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FISCAL, TRADE AND STRUCTURAL DEVELOPMENTS

- Fiscal overview: The total deficit in QI 2002 amounted to LL 942 billion, or 43.5 percent of total expenditure compared to LL 637 billion, or 35.9 percent of total expenditure during the comparable period in 2001. The primary surplus in QI 2002 amounted to LL 22 billion compared to LL 288 billion during QI 2001 (refer to section 1).
- Revenue and expenditure: Total revenue in QI 2002 amounted to LL 1,224 billion compared to LL 1,136 billion in QI 2001. Total expenditure summed up to LL 2,166 billion during QI 2002 compared to LL 1,773 billion in QI 2001. Customs revenue accounted for 32 percent of total revenue, whereas on the expenditure front, debt service expenditure represented approximately 45 percent of total expenditures (refer to sections 2 and 3).
- Public debt: Gross debt increased by LL 1,205 billion or 2.8 percent during the year's first quarter, amounting to LL 43,900 billion at the end of QI 2002 (refer to section 4).
- Trade: Imports decreased by around 6 percent when compared to QI 2001, while exports increased by about 18 percent. The trade deficit therefore declined by 9 percent when compared to QI 2001 (refer to section 5).
- Developments on the VAT front: The VAT was initiated on February 1, 2002 and had generated LL 111 billion of revenue by the end of QI 2002 from customs alone (for two months). Currently, 7,923 taxpayers are registered in the VAT (refer to section 6).
- Budget circular for 2003: In preparation for 2003 budget, the Ministry of Finance issued the 2003 budget circular calling on ministries to limit spending requests to the strict minimum (refer to section 7).
- Revenue enhancement projects such as the Deduction at Source of income tax on Salaries (DASS) and the Global Income Tax are currently under development (refer to section 8).
- Privatization: The legislative framework for the privatization of various sectors is close to finalization. Parliament ratified the mobile phone privatization law on May 30, 2002 and set the deadline for the licensing process for August 31, 2002. In addition, EDL's new management announced a work plan for the company to improve billing and power supply (refer to section 9).
- Parliament ratified a law establishing a Special Account for managing, servicing and reducing public debt. Accordingly, the Ministry of Finance may engage in securitization transactions by creating SPVs that shall be financially separate from the government finances (refer to section 10).
- International and regional agreements: On the regional front, the Euro-Med agreement was initialed in January 2002 and will be signed on June 17, 2002. Moreover, Lebanon has launched the fifth stage of tariff dismantlement in the context of the Greater Arab Free Trade Area (GAFTA) entered into effect in 1998. Other agreements that were signed as part of the government's policy to promote foreign investment are agreements for the Promotion & Reciprocal Protection of Investment as well as Double Taxation Conventions (refer to section 11).
- Other structural and sector measures: In order to re-activate the real economy, the government extended subsidized loans to small and medium size enterprises and housing schemes (refer to section 12).

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Section 1. Fiscal overview

When compared to QI 2001, the **fiscal deficit** for **QI 2002** witnessed an increase from LL 637 billion to LL 942 billion mainly due to higher debt service payments, the timely ratification and implementation of 2002 budget law, the delay in the ratification of the 2001 budget law[1], and larger spending from previous years' appropriations.

A **primary surplus** of LL 22 billion was realized during QI 2002, compared to LL 288 billion during the same period of last year. The **total deficit** for the month of **March 2002** amounted to LL 331 billion compared to LL 375 billion in March 2001, due to lower debt service expenditure on one hand, and collection of VAT revenue amounting to more than LL 64 billion during the month on the other.

[1] The 2001 budget law was late to be ratified by Parliament on June 21, 2001 and hence spending in the first quarter of 2001 was irregular, contrary to spending of budget law 2002 which was ratified on February 4, 2002.

Table 1. Summary of Fiscal Performance

(LL billion)	2001 Mar[1]	2002 Mar	QI 2001	QI 2002	Change 2001-2002	% change
Budget revenue	314	389	1,064	1,123	59	5.6%
o/w customs revenue	*119*	*131*	*362*	*392*	*30*	*8.3%*
o/w Value Added Tax[2]	*0*	*64*	*0*	*111*	*111*	
Budget expenditures	639	564	1,522	1,636	114	7.5%
o/w Debt service	*274*	*217*	*925*	*964*	*39*	*4.2%*
Budget deficit/surplus	-325	-175	-458	-513	-54	-11.8%
in % of budget expenditures	-50.9%	-31.0%	-30.1%	-31.3%		
Budget primary deficit/surplus	-52	42	467	452	-15	-3.2%
in % of budget expenditures	-8.1%	7.4%	30.7%	27.7%		
Treasury receipts	24	25	72	101	29	40.3%
Treasury payments	73	181	251	530	280	111.6%
Total budget and treasury receipts	338	414	1,136	1,224	88	7.8%
Total budget and treasury payments	713	745	1,773	2,166	393	22.2%
Total cash deficit/surplus	-375	-331	-637	-942	-305	-47.8%
in % of total expenditures	-52.6%	-44.4%	-35.9%	-43.5%		
Primary deficit/surplus	-101	-114	288	22	-266	-92.4%
in % of total expenditures	-14.2%	-15.3%	16.2%	1.0%		

Source: Ministry of Finance (MOF), Directorate General of Finance (DGF)

Note: [1] *Revenue and expenditure figures for March 2001 have been modified from previously published data. Tax deductions are now included as revenue and added to expenditures as disbursement.*
[2] *Value Added Tax represents the VAT collected at customs.*

Section 2: Revenue outcome

Total revenue for QI 2002 amounted to LL 1,224 billion, compared to LL 1,136 billion for the same period of last year. The increase in total revenue amounted to LL 88 billion or around 8 percent. This increase in revenue was due to the rise in both budget revenue and treasury receipts.

During the first quarter of 2002, **budget revenue** amounted to LL 1,123 billion, i.e. LL 59 billion or around 6 percent more than budget revenue achieved during the first quarter of 2001. This increase was due to a rise in tax revenue that has more than offset the decline in non-tax revenue.

Tax revenue (as part of budget revenue) amounted to LL 793 billion during QI 2002, compared to LL 623 billion during the same period last year. This increase is attributable to a number of factors among which are the following:

A. Taxes on income, profits, and capital gains were equal to LL 122 billion, compared to LL 103 billion during QI 2001, an increase of approximately LL 19 billion, or 18 percent. The greater part of this revenue was collected in January, when income tax declarations on salaries and wages were due.

The increase in income tax revenue was also caused by two major reasons, namely (a) on-going proceeds that are still being collected through installments from large taxpayers that were audited in 2001, and (b) improved compliance by taxpayers following last year's audit operations.

As for the receipts from the tax regularization, which are included as part of "taxes on income, profits, and capital gains", they are still relatively low due to the extension of the deadline for application and receipt of the regularization's dues from March 24 to June 24, 2002[2].

The tax regularization law is also expected to allow the Revenue Directorate to further monitor current tax compliance and new tax avoidance and evasion.

B. Taxes on domestic goods and services[3] amounted to LL 161 billion during the first quarter of 2002, compared to LL 50 billion during the comparable period of last year. This increase is mainly attributed to VAT receipts in the amount of LL 111 billion collected at customs during the first two months of the VAT's implementation. In accordance with the law, VAT revenue for the first quarter (February and March for 2002) has only become comprehensive on April 18, 2002, since it is only at the end of each quarter that VAT will be collected from domestic sales points.

C. Although imports declined by approximately 7 percent in QI 2002 when compared to QI 2001, **taxes on international trade** increased by around 8 percent, amounting to LL 393 billion during QI 2002, compared to LL 363 billion during QI 2001. This increase was mainly due to the introduction of the VAT which was preceded by a high level of imports and hence high customs revenue in January 2002, in addition to the increase in excise revenue from the import of petroleum products caused by the gasoline tax hikes.

D. Other tax revenue during the first three months of 2002 amounted to LL 48 billion, indicating no growth when compared to the same period of last year. The deadline for the professional flat tax has been fixed for the end of September. Until then, the professional flat tax is not expected to yield its full amount.

[2] It is noteworthy that the tax regularization is valid for the operations of industrial, commercial, and non-commercial entities for the period 1992-1999 (inclusive) for all income tax files that have not yet been audited by the fiscal authorities. It also pertains to the income tax files for the years 1992-1994 that have already been audited but the amounts of which have not yet been settled.

[3] Excise taxes on gasoline, tobacco, alcoholic beverages, cement, and automobiles are collected at customs and hence are not included under taxes on domestic goods and services.

Table 2. Tax Revenue

(LL billion)	QI 2001	QI 2002	% change
Tax revenue[1]	**623**	**793**	27.3%
Tax on income, profits, & capital gains	103	122	18.4%
Tax on property	59	69	16.9%
Domestic taxes on goods & services	50	161	222%
Taxes on international trade[2]	363	393	8.3%
Other tax revenue	48	48	0%

Source: MOF, DGF

Note: [1] Tax revenue is included within budget revenue

[2] Revenue from excise taxes is included within the customs revenue figure.

Non-tax revenue (as part of budget revenue) amounted to LL 330 billion during QI 2002 compared to LL 441 billion during QI 2001. The main underlying reasons for the decline in non-tax revenue were the following:

Income from public institutions and government property amounted to LL 220 billion during the first quarter of 2002 evaluated against LL 306 billion in the comparable period of last year. The decrease in this item was due to lower transfers from the surplus of the Ministry of Post and Telecommunications, which amounted to LL 183 billion during QI 2002 compared to LL 260 billion during QI 2001. As mentioned in earlier reports, telecom receipts are not scheduled on a monthly basis, and hence failure to receive them during a particular month implies a postponement of the receipt. Lower revenue from lottery ticket sales, amounting to LL 2 billion, also contributed to the shortfall in income from public institutions and government property.

Administrative fees and charges witnessed a decrease of 22 percent in QI 2002 (from LL 110 billion to LL 86 billion) when compared to QI 2001, basically due to the decrease in road usage fees and cancellation of consular fees. The decrease in road usage fees is due to the delay in starting to collect these fees until the third week of February, following the ratification of the 2002 budget law in early February.

Table 3. Non-tax Revenue

(LL billion)	QI 2001	QI 2002	% change
Non-tax revenue[1]	**440**	**330**	**-25.0%**
Income from public institutions and government property	306	220	-28.1%
Administrative fees & charges	110	86	-21.8%
Penalties & confiscations	3	4	33.3%
Other non-tax revenue	21	20	-4.8%

Source: MOF, DGF

Note: [1] Non-tax revenue is included within budget revenue

Table 4. Income from Public Institutions and Government Property

(LL billion)	QI 2001	QI 2002
Income from Public Institutions and Government Property	**306**	**220**
Casino du Liban	6	5
National Lottery	9	2
Telecom	260	183
Central Bank	21	20

Source: MOF, DGF

Section 3: Expenditure outcome

Total expenditure (budget and treasury) for QI 2002 amounted to LL 2,166 billion compared to LL 1,773 billion during the comparable period in 2001.

Budget expenditure amounted to LL 1,636 billion during QI 2002 and was approximately LL 114 billion or 7.5 percent higher than expenditure during QI 2001. The increase in budget expenditures could be attributed to the following:

Compared to budget law 2001, the budget law for 2002 was ratified early on during the year, and hence spending during QI 2002 was executed according to the allocation of the budget. Spending during QI 2001 was executed irregularly due to the late ratification of budget law 2001.

Non-interest expenditure increased by LL 74 billion mainly due to the increase in **personnel cost** (composed of wages & salaries and related benefits, end-of-service, and retirement), which was higher than the outcome of QI 2001 due to larger end-of-service payments. The 25 percent increase in the retirement and end-of-service bill could be partly explained by the 6 percent increase in the number of retirees (please refer to Table 6).

Debt service expenditures during QI 2002 increased by LL 39 billion over the comparable period of 2001. This increase was mainly due to the increase in foreign debt service cost by LL 55 billion following the rise in the level of Eurobond issuances in 2001 (US$ 3.1 billion were issued in 2001). Domestic debt service, which had amounted to approximately LL 418 billion in January, decreased to LL 163 billion and LL 189 billion during the months of February and March 2002 respectively. Debt service expenditures for QI 2002 accounted for approximately 59 percent of budget expenditures, remaining close to the ratio achieved during QI 2001 (60.8 percent).

As for **treasury expenditure**, they amounted to LL 530 billion in QI 2002 compared to LL 251 billion in QI 2001, primarily due to LL 113 billion of increased spending from previous years' appropriations.

Table 5. Expenditures

(LL billion)	QI 2001	QI 2002	% change
Total expenditures	**1,773**	**2,166**	22.2%
Budget expenditures	1,522	1,636	7.5%
Expenditures excluding debt service	597	671	12.4%
Debt service	925	964	4.2%
Domestic debt	786	770	-1.9%
Foreign debt	139	194	39.1%
Treasury expenditures	251	530	111.6%
o/w Municipalities	8	9	14.1%
Previous years' appropriations	86	351	

Source: MOF, DGF

Table 6. Personnel Cost

(LL billion)	QI 2001	QI 2002	% change
Personnel cost, *of which:*	**813**	**864**	6.3%
Wages, salaries, and related benefits*	577	568	-1.6%
Retirement and end-of service	236	296	25.4%

Source: MOF, DGF
** Includes Council of the South, Lebanese University, Displaced Council, Council for Reconstruction and Development, and the Educational Center for Research and Development.*
Note: Personnel cost numbers are based on liquidated payment orders.

The transfer from the Treasury to **Electricité du Liban 'EDL'** (please refer to Table 7), has increased from approximately LL 64 billion in QI 2001 to approximately LL 108 billion in QI 2002 mainly owing to approximately LL 61 billion increase in debt service payments on EDL's behalf. No expropriation payments were made on EDL's behalf during QI 2002 compared to approximately LL 24 billion in QI 2001.

Table 7. Treasury Transfers to EDL

(LL billion)	QI 2001	QI 2002	change
EDL	**64.3**	**107.9**	**43.6**
Debt service*	40.5	107.9	67.4
Fuel	-	-	-
Expropriations	23.8	-	-23.8

Source: MOF, DGF

** Includes principal and interest, LL 61 billion of which was paid to settle a maturing loan initially issued for fuel purchases.*

Section 4: Evolution of public debt

Gross public debt amounted to LL 43,900 billion at the end of March 2002, demonstrating an increase of LL 1,205 billion or 2.8 percent during the first quarter of 2002. Two major developments characterized the growth of public debt during QI 2002: The first consisted of the swap operations conducted by the Banque du Liban with the commercial banks in January, which maturing two-year Lebanese Pound denominated treasury bills were swapped for new bills with the same tenor.

The second was the debt replacement transaction conducted between the Banque du Liban and the Ministry of Finance, whereby the BDL exchanged US$1 billion equivalent of Lebanese Pound denominated treasury bills (86 percent of which had maturities of two years) for US Dollar denominated Eurobonds[4].

[4] Kindly refer to the Ministry's website www.finance.gov.lb for further information.

Table 8. Public Debt

(LL billion)	2001 Dec	2002 Mar	change	% change
Gross total debt	42,695	43,900	1,205	2.8%
Gross domestic debt	28,214	27,853	-361	-1.3%
Foreign debt	14,481	16,047	1,566	10.8%
a. Bilateral & multilateral	2,056	2,056	0	0.0%
b. Other foreign debt	12,425	13,991	1,566	12.6%
of which Eurobonds	11,788	13,351	1,563	13.3%
Net domestic debt	26,301	26,010	-291	-1.1%
Net total debt	40,782	42,057	1,275	3.1%

Source: MOF, DGF

Note: Net public (and domestic) debt represents gross total (and domestic) debt less public sector deposits with the Central Bank and commercial banks.

Certain figures differ from previously published data due to the implementation of the DMFAS system (debt management system).

Section 5: Evolution of external trade

Exports have maintained the rising trend that had characterized the first two months of the year, by achieving a rise of approximately 18 percent when comparing the first quarter of 2002 to the same period of last year (please refer to Table 9). In absolute terms, exports rose by USD 33 million, from USD 185 million to USD 218 million.

On the other hand, the level of imports has declined by around 6 percent between the first quarter of 2001 and the same period of 2002, from USD 1,693 million to USD 1,586 million.

As a result, the trade balance improved by approximately 9 percent during the same period.

Table 9. External Trade

(USD million)	QI 2001	QI 2002	% change
Exports	185	218	17.8%
Imports	1,693	1,586	-6.3%
Trade balance	-1,508	-1,368	9.3%

Source: MOF, Directorate General of Customs (DGC)

Sources of imports: Lebanon's main trading partners, namely Arab countries, European Union countries, and the United States, all maintained their shares of total imports for the first quarter of 2002 compared to their shares during the first quarter of 2001 (please refer to Table 10).

However, imports from these countries declined when compared to the same period of last year, with the exception of imports from the US, which recorded a rise. Indeed, imports from Arab countries and the European Union decreased by around 5 and 10 percent respectively, whereas imports from the US rose by around 10 percent.

On a country level, Italy ranked first followed by Germany and the United States. It is noteworthy that, during the last quarter, France ranked first, followed by Italy and Germany. Imports from Italy consisted primarily of textiles, imports from Germany were predominately transport equipment while imports from the United States were mainly composed of prepared foodstuffs (which include tobacco). As for imports from Arab countries, Saudi Arabia ranked first, and the main imported goods from Saudi Arabia consisted of mineral products (primarily petroleum products).

Destination of exports: The shares of Lebanon's main export destinations remained in line with the levels of the previous year. Arab countries remained the main destination with a share of 43 percent, whereas exports to the European Union constituted 17 percent, with a decrease of 5 percent compared to QI 2001 (please refer to Table 10). The share of exports to Switzerland out of total exports increased from 6 to 13 percent while these exports rose by 133 percent when comparing last year's first quarter to this year's.

Exports to Switzerland, which represented Lebanon's number one export destination, were mainly composed of pearls, precious, and semi-precious stones. Lebanon's exports to Saudi Arabia, the second export destination, were made up of machinery and optical equipments. Again, exports to the UAE, Lebanon's third export destination, were composed of pearls, precious, and semi-precious stones.

Table 10. Regional Distribution of Imports and Exports

Imports

(USD million)	2001		2002	
	Q I	% share	Q I	% share
Total	**1,693**	**100%**	**1,586**	**100%**
Arab Countries	225	13%	213	13%
European Union	753	44%	676	43%
United States	125	7%	137	9%
Switzerland	78	5%	48	3%
Other	512	30%	512	32%

Exports

(USD million)	2001		2002	
	Q I	% share	Q I	% share
Total	**185**	**100%**	**218**	**100%**
Arab Countries	80	43%	94	43%
European Union	40	22%	38	17%
Switzerland	12	7%	28	13%
United States	13	7%	11	5%
Other	40	21%	47	22%

Source: MOF, DGC

Composition of imports: The implementation of the Value Added Tax starting February 2002, has affected the level and behavior of imports. Whereas the level of imports was relatively high in January (similarly to the two preceding months), in anticipation of the introduction of the VAT, their levels were at the lowest since eight years in February and March 2002 (USD 405 and 478 million respectively).

For the first quarter of 2002, machinery & mechanical appliances ranked first among the imported items with a share of approximately 15 percent of total imports (please refer to Table 11). Imports of these products increased by around 3 percent over the imported amount for the first quarter of 2001, despite the introduction of the VAT in February 2002.

Mineral products (mainly composed of gasoline) ranked second, with a share of approximately 13 percent, decreasing by approximately 10 percent over last year's import level.

Products of the chemical ranked third with a share of 10 percent and increased by 12 percent when compared to last year's first quarter, mainly owing to a rise in imported pharmaceutical imports.

Transport equipment ranked fourth with a share of around 9 percent and decreased by about 29 percent compared to first quarter of last year.

While the import of tobacco declined in the vicinity of 3 percent, prepared foodstuffs increased by around 3 percent when compared to last year's first quarter. This was mainly due to the 28 percent rise in imports of meat and sugar products.

Table 11. Imports Distribution by Product

(USD million)	2001		2002	
	Q I	% share	Q I	% share
Machinery and mechanical appliances	229	14%	235	15%
Mineral products	235	14%	211	13%
Products of the chemical	137	8%	153	10%
Transport equipment	206	12%	147	9%
Prepared foodstuffs	114	7%	117	7%
Other goods	772	46%	723	46%
Total	**1,693**	**100%**	**1,586**	**100%**

Source: MOF, DGC

Composition of exports: The increase of exports during QI 2002 is mainly due to higher exports of pearls, precious or semi-precious stones. This item remained the primary export of Lebanon, with a share of 22 percent in the first quarter of 2002, increasing by around 71 percent over exports in the first quarter of 2001.

Machinery and mechanical appliances maintained the second position, albeit with a decline in its share from 15 to 12 percent when compared to the same period of last year. These products witnessed a decline of around 4 percent when comparing QI 2002 to QI 2001, mainly due to the decrease in exports of electrical machinery and appliances (includes computer products).

Products of the chemical ranked third with a share of 11 percent and rose by around 81 percent when compared to last year. This was mainly due to a rise in exports of non-organic chemical products, fertilizers, as well as cosmetics and perfumery.

Prepared foodstuffs ranked fourth with a share of approximately 10 percent. In absolute amount, Lebanon continued to export the same quantity when comparing QI 2001 against QI 2002.

Exports of base metals and articles of base metals ranked fifth with a 9 percent share, rising by around 18 percent when compared to last year, mainly due to the rise in exports of steel and its products.

Table 12. Exports Distribution by Product

(USD million)	2001		2002	
	Q I	% share	Q I	% share
Pearls, precious or semi-precious stones	28	15%	48	22%
Machinery and mechanical appliances	28	15%	27	12%
Products of the chemical	16	9%	24	11%
Prepared foodstuffs	21	11%	21	10%
Base metals and articles of base metals	17	9%	20	9%
Other exports	75	41%	78	36%
Total	**185**	**100%**	**218**	**100%**

Source: MOF, DGC

Section 6: Developments on the VAT front

The VAT law was ratified by Parliament on December 5, 2001 and implemented on February 1, 2002. The VAT is levied at a **single rate of 10 percent** on goods and services, both imported and domestically produced.

Forty-two decrees and circulars pertaining to the implementation modalities of the VAT have already been issued.

Registration: To be entitled to charge the VAT, taxpayers should be registered in the VAT directorate. Registration started immediately after the ratification of the law. Registration is divided into two types: **mandatory registration** (for entities with a total turnover over LL 500 million) and **voluntary registration** (for entities with a total turnover between LL 150 million and LL 500 million). As of May 28, 2002, the **total number of registered** entities was **7,923**, up by around 10 percent when compared to the VAT launch date. This increase was mainly due to the 55 percent rise in **voluntary registrations**, which equaled **1,300** by May 28, 2002. The number of **mandatory registrations** therefore amounted to **6,623 companies**.

Over 86 percent of the taxpayers registered are distributed between Beirut and Mount Lebanon, whereas all the other regions have smaller shares (please refer to Table 14).

Table 13. VAT Statistics

	2002 Feb 1	2002 May 28
Number of tax payers registered and accepted	**7,211**	**7,923**
Mandatory registrations	6,371	6,623
Voluntary registrations	840	1,300
Number of field visits to tax payers*	1,107	6,329
Number of lectures organized outside the administration	90	111
Number of visitors to the internet site	4,143	13,858
Number of issued decrees and circulars	30	42

Source: MOF, VAT Directorate

* *As of April 1, 2002, field visits to taxpayers were replaced by audit visits on April 22, 2002.*

Table 14. Number of Tax Payers Registered by Region

	2002		2002	
	Feb 1	Share	May 28	Share
Beirut	2,693	37%	3,024	38%
Mount Lebanon	3,614	50%	3,846	48%
North Lebanon	328	5%	381	5%
South Lebanon	267	4%	320	4%
Bekaa	258	4%	289	4%
Nabatieh	51	1%	63	1%
Total	**7,211**	**100%**	**7,923**	**100%**

Source: MOF, VAT Directorate

A **VAT website** was created to provide information about all the steps that should be taken by a tax payer (www.finance.gov.lb). Copies of the law and decrees were also made available on the website in both Arabic and English.

Results: During the first quarter of 2002 (effectively, for February-March period), LL 111 billion of VAT revenue was collected at customs.

For February and March, the top five sources of VAT receipts at customs were mineral products, machinery & mechanical appliances, prepared foodstuffs, transport equipment, and textile materials which secured approximately 70 percent of total VAT revenue at customs (please refer to Table 15).

Table 15. VAT Revenue Collected at Customs (Five Largest Contributing Items)

(LL billion)	VAT Revenue Feb-Mar 2002
Mineral products	25
Machinery and mechanical appliances	18
Prepared foodstuffs	13
Transport equipment	11
Textile materials	11
Sub total (of five largest contributing items)	**78**
Total VAT revenue collected at customs	**111**

Source: MOF, VAT Directorate

Section 7: The 2003 Budget circular

The Ministry of Finance has started the preparations for the 2003 budget proposal by forwarding the 2003 budget circular to the various spending ministries and agencies on April 13, 2002.

The 2003 budget circular includes the following expenditure guidelines:

A. Current expenditures: In line with the overall policy of expenditure reduction, the Ministry of Finance has requested spending ministries and agencies to:

1. Limit requested allocations to the amount that was actually spent in 2001;

2. Maintain the level of wages and salaries of the 2002 budget law. In addition, spending agencies and ministries will present justification documents on: (a) the number of employees working for the specific agencies, (b) the administrative grading of those employees, and (c) the benefits and allowances to which those employees are entitled;

3. Limit operational expenditures to the strictest necessary requirements that allow the administration's functioning;

4. Cap budgetary transfers to their existing levels and abstain from requesting additional transfers, except after reviewing the benefiting entity's accounts. Also, spending ministries and agencies are requested to attach copies of decrees or decisions allowing the budgetary transfers.

B. Capital expenditures: In line with the request for decreasing spending, the Ministry of Finance has also informed spending ministries and agencies of the following:

1. Construction and equipment requests are to be postponed and limited to the strict essentials, taking into consideration carried-over budgetary allocations and the administration's absorptive capacity. These indispensable requests are to be accompanied by the necessary accounting justifications and are to be based on the assumption that the majority of investment projects will be mainly financed through available soft loans;

2. Program laws are to be constrained to those that have already been presented to and approved by the Cabinet, taking into consideration the following: (a) projects financed through external loans and executed by the CDR in various sectors and regions and (b) the domestic counterpart allocations to be included as part of the budget proposal.

Section 8: Revenue enhancement projects

The Ministry of Finance continues to develop projects that could lead to revenue enhancement such as the following:

Deduction at Source of income tax on Salaries: Currently under development, the DASS project aims to modernize the existing DASS administration and thus pave the way for the introduction of the comprehensive income tax. This would be accomplished through the modernization of the administration and the creation of a reliable and exhaustive database covering the active and retired labor force. More specifically, the database will cover the salaries of private sector employees and public sector servants (both active & retired). Taxation on the fees and remunerations of non-residents would also be collected under the project. The unit for implementation of DASS is set up and should be operational by 2003.

Global Income Tax: A Global Income Tax project is currently under development to unify declaration of all income generating activity into a single procedure. The government will replace the currently existing scheduler income tax by a comprehensive (global) income tax and make universal declaration obligatory for all citizens over eighteen years of age.

Section 9: Developments on the privatization front

The legal framework for privatization is already in place since May 2000. Specific laws for telecom, electricity, and water are already being discussed in Parliament and some of them are already at their final stages. Logistical preparations are also under way in these various sectors.

Telecommunication Sector:
On May 31, 2002, Parliament ratified the mobile phone privatization law which allows the government to launch international auctions towards the selling of the two existing mobile phone licenses for a maximum period of 20 years. The law established the timetable for the execution process and set the deadline for August 31, 2002.
In summary, the law authorizes the government, by virtue of a decree from the Council of Ministers to:

- Offer two licenses for domestic mobile phone services for a maximum period of 20 years, through an international public auction, announced through the local, Arab and international press. The mobile phone services will be limited to the GSM and GPRS systems.

- Launch an international public bidding for the management of the two current operators for a maximum period of ten years. The management firm, if appointed, should secure the government annual revenue equivalent to the amount that the government received in 2001 from the current operators, in addition to the declared profit of the two operators for fiscal year 2001.

The law provides for two alternative scenarios for the auctioning process:

- Option 1: The Lebanese Government receives, for the duration of the license, a proportion that should not fall below 40 percent of the existing operators' total revenue from domestic calls and from all other services provided by the companies. In addition, all revenue from international calls will be transferred to the Government for the duration of the licensing arrangement.

- Option 2: The Lebanese Government will perform a full sale of the two mobile phone licenses, with no revenue sharing.

Electricity: The new management that was appointed at EDL during January 2002 has proposed a working plan to resolve EDL's technical and financial difficulties.

In terms of EDL's financial situation, the report focused on EDL's collection difficulties. Indeed, the report estimates the revenue loss to be due to a 15 percent technical loss and a 30 percent non-technical loss. For the period 1994–2000, the total amount due to the non-technical loss was estimated at USD 1 billion divided into:

- USD 500 million of power loss that was non – invoiced or non-collected.
- USD 500 million of loss as cumulative unpaid bills to be gradually collected.

The current collection is based on a yearly average of USD 365 million for the last five years, whereas the company should potentially be collecting USD 565 million per year (constituting the USD 365 million of actual collection added to the USD 200 million of the yearly average loss).

The report also discussed electricity concessions, mainly situated in Zahlé, Byblos, Aley, and Kadisha. EDL sells these concessions electricity at a relatively low price (sometimes below the cost price), while these concessions sell it at the current prices sold by EDL. It is noteworthy that concessions have a collection rate that is around 97 percent of their bills.

Moreover, the report estimated the consumption needs for electricity to be between 1,400 and 1,600 megawatt, while the actual production currently does not exceed 1,350 megawatt (the potential of the functioning plants is 2300 megawatt). The low production is mainly due to the following reasons:

- Lack of coordination between rehabilitation and development plans for the production plants and the distribution plan.
- High operational and maintenance costs of existing equipment.
- Absence of a comprehensive maintenance system.

For these reasons, the new management has devised a plan of action pertaining to the company's financial situation and production policy.
The plan incorporates the adoption of strict collection and control mechanisms. This could be provided by the installation of counters for the non-compliant clients and the surveillance of the power theft. Up till the end of April 2002, 11,000 new counters had already been installed throughout the country. The new policy of surveillance has led to an increase in revenue equivalent to 30 percent for the period January-April 2002 compared to the same period of 2001.

Section 10: Establishment of a special account to decrease the public debt

On May 30, 2002, Parliament ratified a law which allows the government to establish a Special Account at the Banque du Liban to manage, service, and reduce the public debt.

The net proceeds from the privatization of any public entity within a period of twenty years from the date of publication of this law are to be transferred to the Special Account. These proceeds are to be used exclusively to service, reduce and retire public debt.

The law also authorizes the Ministry of Finance to establish, at the Central Bank, several accounts in the name of the Treasury (other than the already existing accounts), each of which (the accounts) shall be dedicated to the deposit of the current and future revenue from the telecom sector, the tobacco monopoly, Casino du Liban, air traffic revenue, and proceeds from the privatization of any public entity.

The Government may, by decree of the Council of Ministers, upon the recommendation of the Minister of Finance, also transfer the following revenue to the Special Account:

- Loans for the purpose of servicing, reducing or restructuring public debt and which are approved by Parliament;
- Grants received for the same purpose.

Additional revenue could also be transferred to the Special Account, on condition that this revenue can not exceed, for any given year, the primary surplus achieved during the year.

The law authorizes the Ministry of Finance to engage in securitization transactions by creating Special Purpose Vehicles (SPVs) that shall be financially separate from the government finances. The Ministry of Finance may transfer, to the SPVs, part or all of the revenue mentioned above.

A securitization transaction, as defined in the law, is the irrevocable transfer of specific revenue (true sale) to an SPV established for the purpose. The revenue is to be transferred to the SPV in the currency in which it is collected. Any surplus from the securitization transaction is to be transferred to the Special Account as stipulated in Article one of the law.

Section 11: International and regional agreements

On a regional front, the **Euro-Med agreement** was initialed in January 2002 and will be signed on June 17, 2002. Moreover, Lebanon has launched the fifth stage of tariff dismantlement in the context of the **Greater Arab Free Trade Area** (GAFTA) entered into in 1998. Other agreements that were signed as part of the government's policy to promote foreign investment are agreements for the Promotion & Reciprocal Protection of Investment as well as Double Taxation Conventions.

Greater Arab Free Trade Area

The **GAFTA** was launched to promote a free trade area between 17 Arab middle and near-east Arab countries, to be achieved by gradually reducing tariff rates, fees, and taxes by 10 percent each year to create a tariff-free area ten years after its implementation on January 1, 1998. All other non-trade barriers (administrative, quotas, and monetary) would also be eliminated through the GAFTA agreement.

At the beginning of 2002, Lebanon dismantled its tariff rates on products imported from the Arab region by an additional 10 percent, dismantling 50 percent of the value of the original tariff rates to date.

Double Taxation Conventions

The Ministry of Finance continued to sign agreements for the avoidance of double taxation with various countries. The **Double Taxation Convention** grants solutions to those individuals and legal entities that suffer tax treatments on an item in the same time period; i.e. double taxation. This convention settles sharing of the taxation power between two states when such a case occurs.

The goal of this agreement is to promote the exchange of goods and services, the inflow of capital, technology, and persons without the burden of double taxation, on one hand, and the prevention of fiscal evasion through administrative assistance between the contracting parties on the other.

Promotion and Reciprocal Protection of Investment

The **Promotion and Reciprocal Promotion of Investment** agreement is signed to promote private investment between two contracting nations in each other's territory. This agreement creates a legal framework whereby foreign investors and investment are granted the most favorable treatment between the Most Favored National Treatment and the National Treatment in the host country. Moreover, discriminatory measures of any kind are forbidden; fair and equitable treatment and full protection and security are guaranteed to foreign investments in both countries.

Investors are also allowed, according to the agreement, to freely transfer all payments related to the investment. They are also not to be dispossessed, by expropriation or nationalization or any other measure, unless the measure is taken (i) in the public interest according to the law, (ii) without any discrimination, (iii) under due process of the law, and (iv) provided prompt, adequate, and effective compensation.

For further information, please refer to the 'International Agreements' section on the Ministry of Finance website (www.finance.gov.lb).

Agreement	Signed	Ratified	Enforced
DT	4	7	11
IPP	5	13	19

DT: Double Taxation
IPPA: Investment Promotion and Protection

Section 12: Other structural and sector measures

In order to reactivate economic activity, the government has also implemented a number of other real sector measures, the most important of which are summarized below:

Extension of government subsidized loans:

The government has developed a program to help finance small and medium size loans in the sectors of agriculture, tourism, industry, and technology. The Government subsidizes the interest rate on such loans by bearing between 5 and 7 percent of the cost of borrowing. Loans worth less than LL 5 billion would bear an interest rate of 5 percent whereas loans worth between LL 5 billion and LL 15 billion would bear an interest rate of 7 percent. As a result of this measure, government subsidized loans extended by commercial banks have increased from 37 loans in QI 2001 to 155 loans during the same period of 2002. In value, the loans have risen by 157 percent from LL 28 billion to LL 72 billion. The largest share of loans (by loan size) went to industry, followed by tourism.

Table 16. Subsidized Loans, Distribution by Sector

Sectors	Number of loans 2001	Number of loans QI 2001	Value of loans QI 2001 (LL bn)	Number of loans QI 2002	Value of loans QI 2002 (LL bn)
Industry	374	20	13.6	86	54.0
Agriculture	261	8	5.1	40	3.6
Tourism	104	9	9.4	20	11.3
Specialized technologies	17	0	0	9	2.9
Total	**756**	**37**	**28.1**	**155**	**71.8**

Source: Central Bank of Lebanon
These subsidized loans are distributed to the five Mohafazat.

By the same token, the government extended support to the same types of industries through the Guarantee Scheme for loans offered by "Kafalat". The Kafalat program was established as a joint venture between 50 commercial banks, the government, and the National Institute for Deposit Guarantee. In its newly revised scheme in 2001, Kafalat now enables banks to lend up to LL 300 million, up from LL 100 million in the original system. The interest rate on these loans would be 3.5 percent.
Loans should have a maximum maturity of 5 years. Kafalat underwrites 75 percent of the loan in case of default and charges a guarantee fee of 3 percent.

The number of loans provided by "Kafalat" has increased by 14 percent when comparing this year's first quarter to the same period of time of 2001. The largest share of these loans was extended to industry and agriculture. It is noteworthy that loans to the tourism sector more than doubled (please refer to Table 17). By the end of QI 2002, the Kafalat program had issued 378 loan guarantees. Up until December 2001, the program had issued guarantees for 715 loans.

Table 17. Kafalat Loans, Distribution by Sector

Sector	Number of loans 2001	Number of loans QI 2001	Number of loans QI 2002
Industry	278	77	100
Agriculture	323	68	60
Tourism	54	10	23
Handicrafts	14	2	2
Specialized technologies	46	11	7
Total	**715**	**168**	**192**

Source: KAFALAT
Notes: Value of loans is not available
The Kafalat loans are distributed to the five Mohafazat.

Housing loans more than doubled in QI 2002 when compared to QI 2001. There was a large increase in February 2002 where 71 loans worth approximately LL 4,042 million were issued even though no loans were issued in March. Moreover, no loans were issued in US dollars throughout QI 2002.

Housing Loans: Housing loans are granted either in US Dollars or Lebanese Pounds. For the time being, loans in US Dollars carry an interest rate of 7 percent whereas loans in Lebanese Pounds bear an interest rate of 8 percent.

Table 18. Housing Loans in Lebanese Pounds

	Number of loans 2001	Value of loans (LL million) 2001	Number of loans 2002	Value of loans (LL million) 2002
January	15	747	10	1,342
February	9	431	61	4,042
March	6	491	0	0
Total	**30**	**1,669**	**71**	**5,384**

Source: Banque de l'Habitat

For further information, please visit the Ministry's website www.finance.gov.lb
Email: infocenter@finance.gov.lb
Tel: 961-1-981057/8
961-981081/2
Fax: 961-981059