REPUBLIC OF LEBANON
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FISCAL, TRADE AND STRUCTURAL DEVELOPMENTS

- Fiscal overview: During the first semester of 2002, the total deficit (budget and treasury) amounted to LL 1,939 billion or 41 percent of total expenditures compared to LL 1,759 billion or 44 percent of total expenditures during the same period last year. The primary surplus amounted to LL 319 billion or around 7 percent of total expenditures compared to LL 241 billion or 6 percent of total expenditures during the comparable period last year (refer to section 1).
- Revenues and expenditures: The improvement in the primary surplus is due to the LL 572 billion rise in revenues that has more than offset the LL 494 billion increase in non-interest expenditures. By the end of QII 2002, total revenue amounted to LL 2,823 billion compared to LL 2,251 billion during the same period last year. Total expenditures summed up to LL 4,762 billion compared to LL 4,010 billion during Jan-June 2001 while total primary spending increased from LL 2,010 billion up till QII 2001 to LL 2,504 billion this year (refer to sections 2 and 3).
- Public debt: Gross debt had increased by LL 2,602 billion or 6 percent amounting to LL 45,325 billion by the end of QII 2002. This rise in debt was due to the LL 2,809 billion increase in foreign debt, mostly owing to the LL 2,759 billion rise in Eurobond principal (refer to section 4).
- Trade: Imports, during the first half of 2002, decreased by 8 percent when compared to the same period in 2001, while exports increased by 23 percent. Therefore, the trade balance improved by 10 percent compared to Jan-June 2001 (refer to section 5).
- Developments on the VAT front: Up until its fifth month of implementation, the VAT had yielded LL 355 billion, constituting 13% of total revenue (refer to section 6).
- Revenue enhancement projects: In 1997, the government implemented the NAJM project for the automation of customs clearance in accordance with the plan to align the customs administration with world class standards (refer to section 7).
- Developments on the trade liberalization front: On June 17, 2002, Lebanon signed the Euro-Med agreement that ultimately establishes a free trade area between Lebanon and EU member countries (refer to section 8).
- Developments on the privatization front: On August 8, Parliament ratified the electricity privatization law. Moreover, by the end of August, the status of the current mobile phone operators was changed from a BOT to a management contract that will continue till January 31, 2003, after which an international tendering will take place. In addition, calls for expressions of interest were launched for the privatization of the mobile phone and electricity sectors (refer to section 9).
- Development on the securitization front: Two investment banks were mandated to manage the securitization of the future revenue streams from tobacco and mobile phones. The securitization of tobacco is currently undergoing its final preparatory stages (refer to section 10).
- Other structural and sector measures: In its attempt to reactivate the economy, the government continued to extend subsidized loans to small and medium size enterprises. For the first half of the year, Kafalat loans were almost four times higher than the same period of 2001 (refer to section 11).

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Section 1: Fiscal overview

For the first half of 2002, the **total deficit** amounted to LL 1,939 billion as compared to 1,759 billion for the same period last year. The increase of LL 180 billion in the total deficit was mainly due to an increase in both debt service expenditures and treasury payments on account of previous years.
Conversely, a **primary surplus** of LL 319 billion was achieved for the period Jan-June 2002. An improvement of 32 percent when compared to a primary surplus of LL 241 billion during the same period of last year.

Table 1. Summary of Fiscal Performance

(LL billion)	2001 June[1]	2002 June	2001 Jan-June	2002 Jan-June	change 2001-2002	% change
Budget revenue	332	575	2,084	2,617	533	25.6%
o/w customs revenue	*120*	*121*	*738*	*760*	22	3.0%
o/w Value Added Tax[2]	-	60	-	355	355	
Budget expenditures	651	763	3,538	3,826	288	8.1%
o/w Debt service	*338*	*371*	*2,000*	*2,258*	258	12.9%
Budget deficit/surplus	-319	-188	-1,454	-1,209	245	
in % of budget expenditures	-49.0%	-24.6%	-41.1%	-31.6%		
Budget primary deficit/surplus	19	183	546	1,049	503	
in % of budget expenditures	2.9%	24.0%	15.4%	27.4%		
Treasury receipts	24	37	167	206	39	23.4%
Treasury payments	58	223	472	936	464	98.3%
Total budget and treasury receipts	356	612	2,251	2,823	572	25.4%
Total budget and treasury payments	709	986	4,010	4,762	752	18.8%
Total cash deficit/surplus	-353	-374	-1,759	-1,939	-180	
in % of total expenditures	-49.8%	-37.9%	-43.9%	-40.7%		
Primary deficit/surplus	-15	-3	241	319	78	
in % of total expenditures	-2.1%	0.3%	6.0%	6.7%		

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

Note: [1] The figures for June 2001 have been modified from previously published data. Modifications have been introduced to both the revenue and expenditures items, whereby, tax deductions are now included as revenue and added to expenditures as disbursements. Hence, revenue and expenditures are now recorded on a gross basis.

[2] Value Added Tax represents the VAT collected at customs and at internal points of sale(for QI 2002).

Section 2: Revenue outcome

Until the end of QII 2002, **total revenue** amounted to LL 2,823 billion, an increase of LL 572 billion over the same period of last year, or by 25 percent.

During the same period, **budget revenue** amounted to LL 2,617 billion, up by 25.6 percent compared to the same period last year. This increase was mainly due to a large rise in tax revenue that has more than offset the slight decline in non-tax revenue.

Tax revenue (as part of budget revenue) amounted to LL 1,984 billion for the period compared to LL 1,431 billion last year. This LL 553 billion rise was due to an improved performance on the income tax front as well as by the VAT proceeds. More particularly, the increase is attributed to the following:

A. Taxes on income, profits, and capital gains, amounted to LL 554 billion during the first half of 2002, compared to LL 392 billion during the same period last year. The 41 percent increase was generally driven by (a) the settlement of tax regularization which accumulated to LL 75 billion till the end of QII 2002, (b) the adding of those taxpayers that have recently settled their dues, through the tax regularization, to the taxpayers' base, and (c) the on-going proceeds of audited large taxpayers, which debuted at the beginning of 2001.

B. Taxes on Property amounted to LL 140 billion till the end of QII 2002 compared to LL 106 billion during the same period 2001 representing a 33 percent increase, mainly attributed to the increase in property registration fees, directly induced by the growth in tourism and by the implementation of the new real estate law that decreased foreigners' real estate registration fees and facilitated the procedures for foreigners to acquire real estate.

C. Taxes on domestic goods and services equaled LL 435 billion till the end of QII 2002 compared to LL 103 billion during the same period last year. This LL 332 billion leap is attributable to the LL 355 billion additional tax revenue collected following the introduction of the Value Added Tax on February 1, 2002. Out of this amount, LL 303 billion were collected at customs and LL 52 billion at internal points of sale. It is worth noting that, in accordance with the VAT Law, the other taxes on domestic goods and services decreased during the first half of 2002 compared to the same period last year due to the replacement of the following taxes by the VAT: (a) the 5 percent sales tax on restaurants and hotels, (b) the non-alcoholic drinks, cement, and playing cards taxes.

D. During the first half of 2002, **taxes on international trade** (customs + excise revenues) amounted to LL 763 billion compared to LL 740 billion during same period last year. Although customs revenue declined from LL 401 billion to LL 360 billion during the period under consideration, the rise in taxes on international trade was caused by the increase in revenue from excises (from LL 339 billion last year to LL 403 billion this year). Three reasons stood behind this change: (a) the 8% drop in imports, (b) the shifting from customs to excises for imported gasoline products, and (c) the three-times rise in gasoline excise rates.

Table 2. Tax Revenue

(LL billion)	2001 Jan-June	2002 Jan-June	change	% change
Tax revenue	**1,431**	**1,984**	**553**	**38.6%**
Tax on income, profits, & capital gains	392	554	162	41.3%
Tax on property	106	140	34	32.1%
Domestic taxes on goods & services	103	435	332	322.3%
Taxes on international trade, of which	740	763	23	3.1%
Customs	*401*	*360*	*-41*	*-10.2%*
Excises	*339*	*403*	*64*	*18.8%*
Other tax revenue	91	92	1	1.1%

Source: MOF, DGF

Note: Tax revenue is included within budget revenue.

Non-tax revenue (as part of budget revenue), amounted to LL 633 billion during the first half of 2002, representing a 3 percent decrease compared to the same period last year. This is mainly attributed to the LL 15 billion decrease in "**Income from public institutions and government property**", in its majority based on the LL 17 billion reduction in revenue from the surplus of the telecommunications' budget. Revenue from Casino du Liban (CDL) increased by LL 2.5 billion reflecting a more active tourism season compared to same period last year. Indeed, tourism-related revenue, namely, revenue from Beirut International Airport, Jeita Grotto, and CDL increased by 21 percent mainly due to the 4 percent increase in the flow of tourists compared to the same period last year.

Administrative fees and charges declined by LL 7 billion when compared to last year despite the rise in some of this item's sub-components. In fact, all car-related fees such as road usage fees (mecanique), driving license fees, and license plates' fees, as well as passport issuance fees and working license fees increased when compared to last year.

Table 3. Non-tax Revenue

(LL billion)	2001 Jan-June	2002 Jan-June	change	% change
Non-tax revenue	**654**	**633**	**-21**	**-3.2%**
Income from public institutions and government property	409	394	-15	-3.7%
Administrative fees & charges	197	190	-7	-3.6%
Penalties & confiscations	6	9	3	50.0%
Other non-tax revenue	42	40	-2	-4.8%

Source: MOF, DGF
Note: Non-tax revenue is included within budget revenue

Table 4. Entrepreneurial and Property Income

(LL billion)	2001 Jan-June	2002 Jan-June	change
Income from public institutions and government property, o/w	**409**	**394**	**-15**
Casino du Liban	12	14	2
National Lottery	10	8	-2
Telecom	350	333	-17
Central Bank	21	20	-1

Source: MOF, DGF

Section 3: Expenditure outcome

By the end of QII 2002**, total expenditures** (budget and treasury) amounted to LL 4,762 billion compared to LL 4,010 billion during the same period last year, mainly attributed to the increase in treasury expenditures and debt service payments.

Budget expenditures amounted to LL 3,826 billion during the period Jan-Jun 2002 compared to LL 3,538 billion during the comparable period last year. The primary reason behind the 8 percent increase in budget expenditures was the increase in debt service, specifically that on foreign debt.

Debt service increased by LL 258 billion over Jan-Jun 2001. This increase is mainly due to the 92% increase in foreign debt service, which rose from LL 317 billion at end of QII 2001 to LL 608 billion during the period Jan-June 2002 in part owing to the USD 125 million coupon payments on the USD 3.1 billion worth of Eurobonds issued in 2001, and an approximately USD 110 million principal repayment in June 2002 upon maturity of a DM Eurobond.

Personnel cost (wages, salaries, and related benefits, end of service and retirement) amounted to LL 1,529 billion compared to LL 1,564 billion during the comparable period last year. This small decline is caused by the decrease of wages, salaries and related benefits by LL 53 billion. On the other hand, end of service indemnities and pensions increased by LL 18 billion.

As for **treasury expenditures**, they amounted to LL 936 billion during the first half of 2002 compared to LL 472 billion during the comparable period of 2001, representing an increase of LL 464 billion or 98 percent, mainly due to the LL 200 billion and LL 307 billion increase in payments to municipalities and previous years' appropriations (respectively). The increase in municipalities spending is due to the award of Averda the solid waste management of Mount Lebanon.

Table 5. Expenditures

(LL billion)	2001 Jan-June	2002 Jan-June	change	% change
Total expenditures	**4,010**	**4,762**	**752**	18.8%
Budget expenditures	3,538	3,826	288	8.1%
Expenditures excluding debt service	1,538	1,568	30	2.0%
Debt service	2,000	2,258	258	12.9%
Domestic debt	1,683	1,650	-33	-2.0%
Foreign debt	317	608	291	91.8%
Treasury expenditures	472	936	464	98.3%
o/w Municipalities	11	211	200	
Previous years' appropriations	51	358	307	

Source: MOF, DGF

Table 6. Personnel cost

(LL billion)	2001 Jan-June	2002 Jan-June	change	% change
Personnel cost, *of which:*	**1,564**	**1,529**	**-35**	**-2.2%**
Wages, salaries, and related benefits*	1,093	1,040	-53	-4.8%
Retirement and end-of service	471	489	18	3.8%

** Contrary to previous months, "Personnel Cost" figures are extracted from the gross amount based on the liquidated payment orders of the budget execution.*

*** Include wages and salaries for the Council of the South, Lebanese University, Displaced Council, Council for Reconstruction and Development, and the Educational Center for Research and Development.*

EDL: Transfers to "Électricité du Liban" (EDL) amounted to LL 157 billion during the first half of 2002, compared to LL 199 billion in the same period last year, representing a 21 percent decrease (please refer to Table 7). Despite the higher amount incurred for debt service during 2002. No transfers were made for EDL's expropriation payments and fuel purchases this year as EDL is still using the revolving credit lines for fuel purchases provided by various sources.

Table 7. Transfers to EDL*

(LL billion)	2001 Jan-June	2002 Jan-June	change
EDL	**199**	**157**	**-42**
Debt service	113	157	44
Fuel	61	-	-61
Expropriations	25	-	-25

Source: MOF, DGF

** Includes principal and interest, LL 60.9 billion of which was paid in QI 2002 to settle a maturing loan initially issued for fuel purchases.*

Section 4: Evolution of public debt

As of end-June 2002**, gross public debt** amounted to LL 45,325 billion, representing an increase of LL 2,602 billion over the stock of debt as of end-2001. Gross domestic debt has decreased by LL 207 billion, while foreign debt recorded an increase of LL 2,809 billion due to three debt exchange transactions conducted with BDL in March, May and June 2002:

(a) USD 1 billion 10.25% Notes due March 2005;
(b) USD 350 million 10.5% Notes due May 2006; these notes were initially purchased by BDL and subsequently distributed to contractors in settlement of expenses incurred in 2001-2002
(c) USD 500 million 10.5% Notes due June 2006;

All of the replaced LL Treasury Notes held by BDL carried an interest rate of 14.14 percent and had an initial maturity of 24 months.

Furthermore, developments on the foreign debt front were also characterized by the settlement of the equivalent of USD 110 million maturing DM Eurobond issued in June 1997.

During the period under consideration, the total deficit was financed through the issuance of treasury bills, which were originally bought by the Central Bank and thereafter by the local market through secondary market operations.

Table 8. Public Debt

(LL billion)	Dec 2001	June 2002	change	% change
Gross debt	42,723	45,325	2,602	6.1%
Domestic debt	28,214	28,007	-207	-0.7%
Foreign debt	14,509	17,318	2,809	19.4%
a. Bilateral & multilateral	2,087	2,112	25	1.2%
b. Other foreign debt	12,423	15,206	2,783	22.4%
of which Eurobonds	11,477	14,236	2,759	24%
Net domestic debt	26,301	26,192	-109	-0.4%
Net total debt	40,810	43,509	2,699	6.6%

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 for the first semester 2002 amounted to USD 494 million representing a 23 percent increase over the same period of last year. Imports amounted to USD 3,143 million until June 2002 compared to USD 3,400 million, representing a decrease of 8 percent partly due to the accumulation of inventories prior to VAT implementation and to the slowdown in domestic demand.

As a result, till the end of QII 2002, the trade deficit decreased from USD 3,000 million last year to USD 2,694 million, a decline equivalent to 10 percent.

Table 9. External Trade

(USD million)	2001 Jan-June	2002 Jan-June	change	% change
Exports	400	494	94	23%
Imports	3,400	3,143	-257	-8%
Trade balance	-3,000	-2,694	306	10%

Source: MOF, Directorate General of Customs (DGC)

Sources of imports: As of QII 2002, Lebanon's main trading partners, the Arab countries, the European Union, Switzerland, and the United States, maintained their shares of total imports.

The European Union ranked first preserving its 43 percent share of total imports compared to the first half of 2001.

Arab countries ranked second, with total share of 12 percent, 1 percent below the outcome of the comparable period last year.

The United States ranked third with a share of 8 percent, exhibiting no change compared to the same period last year. Vegetables, prepared foodstuff, and transport equipment were the main items imported from the United States during this period.

On a country level, Italy ranked first with a share of 11 percent of total imports. Main items imported from Italy were mineral products, textile products, and machinery and mechanical equipment. Germany ranked second with a share of 10 percent. Its imports consisted mainly of animal products, product of the chemical, machinery and mechanical equipment, and transport equipment. France and the United States ranked third and fourth each with a share of 8 and 7 percent respectively. Imports from France decreased by 22 percent compared to the same period of 2001, mainly due to decrease in imports of textiles. As for the Arab countries, Syria ranked first with a share of 4 percent of total imports, while Saudi Arabia followed with a share of 3 percent. However, till the end of June 2002, imports from both Syria and Saudi Arabia decreased by 26 and 30 percent respectively compared to the same period last year.

Destination of exports: Till the end of June 2002, the destination of Lebanese exports was mainly to the Arab countries, the European Union, Switzerland, and the United States. The Arab countries remained the main importer of Lebanese goods with a share of 46 percent, a decrease of 1 percent compared to the same period last year.

Amongst Arab countries, Saudi Arabia was the major importer of Lebanese goods with a share of 9 percent followed by UAE with a share of 8 percent approximately equal to that of the comparable period last year. Prepared foodstuffs, pulp of wood, paper and paperboard, and machinery and mechanical equipments dominated Lebanese exports to Saudi Arabia, while textile articles, pearls, precious or semi-precious stones, and machinery and optical equipments topped those of UAE. Syria ranked third with a total share of 7 percent.

Amongst countries, Switzerland ranked first with a share of 17 percent, an 8 percent increase over the level achieved last year. This is mainly due to the 79 percent increase in exports of pearls, precious or semi-precious stones.

The 44 percent decrease in Lebanese exports to both France and Greece, till QII 2002, compared to the same period last year, led to a 6 percent decrease in the European Union's share of total Lebanese exports. As a result the European Union ranked third with a share of 14 percent.

The United Stated ranked fourth with a share of 5 percent, a 2 percent decrease compared to the same period of 2001.

Table 10. Regional Distribution of Imports and Exports

Imports

(USD million)	2001		2002	
	Jan-June	% share	Jan-June	% share
Total	**3,400**	**100**	**3,143**	**100**
Arab Countries	440	13	373	12
European Union	1,477	43	1,363	43
United States	258	8	248	8
Switzerland	134	4	112	4
Other	1,091	32	1,047	33

Exports

(USD million)	2001		2002	
	Jan-June	% share	Jan-June	% share
Total	**400**	**100**	**494**	**100**
Arab Countries	183	45	220	46
European Union	81	20	71	14
Switzerland	36	9	86	17
United States	26	7	26	5
Other	74	19	91	18

Source: MOF, DGC

Composition of imports: For the first half of 2002, machinery and mechanical appliances ranked first among the imported items, maintaining their 14 percent share of total imports when compared to the same period last year, and were mainly imported from China. Mineral products ranked second with a share of 13 percent, decreasing by 2 percent compared the same period last year. Major sources of mineral products were Russia and Syria.

Products of the chemical ranked third with a share of 10 percent compared to a share of 7 percent during the comparable period last year, and were mainly imported from France.

Transport equipment ranked fourth with a 9 percent share, a 20 percent decrease compared to 2001.

Prepared foodstuffs ranked fifth with 5 percent decrease over the comparable period of 2001, mainly due to the 12 percent decrease in tobacco imports.

Table 11. Imports Distribution by Product

(USD million)	2001		2002	
	Jan-June	% share	Jan-June	% share
Machinery and mechanical appliances	481	14	463	14
Mineral products	542	15	441	13
Products of the chemical	299	7	317	10
Transport equipment	357	10	286	9
Prepared foodstuffs	240	6	229	7
Other goods	1,697	48	1,407	47
Total	**3,400**	**100**	**3,143**	**100**

Source: MOF, DGC

Composition of exports: The 23 percent increase in exports till the end of June 2002, compared to the same period of the previous year 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 26 percent compared to 18 percent during the comparable period last year, and was mainly exported to Switzerland.

Machinery and mechanical appliances ranked second during the first half of 2002 with a share of 12 percent compared to 14 percent in the same period last year, maintaining the same amount achieved during the same period of 2001. The above products were mainly exported to Iraq.

Products of the chemical ranked third maintaining their share of 10 percent compared to the same period last year, achieving an increase of 32 percent.

Prepared foodstuffs ranked fourth with a share of 9 percent compared to 8 percent during the comparable period last year. In absolute amounts, exports of prepared foodstuffs have increased by around 10 percent when compared to the same period of 2001.

Table 12. Exports Distribution by Product

(USD million)	2001		2002	
	Jan-June	% share	Jan-June	% share
Pearls, precious or semi-precious stones	71	18	126	26
Machinery and mechanical appliances	57	14	57	12
Products of the chemical	38	10	50	10
Prepared foodstuffs	41	8	45	9
Base metals and articles of base metals	34	9	39	8
Other exports	159	41	177	35
Total	**400**	**100**	**494**	**100**

Source: MOF, DGC

Section 6: Developments on the VAT front

Since the implementation of the VAT on February 1, 2002, the total number of registered entities increased from 7,211 to 8,241 tax-payers by October 1, 2002. Out of this number, 6,745 companies were under mandatory registration (businesses with a total turnover above LL 500 million), while 1,496 companies had voluntarily registered (businesses with a threshold between LL 150 million and LL 500 million). Optional registrations recorded an increase of 78 percent since the launch date.

As for the taxpayers' distribution by region (please refer to Table 13), 86 percent of the total 8,241 registered taxpayers are distributed between Beirut and Mount Lebanon.

Table 13. Number of Tax-Payers Registered By Region

	2002			
	Feb 1	Share	October 1	Share
Beirut	2,693	37.3%	3,114	37.8%
Mount Lebanon	3,614	50.1%	4,003	48.6%
North Lebanon	328	4.6%	405	4.9%
South Lebanon	267	3.7%	336	4.0%
Bekaa	258	3.6%	312	3.8%
Nabatieh	51	0.7%	71	0.9%
Total	**7,211**	**100%**	**8,241**	**100%**

Source: Directorate of the VAT

Up till the end of QII, incoming VAT revenue from customs amounted to LL 317 billion (based upon declarations). The top five sources of VAT receipts at customs remained unchanged, namely: mineral products, machinery & mechanical appliances, prepared foodstuffs, transport equipment, and textile materials respectively (please refer to Table 14 for the breakdown).

Table 14. VAT Revenue Collected At Customs (Five Largest Contributing Items)*

(LL billion)	2002	
	Jan-June	Share
VAT customs collection , of which	**317**	**100%**
Mineral products	72	22.7%
Machinery and mechanical appliances	53	16.7%
Transports equipment	37	11.7%
Prepared foodstuffs	34	10.7%
Textiles	26	8.2%
Others	95	30.0%

Source: Directorate of the VAT

** VAT numbers quoted in this table are based on declarations, whereas VAT numbers of Table 1 are based on actual collections.*

VAT revenue from domestic points of sale is equivalent to around LL 148 billion. The figures mentioned in Table 1 are inclusive of VAT revenue from both customs declarations and revenue from domestic points of sale in quarter I, but include only customs declarations for quarter II. VAT revenue from domestic points of sale for QII were provided on July 20, 2002.

Section 7: Revenue enhancement projects

In 1993, the Ministry of Finance initiated a plan to rejuvenate the customs' administration with a clear objective to align its services with world class standards. The core element in this program was the implementation of NAJM (ASYCUDA package for the automation of customs' clearance operations in 1997). NAJM project has shown significant progress and simplified customs clearance at the major ports of entry where it has been applied to date. Indeed, NAJM is already operational at Beirut International Airport, Port of Beirut, and Port of Tripoli that together constitute 90% of Lebanon's international trade. The NAJM project includes many reforms that comprise, among others:

(a) the adoption of an international single standard document for clearance, replacing over 26 antiquated documents
(b) the reduction of the 15-steps signatures' process to a four-step process.

As a result, clearance time has been reduced to 2-3 days, improving upon the previously existing 7-10 days. Besides, by the end of year 2001, the number of cleared goods through the green line (implying that these goods are not physically checked) had increased to 75% of total imports.

The NAJM project introduced the first e-government service in Lebanon (NOOR, NAJM on line) to enable traders to transact electronically with customs.

Table 15. NAJM Results, Transactional Volume

Annual Indicator	1997	1998	1999	2000	2001
Green Line	10 %	30 %	40 %	40 %	75 %
Average Clearance days	6.07	5.06	4.98	4.54	3.50

Source: MOF, DGC, NAJM

Section 8: Developments on the trade liberalization front

Euro-Mediterranean Partnership Agreement: On June 17, the Lebanese Government signed the Euro-Mediterranean Partnership Agreement initialed on January 10, 2002. This marked the conclusion of the negotiations which began in 1995, and were accelerated in 2001 in view of integrating Lebanon in the Euro-Mediterranean Free Trade Area.

The agreement's most important objective is the gradual liberalization of trade between Lebanon and the European Union over a period of 12 years. The agreement also incorporates articles related to political dialogue, competition, intellectual property, liberalization of services, as well as cooperation on various other economic, financial, and social issues.

Custom duties on <u>industrial imports</u> from the EU will be dismantled starting five years after the implementation of the agreement and will be, thereafter, annually reduced by 12 percent until they reach zero percent over a period of twelve years following the entry into force of the agreement.

As for <u>Processed Agricultural Products</u> (PAP), Lebanon also benefits from a five years-grace period after which custom duties will be gradually reduced by 30%, over a period of 7 years, on EU PAP imports with a tariff rate currently above 5%. Custom duties on PAP below the 5% rate will be reduced to zero at the end of the 12th year after the entry into force of the agreement.

Lebanese <u>industrial exports</u> to the EU will continue to be allowed without barriers to trade, in accordance to the cooperation agreement signed between Lebanon and the European countries in 1977. As a result of the new association agreement, PAP and the majority of agricultural products will also be allowed entry to the 15 European countries without import duties.

It is worth noting that several countries in the region such as Egypt, Tunisia, Algeria, Jordan, and the Palestinian Authority, have already signed the agreement with the EU.

Section 9: Developments on the privatization front

The government launched calls for expressions of interest for the privatization of the mobile phone and electricity sectors in the local and international press. This followed the ratification of a series of sector-specific privatization laws.

Telecommunication Sector: On August 31, 2002 the government changed the status of the current mobile phone operators, Cellis and Libancell, from a BOT (Build, Operate and Transfer) to a management contract that will continue until January 31, 2003, after which an international tendering will take place. Under this arrangement, the following financial flows occur starting September 1, 2002:

- ☒ Transfers, by the Treasury, of fixed monthly management fees of LL 12.4 billion and LL 11.8 billion for each of Cellis and Libancell respectively.
- ☒ Total transfer, to the Treasury, of revenue from the mobile phone sector. Indeed, companies are expected to transfer an additional LL 22.6 billion per month (net of charges) over the 2002 budgeted figures.
- ☒ Settlement, by the government, of the net book value of the two companies' assets and any incidental costs incurred due to the early termination of their contracts. Following this settlement, the government may distribute the tender document, which has been finalized and approved, to the interested investors.

Electricity Sector: On August 8, 2002, Parliament ratified the electricity privatization law which allows the selling of 40% of the production and distribution phases of "Électricité du Liban" (EDL). Transmission operations are to be kept entirely under government administration. Subject to

Cabinet approval, EDL may subcontract the management, operation, or development of the transmission phase to the private sector. The price of the company's assets and functions will be set by the Higher Council for Privatization with the help of an international financial or accounting firm.

The new management, which was selected in January 2002, has been trying to improve the company's financial situation in preparation for the sector's privatization. There are many difficulties that the company is addressing, of which are theft, outstanding fees, high fuel prices and underproduction, as well as, transport problems. The new management's rescue plan incorporates the adoption of strict collection and control mechanisms. It involves the award of a private company the collection of fees with the help of current employees. In line with the new electricity privatization law, EDL will centralize control through a "Bureau de Controle" appointed by management. The company has to finish the projects in progress and improve on transportation and distribution methods.

Section 10: Development on the securitization front

In order to ensure financing at lower cost of funds, the government is preparing to perform its first securitization operation. Indeed, the main idea behind securitization is to attain a higher rating than the sovereign, for the bonds securitized through future revenue flows.

Following the issuance of Law no. 430 allowing the government to implement securitization operations in respect of designated revenue flows, including revenues from mobile telephony and tobacco, the Ministry of Finance has launched the securitization of tobacco future customs and excise revenue flows (excluding income tax, value added tax, and municipality tax). Indeed, the following main steps (among others) have already been taken in that respect:

a. RFPs and mandate: Requests for proposals were forwarded to a number of international financial institutions, after which two investment banks "Morgan Stanley Dean Witter" and "Credit Suisse First Boston" were mandated as joint co-leads for the management of the securitization of the tobacco and telecom future revenue flows.

b. Tobacco securitization: Work is already in progress on the securitization of future revenue flows from tobacco.

c. Disclosure of information: A due diligence questionnaire, containing essential information about the tobacco monopoly's financial, administrative, and legal status was completed and circulated to the banks.

d. Due diligence: A due diligence visit to Lebanon was performed by the investment banks.

e. Structure: In the objective of attaining a higher rating than the sovereign, a new arrangement separating the tobacco flows from the control of the government will constitute the main theme of the new cash flow structure. The flow of customs and excise revenues will credit a new account, the Special Purpose Vehicle (SPV), managed by an international and independent trustee. In that sense, securitization is a true sale of future revenues whereby the government cannot disable their flow to the SPV account.

f. Offering circular: A first draft of the offering circular has already been circulated by investment banks.

Net proceeds from this securitization will be transferred to the Special Account effective from the date of publication of the law for a period of twenty years. These proceeds are to be used exclusively to reduce and retire public debt.

With the tobacco securitization already in progress, there are several other possible proceeds that could be securitized such as the revenue sharing from the mobile phone sector (pending the outcome of the January 31, 2003 international tendering).

Section 11: Other structural and sector measures

The government has undertaken several real sector measures to stimulate economic activity. Below is a summary of the recent developments in some of the projects:

Extension of government subsidized loans: The government devised a plan that aims at subsidizing the cost of borrowing on small and medium term loans by 5 to 7 percent. Beneficiaries belong to the industry, agriculture, tourism and technology sectors.

Until the end of June 2002, the number of subsidized loans managed by several commercial banks had reached 595 with a total value of LL 298 billion. The main share was extended to the industry sector, followed by tourism, agriculture and technology respectively.

Table 16. Subsidized Loans, Distribution by Sector

Sectors	Value of loans 2001(LL billion)	Number of loans 2001	Value of loans QII 2002 (LL billion)	Number of loans QII 2002
Industry	323	387	207	331
Agriculture	19	262	16	151
Tourism	175	106	70	93
Specialized technologies	7	17	5	20
Total	**524**	**772**	**298**	**595**

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

The Government is supporting industries through the Guarantee Scheme for loans offered by "Kafalat". It permits banks to lend up to LL 300 million at an interest rate of 3.5 percent. "Kafalat" underwrites 75 percent of the loan, with a maximum maturity of 5 years, in case of default for a guarantee fee of 3 percent.

The number of loans provided by "Kafalat" has amounted to 1,226 loans up until June 2002. The increase was around 2.8 times over the comparable period of last year. Industry and agriculture still receive the largest number of these loans, adding up to 1,042. The tourism sector's share has significantly increased over last year's period from 23 to 103 loans.

Table 17. Kafalat Loans, Distribution by Sector

Sector	Number of loans 2001	Number of loans Jan-Jun 2001	Number of loans Jan-Jun 2002
Industry	278	126	491
Agriculture	323	149	551
Tourism	54	23	103
Handicrafts	14	6	19
Specialized technologies	46	19	62
Total	**715**	**323**	**1,226**

Source: KAFALAT

The average value of loans has also risen by 95%, from LL 50.2 million to LL 98.1 million per loan. This is a direct result of the newly revised scheme adopted in 2001 that allows the banks to finance up to LL 300 million instead of the previous LL 100 million in the original structure. Total loan values mushroomed to LL 120,300 million, an increase of more than 6 times over the same period in 2001.

As for the regional distribution of the loans, Beirut and Mount Lebanon ranked first with 48 percent combined share of total awarded loans. The share of loans allotted to the North region shows the highest increase when compared against last year.

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