



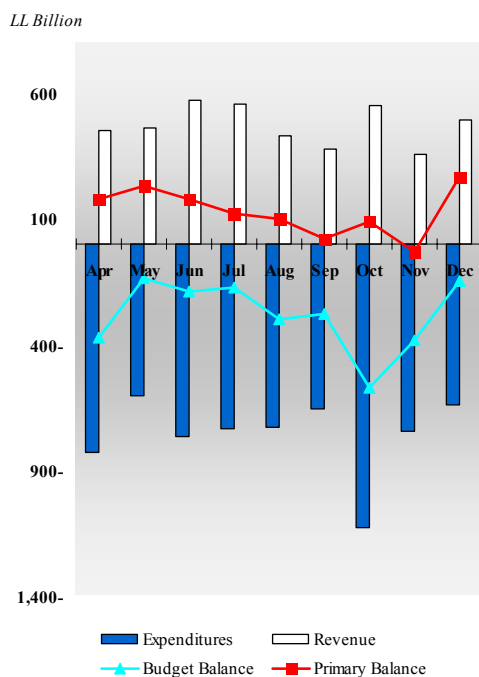
Public Finance Prospects 2002 Ministry of Finance Yearly Report

☒ **General Fiscal Developments:** In line with the government's commitment for fiscal consolidation, the year 2002 was marked by a primary surplus of LL 330 billion compared to LL 82 billion in 2001, pulling up by 301 percent. Also, the budget deficit reached LL 3,088 billion by year end 2002, marking an 11 percent reduction from 2001 ([section1](#)).

improved performance of income tax and of property tax. The 35 percent increase in tax revenues (which amounted to LL 3,995 billion), outgrew the 10 percent increase in budget expenditures (which amounted to LL 8,487 billion), resulting in an improved overall budgetary performance for 2002.

☒ On the other hand, **treasury transactions** (treasury receipts of LL 447 billion and treasury payments of LL 1,652 billion) registered a LL 1,205 billion deficit in 2002 compared to LL 745 billion in 2001. This drove **total deficit** up an additional LL 63 billion from its 2001 level, despite the net improvement in the budgetary component of the deficit as previously mentioned ([sections 2 and 3](#)).

Fiscal Performance 2002



Source: MOF, DGF

☒ **Revenues and Expenditures:** The LL 397 billion decline in the budget deficit in 2002 is mainly attributed to a 27 percent increase in budget revenues (amounting to LL 5,399 billion). This was due to the successful implementation of the VAT introduced in February 2002, and to an

Contents

Fiscal overview.....	Page 3
Revenue outcome.....	Page 4
Expenditure outcome.....	Page 9
Public debt.....	Page 12
Value Added Tax.....	Page 15
Evolution of external trade.....	Page 18
Paris II developments.....	Page 22
Privatization and securitization.....	Page 24
Budget Law 2003.....	Page 27

☒ **Public Debt Developments:** By the end of 2002 the stock of debt cumulated at LL 47,224 billion, an 11 percent increase in stock as end of 2001. Major developments occurred in 2002 on the debt front, particularly as a result of the Paris II conference of November. Indeed, by year end 2002, gross domestic debt (LBP denominated) was reduced by around 10 percent to LL 25,302 billion, with the

distribution of debt shifting to official foreign debtors. Lebanon's foreign debt component rose up to LL 21,922 billion by year end, marking a total increase of LL 7,520 billion from the 2001 outcome, and pulling the ratio of foreign debt to total debt up from 34 percent in 2001 to 46 percent in 2002 ([section 4](#)).

☒ **VAT Developments:** The Value Added Tax (VAT) was introduced in February 2002 at a single rate of 10% and a turnover threshold of LL 500 million. By year end 2002, with 8,757 registrants and a 95 percent compliance rate (*ratio of taxpayers who filed their tax returns out of total registered taxpayers*), the VAT generated LL 1,097 billion (based on VAT and customs declaration forms), of which 66 percent were collected from the import of merchandize, and 34 percent from internal operations ([section 5](#)).

☒ **International Trade:** The balance of trade reached a USD 5,399 million deficit in 2002. A 12 percent decline in imports (namely imports of fuel, transport vehicles, and machinery), and an 18 percent increase in exports (stemming mainly from the export of jewelry) explain the 16 percent reduction in the balance of trade deficit in 2002 ([section 6](#)).

☒ **Paris II Fund Mobilization:** The Paris II donor conference took place on November 23, 2002, and secured for Lebanon over US\$ 4.3 billion in low cost funding. This conference had a remarkable effect on confidence, triggering a steady decline in interest rates, and was followed by additional debt reducing schemes reached with Banque du Liban and Lebanese commercial banks ([section 7](#)).

☒ **Privatization and Securitization:** During 2002, the enabling legal framework was put in place, paving the way for the privatization of public utilities, namely telecom mobile network and electricity. In May 2002 the mobile phone privatization law was ratified by parliament. The process is currently in its final stages of preparation for the upcoming auction. In August 2002, the electricity privatization law was ratified by parliament, and EDL is presently undergoing restructuring prior to its sale. The consolidation of water offices has taken place. The financing of infrastructure work at the Tripoli and at the Bekaa water offices facilitates private sector participation, whereby the process of awarding a management contract to a private operator (water supply) has been already launched for these two regions.

As part of the government strategy to reduce the stock of debt, the securitization of future flows from the tobacco sector is currently being prepared ([section 8](#)).

☒ **Budget Law 2003:** The 2003 Budget Law was ratified by Parliament on January 28, 2003, after being issued by the Council of Ministers on August 25, 2002. According to Budget Law 2003, expenditures are expected to decrease from LL 9,375 billion in the 2002 Budget Law to LL 8,600 billion by year end 2003. Also, revenues are expected to increase from an actual level of LL 5,399 billion in FY 2002 to LL 6,475 by year end 2003. The resulting outcome is expected to be a 45 percent decrease in the budget deficit (of LL 2,125 billion) for 2003, and a further amelioration of the primary surplus, from LL 625 billion in the 2002 Budget Law to LL 1,875 billion for 2003 ([section 9](#)).

Section I: Fiscal Overview 2002

Table 1. Summary of Fiscal Performance

(LL billion)	2001	2002	change	
	Jan-Dec	Jan-Dec	2001-2002	% change
Budget revenues	4,260	5,399	1,139	26.7%
Budget expenditures	7,745	8,487	742	9.6%
<i>o/w Debt service</i>	4,312	4,622	310	7.2%
Budget deficit/surplus	-3,485	-3,088	397	-11.4%
in % of budget expenditures	-45.00%	-36.39%		
Budget primary deficit/surplus	826	1,534	708	85.6%
in % of budget expenditures	10.67%	18.07%		
Treasury receipts	385	447	62	16.0%
Treasury payments	1,130	1,652	522	46.2%
Total budget and treasury receipts	4,646	5,846	1,201	25.8%
Total budget and treasury payments	8,875	10,139	1,263	14.2%
Total cash deficit/surplus	-4,230	-4,292	-63	1.5%
in % of total expenditures	-47.66%	-42.34%		
Primary deficit/surplus	82	330	248	301.8%
in % of total expenditures	0.92%	3.25%		

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

Budget deficit has marked the year 2002 with an 11 percent amelioration, by decreasing from 45 percent of the total budget in 2001 to 36 percent a year later, and reaching LL 3,088 billion (or 11.8 percent of GDP¹) down from LL 3,485 billion (or 13.37 percent of GDP) in 2001. Behind these improvements stands a 35 percent increase in tax revenues, which pulled **total budget revenues** up by 27 percent; from LL 4,260 billion in 2001 to LL 5,399 billion in 2002. **Budget expenditures** cumulated at LL 8,487 billion, marking a 10 percent increase from budget spending in 2001. Nevertheless, in line with the policy of fiscal consolidation and expenditure rationalization, budget expenditures in 2002 were actually LL 888 billion less than the budgeted LL 9,375 billion allocated in the 2002 Budget Law. This is explained by lower levels of spending on both current and capital items.

Total deficit (budget and treasury) for 2002 totaled LL 4,292 billion (16.46 percent of GDP), adding LL 63 billion over the 2001 deficit. Yet, in line with the government's commitment to redress the fiscal imbalances, the year 2002 sustained a **primary surplus** of LL 330 billion (or 1.26 percent of GDP), marking a 302 percent increase from 2001. The primary surplus pulled up from 1 percent to 3 percent of total expenditures compared to one year earlier. The amelioration in the primary surplus is attributed to the 26% increase in **total revenues (budget and treasury)**, amounting to LL 5,846 billion in 2002 (or 22.42 percent of GDP).

On the other hand, **total expenditures (budget and treasury)** reached LL 10,139 billion (or 38.9 percent of GDP) in 2002, up by LL 1,236 billion from 2001. Of this 14 percent rise in 2002 spending, LL 522 billion stemmed from treasury payments (extra-budgetary transfers to municipalities and Electricité du Liban, or EDL). Actual total spending in 2002 fell close to the forecasted LL 10,125 billion.

¹ As per latest IMF data, GDP 2002 equals LL 26,068 billion.

Section II: Revenue Outcome

Table 2. Summary of Revenue Performance

(LL billion)	2001	2002	%
	Jan-Dec	Jan-Dec	change
Budget revenues	4,260	5,399	26.7
Tax revenues	2,961	3,995	34.9
Non tax revenues	1,299	1,404	8.1
Treasury receipts	385	447	16
Total revenues	4,646	5,846	25.8

Source: MOF, DGF

Tax revenues (as part of budget revenues) increased by LL 1,034 billion. Contributing to this rise were increases in revenues from income tax and property tax, and mainly the introduction of the VAT.

☒ **Tax on income** generated LL 727 billion in 2002, overgrowing the LL 650 billion budgeted amount, representing a 16 percent increase from the 2001 level. This net amelioration in revenue generation is mainly attributable to the tax regularization law which was ratified by Parliament in December 2001. The assessment proceeds of the regularization, amounting to LL 161 billion, were partly collected in 2002 (LL 94 billion) and remain partly outstanding for collection in 2003.

This was coupled with other measures, namely the adoption of the Tax Identification Number (TIN) in January 2002 for all importers,

and the introduction of the VAT in February 2002, all of which helped improve tax compliance, monitor avoidance and enlarge the taxpayers' base; contributing to the improved general performance of income tax during 2002.

☒ **Tax on Property:** The enactment of the new legislation on property ownership in 2001, which facilitated foreign property ownership and lowered real estate registration fees for both foreigners and locals contributed to the 10 percent increase in revenues from tax on property as compared to the previous year. Tax on property in 2002 generated LL 300 billion, of which LL 200 billion was from non-recurrent real estate registration fees. The issuance of the assessment schedules (assessment for two or four fiscal years extending over the period of 1997 to 2000,

Table 3. Tax Revenues

(LL billion)	2001	2002	%
	Jan-Dec	Jan-Dec	change
Tax revenues	2,961	3,995	34.9%
Tax on income, profits, & capital gains	626	727	16.1%
Tax on property	273	300	9.6%
Domestic taxes on goods & services, of which	239	1,162	387.1%
Value Added Tax	-	993	100.0%
Taxes on international trade, of which	1,632	1,618	-0.9%
Customs	856	596	-30.5%
Excises	776	1,023	31.8%
Other tax revenues	191	189	-1.2%

Source: MOF, DGF

Note: Value Added Tax represents the VAT collected at customs and at the internal points of sale.

Table 4. Breakdown of Domestic Taxes on Goods and Services

(LL billion)	Jan-Dec 2001	Jan-Dec 2002
Excises*	836	1,031
Petroleum tax	472	703
Alcoholic beverage tax	4	5
Non alcoholic beverage tax	9	2
Tobacco tax	111	166
Cement tax	47	4
Cars	190	151
Other excises	256	358
Profits of fiscal monopolies (Regie)	0.06	0.41
Taxes on specific services (Entertainment, betting)	9	6
Sales Tax (on hotels and restaurants)	21	8
Value Added Tax	-	993
Other taxes on goods and services of which	149	147
Private cars duties	84	81
Total Domestic Taxes on Goods and Services	1,014	2,185

Source: MOF, DGF

* It is important to note that with the event of trade liberalization, year 2002 witnessed a reclassification of custom duties into excises for gasoline & tobacco products, which together with a three times consecutive rise in excises on gasoline explains the increased 2002 outcome.

depending on the geographic region) further stands behind the rise in revenues from tax on property.

☒ **Tax on Goods and Services:** The introduction of the VAT in February 2002 was the main reason behind the 115 percent leap in revenues generated from **domestic taxes on goods and services**, which cumulated at LL 2,185 billion by the end of 2002, outgrowing the budgeted LL 1,940 billion by 13 percent.

☒ The **VAT²** generated LL 993 billion during its first year of implementation, performing better than the budgeted LL 800 billion for 2002.

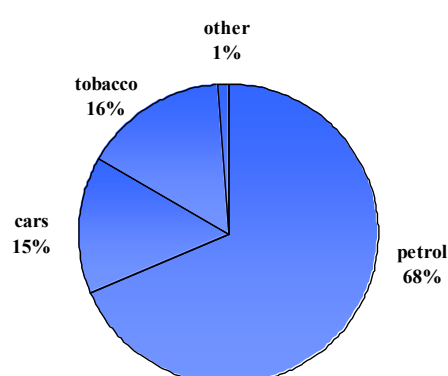
☒ **Excise taxes** (collected on 6 main items, namely tobacco, fuel, cars, alcoholic drinks, non-alcoholic drinks and cement) yielded a cumulative LL 1,031 billion, compared to LL 836 billion in 2001. A process of reclassification of custom duties into excises took place in phases during the year 2002. This explains to a large extent the 23 percent increase in revenues from excises (which by the same means explains the decline in revenues from custom duties as discussed below).

The three consecutive increases in the excise rate on gasoline in 2002 stand behind the 49 percent rise in revenues collected in this category, which cumulated at LL 703 billion by the end of December 2002. Excise revenues from alcoholic beverages and tobacco also increased by 8 and 49 percent, amounting to LL 5 billion and LL 166 billion, respectively. Excise revenues from cars registered a 21 percent decrease in 2002 from the previous year, due to a decline in car imports (from USD 619 million in 2001 to USD 558 million in 2002) in response to the VAT implementation in February 2002. This was further reflected in a 4 percent drop in revenues from private car registration fees from the previous year.

² Note however that this figure again understates the actual amount of VAT collected for the first year of VAT implementation since it is based on cash payment receipts and not on VAT declaration forms and therefore excludes QIV VAT collected from internal operations, which are processed and collected during January 2003. Note also that this figure excludes the end of year refund for VAT carry forwards.

The decrease in revenues from taxes on non-alcoholic beverages and cement in 2002 in comparison to 2001 is explained by their replacement with the VAT as of February 2002 (the residual amount in 2002 budget revenues pertain to the one-month collection prior to the VAT implementation). Similarly, the 5 percent sales tax on hotels and restaurants registered a 63 percent decrease from a year earlier (from LL 21 billion to around LL 8 billion) due to the replacement of this tax by the VAT for hotels and restaurants with turnover exceeding the LL 500 million threshold (while non registered VAT taxpayers remained subject to the 5 percent sales tax).

Breakdown of Excises 2002



Source: MOF, DGF

- ☒ **Taxes on International Trade** (custom duties) amounted to LL 596 billion in 2002, marking a 30 percent decline from the 2001 level. Three main reasons stand behind this decline. First, the 12 percent decline in import volumes registered for 2002 mainly

explains the corresponding reduction in customs revenues. Second, the process of reclassification of custom duties into excises for imported gasoline and tobacco products, which took place in phases starting in mid 2002, further explains the decline in customs revenues (and correspondingly, partially justifies the increase in excise revenues as mentioned earlier). The decrease in tariffs on clothing and leather goods by 10 percent and on tobacco from 138 percent to 113 percent (to be further replaced by VAT) is the third reason behind the decline in revenues from international trade.

For a more comprehensive analysis of taxes on international trade, customs and excises should be considered jointly (specially in light of this process of reclassification of custom duties into excises). Therefore, for a more accurate picture on the real magnitude of change, taxes on international trade (considering jointly customs and excises collected at imports) generated LL 1,632 billion in 2001, and LL 1,618 billion in 2002.

- ☒ **Other tax revenues** remained stable, cumulating at LL 189 billion by the end of 2002 (down from LL 191 billion in 2001); the bulk of which are stamp duties (given that the proceeds from the professional tax which was operational with the ratification of the regularization law will come into effect during 2003).

Table 5. Non- tax Revenues

(LL billion)	2001	2002	%change
	Jan-Dec	Jan-Dec	
Non-tax revenues	1,299	1,404	8.1%
Income from public institutions and government property	800	933	16.6%
Administrative fees & charges	387	373	-3.6%
Penalties & confiscations	34	22	-34.3%
Other non-tax revenues	78	75	-3.0%

Source: MOF, DGF

Non-tax revenues (as part of budget revenues) registered LL 1,404 billion in 2002, an 8 percent increase from the previous year. The 17 percent increase in revenues from state-owned institutions and properties stands behind the improved performance of non-tax revenues as opposed to the previous year.

☒ **Public Institutions and Government Property:** Out of the LL 933 billion of revenues generated from public institutions

and government property, LL 799 billion are transfers from the telecom budget surplus, as opposed to LL 650 billion in 2001. The increase in revenues from the telecom covers for the decrease in revenues from other state owned properties namely, Casino Du Liban, Port of Beirut, and the National Lottery Directorate by 35, 33 and 12 percent respectively. Revenues from the Central Bank decreased by 3 percent in 2002 compared to the 2001 level.

Table 6. Break-down of Entrepreneurial and Property Income

(LL billion)	2001 Jan-Dec	2002 Jan-Dec
Income from non-financial public enterprises <i>of which:</i>	744	867
Revenue from Casino du Liban	52	34
Revenue from tourist sites	1.3	1.6
Revenue from Beirut Port	15	10
Revenue from budget surplus of National Lottery	25	22
Revenue from budget surplus of telecommunications	650	799
Income from public financial institutions (Central Bank)	21	20
Property Income (namely rent of Beirut and International Airport)	30	38
Other Revenue	5	8
Total Income from public institutions and Government property	800	933

Source: MOF, DGF

Table 7. Break-down of Administrative Fees and Charges

(LL billion)	2001 Jan-Dec	2002 Jan-Dec
Administrative fees <i>of which:</i>	303	289
Notary fees	15.9	15.6
Consulate fees	15	1.5
Passport fees/ public security	86	93
Vehicle control fees (mechanic)	140	129
Driving license fees	10	13
Administrative charges*	18	20
Non industrial and incidental sales**	10	11
Permit fees <i>of which:</i>	36	46
Work permit fees	32	38
Other	20	8
Total Administrative fees and charges, non industrial and incidental sales	387	373

Source: MOF, DGF

*Administrative charges includes registration fees in public schools and in the Lebanese University, public exams fees and port authorities fees

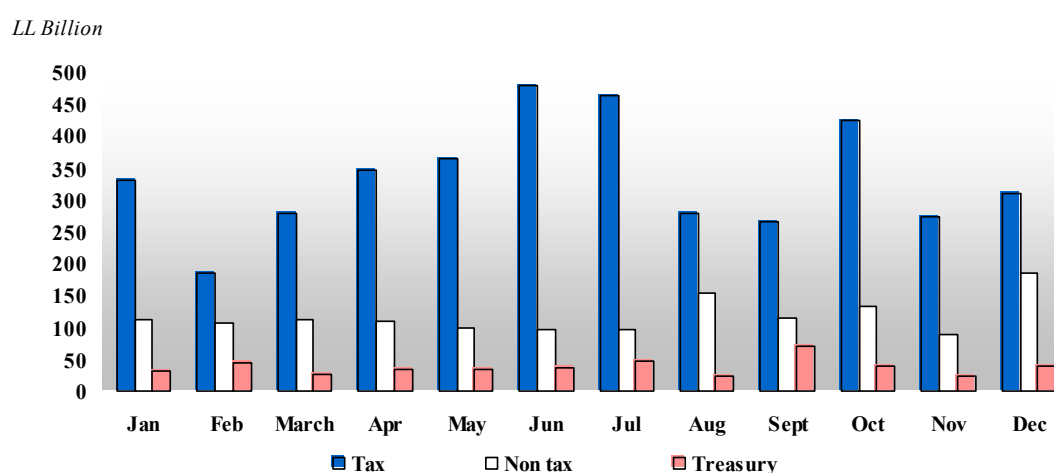
** Non industrial and incidental sales includes fees from the sale of the official gazette and the judicial magazine, plus public car plate fees.

☒ **Administrative fees and charges** witnessed a 4 percent decline from 2001, cumulating at LL 373 billion by year end 2002. Revenues from driving license, passport and work permit fees increased by 30 percent, 8 percent, and 19 percent respectively from 2001 due to the rise in fee rates as stipulated in the 2002 Budget Law. On the other hand, revenues from vehicle control fees (i.e. mechanic fees), the major component of administrative fees and charges, receded by 8 percent from the previous year, which

could be explained by the slowdown in the car market in 2002 caused by the VAT introduction. This, coupled with the 90 percent decrease in revenues from consular fees (from around LL 15 billion in 2001 down to LL 1 billion in 2002), pulled down total revenues from fees and charges by a small 4 percent from their 2001 level ³.

Treasury revenues, which cumulated at LL 447 billion, registered a 16 percent increase from a year earlier, outgrowing the forecasted LL 350 billion for 2002.

Total Revenue 2002



Source: MOF, DGF

³ Note however that these figures somehow underestimate the actual performance of administrative fees in 2002, since the bulk of consular fees for 2002 (besides the LL 1.5 billion) were actually disbursed to the Treasury and recorded as Treasury revenues and not classified within administrative fees and charges.

Section III: Expenditure Outcome

Table 8. Expenditures by Transaction Classification

(LL billion)	2001	2002	
	Jan-Dec	Jan-Dec	% change
Total expenditures	8,875	10,139	14.2%
Budget expenditures	7,745	8,487	9.6%
Expenditures excluding debt service	3,434	3,865	12.5%
Debt service	4,312	4,622	7.2%
Domestic debt	3,470	3,278	-5.5%
Foreign debt	842	1,345	59.8%
Treasury expenditures <i>of which</i>	1,130	1,652	46.2%
Municipalities	110	345	213.6%
EDL	283	305	7.8%
Previous years' appropriations	351	670	90.9%

Source: MOF, DGF

Budget expenditures cumulated at LL 8,487 billion, marking a 10 percent increase from previous year budget spending, but somehow falling short of the budgeted LL 9,375 billion in the 2002 Budget Law. This is explained by lower levels of spending on both current and capital items (please refer to table 9).

Non-interest budget expenditures amounted to LL 3,865 billion; pulling up by 13 percent from their level in 2001.

*Note that tables 8 (above) and 9 (following page) present two methods of expenditure classification. The first method (**fiscal performance table**) analyses expenditures by transaction nature, namely budget and treasury transactions. **Budget transactions** account for all debt related expenses and expenditures pertaining to the execution of the Budget Law for the year under consideration (translating into liquidated payment orders). **Treasury transactions** account for payments not related to Budget Law articles, such as municipalities spending and transfers to EDL. Treasury transactions further pertain to expenditures drawn from previous year or future years' budgets, and to expenditures paid through withdrawals from guarantees and/or deposits accounts (considered as treasury transactions). The second method (**economic classification table**) analyses expenditures by functional*

*nature rather than by transactional nature. Under this method, expenditures are classified according to their **economic function** regardless of the budget year attributable to them. There are three main functional groups along which expenditures are classified, **current expenditures**, **capital expenditures**, and **treasury expenditures**. The "adjustment figure" that reconciles the two methods of expenditure classification is recorded as **unclassified expenditures**, and it represents the amount of checks issued but not yet paid.*

Current expenditures cumulated at LL 8,321 billion in 2002, slightly below the budgeted LL 8,551 billion, the main components of which being (please refer to table 9 for detailed information):

- ☒ **Personnel cost**, which amounted to LL 3,008 billion in 2002, marked a LL 16 billion increase from 2001 due to a rise in retirement and end of service compensation. Conversely, spending on salaries, pensions and related benefits were maintained below the LL 3,155 billion allocated in the 2002 Budget Law.
- ☒ **Materials and supplies** witnessed a 14 percent decline in 2002, in line with the government objective of expenditure rationalization. Expenditures in this category

amounted to LL 130 billion, close to the budgeted level of LL132 billion.

- ☒ **External services** (rent, postal services, insurance, advertisement and public relations) reached LL 80 billion in 2002, less than the budgeted LL 112 billion for 2002 and below the 2001 level of LL 89 billion, further in line with the Government's objective of fiscal prudence.
- ☒ **Various transfers** reached LL 227 billion in 2002, rising up by 38 percent from 2001. Of that total amount, LL 25.5 billion were transfers to Investment Development Authority of Lebanon (IDAL).
- ☒ **Other current expenditures** totaled LL 200 billion in 2002 (as opposed to the budgeted LL 245 billion), of which LL 157 billion consisted of transfers to hospitals, as part of the Ministry of Health spending.
- ☒ **Reserves** in 2002 were budgeted at LL 103 billion. Of this amount, LL 54 billion was spent on interest subsidies for loans to the productive sectors (agriculture, industry, tourism, technology and crafts). The residual amount in that account was budgeted according to the type of spending for which it was needed.

Table 9: Expenditures by Economic Classification

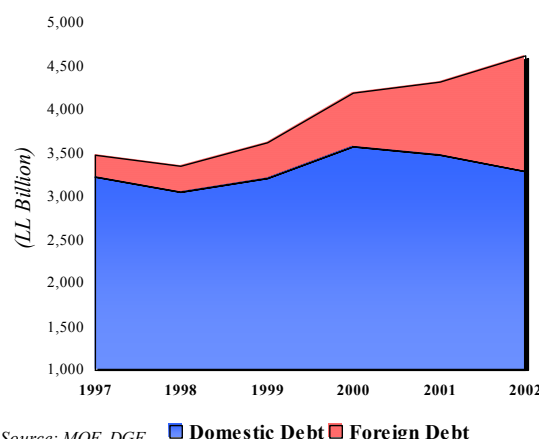
(LL billion)	Total Spending 2001	Budget Law 2002	Total Spending 2002
1. Current expenditures	7,930	8,551	8,321
1.a Personnel cost, <i>of which</i>	2,992	3,155	3,008
<i>Article 13: Salaries and wages</i>	2,004	2,061	1,960
<i>Retirement and end of service</i>			
<i>compensations</i>	834	900	857
1.b Interest payments	4,312	4,500	4,622
<i>Domestic</i>	3,470	3,500	3,278
<i>Foreign</i>	842	1,000	1,345
1.c Materials and supplies	151	132	130
1.d External services	89	112	80
1.e Various transfers	165	303	227
1.f Other current	221	245	200
1.g Reserves (1)	-	103	54
2. Capital expenditures	325	824	610
2.a Acquisitions of land, buildings, for the construction of roads, ports, airports, and water networks		14	0
2.b Equipment		39	63
2.c Construction in Progress		677	479
2.d Maintenance		64	55
2.e Other Expenditures Related to Fixed Capital Assets		30	14
3. Treasury expenditures	620	750	1,138
4. Unclassified expenditures			70
5. Total expenditures	8875	10,125	10,139

Source: MOF, DGF

Capital expenditures reached LL 610 billion in 2002, the bulk of which is construction spending, which cumulated at LL 479 billion, below the budgeted LL 677 billion level. Of this amount, LL 116 billion were allocated to the Council of the South, LL 165 billion to the Council for Development and Reconstruction (CDR), LL 63 billion to the Displaced Fund and LL 94 billion to the Ministry of Public Works and Transport.

Debt service expenditure reached LL 4,622 billion in 2002. A 60 percent rise in foreign debt service, which cumulated at LL 1,345 billion in 2002, stands behind the 7 percent increase in total debt service expenditure. On the other hand, domestic debt service recorded a 6 percent decrease from 2001, leveling off at LL 3,278 billion. The year 2002 witnessed a change in the composition mix of debt service spending, whereby the ratio of foreign debt service payments to total debt service payments rose from 20% in 2001 to 29% in 2002. This mirrors the change in the debt mix (LBP vs. USD denominated debt) whereby the ratio of foreign debt to total debt increased from 33.92 percent in 2001, to 46.42 percent in 2002.

Evolution of Debt Service Expenditure



The three debt replacement transactions with BDL that took place in March (USD 1 billion 10.25% Notes due March 2005), June (USD 500 million 10.5% Notes due June 2002) and October (USD 500 million 10.5% Notes due October 2007) of 2002 helped achieve debt service savings by swapping 24 months, costly LBP denominated T-Bills into longer maturities, less expensive, USD denominated Eurobonds.

In addition, swaps conducted by Lebanese commercial banks during the second half of 2002 on their LBP denominated T-Bills portfolio, whereby short maturities (3 and 6 months) were swapped against longer maturities (24 months) delayed maturing interest payments. This might further explain the decrease in domestic debt service spending for 2002.

Treasury expenditures amounted to LL 1,138 billion, outgrowing the expected amount. Behind this increase in treasury payments stands a LL 345 billion transfer to **The Independent Municipal Fund** (of which LL 218 billion was paid to Sukleen, which handles waste disposal and management in Greater Beirut) and a LL 305 billion transfer to **EDL**. In addition, withdrawals from Guarantees and/or Deposits accounts amounted to LL 296 billion in 2002.

Section IV: Public Debt

Table 10. Total Debt Breakdown

(LL billion)	2001	Nov-02	Dec-02	2001-2002 % change
Total debt	42,616	48,241	47,224	10.8%
Domestic debt	28,214	28,989	25,302	-10.3%
a. Central Bank	6,251	4,619	723	-88.4%
b. Commercial Banks	15,830	17,166	17,211	8.7%
c. Other Domestic Debt (Tbs)	6,133	7,205	7,368	20.1%
o/w public entities	3,055	3,212	3,221	5.4%
o/w public and financial institutions	3,078	3,993	4,147	34.7%
Foreign debt	14,402	19,252	21,922	52.2%
a. Bilateral	661	677	689	4.3%
b. Multilateral	1,364	1,481	1,474	8.1%
c. Other foreign Debt	12,377	17,095	19,759	59.6%
<i>of which Eurobonds held by BDL</i>	<i>544</i>	<i>1,572</i>	<i>2,821</i>	
<i>Eurobonds issued in Paris II context</i>	<i>0</i>	<i>0</i>	<i>1,432</i>	
<i>Other Eurobonds</i>	<i>10,933</i>	<i>14,550</i>	<i>14,609</i>	
Public sector deposits	1,913	2,648	2,655	38.8%
a. Central bank	1,388	2,109	2,109	52.0%
b. Commercial banks	525	538	546	3.9%
Net debt	40,782	45,621	44,260	8.5%

Source: Ministry of Finance, Banque du Liban

Domestic Debt: The domestic debt market in 2002 was characterized by renewed participation of the Lebanese banking sector compared to the previous year and several debt replacement transactions conducted with Banque du Liban, the latest being the transaction conducted in the context of the Paris II conference. During the first half of 2002, and similar to 2001, the Lebanese commercial banks were unwilling to increase their exposure to the government in both the domestic and foreign currency debt markets. Their participation was limited to rolling-over their holdings of government debt. The commercial banks' renewed interest came against the maturity swaps offered to them at rates 2 percent in excess of the nominal rate offered on the 2-year treasury bill. A similar option was offered to the public whose participation increased in 2002 although at lower levels than that of commercial banks. As demonstrated in Table 11, short-term bills with maturities of 3, 6, and 12 months were

swapped into the 24-month category offering a yield in excess of 16 percent. Prior to the Paris II conference, commercial banks increased the rate of their swap operations in a bid to lock-in long-term interest rates before their expectations of a decline materialized.

Banque du Liban Operations: Banque du Liban actively participated in the Treasury bill primary market during the first half of the year to fill in the shortfall in financing left by the conservative attitude of the commercial banks during that period. BDL's subscriptions were concentrated in the 2-year category, the majority of which were periodically exchanged for Eurobonds denominated in US Dollars. Indeed, the Ministry of Finance, in coordination with Banque du Liban, conducted four debt exchange transactions which helped the government lengthen the maturity profile of the outstanding debt.

In addition, and within the context of the Paris II conference, the BDL cancelled LL 2,700 billion (equivalent to USD 1.8 billion) of its Treasury bill portfolio in Lebanese Pounds against the settlement of the Treasury's share in account no. 115 (revaluation of gold). Moreover, it exchanged the remaining Lebanese Pound portfolio amounting to LL 1,221 billion (equivalent of USD 810 million)

and the outstanding amount of Eurobonds holdings (USD 1,060 million) into a special bond, issued under the Global MTN program, for the amount of USD 1.87 billion (see tables 11 and 12 on public debt by holder and instrument). Total Treasury bills in Lebanese Pounds swapped by BDL into Eurobonds in 2002 amounted to approximately LL 3,000 billion (USD 1.98 billion).

Table 11. Public Sector Debt by Instrument

(LL billion)	2001	Nov-02	Dec-02	2001-2002 % change
I. Total Debt (II+III)	42,616	48,241	47,221	10.8%
II. Domestic Debt	28,214	28,989	25,302	-10.3%
1. Long-term bonds	24,069	25,917	22,268	-7.5%
1.1 36 month bonds	1,340	339	339	-74.7%
1.2 24 month	21,998	24,828	21,214	-3.6%
1.3 Coupon Interest	730	750	715	-2.1%
2. Short-term bills	3,974	2,903	2,866	-27.9%
2.1 12 month bills	2,186	1,568	1,522	-30.4%
2.2 06 month bills	1,111	1,015	1,028	-7.5%
2.3 03 month bills	677	320	317	-53.2%
<i>*Accrued Interest included in short-term bills</i>	<i>172</i>	<i>124</i>	<i>117</i>	
3. Other domestic debt	172	170	169	-1.7%
3.1 Central Bank loans	118	114	114	-3.0%
3.2 Commercial banks' loans	54	56	55	1.1%
III. Foreign Debt	14,402	19,252	21,919	52.2%
1. Other foreign debt	2,615	2,670	2,655	1.5%
2. Eurobonds	11,788	16,582	19,264	63.4%

Source: Ministry of Finance, Banque du Liban

Foreign Debt

Eurobonds: Total Eurobonds issued in 2002 amounted to USD 5,920 million. As discussed above, BDL subscribed to USD 3,870 million of these Eurobonds on four occasions, of which USD 1,870 million were subscribed to on December 31, 2002 within the context of the Paris II conference.

In addition to the transactions with the BDL, the Ministry of Finance issued on May 15,

USD 350 million in settlement of dues owed to contractors for works completed in 2001 and during the first four months of 2002.

On August 2, the Ministry of Finance issued USD 750 million to roll-over a maturing bond initially issued in 1999 to contractors who had subsequently discounted the bonds with the domestic commercial banks.

Paris II Related Debt Transactions: The first transaction within the Paris II financial package (other than with the BDL) was executed on December 27, 2002, whereby four participant countries subscribed to a single

Eurobond for the total amount of USD 950 million, carrying a rate of 5 percent and a final maturity of 15 years. USD 350 million of the funds were received in 2002, while the remaining USD 600 million were received in mid-January 2003.

Table 12. Summary of Eurobonds Issued in 2002

Principal amount	US\$ 1 BN	US\$ 350 MN	US\$ 500 MN	US\$ 750 MN	US\$ 500 MN	US\$ 950 MN	US\$ 1870 MN
Subscribers	BDL	Contractors	BDL	Commercial Banks	BDL	KUW/OMAN/ UAE/MAL	BDL
Context	Debt repl.	Settlement of past dues	Debt repl.	Roll-over of maturing debt	Debt repl.	Paris II	Debt repl./ Paris II
Launch date	Mar 05, 02	May 15, 02	Jun 27, 02	Aug 2, 02	Oct 10, 02	Dec 27, 02	Dec 31, 02

Source: Ministry of Finance

☒ **Concessional Debt:** Concessional long-term financing is available to the Treasury from bilateral and multilateral sources to finance projects earmarked for certain activities. Total outstanding debt with

concessional terms at the end of 2002 amounted to LL 2,163 billion (equivalent to USD 1.43 billion) an increase of LL 138 billion.

Section V: Value Added Tax

Table 13. VAT Revenues from Declaration Forms⁶

(LL billion)	QI 2002 Feb- March	QII 2002 Apr- June	QIII 2002 July-Sept	QIV 2002 Oct- Dec	Total
VAT from internal operations	56	97	122	121	396
VAT from imported goods	114	204	211	227	756
Total VAT collected	170	301	333	348	1,152
Total refund claimed ***	3	10	11	31	55
Net VAT collected					1,097

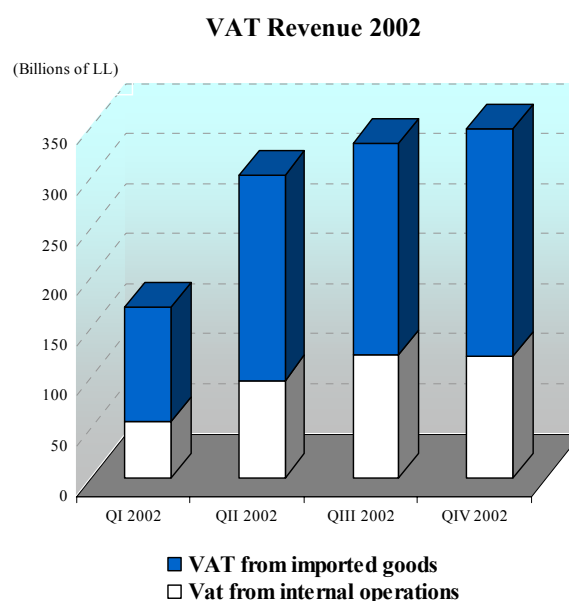
Source: MOF, VAT Directorate and Directorate General of Customs (DGC)

The VAT law was ratified by Parliament on December 5, 2001 and was implemented on February 1, 2002. The VAT is levied at a single rate of 10 percent on all goods and services, both imported and domestically produced. VAT introduction induced a one time inflation impact that did not exceed the projected 4 percent.

As of end-December 2002, the total number of VAT registrants reached 8,757. Out of this number, mandatory registrations amounted to 7,046 companies (*turnover threshold of LL 500 million*). The number of voluntary registrations, therefore, equaled 1,711 (*turnover threshold of LL 150 million*). With an amount of declarations received totaling

8,321, the VAT experienced a 95 percent compliance rate.

VAT Revenues: During its 11 months of operation (*from February till December 2002*), VAT generated LL 1,097 billion, outgrowing the budgeted LL 800 billion. Out of this amount, approximately 66 percent was collected at customs from imports of merchandise, and the remaining 34 percent was generated from internal economic activities, namely services, industry and commerce.



Source: MOF, VAT Directorate and Directorate General of Customs (DGC)

⁶ Source: MOF, VAT Directorate and Directorate General of Customs (DGC)

*VAT figures in this table are based on quarterly VAT declarations and on customs declarations. The VAT figure in the fiscal performance is based on cash collection.

** VAT figures from internal operations are based on processed declaration forms as of February 21st, 2003.

*** Total refund claims are refunds for diplomats, exempt sectors, exporters, tourists and VAT carry forwarders who claim their VAT credit by year end. Note that not all VAT creditors claim a refund by year-end, therefore net VAT collected contains an amount of VAT credit to the private sector.

Table 14. Distribution of VAT on Imports by Product

billion LL	2002 Jan-Dec	% Share
VAT collected on imports, of which	756	100%
Mineral products	192	25%
Machinery and mechanical appliances	114	15%
Transports equipment	88	12%
Prepared foodstuffs	77	10%
Textiles	62	8%
Others	222	29%

Source: MOF, Directorate General of Customs (DGC)

* VAT numbers quoted in this table are based on customs declarations.

VAT Collected from Imports of Merchandise: The increased amount of VAT collected at customs during QII and QIII reflects a pick-up in import volumes following the slowdown witnessed during the first half of 2002 (please refer to table 13 & "Imports 2001-2002" graph on page 18).

Excluding chemicals, the product distribution of VAT proceeds collected at customs somewhat reflects the composition of total imports in terms of the 5 major product categories (please refer to table 14 & "Imports Distribution by Products" graph on page 19). Indeed, despite the fact that chemical products account for the third largest import category in 2002, they do not represent significant weight in VAT collected due to the exemption of a large part of this category from the VAT (namely, drugs, medicines and agricultural chemicals).

Nevertheless, imports of the first two largest product categories, namely mineral products, (essentially fuel and oil), and machinery & mechanical appliances accounted for 25 and 15 percent shares of total VAT from imports, respectively. Despite a large list of VAT exemptions of food products (namely raw agricultural products, and basic food), prepared foodstuffs still accounted for 10 percent of total VAT collected from imports. Although not within the five major imported product categories, textiles (namely clothes) still generated 8 percent of total VAT at customs,

ranking as the fifth major source of VAT at imports.

VAT generated LL 396 billion from internal operations in 2002. Quarterly figures reflected busier internal activity during the second half of 2002 when compared to the second quarter (note that first quarter VAT proceeds accounted for only 2 months of operations).

The distribution of the 2002 VAT proceeds by economic activity (please refer to Table 15) reflects the composition of the Lebanese economy in terms of the major productive sectors, whereby services, namely tourism, business, trade and construction come as the most important VAT- generating activities.

Trading activities (retail and wholesale trade) accounted for 29 percent of total VAT paid in 2002, with around LL 109 billion. The construction sector with approximately LL 39 billion was also a major source of VAT revenues in 2002. Tourism related services, namely hotels and restaurants generated LL 34 billion, whereas VAT proceeds from business services (such as advertising, consulting, audit and legal services, architecture, etc...) amounted to LL 27 billion.

Manufacturing, namely the agro-food industry and the manufacturing of cement articles, has further a 10 percent share of total VAT receipts in 2002, with around LL 39 billion.

Table 15. VAT Receipts by Economic Activity

(in LL billion)

Economic Activity*	VAT Receipt
Retail Trade	73,043
Construction	38,848
Wholesale Trade	35,910
Hotels and Restaurants	34,231
Business activities	26,888
Manufacturing of food products	22,444
Manufacturing of non-metallic mineral products (articles of cement, concrete and plaster)	17,191
Telecommunications	13,962
Sale, maintenance and repair of vehicles	13,100
Other	104,549
Total VAT receipt from internal operations**	380,166

Source MOF, VAT Directorate

* Economic activity is classified along ISIC nomenclature.

** The VAT receipt figure in this table is based on Issued payment orders (unlike in Table 13 where the amount of VAT is based on Declaration forms).

Telecommunications and the car market generated LL 14 and LL 13 billion of VAT revenues respectively.

By end of 2002, total VAT refunds claimed cumulated at LL 55 billion, of which LL 2 billion was for diplomats, LL 8 billion for exempted sectors (Article 59 of VAT Law grants a special refund scheme for exempt activities such as agro-food industry, pharmaceutical industry, printers and publishers, public transport, medical and educational service providers, and non-profit organizations), LL 19 billion for exporters (*a destination-based VAT*), LL 21 billion for end-of-year VAT creditors, and LL 2 billion for tourists.

Section VI: Evolution of External Trade

Table 16. External Trade

(USD million)	2001	2002	
	Jan-Dec	Jan-Dec	% change
Exports	889	1,045	17.6%
Imports	7,291	6,445	-11.6%
Trade balance	-6,402	-5,399	-15.7%

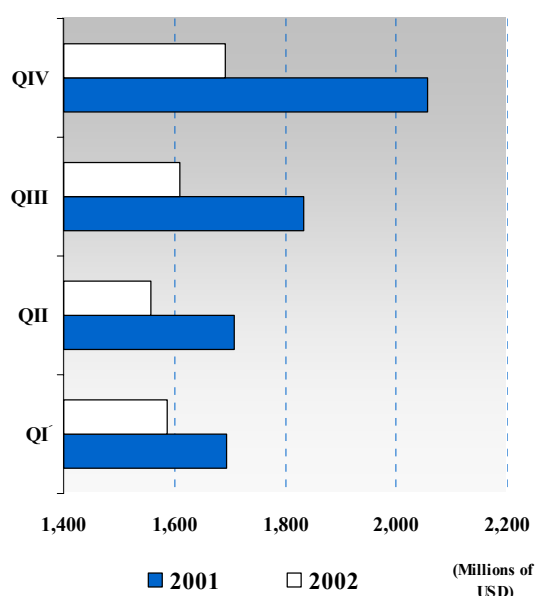
Source: MOF, Directorate General of Customs (DGC)

Balance of Trade: The trade deficit marked a 16 percent decrease, totaling USD 5,399 million by year end 2002, owing to a 12 percent decline in imports and 18 percent increase in exports.

Imports in 2002 amounted to USD 6,445 million, compared to USD 7,291 million in 2001 and USD 6,228 million for the year 2000. This spur of imports in 2001, namely during the last quarter, reflected a "pre VAT implementation" attitude (increase of stocks before the imposition of the new tax), which further translated into low volumes of imports in the months directly following the introduction of the VAT (the first two quarters of 2002). Quarterly analysis of imports in 2001 and 2002 clearly depicted this situation, while figures for the second half of 2002 marked a return to normal levels of imports.

Exports in 2002 increased by USD 156 million from a year earlier, cumulating at USD 1,045 million. This rise in exports partially reflects the 15 % growth in the industrial sector, that is increasingly focusing on more value added export potential products (source: Ministry of Industry).

**Imports 2001-2002
(Quarterly Comparison)**



Source: MOF, DGC

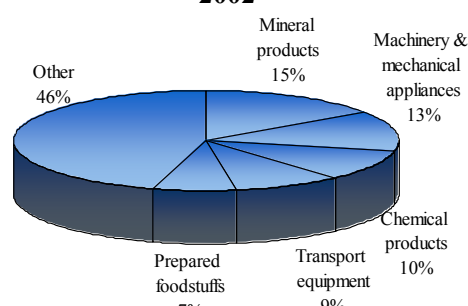
Composition and Sources of Imports: The overall decline in the volume of imports in 2002 is directly attributed to a 27.4 percent decrease in imports of minerals (the bulk of which is fuel and oil, caused by the three consecutive increases in excise rate on gasoline), and to a 20 percent decrease in imports of transportation equipments. Imports of machinery achieved a 14 percent decline from the 2001 outcome, while imports of foodstuffs and of other goods marked smaller decreases (by 6 and 7 percent respectively) than the declines in fuel, car and machinery imports, indicating that the VAT impact on oil, cars and machinery was more severe than its impact on other imported merchandise.

In terms of distribution of imports by products, 2002 does not represent significant changes from 2001. Below is the yearly performance of the five major imported product categories with their respective sources:

Mineral products, with USD 974 million of imports in 2002 (compared to USD 1,341 million in 2001), remained the leading category of imports despite a drop in their percent share of total imports from 18 percent in 2001 to 15 percent in 2002. The bulk of this item was composed of fuel and oil originating from the Russian Federal Republic, Italy, and Turkey (with 20, 13 and 10 percent shares respectively). Salt, sulphur, earths and stones were also imported from the Syrian Arab Republic and Italy (with 37 and 16 percent shares respectively).

The share of **machinery and mechanical appliances** in total imports for 2002 was not significantly altered from 2001 outcome (13 percent share of total imports in 2002 compared to 14 percent in 2001), despite an

**Imports Distribution by Product
2002**



Source: MOF, Directorate General of Customs (DGC)

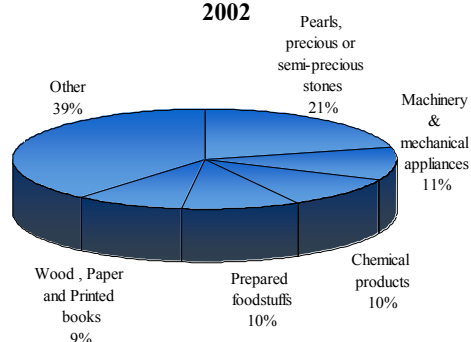
overall decline in the volume of imported machinery in 2002 by USD 136 million. Machinery and mechanical appliances originated mainly from Italy and Germany (mostly reactors and boilers) and from China (mostly electrical equipment).

Chemical products ranked third, with the share of chemical products increasing from 8 to 10 percent of total imports, due to a USD 38 million increase in imports recorded in 2002 compared to the 2001 outcome. The VAT exemption of a large portion of chemical products (including drugs and medicine, fertilizers, insecticides, and pesticides) prevented a VAT adverse effect on these imports. France and Switzerland are Lebanon's major suppliers of pharmaceuticals and cosmetics.

The share of **transport equipment** in total imports decreased from 10 to 9 percent in 2002 compared to 2001, dragging this category to the fourth position from its third position in 2001. This was due to a USD 141 million decrease in the import of transport equipment, further reflecting the slowdown in the car market during 2002 in response to the VAT introduction. Germany is Lebanon's main source of imported transportation vehicles.

Prepared foodstuffs, with USD 23 million less imports than in 2001, still accounted for 7 percent of total imports (equivalent to the previous year's share), mainly composed of beverages and spirits from the United Kingdom and France (51 and 12 percent shares respectively), and tobacco imports from the United States (64 percent share of total tobacco imports).

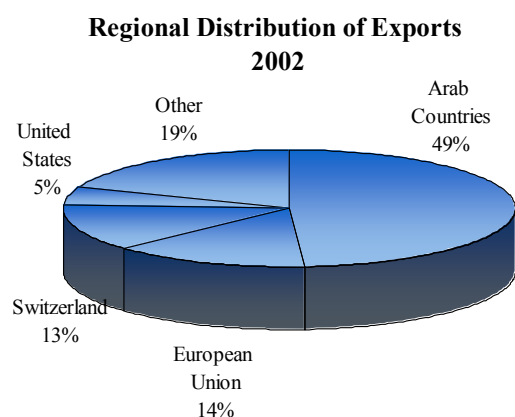
**Exports Distribution by Product
2002**



Source: MOF, Directorate General of Customs (DGC)

Composition and Destination of Exports:

The increase in exports recorded in 2002 stems mainly from the 53 percent increase in the export of jewelry (by USD 74 million from 2001) and from the 63 percent increase in the export of paper products (by USD 38 million from 2001). The following lists the five major exported product categories with their respective destinations:



Source: MOF, Directorate General of Customs (DGC)

Pearls, precious and semi precious stones represent Lebanon's major exported products (cumulating at USD 215 million in 2002 compared to USD 141 million in 2001), with a 21 percent share of total exports in 2002 as opposed to 16 percent in 2001. 60 percent of this category headed to Switzerland, and 17 percent to the United Arab Emirates.

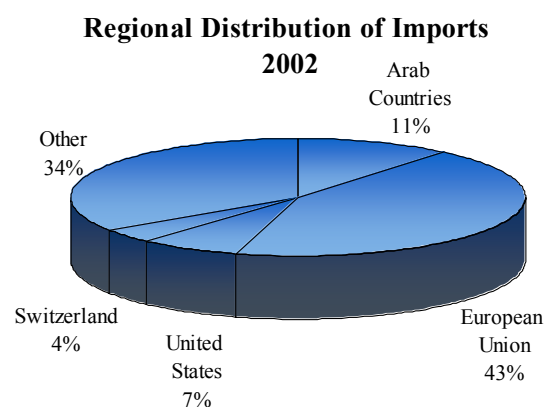
Machinery and mechanical appliance exports amounted to USD 120 million in 2002 (compared to USD 114 million in 2001), and were the second most exported articles, with an 11 percent share of exports in 2002 (declining from a 13 percent share in 2001). Machinery and mechanical appliances headed mainly to Iraq and Saudi Arabia.

Chemical product exports increased by 23 percent (reaching USD 108 million in 2002 compared to USD 88 million in 2001) maintaining their share in 2001 of total exports at 10 percent. Chemical products rose to the third rank, after ranking fourth in 2001. The major destination for chemical products is Italy, namely for chemical compounds and fertilizers.

With exports amounting to USD 102 million in 2002 (as opposed to USD 100 million in 2001, or an 11 percent share of total 2001 exports), **prepared foodstuff** maintained its position as the fourth largest export category, with a 10 percent share of total exports in 2002. Prepared foodstuff traditionally heads mainly to the United Kingdom (spirits and wines) and to the United States (for tobacco products).

Paper products, with USD 98 million worth of exports in 2002 (as opposed to USD 60 million in 2001) achieved a 9 percent share of total 2002 exports. Paper and stationary mainly headed to the Syrian Arab Republic and Saudi Arabia, whereas printed books went mostly to Belgium and Tunisia.

Lebanon Major Trading Partners: In 2002 Lebanon maintained its trading relations at approximately equal shares of imports and exports. Lebanon's major trading partners remain the European Union (most notably Italy, France, Belgium and Germany); Arab countries (the Syrian Arab Republic, Saudi Arabia, the United Arab Emirates), Switzerland, and the United States.



Source: MOF, Directorate General of Customs (DGC)

With a 43 percent share of total imported products (representing USD 2,803 million, which is an 8.5 percent decline from 2001), the **European Union** remained Lebanon's main source of imports, dominated by products from Italy (with a 25 percent share of total EU imports), Germany (with a 21 percent share of total EU imports), and France (with an 18

percent share of total EU imports). In addition, the European Union came as the second main destination for Lebanese exports, albeit with a declining share (from 19 percent in 2001 to 14 percent in 2002) due to the 12 percent fall in EU imports of Lebanese products. Belgium and Italy represented each a 15 percent share of total Lebanese exports to the EU, while the United Kingdoms imported 14 percent of Lebanese exports to the EU.

The share of **Arab countries** in total Lebanese imports in 2002 dropped from 13 to 11 percent (due to a 26 percent decrease in the volume of imported Arab merchandise), while maintaining their second rank as Lebanon's major source of imports. The Syrian Arab Republic accounted for 30 percent of imports from Arab countries, while Saudi Arabia and Egypt's share of total Arab exports to Lebanon equaled 20 and 19 percent, respectively. On the other hand, Lebanon's first export destination remained the Arab countries, with a 49 percent share of total Lebanese exports in 2002 as opposed to 44 percent in 2001 (due to a 29 percent increase in the volume of exported Lebanese merchandise to the Arab states).

Saudi Arabia and the United Arab Emirates accounted for a 19 percent share of exports each. The Syrian Arab Republic imported 15 percent of total Lebanese exports to Arab countries, while Iraq imported 14 percent of total Lebanese exports to Arab countries.

Trade with the **United States** registered slower activity compared to 2001, declining by 10 percent, yet maintaining its 7 percent share of total imports in 2002. On the other hand of the trade balance, with 11 percent less imports from Lebanon in 2002, the United States accounted for 5 percent of total Lebanese exports pulling down from the 7 percent share of 2001. In 2002, the trade balance with **Switzerland** shifted in favor of Lebanon. Lebanon imported from Switzerland 20 percent less than it did in 2001, dragging Switzerland's share of total 2002 imports down to 4 percent from 5 percent in 2001. On the export side, Switzerland represented the third major importer of Lebanese products, with its share of total Lebanese exports pulling up from 7 to 13 percent due to a 110 percent increase in its imports of Lebanese jewelry production.

Section VII: Paris II Developments

The success of the Paris II meeting held on November 23, 2002, which secured Lebanon with over US\$ 4.3 billion in low cost funding has opened a unique window of opportunity to improve the country's general financial conditions. During the conference, Lebanon presented participants with a medium-term economic program, aimed at decreasing the debt to GDP ratios over the period extending from 2003 to 2007. As such, the cornerstones of the program consist of (a) fiscal discipline and adjustment through the adopting of a variety of expenditure and revenue measures, (b) debt reduction measures mainly through

privatization and securitization transactions, and (c) proceeds from friendly countries obtained at lower costs of funding (compared to Lebanon's traditional borrowing rates from domestic and international capital markets). Following the Paris II meeting, capital markets reacted positively with an immediate drop in interest rates, a rise in deposits at commercial banks, an improvement in the secondary market performance of Lebanese Eurobonds, and an inflow of funds resulting in a reversal of the balance of payments from a deficit of \$1.2 billion in 2001 to a surplus of \$1.5 billion in 2002.

Laws Issued in light of Paris II

- ☒ **Law No. 476:** Given the goal of restructuring Lebanese debt, the law allows the Lebanese Government to borrow up to US\$ 7 billion worth of long term loans (not less than 3 years maturity), holding interest rates lower than rates available for previous loans.
- ☒ **Law No. 430:** This law allows for the creation of a separate account at Banque du Liban, named the "Account for Managing, Servicing and Lowering the Public Debt." All proceeds resulting from privatization (applies until 2022), and loans issued for the purpose of servicing the public debt, should be placed in the new BDL account.

Table 17. Received Funds

Creditor	Amounts Received	Type of Financing	Date of Receipt of Funds	Terms
Malaysia	US\$ 300 million	Eurobonds listed on the Luxembourg Stock Exchange	Malaysia bought the bonds & transferred the funds on <u>December 27, 2002</u> .	15-year maturity, 5% s.a. coupon, 5-year grace period for principal repayment, equal amortized principal payments starting year 6. declining coupon payments starting year 6.
Sultanate of Oman	US\$ 50 million	Eurobonds listed on the Luxembourg Stock Exchange	Oman bought the bonds & transferred the funds on <u>December 30, 2002</u> .	Same as Malaysia
United Arab Emirates	US\$ 300 million	Eurobonds listed on the Luxembourg Stock Exchange	UAE bought the bonds & transferred the funds on <u>January 15, 2003</u> .	Same as Malaysia
Kuwait	US\$ 300 million	Eurobonds listed on the Luxembourg Stock Exchange	Kuwait bought the bonds & transferred the funds on <u>January 22, 2003</u> .	Same as Malaysia
Arab Monetary Fund	US\$ 55 million	Structural adjustment and medium term loans	Financing was released prior to year-end: - A loan of US\$ 15 million was signed on December 19, 2002 - An additional US\$ 40 million was transferred on December 30 as part of the trade finance facilities offered by the AMF (to be transferred to EDL to finance fuel imports)	- Loan of US\$ 15 million bearing interest of 4 percent - Loan of US\$ 40 million bearing interest of 1.3 percent,
France	Euro 500 million	Loan through AFD	The loan agreement with AFD was signed on the 28 th of February, 2003 & the transfer of funds took place on the <u>3rd of March 2003</u>	15-year maturity, 5% s.a. coupon, 3-year grace period for principal repayment, declining amortized principal payments starting year 4, declining coupon payments starting year 4.
Kingdom of Saudi Arabia	US\$ 700 million	Eurobonds listed on the Luxembourg Stock Exchange	KSA bought the bonds & transferred the funds on <u>March 7, 2003</u> .	Same as Malaysia

Note that more funds are expected to be mobilized into 2003.

Section VIII: Privatization and Securitization

Privatization

Telecommunication Mobile Network

On July 22, 2002, the telecom law (Law 431) was ratified by Parliament. This law organizes the telecom sector over the Lebanese territories and determines the rules for its transfer, in part or in full, to the private sector including the role of the government in this field.

On June 1, 2002, Parliament ratified Law 393 which authorizes the government, by virtue of a decree from the Council of Ministers to:

- ☒ Grant two mobile licenses for the provision of local telephony services for a 20-years term, limited to GSM and GPRS systems through an international public auction, announced in the local, Arab and international press.

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

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, while 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 value sale of the two mobile phone licenses, with no revenue sharing, while all revenue from international calls will be transferred to the Government for the duration of the licensing arrangement.

- ☒ Grant a management contract over the two existing mobile networks for a period of three years through an international public tender, announced in the same media as the auction above. The management firm, if appointed, should secure to the government annual revenues equivalent to those received by the government in 2001 from the current operators, in addition to the declared

profit of the two operators for fiscal year 2001.

On August 31, 2002, the status of the mobile phone operators was changed from a BOT to a management contract, namely the Network Custody and Operation Contract, whose expiration date was extended from January 31, 2003 to June 30 2003, time by which the auction/tender would have taken place. Starting September 1, 2002, revenues from the mobile phone sector were totally transferred to the Treasury. Indeed, the companies were expected to transfer an additional LL 22.6 billion per month (*net of charges*) over the 2002 budgeted figures. At the same time, a monthly fixed management fee, amounting to LL 12.4 billion and LL 11.8 billion, was paid to each of Cellis and Libancell, respectively. Thus, by end December 2002, the new arrangement was expected to bolster revenues by LL 90.4 billion over the 2002 budget figures. Additionally, by virtues of the Council of Ministers decision dated January 29, 2003, the government also settled the net book value of the two companies' assets and any incidental costs incurred due to the early termination of their contracts.

The government is currently preparing for the auction of the two mobile companies for which the administrative and legal issues have been already completed. Sixteen applicants have submitted expressions of interest, and a committee for the evaluation of the financial offers submitted by participants was assigned. The committee will soon shortlist the participants, and after two rounds of bidding, the Council of the Ministers will announce the winning bidder who will then present an irrevocable banking guarantee amounting to US\$ 100 million, renewable every year prior to the execution of the sale and purchase agreement with the Lebanese Government.

The licensing procedure entails the upgrading of the system and an increased market penetration through the enlargement of the two network capacities (increase the number of subscribers through the use of the 7 digit

numbers). Number portability would further enhance competition, resulting in improved services and a reduction in prices.

The Higher Council for Privatization is recommending to the new licensee to sell up to a 25% share through an initial public offering.

Telecommunication Fixed Line

Audit compilation is underway, laying the ground for the privatization of the fixed line telecommunication sector. In addition, a legal framework, presently under preparation, will enable the consolidation of functions pertaining to delivering fixed line services into a new company (Liban Telecom). An auction is to be launched in 2004 permitting the sale of 40 percent of Liban Telecom. Also, it is expected that a third mobile license will be issued to Liban Telecom.

Electricity

On August 8, 2002, Parliament ratified the electricity privatization law which sets forth the rules, principles and framework governing the electricity sector, including the government's role in this sector, the principles and bases regulating it, as well as the rules governing the total or partial transfer of this sector or of its management to the private sector. EDL's assets are to be dismantled into production, transmission and distribution phases which are independent of each other financially and administratively. The law also provides for the creation of a commercial public corporation under the Lebanese Code of Commerce, responsible for the production and distribution activities and whose shares would be initially owned by the government and subsequently transferred (up to 40%) to a strategic partner. While EDL may subcontract the management, operations, or development to the private sector (subject to Cabinet approval), transmission operations are to be kept under government supervision.

In the interim, BNP Paribas was mandated by the government in March 2001 to act as the financial advisor. Also, Deloitte & Touche, the international audit firm, is performing EDL's financial due diligence. In addition, a new board was nominated in January 2002 to improve EDL's financial situation and to facilitate private sector participation. In October 2002, government launched a call for an expression of interest in both the local and international press, and has received interest from 20 potential investors/operators.

Water Sector

The new water sector law incorporating the waste-water sector was ratified by Parliament in May 2000, and was later amended in December 2001 to include the waste-water sector. The water law calls for reforming the sector by consolidating the management and responsibilities of potable water and waste water from the existing twenty-two to four water regional offices (Beirut/ Mount Lebanon, North, Bekaa, and the South). The Government also mandated an investment bank, "Société Générale de Banque au Liban" (SGBL), for advising on the privatization of the water and waste water sectors in Lebanon. The bank will report on regulatory and institutional issues, prepare a tariff study as well as develop a transactional and sectoral strategy.

The financing of infrastructure work in the Tripoli water office (a 20 million project financed by the Agence Francaise de Development) and in the Bekaa water office (a USD 40 million project financed by the World Bank) facilitates private sector participation in this sector.

In these two regions, a process of awarding a management contract to a private operator (water supply) has been launched and is relatively advanced at present stage. However, such interim management contract does not present any impediment to the sector privatization whereby water delivery, water recycling and water treatment will be privatized through a concession scheme awarded to one or two operators.

Securitization

The government is preparing to perform its first securitization operation as part of the government strategy to reduce the stock of debt. The strategy to be followed on the securitization operation is to pursue the option of 'true sale' (with no recourse on the government), and to design structures which allow for higher rating than the sovereign.

Following the issuance of Law no. 430 allowing the government to conduct securitization operations in respect of designated revenue flows, including revenues from mobile telephony and tobacco, the Ministry of Finance (MOF) 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:

Request for Proposals 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 selected as joint co-leads for the management of the securitization of the tobacco and telecom future revenue flows.

- ☒ **Tobacco:** According to the tobacco sector scheme, customs and excise revenues due from the importation of foreign cigarettes into Lebanon are to be securitized. Tobacco companies will pay their dues in dollars (as opposed to Lebanese pounds) into offshore accounts. The net proceeds will be used to retire expensive local currency debt instruments.
- ☒ **Telecom:** Since the government has been actively engaged in the privatization of this sector, securitization transactions of telecom revenues are pending on the completion of selling the licenses.

More specifically, the following developments have taken place on the tobacco sector front:

Transaction Structure:

The structure which was selected in order to secure offshore payment of the flows is in the process of being finalized.

Due Diligence: The process was completed after the due diligence mission was conducted in September 2002.

Financial Model: A financial model was constructed based on the data requested as well as the audited financial statements of the Regie.

New Customs' Duties Law: A draft law authorizing the payment by the international tobacco companies of customs duties in U.S. dollars and into an off-shore account as directed by MOF has been finalized, and is being sent to the Council of State for opinion.

Offering Circular & Legal Documents: Drafts are currently being examined by the investment banks and the MOF.

Special Purpose Vehicle (SPV): The SPV will be called "International Receivables Finance Ltd".

Section IX: Budget Law 2003

Parliament ratified the 2003 Budget Law on January 28, 2003, with the following main expenditure and revenue figures:

Budget revenue is expected to increase from an actual level of LL 5,399 billion in 2002 to LL 6,475 billion in the 2003 Budget Law (or by 20%), reflecting a rise from an actual level of 21% of GDP in 2002 to around 24% of GDP in the 2003 Budget Law. This will be accomplished through the introduction of new revenue measures such as the introduction of a 5 percent tax on interest revenue, the increase in local fixed line phone call and monthly subscription fees, the implementation of a decrease in the current VAT threshold, the introduction of a Large Taxpayer's Unit, and the ratification of the opposed to 2002 when the VAT Law was only ratified and applied starting February.

Budget expenditure will decrease from LL 9,375 billion in the 2002 Budget Law to LL 8,600 billion in the 2003 Budget Law (or by 8%), or from a level of 36% of GDP in the 2002 Budget Law to 31% of GDP in the 2003 Budget Law, mainly through limiting recurrent (*excluding personnel cost*) and capital spending to their minimum possible levels and decreasing the cost of debt service. While expenditure items of the various public administrations' budgets were reduced and rationalized, the Government increased social spending (consisting of health, education, and other social transfers) by 4% compared to the 2002 Budget Law (please refer to Table 6).

As a result, the **budget deficit** is projected to decrease by 45 percent, reaching LL 2,125 by year end 2003, while the **primary surplus** is expected to continue growing, to reach LL 1,875 billion by the end of 2003.

For more information on the Budget Law 2003, refer to 'Budget Law 2003 Brief Note' available on www.finance.gov.lb.

Table 18. 2002 and 2003 Budget Laws

<i>(LL billion)</i>	2002 Budget Law	2003 Budget Law	Magnitude of change over Budget '02	Percentage of change over Budget '02
Budget Revenue	5,500	6,475	975	18
1. Tax revenue	4,036	4,726	690	17
2. Non-tax revenue	1,464	1,749	285	20
Budget Expenditure	9,375	8,600	(775)	(8)
1. Current expenditure	8,551	8,203	(348)	(4)
a. Debt service bill	4,500	4,000	(500)	(11)
b. Other current	4,051	4,203	152	4
2. Capital expenditures	824	397	(427)	(-52)
Budget Deficit	(3,875)	(2,125)	(1,750)	(-45)
Primary Deficit /Surplus	625	1,875	1,250	200