REPUBLIC OF LEBANON
MINISTRY OF FINANCE

# Public Finance Prospects 2003
# Ministry of Finance Yearly Report

- **General Fiscal Developments:** In line with the government's commitment to fiscal consolidation, the year 2003 was marked by an increase of the primary surplus to 3.5 percent of GDP compared to a level of 1.2 percent in 2002 **(section 1)**.
- **Revenues and Expenditures:** The total deficit declined by LL 370 billion between 2002 and 2003, equivalent to 1.4% of GDP. The decline in the deficit was mainly due to higher revenues (from LL 5,830 to LL 6,654 billion), chiefly as a result of increased VAT revenues and the successful implementation of the 5% tax on interest. The 14 percent increase in revenues outweighed in magnitude the 4.5 percent rise in expenditures, which was largely owing to the increase in debt service payments and in transfers to EDL **(section 2 and 3)**.
- **Public Debt Developments:** By the end of 2003, the gross stock of debt cumulated at LL 50,193 billion, marking an increase of 6 percent as compared to the 11 percent increase of 2002. Foreign debt amounted to LL 23,353 billion by year end, marking a total rise of LL 1,381 billion from the 2002 outcome, and keeping the ratio of foreign debt to total debt stable at 46.5 percent when compared to 2002. By year end 2003, net market debt declined by around 21 percent to reach LL 26,789 billion **(section 4)**.
- **Paris II Developments** The financial inflows of the Paris II conference from lender countries, coupled with the two schemes from the Central Bank and Lebanese commercial banks, represented a financial package worth US$ 10.1 billion which re-profiled the equivalent of 32 percent of the total stock of debt and had therefore a remarkable effect on confidence, triggering a steady decline in interest rates. This in turn resulted in a reduction in the cost of debt service from a weighted average of around 12 percent at end November 2002 to around 8 percent at end December 2003 **(section 5)**.
- **External Trade:** A USD 723 million, or 11 percent increase in imports, and a USD 479 million, or 46 percent, increase in exports are behind the 5 percent increase in the balance of trade deficit, which reach USD 5,644 million by year end 2003 **(section 6)**.
- **VAT Developments:** By year end 2003, with 12,302 registrants and a 90 percent compliance rate, the VAT generated LL 1,361 billion, equivalent to around 5 percent of GDP; and of which 66 percent were collected from the import of merchandise, and 34 percent from internal activities **(section 7)**.
- **Privatization & securitization developments:** Throughout 2003, preparatory work was completed on the securitization of tobacco receipts while, on the privatization front, the status of the 2 cellular companies witnessed modifications **(section 8)**.

**Contents**

# Section I: Fiscal Overview 2003

## Table 1. Summary of Fiscal Performance

| (LL billion) | 2002 Jan-Dec | 2003 Jan-Dec | change 2002-2003 | % change |
|---|---|---|---|---|
| Budget revenue | 5,385 | 6,219 | 833 | 15.5% |
| Budget expenditures | 8,487 | 8,810 | 323 | 3.8% |
| *o/w Debt service* | 4,622 | 4,874 | 252 | 5.5% |
| | | | | |
| **Budget deficit/surplus** | **-3,101** | **-2,591** | **510** | **-16.4%** |
| in % of budget expenditures | -36.5% | -29.4% | | |
| **Budget primary deficit/surplus** | **1,521** | **2,283** | **762** | **50.1%** |
| in % of budget expenditures | 17.9% | 25.9% | | |
| | | | | |
| Treasury receipts | 445 | 436 | -9 | -2.0% |
| Treasury payments | 1,652 | 1,783 | 131 | 7.9% |
| | | | | |
| Total budget and treasury receipts | 5,830 | 6,654 | 824 | 14.1% |
| Total budget and treasury payments | 10,138 | 10,592 | 454 | 4.5% |
| | | | | |
| **Total cash deficit/surplus** | **-4,308** | **-3,938** | **370** | **-8.6%** |
| in % of total expenditures | -42.5% | -37.2% | | |
| **Primary deficit/surplus** | **314** | **936** | **622** | **198.3%** |
| in % of total expenditures | 3.1% | 8.8% | | |

*Source: Ministry of Finance (MOF),*

The 2003 **budget deficit** improved by 16.4 percent compared to the previous year, decreasing from 36.5 percent of budget expenditures in 2002 to 29 percent in 2003. As a percentage of GDP[1], the budget deficit improved from 11.8 percent in 2002 to 9.5[2] percent in 2003, bringing the ratio to below the 10 percent of GDP threshold for the first time in at least a decade. Behind these improvements stands, first, a 12.7 increase in tax revenues and a 23.5 percent increase in non tax revenues, which pulled **budget revenues** up by 15.5 percent; from LL 5,385 billion in 2002 to LL 6,219 billion in 2003. The increase in budget revenues was largely sufficient to offset the 3.8 percent increase in **budget expenditures,** which as a result of higher levels of spending on both capital and debt service spending ended up cumulating at LL 8,810 billion.

On the other hand, **total expenditures (budget and treasury)** reached LL 10,592 billion (or 39 percent of GDP) in 2003, increasing by LL 454 billion from 2002. Of this 4.5 percent rise in 2003 spending, LL 252 billion, or 56 percent, stemmed from the increase in debt service spending. Actual total spending in 2003 differed from the budgeted LL 9,400 billion because the actual debt service exceeded the budgeted amount (projected at that time, considering proceeds from privatization and securitization which did not materialize) by an amount equaling LL 874 billion.

**Total deficit** (budget and treasury) for 2003 totaled LL 3,938 billion (14.52 percent of GDP), adding LL 370 billion (1.36 percent of GDP) over the 2002 deficit. Yet, in line with the government's commitment to redress the fiscal imbalances, the year 2003 sustained a **primary surplus** of LL 936 billion, or 3.45 percent of GDP, compared to 1.2 percent in 2002. The amelioration in the primary surplus is attributed to the 14% increase in **total revenues,** which amounted to 6,654 billion in 2003 (or 24.53 percent of GDP).

[1] *As per latest GDP 2003 estimates (MOF, BDL, & IMF), GDP for 2002 equals LL 26,068 billion, while GDP for 2003 equals LL 27,121 billion.*
[2] *The budgeted ratio of expenditures (excluding treasury payments) to GDP was of 9.31 percent.*

## Section II: Revenue Outcome

**Table 2. Summary of Revenue Performance**

| (LL billion) | 2002 Jan-Dec | 2003 Jan-Dec | % change |
|---|---|---|---|
| Budget Revenues | 5,385 | 6,219 | 15.5% |
| Tax Revenues | 3,995 | 4,502 | 12.7% |
| Non Tax Revenues | 1,390 | 1,717 | 23.5% |
| Treasury Receipts | 445 | 436 | -2.0% |
| **Total Revenues** | **5,830** | **6,654** | **14.1%** |

*Source: MOF, DGF*

**Tax revenues** (as part of budget revenues) generated LL 4,502 billion in 2003, equivalent to 16.6 percent of GDP, and increasing by LL 507 billion or by 13 percent. Contributing to this rise were the increase in the VAT revenue, the introduction of the new 5% tax on interest income, and increases in revenues across all tax categories.

**Tax on income, profits and capital gains** generated LL 783 billion in 2003, or 3 percent of GDP, representing an 8 percent increase from the 2002 level. This net amelioration in revenue generation is mainly attributable to the new **5% tax on interest generating income** which was ratified by Parliament as part of the 2003 Budget Law (Law 497).[3] This new tax on interest income allowed a total collection of LL 145 billion, during its 11 months of implementation in 2003.[4] This was coupled with another revenue enhancement measure with Article 21 of Budget Law 2003 which amended **the Income Tax Law on wages and salaries** by changing the schedule of filing and payments from semi-annual to quarterly.[5]

This resulted in lower tax arrears, further securing the Treasury with higher frequencies of inflows. By end of December 2003, with four filing and payment dates instead of two, the payroll tax accumulated LL 173 billion, registering an increase of 26 percent from the 2002 level when LL 137 billion were collected.

Collection of **income tax on profits** receded by 18 percent in 2003 compared to 2002 owing largely to lower outstanding tax regularization. A total of LL 99 billion of tax regularization proceeds were collected in 2002 compared to LL 32 billion of installments collected by December 2003[6].

On the other hand, efforts were made to enlarge the taxpayers' base: professionals were called upon to register in the Income Tax Department and receive a Personal Identification Number[7]. This will ultimately secure added income tax revenues from professionals in the future.

**Income tax on capital gains and dividends,** with a total collection of LL 51 billion by the end of December 2003, registered 40 percent less revenues than 2002 where proceeds amounted to LL 97 billion. The proceeds from the tax on capital gain arise mostly from commercial banks' distribution of dividends, implying a reduction in the distribution of profits in 2003 as compared to a year earlier.

[3] *The tax is applicable to interest income in all currencies, including deposit accounts (current and savings) of which also non-resident accounts, fund management accounts, Certificates of Deposit, debt securities issued by private sector entities, and Treasury Bill accounts. Banks are required to collect and forward this tax to the Treasury on a monthly basis.*

[4] *The 5% tax on interest income was implemented in February 2003 and the tax was collected with a one month lag. Proceeds are collected in the first fifteen days of the following month, and hence December 2003 proceeds were collected in January 2004. The LL 145 billion in 2003 pertains therefore to 10 months collection from a cash basis perspective.*

[5] *Previously, payments of payroll tax were effected in January and in July, whereas now, with the amendment of the Income Tax Law, payments are effected in January, April, July and October of each year.*

[6] *The Tax Amnesty Law which was ratified by Parliament by the end of the fiscal year 2001 resulted in a total tax regularization assessment of LL 161 billion, partly paid in 2002 and the balance was to be paid on installment basis throughout 2003-2005.*

[7] *The regularization of professionals permitted the collection of a certain amount of regularization proceeds and in December 2003, when the bulk of the registrations were effected a total of LL 584 million was collected.*

**Table 3. Tax Revenue**

| (LL billion) | 2002 Jan-Dec | 2003 Jan-Dec | % change |
|---|---|---|---|
| **Tax revenue** | **3,995** | **4,502** | **12.7%** |
| **Tax on income, profits, & capital gains, of which** | **727** | **783** | 7.7% |
| *Income Tax on Profits of which:* | *482* | *397* | -17.6% |
| *Regularization Tax* | *99* | *32* | -67.7% |
| *Income Tax on Wages and Salaries* | *137* | *173* | *26.3%* |
| *Income Tax on Capital Gains & Dividends* | *97* | *51* | *-47.4%* |
| *5% Tax on interest income* | | *145* | |
| **Tax on property** | **300** | **321** | ***7.0%*** |
| **Domestic taxes on goods & services**, of which | **1,162** | **1,537** | ***32.3%*** |
| *Value Added Tax* | *993* | *1,361* | *37.1%* |
| *Taxes on specific services (Entertainment, betting)* | *5* | *5* | *0.0%* |
| *Sales Tax (on hotels and restaurants)* | *8* | *3* | *-62.5%* |
| *Other taxes on goods and services of which:* | *147* | *166* | *12.9%* |
| *Private cars duties* | *81* | *92* | *13.6%* |
| *Passenger Departure Tax* | *63* | *71* | *12.7%* |
| **Taxes on international trade**, of which | **1,618** | **1,643** | ***1.5%*** |
| *Customs* | *596* | *475* | *-20.3%* |
| *Excises of which:* | *1,023* | *1,167* | *14.1%* |
| *Petroleum tax* | *703* | *819* | *16.5%* |
| *Tobacco tax* | *166* | *185* | *11.4%* |
| *Cars* | *151* | *161* | *6.6%* |
| **Other tax revenue** | **189** | **217** | ***14.8%*** |

*Source: MOF, DGF*

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

**Tax on property:** Proceeds from the **property tax** cumulated at LL 321 billion by the end of December 2003, 7 percent above the collected amount during 2002. This increase stems, first, from the improvement in the overall performance of the **Built Property Tax** (the recurrent component of the tax) which witnessed a 26 percent amelioration increasing to LL 82 billion in 2003 (this is explained by an extensive audit activity in 2003, and the issuance of the assessment schedules for the Baabda region for the years 1993-1995) and, second, from an 8 percent increase in the **inheritance tax** collection which reached LL 37 billion. The bulk of the tax on property, LL 203 billion, was generated from real **estate registration fees** which increased by 1.5 percent with respect to 2002. This may suggest a slow down of activities in the real estate market during 2003, especially when compared to a 9 percent increase in registration fees witnessed in 2002. This relative slow-down in the demand for real estate however did not apply to the demand of foreigners. Foreigner's acquisition of real estate in 2003 accounts for the bulk of this 1.5 percent increase in cadastre fees. (for more details, please refer to Box 2).

**Tax on Domestic Goods and Services:** The **VAT** constituted 88.5 percent of **domestic taxes on goods and services**. It generated LL 1,361 billion and represented 5 percent of GDP in 2003. The LL 368 billion increase in VAT collected accounted for 98 percent of the increase in **domestic taxes on goods and services**, which increased to LL 1,537 billion, by the end of 2003.

In 2003, the **VAT** outperformed the budgeted amount by 23.7 percent and its 2002 performance by 37 percent. The LL 368 billion increase in VAT resulted from the following factors:

(a) In 2003, the VAT was collected for the full year, unlike 2002 when it was implemented for only 11 months (it was implemented in February 2002). The "January effect" accounted for approximately 50 percent of the increase of the VAT in 2003.

(b) VAT collected at imports in 2003 totalled LL 903 billion, with a pick up in the second half of the year (mirroring increased import flows with respect to 2002) while VAT collected from internal operations amounted to LL 458 billion with a pronounced peak in October (pertaining

to the intensive economic activity during the summer season).
(c) The lowering of the VAT threshold to LL 300 million is a third factor explaining the rise in VAT collected in 2003 besides the "January effect" and the improvement in consumption levels as suggested by certain fiscal indicators.

**Taxes on international trade** generated LL 1,643 billion by the end of December 2003, 1.5 percent higher than the collected amount in 2002. Of that total amount, 71 percent are excises[8] and the remaining LL 475 billion are custom duties. Revenues from excises increased by 14 percent from the level achieved in 2002, whereas custom duties witnessed a 20 percent decline, owing mainly to the reclassification process[9].

For a more accurate picture of the trends in trade revenues, excises and customs should be considered jointly. This increase in trade revenues (**excises and custom duties**) mirrors the 11 percent rise in imports witnessed during the year. In fact, the increase in the value of imports in 2003 stems mostly from equal increases in the following excisable items, transport equipment namely cars and mineral products namely fuel and gasoline (*for further details, please refer to the trade section*).

During 2003, gasoline imports (one of the component of mineral fuel and its derivatives which is mainly used for cars) increased by 4 percent (in billions of liters) even though their price was 16 percent higher than in 2002. Note that the trade revenues from gasoline are levied on liters (at LL 493 per liter, almost unchanged from the previous year), and not on values, therefore the increase in tax revenues from gasoline (of around 2 percent) is of a smaller magnitude then the equivalent increase in gasoline imports (almost 21 percent)[10].
As for cars, the increase in imports (by 10 percent) is reflected in a similar 9 percent increase in trade revenues from cars. The suggested improvement in the car business is further reflected in a 13.5 percent increased collection of car registration fees (other taxes on goods and services), which cumulated at LL 92 billion by end of December 2003. Both indicators hint to a rebound in the car market, as compared to 2002, despite the appreciation of the Euro in 2003.

**Other tax revenues,** namely fiscal stamp duties, increased by LL 28 billion, cumulating at LL 217 billion by the end of 2003. This almost 15 percent increase suggests a higher level of transactions taking place in 2003.

[8] *Excises at customs are levied mainly on fuel, cars and tobacco*
[9] *In the second half of 2002, a process of reclassifying custom duties into excises took place, therefore comparing excises and customs with 2002 figures on a separate basis is somehow misleading of the accurate trends in trade revenues.*
[10] Trade revenues (customs and excises) from gasoline and cars described above are from custom's database.

**Table 4. Non-tax Revenue**

| (LL billion) | 2002 Jan-Dec | 2003 Jan-Dec | % change |
|---|---|---|---|
| **Non-tax revenue** | **1,390** | **1,717** | **23.5%** |
| Income from public institutions and government property | 916 | 1,252 | 36.7% |
| *Transfer from the telecom surplus* | *785* | *1,086* | *38.3%* |
| Administrative fees & charges | 376 | 383 | 1.9% |
| Penalties & confiscations | 21 | 6 | -73.4% |
| Other non-tax revenue | 77 | 75 | -1.4% |

*Source: MOF, DGF*

*Note: Non-tax revenue is included within budget revenue*

In 2003, **non-tax revenues** increased by 24 percent as compared to 2002, cumulating at LL 1,717 billion.. This improvement was mainly due to the 37 percent increase in revenues from **public institutions and government properties.**

**Public Institutions and Government Property**: In 2003, public institutions and government property generated LL 1,252 billion of which LL 1,086 billion (the equivalent of 4 percent of the GDP) were transfers from the telecom budget surplus (both mobile and fixed lines). This compares to LL 785 billion collected from the telecom surplus in 2002. Since a breakdown between net revenues from the mobile and fixed lines is not available, the assumption is that the 38 percent rise in 2003 is partly due to the full transfer of the mobile telecom revenues. Another explanation behind the amelioration in the telecom surplus could have resulted from the increase, in 2003, of local fixed line phone call fees from LL 40 to LL 49 per minute as well as from the increase in monthly fixed line subscription fees from LL 12,000 to LL 20,000. The increase in revenues from Telecom was accompanied by the increase in revenues from other state-owned properties namely, Casino du Liban, Port of Beirut and the National Lottery Directorate by 15, 100, and 59 percent respectively. The Treasury further received a total of LL 57 billion of income from owned properties namely from rent proceeds of the Beirut International Airport representing a 73 percent increase from their 2002 level of collection. There were no revenues from the Central Bank in 2003 compared to LL 20 billion in 2002.

**Table 5. Break-down of Entrepreneurial and Property Income**

| (LL billion) | 2002 Jan-Dec | 2003 Jan-Dec | % change |
|---|---|---|---|
| **Income from non-financial public enterprises** *of which*: | **853** | **1,182** | **38.6%** |
| *Revenue from Casino du Liban* | *34* | *39* | 14.7% |
| *Revenue from tourist sites* | *2* | *2* | 0.0% |
| *Revenue from Beirut Port* | *10* | *20* | 100.0% |
| *Revenue from budget surplus of National Lottery* | *22* | *35* | *59.1%* |
| *Revenue surplus of telecommunications* | 785 | 1,086 | *38.3%* |
| **Income from public financial institutions** (Central Bank) | **20** | **0** | |
| **Property Income** (namely rent of Beirut and International Airport) | **35** | **58** | **65.7%** |
| **Other Revenue from public institutions and Government property** | **8** | **12** | **50.0%** |
| **Total Income from public institutions and Government property** | **916** | **1,252** | **36.7%** |

*Source: MOF, DGF*

- **Administrative fees and charges** witnessed a 2 percent increase from 2002, cumulating at LL 383 billion by year end 2003. This increase is mainly attributed to the higher collection of road usage fees (mechanic) which constitute the major component of administrative fees, and which amounted to LL 146 million (a rise of 13 percent). This is attributable to an increase in fee rates as stipulated in Budget Law 2003.

**Table 6. Break-down of Administrative Fees and Charges**

| (LL billion) | 2002 Jan-Dec | 2003 Jan-Dec | % change |
|---|---|---|---|
| **Administrative fees** *of which:* | 293 | 299 | *2.0%* |
| *Notary fees* | *16* | *16* | *0.0%* |
| *Consular fees* | *4* | *2* | *-50.0%* |
| *Public security/Passport fees* | *93* | *87* | *-6.5%* |
| *Road Usage fees (mechanic)* | *129* | *146* | *13.2%* |
| *Judicial fees* | *17* | *20* | *17.6%* |
| *Driving license fees* | *13* | *14* | *7.7%* |
| **Administrative Charges*** | **20** | **26** | **30.0%** |
| **Non industrial and incident sales**** | **11** | **9** | **-18.2%** |
| **Permit fees** *of which*: | **46** | **41** | **-10.9%** |
| *Work permit fees* | *38* | *35* | *-7.9%* |
| **Other fees and non industrial and incidental sales** | **7** | **8** | **14.3%** |
| **Total Administrative fees and charges, non industrial and incidental sales** | **376** | **383** | **1.9%** |

*Source: MOF, DGF*

** Administrative charges include registration fees in public schools and in the Lebanese University, public exams fees and port authority fees*

***Non industrial and incidental sales include fees from the sale of the official gazette and the Judicial magazine, plus public car plate fees*

Revenues from driving license and judicial fees increased by 7.7 and 17.6 percent respectively from their 2002 level. On the other hand revenues from public security,[11] permit fees (mostly work permit fees), and consular fees decreased from LL 93 billion, LL 46 billion and LL 4 billion in 2002 down to LL 87 billion, LL 41 billion and LL 2 billion, respectively. Others, such as notary fees maintained their 2002 collection level at around LL 16 billion.

**Treasury Revenues** which cumulated at LL 436 billion registered a 2 percent decrease from a year earlier, yet still outgrowing the forecasted LL 400 billion for 2003. Treasury revenues stemmed mainly from municipalities (in the amount of LL 116 billion) and guarantees (in the amount of LL 180 billion).

[11] also *known as passport fees, it is the second major component of public fees paid to the treasury*

### BOX 1: The Impact of Tourism on Government Revenues
**Summary Information**

According to the Lebanese Ministry of Tourism, more than 1 million visitors targeted Lebanon in 2003 compared to 956,464 in 2002 and 837,067 in 2001 i.e. achieving respective increases of 6 and 14 percent. This augmentation occurred despite the weak performance of March, April and May which reflected the geopolitical tensions in the region. It is therefore important to analyze the impact this increase in the tourism industry had on the Lebanese economy and consequently on government revenues.

I- a-Revenues from the Value Added Tax have been positively affected by the increased touristic activity. VAT collected on internal points of sales has increased to LL 238 billion, or 18 percent, and by LL 267 billion, or by 19 percent in the third and fourth quarters respectively as compared to 2002, partly as a result of the increase in tourism during the second and third quarters of the year.

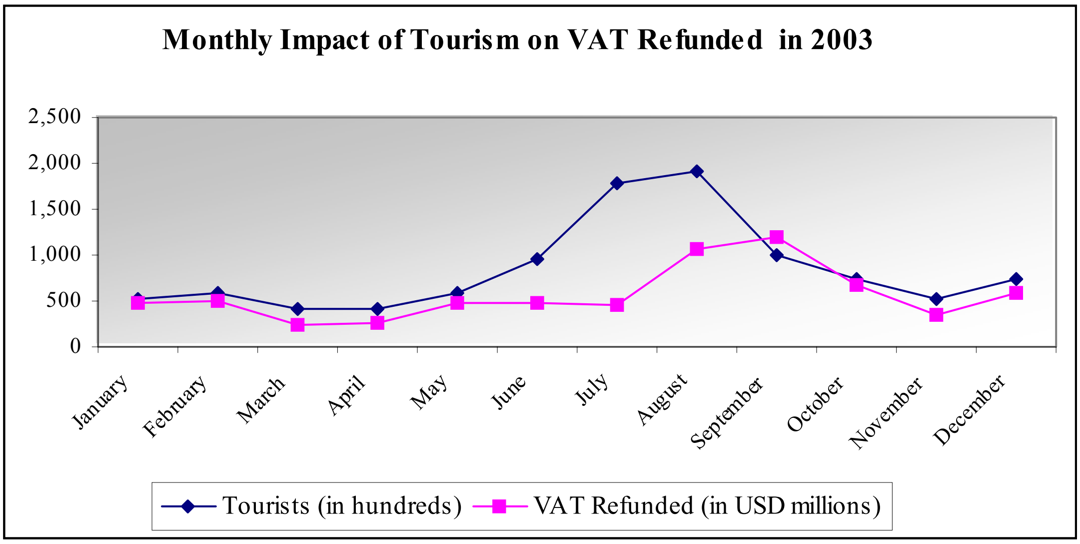
Moreover, VAT collected monthly on imports has also increased with respect to VAT collected in 2002 on imports (with the noticeable exception of the month of April because of the Iraq War). Part of this increase is likely to be attributable to the increase in touristic activity, as was confirmed by the increasing trend displayed by VAT collected at customs in the first three quarters which was correlated with the steady increases in the number of tourists between the first, second and third quarter. Furthermore, the increase in tourists by 8, 23 and 18 percent in July, August and September with respect to 2002 were accompanied by increases of 5, 15 and 25 percent of the VAT collected at customs. The drop in the number of tourists in the last quarter did not affect the VAT collected on imports. This can be explained by the effect that the national festivities had on the import pattern in Lebanon (highest levels of imports were reached in 2003 during the fourth quarter) as well as better expectations for 2004.

The two years of VAT implementation seem to reveal that there is usually a one quarter lag between higher VAT revenue collection and increased touristic activity in a given quarter.

b- An even more systematic relationship can be found between the number of tourists that came to Lebanon and the amount of VAT refunded to them mostly at the Airport. The trend displayed by the monthly visitors inflow matches the trend displayed by the monthly amount of VAT refunded to the tourists. Such a clear-cut evidence of the impact of tourism on refundable goods strengthens our conviction that there is a correlation between the number of tourists and the VAT collected and hence the argument that tourism played a role in the increase of VAT collected in 2003 during the second, third and fourth quarters of the year.

II- Quarterly comparisons show that excise taxes increased by 3 percent the second quarter, 14 percent the third and dropped by 4 percent in the last quarter. This trend was mirrored by the touristic activity which increased by 28 percent during the second quarter, by 141 percent during the third quarter and dropped by 58 percent in the last quarter. Therefore, there seems to be a correlation (although weak because the impact of tourism on excisable items is rather indirect) between the number of tourists and the excise taxes collected in 2003.

**Graph 2.**




*Source Ministry of Tourism, Global Refund*

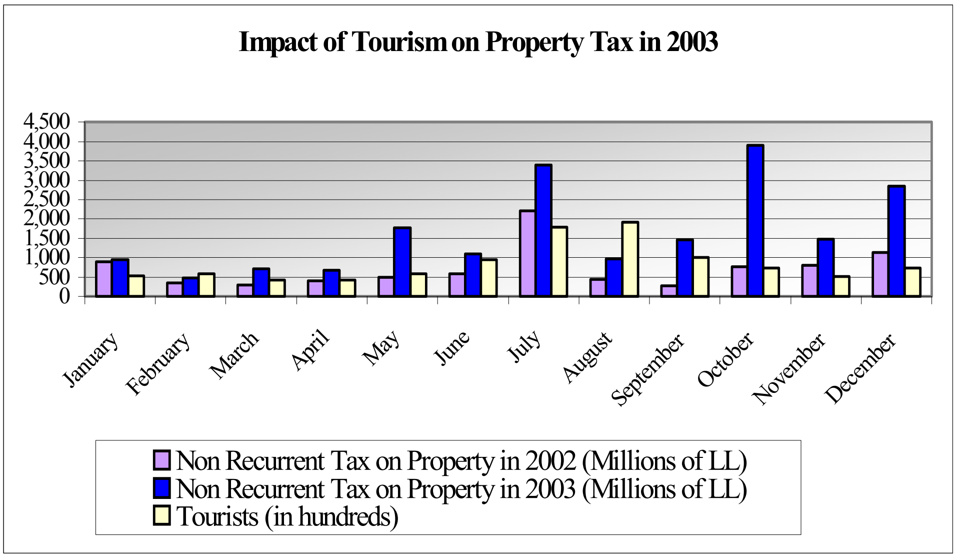
## The Impact of Tourism on Revenues

Summary Information (*...Continued*)

III- Although the increase in the real estate registration fees (which are considered as non recurrent taxes on properties and are also known as cadastre fees) witnessed only a 1.4 percent increase, the cadastre fees collected from foreigners increased by 129 percent from LBP 8,650 million up to LL 19,766 million accounting for 100 percent of the increase in the collected total cadastre fees and representing 10 percent of the total cadastre fees collected. The monthly analysis reveals that the cadastre fees collected in 2003 from foreigners were systematically higher than fees collected in 2002 and were peaking in the summer season. In addition to the increase in tourism which positively affected cadastre fees, it should be remembered that the legislation on foreign ownership endorsed by the Parliament on March 20, 2001 provided serious incentives for foreign investment by easing the legal limits on foreign ownership of property and cadastre fees to 5% for both Lebanese and foreign investors.

IV- Miscellaneous tax revenues such as passenger departure taxes have increased by 13 percent and provided an additional LBP 8 billion. Miscellaneous non tax revenues such as revenues from the Airport, revenues from the Casino as well as revenues from touristic sites also present evidences of correlation. Airport, Casino and touristic sites revenues have increased respectively by 73, 15 and 2 percent and provided respectively an additional LBP 24 billion, LBP 5 billion and LBP 35 million to the non tax revenues collected.

**Graph 3.**




*Source: Directorate of Land Registration and Cadastre*

## Section III: Expenditure Outcome

**Table 7. Expenditure by Transaction Classification**

| (LL billion) | 2002 Jan-Dec | 2003 Jan-Dec | % change |
|---|---|---|---|
| **Total expenditures** | **10,138** | **10,592** | **4.5%** |
| Budget expenditure | 8,487 | 8,810 | 3.8% |
| Expenditures excluding debt service | 3,865 | 3,935 | 1.8% |
| Debt service | 4,622 | 4,874 | 5.5% |
| Domestic debt | 3,278 | 3,108 | -5.2% |
| Foreign debt | 1,345 | 1,766 | 31.4% |
| | | | |
| Treasury expenditure | 1,652 | 1,783 | 7.9% |
| o/w Municipalities | *345* | *180* | -47.9% |
| Previous years' appropriations | *670* | *739* | 10.3% |

*Source: MOF, DGF*

**Total Expenditures (budget and treasury)** remained stable as a percentage of GDP, at 39 percent in both years, although they increased in absolute terms, from LL 10,138 billion in 2002 to LL 10,592 billion in 2003.

**Budget expenditures** cumulated at LL 8,810 billion, marking a 3.8 percent increase from the budget spending in 2002; and a LL 210 billion increase from the budgeted LL 8,600 billion (Budget Law 2003). This is mainly due to the higher than anticipated interest payments in 2003.

**Non-interest budget expenditures (primary budget expenditure)** amounted to LL 3,935 billion in 2003, equivalent to 14.5 percent of GDP increasing by LL 70 billion or 1.8 percent from their level in 2002.

When expenditures are examined from a more economically oriented perspective, both current and capital spending have increased in 2003[12].

**Current expenditures** cumulated at LL 8,820 billion in 2003, LL 617 billion above the budgeted LL 8,203 billion (Budget Law 2003), mainly due to the higher than expected debt service spending. Interest payments amounted to LL 4,874 billion, LL 874 billion above the budgeted LL 4,000 billion for 2003 and LL 252 billion above their level in 2002. Primary current expenditure amounted to LL 3,946 billion, LL 257 billion below the budgeted LL 4,203 billion. The main components of current expenditures are (*please refer to table 8*):

- **Personnel cost** amounted to LL 3,078 billion in 2003, marking a LL 70 billion increase from its level in 2002. A large part of this increase is explained by the compensation that was paid to public school teachers as a result of adjustments in their salaries. Conversely, spending on pensions was maintained at LL 845 billion, decreasing by LL 12 billion from their 2002 level.
- **Materials and supplies** amounted to LL 120 billion in 2003, decreasing by LL 10 billion from their 2002 level.
- **External services** (rent, postal services, insurance, advertisement and public relations) remained almost stable at LL 81 billion in 2003.
- **Various transfers** reached LL 271 billion in 2003, rising by LL 44 billion or 19 percent from 2002. Of that amount, LL 29 billion were transfers to Investment Development Authority of Lebanon (as compared to LL 25.5 billion in 2002).

[12] *Note that tables 7 (above) and 8 (following page) present two methods of expenditure classification. Table 7 analyses expenditures by transaction nature, namely budget and treasury transaction. Table **8** analyses expenditures by economic nature. For further information about the method, please refer to the "2002 Yearly Report" available at www.finance.gov.lb*

☒ **Other current expenditures** totaled LL 330 billion in 2003, rising by LL 130 billion from their 2002 level. This rise is mainly due to a misclassification in transfers to hospitals in 2002 which resulted in the total sum being only partially represented in 'other current expenditures' while the remainder was classified as other treasury expenditure. With that considered, transfers to hospitals equaled LL 268 billion in 2003, rising by LL 34 billion from their LL 234 billion level in 2002 (as part of the Ministry of Health spending).

☒ **Reserves** amounted to LL 66 billion in 2003 and were spent on interest subsidies for loans to the productive sectors (agriculture, industry, tourism, technology and crafts). The LL 21 billion that remained from the budgeted LL 87 billion was reallocated according to its economic classification.

**Capital expenditures** reached LL 713 billion in 2003, LL 103 billion above their 2002 level. Of this amount, LL 561 billion, or 79 percent, was allocated to “construction in progress”, subdivided into LL 241 billion for the Council for Development and Reconstruction (CDR), LL 107 billion for the Council of the South, LL 73 billion for the Displaced Fund and LL 72 billion for the Ministry of Public Works and Transport.

**Table 8. Expenditures by Economic Classification**

| (LL billion) | Total Spending 2002 | Total Spending 2003 | Budget Law 2003 |
|---|---|---|---|
| **1. Current expenditures** | **8,321** | **8,820** | **8,203** |
| 1.a Personnel cost, *of which* | 3,008 | 3,078 | 3,353 |
| *Article 13: Salaries and wages* | *1,960* | *2,026* | *2,178* |
| *Retirement and end of service compensations* | *857* | *845* | *1,000* |
| 1.b Interest payments | 4,622 | 4,874 | 4,000 |
| *Domestic* | 3,278 | 3,108 | |
| *Foreign* | 1,345 | 1,766 | |
| 1.c Materials and supplies | 130 | 120 | 124 |
| 1.d External services | 80 | 81 | 104 |
| 1.e Various transfers | 227 | 271 | 296 |
| 1.f Other current | 200 | 330 | 239 |
| 1.g Reserves | 54 | 66 | 87 |
| **2. Capital expenditures** | **610** | **713** | **397** |
| 2.a Acquisitions of land, buildings, for the construction of roads, ports, airports, and water networks | 0 | 12 | 8 |
| 2.b Equipment | 63 | 57 | 41 |
| 2.c Construction in Progress | 479 | 561 | 261 |
| 2.d Maintenance | 55 | 61 | 52 |
| 2.e Other Expenditures Related to Fixed Capital Assets | 14 | 23 | 35 |
| **3. Other treasury expenditures** | **1,138** | **1,014** | **800** |
| **4. Unclassified expenditures** | **70** | **44** | |
| **5. Total expenditures** | **10,139** | **10,592** | **9,400** |
| **6. Total primary expenditures[13]** | **5,517** | **5,718** | **5,400** |

*Source: MOF*

[13] *Total expenditures excluding interest payments*

**Debt Service Expenditures:** The interest bill on foreign currency debt increased due to the execution of the Paris II Eurobonds and loans. The debt service bill for 2003 would have been higher by approximately LL 1,000 billion had the Paris II package (including the Paris II contributions, the BDL scheme, and the commercial bank schemes) not materialized. The low cost financing provided by the Paris II schemes led to large savings. The interest bill is expected to fall further in 2004 and thereafter, once the full impact of the Paris II schemes and the effects of lower interest rates fully materialize. It is worth noting that the LL 4,000 billion allocated to debt service expenditure in the 2003 Budget Law was based on anticipations of larger Paris II proceeds, as well as income from privatization and securitization. Since these projections did not materialize in 2003, debt service reached LL 4,874 billion, thus surpassing its budgeted level by LL 874 billion.

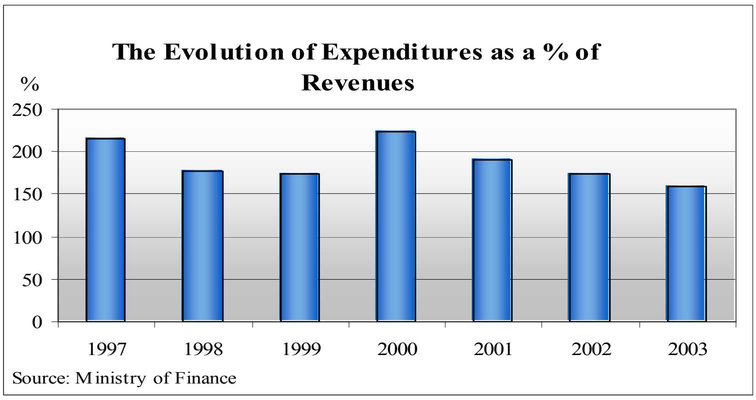
**Table 9. Transfers to EDL**

| (LL billion) | 2002 Jan-Dec | 2003 Jan-Dec | % Change |
|---|---|---|---|
| **EDL** | **305** | **413** | **35.4%** |
| Debt service* | 305 | 338 | 10.8% |
| Treasury advances for fuel purchases | - | 75 | - |
| Expropriations | - | - | - |

*Source: MOF, DGF *Includes Principal and Interest Payments*

**BOX 2: The Expenditure Ratio**
**Summary Information**

**Total expenditure** amounted to LL 10,592 billion in 2003, LL 454 billion or 4.5 percent above the 2002 level. **The expenditure ratio** however, ( total expenditure as a percentage of revenues) decreased from 174 percent in 2002 to 159 percent in 2003, reflecting the impact of an increase in revenues and the streamlining of expenditures.



# Section IV: Public Debt

## Table 10. Total Debt Breakdown

| (LL Billion) | 2001 Dec-01 | 2002 Nov-02 | 2002 Dec-02 | 2003 Dec-03 | Change YOY (LL Billion) | YOY % |
|---|---|---|---|---|---|---|
| **Total debt** | **42,637** | **48,241** | **47,274** | **50,193** | **2,919** | **6.20%** |
| | | | | | | |
| **Domestic debt** | **28,214** | **28,989** | **25,302** | **26,840** | **1,538** | **6.10%** |
| a. Central Bank | 6,251 | 4,619 | 723 | 8,938 | 8,215 | **1136.50%** |
| *o/w Zero coupon T-bills* | | | | *3,508* | 3,508 | |
| *o/w Special Tbills issued at 4%* | | | | *4,299* | | |
| b. Commercial Banks | 15,830 | 17,166 | 17,211 | 12,300 | -4,912 | **-28.50%** |
| *o/w Zero coupon T-bills** | | | | *880* | 880 | |
| c. Other Domestic Debt (T-bills) | 6,133 | 7,205 | 7,368 | 5,603 | -1,766 | **-24.00%** |
| *o/w Public entities* | *2,729* | *3,212* | *3,221* | *2,584* | -637 | **-19.80%** |
| **Foreign debt** | **14,423** | **19,252** | **21,972** | **23,353** | **1,381** | **6.30%** |
| a. Bilateral and Multilateral | 2,046 | 2,158 | 2,214 | 2,371 | 157 | 7.10% |
| b. Paris II related FX debt | | | 4,251 | 6,550 | 2,299 | |
| *o/w BDL Eurobond* | | | *2,819* | *2,819* | *0* | |
| c. Market Eurobonds | 11,477 | 16,122 | 14,611 | 13,673 | -938 | -6.40% |
| *o/w Zero interest Eurobonds issued to com banks* | | | | 1,083 | 1,083 | |
| d. Other foreign debt** | 900 | 972 | 896 | 758 | -138 | -15.40% |
| **Public sector deposits** | **1,913** | **2,655** | **2,964** | **2,980** | **16** | **0.50%** |
| | | | | | | |
| **Net debt** | **40,724** | **45,586** | **44,310** | **47,213** | **2,902** | **6.50%** |
| **Gross market debt***** | **31,612** | **38,253** | **36,866** | **29,770** | **-7,096** | **-19.20%** |

*Source: Ministry of Finance, BDL*

* Includes Treasury bills submitted during Jan-May 2003 in addition to the LL cash tranche of March, July and August 2003. T-bills issued in exchange for the LL and USD cash tranches of Jan and Feb in addition to the USD cash tranche of March, July and August 2003 are held by the BDL

** Includes accrued interest and foreign currency private sector loans.

***Market debt represents total debt represents total debt excluding BDL held debt, NSSF held debt, bilateral and multilateral debt, and debt held by Paris II countries.

Note that figures may differ from previously published data due to constant updates of the debt management system.

**Public debt:** Gross public debt reached LL 50,193 billion at the end of 2003, registering an increase of LL 2,919 billion or 6.2 percent over the December 2002 level. This rate of growth is significantly lower than the 11 percent registered the year before, and is mainly due to the LL 936 billion primary surplus in 2003.

**Domestic Debt**: Domestic debt reached LL 26,840 billion at the end of 2003, constituting 54 percent of the total debt as compared to 60 percent in November 2002 at the time of the Paris II conference (see section V). The proceeds from lending countries (USD 2.4 billion) as well as from the special schemes executed with 'Banque du Liban' (USD 4.1 billion) and the Lebanese commercial banks (USD 3.6 billion), have been mainly used to redeem or replace the more costly debt denominated in Lebanese pounds with longer term, less costly foreign currency debt. Moreover, the domestic debt itself has been partly re-profiled into longer dated debt with the introduction of the new 36-month Treasury bills in November 2003.

After completing the debt exchange and cancellation operations of the BDL portfolio in December 2002, LL 648 billion of principal and interest on maturing Treasury Bills held by BDL were rolled over in July 2003 via a special Treasury Bill carrying a 4 percent coupon and having a 5 year maturity. Note that part of the increase in the BDL portfolio witnessed in 2003 was due to its intermediation in the commercial bank's special scheme (see section V).

Also, commercial bank holdings of domestic debt decreased by 28.5 percent in 2003. This was mainly due to the repayment of maturing principal and interest that took place between February and November when the Treasury halted the issuance of Treasury bills and used Paris II inflows to retire domestic debt owed to commercial banks.

**Foreign Debt:** Foreign debt reached LL 23,353 billion, the equivalent of US$15.5 billion, at the end of 2003 registering a 6.3 percent increase year-on-year. The foreign debt increased as a result of the issuance of Eurobonds and loans to the Paris II contributing countries. Total foreign currency debt constituted 47 percent of total public debt by December 2003 compared to 40 percent in November 2002 prior to the conference.

Total outstanding Eurobonds as of end of 2003 amounted to US$12.8 billion. These Eurobonds have an average maturity of approximately 4 years. Of this amount, zero-interest bonds, worth approximately US$700 million, were issued under the commercial banks' special scheme. Moreover, US$1.85 billion of the amount are Eurobonds held by Paris II contributors and US$ 1.87 billion are held by the BDL. The remaining amount corresponds to Eurobonds issued at market rates prior to the Paris II conference.

## Section V: Paris II Developments[14]

The financial outcome of the Paris II conference translated into **commitments** dedicated to debt reduction and management totaling US$ 3.1 billion (an additional amount of US$ 1.3 billion was secured to fund projects earmarked for socio-economic development). To date, proceeds totaling **US$ 2.4 billion** dedicated for debt re-profiling have been **received** by the Lebanese Treasury. This amount represents around 77 percent of the US$ 3.1 billion pledged for debt management in the form of long term and less expensive financing. The funds received to date carry an interest rate of 5 percent and a final maturity of 15 years with grace periods of up to five years.

Additional funding to support the debt re-profiling strategy of the Lebanese government was secured locally from the Central Bank of Lebanon and the Lebanese commercial banks through two financial support schemes. The first scheme, in the equivalent amount of **US$ 4.1 billion**, was concluded with the **Central Bank** of Lebanon in December 2002 and consisted of the following: (a) the cancellation of the equivalent of US$1.8 billion of BDL's Lebanese Pound Treasury bills portfolio against reserves due to the Lebanese Treasury as per Article 115 of the Code of Money and Credit, (b) the exchange of the equivalent of US$ 1.9 billion of BDL's Lebanese Pounds Treasury bills, Eurobonds, and accrued interest for new debt with longer maturity (15 years) and lower interest (4%), and (c) the roll over of US$0.4 billion of principal and interest on maturing Treasury bills held by BDL via a new issue of 5-year, 4% special Treasury bills in July 2003.

The second scheme, in the equivalent amount of **US$ 3.6 billion**, was concluded with the Lebanese **commercial banks,** and involved a voluntary supply of two-year, zero interest financing to the Government.

Therefore, the financial inflows of the Paris II conference from lender countries, coupled with the two schemes from the Central Bank and Lebanese commercial banks discussed above, represent a **financial package** worth **US$ 10.1 billion**, equivalent to more than 56% of GDP, which has re-profiled, to date, the equivalent of 32% of the total stock of debt outstanding at the time of the Paris II conference. In addition, these developments improved the profile of the debt by extending its maturity, reducing its cost, and changing its composition (lower share of market vs. non-market debt). In fact, the overall average cost of total debt has been reduced by 376 basis points since Paris II (from 11.97 percent at end-November 2002 to 8.21 percent at end-December 2003) and is expected to decline further once the full impact of the debt management measures bear fruit starting in 2004. The share of market debt to total debt has declined from 78 percent, prior to Paris II, to 57 percent.

The rapid execution of the above mentioned measures was well received by the market and resulted in a series of positive developments on the macroeconomic front. In the weeks following the conference, interest rates on government Treasury bills dropped drastically, by more than 30 percent compared to their level before the convening of Paris II. In fact, the secondary market yield on the 24-month Treasury bill (the most widely

*[14] For more information, please refer to "One-Year Progress Report After Paris II", issued by the MoF in December 2003.*

floated category) declined from a level of above 16 percent to around 9 percent in less than two months - a level not witnessed in over two decades. By December 2003, it declined further to 7.8 percent. Moreover, prices of all outstanding Eurobond issues of the Lebanese Republic rallied. Gross foreign exchange reserves (excluding gold) reached a level of US$10.2 billion by end-December 2003, while the balance of payments registered a substantial improvement recording a surplus of US$3.4 billion in 2003, more than doubling their US$ 1.6 billion level in 2002.

## Table 11. Monthly Disbursement from Paris II Lender Countries (USD million)

| | Countries | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Malaysia | Oman | UAE | Kuwait | France | KSA | Qatar | Total |
| Dec-02 | 300 | 50 | | | | | | 350 |
| Jan-03 | | | 300 | 300 | | | | 600 |
| Feb-03 | | | | | | | | - |
| Mar-03 | | | | | 540* | 700 | | 1,240 |
| Apr-03 | | | | | | | | - |
| May-03 | | | | | | | 200 | 200 |
| **Total** | 300 | 50 | 300 | 300 | 540 | 700 | 200 | **2,390** |

*Source: Ministry of Finance*
*Note: *Counter value of contributions in Euro at USD/Euro 1.08 rate*

## Table 12. Eurobonds (USD) Issued under Paris II Package

| Subscriber | Principle Amount | Coupon Rate | Maturity Date |
|---|---|---|---|
| BDL | USD 1,870 MN | 4.00% | 12/31/17 |
| UAE/Kuw/Oman/Mal - PII | USD 950 MN | 5.00% | 12/27/17 |
| KSA PII | USD 700 MN | 5.00% | 03/07/18 |
| Qatar PII | USD 200 MN | 5.00% | 05/27/18 |
| **Sub Total** | **USD 3,720 MN** | | |
| Commercial banks | USD 423 MN | 0% | Jan-May 2005 |
| | EURO 236 MN | 0% | Jan-May 2005 |
| **Sub Total** | **USD 727 MN** | | |
| **Grand Total** | **USD 4,447 MN** | | |

*Source: Ministry of Finance*

## Table 13. Cost of Public Debt Prior Paris II and as of end-Dec 2003

| | Date | Total Debt | Domestic Debt | Foreign Currency Debt |
|---|---|---|---|---|
| Before PARIS II | Nov-02 | 11.97% | 13.82% | 9.21% |
| After PARIS II | Dec-03 | 8.21% | 8.93% | 7.39% |
| **Change** | | **-3.76%** | **-4.89%** | **-1.82%** |

*Source: Ministry of Finance*

# Section VI: Evolution of External Trade

**Table 14. External Trade**

| (USD million) | 2002 Jan-Dec | 2003 Jan-Dec | % change |
|---|---|---|---|
| Exports | 1,045 | 1,524 | 46% |
| Imports | 6,445 | 7,168 | 11% |
| **Trade balance** | **-5,400** | **-5,644** | **5%** |

*Source: MOF, Directorate General of Customs (DGC)*

**Balance of Trade**: The trade deficit marked a 5 percent increase, totaling USD 5,644 million by the end of 2003, owing to an 11 percent increase in imports, which in absolute terms, outgrew the 46 percent increase in exports.

**Imports** in 2003 amounted to USD 7,168 million, compared to USD 6,445 million in 2002. The increase of imports in 2003 reflects, to a large extent, the increase in fuel and oil imports which rose by 22 percent compared to 2002 representing USD 216 million i.e. 30 percent of the USD 723 million total increase in imports. In response to the appreciation of the Euro, one might have expected a decrease in European imports and, given their share in total imports (43 percent), a decrease of total imports. However, it seems that a strong internal demand offset the negative effect of the Euro appreciation.

**Exports** in 2003 increased by USD 479 million from a year earlier, cumulating at USD 1,524 million. This rise in exports partially reflects the government's efforts to encourage exports through the "Export Plus" program which aims to promote agricultural exports and the "One Stop Shop" program, designed to facilitate investments in Lebanon. Another factor behind this upsurge in exports is the 116 percent increase in the value of precious metals (namely gold) exported mainly to Switzerland. This increase represents 52 percent of the export increase observed in 2003.

**Table 15. Imports Distribution by Product**

| (USD million) | 2002 | | 2003 | |
|---|---|---|---|---|
| | Jan-Dec | % share | Jan-Dec | % share |
| Mineral products | 974 | 15% | 1,190 | 17% |
| Machinery and mechanical appliances | 863 | 13% | 873 | 12% |
| Products of the chemical | 633 | 10% | 716 | 10% |
| Transport equipment | 572 | 9% | 696 | 10% |
| Prepared Foodstuffs | 475 | 7% | 477 | 7% |
| Other goods | 2,929 | 45% | 3,217 | 45% |
| **Total** | **6,445** | **100%** | **7,168** | **100%** |

*Source: MOF, Directorate General of Customs (DGC)*

**Composition and Sources of Imports:** The overall increase in the volume of imports in 2003 as compared to 2002 is directly attributed to a 30 percent increase in the import of mineral products (cumulating at USD 1,190 million by end of December 2003) and to a 22 percent increase in imports of transportation equipment (amounting to USD 696 billion). The increase in the volume of gasoline imports stems from a 16 percent hike in imported fuel prices, but also from an increase of 4 percent in the imported quantity (billion liters). As for transportation equipment, the total number of cars imported in 2003 increased to 31,294 cars, as compares to 27,612 cars imported in 2002. This 13 percent rise in 2003 reflects a return to normalcy in car imports after consumers adjusted their behavior to import more cars in the last few months of 2001 (to avoid being subject to the anticipated VAT introduction, reaching 34,047 cars by the end of the year), and subsequently less cars in the first few months of 2002 (resulting in 27,612 cars imported by the end of 2002). The fact that 2003 results are in line with the average number of cars (31,092) imported yearly from 2000 until 2003 further demonstrates this return to normalcy. In addition, as a reaction to the appreciation of the Euro in 2003, demand for expensive cars was partially substituted with demand for more economic cars, resulting in a decline in the average price per imported car, from LL 21 million in 2002 to LL 20.5 million in 2003. .....

Imports of chemical products witnessed a 13 percent increase from 2002, whereas imports of machinery rose by only 1.2 percent from 2002. Imports of foodstuffs marked the smallest increase from 2002 (by 0.2 percent only). Imports of "other goods"[17] increased by 10 percent, representing USD 288 million or 40 percent of the total increase in the imports volume.

In terms of distribution of imports by products, 2003 did not represent significant changes from 2002. Below is the yearly performance of the five major imported product categories with their respective sources:

Imports of **mineral products** ended the year at USD 1,190 million in 2003 (compared to USD 974 million in 2002), representing 17 percent of the total imported volume as compared to 15 percent of total imports in 2002 and 18 percent in 2001. The bulk of this item was composed of fuel and oil originating from the Russian Federal Republic, Saudi Arabia, and France (with 21, 11 and 10 percent shares, respectively).

**Machinery and mechanical appliances** imports increased by 1 percent and cumulated at USD 873 million (compared to USD 863 billion in 2002[18]). Their share in total imports for 2003 was not significantly altered from the 2002 outcome (12 percent share of total imports in 2003 compared to 13 percent in 2002 and 14 percent in 2001). Machinery and mechanical appliances originated mainly from Italy and China (mostly reactors and boilers) and from China and United Kingdom (mostly electrical equipment).

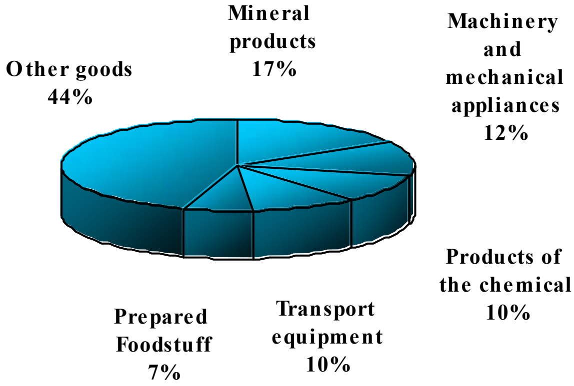
*[17] The "other goods" category includes notably "base metals and articles of base metals", "textile and textile articles", "live animals and animal products" and "vegetable products", which accounted in 2003 for 53 percent of the "other goods" category.*
*[18] It should be noted that imports in 2002 were affected by the implementation of the VAT in February 2002)*

**Chemical products** ranked third, with the share of chemical products remaining stable at 10 percent of total imports, despite a USD 83 million increase in imports recorded in 2003 compared to the 2002 outcome. Chemical products ended up, therefore, at USD 716 million in 2003 (compared to USD 633 million in 2002 and USD 595 million in 2001). France and the United Kingdom are Lebanon's major suppliers of pharmaceutics and cosmetics.

By the end of December 2003, imported **transport equipment** reached USD 696 million as opposed to USD 572 million. This positive trend was, however, not sufficient to bring this category back to its 2001[19] third position from where it was dragged down in 2002. The increase in transport equipment in 2003 is partly the result of the 16 percent increase in the new cars market demand. As already mentioned, in 2003, European cars dominated the market with 46 percent of total cars sold despite the substantial appreciation of the Euro. The share of cars imported from the United States continued to fluctuate at around 3 percent. The share of **transport equipment** in total imports increased from 9 to 10 percent in 2003 probably as a result of the USD 124 million, or 22 percent increase, with respect to 2002.

The volume of imported **prepared foodstuffs** reached USD 477 million in 2003, remaining relatively stable compared to 2002. Consequently, **prepared foodstuffs** continued to account for 7 percent of total imports in 2003 (equivalent to 2002 and 2001 shares). This category is mainly composed of beverages and spirits from the United Kingdom and France (48 and 14 percent shares, respectively), and tobacco imports from the United States (63 percent share of total tobacco imports to Lebanon).

**Imports Distribution by Product 2003**




*Source: MOF, Directorate General of Customs (DGC)*

[19] *Transport equipment cumulated at USD 713 million in 2001.*

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**Table 16. Exports Distribution by Product**

| (USD million) | 2002 | | 2003 | |
|---|---|---|---|---|
| | Jan-Dec | % share | Jan-Dec | % share |
| Pearls, precious or semi-precious stones | 215 | 21% | 464 | 30% |
| Machinery and mechanical appliances | 120 | 11% | 179 | 12% |
| Prepared foodstuffs | 102 | 10% | 150 | 10% |
| Products of the chemical | 108 | 10% | 115 | 8% |
| Base metals and articles of base metals | 79 | 8% | 115 | 8% |
| Other exports | 421 | 40% | 501 | 33% |
| **Total** | **1,045** | **100%** | **1,524** | **100%** |

*Source: MOF, Directorate General of Customs (DGC)*

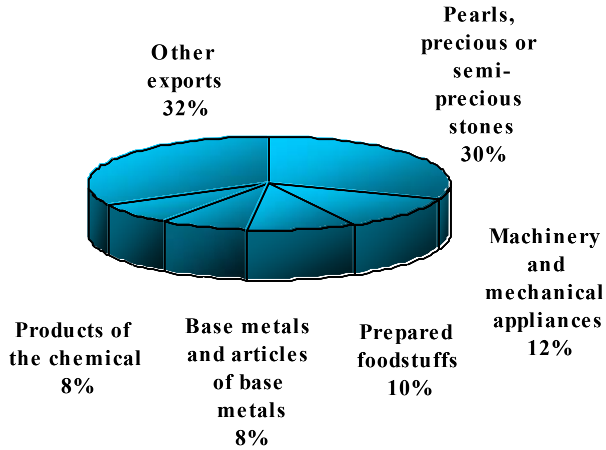
**Composition and Destination of Exports:** The increase in exports recorded in 2003 stems mainly from a 116 percent increase in the export of jewelry (by USD 249 million) from 2002 and from the 19 percent increase in the export of "other items" (by USD 80 million) from 2002. The following lists the five major exported product categories with their respective destinations:

**Pearls, precious and semi precious stones** increased by 116 percent and represented Lebanon's major exported products (cumulating at USD 464 million in 2003 compared to USD 215 million in 2002), with a 30 percent share of total exports in 2003 as opposed to 21 percent in 2002. 81 percent of this product category headed to Switzerland, and 9 percent to the United Arab Emirates.

**Machinery and mechanical appliances** exports increased by 49 percent and cumulated at USD 179 million (compared to USD 120 million in 2002). This is the second most exported article, with a 12 percent share of total exports, increasing from an 11 percent share in 2002. Machinery and mechanical appliances headed mainly to Saudi Arabia and Iraq.

**Chemical products** exports increased by 6 percent from 2002 (reaching USD 115 million in 2003 compared to USD 108 million in 2002) but declined as a share of exports to 8 percent (from 10 percent in 2002). Chemical products lost their third rank and went back to the fourth position they were occupying in 2001 as a share of exports. The major destinations for Lebanese chemical products are Turkey, India and Italy, namely for chemical compounds and Iran, Brazil, Syria, and Italy for fertilizers.

**Exports Distribution by Product 2003**




*Source: MOF, Directorate General of Customs (DGC)*

With exports amounting to USD 150 million in 2003 and representing a 47 percent increase compared to the 2002 level of USD 108 million in 2002, **prepared foodstuff** dethroned chemical products as the third largest export category, with a 10 percent share of total exports in 2003. Prepared foodstuff is traditionally exported to the United Kingdom (spirits and wines) and to the United States (tobacco products).

Exports of **base metal and articles of base metals** totaled USD 115 million in 2003, as opposed to USD 79 million of exports in 2002, representing a 46 percent increase. With the share of exports fluctuating at around 8 percent, this category is now ranking ex-aequo with chemical products at the fourth position in 2003.

The next category is paper products with USD 89 million worth of exports in 2003 (as opposed to USD 98 million in 2002). This category saw its share of the export market declining from 9 to 6 percent of total 2003 exports.

**Table 17. Regional Distribution of Imports and Exports**

**Imports**

| (USD million) | 2002 | | 2003 | |
|---|---|---|---|---|
| | Jan-Dec | % share | Jan-Dec | % share |
| **Total** | **6,445** | **100%** | **7,168** | **100%** |
| European Union | 2,803 | 43% | 3,066 | 43% |
| Arab Countries | 697 | 11% | 920 | 13% |
| United States | 465 | 7% | 431 | 6% |
| Switzerland | 267 | 4% | 216 | 3% |
| Other | 2,213 | 34% | **2,534** | 35% |

**Exports**

| (USD million) | 2002 | | 2003 | |
|---|---|---|---|---|
| | Jan-Dec | % share | Jan-Dec | % share |
| **Total** | **1,045** | **100%** | **1,524** | **100%** |
| Arab Countries | 508 | 49% | 638 | 42% |
| European Union | 150 | 14% | 143 | 9% |
| Switzerland | 132 | 13% | 379 | 25% |
| United States | 54 | 5% | 66 | 4% |
| Other | 201 | 19% | 298 | 20% |

*Source: MOF, DGC*

**Lebanon's major trading partners** remain countries of 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. With USD 3,066 million worth of imports, representing 43 percent of total imports, the EU remained Lebanon's main source of imports. Italy occupied 22 percent of the total imports from the EU, while France and Germany were occupying 19 percent (of total EU imports) each.

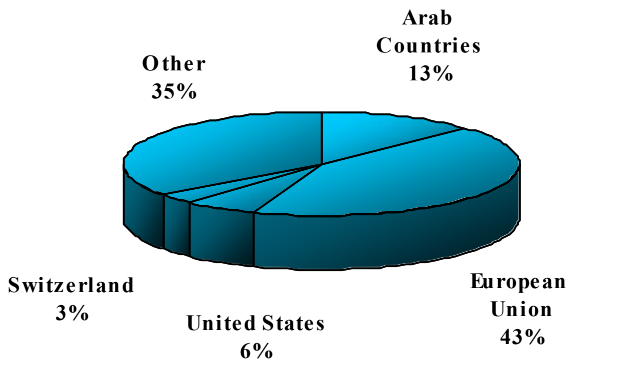
Although the **European Union** remained the second main destination for Lebanese exports, its share of total Lebanese exports declined from 14 percent in 2002 to 9 percent in 2003 (from USD 150 million in 2002 to 143 million in 2003), suggesting that the appreciation of the Euro did not favor Lebanese exports to Europe. Italy and France each represented 20 percent share of total Lebanese exports to the EU, a respective increase of 5 and 7 percentage points with respect to 2002, while Germany and the United Kingdom imported 14 and 11 percent of the Lebanese exports to the EU.

In 2003, the trade balance with **Switzerland** continued its shift in favor of Lebanon. Lebanon imported from Switzerland goods worth USD 216 million, 19 percent less than in 2002. Switzerland's share of 2003 total Lebanese imports was, therefore, dragged down to 3 percent from 4 percent in 2002 and 5 percent in 2003. On the export side, **Switzerland** represented the third major importer of Lebanese products, with its share of total Lebanese exports pulling up from 13 to 25 percent due to a 116 percent increase in its imports of Lebanese jewelry production

The share of **Arab countries** in total Lebanese imports in 2003 increased from 11 to 13 percent due to a 32 percent increase in the volume of imported Arab merchandise (from USD 697 million in 2002 to USD 920 million in 2003). Imports from Arab countries maintained their second rank as Lebanon's major source of imports. The Syrian Arab Republic, with imports valued at USD 259 million, accounted for 28 percent of total imports from Arab countries, while Saudi Arabia and Egypt's share of total Arab exports to Lebanon equaled 24 and 19 percent, respectively. The increase in imports from Arab countries is correlated with the increase in the imports of mineral products (namely fuel) since a significant portion of this category is imported from Arab countries .

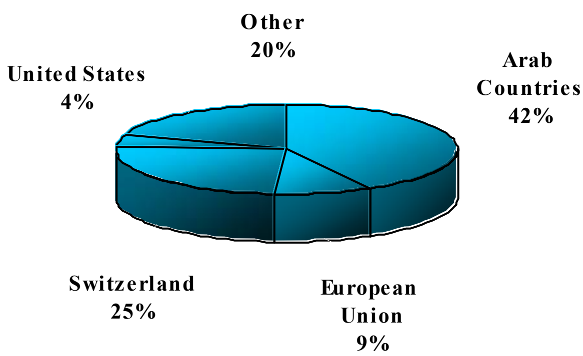
On the other hand, Lebanon's first export destination remained the Arab countries with total exports increasing to USD 638 billion (from USD 508 million in 2002). At the same time, their share of total Lebanese exports declined from 49 percent in 2002 to 42 percent in 2003. Exports to Saudi Arabia and the U.A.E, which reached USD 104 million, accounted for a 16 percent share of total exports to Arab countries each. Lebanon exported the equivalent of USD 100 million to the Syrian Arab Republic, representing a 16 percent share of total Lebanese exports to Arab countries, while Iraq, with 122 USD million imported, represented a 19 percent share of total Lebanese exports to Arab countries. This is a 5 percentage point decline with respect to 2002, which is one of the direct outcomes of the Iraq war.

**Regional Distribution of Imports 2003**




*Source: MOF, Directorate General of Customs (DGC)*

**Regional Distribution of Exports 2003**




2002 to 6 percent. Also, and despite a 22 percent upsurge that drove Lebanese exports from LL 54 million up to USD 66 million, the United States accounted for 4 percent of total Lebanese exports pulling down from its 5 percent share of 2002.

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# Section VII: Developments in the Value Added Tax

### Table 18. VAT Revenues from Declaration Forms

| (LL Billion) | Jan-Dec 2002 | Jan-Dec 2003 | change | % change |
|---|---|---|---|---|
| VAT from interior operations | 397 | 469 | 72 | 18.1 |
| VAT from imported goods | 733 | 903 | 170 | 23.2 |
| Total VAT collected | 1,130 | 1,372 | 242 | 21.4 |
| Total refund claimed* | 55 | 80 | 25 | 45.5 |
| **Net VAT collected** | **1,075** | **1,292** | **198** | **18.4** |

***Source: MOF, VAT Directorate***
*VAT figures in this table are based on VAT declarations whereas 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 24th, 2004*
**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 refund by year-end.*

**VAT Revenues**: In its second year of implementation, the VAT generated LL 1,361 billion on a cash basis, equivalent to 5 percent of GDP and outgrowing the budgeted amount by 13 percent. Approximately two thirds of VAT revenues was collected at customs from imports of merchandise, and the remaining third was generated from internal economic activities, namely services, industry and commerce.

**VAT Collected from Imports** amounted to LL 903 billion in 2003 up by LL 170 billion or 23 percent from the previous year. Even when compared on an 11-months basis, the VAT shows a better performance in 2003. More specifically, a comparison between the 11 months of 2003 and the 11 months of 2002 still represents an increase of LL 104 billion in 2003. This is in line with the 14 percent rise in imports for the comparable period of 2002 and 2003.

- Reflecting the increase in their total share of imports from 15 percent to 17 percent, the share of VAT collected from imports of **mineral products** also increased from 25 percent to 27 percent. In absolute terms, revenues from this category increased from LL 192 billion to LL 249 billion or by 30 percent from the previous year.

- Reflecting the decrease in their total share of imports from 13 percent to 12 percent, the share of VAT collected from imports of **machinery and mechanical appliances** also decreased from 15 percent to 17 percent. In absolute terms, revenues from this category increased from LL 114 billion to LL 130 billion or by 14 percent from the previous year.

- **Transport equipment** generated the third highest VAT revenue from imports in 2003, reaching LL 111 billion, up from LL 88 billion in 2002 and maintaining the 12 percent share of total VAT collected at customs. The total share of imports from this category increased only slightly from 9 percent to 10 percent in 2003.

- **Prepared food stuffs** accounted for 9 percent of the VAT revenue from imports in 2003, generating LL 84 billion and increasing by LL 7 billion from its 2002 level despite a large list of

VAT exemptions of food products (namely raw agricultural products, and basic food). The total share of imports from this category remained constant at 7 percent in 2003.

- **Base metals and art of base metals**, the fifth most contributing import, represented LL 73 billion or 8 percent of the VAT revenue from imports in 2003 as compared to LL 51 billion in 2002.

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 tables 15 and 19).

**Table 19. VAT Revenue Collected at Customs ( Five Largest Contributing Items )**

| billion LL | 2002 | | 2003 | |
|---|---|---|---|---|
| | Jan-Dec | % Share | Jan-Dec | % Share |
| **VAT customs collection , of which** | **756** | **100%** | **922** | **100%** |
| Mineral products | 192 | 25% | 249 | 27% |
| Machinery and mechanical appliances | 114 | 15% | 130 | 14% |
| Transports equipment | 88 | 12% | 111 | 12% |
| Prepared foodstuffs | 77 | 10% | 84 | 9% |
| Base metals & art of base metal | 51 | 7% | 73 | 8% |
| Others | 233 | 31% | 275 | 30% |

*Source: Directorate General of customs (DGC)*
*Please note that VAT collected at customs in this table is different from the VAT data previously published in the report because this data is captured from customs declaration forms, whereas VAT in the fiscal performance is net of the municipalities share from trade revenues.*

VAT generated LL 469 billion **from internal operations** in 2003 as compared to 397 billion for the 11 months of 2002. The distribution of the 2003 VAT proceeds by economic activity reflects the composition of the Lebanese economy in terms of the major productive sectors, whereby services, namely trade, construction, hotels, restaurants and business activities come as the most important VAT generating activities (please refer to table 20).

Trading activities (retail and wholesale trade) accounted for LL 134 billion or 29 percent of total VAT receipts from internal activities in 2003, as compared to LL 113 billion or 29 percent of total VAT receipts in 2002. The construction sector generated approximately LL 43 billion accounting for 9 percent of VAT revenues from internal activities in 2003 as compared to LL 40 billion or 10 percent for the 11 months of 2002. Tourism related services, namely hotels and restaurants, generated approximately LL 39 billion or 8 percent of VAT proceeds from internal activities as compared to LL 34 billion or 9 percent in 2002. VAT proceeds from travel agencies and tour operators increased significantly in 2003 amounting to almost LL 19 billion as compared to LL 3 billion in 2002 due in part to the lowering of the VAT threshold and to the rise in the number of tourists in 2003. VAT proceeds from manufacturing of food and non-metallic mineral products activities declined by LL 5 billion in 2003 comprising 8 percent of the total VAT receipts from internal activities in 2003 as compared to 10 percent for the 11 months of 2002.

By the end of 2003, total VAT refunds claimed cumulated at LL 80 billion, of which LL 3 billion was for diplomats, LL 12 billion for exempted sectors (under Article 59 of VAT Law), LL 40 billion for exporters *(a destination-based VAT)*, LL 19 billion for end- of-year VAT creditors and LL 6 billion for tourists, compared to LL3 billion of total tourists refund in 2002..

**Table 20. VAT Receipts by Economic Activity**

| **Economic Activity** *(in LL millions)* | **2002** | **% share** | **2003** | **% share** | **change** | **% change** |
|---|---|---|---|---|---|---|
| Retail Trade | 75,216 | 19 | 87,468 | 19 | 12,252 | 16.3 |
| Wholesale Trade | 37,748 | 10 | 46,319 | 10 | 8,571 | 22.8 |
| Construction | 39,903 | 10 | 43,186 | 9 | 3,283 | 8.2 |
| Hotels and Restaurants | 33,539 | 9 | 38,829 | 8 | 5,290 | 15.8 |
| Business Activities | 27,927 | 7 | 36,013 | 8 | 8,086 | 29.0 |
| Telecommunication | 14,004 | 4 | 28,570 | 6 | 14,566 | 104.0 |
| Manufacturing of Food Products | 22,223 | 6 | 19,387 | 4 | (2,836) | -12.8 |
| Travel Agencies and Tour Operators | 3,100 | 1 | 18,463 | 4 | 15,363 | 495.6 |
| Sales, Maintenance, Repair of Vehicles and Petrol Stations. | 13,921 | 4 | 18,430 | 4 | 4,509 | 32.4 |
| Manufacturing of Non-Metalic Mineral Products | 17,370 | 4 | 15,127 | 3 | (2,243) | -12.9 |
| Other | 119,111 | 30 | 106,281 | 23 | (12,830) | -10.8 |
| **Total** | **393,153** | 100 | **456,844** | 100 | **63,691** | **16.2** |

*Source: MOF, VAT Directorate*

In its second year of implementation, the VAT mandatory registration threshold was reduced in the 2003 Budget Law from a minimum annual turnover of LL 500 million to LL 300 million, starting April first 2003. The voluntary registration threshold was kept at LL 150 million. As of end-December 2003, the total number of VAT registrants reached 12,302. As of April 2003, 2,129 additional entrants were registered due in part to the lowering of the threshold. With an amount of declarations received totaling 10,986, the VAT experienced an approximate 90 percent compliance rate.

# Section VIII: Privatization and Securitization Developments

## On the Privatization Front:

### Telecommunication Mobile Network

In June 2002, Parliament passed a law authorizing and regulating the sale of two licenses for the provision of mobile telephony services in Lebanon for a 20 year term and the sale of related assets which were held by the existing operators of the mobile networks.

In May 2003, the Higher Council for Privatization (HCP) released the names of six companies that were found eligible to participate in the auction for the sale of the two Lebanese mobile businesses and tender for granting a management contract for the two networks. The management option would be resorted to in case the financial offers submitted by would-be buyers are not satisfactory.

The HCP resolved to the prequalification of these six companies following the Special Committee's assessment of applications and supporting documents. Five companies, namely LibanCell SAL, Investcom Holding (Luxembourg) S.A., Orange S.A. (France), Hellenic Telecommunications Company (OTE) S.A. (Greece), Mobile Telecommunications Company (MTC) and The National Mobile Telecommunication Company (Wataniya Telecom) (Kuwait), were qualified for participation in the Auction and Tender, while Detecon International GmbH (Germany) was qualified to participate only in the tender. It is worthwhile to note that The National Mobile Telecommunication Company (Watanya Telecom) was later disqualified by the Council of Ministers as it was not deemed to satisfy the criterion of having five years of experience in operating GSM networks.

On September 25, 2003, the Network Custody and Operation Contracts (NCOCs), the management contracts granted to the current mobile phone operators, which were due to expire on September 30, 2003, were extended for four months. In the meantime, the qualified bidders were given access to the Data Rooms where they reviewed the transaction documents, in anticipation of submitting their financial offers. On December 22, 2003, The Council of Ministers resolved to re-extend the management contracts of LibanCell and Cellis (due to expire on January 31, 2004) for two additional months, making the end of March 2004 the new target date for closing the transaction.

On January 7, 2004, the HCP received financial offers from three companies, namely LibanCell SAL for the Tender only, Investcom Holding (Luxembourg) S.A. bidding for the Auction as well as the Tender and Orange S.A. which offered a non-binding bid for the Tender. While Mobile Telecommunications Company (MTC) and Detecon International GmbH withdrew from the process, no withdrawal correspondence was received from Hellenic Telecommunications Company (OTE) S.A., which refrained from submitting a financial offer.

On January 30, 2004, the government cancelled the outcome of the Auction and Tender due to the unsatisfactory bids, and entrusted the Ministry of Telecommunications with launching a new Tender for the management of the two networks, based on new Tender Rules and

Procedures as well as transaction documents.

On February 15, 2004, the Council of Ministers approved the Tender Rules and

Procedures prepared by the Ministry of Telecommunications, which calls for a management contract for a period of 4 years. Compared to the old Auction/Tender Rules and Procedures, this document reflects major amendments such as moving the arbitration seat from Beirut to Geneva (or The Hague if the operator is of Swiss origin), and tougher prequalification criteria regarding the subscriber base (at least 500,000 subscribers) deterring the current operators, which have approximately 400,000 subscribers from bidding.

As of March 12, 2004, thirteen companies had obtained the tender documents according to the Ministry of Telecommunications. The extension of the deadline for submission of the financial offers from March 22, 2004 till March 29, 2004, as per some companies' request, is possible in case of unanimous consensus among all the companies. Regarding the possible extension of the NCOCs which are due to expire at the end of March 2004, the Ministry accepted the terms set out by the current operators, consisting of a grace period of 45 days effective May 2004 for any eventual termination of the contracts. In this respect, the preparation for an addendum to the NCOC is currently underway. Such extension would guarantee the continuity of operation during the transitory period to the winning bidder.

## Electricity Sector

In September 2002, Parliament passed a law regulating the electricity sector which, among other matters, provides for the establishment of an independent regulator, the separation of production, transmission and distribution activities, and the creation of a commercial public corporation responsible for the production and distribution activities.
The law also provides for the creation of a commercial public corporation 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. As for the transmission company, its management will be solely transferred to the private sector through a management contract.
In the interim, the Government has appointed an investment bank and other specialists to assist in the sector's privatization and has received interest from 20 potential investors/operators pursuant to a call for expression of interest launched in October 2002.

In February 2004, the results of the tender for operating and maintaining the two electricity plants of Deir Ammar and Zahrani were cancelled due to irregularities in the bidding process. The company that initially would have won the tender was an Irish company (Shanahan)- the only one with an acceptable offer. The other four companies that gave in offers were rejected. As of March 16, 2004, the government began negotiating with the current Italian operating company, ENEL, the extension of its management contract (which expired on February 15, 2004) for three non-renewable months (till May 15, 2004) at the same contract price. In the meantime, a new tender has been launched: the companies which had expressed their interest for the first tender were invited to re-express their interest, and three out of five companies, namely, Siemens (Germany), Ansaldo (Italy) and Taamirat (Iran) have responded and submitted their offers.

## On the Securitization Front:

Following the issuance of Law no 430/ 30.5.2002, in an effort to find a new less costly financing scheme, the government decided to securitize the future flows emanating from the sectors that are included in the said law, namely the Telecom and Tobacco Industries. Since the government had been actively engaged in the privatization of the Telecom industry, securitization of its revenues had not been considered yet.

**Tobacco Securitization:**

In the Tobacco sector securitization 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 in offshore accounts. Revenues will then be transferred to the Lebanese treasury to be pledged against the issuance of secured bonds. The net proceeds will be used to retire the more expensive local currency debt instruments reducing the cost of public debt.

The following developments have so far taken place:

- **Transaction Structure:** MOF, BDL, the banks and the legal teams of all parties concerned identified two possible structures to secure offshore payments of the flows.
- **Due Diligence:** An extensive questionnaire was provided by the banks and was filled by the MOF, Regie, BDL and Customs Authorities.
- **Financial Model:** A financial model was conducted based on the data requested as well as the audited financial statements of the Regie. The data was sent to the Regie and to their auditors KPMG for validation.
- **New Customs' Duties Law:** A draft law authorizing the payment by international tobacco companies of customs' duties in US dollars in offshore accounts has been submitted to the Council of Ministers for approval.
- **Tobacco Companies:** Several meetings were held with Tobacco companies that have at least 5% of the share of the Lebanese market to obtain their feedback on the proposed transactions structures. The companies were asked to confirm that they are aware that all rights to the duties have been sold to a Special Purpose Vehicle (SPV) and to pay the duties as specified in the new Customs' Duties Law. They were also instructed to notify the Trustee in the event that they shall receive any notice or instruction of either a change in the Customs law or a request to make payments of any Duties in a currency other than US dollars and/or to an account other than the Offshore Account.
- **Offering Circular and Transaction Documents:** Drafts are being reviewed by the banks and the MOF team.
- **Paying Agent, Indenture Trustee and Listing Agent:** After requesting RFPs from Deutsche Bank, Citibank, Chase Bank and the Bank of New York, the latter was appointed based on favorable experience and advantageous pricing.
- **Rating Agencies:** Moody's was appointed to rate the transaction. Their due diligence mission came to Lebanon in January 2003. They gave their preliminary feedback in May 2003.
- **Special Purpose Vehicle:** The SPV is called "International Receivables Fund Ltd" and was incorporated in January 2003 by "Walkers" in the Caiman Islands.

Modifications in the Customs Law were sent to the Council of Ministers in July 2003. Information regarding the proposed transaction structure was requested from the Ministry of Finance, which shortly after, submitted the solicited information. The Council of Ministers met again in January 2004 and proposed amendments to the transaction structures.