: Fiscal Developments

Part 3: Outstanding Debt

Part 4: Balance of Payments

Part 5: Inflation and Price Levels

Part 6: Exchange Rate and International Reserves

Part 7: Monetary Developments

During 1997, the Lebanese Government upheld its previous policy thereby maintaining the Lebanese Lira as a nominal anchor and providing the appropriate climate for a continuous growth.

Moreover, the government persisted in its efforts to improve the administrative and financial structure. In this regard, tax collection procedures have been modernized, a new system for customs duties has been adopted, property tax collection procedures have been reviewed, and income tax collections have been re-examined with the help of the Canadian Government (Please, refer to Chapter 3 for revenue collection reform, pages 27-28).

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1. Movements in Gross Domestic Product

During 1997, estimates for nominal GDP in 1994 and 1995 were published by the Directorate of Central Statistics. It is worth mentioning here that these numbers correspond to the estimates of the Ministry of Finance for the same years.

For 1997, GDP was estimated at its previous real growth rate of 4 per cent amounting to L.L 23,034 billion in nominal terms. In this respect, it is important to mention that the growth rate of real GDP did not reach the estimated 7 per cent due to several reasons, most significantly the slow down in construction and investment activities which are directly related to difficult regional circumstances, and the continuous Israeli attacks.

Table 2-1. Real GDP Growth, 1992 - 1997

	1992	1993	1994	1995	1996	1997
Growth Rate of Real GDP	4.5%	7.0%	8.0%	6.5%	4.0%	4.0%

Chart 2-1

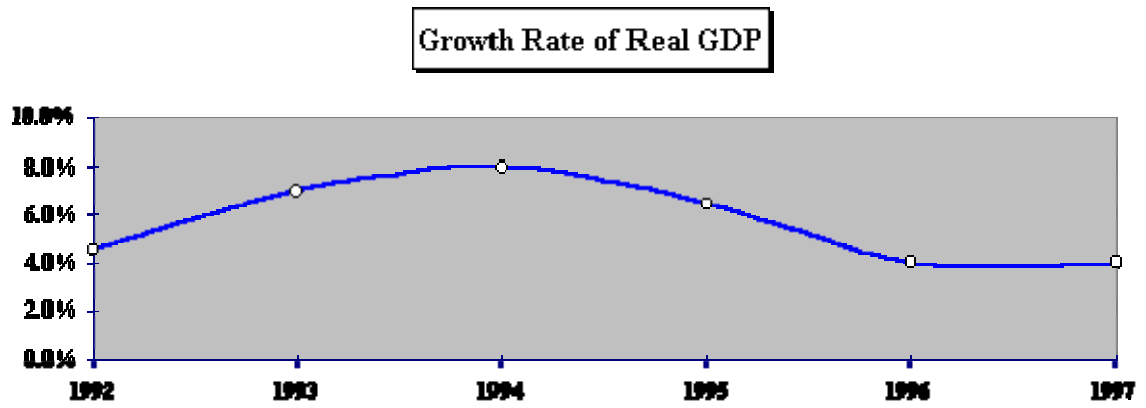


Table 2-2a. Nominal GDP Growth, 1992 - 1997

(LL Billion)

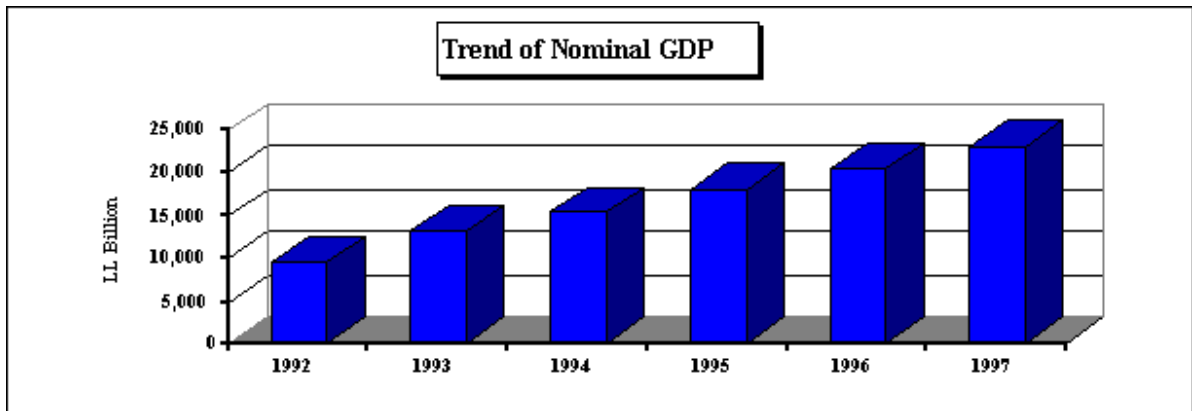
	1992	1993	1994	1995	1996	1997
Nominal GDP	9,409	13,122	15,305	18,028	20,417	23,034

Table 2-2b. Nominal GDP Growth, 1992 - 1997

(USD Million)

	1992	1993	1994	1995	1996	1997
Nominal GDP	5,545	7,537	9,110	11,122	12,996	14,957
<i>LR: Exchange rate used for the average for each of the years 1992-1997.</i>						

Chart 2-2



2. Fiscal Developments*

During 1997, as in previous years, the Lebanese Government has been confronted with the difficult tasks of macroeconomic stabilization and fiscal consolidation on the one hand, and pursuing reconstruction expenditures and greater resource allocation to social services on the other while avoiding a dramatic increase in taxation. Consequently, the government strived to obtain the necessary resources to meet those social needs while maintaining macro-economic stability. _

Table 2-3. Public Finances - Budget 1992-1998

(LL Billion)

	1992	1993	1994	1995	1996	1997	1998	1998 Budget Law including non-budget treasury expenditures*
Total Expenditures (a+b)	1,654	3,400	4,106	5,630	6,458	6,433	7,320	7,920
a. Current Expenditures	1,424	2,989	3,989	4,929	5,798	5,825	6,705	7,015
- Interest Expenditures	485	949	929	1,670	2,000	2,700	3,200	3,200
b. Capital Expenditures	230	411	117	1,697	660	608	514	904
Total Revenues	973	1,781	2,216	3,158	4,825	4,308	4,688	4,688
Total Deficit	680	1,619	1,890	2,472	1,633	2,125	2,632	3,232
Primary Deficit / Surplus (-)	207	859	948	808	-167	-367	-688	128
Deficit to Expenditure Ratio	41.28%	47.91%	45.78%	43.90%	25.29%	33.03%	35.96%	40.80%

* Estimated figures for 1998 = Budget 1998 + Estimated treasury spending for 1998.

It is important to mention that, in effect, total capital spending amounts to L.L 1,047 billion when Part I capital transfers, amounting to LL 143 billion, are added to LL 904 billion. Part I capital transfers (LL 143 billion) represent the share of domestic financing from the total foreign financed investment projects.

Chart 2-3

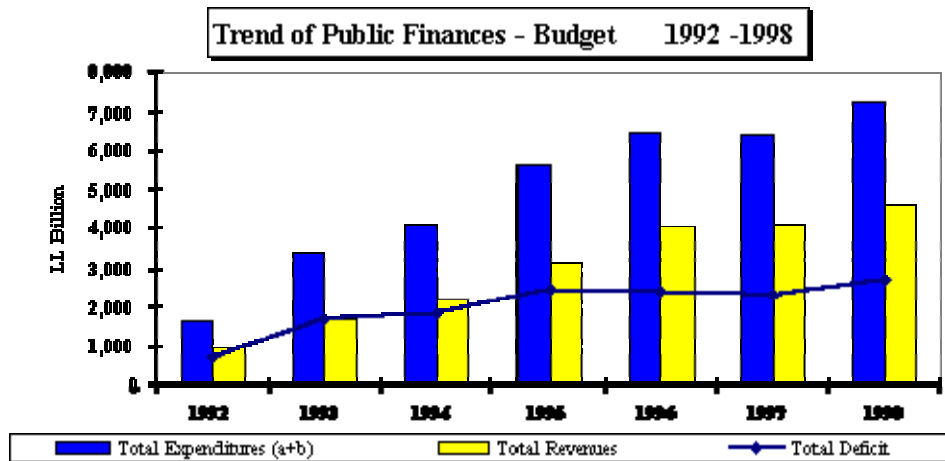


Table 2-4. Public Finances - Actual 1992-1997

(LL Billion)

	1992	1993	1994	1995	1996	1997	'98 Bud.Law incl. non-bud. treas. exp.*
Total Expenditures	2,219	3,017	5,204	5,856	7,225	9,162	7,920
- Interest Expenditures	578	724	1,488	1,875	2,453	3,378	1,200
Total Revenues	1,198	1,855	2,241	3,033	3,533	3,753	4,600
Total Deficit	1,081	1,162	2,963	2,823	3,692	5,409	3,320
Primary Deficit / Surplus (-)	563	378	1,475	948	1,039	2,031	120
Deficit to Expenditure Ratio	48.7%	38.5%	56.9%	48.2%	51.1%	59.0%	41.9%
Ratio Interest Exp \ Total Exp	23.3%	26.0%	28.6%	32.0%	36.7%	36.9%	40.4%

* Estimated figures for 1998 = Budget 1998 + Estimated treasury spending for 1998.

Chart 2-4

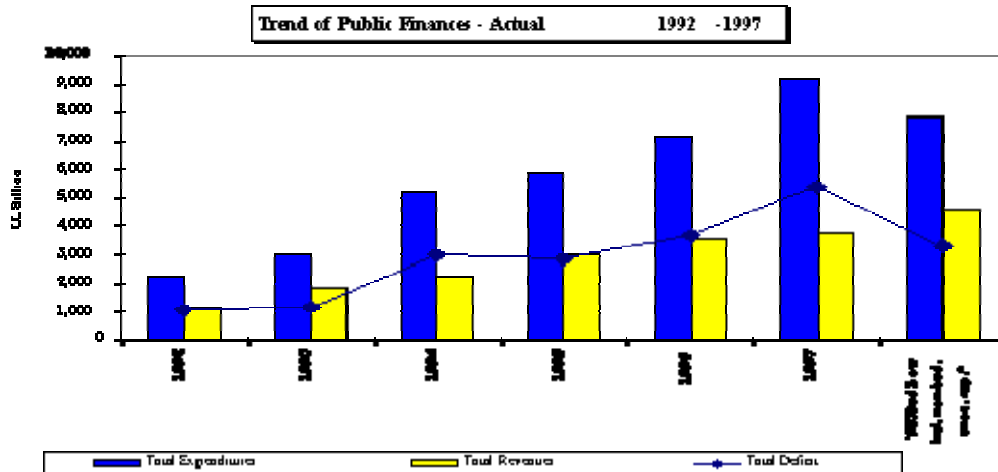


Table 2-5. Summary of Public Finances - Actual 92-96

(LL Billion)

	1993	1994	1995	1996
Revenues	1,855	2,241	3,033	3,533
Direct Taxes, of which:	1,208	1,636	2,100	2,888
<i>Custom Duties</i>	<i>467</i>	<i>791</i>	<i>1,320</i>	<i>1,672</i>
Indirect Taxes & other revenues	647	585	933	665
Expenditures	3,017	5,204	5,856	7,225
Current Expenditures	2,624	3,954	4,640	6,002
<i>Wages and Salaries</i>	<i>1,295</i>	<i>1,710</i>	<i>1,869</i>	<i>2,261</i>
<i>Interest Expenditures</i>	<i>784</i>	<i>1,488</i>	<i>1,875</i>	<i>2,633</i>
<i>Other</i>	<i>545</i>	<i>756</i>	<i>896</i>	<i>1,088</i>
Capital Expenditures	393	1,230	1,216	1,223
Deficit	1,162	2,963	2,823	3,692

During 1997, treasury expenditures reached L.L 9,162 billion, thereby exceeding the 1997 Budget Law by L.L. 2,722 billion. As a result, expenditures to GDP ratio increased from 35 percent in 1996 to 40 percent in 1997. This increase in expenditures which has aggravated the budget deficit, is partly due to the following reasons:

- 1- Considerable amounts of carry-over expenditures from previous budgets,
- 2- Significant levels of debt service payments
- 3- Additional appropriations for the Ministry of Health and a supplementary salary increase to school teachers.

On the other hand, by the end of 1997, total treasury revenues amounted to L.L. 3,753 billion which represents about 92% of the total estimated revenues in the 1997 Budget Law. Thus, total treasury revenues did not reach the estimated level due to many reasons, including the slowdown of economic activity and the lower than anticipated collection of some revenues.

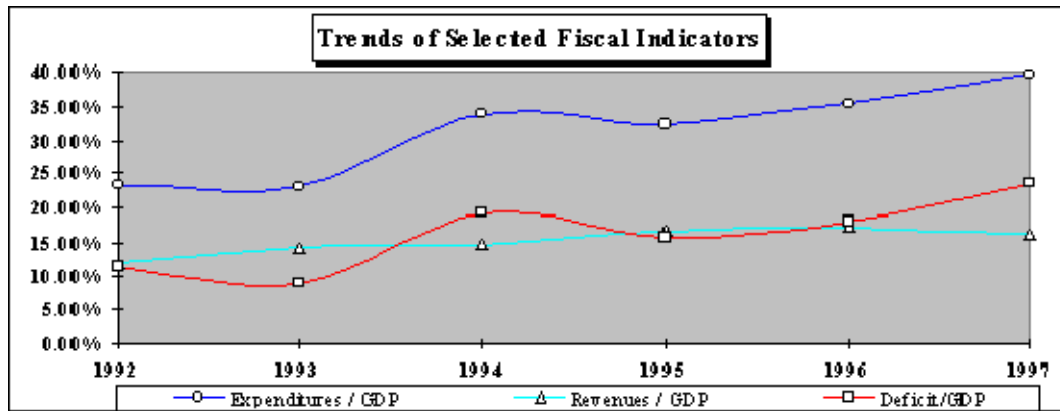
As a result of these developments, the 1997 budget deficit amounted to L.L 5,409 billion. This expansion in the fiscal deficit is explained by the above mentioned higher than expected expenditures and lower than anticipated revenues.

Table 2-6. GDP and Fiscal Performance, 1992-1997

(LL Billion)

	1992	1993	1994	1995	1996	1997
Nominal GDP	9,499	13,122	15,305	18,028	20,417	23,091
Expenditures	2,219	3,017	5,204	5,856	7,225	9,162
Expenditures / GDP	23.36%	22.99%	34.00%	32.48%	35.38%	39.78%
Revenues	1,138	1,855	2,241	3,039	3,539	3,759
Revenues / GDP	11.98%	14.14%	14.64%	16.82%	17.30%	16.29%
Deficit	1,081	1,162	2,963	2,829	3,682	5,409
Deficit/GDP	11.38%	8.86%	19.36%	15.66%	18.08%	23.48%

Chart 2-5



3. Outstanding Debt

(Please refer to Chapter 5 for more details on external public debt)

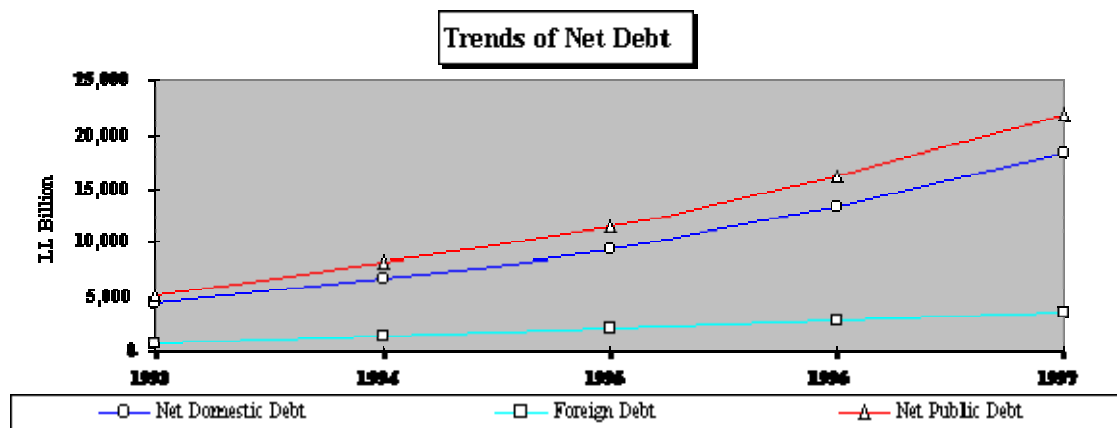
The continuous increase in the budget deficit has been largely financed through borrowing and specifically through the issuance of short and medium term treasury bills in Lebanese Lira. Consequently, net domestic debt increased from L.L 13,358 billion at the end of 1996 to L.L 18,379 billion at the end of 1997, which represents an increase of 37 percent. Therefore, net public debt increased from L.L 16,266 billion at the end of 1996 to L.L 22,006 billion at the end of 1997, thereby representing a nominal increase of LL 5,740 billion and a percentage increase of around 35 percent compared to 43 percent between 1995 and 1996.

Table 2-7. Net Outstanding Public Debt, 1992-1997

(LL Billion)

	1992	1993	1994	1995	1996	1997
Deficit	1,081	1,162	2,963	2,823	3,692	5,402
Net Domestic Debt	n.a.	4,407	6,712	9,287	13,358	18,379
Foreign Debt	n.a.	730	1,415	2,112	2,908	3,627
Net Public Debt	4,383	5,138	8,127	11,399	16,266	22,006

Chart 2-6



Investment expenditures were partly financed by external borrowings. Consequently, external public debt amounted to LL 3,627 billion by the end of 1997, thereby denoting an increase of 25 percent when compared to the external debt levels of 1996 and representing 16 percent of total net public debt.

Table 2-8 and the graphs below show the continuous decline of the weighted average yield on the treasury bills during 1997.

Table 2-8: Weighted average yield on treasury bills, 1992-1997

(In percentage)

Quarter	3 months	6 months	12 months	24 months
1992 (1)	23.84	25.34	29.01	30.50
1992 (2)	23.84	24.34	29.01	30.50
1992 (3)	34.18	35.28	34.20	33.59
1992 (4)	13.00	15.00	20.99	26.00
1993 (1)	21.01	22.01	22.01	26.00
1993 (2)	18.48	20.08	22.01	26.00
1993 (3)	18.06	19.85	21.00	24.99
1993 (4)	17.22	19.65	21.07	23.99
1994 (1)	16.33	18.04	19.92	20.34
1994 (2)	15.30	17.47	19.31	20.07
1994 (3)	14.47	17.21	19.04	18.53
1994 (4)	13.49	14.83	14.73	15.84
1995 (1)	16.55	18.00	19.66	18.81
1995 (2)	19.94	21.70	26.45	24.06
1995 (3)	25.30	27.91	37.85	29.05
1995 (4)	16.01	17.21	18.26	23.39
1996 (1)	15.81	17.16	18.15	23.25
1996 (2)	15.56	16.99	17.96	23.08
1996 (3)	14.61	16.92	17.80	22.83
1996 (4)	14.29	16.15	17.02	20.54
1997 (1)	13.75	14.49	15.20	16.73
1997 (2)	13.40	14.21	15.20	16.73
1997 (3)	13.09	13.97	15.20	16.73
1997 (4)	13.09	13.97	15.20	16.73

Chart 2-7

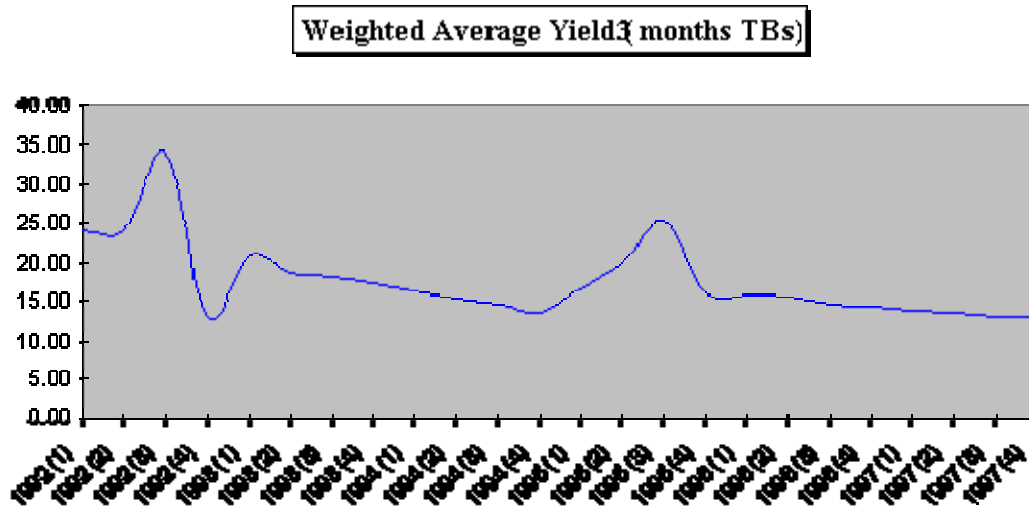


Chart 2-8

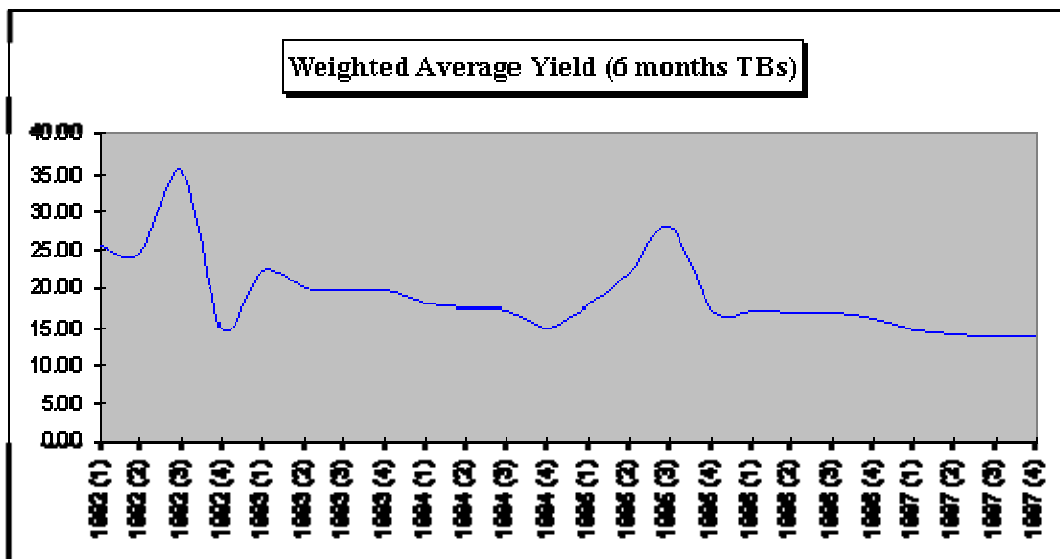


Chart 2-9

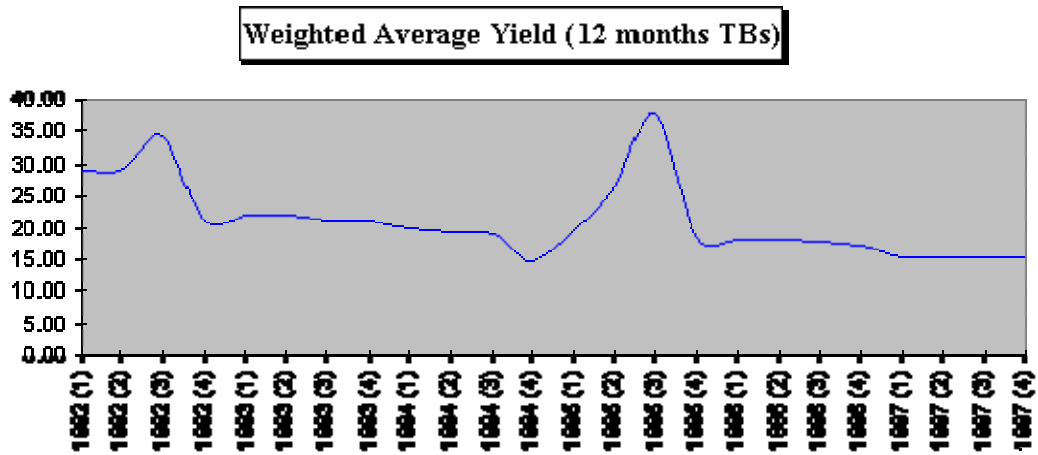
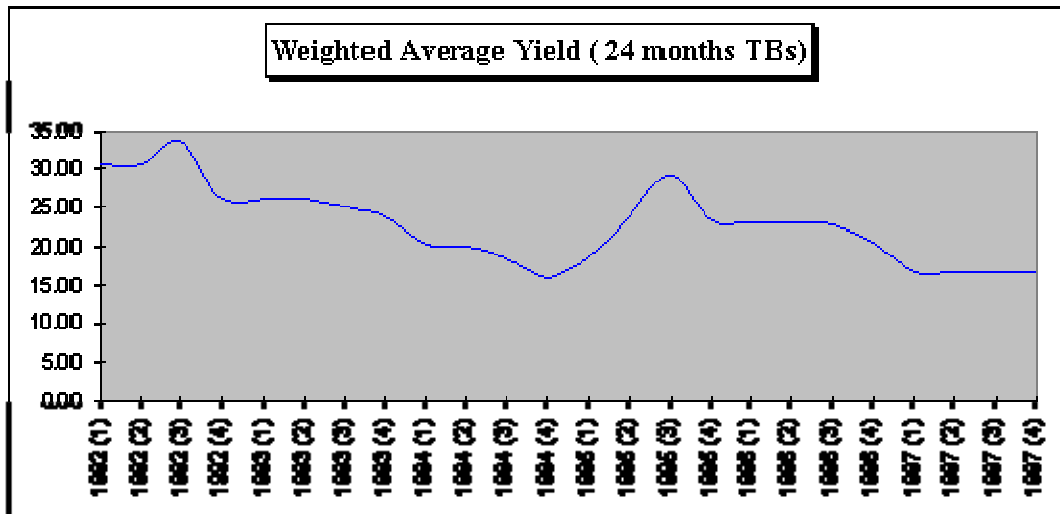


Chart 2-10



4. Balance of Payments

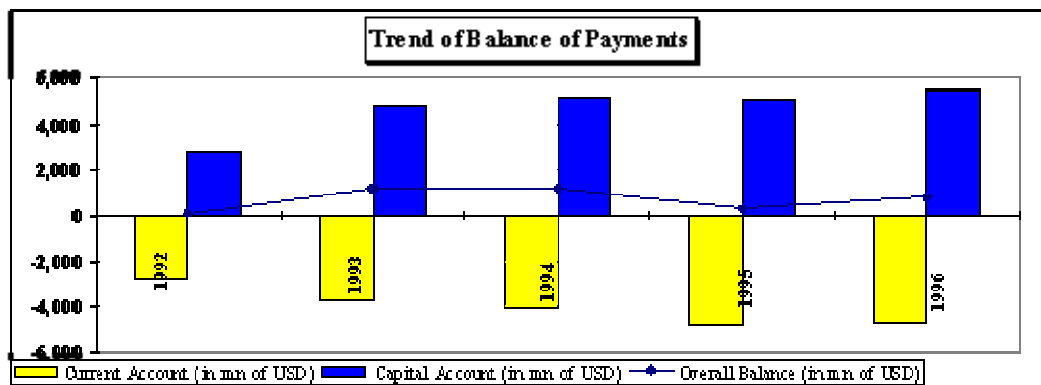
The balance of payments scored a surplus of USD 420 million during 1997. It is worth noting that, as usual and despite the growing deficit in the balance of trade, the

balance of payments surplus was sustained by emigrants' remittances, capital inflows, and direct investment.

Table 2-9. Summary of Balance of Payments, 1992-1997

	1992	1993	1994	1995	1996	1997
Current Account (in mn of USD)	-2,763	-3,692	-4,900	-4,817	-4,703	n.a.
o/w Balance of Trade	-3,005	-4,221	-4,804	-5,740	-5,926	-6,814
<i>Exports, f.o.b.</i>	<i>601</i>	<i>601</i>	<i>727</i>	<i>982</i>	<i>1,066</i>	<i>612</i>
<i>Imports, f.o.b.</i>	<i>3,706</i>	<i>4,907</i>	<i>5,531</i>	<i>6,722</i>	<i>6,992</i>	<i>7,426</i>
Capital Account (in mn of USD)	2,817	4,961	5,190	5,873	5,209	n.a.
Overall Balance (in mn of USD)	84	1,169	1,131	786	706	429

Chart 2-11



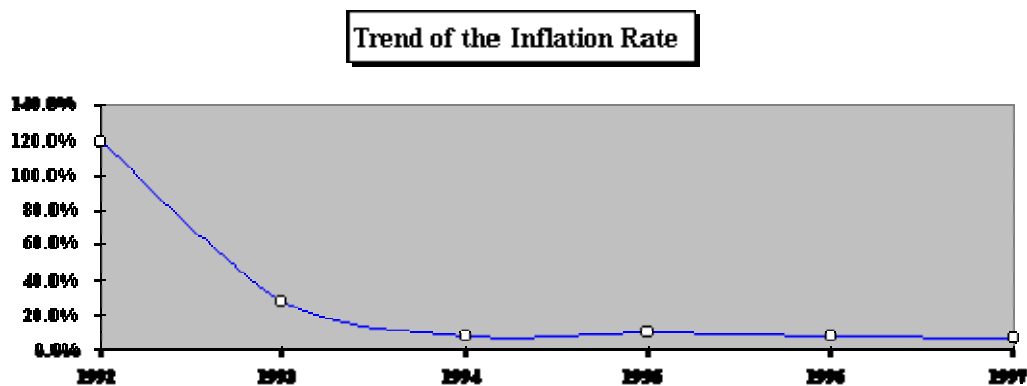
5. Inflation and Price Levels

Although there are still no official inflation statistics in Lebanon, proxy indicators (table 2-10 and graph 2-12) show that a gradual return to relative price stability is slowly occurring.

Table 2-10. Inflation Rates, 1992-1997

	1992	1993	1994	1995	1996	1997
Inflation Rate (%)	120.0%	29.1%	8.0%	10.6%	8.9%	7.8%

Chart 2-12



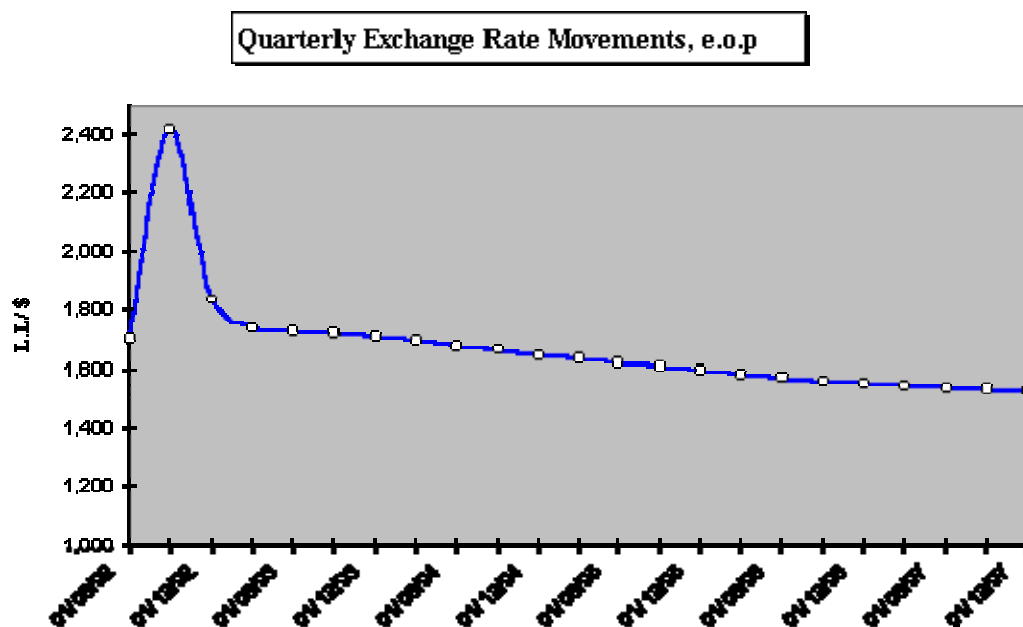
6. Exchange Rate and International Reserves

As can be seen in table 2-11 and chart 2-13 below, since 1992, the Lebanese Lira has been moderately appreciating due to several reasons, mainly, the continuous capital inflows. The appreciation in the exchange rate between end 1992 and December 1997 approximately amounts to 17 percent.

Table 2-11. Exchange Rate Movements, 1992-1997

	1992	1993	1994	1995	1996	1997
Exchange Rate LL per USD (e.o.p.)	1,838	1,711	1,647	1,596	1,552	1,527
Exchange Rate LL per USD (avg.)	1,713	1,741	1,680	1,621	1,571	1,539

Chart 2-13



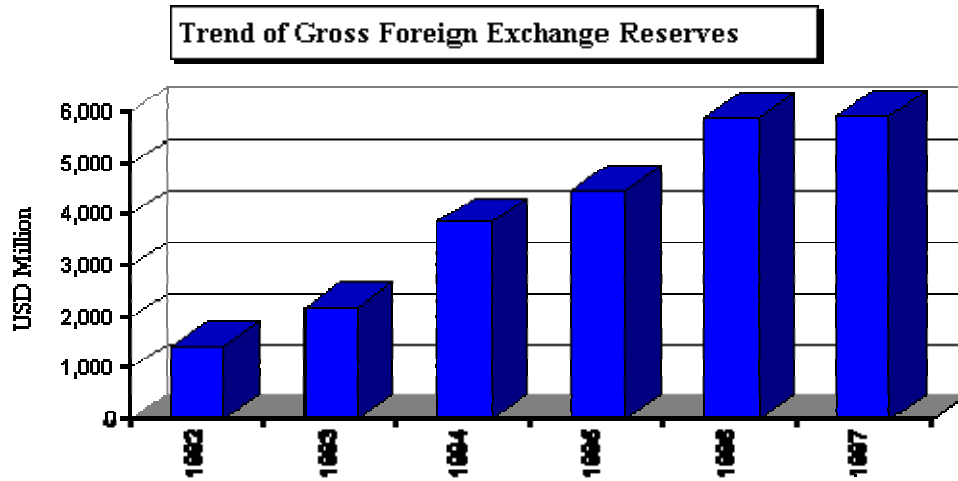
In sum, the Government's exchange-based stabilization policy has led to an appreciating currency and has brought inflation down considerably. Foreign exchange reserves have been replenished, with gross reserves (excluding gold), at the Bank of Lebanon rising from around USD 1,448 million in 1992 to USD 5,932 million by end 1997.

Table 2-12. Gross Foreign Exchange Reserves, 1992-1997

(USD Million)

	1992	1993	1994	1995	1996	1997
Gross Foreign Exchange Reserves	1,448	2,220	3,840	4,487	5,886	5,932

Chart 2-14



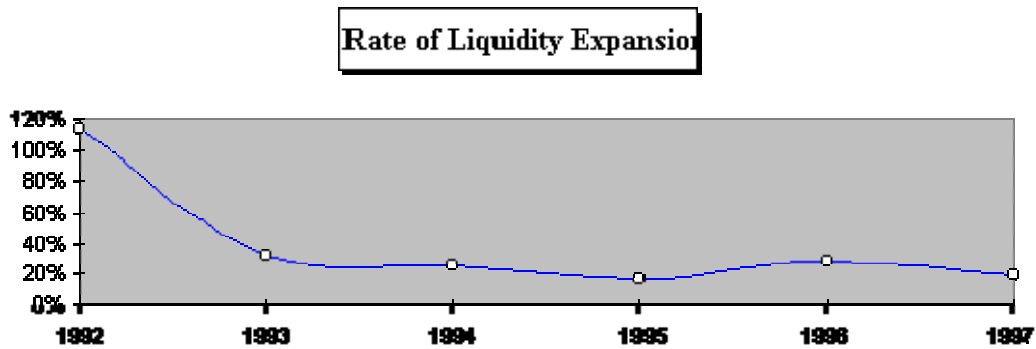
7. Monetary Developments

By the end of 1997, M3* had reached LL 34,897 billion compared to LL 29,241 billion in 1996, representing a growth rate of 19 percent. This rate of monetary growth is associated mainly with the large amount of credits to the private sector in addition to the commercial banks net credit to the public sector.

Table 2-13. Liquidity Expansion, 1992-1997

	1992	1993	1994	1995	1996	1997
Rate of Liquidity Expansion	114%	32%	23%	16%	28%	19%

Chart 2-15

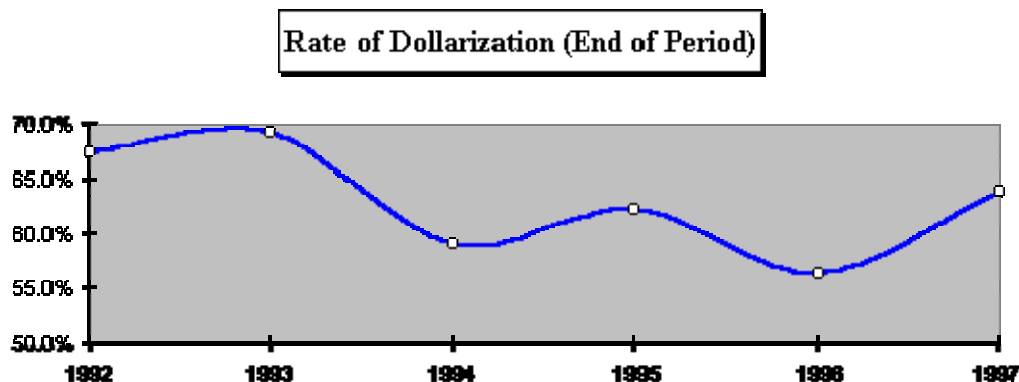


By the end of 1997, the degree of dollarization or the ratio of foreign currency deposits to total deposits of commercial banks had scored a 7 percent increase when compared to the end of 1996.

Table 2-14. Dollarization, 1992-1997

	1992	1993	1994	1995	1996	1997
Rate of Dollarization*	67.5%	69.3%	59.1%	62.3%	56.5%	63.9%
<i>* Dollarization = Foreign currency Deposits / Total Deposits</i>						

Chart 2-16



The consolidated balance sheet of commercial banks grew from LL 37.2 trillion at end 1996 to about LL 45.6 trillion by end 1997. This growth of 23 percent has allowed credit to the private sector to increase by 22 percent when compared to 1996, while at the same time providing resources to finance the fiscal deficit.

On the other hand, capital accounts of commercial banks were recorded to be around LL 2,990 billion (or equivalent to USD 1.96 billion) during 1997. This constitutes an increase when compared to 1996 figures which were LL 1,944 billion (or equivalent to USD 1.25 billion) as can be seen in table 2-16 and chart 2-18 below.

Table 2-15. Assets of Commercial Banks, 1992-1997

(LL Billion)

	1992	1993	1994	1995	1996	1997
Total Assets	14,694	18,809	24,285	29,055	37,183	45,633
Credit to the private sector	4,804	5,898	7,800	10,320	12,687	15,451
Credit to the public sector	3,098	4,013	6,908	7,949	12,060	13,294

Chart 2-17

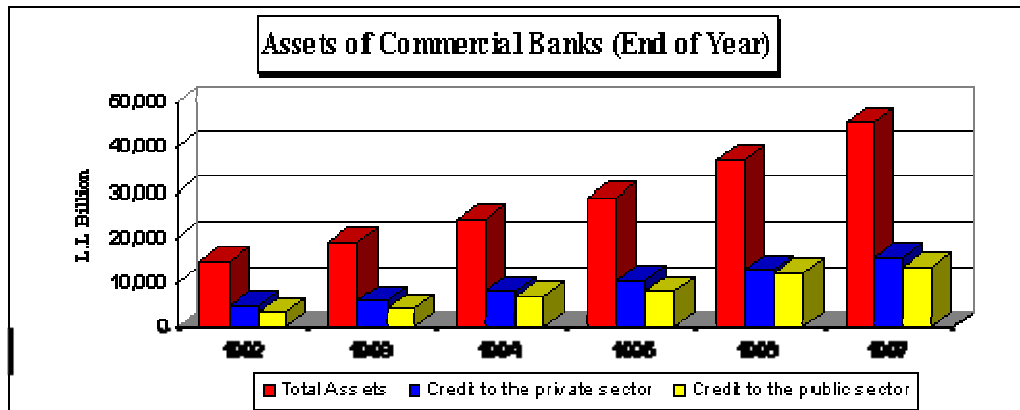
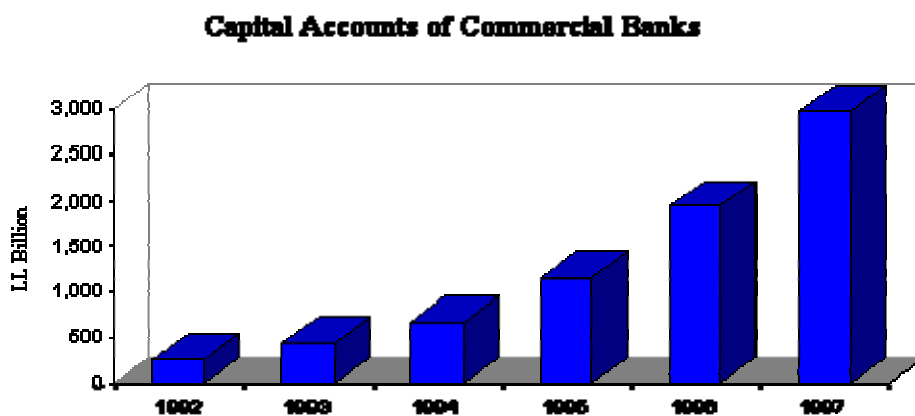


Table 2-16. Capital Accounts of Commercial Banks, 1992-1997

(LL Billion)

	1992	1993	1994	1995	1996	##
Capital accounts of commercial banks	264	444	676	1,146	1,944	##

Chart 2-18



* All fiscal data are based on Bank of Lebanon statistics covering the treasury accounts.

* M3 = M1 + M2 + Deposits in foreign currencies

(M1 = Currency in Circulation + Sight Deposits in LL.)

(M2 = Other Deposits in LL.)

CHAPTER III

The Economic Context of the 1998 Budget

The Fiscal Stance

Faced with unlimited wants and limited available means, the Lebanese Government at the end of 1992 took over the responsibility of reestablishing social cohesion, reinstating national security and rebuilding the economy. Six years into this massive effort, the Government has realized a significant proportion of its agenda. Nevertheless, much remains to be achieved in order to eradicate the vestiges of seventeen years of turmoil and complete the transformation of Lebanon's economy from a war based economy to a thriving and dynamic post-war economy.

The adopted post-war economic revival program relied in part on the resourceful and deep pool of talented human capital in the country. To unleash this potential, however, it was essential for the public sector to invest heavily in the country's social and physical infrastructure. While these investments resulted in budget deficits and debt build up, they were prerequisites for long term economic growth.

Having successfully completed the first phase of the economic revival program the Government is paying due regard to control the budget deficit and ameliorate the debt dynamics. Over the medium term, the Government's strategy of fiscal containment envisages a horizon over which fiscal deficits will be reduced. To this effect, a primary surplus must be realized. In brief, the primary balance is the difference between revenues and expenditure excluding interest payments. A primary balance, therefore, will lead to a reduction in the debt/GDP ratio provided that nominal interest rates on government debt do not exceed nominal GDP growth. Furthermore, a primary surplus implies that the Government, without resorting to borrowing, will possess the financial ability to cover at least part of its interest obligations. In this regard, the 1998 Budget law anticipates a significant decrease in the primary deficit.

Indeed, both the 1996 and 1997 Budget Laws represented important steps towards addressing and ultimately reversing the debt dynamics. Both laws envisaged a transformation in the primary balance from deficits to modest surpluses. Unfortunately, events in both those years, and even in 1995, influenced the real outcome and to a certain extent delayed the fiscal consolidation path.

The fiscal position in 1996 was exasperated by first, the sharp rise in interest rates in 1995 due to internal political uncertainty and second, the Israeli aggression in 1996 which resulted in higher than anticipated expenditures, delayed investment and thus slowed down growth. The combined effect of those two events delayed the soft landing scenario and to a certain extent influenced the 1997 fiscal outcome.

As mentioned in the 1997 Budget report, given the temporary fiscal setbacks of 1996, and the importance of maintaining the fiscal consolidation path, it was imperative to make up in 1997, for the deviation that took place in the previous year. Consequently, expenditures in the 1997 Budget Law were maintained at almost the same level of the 1996 Budget.

To achieve this result and given the rigidity of all non-discretionary spending, discretionary spending had to be reduced along with a further rationalization of investment expenditure in Part II of the budget.

Accordingly, the preparation of the 1997 Budget was based on the following principles:

- The 1996 salaries and wages would remain constant after taking into consideration the 20 percent increase that came into effect on January 1, 1995.
- All discretionary recurrent expenditures were reduced below the 1996 budget level.
- Capital expenditures were reduced below their 1996 levels.

Developments in 1997 resulted in a different fiscal outcome than initially anticipated. Having achieved a lower than expected growth rate, total revenue amounted to L.L. 3,753 billion which represents an 8% shortfall of budgeted revenues. With actual revenues, coming in close to the budgeted figure, the larger than anticipated budget deficit is mainly due to expenditure overruns. Such expenditure overruns, over the past few years, occurred due to unanticipated external factors and more commonly to previously contracted expenditure, or carryovers, and cash commitment expenditure in the form of treasury advances. In 1997, the bulk of overruns were due to:

- A drawn down of L.L.1,850 billion in public sector deposits at the Treasury and carryovers.

- Larger than anticipated interest payments which exceeded the budgeted amount by L.L. 685 billion largely due to the unforeseen sterilization effort and swap operations. In fact, The interest payment projections in the 1997 Budget assumed a draw down of cash balances which only took effect in the third quarter of the year.

- Additional appropriations for the Ministry of Health (L.L. 76 billion) and for the wage and salary increase of school teachers (L.L. 180 billion)

According to BDL data, the fiscal outcome for 1997 is as follows:

(in billion L.L.)

Total Expenditure	9,162 *
Total Revenue	3,753
Budget deficit	5,409
Deficit/expenditure	59%
Deficit/GDP	23.5%

** Not all 1997 Budget appropriations were fully spent.*

Given the fiscal deviations that occurred in 1996 and 1997, the Government remains committed to ameliorate the debt dynamics and allow for a soft landing of the economy over the medium term. To this effect, the Government is proposing for 1998 a strict, and more importantly, a realistic budget which entails a front loaded fiscal adjustment. In fact, the 1998 Budget law directly aims to rectify the deviations that took place in 1996 and 1997.

The 1998 Budget Law

The expenditure side of the 1998 Budget law continues to be dominated by non-discretionary spending, mainly interest payments, wages and salaries, and direct and

indirect social transfers. Discretionary spending, in line with previous budgets has been kept at a minimum. What distinguishes the 1998 Budget law, however, is that non-budget treasury expenditures amounting to L.L 600 billion., have been included in the presentation for the first time to ensure that actual expenditure are in line with Budget projections.

Furthermore, the Budget Law includes a provision to cancel most of uncommitted carryovers for the year 1995 and prior. This provision would significantly reduce existing spending capacity, thereby reducing the potential for carryovers in 1998 and beyond. Also, to further curb the potential for expenditure overruns, the Government has reaffirmed its determination not to incur any expenditure from outside the budget and not to undertake any additional expenditure without additional, appropriate and proportional revenue increases.

The expenditure side of the 1998 Budget consists of the following components (in billion L.L.)

<u>Total Budget Expenditure</u>	7,320
Wages and Salaries.....	2,480
Interest Payments.....	3,200
Social Expenditures.....	563
Other Current.....	380
Capital Expenditures (including capital transfers).....	697
<u>Non Budget Treasury Expenditures</u> :.....	600
Carryover.....	400
Municipalities.....	200
-	
<u>Total Estimated Treasury Expenditures</u>	7920

Given the constraints on the expenditure side of the Budget, any serious deficit reduction procedure must emanate from the revenue side. Indeed the current Budget law entails a revenue enhancement package, that if adhered to, would cover major grounds in the fiscal consolidation path. The 1998 Budget law projects total revenue to amount to L.L. 4600 billion broken down as follows:

Table 3-1 Revenue Classification of Budget 1998

(L.L. billion)		
CODE	REVENUES	1998 (P)
11	Tax on income, profits and capital gains	440
12	Tax on property	410
13	Domestic taxes on goods and services	298
14	Taxes on international trade and transactions	2,190
15	Other taxes	230
	TOTAL TAX REVENUES	3,566
26	Income from public enterprises	554
27	Administrative fees and charges, non-industrial and incidental sales	408
28	Fines and confiscations	11
29	Other non-tax revenues	63
	TOTAL NON-TAX REVENUES	1,034
	GRAND TOTAL	4,600

More specifically, the 1998 Budget law builds on the revenue measures taken in August 1997 which consisted of an increase in the price per minute of the use of cellular phones, customs duties on automobiles and taxes on tobacco as well as a 2% increase on virtually all imports with the exception of petroleum products, bank notes, gold, airplanes and large ships (effective October 5, 1997) and proposes the following additional measures:

1. 5% Service tax on Hotels and Restaurants.
2. Simplification and increase in Road Use tax.
3. Increase in the yearly tax on private cargo trucks.
4. 50% increase on foreign workers' residence permits.

5. Increase of passport issuance fee by 150%.
6. Increase of cement tax and import duties from L.L. 6,000 per ton to L.L. 13,000 per ton.
7. Introduction of a title deed renewal fee of L.L. 50,000 per deed.

These measures reflect the intention to broaden the tax base and establish the necessary building blocks for the introduction of a general sales tax (GST) - the 2% import fee and the 5% of services tax. The measures also build on the progress in strengthening the tax administration through the taxpayer survey, the recruitment of additional tax auditors, and the reorganization of the Revenue Department. Indeed, the Ministry of Finance has been authorized to recruit 300 tax auditors on contract basis and to reorganize the Revenue Department and implement a taxpayer survey, which should enhance revenue collection significantly.

In this regard, 1997 saw the introduction of the customs computerized system NAJM to the Beirut Port. This integrated computer-based system will provide the data required for processing import and export declarations. In 1998, NAJM will be installed at the other ports and land entry locations, as well as the Beirut Airport. Given the early positive results following the introduction of NAJM to the Beirut Port, the eventual adoption of this system by other ports of entry promises to markedly enhance the efficiency of both customs services and revenues.

Moreover, revenues are set to increase further due to the ongoing reform effort at the Directorate of Land Registry and Cadastre. Indeed, reforms will completely overhaul the outdated system and work processes by creating electronic (digital) information and technology infrastructure that will support the effective and efficient management of real property records. Also, the Title Registers are being computerized and a geographic information system (GIS) will be developed. Indeed, both the ongoing modernization effort at the Ministry of Finance and the revenue measures proposed in the 1998 Budget promise to enhance future revenues.

At this point, it is important to mention that the guiding principle behind the proposed tax policy package (mentioned on p. 26) paid due regard to first, the revenue productivity of the proposed measures, second, the administrative feasibility, third, to its consistency with the planned outcome of tax reform. Indeed, the most potent and promising short-term measures emphasize increases in the rates of indirect taxes

specifically broad based sales taxes and excises. This is especially relevant for Lebanon, as the bulk of wealth is foreign based and can best be captured through indirect taxes.

In the long-run, a crucial attribute of a tax system is its ability to generate revenue increases, at least in line with growth in nominal income, without repeatedly altering tax rates or introducing new taxes. This is fundamental to financing government spending without resorting to inflationary financing.

The following statistics show the evolution of the percentage of income tax to revenues during the years preceding the Lebanese war which were characterized by economic prosperity, a sound Lebanese administration and high income tax rates. The steadily progression of this percentage between 1995 and 1997, as a result of the implementation of the new tax system, indicates the potential for further growth, especially with the amelioration of the assessment and collection procedures.

Table 3-2 The Percentage of Income Tax to Revenues

Year	1971	1972	1973	1974	1995	1996	1997
Percentage	7%	6%	6%	7%	6%	7%	10%

The 1998 Budget law projects total revenue to amount to L.L. 4,600 billion which represents almost a 12% increase over the 1997 Budget law and a 23% increase over actual revenues in 1997. In fact, this year's Budget law will potentially reduce the Deficit/GDP ratio by 10 percentage points. This is a significant front loaded adjustment, especially when compared to other countries. Indeed, there are very few examples of countries that have been able to successfully undertake a one year adjustment of this magnitude, via a decline in the non-interest segment of the budget and not via debt relief.

In essence, the most important aspect of this years proposal is the broad consensus in the Lebanese body politic to actualize the Budget and to realize a deficit/expenditure ratio of 42%. Indeed, this is a significant development which bodes well for the successful implementation of the Budget and an eventual soft landing of the economy in the medium term.

CHAPTER IV

BUDGET STRUCTURE ANALYSIS

Table 4-1. 1998 Budget as compared to 1997 Budget

	1997	1998	1998 Budget Law including non budget treasury expenditure
<i>in billion LL</i>			
Total Expenditure (a+b)	6433	7320	7920
<i>a. Current Expenditures</i>	5824	6766	
-Interest Expenditures	2700	3200	
<i>b. Capital Expenditures</i>	608	554	
Total Revenues	4100	4600	4600
Total Deficit	2333	2720	3320
Deficit to Expenditures ratios	36.26%	37.00%	42.00%
Primary Surplus	367	480	

For the first time, non budget treasury expenditure estimated at 600 billion Lebanese pounds were included in the presentation of the 1998 budget law in order to ensure that actual expenditure are in line with budget projections. Non budget treasury expenditures include the following:

Table 4-2. Projected Non Budget Treasury Expenditure for 1998

<i>in billion LL</i>	Non-Budget Treasury Expenditure
Carryovers	400
Municipalities	200
Total	600

Accordingly, total budget and treasury expenditure estimated for 1998 amount to 7,920 billion Lebanese pounds which brings the overall deficit to 42.00 %-a ratio which the Government is committed to.

The 1998 budget law projects that revenues will approximately reach LL 4,600 billion. This represents an increase of LL 500 billion over budgeted revenues for 1997. This increase is based on the proposed revenue measures which are discussed, fully, in Chapter 3.

Due to the introduction of the new nomenclature, it is now possible to classify revenues and receipts by source and category. Revenues can now be divided into three main categories capital revenue, tax revenues and non tax revenues. Their projected levels for 1998 are:

Table 4-3. Breakdown of Total Revenues

<i>In Million LL</i>	1997 Budget Law	1998 Budget Law
Total Tax Revenues	3,152	3,566
Total Non-Tax Revenues	708	1,034
Total Capital Revenue (including repayment of treasury advances)	240	0
Total	4,100	4,600

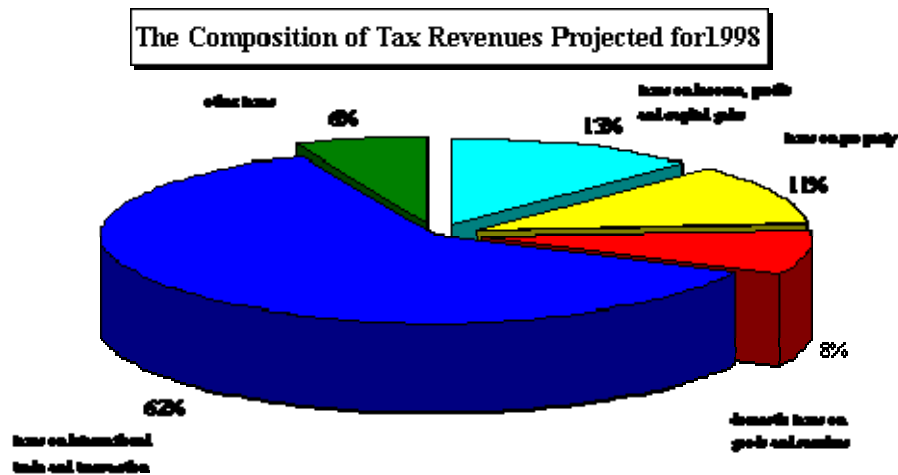
a) Tax revenues

Tax revenues are broken down into:

Table 4-4. Breakdown of Tax Revenues

<i>In Billion LL</i>	1997 Budget Law	1998 Budget Law
Tax on income, profits and capital gains	375	440
Tax on property	405	410
Domestic taxes on goods and services	292	296
Taxes on international trade and transactions	1,800	2,190
Other taxes	280	230
Total	3,152	3,566

Chart 4-1.



b) Non-Tax Revenues

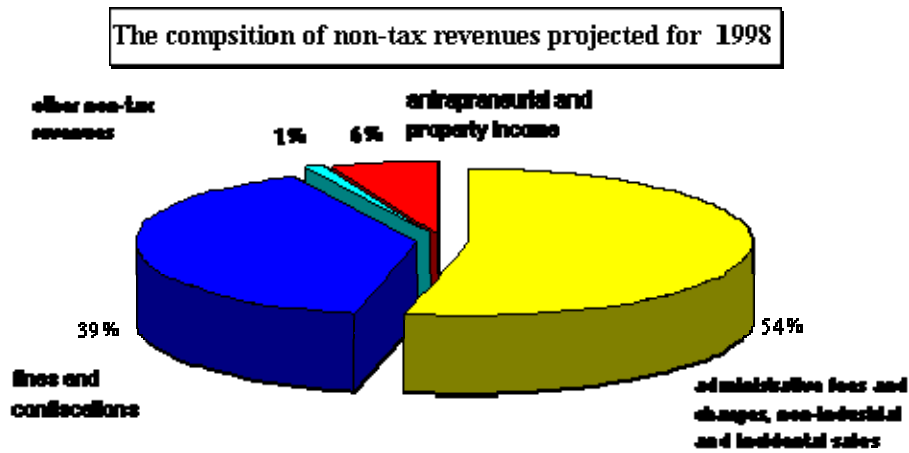
Non tax revenues are broken down into:

Table 4-5. Breakdown of Non-Tax Revenues

In Billion L.L.	1997 Budget Law	1998 Budget Law
Income from Public Enterprises	154	554
Administrative fees and charges	250	406
Fines and confiscations	20	11
Other non-tax revenue	285	63
Total	708	1,034

Projected revenues from fines and confiscations and other non-tax revenues, have been reduced in the 1998 budget to L.L. 11 billion and L.L. 63 billion respectively because actual figures for 1997 fell short of the level projected in the 1997 Budget Law of L.L. 20 billion and L.L. 285 billion respectively.

Chart 4-2.



c) Capital revenues

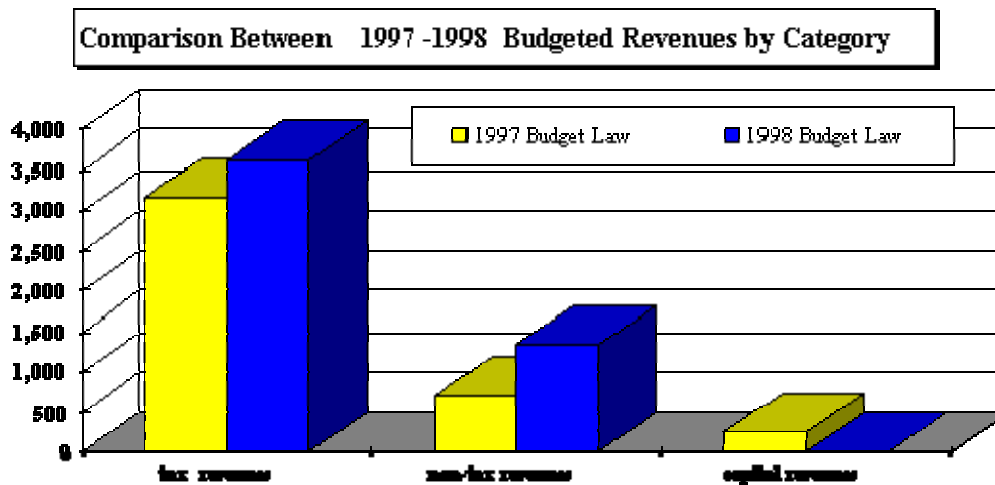
This year, revenues from sales of fixed capital assets are not foreseen in the 1998 budget. This is mainly due to the fact that the Ministry of Post and Telecommunications has repaid all treasury advances and is now financing the treasury from the surplus of its budget.

Table 4-6. Breakdown of Capital Revenues

-

<i>in Billion LL</i>	1997 Budget Law	1998 Budget Law
Sales of fixed capital assets	15	0
Repayment of financial assets and advances	225	0
Total	240	0

Chart 4-3.



2. Expenditures

a) Administrative classification

In preparing the 1998 budget, the Government exerted a great effort to rationalize and limit expenditures in order to meet the targets set for the 1998 budget. Therefore, since debt service expenditures are expected to increase by L.L. 500 billion, all outlays, other than wages and salaries, have been reduced to a minimum. The figures of recent budgets as well as the current budget, indicate the extent to which the public finance position and structure have been influenced by the previous events. Fixed expenditure items such as interest payments, wages and salaries and direct and indirect social contributions continue to dominate the expenditure side of the budget. This leaves the Government little room for maneuver.

Table 4-7. Part I and Part II Expenditure figures for the 1997 and 1998 Budget Laws:

(in billion LL)

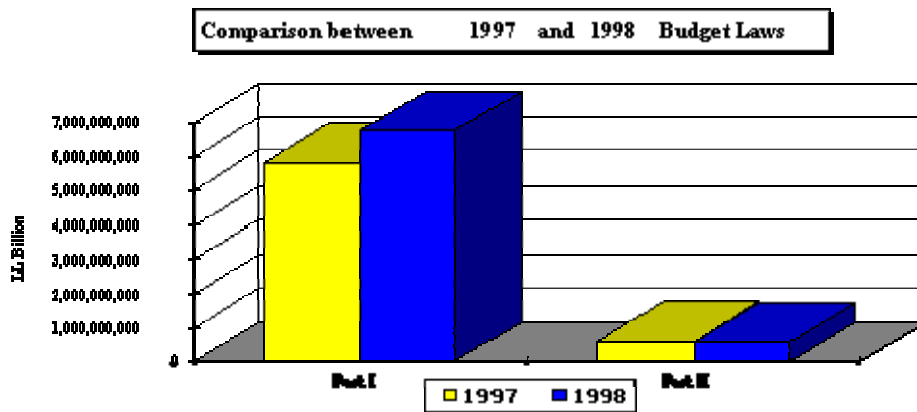
Year	Part I	Part II	Total
1997	5,824,807,857	808,082,143	6,433,000,000
1998	6,788,257,739	553,742,261*	7,320,000,000
percentage increase	16.18%	-8.91%	13.78%

*Investment expenditures amounting to L.L. 697 billion include investment transfers which represent local counterpart funds for investment projects financed by foreign loans.

These transfers which amount to L.L. 143 billion are in Part I of the 1998 budget. Accordingly, total investment expenditures estimated for 1998 are as follows:

total of Part II		L.L. 554billion
	+	
total investment transfers		<u>L.L. 143 billion</u>
		L.L. <u>697</u> billion

Chart 4-4.



The 1998 budget is subdivided between Parts I and II as follows:

Table 4-8. Expenditures for 1998 Distributed by Titles

(000 LL)

Section	1997 Budget Law	1998 Budget Law (Est.)	1998 Budget Law (Est.)	Total Expenditure (Est.)
1 Presidency of the Republic	2,732,000	2,703,700	375,000	2,670,700
2 Parliament	39,166,000	31,852,000	3,320,000	34,950,000
3 Presidency of Council of Ministers	408,757,532	355,873,504	716,844,894	477,676,622
4 Ministry of Justice	31,317,079	28,794,459	5,350,618	33,927,877
5 Ministry of Foreign Affairs	79,426,954	75,791,250	10,434,000	86,225,250
6 Ministry of the Interior	349,205,942	324,350,928	14,365,030	338,525,350
7 Ministry of Finance	43,972,110	39,288,699	7,894,699	41,225,390
8 Ministry of National Defence	738,131,940	712,422,793	97,547,725	749,970,506
9 Ministry of Education & Fine Arts	387,883,500	446,884,350	8,525,000	455,399,350
10 Ministry of Public Health	159,046,029	252,943,387	8,394,215	261,279,802
11 Ministry of Labour	3,795,413	4,330,452	55,370	4,385,822
12 Ministry of Information	22,196,607	25,350,540	583,500	25,884,040
13 Ministry of Public Works	145,658,952	15,351,712	109,410,750	124,762,462
14 Ministry of Agriculture	47,449,663	35,444,367	7,894,398	37,300,765
15 Ministry of Economy & Trade	4,648,501	3,977,292	6,094,913	10,072,205
16 Ministry of Post & Telecommunications	15,858,274	71,304,125	7,544,400	12,872,723
17 Constitutional Council	1,200,100	1,584,140	5,600	1,591,700
18 Ministry of Hydraulic & Electric Resources	143,358,290	6,407,583	82,077,400	88,514,993
19 Ministry of Tourism	13,084,210	6,806,407	3,563,000	10,369,407
20 Ministry of Oil	691,498	444,875	34,754	392,825
21 Ministry of Housing & Cooperatives	3,740,500	53,138,044	617,725	53,664,191
22 Ministry of Displaced Affairs	7,277,900	8,540,870	284,375	8,822,445
23 Ministry of Municipal & Rural Affairs	549,804	714,485	262,000	976,635
24 Ministry of Vocational & Technical Training	39,903,700	28,940,928	5,723,000	32,670,928
25 Ministry of Social Affairs	94,513,075	94,394,520	207,000	94,382,320
26 Ministry of Emigrant Affairs	6,743,776	5,589,200	140,000	5,739,200
27 Ministry of Transportation	90,633,300	28,079,505	75,348,425	101,447,920
28 Ministry of Culture & Higher Education	153,847,917	139,421,842	55,795,875	195,357,737
29 Ministry of the Environment	5,540,089	2,489,700	2,759,250	5,238,950
30 Ministry of Industry	1,386,000	2,970,500	120,000	2,794,500
31 Debt Servicing	2,700,000,000	3,200,000,000	0	3,200,000,000
32 Budget Reserve	690,675,336	828,247,852		828,247,852
TOTAL (LBP)		6,706,307,930	883,541,302	7,320,000,000

NB. In addition to total budget expenditure of LL 7320 billion, total non-budget expenditure are estimated at LL 600 billion. This will bring total budget and treasury expenditure, in 1998, to LL 7920 billion.

Table 4-9. Analytical table for the 1998 Budget Law

in billion LL	1997 Budget Law	1998 Budget Law
Current Expenditure	5689	6543
Total Wages, Salaries and Benefits	2261	2480
Debt Service	2700	3200
Displaced Fund	64	
Council of the South	64	64
Social Service Institution	98	91
Center for Education	16	25
Administrative Expenditures (Goods & Services)	247	230
Hospitalization Expenses	96	225
Interest subsidy on financial loans and the grains & sugar beets office (does not include tobacco subsidy)	39	39
EDL subsidy		100
Public Housing Institution		50
Other current expenditure	104	39
Capital Expenditure	658	697
Construction in Progress	432	394
Equipment	79	64
Maintenance	69	62
Investment transfers which represent local counterpart funds for investment projects financed by foreign loans	50	143
Other capital expenditure	28	34
Budget Reserves	86	80
Total Budget Expenditure	6433	7320
Carryovers		400
Municipalities		200
Total Budget and Treasury Expenditure	6433	7920

Annex Budgets:

As for Annex Budgets, the expenditure figures of 1998 compared with those of 1997 total are:

Table 4-10. Expenditure Figures of the 1997 and 1998 Annex Budgets

<i>in million LL</i>	1996	1997
Telecommunications	475,000	66,000
National lottery	62,160	177,000
Grains and sugar beet office	96,018	527,000
Total	633,178	770,000

-

The main chapters of the 1998 budget are detailed as follows:

1. Debt Servicing

The debt servicing for 1998 is estimated at L.L. 3,200 billion, which represents 44 percent of budget expenditure and is composed of two components:

- Interest on treasury bills amounting to L.L. 2,900 billion.
- Interest on external debt amounting to L.L. 300 billion.

It should be emphasized that the debt service estimate was based on the assumption that interest rates are to remain stable and will tend to decrease during the course of 1998.

-

2. Budgetary Reserves

Total budgetary reserves are estimated at L.L. 828 billion, of which the most important are:

- L.L. 7 billion towards filling job vacancies
- L.L. 520 billion for pensions and end of service indemnity
- L.L. 5.6 billion for judicial arbitration and amicable settlements
- L.L. 15.3 billion for the National Institution for Deposit Insurance
- L.L. 60 billion allocated to social security payments
-

It is important to note that the 1998 budget does not include in the chapter of Reserves any provisions for the introduction of new salary scales or costs of living adjustments. Should the need arise, new additional sources of revenue, compatible in their amount and nature to any new expenditure, will have to be raised to cover the proposed increase in expenditures.

3. Presidency of the Council of Ministers

The most important expenditure items in this category are:

- L.L. 4 billion for the Central Fund for the Displaced
- L.L. 149.8 billion to the Council for Development and Reconstruction
- L.L. 64 billion to the Council of the South
- L.L. 0.65 billion to the Institution for Consumption Cooperatives
- L.L. 1.5 billion for the Investment and Development Authority of Lebanon (IDAL)
- L.L. 4.5 billion to the National Council for Scientific Research
- L.L. 1.85 billion for Administrative Reform

It should be noted that the expenditure item of L.L. 149.8 billion to the Council for Development and Reconstruction under the chapter of the Presidency of the Council of Ministers is composed of two categories, administrative budget totaling L.L. 6.8 billion and investment transfers which represent local counterpart funds for investment projects financed by foreign loans amounting to L.L. 143 billion. These investment projects are financed by concessional foreign loans and are listed in the following table:

Table 4-11. Investment Projects

Projects	Foreign Financing	Counterpart Funds
Basic Infrastructure	49,492,889	5,497,140
Electricity	4,830,000	0
Post & Telecommunications	9,954,000	0
Roads & Highways	34,648,889	5,497,140
Social Infrastructure	116,671,189	27,306,200
Education Youth & Sports	4,761,500	3,106,000
Vocational & Technical Training	16,747,000	8,272,450
Culture & Higher Education	32,083,906	0
Public Health	62,278,783	15,427,750
Housing	800,000	500,000
Public Services	94,880,002	56,128,500
Water	65,793,483	25,373,500
Waste Water	14,661,519	27,205,000
Solid Waste	14,425,000	3,550,000
Productive Sectors	52,852,871	3,894,870
Agriculture	10,076,063	3,476,225
Irrigation	11,001,500	283,645
Private Sector Services	50,000	75,000
Airport	31,725,308	0*
Public Administration	23,689,858	2,968,363
Government Buildings	23,689,858	781,615
Management & Implementation	0	2,186,748
Grand Total	337,526,809	95,735,073

* Counterpart funds for the airport are within the budget of the Ministry of Transportation.

4. Expenditure Allocations for Large Ministries

Most Ministries have large carryovers from previous budgets for investment expenditures and do not require additional appropriations to fulfill their responsibilities. Non-fixed recurrent expenditures in Part I of the budget have been cut substantially, also in line with the Government's attempt to rationalize expenditures. In addition, the appropriations of some Ministries have been cut such as the Ministry of Hydraulic and Electric Resources and the Ministry of Public Works.

It should be noted that the Government allocated L.L. 100 billion to the EDL.

As for the ministries which are responsible for social services such as the Ministry of Health, the Ministry of Housing and Cooperatives, the Ministry of Education and Fine Arts and the Ministry of Culture and Higher Education, their appropriations have been increased to enable them to undertake their responsibilities and execute their projects more efficiently.

The table below shows the expenditure allocations for large ministries:

Table 4-12. Expenditure Allocations for Large Ministries

	Titles (LL million)	1997 Budget Law	1998 Budget Proposal	% of Total Budget (Excluding Debt Servicing)
MND	Ministry of National Defense	736,132	749,971	18%
PCM	Presidency of Council of Ministries	408,757	472,676	11%
MEFA	Ministry of Education & Fine Arts	387,883	455,600	11%
MI	Ministry of the Interior	349,206	338,525	8%
MPW	Ministry of Public Works	145,659	124,742	3%
MHER	Ministry of Hydraulic & Electric Resources	143,358	88,515	2%
MPH	Ministry of Public Health	158,646	261,280	6%
MHC	Ministry of Housing & Cooperatives	3,741	53,556	1%
MFA	Ministry of Foreign Affairs	79,427	86,225	2%
MCHE	Ministry of Culture & Higher Education	153,848	195,358	4%
OT	Other Titles	472,668	465,304	12%
BR	Budget Reserves	680,675	828,248	20%
	Total	3,733,000	4,130,000	100%

The table below shows that total expenditures allocated to Social Affairs in 1998 increased by almost seven-folds when compared to 1992. In addition, expenditures on social issues (Health, Education, Vocational and Technical Training and Higher Education) in 1998 increased by approximately three-folds when compared to 1992. Indeed, social expenditure figures in 1992 in comparison with 1998 figures depict that these expenditures increased progressively thereby highlighting the policy of the Government regarding social sectors.

Table 4-13. Comparative Table Between 1992 and 1998 Figures on Social Expenditures

Affairs(in billion LL)	1992	1998
Health Affairs	89	270
Educational Affairs *	207	470
Vocational and Technical Training Affairs *	-	33
Higher Education Affairs *	-	187
Social Affairs	14	94

*** total spending on educational affairs, vocational and technical training affairs and higher education affairs totaling LL 690 billion in 1998 should be compared with spending on educational affairs in 1992 totaling LL 207 billion.

Furthermore, it is worth mentioning that concessional loan agreements amounting to USD 767 million, of which USD 680 million are earmarked for social affairs, are in Parliament for ratification. Also, the Council for Development and Reconstruction is currently negotiating projects with a total cost of USD 666 million of which USD 420 million for social affairs projects.

Chart 4-5.

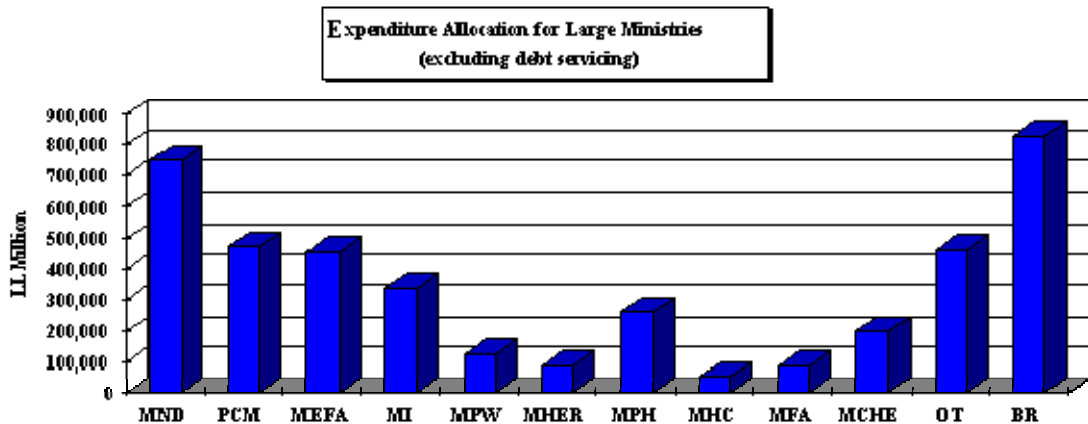
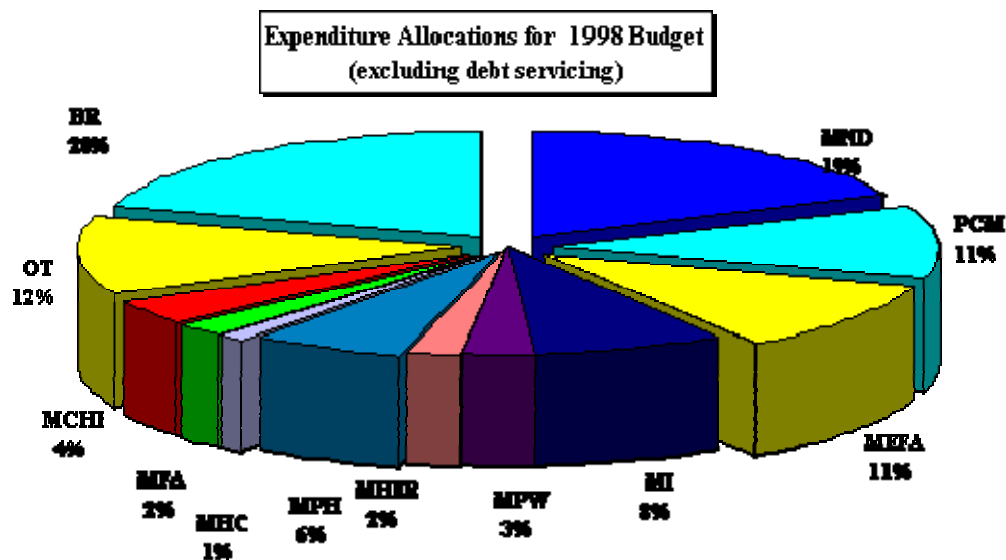


Chart 4-6.



The above mentioned total expenditures including non budget treasury expenditure exceeded total revenues by L.L. 3320 billion rendering the need to increase domestic borrowing by the full amount of this budget deficit. Here, it is important to recall from the previous sections that the Government is attempting to enhance its collection of revenues through the reform programs in the entire Ministry of Finance, including Customs, Land Registration and Internal Revenues.

B. Economic Classification

The economic classification of the budget which indicates the expenditure items by type is presented below.

Table 4-14. Economic Classification of the 1998 Budget Law:

Code	TOTAL EXPENDITURES	1998 (in 000 LL)
11	Materials and Supplies	138,909,218

12	External Services	93,668,077
13	Salaries and Wages	1,648,510,625
14	Subsidies and Transfers *	1,184,284,756
16	Other Expenses	221,280,211
17	Interest Payments and Financial Charges	3,200,000,000
18	Unallocated General Reserves	279,604,852
	TOTAL CURRENT EXPENDITURES	6,766,257,739
221	Acquisitions of Land	1,725,000
222	Acquisition of Buildings	2,135,000
223	Acquisition for the Construction of Roads, Ports and Airports	1,890,000
224	Acquisitions for the Construction of Water Networks	3,090,000
225	Acquisitions for the Construction of Electricity Networks	20,000
226	Equipment	64,401,323
227	Construction in Progress	393,940,025
228	Maintenance	62,349,713
229	Other Expenditures Related To Fixed Capital Assets	24,191,200
	TOTAL CAPITAL EXPENDITURES *	553,742,261
	GRAND TOTAL	7,320,000,000

* The Grand Total of Salaries, Wages, and Benefits amounts to LL 2480 billion as it includes in addition to the item of wages and salaries, 60 billion from Reserves for Social Security Contributions and 771 billion from the item of Subsidies and Transfers for end of service indemnities.

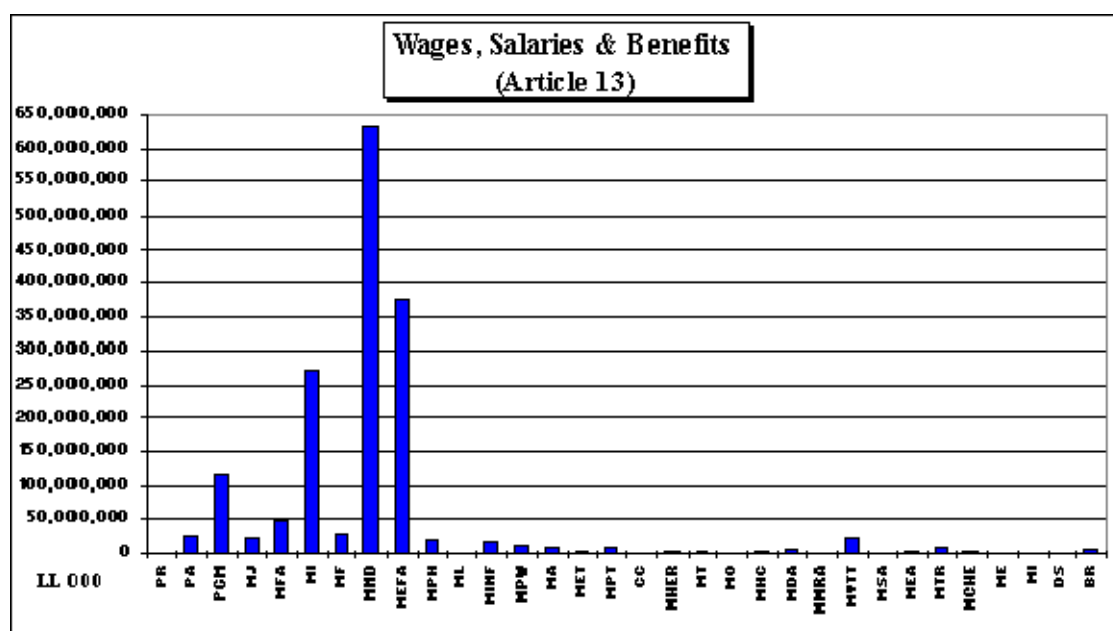
** Total Capital Expenditures with its share from Transfers and Subsidies amount to LL 697 billion.

The economic classification clearly demonstrates how each Ministry allocates its expenditures, which helps in identifying expenditure behavior and patterns. As an example, the total sum of wages and salaries for all ministries amounts to LL 1,649 billion. This figure, however, underestimates the total wages and salaries bill; since transfer payments that equal LL 1,184 billion, include LL 831 billion in wage and salary supplements (771+60). Including the LL 831 billion, total wage and salary and other benefits payments amount to LL 2,480 billion, which represent 34 percent of budget expenditure.

Table 4-15. Wages, Salaries and Benefits, Grand Total

In Millions LL	1998 Budget Law
1. Transfers and Subsidies (Article 14)	1,184
2. Share of Wages, Salaries and Benefits out of Article 14	771
3. Reserves for Social Security Contributions	60
4. Wages, Salaries and Benefits according to Article 13	1,649
Wages, Salaries and Benefits, Grand Total (2+3+4)	2,480

Chart 4-7.



C. Functional Classification

The functional classification highlights sectoral expenditures and accordingly, shows the shares of General Government Services, Community and Social Services and Economic Services out of total expenditures. The General Governmental Services, including debt servicing, represents 19.5 percent of total expenditure and is composed of: General Public Services, Defense Affairs and Services and Public Order and Security Affairs, of which Defense Affairs and Services alone represents 11.31 percent.

Community and Social Services comprise approximately 20 percent of total expenditure, of which the most important components are: Education Affairs and Services (8.96 percent), Health Affairs and Services (3.57 percent), Social and Welfare Affairs and Services (4.54 percent), Housing and Community Amenity Affairs and Services (2.27 percent).

Economic Services take up approximately 5 percent of total expenditure, and its major components are Transportation and Communication Affairs and Services, as well as Other Economic Affairs and Services. The latter category includes among others: Tourism, Hotel and Restaurant Affairs and Services and General Labor Affairs and Services.

Table 4-16. Functional Classification:

(000 LL)

Code	FUNCTION	1997 Budget Law	1998 Budget Law	% OF TOTAL 98
1	General Governmental Services	1,426,196,428	1,427,471,859	22.17%
11	General Public Services	286,783,743	283,672,166	3.90%
12	Defense Affairs and Services	818,479,492	827,576,046	11.31%
13	Public Order and Safety Affairs	320,931,191	314,223,647	4.29%
2	Community and Social Services	1,181,667,697	1,470,871,368	20.09%
21	Education Affairs and Services	540,917,200	655,944,970	8.96%
22	Health Affairs and Services	139,646,029	261,279,803	3.57%
23	Social and Welfare Affairs and Services	253,934,794	332,305,831	4.54%
24	Housing and Community Amenity Affairs and Services	164,574,651	166,387,735	2.27%
25	Recreational and Cultural Affairs and Services	60,724,024	53,202,042	0.73%
26	Religious Affairs and Services	1,870,999	1,730,987	0.02%
3	Economic Services	434,460,539	393,408,919	5.37%
31	Agriculture Affairs and Services	48,449,663	38,000,705	0.52%
32	Manufacturing, Fuel and Energy Affairs and Services	2,627,498	4,244,100	0.06%
33	Transportation and Communication Affairs and Services	236,833,234	216,396,281	2.96%
34	Other Economic Affairs and Services	146,528,124	134,767,833	1.84%
4	Multi-Functional Expenditures	3,390,675,336	4,028,247,852	55.03%
41	Public Debt Transactions	2,200,000,000	3,200,000,000	43.72%
42	Non-Classified Budgetary Expenditures	470,000,000	532,600,000	7.28%
43	Reserves	220,675,336	295,647,852	4.04%
	TOTAL	6,433,000,000	7,320,000,000	100.00%

Chart 4-13.

Functional Classification

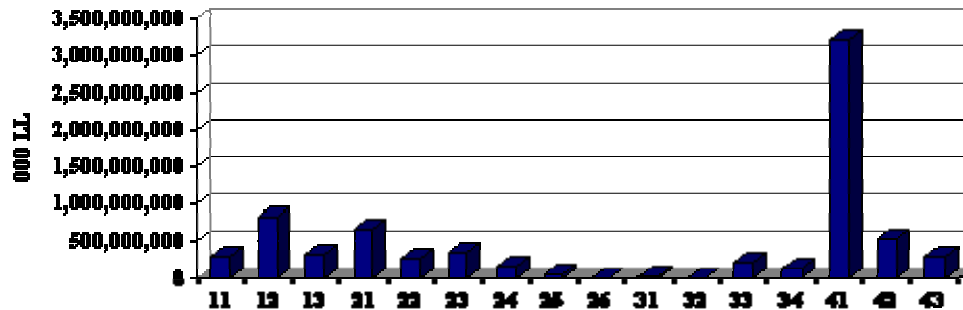
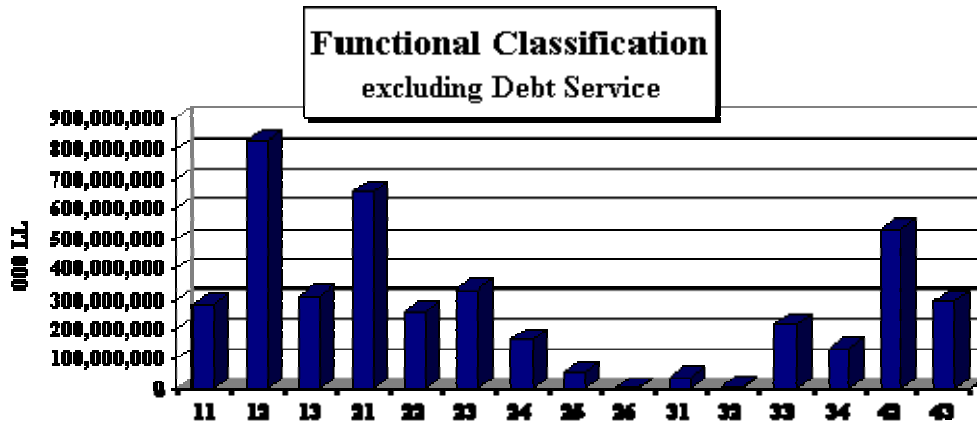


Table 4-17. Functional Classification excluding Debt Service:

FUNCTION	1998 Budget	% OF TOTAL 98
General Governmental Services	1,427,471,859	34.65%
General Public Services	285,672,166	6.93%
Defense Affairs and Services	827,576,046	20.09%
Public Order and Safety Affairs	314,223,647	7.63%
Community and Social Services	1,470,871,368	35.70%
Education Affairs and Services	655,944,970	15.92%
Health Affairs and Services	261,279,803	6.34%
Social and Welfare Affairs and Services	332,305,831	8.07%
Housing and Community Amenity Affairs and Services	166,387,735	4.04%
Recreational and Cultural Affairs and Services	53,202,042	1.29%
Religious Affairs and Services	1,750,987	0.04%
Economic Services	393,408,919	9.55%
Agriculture Affairs and Services	38,000,705	0.92%
Manufacturing, Fuel and Energy Affairs and Services	4,244,100	0.10%
Transportation and Communication Affairs and Services	216,396,281	5.25%
Other Economic Affairs and Services	134,767,833	3.27%
Multi-Functional Expenditures	828,247,852	20.10%
Non-Classified Budgetary Expenditures	532,600,000	12.93%
Reserves	295,647,852	7.18%
TOTAL	4,119,999,998	100.00 %

Chart 4-14.



CHAPTER V

PUBLIC EXTERNAL DEBT

In April 1997, a Public Debt Administration (PDA) was created within the Ministry of Finance. The central aim of this newly created body is to monitor and report the state of the Republic's foreign debt obligations. To do so, the PDA will rely on a computerized debt management system, maintained by the Banque du Liban, the Ministry of Finance and the Council for Development and Reconstruction.

The following observations are based on information available at December 31, 1997:

1. Total public external debt at December 31, 1997 reached USD 2351 million, which represents 15.6 percent of GDP. Lebanon, therefore, in 1997 maintained its low foreign debt exposure.
2. Table 5-1 shows the trend of external debt in USD between 1993 and 1997.
3. Charts 5-2 and 5-3 show the yearly debt service obligations and disbursements between 1993 and 1997.
4. Table 5-2 shows the maturity structure of the public external debt. This table demonstrates that the current external debt position is largely long term, with 94.4% of undisbursed loans being for ten years or longer.
5. Table 5-3 outlines the development of total public debt broken down by domestic and external debt.

The Ministry of Finance is actively seeking to restructure its debt obligations with a view towards extending the maturity and reducing the debt service on the outstanding debt stock. Indeed, the 1998 Budget included a provision that raised the external borrowing ceiling by USD 2 billion to be finally settled in no longer than thirty years. The MOF anticipates to gradually raise the funds over the medium term and to refinance short term high interest domestic debt with long term low interest external debt.

Table 5-1: Public External Debt 1993-1997

(US Dollars)

Year	Disbursement	Principal	Interest and commission	Total debt service	debt at year end
1993	224,483,599	41,382,449	22,157,446	63,539,895	427,094,503
1994	503,819,997	89,700,789	31,251,596	120,952,385	859,040,957
1995	544,964,427	108,278,509	80,901,474	189,179,983	1,322,786,529
1996	585,244,696	20,421,798	121,364,677	141,786,475	1,874,076,522
1997	455,232,747	29,419,355	135,743,133	165,162,487	2,351,125,917

* Amounts in USD, translated at end of period exchange rate.

Chart 5-1

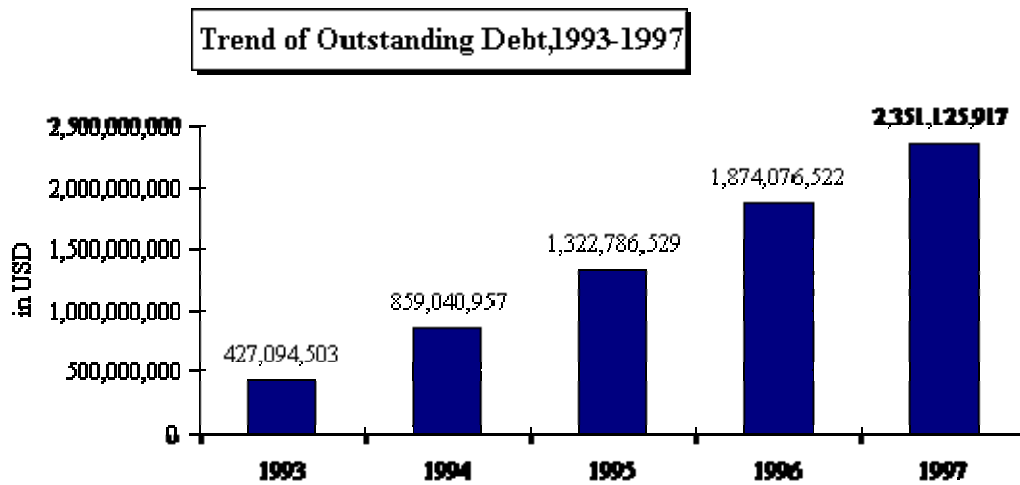


Chart 5-2

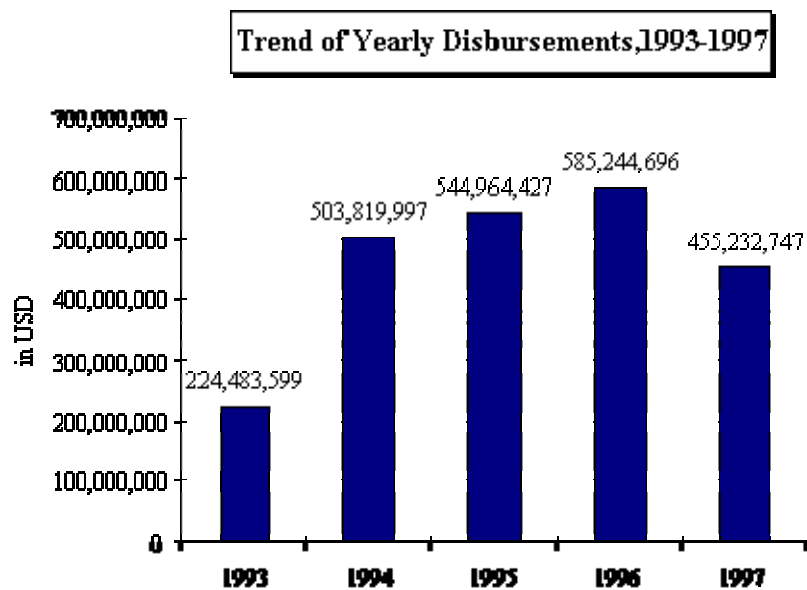


Table 5-2: Breakdown of public external debt by maturity

Year	% of signed loans	services	undisbursed loans
Less than 5 years	2.60%	4.26%	0.00%
5 to 10 years	16.31%	23.78%	5.29%
10 years	13.13%	21.38%	0.28%
10 years and above	67.96%	50.57%	94.44%
	100%	100%	100%

Chart 5-3

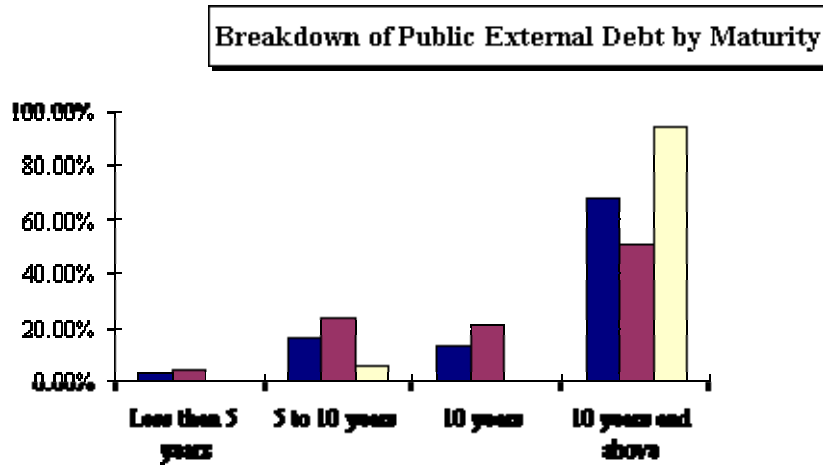
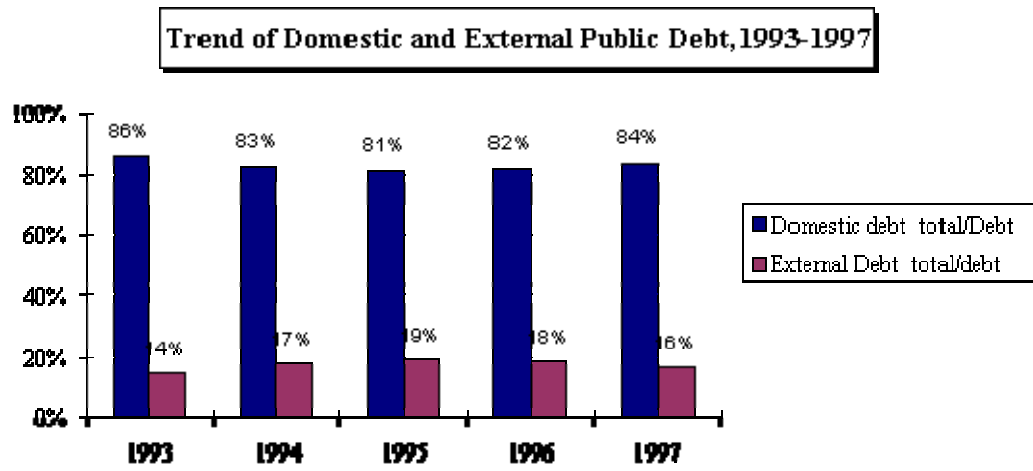


Table5-3: Trend of Domestic and External Debt 1993-1997

Year	Net domestic debt (bill L.L)	Net domestic debt (bill USD)	External debt (bill USD)	Domestic debt total/Debt	External Debt total/debt
1993	4,407	2,576	0.427	86%	14%
1994	6,712	4,075	0.859	83%	17%
1995	9,287	5,819	1.323	81%	19%
1996	13,358	8,607	1.874	82%	18%
1997	18,379	12,036	2.351	84%	16%

Chart 5-4



CHAPTER VI

CONCLUSION

As discussed in the previous sections, the fiscal developments over the past five years reflected the need to expand, dramatically, public expenditures in order to satisfy the growing demand for social services and public infrastructure. Despite the rapid growth of public revenues, large and persistent budget deficits have occurred thereby resulting in a significant build up in public debt.

The most important fiscal development to date, has been the emergence of a broad consensus regarding the importance of effectively addressing the persistent fiscal deficit. Naturally, this ambitious objective requires close cooperation between the Legislative and Executive branches of Government. Indeed, the deliberations of the Finance and Budget Committee illustrated, clearly, the strong commitment of both branches of Government to achieve an unambiguous turning point on the fiscal front in 1998.

The 1998 Budget Law aims precisely to achieve such a turning point through containing as much as feasible public expenditures as well as including recurrent treasury expenditure in the overall budget presentation. Moreover, the 1998 Budget Law, also proposes a sharp reduction in the existing spending capacity through the elimination of all non-committed appropriations carried over from the budget prior to 1995.

Most important, however, the 1998 Budget Law includes a comprehensive package of revenue measures that aims at raising revenue by more than 22% as compared to the revenues collected in 1997. These revenue measures coupled with the expenditure rationalization of the 1998 Budget represent a major step towards resolving the persistent fiscal problem. Consequently, it is crucial that this revenue package or a package of equivalent fiscal impact be ratified by Parliament in order to ensure that we achieve a turning point the public finances of Lebanon.

Naturally, fiscal consolidation in Lebanon is a medium-term task which requires dedication, persistence and sacrifice. To this end, the Government has approved the Reform package as proposed by the President of the Republic, the President of Parliament, the President of the Council of Ministers and endorsed by members of the parliament. This ambitious package, once fully implemented, would help contain

expenditures over the medium-term and thus contribute significantly, to fiscal consolidation beyond 1998. The most significant aspect of the Reform Package is that it begins, to address the basic structural rigidities in the budget inter-alia the size of government, compensation to civil servants including retirement benefits, and a restructuring of domestic debt. If these crucial issues are fully addressed, the Lebanese economy will be placed on an irreversible path to fiscal consolidation and economic growth.

The final component, that remains to be tackled effectively, in order to ensure permanent and sustained fiscal consolidation is the administrative capacity of the public sector to collect revenues. Over the medium and long term revenues must continue to grow significantly and the only way to achieve this without continuously raising taxes is to overhaul completely the agencies that collect revenues beginning with those belonging to the Ministry of Finance. Unless we can seriously resolve this crucial problem we will either face growing taxes or continuous budget deficits. Hence, it is imperative that the existing spirit of cooperation between Parliament and the Council of Ministers be channeled to resolve this outstanding problem.