



## Lebanon – Country Profile 2005

### GENERAL BACKGROUND

#### *Area and Population*

The Republic is situated in the Levant on the eastern most part of the Mediterranean Sea. The Republic's Mediterranean shoreline extends 192 kilometers from north to south; its greatest width from west to east is 85 kilometers. The total area of the Republic is 10,452 square kilometers.

The Republic is a mountainous country with over half its area lying above 1,000 meters. There are two parallel ranges of mountains running north to south: the Mount-Lebanon Range hugging the Mediterranean coast reaches an altitude of 3,088 meters and the Anti-Lebanon Range, reaching an altitude of 2,814 meters, runs along the eastern border. The fertile Bekaa valley lies between these two mountain ranges. The two main rivers, the Asi (Orontes) and the Litani, flow out of this valley.

The climate of the Republic is alpine in the mountains and Mediterranean along the coast. All four seasons are equally distributed throughout the year. The rain in winter can be torrential and snow falls on mountains above 1,000 meters. There is high humidity in the coastal regions with hot, rainless summers.

The historic and cultural heritage of Lebanon dates back over six thousand years to the Phoenicians and the subsequent civilizations that were established in or interacted with the Lebanese. Throughout its history Lebanon has been a contact center between various cultures and civilizations, which has in the past rendered the Republic a highly cosmopolitan country with a great deal of tourism.

According to the "Living Conditions National Survey 2004/First Statistical Results" survey dated July 7, 2005 (the "2005 CAS Survey") conducted by the Central Administration of Statistics (the "CAS"), the Ministry of Social Affairs and the United Nations Development Program, the number of Lebanon's permanent residents was estimated in 2004 at approximately 3,754,000, 93.40 per cent. of whom were Lebanese. This number does not include temporary residents such as migrant workers.

The following table shows the breakdown of population by age in 2004:

	<b>Total</b> (per cent.)
Under 20.....	37.16
20-59 .....	51.97
60 and over.....	10.87

Source: 2005 CAS Survey

The population is composed of Christians, Muslims and minorities and is Arabic speaking, with French and English being widely used. In the period 1975-1993, a decline in population of about 300,000 occurred, as a result of relocations mainly to North and South America, Europe, Africa, Australia and the Arabian Gulf States.

The main cities are Beirut, the capital, Tripoli, Sidon, Jounieh, Zahle and Tyre. Approximately 32 per cent. of the population lives in Beirut and its suburbs.

# TABLE OF SELECTED LEBANESE ECONOMIC INDICATORS<sup>(1)</sup>

*Set forth below is a summary of certain information contained elsewhere in this Offering Circular. It does not purport to be complete and is qualified in its entirety by the more detailed information appearing elsewhere, or incorporated by reference in, this Offering Circular.*

	2001	2002	2003	2004	2005
<b>The Economy</b>					
GDP <sup>(2)</sup> (at current market prices in billions of Lebanese Pounds).....	25,726	27,832	29,991	32,815	33,243
GDP <sup>(3)</sup> (at current market prices in millions of U.S. Dollars).....	17,071	18,468	19,901	21,775	22,059
Real Growth Rate (per cent.).....	2.0	2.0	3.0	5.0	1.0
<b>Balance of Payments</b> (in millions of U.S. Dollars)					
Current account.....	(5,390)	(4,354)	(4,414)	(5,513)	N.A.
Capital account.....	4,221	5,918	7,800	5,681	N.A.
Overall balance of payments <sup>(4)</sup> .....	(1,169)	1,564	3,386 <sup>(5)</sup>	169	747
<b>Reserves</b> (in millions of U.S. Dollars)					
Gross Foreign currency reserves.....	4,361	5,070	10,197	9,494	9,845
Gold <sup>(6)</sup> .....	2,561	3,216	3,834	4,006	4,736
Gold (Thousands of Troy Ounces).....	9,222	9,222	9,222	9,222	9,222
<b>Public Finance</b> (in billions of Lebanese Pounds)					
Central Government Revenues.....	4,649	5,830	6,654	7,514	7,405
Central Government Expenditures <sup>(7)</sup> .....	8,879	10,139	10,592	10,540	10,203
Central Government Overall Deficit.....	(4,230)	(4,308)	(3,938)	(3,026)	(2,798)
Primary Deficit/Surplus <sup>(8)</sup> .....	82	314	936	995	737
<b>Public Debt</b>					
Net Domestic Public Debt (in billions of Lebanese Pounds).....	26,301	22,338	23,824	22,012	23,722
Public External Debt (in millions of U.S. Dollars) <sup>(9)</sup> .....	9,573	14,576	15,550	18,358	19,176
Public Debt as a % of GDP.....	170	181	186	184	175

## Notes:

- (1) Certain figures differ from previously published data.
- (2) The 2001 and 2002 GDP figures included in their table are based on figures published by the Ministry of Economy and Trade, National Accounts Committee (Lebanon's Economic Accounts 1997-2002, Beirut, July 2005) and estimates for 2003-2005.
- (3) Translated at period average exchange rates.
- (4) Includes a U.S. \$500 million deposit from Saudi National Commercial Bank made in December 1997 but subsequently reduced through partial repayment, a U.S. \$100 million deposit from the Kuwaiti Investment Authority made in February 1998 and a U.S. \$100 million deposit from the National Bank of Abu Dhabi made in May 1998.
- (5) Includes proceeds from loans and bonds issued in connection with the Paris II Conference.
- (6) Parliament passed Law No. 42/86 dated September 24, 1986 forbidding dispositions of gold reserves without parliamentary legislation.
- (7) Not including expenditures by the Council for Development and Reconstruction financed with foreign funds (see "Public Finance — Operations of the Central Government").
- (8) Surplus or deficit, excluding domestic and external debt service.
- (9) Calculated at end of period exchange rates, commencing in 1998.

## History

### *Overview*

From 1516 to 1918, Lebanon was under the administrative rule and political sovereignty of the Ottoman Empire. In 1920, the territory defined by the present-day boundaries became a state called "*Grand-Liban*" (Greater Lebanon) by decree of General Gouraud, head of the French troops in the Levant. The state remained under French Mandate until November 26, 1941. A constitution was adopted on May 25, 1926 establishing a democratic republic with a parliamentary system of government. Effective political independence of the Republic occurred on November 22, 1943 (Independence Day). In 1945, Lebanon became a founding member of the League of Arab States, then of the United Nations. Departure of the foreign troops then on the Republic's territory was completed on December 31, 1946.

Over the next 30 years, Lebanon became a melting pot with a diverse cultural heritage. The instability in surrounding countries caused Lebanon to experience large waves of immigration from neighboring countries and attracted thousands of skilled laborers, entrepreneurs and intellectuals. The economic force of the Republic has mainly revolved around its entrepreneurs. In addition, Lebanon's democratic traditions, its attachment to freedom of speech and expression and its educated population enabled the Republic to become the cultural, academic and medical center of the region.

A combination of internal and external factors led to the outbreak of conflict in 1975. The regional instability and conflicting relations between neighboring countries contributed to destabilizing the domestic political and economic situation. Successive rounds of fighting took place, aggravated by two Israeli military invasions in 1978 and 1982. The period of conflict witnessed a significant reduction of government authority, large losses in human lives, substantial physical and infrastructure damage and a considerable emigration of skilled labor from the country.

In the aftermath of the Taif Reconciliation Accord (the "*Taif Agreement*") signed in Saudi Arabia in 1989, military hostilities effectively came to an end in October 1990. President Elias Hrawi assumed office with Dr. Salim Al Hoss as Prime Minister. In 1992, Mr. Rafik Hariri was appointed Prime Minister and the first parliamentary elections in 20 years were held. In 1995, President Hrawi's term of office was extended for an additional three year period, after a constitutional amendment.

In October 1998, General Emile Lahoud was elected President and appointed Dr. Salim Al Hoss as Prime Minister. In his inaugural speech before Parliament, President Lahoud emphasized the preeminence of the rule of law, the strengthening of governmental institutions, the requirement for transparency and accountability in the conduct of public affairs and the promotion of social justice and equality.

In October 2000, Mr. Hariri was appointed Prime Minister by President Lahoud after parliamentary elections in August and September 2000. On April 16, 2003, Mr. Hariri resigned and was reappointed Prime Minister on April 17, 2003.

On August 28, 2004, the Council of Ministers adopted a resolution to submit to Parliament a draft law extending the term of the office of Emile Lahoud, the President of the Republic.

On September 2, 2004, the United Nations adopted Resolution 1559, which was co-sponsored by the United States and France. Among other matters, this Resolution declared support for a free and fair electoral process in the Republic without foreign interference or influence, for the restoration of the territorial integrity, full sovereignty and political independence of the Republic, the withdrawal of foreign troops from the territory of the Republic and the disarming of Lebanese and non-Lebanese militia. The Resolution further provided for the Secretary-General to report to the Security Council within 30 days on its implementation by the parties. On October 1, 2004, the Secretary-General submitted his report to the Security Council which concluded that the requirements imposed on the various parties pursuant to Resolution 1559 had not been met.

On September 3, 2004, President Lahoud's term of office was extended by Parliament for an additional three year period, pursuant to a constitutional amendment, amid domestic and international objections. On October 26, 2004, President Lahoud appointed Mr. Omar Karami as Prime Minister.

In October 2004, an assassination attempt against Mr. Marwan Hamade, the current Minister of Telecommunications, and an ally of former Prime Minister Mr. Rafik Hariri and Mr. Walid Jumblatt, was carried out. This was followed by a series of assassinations or assassination attempts of political figures and journalists, culminating in the assassination of Mr. Rafik Hariri described below, and including an assassination attempt on Mr. Elias Murr, the current Deputy Prime Minister.

On February 14, 2005, the former Prime Minister, Mr. Rafik Hariri, together with a number of his bodyguards and assistants, was assassinated in Beirut. The terrorist act resulted in the death of 20 persons, including Dr. Basil Fuleihan, the former Minister of Economy and Trade and a member of Parliament, and the injury of numerous others. Between 1992 and 2004, Mr. Hariri served as Prime Minister for a total of approximately 10 years. He was instrumental in the economic revival of the Republic following the 1975 - 1990 conflict and was the principal architect of the Paris II Conference discussed below.

Mr. Hariri's assassination generated widespread domestic and international condemnation and calls from the European Union and the United States for the immediate implementation of Security Council Resolution 1559, including the withdrawal of Syrian troops from Lebanon and the disarming of Lebanese and non-Lebanese militia.

On February 15, 2005, the President of the Security Council issued a statement on behalf of the Security Council requesting the Secretary-General of the United Nations to follow closely the situation in the Republic and to report urgently on the circumstances, causes and consequences of the assassination of former Prime Minister Hariri. On February 18, 2005, the Secretary-General announced that he was sending a fact-finding mission to Beirut headed by Deputy Police Commissioner of the Irish Police, Mr. Peter Fitzgerald, to gather such information as necessary for him to report to the Security Council.

On February 28, 2005, Prime Minister Omar Karami submitted the resignation of the Government headed by him. Following mandatory Parliamentary consultations, Mr. Karami was reappointed by the President of the Republic as Prime Minister designate. Mr. Karami was not successful in forming a new Government and advised the President of the Republic accordingly. Following further mandatory Parliamentary consultations, Mr. Mohamed Najib Mikati, a former Minister and a prominent businessman, was appointed Prime Minister on April 19, 2005.

On March 14, 2005, the largest demonstration in the history of the Republic took place. More than one million persons demanded the withdrawal of Syrian troops from the territory of the Republic and the identification and prosecution of the persons and parties responsible for the assassination of Mr. Hariri and his companions.

On March 21, 2005, the report from the fact-finding mission to Lebanon was published. The report concluded among other matters that the investigation process into the assassinations conducted in Lebanon suffered from serious flaws, and recommended that an international independent investigation be carried out.

On April 7, 2005, the Security Council adopted Resolution 1595 which resolved to establish an international independent investigation commission based in Lebanon to assist the Lebanese authorities in their investigation of all aspects of Mr. Hariri's assassination. Resolution 1595 further provides that the commission shall enjoy the full cooperation of the Lebanese authorities, including full access to documentary, testimonial and physical information and evidence in the possession of such authorities. Further, the resolution grants the commission authority to collect any additional information and evidence it deems relevant. The Resolution also provides that the commission must complete its work within three months of the date on which it commences its full operations and authorizes the Secretary-General to extend the commission's term for a further period not exceeding three months.

On April 26, 2005, in a letter to the United Nations, Syria informed the United Nations that Syrian troops and intelligence operatives completed their withdrawal from Lebanon. A United Nations mission was conducted from May 1 to May 13, 2005 to verify such withdrawal. In a report dated May 23, 2005, this mission concluded that, with the possible exception of withdrawal from the Deir Al-Ashayr area on the Syrian-Lebanese border (the status of which was noted to be unclear), Syrian troops

have been withdrawn from Lebanese territory. However, the report noted that the withdrawal of the Syrian intelligence apparatus has been harder to verify.

On May 7, 2005, General Michel Aoun, a former Prime Minister, returned to Lebanon after 15 years in exile in France and participated in the Parliamentary elections in Lebanon that took place in May and June 2005.

In May and June 2005, Parliamentary elections were conducted by the Mikati Government. See "*Elections*" below. Following mandatory Parliamentary consultations, Mr. Fouad Siniora, a former Minister of Finance in the Hariri governments, was appointed Prime Minister on June 29, 2005.

In July 2005, Dr. Samir Geagea, the former head of the Lebanese Forces, was released from prison after 11 years of incarceration, following the adoption of a special amnesty law.

On August 25, 2005, the UN independent investigation submitted a preliminary report to the Security Council.

On August 30, 2005, the independent investigation commission questioned four senior Lebanese security and military officers, including the former heads of general security and military intelligence and the chief of the presidential guard. Following this questioning, Mr. Detlev Mehlis the head of the independent investigation commission, declared that the four officers were suspects in the murder of Mr. Hariri and recommended that the Lebanese authorities arrest them. On September 3, 2005, the prosecutor general of the Republic issued arrest warrants against the four officers, who are currently under arrest.

On October 19, 2005, the independent investigation commission published its first report. In this report, the commission stated that it had interviewed more than 400 persons and reviewed 60,000 documents and identified several suspects. The report further stated that "there is converging evidence pointing at both Lebanese and Syrian involvement in the terrorist act" and that "given the infiltration of Lebanese institutions and society by the Syrian and Lebanese intelligence services working in tandem, it would be difficult to envisage a scenario whereby such a complex assassination plot would have been carried out without their knowledge".

Following publication of the report, the Secretary General of the United Nations extended the commission's mandate until December 15, 2005.

On October 31, 2005, the Security Council adopted Resolution 1636, which, among other matters, requires States to freeze the assets of individuals designated by the commission as suspects of the assassination, establishes a committee of the Security Council to undertake designated tasks relating to such individuals and demands full Syrian cooperation with the investigations of the commission.

Following the assassination of Mr. Hariri, Lebanon witnessed a series of bombings and assassinations of public figures. Most recently, on December 12, 2005, Mr. Gebrane Tueini, a member of Parliament and newspaper editor and a public critic of Syria's actions in Lebanon, and two of his bodyguards, were assassinated in a car bombing.

On December 12, 2005, the independent investigation commission published its second report. In this report, the commission stated that many leads point directly to Syrian security officials as being involved with the assassination. The commission's report also supported the request of the Lebanese Government that the commission's mandate be further extended for a minimum period of six months.

On December 15, 2005, the Security Council adopted Resolution 1644, which, among other matters, extended the commission's mandate for six months with a request that the commission report to the Security Council at least every three months, including on the cooperation of the Syrian authorities.

On January 11, 2006, the Secretary General of the United Nations appointed Mr. Serge Brammertz as the head of the international independent investigation committee, replacing Mr. Detlev Mehlis.

Copies of the UN resolutions referred to above and of the reports issued by the independent investigation commission are available on the UN website (<http://www.un.org>).

On February 14, 2006, which is the first anniversary of the assassination of Mr Hariri, a large demonstration was held in Beirut to commemorate the event. During that demonstration, leaders of the majority coalition expressed their intention to cause the resignation of President Emile Lahoud by March 14, 2006, prior to the expiration of his extended term, through constitutional and popular initiatives. A national dialogue is currently being held at the Lebanese Parliament to debate a number of divisive topics including the assassination of late Prime Minister Hariri, the implementation of Security Council Resolution 1559 (which includes the extension of the President's term as well as Hizbollah and Palestinian arms), the relationship with Syria and the status of the President of the Republic, three sessions have been held to date.

### *Description of the Conflict*

*An attempt is made below to describe the Lebanese conflict briefly. Investors are urged to do further research should they wish to gain a fuller understanding of the conflict.*

### *The 1975-1990 Conflict*

The heavily militarized turmoil lasted from April 1975 until October 1990. In 1975, the conflict first appeared to be contained between the Palestinians and the Christian militia but instead it continued to escalate and subsequently included many factions, mostly supported by foreign governments. Many alliances among these factions took place only to be broken. Almost every faction was at war with another. Coalitions were unstable and often short-lived, resulting in widespread fighting between and among all of the factions involved.

In 1982, Israel invaded the southern half of Lebanon up to and including Beirut. The United States, France, Italy and the United Kingdom sent a Multi-National Force to provide security while Israel pulled back and Palestinian forces left for Tunis.

President Amine Gemayel was elected in 1982. There was a relative return to normality until early 1983. However, car bombs at the United States Embassy and the United States and French barracks led the Multi-National Force to pull out. Fighting resumed in late 1983.

In 1988, the crisis intensified when Parliament failed to elect a president. The departing president, Amine Gemayel, appointed General Michel Aoun Prime Minister. However, Dr. Salim Al Hoss, Prime Minister of the then existing government, refused to recognize the appointment and remained in office at the same time. The Lebanese army, led by General Aoun and Syrian troops began heavy fighting in Lebanon.

In October 1989, the Taif Agreement was signed and, in November of the same year, Elias Hrawi was elected President. A new government, known as the national reconciliation government, was formed and began implementation of the Taif Agreement.

In January 1990, the Lebanese army, led by General Aoun and the Lebanese Forces (the successor to the Christian militia) engaged in heavy fighting. In October 1990, Syrian troops attacked the Presidential palace and stormed the area controlled by General Aoun. General Aoun took refuge in the French embassy and in September 1991 left for exile in France. He returned to Lebanon in May 2005.

In October 1990, the fighting came to an end and in 1991 most of the militias (with the exception of "*Hizbollah*") were disbanded by the Lebanese Army.

### *Syrian Presence*

In May 1976, at the request of the Lebanese Government, the Arab League agreed to send the Arab Deterrent Force to restore security in the Republic. The Riyadh and Cairo summits arranged for a 30,000 strong Arab Deterrent Force composed mostly of Syrian troops but including Saudis, Yemenis, Libyans and troops from the United Arab Emirates. As the conflict persisted, the Syrian forces stayed while the other Arab forces departed.

The presence of Syrian troops in Lebanese territory was debated among various leaders in Lebanon. Certain leaders requested the withdrawal of Syrian troops from Lebanese territory. The Government

declared that the presence of Syrian troops was legal, temporary and necessary. In June 2001, Syrian troops withdrew from some areas around Beirut.

Following the adoption of Resolution 1559 by the United Nations Security Council on September 2, 2004, the assassination of the former Prime Minister, Mr. Rafik Hariri, on February 14, 2005, and the largest demonstration in the history of the Republic, which called for the withdrawal of Syrian troops from the territory of the Republic on March 14, 2005, Syrian troops were completely withdrawn from the Republic by the end of April 2005.

The Syrian military presence in Lebanon lasted from May 1976 until April 2005.

### *Israeli Occupation*

An armistice agreement was signed between the Republic and Israel in 1949. The agreement governs the security issues related to the southern border. However, since then, Israeli attacks on Lebanese territory persisted, culminating in Israeli invasions of the Republic's territory in 1978 and 1982.

In 1978, Israel invaded the southern part of Lebanon and declared that part of the country a security zone for its border. In 1982, Israel invaded Lebanon up to and including Beirut. The United States, France, Italy and the United Kingdom sent a Multi-National Force to provide security while Israel pulled back and Palestinian forces left for Tunis. The Multi-National Force left Lebanon in 1984. Israel partially withdrew from central Lebanon in 1984 and 1985 but enlarged its occupation of the southern part of the country up to the area of Jezzine.

On April 11, 1996, following an escalation in intermittent skirmishes, Israel commenced a bombardment of southern Lebanon and certain other targets in Lebanon, including the southern suburbs of Beirut. On April 27, 1996 a cease-fire came into effect. The cease-fire was based on a written but unsigned agreement drawn up by France and the United States and setting out a position mutually acceptable to Israel, Syria and Lebanon, which expanded and consolidated oral cease-fire understandings reached in July 1993. These arrangements established an international group composed of representatives of the United States, France, Syria, Lebanon and Israel to monitor the cease-fire. Meetings of the monitoring group took place on a regular basis for the purpose of addressing repeated breaches of the cease-fire.

On June 24, 1999, February 7, 2000 and May 5, 2000, Israeli military aircraft attacked several power stations and bridges near Beirut, as part of more frequent recent air attacks on Lebanese territory. The rehabilitation of the infrastructure damaged by these Israeli attacks has been completed.

On May 24, 2000, Israel withdrew its troops from territory in southern Lebanon which it had been occupying since 1978. The withdrawal followed a notification by Israel to the United Nations that it planned to withdraw its troops in Lebanon to the internationally recognized borders between Lebanon and Israel, in fulfillment of United Nations Resolution 425 which was passed by the United Nations Security Council in 1978, following the first Israeli invasion of Lebanese territory. The Government is reasserting its authority over that territory. A significant issue relating to the withdrawal remains unsettled. This relates to the status of certain villages and adjacent land on the eastern side of Alsheikh Mountain, known as the "*Shebaa Farms*," which have been occupied by Israel since 1967. The Government advised the United Nations that it considers the area to be Lebanese territory and that, as such, the withdrawal must encompass it.

There exists a United Nations Interim Force in Lebanon (UNIFIL) deployed in southern Lebanon with a mandate to help the Lebanese Government restore security after the Israeli withdrawal requested in Resolution 425 by the Security Council. The number of UNIFIL personnel was increased from 4,500 to 5,730 following the Israeli withdrawal. The Lebanese army and UNIFIL are working jointly to clear landmines in southern Lebanon.

On January 22, 2001, the Secretary General of the United Nations submitted to the United Nations Security Council a report covering the period between July 18, 2000 to January 18, 2001 which described the situation in southern Lebanon as generally stable, with the exception of certain breaches of the line of withdrawal (the so called "*Blue Line*"). The breaches consist of Israeli attacks on Lebanese territory and attacks on Israeli military targets in the "*Shebaa Farms*" area.

On January 30, 2001, the Security Council adopted a resolution extending UNIFIL's mandate for a further period of six months, until July 31, 2001 and reducing the military personnel of UNIFIL to approximately 4,500 (from 5,730).

There are currently 1,995 UNIFIL personnel in Lebanon. Most recently, the mandate of the UNIFIL was extended until January 31, 2006 by Secretary Resolution 1614 of July 29, 2005. Resolution 1614 calls inter alia upon the Government of Lebanon to fully extend and exercise its sole and effective authority throughout the south, including the deployment of sufficient numbers of Lebanese armed and secured forces.

In April and June 2001, Israeli aircraft attacked military positions maintained by Syrian troops in Lebanon, following attacks by members of the "*Hizbollah*" party on Israeli troops in the disputed "*Shebaa Farms*" area.

Following the September 11, 2001 events in the United States, the United States informally requested that the Government freeze certain assets of the "*Hizbollah*" party in the banking system in the Republic. To date, the Government has not acceded to the informal request on the grounds that the "*Hizbollah*" party is conducting a national liberation campaign and is not engaged in terrorist activities.

In January 2004, Israel and the "*Hizbollah*" party effected an exchange of prisoners held in Israeli jails for the release of an Israeli citizen and the return of the bodies of three Israeli soldiers.

### ***Constitutional System***

Three laws have governed the constitutional system of the Lebanese parliamentary democracy. The first was promulgated in 1926, the second in 1943 and the third in 1990, following the Taif Agreement.

The Constitution of September 21, 1990 (the "*Constitution*") amended the 1926 Constitution and reiterates the principle that the Republic is an independent, united and internationally acknowledged sovereign state. It also confirms the Republic's Arab identity and involvement in both the Arab League and the United Nations, as a founding and active member. Furthermore, the Constitution emphasizes the respect for freedom of speech and belief and the Republic's commitment to human rights, parliamentary democracy, private ownership, free market economics and balanced regional development and emphasizes the firm support for peaceful co-habitation between the various religious communities.

The Republic's political system is based on the separation of executive, legislative and judicial powers and a system of checks and balances. The Government determines overall policy, appoints senior administrators and submits proposed legislation to Parliament. Parliament, which is elected every four years, proposes and adopts laws and supervises government policy. Judicial power is fully vested in the courts and is autonomous. The Constitution provides for the formation of a Constitutional Council to rule on the constitutionality of laws and on challenges to the validity of presidential and parliamentary elections. The Constitutional Council was formed in 1994. It consists of a maximum of ten members, five of whom are elected by a simple majority of Parliament and five of whom are appointed by the Council of Ministers acting by vote of a two-thirds majority of the Ministers. The Constitutional Council acts by vote of a majority of seven members and has rendered several significant decisions to date, including the invalidation of the 1996 election of four members of Parliament and the invalidation of governmental decrees extending the term of municipal councils. The Constitution also specifies that a Supreme Council, constituted of seven deputies elected by Parliament and eight of the highest ranking judges, has jurisdiction to try the Presidents (President of the Republic, Speaker of Parliament, President of the Council of Ministers) and Ministers. The members of the Supreme Council that are elected by the Parliament are appointed for a period of four years. The first Supreme Council was constituted in 1996.

The Taif Agreement provided the framework for a two-stage process of political reform. The first stage resulted in improving the distribution of political power among representatives of the various religious communities: seats in Parliament are equally divided between Christian and Muslim communities and the powers of the Council of Ministers and of Parliament have been reinforced. The second stage calls for the elimination of the sectarian political system.

The Executive Branch consists of the President of the Republic and the Council of Ministers (the Cabinet). The President is the Head of State. The President is elected for a six-year term by a two-thirds majority of Parliament in the first voting round and by a simple majority if a subsequent round is required. The President's functions include: Chairman of the High Defense Council, Commander in Chief of the Army, which is subject to the authority of the Council of Ministers, and chairing the Council of Ministers whenever he attends its meetings, although he has no voting power at these meetings. The President appoints the Prime Minister following consultations with Parliament. The President must appoint the prime ministerial candidate who has the greatest level of support in Parliament. The President also negotiates treaties in conjunction with the Prime Minister. Treaties become final after the approval of the Council of Ministers and ratification by Parliament. Pursuant to constitutional custom in effect since the Republic's independence in 1943, the President is a Christian Maronite, the Speaker of Parliament is a Shiite Muslim and the Prime Minister is a Sunni Muslim. The Vice-Speaker and the Vice-Premier traditionally come from the Christian Greek Orthodox community. The Cabinet is headed by the Prime Minister. The Prime Minister is the President of the Council of Ministers, supervises and follows up on the work of ministries and administrators and co-ordinates ministerial policies.

The Legislative Branch consists of a single-chamber Parliament of 128 members. Members are elected for four-year terms in regional ballots, with the number of members for each region determined on the basis of the size and population of each region, subject to an overall number of members for each religious community. Parliament may be dissolved by the Council of Ministers, acting by vote of a two-thirds majority of the Ministers, upon request of the President of the Republic only on the basis of one of the following grounds:

- if the Parliament fails to meet during one ordinary session or two extraordinary sessions (except in the event of force majeure); or
- if the Parliament fails to pass a budget law for the purpose of paralyzing the Council of Minister's work.

The court system consists of one administrative court, the State Council Court ("*Conseil d'Etat*") and judicial courts (which include civil courts (which comprise commercial chambers) and criminal courts). The Supreme Court is the highest court of appeal for civil and commercial matters. Constitutional matters and conflicts relating to elections are referred to the Constitutional Council discussed above. The judges of the various courts (excluding certain members of the Constitutional Council) are appointed by the Government after favorable recommendation of the Supreme Council of Justice.

## **Elections**

Parliamentary elections took place in 1992, 1996, 2000 and 2005. The 1992 parliamentary elections were the first such elections in Lebanon since 1972. Certain political groups abstained from participating in the elections, although the 1996, 2000 and 2005 parliamentary elections were characterized by high voter participation.

In May and June 1998, municipal elections took place for the first time since 1963. All political parties participated. Municipal elections also took place in May 2004. There are 919 municipal councils in Lebanon with a total of 10,818 elected members.

Parliamentary elections for the election of all 128 members of Parliament took place in May and June 2005. The Beirut elections resulted in success for the Future Movement, founded by former Prime Minister Rafik Hariri. Elections in Southern Lebanon resulted in success for the candidates from the Hizbollah and the Amal movement alliance. Elections in three districts composing the Bekaa Valley regions resulted in success for the candidates from the Hizbollah and the Amal movement alliance, the alliance between the Future Movement, the Progressive Socialist Party, and the Free Patriotic Movement (headed by General Michel Aoun), respectively. Elections in Mount Lebanon resulted in success for the Free Patriotic Movement and the alliance between the Future Movement, the Progressive Socialist Party, the Lebanese Forces and members of the Qornet Shahwan Gathering. Elections in Northern Lebanon resulted in success for the Free Patriotic Movement and the alliance between the Future Movement, the Lebanese Forces and members of the Qornet Shahwan Gathering.

The following table sets forth the composition of the Assembly by total number of seats as of the date hereof.

<b><u>Political Party</u></b>	<b><u>Number of seats</u></b>
Future Movement, Progressive Socialist Party, Lebanese Forces and members of the Qornet Shahwan Gathering .....	72
Free Patriotic Movement and allies .....	21
Amal Movement .....	13
Hizbollah party .....	10
Others .....	12

On June 28, 2005 Mr. Nabih Berri who has served as Speaker of Parliament since 1992, was re-elected as Speaker of Lebanese Parliament for four additional years.

### ***Government and Political Parties***

The democratic political system in the Republic and the constitutional rights to freedom of speech and belief have nurtured a wide and diversified spectrum of political parties. The classification and categorization of the parties are blurred.

There are more than 30 parties and political groups in Lebanon reflecting many ethnic backgrounds and political beliefs.

In accordance with the Constitution, in October 2000, mandatory consultations between the President and members of Parliament regarding the appointment of the Prime Minister took place following the 2000 elections. A majority consisting of 106 members of Parliament selected Mr. Hariri as their nominee for Prime Minister and the President appointed Mr. Hariri Prime Minister as a result of consultations with Parliament's members. Following consultations between Mr. Hariri and members of Parliament, a new Government was formed in October 2000.

On April 16, 2003, Mr. Hariri submitted the Government's resignation to the President of the Republic, who accepted it. As provided in the Constitution, the President of the Republic conducted consultations with members of Parliament, following which Mr. Hariri was reappointed Prime Minister. A new Cabinet was formed on April 17, 2003. It was composed of thirty ministers, nineteen of whom were members of the prior Cabinet.

Following the extension of President Lahoud's term in September 2004, Mr. Omar Karami was appointed Prime Minister on October 21, 2004, and a new Cabinet composed of 30 members was formed on October 26, 2004. On November 6, 2004, Parliament granted confidence to the Government by a vote of 59 members in favor, out of the 108 members present at the session.

Following the assassination of Mr. Hariri in February 2005, Prime Minister Omar Karami submitted the resignation of the Government headed by him. Following mandatory Parliamentary consultations, Mr. Karami was reappointed by the President of the Republic as Prime Minister designate. Mr. Karami was not successful in forming a new Government and advised the President of the Republic accordingly. Following further mandatory Parliamentary consultations, Mr. Mohamed Najib Mikati, a former Minister and a prominent businessman, was appointed Prime Minister on April 19, 2005. A Government composed of 14 members was formed on April 19 2005. On April 27, 2005, Parliament granted confidence to the Government by a vote of 110 members in favor, out of the 120 members present at the session.

Following Parliamentary elections in May and June 2005, Mr. Fouad Siniora, a former Minister of Finance in the Hariri governments, was appointed Prime Minister on June 29, 2005. A Government composed of 24 members was formed on July 19, 2005, 15 of whom are members of the alliance between the Future Movement, the Progressive Socialist Party, the Lebanese Forces and members of the Qornet Shahwan Gathering. On July 30, 2005, Parliament granted confidence to the Government by a vote of 92 members in favor, out of the 108 members present at the session.

In July 2005, the Siniora Government submitted a program to Parliament indicating that the economic policy of the Government will be based on the following principles:

1. Re-gaining international and domestic trust and confidence in the future of the economy by restoring the credibility of the State and implementing the required financial, economic and social reforms whose foundations were set out in the Paris II Conference and in the draft 2005 budget;
2. Committing to fighting corruption and the squandering of public funds and promoting transparency and accountability in public financing;
3. Working on fighting poverty, illiteracy and diseases and promoting a balanced and sustainable development plan;
4. Building a modern economy whose cornerstone would be a dynamic private sector, capable of competing in the international arena;
5. Associating political forces, civil society and the international community in the Government's reform process;
6. Developing and consolidating economic ties with the Arab countries and the EU and accelerating accession of the Republic to the World Trade Organization; and
7. Reducing public expenditure, increasing revenue by modernizing the tax system, modernizing public debt management activities, implementing the privatization program and seeking to renew the support of the Republic's friends and allies in the international community.

### ***Legal System***

The Republic's legal framework is based on the Constitution and on a body of well-established laws, dating back to 1930. The Constitution and the laws thereunder guarantee the private ownership of property, the free flow of funds and currencies in and out of the country and the freedom of contract between parties (so long as contracts do not contravene public policy).

Lebanese civil law is mostly based on the Code of Obligations and Contracts (which is based on the French Civil Code and was promulgated in 1932) and the Land Ownership Law. Other major legislation includes the Commercial Code (promulgated in 1942), the Code of Money and Credit (promulgated in 1963) and the complementary legislative decrees (issued in 1967) related to commercial agency representation, stock exchange, limited liability companies and business concerns and the New Code of Civil Procedure (promulgated in 1983).

An active legislative reform movement is taking place both in Parliament and through special committees formed by *Banque du Liban* and the Ministry of Justice to modernize Lebanese law following the end of the period of conflict. Significant laws and regulations have been adopted in various areas, including a law authorizing and regulating fiduciary activities, a law eliminating the different classes of shares for banks and a law regulating the issuance of notes and other debt securities by banks.

### ***International Relations***

Lebanon is a founding member of the United Nations and the League of Arab States and is a member of all international organizations under the auspices of the United Nations (United Nations Educational, Scientific and Cultural Organization, Food and Agriculture Organization, International Fund for Agricultural Development and others), the International Bank for Reconstruction and Development (the "*World Bank*"), (and its affiliates, the International Finance Corporation and the Multilateral Investment Guaranty Agency), the International Monetary Fund and the International Development Association.

The Republic maintains diplomatic relations with 146 countries and has 94 diplomatic and consular missions abroad. It hosts 140 diplomatic missions in its territory, including the diplomatic missions of the European Union (the "EU") and the Arab League. The Republic also hosts a number of international organizations such as the United Nations Regional Office for Education, Science and Culture in the Arab Countries, the United Nations High Commission for Refugees, Food and Agriculture Office of the United Nations, the World Health Organization, the United Nations Fund for Childhood, United Nations Development Program and the Arab Center for Legal and Judicial Research, which is affiliated with the Arab League. The Economic and Social Commission for Western Asia (ESCWA), an agency of the United Nations, relocated its headquarters to Beirut in October 1997 and the World Bank opened an office in Beirut in January 2000.

In January 2001, the Secretary General of the United Nations appointed a personal representative for southern Lebanon and entrusted him with responsibility for coordinating UN activities in that region.

Having successfully liberated most of its territory from Israeli occupation in May 2000, Lebanon remains committed to the principles agreed upon at the Madrid Peace Conference in 1991. Lebanon supports United Nations and international efforts towards the achievement of a just, comprehensive and lasting settlement in the region. Such a settlement should involve the total withdrawal of Israeli troops from all Arab occupied territories up to the borders in place on June 4, 1967 and the implementation of the right of Palestinian refugees to return to their homeland in Palestine.

The Republic has entered into a number of treaties with Syria relating to co-operation in various areas. These treaties include the Treaty of Fraternity, Co-operation and Co-ordination, which was entered into on May 22, 1991 and ratified by Parliament on May 29, 1991. This treaty provides for co-ordination between the two countries in economic, social, foreign and military affairs and establishes a number of high level joint commissions to implement such co-ordination. Following the withdrawal of Syrian troops from the territory of the Republic in 2005, Syria applied economic pressure on the Republic by, among other measures, restricting border access for merchandise from the Republic. Prime Minister Siniora pledged to resolve these issues amicably and called for friendly relations between Syria and the Republic, on the basis of respect for the sovereignty of each country. As of the date hereof, these issues have largely been resolved.

The Republic has a long tradition of openness to the international community with close ties to the Arab world, Europe and America. The Government is implementing a comprehensive strategy for trade liberalization. The Republic is committed to democratic principles.

The Republic is implementing free trade agreements entered into with Syria (1993), Kuwait (1996) and Egypt (1998). It also signed a free trade agreement with the United Arab Emirates in April 2000, which Parliament has now ratified. The free trade agreement with Syria was implemented in two stages. In February 1998, the two countries agreed to reduce tariffs on industrial goods by 25 per cent. per year, with effect from January 1999 and on agricultural goods by 50 per cent. with effect from November 1999, with further annual reductions of ten per cent. over a period of five years. The Republic has also entered into agreements for economic cooperation with Arab countries such as The Kingdom of Saudi Arabia, Qatar, Kuwait, Yemen and Morocco and is in the process of ratifying an Agreement for an Economic Free Trade Zone with the Hashemite Kingdom of Jordan. The Republic is also a party to the Arab Free Trade Agreement pursuant to which tariffs between 14 Arab countries are reduced by 10 per cent. annually with effect from January 1, 1998. All tariffs with respect to the parties to the Arab Free Trade Agreement were eliminated in January 2005.

Since 1992, the Republic has ratified or signed a number of treaties for the promotion and protection of investments. The Republic has ratified such treaties with each of Armenia, Australia, Austria, Azerbaijan, Belarus, Benelux, Bulgaria, Canada, Chile, China, Croatia, Cuba, Cyprus, Czech Republic, Egypt, Finland, France, Gabon, Germany, Greece, Hungary, Iran, Italy, Kuwait, Malaysia, Morocco, the OPEC Fund, Pakistan, Romania, Russia, Slovakia, Spain, Sweden, Switzerland, Syria, Tunisia, Ukraine, Uruguay, the United Arab Emirates, the United Kingdom and Yemen. The Republic has signed such treaties with each of Austria, Benelux, Cyprus, Gabon and Hungary and is in the process of ratifying such a treaty with Bulgaria. The Republic has also ratified treaties for the avoidance of double taxation with 20 countries and signed such treaties with eight additional countries.

On June 17, 2002, the Republic signed an association agreement, which Parliament ratified on December 12, 2002, with the European Union (EU), as part of the Euro-Mediterranean Partnership initiative. The EU is one of the Republic's major trading partners. The proposed partnership covers several areas of cooperation, including the progressive liberalization of trade in goods with an ultimate goal of creating a Mediterranean free-trade area. In addition, the agreement addresses various other aspects of economic and financial cooperation.

Under the agreement, industrial products originating in Lebanon will be admitted to the EU duty-free. The Republic must commence dismantling tariffs beginning in 2008 until they reach 0 per cent. by 2014. To date, 14 out of the original 15 EU member states have ratified the agreement. An interim trade agreement has been in force since March 2003, and as such, the grace period for tariff reductions by the Republic will end March 2008. Once the Dutch Parliament ratifies the association agreement, it will enter into force, effectively replacing the interim agreement. Currently, the Republic is engaged in preparatory talks with the EU regarding the European Neighborhood Policy (ENP) as a result of the new situation created by the EU enlargement. The Republic is expected to commence negotiations to join the ENP.

The Republic applied for membership in the World Trade Organization ("WTO") and was granted observer status in April 1999. On May 15, 2001, the Government submitted to the WTO the Memorandum of Foreign Trade Regime as a second step toward its accession. As of early October 2002, the Government entered into negotiations with the WTO for full membership and has provided replies to all queries presented to-date by member states. Three working party meetings have been held to date, the first in October 2002, the second in December 2003 and the third in July 2004. A Factual Summary of Points Raised (summarizing the discussions of the Working Party) was circulated in June 2004. A revised version of the Factual Summary is currently being prepared. Bilateral market access negotiations are underway on the basis of revised offers on goods and services. A fourth meeting of the Working Party is expected to be held during the first quarter of 2006. WTO membership is expected by the end of 2006.

In June 2004, the Republic entered into a free trade agreement with the European Free Trade Association (EFTA), which consists of Switzerland, Liechtenstein, Norway and Iceland. The Agreement was approved by the Council of Ministers on June 16, 2005 and awaits approval by Parliament. The EFTA-Lebanon Free Trade Agreement covers trade in industrial goods, including fish and other marine products, as well as processed agricultural products.

## **THE ECONOMY**

### ***Economic System***

Lebanon has a long tradition of domestic free trade and investment policies, with free market pricing for most goods and services, an unrestricted exchange and trade system and extensive links with the developed world in practically all economic activities. The Government has maintained a generally non-interventionist stance toward private investment, and public ownership has generally been limited to infrastructure and utilities. There are no restrictions on the movement of capital and goods by residents and non-residents of the Republic, including on entry or exit of firms or on access to foreign exchange, which makes Lebanon a supportive system for private sector development.

The Government continues to favor a strong role for the private sector in a liberal policy environment. It welcomes foreign investment in the economy. There are no legal restrictions on setting up and operating private businesses in Lebanon, subject to limited exceptions (see "*External Sector—Foreign Direct Investment*"). Investment in infrastructure activities historically has been undertaken by the public sector. The absence of exchange controls in Lebanon allows foreign investors freely to import and export capital in any form they wish.

The Lebanese economy, characterized by freedom of exchange and transfers, is based on private initiative. The private sector is estimated by CAS to contribute over 80 per cent. to aggregate demand and includes industries such as agriculture, manufacturing, construction, trade and tourism, in addition to services such as banking and finance, hotels and restaurants, media and advertising, and consulting and engineering. The manufacturing and industrial sectors are estimated by the CAS to contribute

approximately one-fifth of the national income. They are provided only with a limited level of protection from international competition.

### ***Recent Economic History***

The Republic had developed into a prosperous, lower middle income country by the mid-1970s. Economic growth averaged 5 per cent. per year during the period 1960-1970 and then accelerated to 7 per cent. per year in the period 1970-1975. The main source of growth was the services sector, in particular, tourism, banking, insurance and free port activities. The banking sector, aided by a stable and liberal regime, a freely convertible currency, favorable regulations and skilled management, permitted Beirut to serve as a financial center to the Middle East. This environment allowed Lebanese entrepreneurial and financial skills to evolve to a high degree, and in the 1970s its bankers and traders enjoyed an excellent reputation in the region. Although smaller in size than the services sector, the export-oriented agricultural and manufacturing sectors also grew (at annual rates averaging between 4 per cent. and 6 per cent.), contributing to overall growth of income. Having grown at an average of 3 per cent. per annum since 1960, per capita gross national product ("*GNP*") was estimated at U.S. \$1,070 in 1974, just prior to the outbreak of the conflict in April 1975.

Estimates put the Republic's GNP per capita at about U.S. \$820 in 1990, barely one third of its 1975 level in real terms. Damage to infrastructure and physical assets due to the conflict amounted to U.S. \$25 billion, according to United Nations estimates, with none of the principal sectors emerging from the conflict unscathed. While limited investment and maintenance expenditure led to the erosion of the capital base, the sizeable emigration of skilled manpower constituted a major loss to the economic potential of Lebanon. As a result, from 1975 to 1990, aggregate national output steadily declined. In addition, the confidence in, and credibility of, the Lebanese Pound and economic stability began to erode. The shift in authority from the Government to non-official entities gave rise to a parallel economy that severely hampered the Government's ability to collect revenues as most trading was conducted through unofficial ports of entry. This dearth in Government revenue and the growing expenditure on public services led to large and rapidly growing Government budget deficits. These negative developments, along with the prevailing political uncertainty, plunged the Lebanese economy into a vicious cycle of large budget deficits leading to monetary expansion and inflation, which translated into dollarization of the economy and capital outflows. This in turn led to a dramatic depreciation of the value of the Lebanese Pound and further inflation.

The cessation of hostilities was followed by a recovery in the economy in 1991; according to IMF estimates, GDP rose by almost 40 per cent. and inflation moderated in the course of the year. Large capital inflows, along with a partial recovery of exports, resulted in an overall balance of payments surplus of over U.S. \$1 billion. However, the fiscal deficit remained high in 1991 (56 per cent. of expenditures). By the beginning of 1992, *Banque du Liban* had stopped supporting the Lebanese Pound, the value of which declined to all time lows. The cycle of deficit financing, dollarization and capital outflows led to escalating inflation and exchange rate depreciation, with the value of the Lebanese Pound reaching LL 2,420 per U.S. Dollar in September 1992.

Following the appointment of the first Government led by Mr. Hariri in October 1992, the Government took measures to restore economic stability and renew confidence in the Lebanese Pound.

Between 1993 and 1998, the economic program of the successive Hariri Governments rested on the dual, and sometimes conflicting, tasks of economic revival and stabilization. This framework aimed to rehabilitate the country's damaged infrastructure, replenish the depleted capital stock, reinstate traditional public services, implement programs for the return of displaced persons to their villages and provide a conducive environment for the return of the expatriate Lebanese community, while pursuing exchange rate stability and anti-inflationary policies. This strategy has been successful to a certain extent. As the Government-led reconstruction program got underway and with the normalization of the economic environment, real economic growth averaged 5.7 per cent. over the period from 1992 to 1997. At the same time, the foreign exchange rate gradually appreciated, reaching LL 1,516 per U.S. Dollar at the end of 1998. The inflation rate was reduced from over 120 per cent. in 1992 to approximately three per cent. in 1998. Interest rates have gradually declined since 1995. However, efforts at improving monetary stability and expenditures on large scale reconstruction projects contributed to increased fiscal deficits and consequential public borrowings. As at December 31, 1997, the fiscal deficit represented 23.64 per cent. of GDP.

The Government headed by Dr. Al Hoss held office from December 1998 until October 2000. The Al Hoss Government continued to foster monetary stability. Inflation was further reduced to 0.25 per cent. in 1999, the foreign exchange rate remained stable and the balance of payments registered a surplus in 1999.

When it assumed office in October 2000, the then Hariri Government faced a number of challenges, including an economic slowdown, a large fiscal deficit and a significant debt service burden. For the years ended December 31, 1999 and December 31, 2000, the fiscal deficit represented approximately 14.4 per cent. and 23.6 per cent., respectively, of GDP and debt service represented approximately 74 per cent. and 92 per cent., respectively, of total revenues. Net Public Debt (consisting of Net Domestic Debt and Public External Debt) represented approximately 120 per cent. of GDP as at December 31, 1999 and 142 per cent. of GDP as at December 31, 2000. See "*Public Finance – The Budget Deficit*".

To address these challenges, the then Hariri Government devised a four-pronged strategy seeking to:

- revitalize the economy by inducing the private sector to act as the conduit for growth, adopting measures designed to promote investment and growth and further integrating Lebanon into the global economy; these measures included the adoption of a new customs law, the extension by *Banque du Liban* of interest subsidies and partial guarantees of loans to enterprises in certain sectors, the easing of restrictions on foreign ownership of real property and the reduction of employers' contributions to social security;
- improve the Republic's overall fiscal condition, by (among other things) controlling discretionary expenditures and enhancing revenues, reducing its heavy debt service burden, imposing VAT on most goods and services, pursuing a comprehensive privatization program, reactivating development projects put on hold by the previous Government (for which external financing has been secured through soft loans), acceding to the WTO, implementing a policy of open skies for the airline industry, reducing customs duties and relaxing other trade barriers, and concluding additional agreements with the EU and other Arab countries;
- modernize the legal system; and
- maintain monetary stability and lower inflation.

As a result of the implementation of this strategy, the economy improved slightly, recording in 2001 a growth rate of 2.0 per cent., a (0.4) per cent. inflation rate and a decline in the fiscal deficit by 7.0 per cent. to 16.8 per cent. of GDP and, in 2002, a real growth rate of 2.0 per cent., a 1.8 per cent. inflation rate and a decline in the fiscal deficit by 1.5 per cent. to 16.5 per cent. of GDP. In 2001, debt service represented 93.0 per cent. of total revenues and Net Public Debt rose to 162.5 per cent. of GDP and, in 2002, debt service represented 79 per cent. of total revenues and Net Public Debt rose to 170.0 per cent. of GDP.

At the end of 2002, the then Hariri Government implemented a series of measures to address the issue of public debt service. The Paris II Conference, which is described below, was the most prominent of these measures. In addition, at the end of December 2002, *Banque du Liban* retired LL 2,700 billion (approximately U.S. \$1.80 billion) of its 24-month Lebanese Pounds treasury bill portfolio by offsetting this amount against credit balances in the Treasury's account with *Banque du Liban*. *Banque du Liban* also exchanged LL 1,221 billion of Lebanese Pound-denominated treasury bills and U.S. \$1.04 billion of eurobonds held by it for a new U.S. \$1.87 billion, 15 year, 4 per cent. eurobond with a five year grace period.

As a further measure to reduce public debt service *Banque du Liban* issued decision N° 8312, pursuant to which all banks operating in Lebanon were required to subscribe to Lebanese treasury bills or eurobonds issued by the Lebanese Republic. These notes do not bear interest and have a maturity of two years, with the aggregate amount subscribed by each bank equaling 10 per cent. of such bank's deposits in all currencies as at October 31, 2002. The decision provided the commercial banks with the option to subscribe to the non-interest bearing notes in cash or through the delivery of treasury bills or

eurobonds previously issued by the Lebanese Republic. Total subscriptions by Lebanese banks amounted to approximately U.S. \$3.6 billion, most of which was subscribed in cash.

As a result of the inflow of the funds collected to date from participants in the Paris II Conference and the other debt service reduction measures described above, the Republic has re-profiled approximately 32 per cent. of its total debt outstanding at the time of the Paris II Conference by extending its maturity and reducing its cost. The application of Paris II Conference funds, which constitute non-market debt, to repay market debt (i.e., gross public debt excluding the portfolios of *Banque du Liban*, public institutions, bilateral and multilateral loans and debt issued to the Paris II Conference lender countries and agencies) has also lowered the ratio of market to non-market debt from 79 per cent. prior to the Paris II Conference to 59 per cent. in December 2004.

Eurobond issuances of market debt ceased from the Paris II Conference until May of 2004 (see "*Public Finance – The Budget Deficit*"). Additionally, the average cost of public debt (in Lebanese pounds and foreign currency) has declined by 541 basis points from 11.97 per cent. at the end of November 2002 to 6.56 per cent. at the end of December 2004. Average interest rates on Treasury bills declined by more than 30 per cent. with the secondary market yield on the 24-month Treasury bill declining from over 14 per cent. in November 2002 to approximately 9 per cent. in January 2003 and to 7.74 per cent. as at December 2004, which is the lowest yield in over two decades. Gross foreign exchange reserves (excluding gold) were U.S. \$9.5 billion as at the end of December 2004. *Banque du Liban* reduced its rate on 45 day certificates of deposit from 9.50 per cent. as at the end of November 2002 to 4.50 per cent. as at the end of May 2003 and to 4.40 per cent. since November 2003. Average lending rates of commercial banks in Lebanese Pounds decreased by approximately 563 basis points from 16.11 per cent. in November 2002 to 10.48 per cent. in December 2004. Average deposit rates in Lebanese Pounds decreased by approximately 343 basis points from 10.44 per cent. in November 2002 to 7.01 per cent. in December 2004. The dollarization rate of commercial bank deposits declined from 74.2 per cent. in May 2002 to 73.13 per cent. in December 2005. See "*External Sector -- Foreign Borrowings and Grants*".

When it assumed office again in 2003, the government of late Prime Minister Hariri acknowledged the role of the prior Government in addressing the economic and fiscal situation of the country. It pledged to continue the implementation of the fiscal reforms undertaken by the prior Government in order to reduce the public deficit and interest rates and increase the primary surplus.

As part of its debt service reduction measures, the Government refinanced U.S. \$0.43 billion of principal and interest on maturing treasury bills held by *Banque du Liban* by issuing, in July 2003, new Lebanese pound denominated treasury bills maturing in 2008 and bearing interest at 4 per cent. The Government has used these funds to redeem and cancel higher-interest bearing maturing debt.

However, the implementation of some of the economic and fiscal reforms described above, which were included in the fiscal reform program submitted by the prior Government during the Paris II Conference, such as privatization and securitization, has been delayed because of differences in views between political leaders in an election year.

Economic activity continued to improve, recording, in 2003, a growth rate of 3 per cent., a 1 per cent. inflation rate and a decline in the fiscal deficit by 8.5 per cent. to 14.5 per cent. of GDP. In 2003, debt service represented 73 per cent. of total revenues, decreasing by 6 percentage points and net public debt represented 174 per cent. of GDP, marking a 4 percentage point increase.

In 2004, the Lebanese economy continued to grow. Real GDP grew by 5 per cent. and fiscal deficit decreased by 23 per cent. to a level of 10.2 per cent. of GDP. Debt service represented 53.5 per cent. of total revenues, decreasing by 19 percentage points and net public debt represented 169 per cent. of GDP, registering a 5 percentage points decrease. The inflation rate was approximately 3 per cent. in 2004.

The balance of payments registered overall surpluses during the period from 1993 to 1997, despite growing trade deficits. In 1998, however, the balance of payments registered a deficit of U.S. \$787 million for the first time since the end of the conflict. While a small surplus of U.S. \$261 million was realized in 1999, in 2000 and 2001, the balance of payments again registered deficits of U.S. \$289 million and U.S. \$1.17 billion, respectively, mainly due to the large trade deficit and the effect of

regional developments. During 2002 and 2003, the Republic's balance of payments improved, registering surpluses of U.S. \$1,564 million in 2002 and U.S. \$3,386 million in 2003. The 2003 balance of payment figure was exceptionally high due to the large inflows following the Paris II Conference. As at the end of 2004, the balance of payments recorded a surplus of U.S. \$168.5 million. The absence of Paris II Conference inflows during 2004, together with an increase in the deficit of the trade balance, resulted in the decline in 2004 compared to the 2003 year end balance.

The period following the assassination of Mr. Rafik Hariri in February 2005 witnessed an economic slowdown and significant conversions from Lebanese pound deposits to foreign currency deposits followed by a decline of foreign currency reserves due to the intervention of *Banque du Liban* on the foreign exchange markets.

As at the end of December 2005, the balance of payments recorded an overall surplus of U.S. \$747 million, as compared to a surplus of U.S. \$169 million for 2004.

### ***Role of the Government in the Economy and Privatization***

Lebanon has a long and established tradition of having an open and free market economy. The state sector has traditionally been small, with the Government having a history of minimal intervention in economic activity.

For the first eight years of the conflict (until 1983/84), Government authority was still present, albeit in a much weaker form than before the conflict began, and some tax revenue was forthcoming. From 1983/84, the Government effectively lost control of all ports, and non-payment of direct taxes and bills to state-owned utilities became widespread, leading to a financing of current Government expenditure through money creation.

After the conflict, the Government continued the policy of reliance on private sector initiative, which had served the country well in the pre-conflict era. However, in recent years, the Government has assumed a larger role than it had historically by making substantial investments in infrastructure needed to create an environment conducive to long-term growth based on private sector activity. See "*Public Finance — Operations of the Central Government*". However, the various post-conflict governments have also been seeking to increase private sector participation in infrastructure financing.

In May 2000, Parliament adopted a privatization law, which sets the framework for the privatization of state-owned enterprises. The privatization law established a Higher Council for Privatization and provides that the proceeds from privatization will be applied towards debt repayment. While the state sector in Lebanon does not account for a large portion of GDP (7.4 per cent. of GDP in 1995, excluding certain government agencies), it nevertheless includes several enterprises and types of assets which have been successfully privatized in other emerging markets. EDL (which supplies virtually all electricity in the Republic), Société des Eaux de Beyrouth and other water companies, the airport and port companies, the fixed-line and mobile telephone networks and other assets, many of which may be eligible for privatization, are directly or indirectly state-owned. *Banque du Liban* also owns significant commercial assets, including substantially all of the shares of the national air carrier, Middle East Airlines.

With the exceptions of the sales by *Banque du Liban* of its shares in Credit Libanais S.A.L. in 1997 and in *Banque Libanaise pour le Commerce* in 2005, prior Lebanese governments did not conduct sales of state-owned enterprises.

Due to political interference and disagreements within the Executive Branch of the Government, the Republic's privatization program has not been successfully implemented to date.

The current Government intends to re-launch the privatization program, and has reactivated the Higher Council for Privatization. The Government believes that privatization is likely to result in significant economic benefits, including a reduction in public debt and a consequent decrease in the budget deficit. In addition, the Government believes that by offering to the public shares in the private companies resulting from the privatization of state-owned enterprises, the stock market will be activated and the financial markets will be developed. The current status of privatization activities is as follows:

### *Telecommunications Sector*

A modern telecommunications law ("*Law 431*"), was adopted by Parliament in July 2002. Law 431 organizes and regulates the telecommunications sector in the Republic. It provides for the formation of a joint stock company, Liban Telecom, to which the fixed line operations and assets of the Ministry of Telecommunications will be transferred and grants it a 20-year license for the provision of telecom services. A decree for the formation of Liban Telecom was adopted by the Council of Ministers in December 2004. Law 431 provides for the sale of up to 40 per cent. of Liban Telecom's shares to a strategic partner within two years of the establishment of the company. In addition, Law 431 provides for the establishment of a Telecommunications Regulatory Authority whose functions include tariff monitoring and encouraging competition and transparency.

In May 2002, Parliament passed a law authorizing and regulating the sale of two licenses for the provision of GSM and GPRS mobile telephony services in Lebanon for a 20 year term and related assets which were held by the existing operators of the mobile networks. This law authorized qualified bidders to submit offers for one or more of the following sale or management options:

- the first option authorized bidders to submit a cash offer on the basis that the Government retains 40 per cent. of the revenues from domestic calls and all other services provided to customers and 100 per cent. of the revenues from international calls;
- the second option authorized bidders to submit a cash offer on the basis that the Government shall not retain any portion of the revenues from domestic calls and other services provided to customers but will retain 100 per cent. of the revenues from international calls;
- the third option authorized bidders to submit an offer for the management of the mobile networks for a period of up to three years; the Government has indicated that the management option would be considered if it shall not be satisfied with the results of the other options.

The auction and tender were conducted by an investment bank in January 2004. The Government was disappointed with the outcome of the bidding, which resulted in one of the existing operators of the mobile network and the shareholder of another operator submitting the sole binding offers. The Government rejected these bids, as it was authorized to do pursuant to the auction and tender rules and directed the Minister of Telecommunications to conduct a new international tender for the award of two four year management contracts. The tender for the management contracts was successfully completed in March 2004 and resulted in the selection of a German company and a Kuwaiti company as the successful bidders.

The Ministry of Telecommunications has the right to terminate the management contracts upon six months prior notice to the operators and the payment of management fees covering a four month period.

### *Electricity Sector*

In September 2002, Parliament passed a law (Law 462) regulating the electricity sector which, among other matters, provides for the establishment of an independent regulator, the separation of production, transmission and distribution activities, the privatization of production and distribution activities through the granting of concessions and/or the formation of new entities whose shares will be initially owned by the Government and up to 40 per cent. subsequently transferred to strategic and other private investors. Law 462 provides that the transmission assets must remain the property of the Republic but that management contracts for the operation of the transmission networks may be appointed to private parties. The last Government headed by Mr. Hariri, had also appointed an investment bank and other specialists to assist it in the privatization and had received indications of interest from a number of international operators.

The current Government is in the process of developing a comprehensive plan for the energy sector of the Republic. As an initial step, the Government has entered into a long-term fuel supply agreement

with Kuwait, which is expected to generate savings. In addition, the Government is considering establishing new companies pursuant to Law 462 to which production assets, or the right to use these assets, will be transferred. This would be a prelude to any subsequent privatization in the energy sector.

#### *Water Sector*

A draft law regulating the water sector is in the process of being prepared. Work on the privatization of this sector had commenced under the last Hariri Government.

#### *Finance Sector*

In December 2005, *Banque du Liban* sold its shares in Banque Libanaise Pour Le Commerce SAL.

#### *Securitization*

Following its desire to reduce borrowing costs and its debt levels, the Government submitted to Parliament, and, in June 2002, Parliament adopted a law authorizing the Government to engage in securitization transactions and mandating that the Government deposit in a special account at *Banque du Liban*, dedicated to the payment, management and reduction of public debt, the proceeds of any securitization transaction, as well as the revenues derived by the Government from specific sectors, such as telecommunications, tobacco, Casino du Liban and others.

Prospective holders of notes should be aware that, to the extent the Government undertakes securitization transactions, future revenues from the assets or flows being transferred pursuant to any such transactions may no longer be available for the payment of interest and principal in respect of Notes.

#### *Gross Domestic Product*

Since 1977, no official GDP calculations were made, with the exception of the GDP calculations for 1994 and 1995 published by CAS and the 1997 GDP figures published in May 2003 by the Ministry of Economy and Trade. On September 30, 2005, the Ministry of Economy and Trade, National Accounts Committee, released GDP calculations for the period 1997-2002.

The following table shows GDP figures for the years 1997-2002<sup>(1)</sup>:

	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
GDP (at market prices), billions of LL.....	24,008 <sup>(2)</sup>	25,638	25,647	25,143	25,726	27,832
Exchange rate, LL per U.S. \$ (period average).....	1,539.2	1,515.9	1,507.8	1,507.5	1,507.5	1,507.5
Growth of Real GDP .....	N/A	3.0%	(0.8)%	0.9%	4.4%	2.6%
Growth of Nominal GDP.....	N/A	6.8%	0.0%	(2.0)%	2.3%	8.2%
GDP Inflation .....	N/A	3.7%	0.8%	(2.8)%	(2.0)%	5.4%

Source: Ministry of Economy and Trade, National Accounts Committee, National Accounts: 1997-2002.

Notes:

- (1) The newly published GDP figures for 1998-2002 are higher than the previously published estimates of GDP for these years.
- (2) This number differs from the GDP figure for 1997 previously published by the Ministry of Economy and Trade, which was LL 24,108 billion.

The following table shows GDP figures by sector for the years 1997-2002:

	1997	1998	1999	2000	2001	2002
Agriculture.....	1,556	1,544	1,584	1,614	1,546	1,622
Energy and water supply .....	226	395	372	221	297	271
Industry.....	3,232	3,425	3,249	3,027	3,159	3,248
Construction .....	2,256	2,679	2,239	2,000	2,099	2,144
Transport and communication .....	1,256	1,333	1,551	1,643	1,715	1,805
Services .....	7,599	8,126	8,306	8,491	8,559	9,161
Trade.....	5,118	5,341	5,233	5,003	5,070	6,071
Public Administration.....	2,765	2,794	3,113	3,143	3,281	3,510
<b>Total GDP (at market prices), billions of LL .....</b>	<b>24,008</b>	<b>25,638</b>	<b>25,647</b>	<b>25,143</b>	<b>25,726</b>	<b>27,832</b>

Source: Ministry of Economy and Trade, National Accounts Committee, National Accounts: 1997-2002.

With the restoration of peace and stability, GDP registered high growth rates for the period from 1993 to 1995, averaging an estimated real growth rate of 7.2 per cent. per annum. Real GDP grew at slower estimated rates of 4.0 per cent. in 1996 and 1997, 3.0 per cent. in 1998, 1.0 per cent. in 1999 and was 0.5 per cent. in 2000. Real GDP growth was 4.4 per cent. in 2001, 2.6 per cent. in 2002, 5.0 per cent. in 2003 and 6.0 per cent. in 2004.

The following table shows GDP estimates<sup>(1)</sup> for the years 2003 to 2005:

	2003	2004	2005
GDP (at market prices), billions of LL.....	29,991	32,815	32,243
Exchange rate, LL per U.S. \$ (period average) .....	1,507.5	1,507.5	1,507.5
GDP (at market prices), millions of U.S. Dollars.....	19,901	21,775	22,059
Growth of Real GDP .....	5.0%	6.0%	1.0%
Growth of Nominal GDP.....	7.8%	9.4%	1.3%
GDP Inflation .....	1.3%	3.0%	0.3%

Source: Ministry of Finance, Banque du Liban and IMF Article IV.

Note:

(1) The figures in this table have been revised and may differ from previously published data.

Recognizing that statistical weaknesses and the absence of reliable and current information concerning GDP figures and other economic data constitute serious obstacles to the analysis of the Republic's economy, a decree was adopted by the Prime Minister in 2002 establishing a steering committee, headed by the Minister of Economy and Trade, for the establishment of a national accounts database for the years 1997/2002. Technical assistance was provided by the French National Institute of Statistics and Economic Studies (INSEE).

In May 2003, the Ministry of Economy and Trade published GDP figures for 1997. In September 2005, the Ministry of Economy and Trade published revised GDP figures for 1997, and GDP figures for 1998-2002.

The following table shows the composition of the Republic's GDP for the year 2002, as calculated by the Ministry of Economy and Trade:

Composition of 2002 GDP by Sector		(per cent.)
At market prices, in billions of LL, except for statistical information		
Agriculture.....	1,622	5.8
Energy and water .....	271	1.0
Manufacturing .....	3,248	11.7
Construction.....	2,144	7.7
Transport and communications.....	1,805	6.5
Services.....	9,161	32.9
Trade.....	6,071	21.8
Non-market services .....	3,510	12.6
<b>Total.....</b>	<b>27,832</b>	<b>100.00</b>

Source: Ministry of Economy and Trade.

### ***Principal Sectors of the Economy***

At the end of the conflict, all sectors of the Republic's economy were characterized by widespread damage to physical assets and an obsolescence of remaining facilities, given the reluctance during the years of conflict to invest in new capital or spend funds on maintenance. In addition, there was an outflow of professional and entrepreneurial skills from Lebanon. A lower production capacity, together with rigidities in internal flows of goods and labor, led to low levels of output.

The end of the conflict in 1990 marked the unification of the internal market and an upsurge in output in most sectors of the economy. Since then, there has been an increase in investment and a gradual return of skilled workers to the country. Although the economy suffered a slow-down in 1998 to 2000, it resumed a modest recovery in 2001 and 2002, and growth resumed in 2003 and 2004. Real GDP grew by 5.0 per cent. in 2004 and 3.0 per cent. in 2003. Real GDP growth was 1 per cent. in 2005, following the aftermath of Mr. Hariri's assassination.

The following table sets forth selected indicators of economic activity in significant sectors for the periods indicated:

### **Selected Indicators of Economic Activity**

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>Industry</b>					
Recorded Exports (million of U.S. Dollars) .....	889	1,045	1,524	1,747	1,644 <sup>(2)</sup>
Electricity Production (million kwh).....	9,437	10,193	10,547	10,491	9,684 <sup>(2)</sup>
Cement Deliveries ('000 tons).....	2,715	2,601	2,704	2,729	2,781 <sup>(2)</sup>
<b>Construction</b>					
Construction Permits <sup>(1)</sup> .....	10,249	11,704	11,384	11,258	11,632
Area ('000 sq. meters).....	6,854	7,896	8,807	9,166	7,535
<b>Commerce</b>					
Port of Beirut (no. of ships) .....	2,647	2,526	2,333	2,366	2,229
Beirut Airport (no. of passengers '000s).....	2,373	2,513	2,718	4,000	3,016
<b>Documentary Credits for Imports</b>					
(million of U.S. Dollars) .....	2,592	2,728	3,273	3,852	3,639

Source: Ministry of Finance, Banque du Liban, Port of Beirut, Order of Engineers of Beirut and Tripoli.

Note:

(1) Construction permits data excludes permits for Northern Lebanon.

(2) Through 30 November 2005.

## *Services*

The Lebanese economy is based primarily on the service sector, which accounts for approximately 60 per cent. of GDP (down from approximately 70 per cent. in the 1970s). Major subsectors are commerce, tourism and financial services. Other components include health care and higher education.

## *Commerce*

The Port of Beirut plays an important role in Lebanon's commercial activities. After World War II, Beirut became the most important Arab port on the Eastern Mediterranean serving the Arab world. A free-port area for re-exports added to Beirut's success. During the conflict, the Port of Beirut virtually closed down and related commerce ground to a halt.

Work has been completed on the reconstruction of the Duty Free Zone at the Port of Beirut to restore its prewar capacity and a project for the rehabilitation and expansion of the Port of Beirut is underway. A contract to equip and operate the new Beirut container terminal was entered into in 1998 by the Beirut Port Authority and the Port Development Group on the basis that the Beirut Port Authority would construct the infrastructure required for this terminal. This contract was awarded to the Port Development Group following an international public tender. The Port Development Group is a Lebanese company cooperating technically with the Dubai Port Authority. The chairman of the board of the Port Development Group is the director of the Dubai Port Authority. The Beirut Port Authority completed the execution and financing of the required infrastructure in September 2000 at a cost of approximately U.S. \$150 million.

The following table sets forth data concerning trade activity at Beirut Port for the years 2001 to 2005:

### **Trade Activity at Beirut Port**

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
No. of ships.....	2,647	2,526	2,333	2,366	2,229
Incoming freight <sup>(1)</sup> .....	5,134	4,713	4,294	4,334	3,722
Outgoing freight <sup>(1)</sup> .....	329	383	472	727	753

Source: Ministry of Finance, Banque du Liban, Port of Beirut.

Note:

(1) In thousands of metric tons.

## *Tourism*

The strategic position of Lebanon, its mild climate and natural beauty, consisting of snow-capped mountains, valleys and the Mediterranean Sea, make it a natural tourist attraction. Apart from its privileged geographical and natural situation, Lebanon benefits from qualified and experienced human resources in the tourism industry.

Prior to the outbreak of the conflict, tourism (including hotels and restaurants) contributed approximately 20 per cent. to Lebanon's GDP. This is notable given that, at that time, the international tourism industry was not as developed as it is today.

Significant private investment is currently being made in the modernization and expansion of this sector and international hotel companies have returned to Lebanon. Casino du Liban, which historically constituted a major tourist destination, reopened in 1996. Lebanon is the only country in the Arab world that offers skiing and related winter sports activities. The largest ski resort in the country has been expanded and modernized. The Government believes that, because of the return of peace and stability to the country and with the development of the necessary infrastructure, tourism will again contribute significantly to Lebanon's economy. Lebanon's tourism industry also relies on the large number of Lebanese living abroad, who return regularly to the country during the summer season.

Since 2001, and especially after the events of September 11, 2001, Lebanon has regained its attraction for tourists from the Gulf region. The number of tourists from the Gulf has increased significantly. By

the end of 2004, incoming tourists reached 1,278,469. Tourist arrivals were expected to continue to increase during 2005. However, the assassination of Mr. Hariri in February 2005 adversely affected tourism in 2005, and by the end of July 2005, incoming tourists numbered 610,866 as compared to 731,733 during the same period of 2004.

### *Financial Services*

From the 1950s to the start of the conflict in 1975, Beirut was the region's financial services center. At the onset of the oil boom starting in the 1960s, Lebanon-based banks were the main recipients of the region's petrodollars.

Currently, the main financial services offered are commercial banking, investment banking, private banking and insurance. Despite the conflict and a crisis in the late 1980s involving a small number of banks, the commercial banking sector remains a centerpiece of the Republic's service-oriented economy. The Lebanese banking sector has witnessed unprecedented growth during the period from 1992 to the present. Resident and non-resident private sector deposits with commercial banks increased from U.S. \$6.6 billion at the end of 1992 to U.S. \$57.38 billion at the end of December 2004. In addition, since 1996, Lebanese banks have been successfully accessing the international capital markets. Since 1996, Lebanese banks have raised around U.S. \$3.0 billion on the international debt markets and over U.S. \$300 million through the issuance of global depository receipts on the international equity markets. The banking system is seen as having a key role by being the entry point for capital inflows for the region's development. At the same time the authorities are aiming at widening and deepening the financial sector by facilitating the establishment and evolution of, and providing a regulatory framework to, more diversified private financial institutions. Several investment banks, with capital raised offshore, have been established in Beirut and offer a variety of traditional investment banking services, including debt and equity raising and corporate finance advisory services. Several commercial banks have established investment banking subsidiaries offering similar services.

As part of the Government's strategy of reestablishing Beirut as a regional financial services center *Banque du Liban* established in 1994 a central depository, settlement and clearing agency, Midclear, which is a joint stock company organized under the laws of the Republic. The Government reopened the Beirut Stock Exchange in 1996.

### *Construction*

Prior to the conflict, the property sector had always been important, with a substantial portion of the activity concentrated in Beirut, where the housing needs of the city's rapidly increasing urban population had to be met. Beirut saw an almost uninterrupted boom from the late 1950s to the early 1970s, when it expanded dramatically, eventually to house half of the country's population. Mountain towns and villages close to Beirut favored by tourists, such as Aley and Bhamdoun, also experienced a boom.

The post-conflict era has witnessed a significant construction boom. Real estate prices have risen steeply, especially for prime property, but have recently stabilized. The boom has been fuelled by a mixture of local, expatriate and Gulf Arab funds. With respect to residential property, it has been concentrated mostly at the upper end of the housing market. As the stock market has resumed its operations only recently, land and construction have been viewed by many as attractive investment opportunities. Construction projects are financed mainly by equity investments. The Government estimates that, in 1997, construction activity accounted for 9.4 per cent. of GDP, a significant increase from approximately 4.5 per cent. in 1972.

### *Industry*

In 2001, the industrial sector (mainly production of cement, furniture, paper products, printing and packaging, detergents, fertilizers, cosmetics, pharmaceuticals, jewelry, clothing and food products) accounted for 17.3 per cent. of GDP, an increase from 15.7 per cent. of GDP in 1972.

Exchange rate and price stability coupled with the gradual decline in Lebanese Pound interest rates have contributed to a better environment for investment and growth in industry. Infrastructure bottlenecks resulting from the conflict are being addressed as improvements in roads, telephones and

electricity supply are realized. The Government provides various monetary and fiscal incentives for the establishment of industrial facilities in Lebanon, including tax exemptions and low interest financing. As export promotion is considered a priority by the Government, other export-financing incentives are under consideration.

From 1993 to February 2001, the International Finance Corporation ("*IFC*") carried out 34 investment and financing projects in Lebanon in an aggregate amount of U.S. \$336 million, with an additional U.S. \$256 million raised by the IFC through loan participations. Investments during 2000 included loans to three companies for U.S. \$21 million. As at February 28, 2001, U.S. \$219 million representing IFC loans, loan participations and equity investments had been disbursed and remained outstanding.

Additionally, a Euro 30 million facility provided by the European Investment Bank ("*EIB*") to local banks, a loan guarantee scheme provided by a joint venture between 50 commercial banks, the Government and the National Institute for Deposits Guarantees known as "*KAFALAT*", a department at the Ministry of Industry providing industrial licenses, planning and building permission, and various incentive schemes promoted by the Investment Development Authority of Lebanon ("*IDAL*") are expected to have a positive impact on the growth prospects on the Lebanese industrial sector.

### *Energy and Electricity*

Lebanon has no known fossil fuel resources. Apart from relatively modest hydroelectric resources and the import of approximately 200 megawatts of electricity annually from Syria, all energy needs are met with imports of petroleum products, which represented over 4.4 million TOE (tons of oil equivalent) in 2000.

Two state-owned refineries (one in Tripoli and one in Zahrani) are currently non-operational. The power sector accounts for about two-thirds of fuel imports.

Lebanon's energy sector is dominated by the state-owned monopoly, EDL. EDL is a vertically integrated utility which is involved in power generation, transmission and distribution with approximately 1.05 million customers. Lebanon's energy production facilities include two thermal power stations (900 MW combined installed capacity), gas turbine stations in each of Baalbek and Tyre (35 MW installed capacity in each) and one hydroelectric station (10 MW installed capacity) and two new combined cycle power plants (435 MW installed capacity in each). The transmission system measures approximately 1,000 km and the transformer capacity is approximately 1,600 MVA. A 360 km transmission system with ten new substations is currently under construction. EDL's distribution network covers most of Lebanon. EDL is also the majority shareholder in the previously privately-owned Kadisha company, a thermal and hydro power producer and distributor to about 100,000 customers in North Lebanon.

The power sector sustained severe physical damage to all its production, transmission and distribution facilities during the conflict. EDL also incurred financial losses resulting from low tariffs, high technical and non-technical losses, including widespread illegal connections, and loss of control over its commercial operations.

EDL has been regaining control over its operations. In January 2002, a new management team began to formulate and assess a plan to restructure EDL to resolve certain technical difficulties facing the company. This team identified the source of EDL difficulties as insufficient maintenance and lack of coordination, leading to only 60 per cent. production efficiency. The team also noted significant collection difficulties due to both non-invoiced power distribution and uncollected bills, which it quantified at approximately U.S. \$1 billion. EDL has adopted a new plan with strict measures aimed at increasing control and collection abilities. The plan requires the installation of new counters and the strict surveillance of power theft. Through the end of April 2002, EDL had installed 11,000 new counters throughout the country and, as a result of stricter surveillance, collections increased by 30 per cent. for the period January to April 2002, as compared to the corresponding period in 2001.

For the past several years, the Ministry of Finance has made large contributions to EDL to fund significant continuing losses. Transfers during the first seven months of 2005 amounted to LBP 599 billion as compared to LBP 336 billion in the same period in 2004 representing an increase of LBP 262 billion, largely due to increased oil prices.

## *Agriculture*

Approximately one third of the Republic is arable. The most fertile areas are located along the coastal strip and in the Bekaa valley. The diversity of the Republic's topography and climate enables cultivation of a wide variety of vegetables, fruits, industrial crops and cereals. The Government estimates that, in 1997, agriculture contributed approximately 6 per cent. to the Republic's GDP, as compared to approximately 9.9 per cent. in 1972. Food and agricultural exports, which include forestry products, provide about 10 per cent. of merchandise export earnings.

## *Prices and Inflation*

Movements in the exchange rate of the Lebanese Pound are intertwined with domestic price developments due to the openness of the Lebanese economy. Since the mid-80s, Lebanon has suffered from rapid increases in prices, peaking at 500 per cent. per annum in Lebanese Pound terms in 1987. This trend was evident until the appointment of the first Hariri Government in October 1992. The last quarter of 1992 saw a significant appreciation in the value of the Lebanese Pound against major currencies. This, together with the gradual appreciation to date, has been accompanied by a decline in the rate of inflation. Since 1993, inflation is estimated to have declined gradually to approximately 7.8 per cent. in 1997, 4.5 per cent. in 1998, 0.2 per cent. in 1999, (0.4) per cent. in 2000 and 2001, 1.8 per cent. in 2002, 1.3 per cent. in 2003, 3 per cent. in 2004 and 0.3 per cent. in 2005. This marks the first prolonged return to relative price stability. The current level of inflation is attributable principally to the implementation by *Banque du Liban* of a tight monetary policy, including maintaining a stable exchange rate (by using a nominal anchor policy with the U.S. Dollar) and high interest rates on Lebanese Pound assets;

## **RECONSTRUCTION**

### *The Council for Development and Reconstruction and the Reconstruction Program (CDR)*

The CDR is a government agency entrusted with a key role in the process of reconstruction and economic recovery. It was established in 1977 in response to the needs of reconstruction as a successor to the Ministry of Planning and was reorganized in 1991. The CDR is an executive agency for the Council of Ministers. It is responsible for formulating and monitoring the implementation of public investment projects as well as seeking foreign funding. In 1992, a three-year (1993-1995) U.S. \$2.25 billion National Emergency Reconstruction Program ("*NERP*") was established by the CDR. The initial program covered a series of rehabilitation investments, in the fields of power, water and wastewater, solid waste, education, housing and development. Financing for the NERP was provided in part by an International Bank for Reconstruction and Development ("*World Bank*") loan of U.S. \$225 million.

Proposals for projects forming part of the reconstruction program are submitted for Parliamentary approval on a project by project basis. Approximately 2,681 contracts with a total value of approximately U.S. \$6.6 billion were awarded by the CDR for the period since reconstruction efforts started in 1992 to the end of 2002.

The CDR is directly responsible for implementing a large part of the reconstruction program. It acts in this capacity in coordination with the various institutions (consisting principally of the relevant ministries) which will ultimately use or operate the investments. The other parts of the reconstruction programs have been implemented by various ministries and other governmental agencies, such as the Conseil Exécutif des Grands Projets and the Conseil Exécutif des Grands Projets de la Ville de Beyrouth. In March 2001, Parliament adopted a law merging these two agencies into the CDR, thereby expanding the range of reconstruction and development projects for which the CDR is responsible. In April 2001, the Government extended the powers of the CDR to include a supervisory function and vested it with the responsibility for administering loans to infrastructure and development projects and for the operation of tenders for such projects. The rationale for this merger is the desire of the Government to create a single executive agency to implement infrastructure and development projects.

In March 2000, the CDR prepared and submitted to the Government a five-year development program, covering existing and proposed projects in an aggregate amount of approximately U.S. \$6 billion. The development program has been approved by the Government although its implementation is taking

place gradually as projects are not being undertaken unless external sources of financing have been secured.

CDR expenditures on reconstruction and development programs are financed partly by grants and borrowings from international development agencies and other overseas entities and partly by appropriations from the budget. These appropriations are included as capital expenditures in the public accounts, but expenditures financed by borrowings as described above are not included in the public accounts (but are included in foreign debt figures). However, interest in respect of these borrowings is included in the national budget for the year in which it is scheduled to be paid. The Government's strategy is to finance the reconstruction and development program principally through the use of external financing, preferably concessionary financing (in the form of grants and soft loans). Other sources of external financing include commercial loans with export credit guarantees and the issuance by the Government of eurobonds and other international debt securities. As discussed elsewhere, the Government also seeks to partially finance the reconstruction program through participation by private sector companies.

### ***Infrastructure***

As a major regional entrepot and financial center, the Republic had a well-developed infrastructure prior to the conflict. The country's ports (Beirut, Tripoli, Sidon and Junieh) and Beirut International Airport (now Rafik Hariri International Airport) were especially productive assets of the economy operating under a free exchange system. Catering to the large number of residents, businesses and international visitors, the housing and telecommunications sectors had been built up to high standards. The development of the road network had not, however, kept pace with the growth of the economy. The years of conflict exacted a heavy toll on the infrastructure. Since 1992, significant progress has been made in restoring and upgrading the infrastructure: telecommunications systems have been significantly upgraded and are functioning better; emergency water supply repairs have been undertaken; road networks are being upgraded; and collection of solid waste has markedly improved.

### ***Electricity Generation***

Work on a rehabilitation program for power plants with a cost of U.S. \$410 million started in 1993 and is now completed. This program involved the repair and reconstruction of existing generation, transmission and distribution facilities so that a nominal production capacity of 1,250 megawatts could be attained. Electricity is now available to consumers in all of Lebanon 24 hours a day, with the power supply temporarily being augmented by the purchase from Syria of between 50 and 100 megawatts semi-annually. Another program, aimed at modernizing the electricity sector, began in 1996, with a cost estimated at U.S. \$1 billion. This program included the installation of four gas turbines in Tyre and Baalbeck, with a capacity of 140 megawatts. These turbines became operational in 1996. In order to meet increasing demand and to anticipate the replacement of some older units, two combined cycle power plants providing additional production capacity of a total of approximately 900 megawatts have been installed and are currently operational at full capacity. In addition, a new national 220KV network is being installed. A National Control Center project is currently under bidding and is expected to be completed by the end of 2005

### ***Water and Wastewater Sectors***

A rehabilitation and development program for the water and wastewater sector is underway and is estimated to cost approximately U.S. \$1 billion. This program is designed to comply with the Convention on Protecting the Mediterranean from Pollution and to protect inland water resources from pollution and comprises the following principal components:

- the rehabilitation of existing infrastructure, including wells, springs, reservoirs and transmission and distribution networks for water supply, main sewers and collectors for wastewater;
- the development and extension of the water and wastewater infrastructure, including increasing the available water resources, extending the distribution and transmission

networks, and constructing sewer networks and wastewater treatment plants to protect water sources, groundwater and coastal areas;

- the establishment of a National Water Resources Authority and five regional Water sanitation and irrigation companies, with the provision of technical assistance to the Ministry of Energy and Water and to the regional water companies; and
- the operation and maintenance of wastewater and storm water systems in the major Lebanese urban centers (Jounieh, Greater Beirut, Tripoli, Zahle, Nabatiya, Saida and Tyre).

The rehabilitation program began in May 1993 and cost approximately U.S. \$60 million in the first year. This included urgent repairs related to existing networks throughout Lebanon. Extension of the water treatment plant at Dbaye, which supplies clean water to a large part of Beirut was completed at a cost of approximately U.S. \$5.7 million. The rehabilitation program for Greater Beirut, (Beirut & Ain al Delbeh Water Authorities) is currently being implemented at a cost of approximately U.S. \$50 million. Rehabilitation and replacement of main water treatment plants and pumping stations in the rest of Lebanon is underway and is expected to cost approximately U.S. \$43 million.

Contracts for the rehabilitation and development of water and wastewater systems in North and South Lebanon, Mount Lebanon and the Bekaa were awarded between 1992 and 2002 at a value of U.S. \$477 million. These contracts comprise feasibility studies, environmental impact studies, design and preparation of tender documents, works and supervision.

A number of projects are currently in the planning stage and are estimated to cost approximately U.S. \$132 million. Such projects include water supply networks, water treatment plants and management contracts and are intended to serve all regions of Lebanon. A number of other projects have been completed or are currently underway at a cost of approximately U.S. \$363 million.

### ***Telecommunications***

Work on the expansion and rehabilitation of the fixed line system commenced in November 1993. 800,000 new digital lines were commissioned in July 1993 and the current installed capacity is 1,800,000, of which 830,000 were connected to subscribers in January 2001. 55,000 telephone lines were installed in Southern Lebanon in October 2002. 6,688 basic access and 570 primary rate ISDN lines have also been installed and an Intelligent Network platform was installed in April 2003. The total value of rehabilitation and extension contracts entered into is approximately U.S. 800 million.

Two compatible mobile phone networks currently aggregating over 700,000 lines are operational, in addition to the fixed line system. The mobile telephone networks have been privately financed through two BOT contracts awarded to two different operators. In May 2000, the Government notified the two operators that they had each failed to pay to it an amount of U.S. \$300 million on account of back taxes and revenue-sharing under the BOT contracts and that, absent such payments, the BOT contracts would be terminated. In June 2001, the Government notified the two mobile operators of the early termination of their BOT contracts in accordance with their respective terms and the BOT Contracts were terminated effective on August 31, 2002. Following this dispute, each of the mobile telephone network operators initiated arbitration proceedings. The arbitration proceedings between each of the former mobile operators in the Republic, FTML, SAL and LibanCell, SAL on the one hand, and the Government on the other hand, resulted in arbitration awards in favour of the former operators in the amount of approximately U.S. \$270 million each. FTML SAL and the Government entered into a settlement agreement providing for the Government to pay an amount of approximately U.S. \$96 million over a two-year period. Closing of the settlement agreement is subject to a number of conditions precedent. The award in favour of LibanCell SAL remains outstanding.

### ***Transportation***

The first phase of road projects has been substantially completed. It included the rehabilitation of the capital's road network, the completion of extensions started before the conflict and the extension of the coastal highway system north to Tripoli and south to Sidon, which were completed in 1996. An

aggregate amount of U.S. \$1 billion was disbursed during the period 1991-2002 in connection with the road improvement program.

The extension and redevelopment of Beirut's international airport, with targeted passenger movement of 6 million persons per annum, amounted to U.S. \$539 million. Two major contracts totaling U.S. \$490 million have been awarded under a multi-year project approved by Parliament. Financing of U.S. \$179 million has been secured from the European Investment Bank, the Kuwait Fund for Arab Economic Development and the French Government, and a number of the airport's facilities (for example, the car park) have been financed through BOT contracts reducing the portion of the costs to be funded by public expenditure. A new passenger terminal was put in service at the beginning of 1998 and the project was completed in 2000. The principal contractor initiated arbitration proceedings for alleged non-payment of cost overruns and other matters.

A project for the rehabilitation of the Port of Beirut, estimated to cost U.S. \$150 million, is intended to restore port capacity to pre-conflict levels. Contracts relating to the first sections of the civil works component of this project were awarded in October 1996 for an amount of U.S. \$102.8 million, subsequently reduced to U.S. \$90 million. Partial financing for this project amounting to the equivalent of U.S. \$54 million has been secured from the European Investment Bank (the "*EIB*"). Contracts relating to the purchase of handling equipment for this project were awarded in 2002 for an amount of U.S. \$30 million.

A project for the expansion of the Port of Tripoli, estimated to cost U.S. \$80 million, was launched in 1999. Partial financing for this project amounting to U.S. \$45 million has been secured from the EIB.

### ***Solid Waste***

Since 1992, a number of contracts relating to the construction of landfills, the procurement of supplies and the operation of waste collection and treatment plants have been awarded in the solid waste sector. The total value of these contracts is approximately U.S. \$682 million. The majority of these contracts are long-term, with terms of up to 10 years.

### ***Public Health***

The Government's program for the Health sector is to provide adequate health services to people in all regions of Lebanon. The Government's focus in this sector has been on conducting studies that support and strengthen the administrative capacity of the Ministry of Public Health, with a special emphasis on primary health care and rationalization of increasing health related expenses. To date, 27 new health care centers covering all regions of Lebanon and seven new public hospitals have been completed. Work is underway on the construction, expansion and renovation of 15 hospitals. To date, contracts in the amount of U.S. \$238 million have been awarded. Several projects relating to technical assistance for development and construction of health centers are in the planning stage and are estimated to cost U.S. \$44 million.

### ***SOLIDERE***

Following the end of the period of conflict in 1990, the Government was confronted with the issue of how to redevelop areas in Lebanon that had suffered damage during the hostilities. Redevelopment was particularly critical for the Beirut Central District (the "*BCD*"), which had been the historical center of government and commercial activity and which had also been the subject of extensive damage during the hostilities. The BCD is considered the heart of Beirut. The area contains many important government buildings and the Lebanese Parliament. It has traditionally been considered the center of banking and commerce in Lebanon. The hotel district, internationally renowned before the hostilities, lies at the western edge of the BCD.

In 1991, the Government created a legal framework that would allow for the establishment of private real estate companies to carry out the redevelopment of damaged areas in accordance with a master plan approved by the Government. Such companies would be capitalized partly by cash subscriptions by investors and partly by issuance of shares in exchange for the compulsory contribution of property rights by the original owners and lessees (subject to an option in favor of such owners to regain

ownership of certain properties). Parliament established the foundation for this legal framework with the enactment in 1991 of Law 117 ("*Law 117*").

A master plan for the development of the BCD, supplemented by a detailed plan, defines the geographical limits of the BCD and contains the body of guidelines and rules governing the rehabilitation and redevelopment of the BCD, including certain guiding principles aiming to preserve and promote the historic heritage of the BCD and to ensure the harmonious integration of traditional and modern architecture.

SOLIDERE was the first real estate development and reconstruction company created pursuant to Law 117, in May 1994, and the only such company with responsibility for the development and reconstruction of the BCD (the "*Project*"). The entire area is approximately 1.8 million square meters, consisting of the traditional BCD and the reclaimed land. The traditional BCD constitutes the area of the BCD which existed prior to the hostilities in Lebanon and covers a surface area of approximately 1.2 million square meters. Under the master plan for the Project, the aggregate permitted built-up floor space in the entire BCD (including certain exempted lots which are government and religious buildings) and the lands reclaimed from the Mediterranean sea is limited to 4.69 million square meters.

SOLIDERE accomplished infrastructure works in the traditional BCD, the restoration of the majority of preserved buildings, and the Western Marina. Many new projects were also completed by SOLIDERE, mainly, the UN House (ESCWA building), the British Embassy complex near the Serail, the Saifi village, a multi-use complex for offices and residence in Rue de France. In early 2005, SOLIDERE started a major project of Beirut Souks which is expected to be completed in two years.

SOLIDERE intends to focus on the new waterfront district with a view toward the re-launching of Beirut as an international regional center. This entails completing the waterfront district infrastructure, after completing treatment works on the reclaimed land, developing the eastern marina and launching new and mixed use developments.

SOLIDERE's capital at establishment was U.S. \$1,820,001,290, composed of real estate of the original owners and the lessees in the BCD, who received 65 per cent. of SOLIDERE's shares, (or U.S. \$1,170,001,290) in compensation for their properties and rights, and cash contributions equal to U.S. \$650,000,000 from Lebanese and Arab investors, who subscribed to the flotation of shares in SOLIDERE, which closed on January 10, 1994. In June 1997, SOLIDERE amended its by-laws to reduce its capital to U.S. \$1,650,000,000.

On September 30, 1996, the shares of SOLIDERE, previously listed on the Beirut Secondary Market, were listed and began trading on the Beirut Stock Exchange

On December 3, 1996, 6,700,000 Global Depositary Receipts representing fractional economic interests in SOLIDERE shares were issued and currently are trading on the London Stock Exchange. In September 1997, SOLIDERE amended its by-laws and, in October, 1997, it obtained the necessary governmental approval to permit foreign investors to own shares in SOLIDERE. In March 2005, the shares of SOLIDERE began trading on Kuwait Stock Exchange.

Commercial activity in the BCD is developing rapidly with banks and other institutions relocating there.

### ***Human Resources***

Lebanon's human resources have traditionally been the backbone of its economy. The Republic's human resources had been developed to levels comparable to, or higher than, those of lower middle-income countries. Prior to the conflict, Lebanon was endowed with a well-trained population and labor force with adequate health facilities. The conflict resulted in setbacks for the human resources of the Republic. A significant emigration of skilled labor took place with large numbers of professionals, traders, industrial workers and construction workers leaving the country. The educational system also suffered (see "*Educational System*" below).

However, a significant reversal of emigration has been observed since the end of the conflict and the installation of the Hariri government in October 1992. A large number of families living abroad have now returned, as well as young persons, who have been educated and have worked abroad, and who

have either entered, or are looking to enter, the workforce. They are expected to contribute positively to the economic development of the country.

## Educational System

The variety of Lebanese educational institutions (schools as well as universities) is a reflection of the openness of the Republic to the international community. Private schools have a long and strong tradition in Lebanon. Aside from private schools established by western clerics (French, Anglo-Saxons, Germans, Italians), there are many and diverse local and foreign religious and secular schools. The Educational Center for Research and Development has recently revised and updated the national curriculum for schools.

The table below shows the percentage of the population attending schools or universities for the 2002-2003 academic year:

Age	Male		Female		Total	
	(number)	(per cent.)	(number)	(per cent.)	(number)	(per cent.)
< 5 years .....	47,191	5.21	44,957	4.97	92,148	10.18
5 - 9 years .....	169,963	18.77	162,424	17.94	332,387	36.71
10 - 14 years .....	163,157	18.02	159,657	17.63	322,814	35.65
15 - 19 years .....	71,902	7.94	81,085	8.96	152,987	16.90
20 - 24 years .....	1,921	0.21	3,080	0.34	5,001	0.55
25 years and over.....	31	0.0034	77	0.0085	108	0.01
	<b>454,165</b>	<b>50.16</b>	<b>451,280</b>	<b>49.84</b>	<b>905,445</b>	<b>100</b>

Source: The Ministry of Education and Higher Learning, Center for Research and Development.

Based on information in the 2005 CAS Survey, the adult literacy rate was approximately 90.43 per cent. in 2004, as compared to 88.4 per cent. in 1997 and 68.2 per cent. in 1970.

The Republic traditionally had an advanced educational structure, and well-trained technicians and engineers. Prior to the conflict, Beirut served as an educational center for the region. However, a substantial part of this human capital was reduced during the conflict, and the educational system suffered damage and lack of investment. In spite of the turmoil, however, the educational system has survived and still retains high standards.

The following table gives a summary of the school system during the academic years 2000-2001 and 2002-2003:

## School System

	<b>2001-2002</b>	<b>2002-2003</b>
Total number of schools .....	2,698	2,704
Public schools (as a percentage of total) .....	50.44%	50.52%
Private commercial schools (as a percentage of total).....	71.05%	70.79%
Private non-commercial schools (as a percentage of total) .....	38.26%	38.37%
Total number of students in schools .....	899,508	905,445

Source: Ministry of Education and Higher Learning.

The Lebanese Baccalaureate (originally based on the equivalent French school diploma) is the qualification obtained by most high school graduates. A few other foreign qualifications (French, British and American) are also prepared for and awarded in the Republic. The Government has recently introduced vocational training for students in order to encourage growth of technical expertise within the Republic.

Lebanon's universities had a total of 123,371 students during the academic year 2002-2003. 9.05 per cent. of university students were foreign compared with 75.3 per cent. in 1974-1975. Lebanon's

universities had a total of 84,446 students during the academic year 1995-1996 and 87,957 students during the academic year 1996-1997. In 1998-1999, the total number of students enrolled at university was 101,400.

The principal universities in Lebanon consist of the Lebanese University, with five branches (65,530 enrolments in 2002-2003), Université Saint Joseph (USJ) (founded and run by French Jesuits) (8,184 enrolments in 2002-2003), the Arab University (sponsored by the Egyptian University of Alexandria) 7,314 enrolments in 2002-2003), American University of Beirut (AUB) (6,270 enrolments in 2002-2003), Lebanese American University (4,292 enrolments in 2002-2003), Notre Dame University (3,759 enrolments in 2002-2003), Kaslik University (4,659 enrolments in 2002-2003), the recently established Balamand University (Hybrid System) (2,558 enrolments in 2002-2003) and Haigazian University (530 enrolments in 2002-2003). Each of the Lebanese University, the USJ and the AUB has a medical school.

At the initiative of the Lebanese and French governments, and with the support of the Paris Chamber of Commerce and Industry, *Banque du Liban* and various private sponsors, the "*Ecole Supérieure des Affaires*" (the "*ESA*") was established in Beirut in April 1996. The ESA offers a full-and part-time MBA program and, through its Monetary and Financial Institute, aims to attract bank and finance executives who wish to develop their knowledge of modern financial products and financing techniques.

The Government's program for the education section is to provide a primary education to every child of school age and includes the construction of new schools, the renovation of and provision of equipment to old schools, the construction, renovation of and provision of equipment to vocational and technical schools, the construction of buildings for Lebanese universities and the construction of sports facilities. Since 1992, the total value of contracts awarded in this sector is approximately U.S. \$539 million.

The Government's emphasis on education is evidenced by the existence of three active ministries with responsibilities relating to educational matters. They are the Ministry of National Education and Higher Education, the Ministry of Youth and Sport and the Ministry of Culture.

## **EXTERNAL SECTOR**

### ***Balance of Payments and Foreign Trade***

Lebanon is a predominantly importing country and is characterized by large trade deficits; however, net foreign income earnings, remittances and earnings from tourism, banking, insurance and other services help offset the trade deficits. The trade balance recorded deficits of approximately U.S. \$5,919 million in 2001, U.S. \$4,956 million in 2002, U.S. \$5,221 in 2003, and U.S. \$7,105 in 2004. Substantial capital inflows and continuing remittances from the Lebanese diaspora financed these deficits. Even during the conflict, the balance of payments was generally in surplus. It showed minor deficits in 1979, 1983, 1984 and 1986, but larger deficits occurred in 1989 and 1990. In all other years in the period 1975-1997, there were surpluses in the balance of payments.

In 1991, the first full year of peace, large capital inflows together with a partial recovery of exports resulted in an overall balance of payments surplus of over U.S. \$1,074 million. In 1992, the balance of payments registered a surplus of U.S. \$54 million, although imports rose steeply during that period. In 1993, the current account deficit increased but was more than offset by large capital account inflows, leading to a balance of payments surplus of U.S. \$1,170 million. The trend continued in the following two years, with the overall balance recording a surplus of U.S. \$1,131 million in 1994 and U.S. \$256 million in 1995. The balance of payments recorded a surplus of U.S. \$786 million in 1996 and U.S. \$420 million in 1997. However, the balance of payments registered a deficit of U.S. \$488 million in 1998. Following the appointment of the Al Hoss Government and a reduction in the amount of foreign borrowings, the balance of payments recorded a surplus of U.S. \$261 million in 1999. In 2000, the balance of payments recorded a deficit of U.S. \$289 million due principally to increased capital outflows resulting from losses incurred by investors in international equity markets, increased fuel prices, a decline in new external borrowings of approximately 41 per cent. and the near doubling of amortization on external public debt.

In 2001, the balance of payments registered a deficit of U.S. \$1,169 million due primarily to an increase in the trade balance deficit and the effect of regional developments. During 2002 and the first half of 2003, the Republic's balance of payments improved significantly. By year end 2002, the balance of payments registered a surplus of U.S. \$1,564 million, benefiting from an increase in exports and a substantial inflow of funds from the Paris II Conference in November of 2002. By December 2003, due to the large inflows following the Paris II Conference, the balance of payments surplus increased to U.S. \$3,386 million.

During 2004, despite an increase in the trade deficit and a net decline in capital inflows compared to the previous year, the balance of payments recorded a surplus of U.S. \$168.5 million.

As at the end of December 2005, the balance of payments recorded an overall surplus of U.S. \$742 million , as compared to a surplus of U.S. \$168.5 million for 2004.

The following table sets out information relating to the Republic's foreign trade from 2001 to 2004:

### Balance of Payments Summary<sup>(1)</sup>

	2001	2002	2003	2004
	<i>(in millions of U.S. Dollars)</i>			
<b>Current account</b> .....	<b>-5,390</b>	<b>-4,354</b>	<b>-4,414</b>	<b>-5,513</b>
<b>Trade balance</b> .....	<b>-5,919</b>	<b>-4,956</b>	<b>-5,221</b>	<b>-7,105</b>
Exports. f.o.b. <sup>(2)</sup> .....	880	1,018	1,444	1,598
Imports. f.o.b. <sup>(2)</sup> .....	-6,800	-5,974	-6,665	-8,704
<b>Services</b> .....	<b>378</b>	<b>523</b>	<b>540</b>	<b>1,010</b>
Factor .....	-75	-540	-669	-533
Interest .....	-124	-515	-410	-323
Bank of Lebanon (net) .....	228	52	114	163
Interest on external public debt .....	-351	-567	-524	-486
Investment income .....	49	-25	-259	-211
Commercial banks (net) .....	-37	-108	-146	-146
Earnings .....	341	257	176	202
Payments .....	-378	-364	-322	-348
Non banks <sup>(3)</sup> .....	86	83	-114	-65
Earnings .....	179	285	123	264
Payments .....	-93	-202	-237	-329
Nonfactor .....	453	1,063	1,209	1,544
Insurance and freight .....	-551	-536	-597	-764
Travel and transportation .....	1,054	1,601	1,815	2,262
Communication services .....	35	56	94	87
Medical services .....	0	0	0	0
Financial services .....	-15	-1	-1	-2
Other <sup>(4)</sup> .....	-72	-57	-102	-39
Unrequited transfers .....	151	80	267	582
Public sector grants .....	492	59	34	64
Private transfers .....	-336	24	250	523
Others <sup>(5)</sup> .....	-5	-4	-17	-5
<b>Capital account</b> .....	<b>4,221</b>	<b>5,918</b>	<b>7,800</b>	<b>5,681</b>
Direct investment .....	1,450	1,336	1,506	1,293
Real estate investment .....	1,451	1,336	1,506	1,296
Other .....	-1	0	0	-3
Portfolio investment .....	-479	610	-922	-1,165
External public disbursements .....	1,017	2,848	2,681	2,923
Contracted loans .....	200	162	769	160
Eurobond .....	817	2,685	1,911	2,762
Amortization on external public debt .....	-255	-490	-505	-940
Non-bank short-term capital .....	-273	-921	516	275
Claims on foreign banks (increase) .....	-142	-843	-386	-597
Liabilities to foreign banks .....	-131	-78	902	872
Other capital <sup>(6)</sup> .....	2,761	2,535	4,524	3,295
<b>Overall balance<sup>(7)</sup></b> .....	<b>-1,169</b>	<b>1,564</b>	<b>3,386</b>	<b>169</b>

Source: Higher Council of Customs/Banque du Liban.

#### Notes:

- (1) Certain line items differ from previously published data due to revisions agreed with the IMF.
- (2) Customs data.
- (3) Data on the flow of international bank lending to non-bank residents of Lebanon and on the flow of deposits by residents of Lebanon with international banks are obtained from BIS stocks.
- (4) Includes public sector services in computer and information, construction, and financial and business services.
- (5) Includes governmental transfers.
- (6) Includes valuation adjustments and errors and omissions (mainly unrecorded flows of both current and capital items). The increase in errors and omissions in 1999 is due, in part, to the new compilation of the balance of payments during such period.
- (7) Includes a U.S. \$500 million deposit from Saudi National Commercial Bank made in December 1997 but subsequently reduced through partial repayment, a U.S. \$100 million deposit from the Kuwaiti Investment Authority made in February 1998 and a U.S. \$100 million deposit from the National Bank of Abu Dhabi made in May 1998.

The following table indicates the principal destinations of exports for the years 2000 to 2005:

<b>Destination of Exports<sup>(1)</sup></b>						
<b>Country</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<i>(per cent.)</i>					
Switzerland .....	7	7	13	25	11	7
Iraq.....	4	8	7	8	15	9
UAE.....	10	8	9	7	8	8
Saudi Arabia .....	11	10	9	7	6	7
Syria.....	4	4	7	7	8	10
USA .....	6	7	5	4	3	3
Turkey.....	3	3	3	4	7	6
Kuwait .....	4	3	3	3	4	4
Jordan .....	4	3	3	3	4	4
Italy.....	3	3	2	2	1	1
Egypt.....	3	3	3	2	2	3
Algeria .....	1	1	2	2	1	1
France .....	5	4	2	2	2	2
Germany .....	2	2	1	1	1	1
Nigeria .....	1	1	1	1	1	1
Spain.....	3	2	2	1	1	1
United Kingdom .....	2	2	2	1	1	2
Qatar .....	1	1	1	1	2	2
Malta.....	2	2	2	1	0	0
India.....	2	2	1	1	2	1
The Netherlands.....	2	2	1	1	1	1
Cyprus.....	1	1	1	1	1	1
Belgium .....	2	1	2	1	1	1
Bahrain .....	1	1	1	1	1	1
Hong Kong .....	1	1	1	1	1	0
Other countries.....	16	18	15	14	17	22
<b>Total.....</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: Directorate General of Customs, Ministry of Finance.

Notes:

(1) Discrepancies in the figures appearing in this table are due to rounding.

The following table shows the composition of exports for the years 2000 to 2005:

### Composition of Exports

	2000	2001	2002	2003	2004	2005
<b>Goods</b>			<i>(per cent.)</i>			
Live animals; Animal products .....	0	1	1	1	1	0
Vegetable products .....	7	6	5	4	5	4
Fats and edible fats and oils .....	1	1	1	1	1	1
Prepared foodstuffs .....	10	11	10	10	8	10
Mineral products .....	5	4	4	4	6	7
Products of the chemical .....	12	10	10	8	9	9
Plastics and articles thereof .....	2	3	3	2	3	4
Raw hides and skins, leather, furs ..	2	3	1	1	1	1
Wood and articles of wood .....	1	1	1	1	1	1
Paper and paperboard and articles thereof .....	7	7	9	6	6	6
Textiles and textile articles	6	9	6	4	4	4
Footwear, headgear, prepared feathers .....	1	2	1	1	1	1
Articles of stone, plaster, cement	3	3	2	2	3	3
Pearls, precious or semi-precious stones .....	18	16	21	30	16	12
Base metals and articles of base metal .....	9	7	8	8	13	15
Machinery and mechanical appliances .....	10	13	11	12	16	17
Transport equipment .....	2	1	1	1	1	1
Optical instruments and apparatus	1	1	1	1	1	1
Arms and ammunition .....	0	0	0	0	0	0
Miscellaneous manufactured articles .....	3	3	3	3	3	3
Works of art .....	0	0	0	0	1	0
<b>Total .....</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: Directorate General of Customs, Ministry of Finance.

The following table sets out the major sources of imports for the years 2001 to 2005:

### Sources of Imports<sup>(1)</sup>

	2000	2001	2002	2003	2004	2005
Country	(per cent.)					
Italy.....	11	10	11	9	10	10
France .....	8	8	8	8	8	8
Germany .....	8	9	9	8	8	7
China.....	5	6	7	7	8	8
USA .....	7	7	7	6	6	6
Russia .....	3	6	4	4	6	5
United Kingdom .....	4	4	4	4	4	3
Japan.....	3	3	3	4	4	3
Syria.....	5	4	3	4	3	2
Turkey.....	2	3	4	3	3	2
The Netherlands.....	2	2	2	3	2	2
Saudi Arabia .....	3	4	2	3	4	4
Switzerland .....	7	5	4	3	4	5
Spain.....	2	3	3	3	2	2
Egypt.....	1	1	2	2	3	3
Ukraine .....	1	2	2	2	2	1
Belgium .....	2	2	2	2	2	2
U. Arab Emirates .....	1	1	1	1	2	1
India.....	1	1	1	1	1	1
Greece.....	3	2	1	1	1	1
Korea .....	1	1	1	1	1	1
Romania.....	1	1	1	1	1	2
Thailand .....	1	1	1	1	1	1
Brazil .....	1	1	1	1	1	2
Ireland.....	1	1	1	1	1	1
Other Countries.....	15	15	15	14	15	16
<b>Total.....</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: Directorate General of Customs, Ministry of Finance.

Note:

(1) Minor discrepancies in the figures appearing in this table are due to rounding.

### Foreign Direct Investment

Prior to 1975, foreign direct investment was substantial. It was concentrated in property, services, banking and tourism. Predictably, foreign direct investment was weak during the period of conflict.

The onset of peace marked a reversal of this trend. Since 1990, considerable amounts of private Arab capital have been invested in real estate. Two principal sources for foreign direct investment have been the substantial funds held by Lebanese abroad and the large pool of private Arab wealth.

The Government continues to favor a strong role for the private sector in a liberal policy environment and welcomes foreign direct investment in the economy. The legal framework is sound and conducive to foreign investment. There are no special financial provisions for, or constraints on, foreign investors in the Republic, except that certain restrictions exist on foreign ownership of companies involved in media activity, land ownership (both directly and when holding shares in companies owning real property) and the employment of foreign labor. A government agency, the IDAL, which has been established in 1994, assists foreign investors in setting up their businesses in Lebanon.

Lebanon's membership in the Multilateral Investment Guarantee Agency was ratified by Parliament as a means of reinforcing the confidence of foreign investors wishing to invest in Lebanon. In addition, the National Institute for the Guarantee of Investment makes insurance coverage available to investors, in the form of compensation, for losses resulting from non-commercial risks.

### ***Foreign Borrowings and Grants***

As at the end of January 1999, the Republic had obtained foreign financing facilities (excluding the proceeds of outstanding eurobonds) totaling approximately U.S. \$5.2 billion, of which approximately U.S. \$4.08 billion had been drawn down and approximately U.S. \$1.12 billion had not been utilized, as well as approximately U.S. \$0.55 billion in the form of grants. These facilities and grants have been provided principally by the following countries and institutions: the Abu-Dhabi Fund for Development, the Arab Fund for Economic and Social Development, Belgium, the European Investment Bank, the European Union, France, Germany, the International Fund for Agricultural Development, the Islamic Development Bank, Italy, Japan, Kuwait, Qatar, Oman, OPEC Fund for International Development, Saudi Arabia, the United Nations and the World Bank.

The Government's strategy has been to maximize the use of external financing, preferably concessional financing (in the form of grants or soft loans). Other sources of external financing include commercial loans with export credit guarantees and the issuance by the Government of eurobonds and other international debt securities.

The Government has sought the assistance of friendly countries, such as France, the United States and Japan and multinational agencies, to address the issues it was facing. To this end, in February 2001, a meeting was convened in Paris by the President of France and was attended by the President of the World Bank, the President of the European Commission, the Vice Chairman of the European Investment Bank and members of the French government. The purpose of the meeting was to discuss the Government's economic program and consider proposals to support this program; these proposals included the issuance of partial guarantees of some of the Republic's external debt issues.

On November 23, 2002 a second conference (the "*Paris II Conference*"), was convened by the President of France. The meeting was attended by representatives of a number of countries, including the president of Malaysia, the prime ministers of Belgium, Canada, Germany, Italy and Spain and senior officials from Bahrain, Denmark, Japan, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates and the United Kingdom. Also in attendance were senior representatives of the European Commission, the World Bank, the IMF, the European Investment Bank and various Arab multilateral agencies. The participants at the conference expressed support for the economic reform measures of the Government and pledged to contribute approximately U.S. \$3.1 billion in long-term, low interest financing to the treasury of the Government and approximately U.S. \$1.3 billion in long-term, low interest financing for projects. As at December 31, 2004, the Government had collected proceeds totaling approximately U.S. \$2.4 billion, representing approximately 77 per cent. of the U.S. \$3.1 billion pledged at the Paris II Conference. In exchange for these contributions, the Republic issued eurobonds and entered into a loan agreement with the Agence Française de Développement, bearing interest at the rate of 5 per cent. and having a final maturity of 15 years with a grace period of up to five years. The Government has used these funds to redeem and cancel higher-interest bearing maturing debt.

In addition to the U.S. \$2.4 billion received from the lender countries mentioned above, the Republic also received contributions from two multilateral institutions in the form of a U.S. \$15 million medium term loan for structural adjustment from the Arab Monetary Fund and a U.S. \$40 million facility to be used to finance fuel imports by EDL. The EU contributed Euro 12.25 million as a grant to be used for structural adjustment and fiscal reforms.

The following table details the amounts received from countries and institutions as a result of the Paris II Conference.

### Paris II Conference Funds Received

<b>Creditor</b>	<b>Amounts Received</b>
Malaysia .....	U.S. \$300 million
Sultanate of Oman .....	U.S. \$50 million
United Arab Emirates .....	U.S. \$300 million
Kuwait .....	U.S. \$300 million
Kingdom of Saudi Arabia .....	U.S. \$700 million
State of Qatar .....	U.S. \$200 million
France-French Treasury & Agence Française de Développement (AFD).....	Euro 500 million
Arab Monetary Fund (AMF).....	U.S. \$55 million
European Union (EU).....	Euro 12.25 million

Source: Ministry of Finance.

On September 19, 2005, a meeting was held at the United Nations Headquarters, New York, which was attended by, among other parties, the Prime Minister, the Finance Minister and other members of the Government, as well as the Secretary General of the United Nations, the President of the World Bank, the High Representative for the Common Foreign and Security Policy of the European Union and the foreign ministers of Egypt, Italy, France, Saudi Arabia, the United Kingdom and the United States and representatives of the Russian Federation. The participants expressed their support for the reform program of the Government and agreed to convene a donors' conference which is tentatively scheduled to be held in Beirut during the second quarter of 2006.

### PUBLIC DEBT

#### General

As at December 31, 2005, the Republic's gross public debt was LBP 58,048 billion (U.S. \$38,519 million) consisting of LBP 29,140 billion of gross domestic debt and LBP 28,909 billion of public external debt. Net outstanding public debt of the Republic was LBP 52,630 billion (U.S. \$34,924 million) as of December 31, 2005.

The table below shows the Republic's net public sector debt as at December 31, in each of the years 2001 to 2005.<sup>(1)</sup>

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<i>(in billions of Lebanese Pounds)</i>				
I. Gross Domestic Debt .....	28,214	25,302	26,843	26,371	29,140
II. Public External Debt <sup>(2)</sup> .....	14,431	21,974	23,442	27,677	28,909
<b>III. Gross Public Debt (I + II).....</b>	<b>42,645</b>	<b>47,276</b>	<b>50,285</b>	<b>54,048</b>	58,048
IV. Public Sector Deposits <sup>(3)</sup> .....	1,913	2,964	3,019	4,360	5,418
V. Net Domestic Debt (I – IV) .....	26,301	22,338	23,824	22,012	23,722
<b>VI. Net Public Debt (III – IV).....</b>	<b>40,732</b>	<b>44,312</b>	<b>47,266</b>	<b>49,688</b>	<b>52,630</b>

Source: Ministry of Finance/Banque du Liban.

Notes:

- (1) Debt figures differ from previously published figures due to continuing implementation of the Debt Management System.
- (2) Amounts translated into Lebanese Pounds at end of period rates; includes accrued interest.
- (3) Represent public sector deposits at Banque du Liban and commercial banks.

The table below shows the Republic's gross and net public debt as a percentage of GDP for the periods indicated below.

	2001	2002	2003	2004	2005
		<i>(as a per cent. of GDP)</i>			
Gross Public Debt.....	166	170	168	165	175
Net Public Debt .....	158	159	158	151	158

Source: Ministry of Finance/Banque du Liban.

Net public debt as a percentage of estimated GDP increased from 46 per cent. in 1992 to 105 per cent. in 1998, 142 per cent. in 2000, 162 per cent. in 2001, 170 per cent. in 2002 and 174 per cent. in 2003 and decreased to 169 per cent. in 2004 and 158 per cent. in 2005.

### **Internal Debt**

The Government has elected to finance the budget deficit principally through the issuance of LL denominated Treasury bills (with maturities of three months, six months and twelve months), and Treasury bonds (with maturities of 24 months and 36 months). Following the Paris II Conference, yields on Treasury bills have been on a declining trend and market auctions were halted for a period of approximately nine months (between mid February 2003 and the end October 2003) on account of the inflow of Paris II Conference funds and the commercial bank and *Banque du Liban* debt service reduction measures. The issuance of Treasury bills and bonds resumed during November of 2003, and Treasury bonds in Lebanese Pounds with maturities of 36 months were introduced for the first time to the market.

The table below shows the Republic's composition of domestic debt as of December 31, 2005:

	<i>(in billions of Lebanese Pounds)</i>	<i>(in millions of U.S. Dollars)</i>
<b>Long term bonds<sup>(1)</sup> .....</b>	<b>23,383.50</b>	<b>15,516.59</b>
Special bonds issued to <i>Banque du Liban</i> .....		
60 months .....	1,771.60	1,175.58
54 months .....	616.00	408.76
48 months .....	633.00	420.04
36 months .....	14,520.00	9,635.04
30 months .....	3,032.70	2,012.41
24 months .....	2,385.00	1,582.61
Coupon interest.....	424.70	281.82
<b>Short term bills .....</b>	<b>5,247.00</b>	<b>3,481.75</b>
12 months .....	3,023.40	2,006.24
6 months .....	2,067.70	1,372.06
3 months .....	155.90	103.45
<i>Accrued interest included.....</i>	<i>91.80</i>	<i>60.92</i>
<b>Other domestic debt .....</b>	<b>509.20</b>	<b>337.89</b>
<b>Total Domestic Debt .....</b>	<b>58,048.40</b>	<b>38,519.18</b>

Source: Ministry of Finance/Banque du Liban.

Note:

(1) Long-term bonds have maturities of two years or longer.

### **External Debt**

The outstanding public external debt end of 1992, a year after the end of the war, was approximately U.S. \$362 million. Commencing in 1994, the Republic became a frequent issuer on the international capital markets as it sought to finance its budget deficit and to convert its high interest domestic debt

into lower interest external debt. As at December 31, 2005, the outstanding public external debt of the Republic was approximately LBP 28,909 billion.

The table below shows the composition of the Republic's foreign debt as at December 31, 2005:

	<i>(in billions of Lebanese Pounds)</i>	<i>(in millions of U.S. Dollars)</i>
Eurobonds.....	25,161	16,696
Paris II Conference Eurobonds <sup>(1)</sup> .....	5,608	3,720
Loans .....	3,747	2,487
Paris II Conference concessional loans <sup>(2)</sup> .....	892	592
Bilateral and multilateral loans .....	2,658	1,763
Foreign private sector loans .....	197	131
<b>Total Foreign Debt <sup>(3)</sup> .....</b>	<b>28,909</b>	<b>19,177</b>

Source: Ministry of Finance/Banque du Liban.

Notes:

- (1) Includes U.S. \$1.87 billion issued to *Banque du Liban*.
- (2) Contribution of France (AFD Loan).
- (3) Includes accrued interest.

The following table shows the Republic's public external debt by type of creditor at the end of the periods indicated:

**Public Sector External Debt By Type of Creditor<sup>(1)(2)</sup>**

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>Bilateral</b>	<b>453</b>	<b>470</b>	<b>1,126</b>	<b>1,187</b>	<b>1,063</b>
Abu Dhabi Fund for Development .....	19	16	14	11	9
Agence Française de Développement(AFD) .....			629	689	602
Austrian Government .....	28	29	31	31	25
Government of Belgium .....	1	2	2	2	2
Government of China .....	6	6	6	6	6
Dexia .....					1
Exim Bank .....	7	5	4	3	3
Fortis Bank .....		1	1	1	1
Italian Government.....	23	25	29	30	26
Kerditanstalt Fur Wiederaufbau .....	32	32	33	30	21
Kuwaiti Fund for Arab Economic Development .....	139	140	140	137	141
Mediocredito Centrale .....	17	16	15	14	13
Natexis Banque .....	70	83	99	109	96
Overseas Econ. Coop. Fund (OECF) .	2	10	21	25	24
The Saudi Fund for Development .....	106	102	99	96	95
<b>Multilateral</b>	<b>962</b>	<b>1,071</b>	<b>1,232</b>	<b>1,313</b>	<b>1,280</b>
Arab Fund for Economic and Social Development .....	290	328	344	357	370
Communaute Economique Europeenne .....	3	4	6	7	6
European Investment Bank .....	264	277	347	352	304
International Bank for Reconstruction and Development .....	286	321	345	366	362
International Fund for Agricultural Development .....	7	8	9	11	10
Islamic Development Bank .....	105	126	173	206	212
The OPEC Fund for International Development .....	6	8	9	13	15
<b>Private Credits.....</b>	<b>7,970</b>	<b>12,773</b>	<b>12,987</b>	<b>15,621</b>	<b>16,551</b>
<b>Commercial Banks .....</b>	<b>357</b>	<b>289</b>	<b>224</b>	<b>169</b>	<b>130</b>
<b>Bonds.....</b>	<b>7,613</b>	<b>12,484</b>	<b>12,762</b>	<b>15,452</b>	<b>16,422</b>
<b>TOTAL<sup>(3)</sup></b>	<b>9,381</b>	<b>14,313</b>	<b>15,342</b>	<b>18,118</b>	<b>18,894</b>

Source: Ministry of Finance/*Banque du Liban*..

Notes:

- (1) Certain figures in this table differ from previously published data due to continuous implementation of the Debt Management System; excluding accrued interest.
- (2) Amounts translated into U.S. Dollars at end of period rates.
- (3) This figure does not include accrued interest.

During 2004, the Republic resumed issuances of Eurobonds in the capital markets, after having met its external financing needs in 2003 principally through borrowings from participants in the Paris II Conference. The Republic issued Eurobonds under the U.S. \$17,000,000,000 Global Medium-Term Note Program in an aggregate principal amount of U.S. \$5.22 billion<sup>1</sup>, divided as follows:

<sup>1</sup> Includes amounts issued pursuant to exchange transaction for the amount of U.S. \$1,186,532,000.

- U.S. \$1,000,000,000 7.875 per cent. Notes due 2011 (Series 28) and Euro 225,000,000 7.25 per cent. Notes due 2009 (Series 29) were issued on May 18, 2004.
- U.S. \$1,265,000,000 7.125 per cent. Notes due 2010 (Series 30) and U.S. \$275,000,000 7.750 per cent. Notes due 2012 (Series 31) were issued on September 7, 2004. The Series 30 Notes and the Series 31 Notes were issued as part of an exchange offer pursuant to which the Republic offered to exchange any and all of its outstanding Eurobonds maturing in 2005 in an aggregate principal amount of U.S. \$2,163,995,000<sup>2</sup> for Series 30 Notes, Series 31 Notes or a combination thereof. U.S. \$1,069,482,000 in aggregate principal amount of Series 30 Notes and U.S. \$117,050,000 in aggregate principal amount of Series 31 Notes were issued pursuant to the exchange offer. The balance of the Series 30 Notes and the Series 31 Notes were issued for cash.
- U.S. \$700,000,000 6.375 per cent. Notes due 2008 (Series 32) and U.S. \$300,000,000 6.875 per cent. Notes due 2010 (Series 33) were issued on November 12, 2004. The Series 32 Notes and the Series 33 Notes were issued pursuant to a debt replacement transaction between the Ministry of Finance and *Banque du Liban* pursuant to which *Banque du Liban* exchanged certain treasury bills denominated in Lebanese pounds for the Series 32 Notes and the Series 33 Notes. The transaction was part of the Republic's Debt Management System.
- U.S. \$325,000,000 7.750 per cent. Notes due 2012 (Series 31, Tranche 2) were issued on November 29, 2004. These Notes were issued as part of a reopening transaction and were consolidated and form a single series with the U.S. \$275,000,000 7.750 per cent. Notes due 2012 (Series 31, Tranche 1) issued by the Republic on September 7, 2004.
- U.S. \$625,000,000 Floating Rate Notes due 2009 (Series 34) were issued on November 29, 2004.
- U.S. \$425,000,000 7.000 per cent. Notes due 2009 (Series 35) were issued on December 14, 2004.

In 2005, the Republic issued Eurobonds under the U.S. \$17,000,000,000 Global Medium-Term Note Program in an aggregate principal amount of U.S. \$1.75 billion, divided as follows:

- U.S. \$750,000,000 6.50 per cent. Notes due 2007 (Series 36, Tranche 1) were issued on February 25, 2005. The Series 36 Notes were issued pursuant to a debt replacement transaction between the Ministry of Finance and *Banque du Liban* pursuant to which *Banque du Liban* exchanged certain treasury bills denominated in Lebanese pounds for the Series 36 Notes. The transaction was part of the Republic's Debt Management System.
- U.S. \$250,000,000 6.50 per cent. Notes due 2007 (Series 36, Tranche 2) were issued on April 12, 2005. These Notes were issued as part of a reopening transaction and were consolidated and form a single series with the U.S. \$750,000,000 6.50 per cent. Notes due 2007 (Series 36, Tranche 1) issued by the Republic on February 25, 2005. These Notes were also issued pursuant to a debt replacement transaction between the Ministry of Finance and *Banque du Liban* pursuant to which *Banque du Liban* exchanged certain treasury bills denominated in Lebanese pounds for the Series 36 Notes.

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<sup>2</sup> This amount excludes the zero coupon Eurobonds issued to Lebanese commercial banks in 2003 in the context of the Paris II conference held in November 2002.

- U.S. \$250,000,000 7.00 per cent. Notes due 2008 (Series 37) were issued on May 11, 2005. The Series 37 Notes were issued pursuant to a debt replacement transaction between the Ministry of Finance and *Banque du Liban* pursuant to which *Banque du Liban* exchanged certain treasury bills denominated in Lebanese pounds for the Series 37 Notes.
- U.S. \$250,000,000 7.375 per cent. Notes due 2008 (Series 38) and U.S. \$250,000,000 8.625 per cent. Notes due 2013 (Series 39) were issued on June 20, 2005.
- U.S. \$750,000,000 8.50 per cent. Notes 2016 (series 40) were issued on October 17, 2005.

In addition, on April 25, 2005, *Banque du Liban* issued Euro deposit certificates in foreign currencies (the "*Certificates*") in an aggregate principal amount of U.S. \$2,000,000,000. The Certificates have a maturity of 10 years, an interest rate of 10 per cent. and were issued at a price of 96.95 per cent. Holders of the Certificates have a put option to request redemption of all or part of the Certificates held by them, exercisable seven years after the issue date, at a price of 91.63 per cent, plus accrued interest. The Certificates are not listed and this was the first issuance by *Banque du Liban* of securities traded on the international capital markets.

The following table shows the Republic's public external debt by currency at the end of the periods indicated:

**Public Sector External Debt by Type of Currency<sup>(1)(2)</sup>**

	<b>2001</b>	<b>%</b>	<b>2002</b>	<b>%</b>	<b>2003</b>	<b>%</b>	<b>2004</b>	<b>%</b>	<b>2005</b>	<b>%</b>
Arab Emirates	19	0.20	16	0.11	14	0.09	11	0.06	9	0.05
Dirhams .....										
Swiss Francs .....	11	0.12	12	0.08	12	0.08	12	0.07	9	0.05
China Yuan										
Renmimbi .....	6	0.06	6	0.04	6	0.04	6	0.03	6	0.03
Euros(3) .....	1,179	12.57	1180	8.25	2,044	13.33	2,105	11.63	1,536	8.13
Pounds Sterling ..	0.88	0.01	0.9	0.01	0.92	0.01	1	0.00	1	0.00
Islamic Dinars ....	47	0.50	46	0.32	44	0.29	47	0.26	71	0.38
Japanese Yen .....	20	0.21	28	0.20	39	0.25	44	0.24	37	0.20
Kuwaiti Dinars ...	429	4.57	468	3.27	484	3.16	503	2.78	511	2.70
Saudi Arabian	106	1.13	102	0.71	99	0.65	96	0.53	95	0.50
Riyals .....										
Special Drawing										
Rights .....	7	0.07	8	0.06	9	0.06	11	0.06	10	0.05
U.S. Dollars .....	7557	80.55	12,442	86.95	12581	82.05	15,270	84.34	16,610	87.91
<b>Total .....</b>	<b>9,382</b>	<b>100.00</b>	<b>14,309</b>	<b>100.00</b>	<b>15,333</b>	<b>100.00</b>	<b>18,106</b>	<b>100.00</b>	<b>18,895</b>	<b>100.00</b>

Source: Ministry of Finance.

Notes:

- (1) Certain figures in this table differ from previously published figures due to continuing implementation of a new debt management system; excluding accrued interest
- (2) Amounts translated into U.S. Dollars at end of period rates.
- (3) This category includes external debt incurred in European currency units prior to the introduction of the euro in January 1, 1999 at the start of the third stage of the European Economic and Monetary Union.

The following table shows the Republic's public external debt projections and estimated future disbursements of contracted amounts for the years indicated.

# Public Sector External Debt Projections and Estimated Future Disbursements as of December 31, 2005

	2006	2007	2008	2009	2010
		<i>(in millions of U.S. Dollars)<sup>(1)</sup></i>			
Estimated Disbursements <sup>(2)</sup> .....	288	209	96	19	1
Principal Payments .....	2,860	1,815	2,635	2,702	2,289
Principal Repayment-Loans .....	366	346	358	373	352
Principal Repayment-Eurobonds .....	2,494	1,469	2,277	2,329	1,937
Eurobond (USD) 2006 .....	1,110	-	-	-	-
Eurobond (USD) 2006 .....	318	-	-	-	-
Eurobond (USD) 2006 .....	105	-	-	-	-
Eurobond (USD) 2006 .....	641	-	-	-	-
Eurobond (Euro) 2006 .....	321	-	-	-	-
Eurobond (USD) 2007 .....	-	750	-	-	-
Eurobond (USD) 2007 .....	-	250	-	-	-
Eurobond (USD) 2007 .....	-	100	-	-	-
Eurobond (USD) 2007 .....	-	369	-	-	-
Eurobond (USD) 2008 .....	-	-	750	-	-
Eurobond (USD) 2008 .....	-	-	700	-	-
Eurobond (USD) 2008 .....	-	-	250	-	-
Eurobond (USD) 2008 .....	-	-	250	-	-
Eurobond (USD) 2009 .....	-	-	-	386	-
Eurobond (Euro) 2009 .....	-	-	-	250	-
Eurobond (USD) 2009 .....	-	-	-	625	-
Eurobond (USD) 2009 .....	-	-	-	425	-
Eurobond (USD) 2009 .....	-	-	-	271	-
Eurobond (USD) 2010 .....	-	-	-	-	1,265
Eurobond (USD) 2010 .....	-	-	-	-	300
Eurobond (USD) 2011 .....	-	-	-	-	-
Eurobond (USD) 2012 .....	-	-	-	-	-
Eurobond (USD) 2012 .....	-	-	-	-	-
Eurobond (USD) 2016 .....	-	-	-	-	-
Eurobond (USD) 2017 .....	-	-	187	187	187
Eurobond (USD) 2017 .....	-	-	95	95	95
Eurobond (USD) 2018 .....	-	-	35	70	70
Eurobond (USD) 2018 .....	-	-	10	20	20
Interest & Commissions .....	1,208	981	855	710	480
Loans .....	135	130	119	105	89
Coupon Payments .....	1,073	851	736	605	391
Eurobond (USD) 2006 .....	55	-	-	-	-
Eurobond (USD) 2006 .....	28	-	-	-	-
Eurobond (USD) 2006 .....	5	-	-	-	-
Eurobond (USD) 2006 .....	67	-	-	-	-
Eurobond (Euro) 2006 .....	34	-	-	-	-
Eurobond (USD) 2007 .....	49	24	-	-	-
Eurobond (USD) 2007 .....	16	8	-	-	-
Eurobond (USD) 2007 .....	8	8	-	-	-
Eurobond (USD) 2007 .....	32	32	-	-	-
Eurobond (USD) 2008 .....	76	76	76	-	-
Eurobond (USD) 2008 .....	45	45	22	-	-
Eurobond (USD) 2008 .....	18	18	9	-	-
Eurobond (USD) 2008 .....	40	40	31	22	22
Eurobond (USD) 2009 .....	40	40	40	40	-
Eurobond (Euro) 2009 .....	26	26	26	26	-
Eurobond (USD) 2009 .....	37	37	37	37	-
Eurobond (USD) 2009 .....	30	30	30	30	-
Eurobond (USD) 2009 .....	20	20	20	20	-
Eurobond (USD) 2010 .....	90	90	90	90	45
Eurobond (USD) 2010 .....	21	21	21	21	21
Eurobond (USD) 2011 .....	79	79	79	79	79
Eurobond (USD) 2012 .....	21	21	21	21	21
Eurobond (USD) 2012 .....	25	25	25	25	25
Eurobond (USD) 2016 .....	47	47	47	47	47
Eurobond (USD) 2017 .....	75	75	73	65	58
Eurobond (USD) 2017 .....	48	48	46	42	37
Eurobond (USD) 2018 .....	35	35	35	32	29
Eurobond (USD) 2018 .....	10	10	10	9	8
<b>Total External Debt Service .....</b>	<b>4,068</b>	<b>2,796</b>	<b>3,490</b>	<b>3,412</b>	<b>2,769</b>

Source: Ministry of Finance

Notes:

- (1) Amounts translated into U.S. Dollars at the rate of U.S. \$1.2503 = Euro 1.00, the U.S. Dollar/Euro rate of exchange as at December 31, 2005.
- (2) Estimated disbursements in respect of financing arrangements (excluding Eurobonds) entered into by the Republic or its agencies and in effect on December 31, 2005. Estimated disbursements and principal payments exclude debt service in connection with further issuances of Eurobonds and similar securities. External debt incurred by the Republic during the projected period may differ significantly from the amounts shown in the table.

## **Debt Record**

The Republic had little public external debt prior to 1975 and, with one minor exception, has been current on its debt service, including during the 1975-1990 period of conflict. The only instance of arrears during the conflict was in respect of a debt to the United States Commodity Credit Corporation, which financed a sale on concessional terms in 1970. The loan fell into arrears in April 1986 as the Ministry of Finance, which coordinates external debt service, was then unaware of its existence due to loss of records during the conflict period. The loan was not accelerated. The Ministry of Finance assumed responsibility for the debt and the arrears (amounting to U.S. \$5.5 million in principal and accrued interest and U.S. \$713,000 in late interest) were cleared in 1995.

The Republic has never conducted a Paris Club or London Club rescheduling of its external debt.

## **MONETARY SYSTEM**

### **Role of *Banque du Liban***

*Banque du Liban* is the sole custodian of public funds, supervises and regulates the banking system and is vested by law with the exclusive authority of issuing the national currency. *Banque du Liban's* primary role is to safeguard the currency and promote monetary stability, thereby creating a favorable environment for economic and social progress. *Banque du Liban* also advises the Government on various economic and financial matters. In conducting its monetary management function, *Banque du Liban* utilizes a wide range of instruments, including reserve requirements on Lebanese Pound deposits with commercial banks, liquidity requirements on U.S. Dollar deposits in commercial banks, Treasury bill repurchase and swap agreements with commercial banks, as well as Lebanese Pound denominated certificates of deposits issued by *Banque du Liban*.

As a result of high inflation prior to 1992, the Lebanese economy became substantially dollarized. Since October 1992, monetary policy has been targeted at stabilizing the Lebanese Pound exchange rate and controlling the inflation rate and money growth. The return of confidence in monetary stability and the high returns on investment in LL-denominated financial securities led to a significant decline of the dollarization of deposits in the economy and to a build up in foreign exchange reserves until the end of 1996. Thus, the proportion of foreign currency deposits decreased from 73.6 per cent. in December 1990 to 56.3 per cent. in June 1997 before increasing to 63.9 per cent. at the end of 1997 and 65.5 per cent. at the end of 1998 due in part to the turmoil generally affecting emerging markets following the Asian crisis. In 1999, the proportion of foreign currency deposits declined gradually to reach 61.6 per cent. at year end, with a further decline to 61.0 per cent. at end-March 2000. From March 2000, the proportion of foreign currency deposits increased to 72.53 per cent. as at December 31, 2001 due to regional tensions and a higher than expected budget deficit. This ratio continued to increase until May 2002, reaching 74.24 per cent., when it again started to decline, reaching 69.28 per cent. by the end of 2002, and 66.14 per cent. by the end of 2003. Heightened internal political tension during the second half of 2004 once again resulted in a slight increase in the dollarization level, to 70.01 per cent. by the end of 2004. As a result of the assassination of the late Prime Minister Hariri in February 2005 and the ensuing turmoil, the dollarization level reached 73.13 per cent. as at end December 2005.

The following table sets out the balance sheet of Banque du Liban as at December 31 for the years 2001 to 2005:

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<i>(in billions of Lebanese Pounds)</i>				
<b>Assets</b>					
Gold .....	3,861	4,849	5,779	6,039	7,140
Foreign currencies.....	6,574	7,644	15,372	14,313	14,841
Other foreign assets .....	0	0	0	0	0
Claims on private sector.....	201	205	398	354	307
Loans to banks and financial companies .....	781	1,720	1,827	1,859	1,796
Claims on public sector.....	117	114	307	455	453
Securities portfolio.....	7,328	4,499	12,399	13,806	14,589
Fixed assets.....	221	222	266	384	465
Unclassified assets <sup>(1)</sup> .....	255	287	1,085	2,436	3,831
<b>Total assets .....</b>	<b>19,388</b>	<b>19,539</b>	<b>37,433</b>	<b>39,645</b>	<b>43,423</b>
<b>Liabilities</b>					
Currency in circulation outside .....	1,527	1,542	1,717	1,783	1,736
Deposits of banks .....	10,625	11,849	28,152	29,068	28,474
Deposits of specialist banks .....	203	288	1,287	1,260	1,136
Private sector deposits.....	91	63	27	45	55
Public sector accounts.....	1,402	2,373	1,693	2,879	3,855
Valuation adjustment .....	2,742	103	646	372	1,392
Foreign liabilities .....	230	239	204	195	161
Special long-term liabilities .....	1,386	1,419	1,343	961	490
Capital accounts.....	1,049	1,255	1,914	1,900	1,618
Unclassified liabilities <sup>(2)</sup> .....	81	407	450	1,181	1,463
<b>Total liabilities.....</b>	<b>19,338</b>	<b>19,539</b>	<b>37,433</b>	<b>39,645</b>	<b>43,423</b>

Source: Banque du Liban.

Notes:

(1) Unclassified assets include the following items: other debtor accounts, counterpart securities, accounts receivable, a regularization account, inventory and fixed assets.

(2) Unclassified liabilities include the following items: notes payable, other creditor accounts and a regularization account.

## Banking Sector

As at the end of March 2005, there were 54 active commercial banks and 10 specialized medium and long term credit banks, with 815 branches, 30 financial institutions, nine financial intermediaries, and three leasing companies in the Republic. Foreign banks were well represented, maintaining 10 entities with many branches and having majority equity stakes in 14 local banks and minority equity stakes in 13 other local banks. Foreign banks have traditionally established themselves in Lebanon, with either receiving a banking license or operating through a representative office or acquiring participations in the capital of Lebanese banks. Foreign presence is seen important to diversifying the financial sector and strengthening competitive forces.

Unlike the banking sector in some other emerging market countries, the banking sector in Lebanon is generally characterized by its openness evidenced by the size of interaction with correspondent banks and Lebanese abroad and the remarkable foreign presence as already mentioned. The Lebanese banking sector, with an asset-to-GDP ratio of 347.4 per cent., is also well capitalized with key risk and return measures kept in line with those reported by the top international banks with few exceptions for reasons related to the specificities of the Lebanese market. In addition it plays many critical roles in the economy as a whole of which financial intermediation, payments, guarantor, investment advisor, agency and policy roles.

The banking sector currently offers a diversity of services very close to those offered worldwide including specialized saving plans, retail payment services, consumer credit, corporate credit and trade finance, and investment, private and consulting services. It recruits qualified personnel and invests heavily in professional training of employees and in the latest information and communication technology.

Banks in Lebanon are well regulated and supervised in conformity with the international best practices and standards and cooperate fully with the regulatory and supervisory authorities believing that such cooperation is essential for maintaining their credibility domestically and internationally. From March

1995, commercial banks were required to meet a minimum capital adequacy ratio of 8 per cent. in line with the Basle Accord. In September 1999, *Banque du Liban* required banks to raise their capital adequacy ratios to 10 per cent. by the end of 2000 and 12 per cent. by the end of 2001.

Believing in the benefits of modernization and restructuring in a changing operating environment, regulators, supervisors and banks were heavily engaged over the past few years in proposing banking reforms. A law facilitating bank mergers by (among other things) making banks eligible for soft loans from *Banque du Liban*, was passed in 1993 and renewed in 1998 until 2003. It was then reinstated for an indefinite period by a new law in February 2005. In addition, Parliament passed legislation to revitalize the Housing Bank. State participation in the shareholding of this bank has been reduced to a minority stake. Parliament passed as well laws relating to the listing of bank shares on stock exchanges and the acquisition of bank shares without any discrimination between Lebanese and non-Lebanese and between residents and non-residents. Several banks currently list their eligible shares on the Beirut Stock Exchange. In February 2004, the Parliament passed a new law regulating Islamic Banking in Lebanon. This law will enable the enhancement of Islamic banking activities in Lebanon while assuring a modern regulation and good supervision for such activities. On December 9, 2005, Parliament enacted laws No. 705 and 706, governing securitization of assets and collective investment schemes, respectively. On March 1, 2006, a draft law governing the capital markets in Lebanon and the creation of a regulatory authority was approved by the Government and submitted to Parliament for its approval.

Efforts undertaken by the regulatory and supervisory authorities, the Association of Banks in Lebanon, *Banque du Liban* and the Ministry of Finance resulted in the promulgation of a law on money laundering by the Lebanese Parliament in 2001, incriminating money laundering activities and permitting the efficient combating of such activities and the cooperation with the international community on such an issue.

Recently banks have started to enter new markets and receive licenses to operate in many Arab countries, including Syria, Jordan, Sudan, and Algeria.

The following table sets out the combined balance sheet of the commercial banks as at December 31, 2001 to 2005:

### Balance Sheet of Commercial Banks in Lebanon

	2001	2002	2003	2004	2005
	(in billions of Lebanese Pounds)				
<b>Assets</b>					
Reserves.....	10,656	11,960	28,332	29,878	30,917
Currency.....	146	166	186	197	201
Deposits with Banque du Liban.....	10,510	11,794	28,146	29,682	30,717
Claims on Private Sector.....	22,358	22,927	22,836	24,020	24,467
Lebanese Pounds .....	3,285	4,139	3,856	4,268	4,306
Foreign Currency.....	19,073	18,788	18,980	19,752	20,161
Claims on Public Sector.....	23,067	26,577	21,006	24,155	26,697
Treasury Bills .....	22,151	26,523	20,961	24,106	26,638
Other.....	916	55	45	49	58
Foreign Assets .....	12,989	14,327	14,937	20,431	20,017
Fixed Assets .....	2,568	2,884	2,931	3,131	3,458
Unclassified Assets .....	384	561	581	570	458
<b>Total assets .....</b>	<b>72,021</b>	<b>79,236</b>	<b>90,623</b>	<b>102,187</b>	<b>106,015</b>
<b>Liabilities</b>					
Residential Private Sector Deposits, of					
which: .....	51,652	55,451	61,791	68,268	71,632
Lebanese Pounds.....	15,971	19,092	23,649	23,347	22,042
Sight.....	904	1,094	1,277	1,389	1,352
Term.....	15,067	17,998	22,372	21,958	20,684
Foreign currency .....	35,681	36,359	38,142	44,921	49,590
Public Sector deposits	526	591	1,325	1,480	1,705
Non Resident Private Sector Deposits .....	9,268	9,237	11,663	14,422	14,274
Bonds.....	8	157	58	150	88
Deposits of Non Resident Financial					
Sector.....	1,796	1,859	2,398	3,813	3,263
Capital accounts.....	4,463	5,023	5,499	5,809	6,411
Unclassified liabilities.....	4,309	6,918	7,889	8,244	8,641
<b>Total liabilities.....</b>	<b>72,021</b>	<b>79,236</b>	<b>90,623</b>	<b>102,187</b>	<b>106,015</b>

Source: Banque du Liban.

### Interest Rates

Prior to 1993, interest rates on Treasury bills were fixed by the Ministry of Finance in consultation with *Banque du Liban*. In May 1993, *Banque du Liban* began selling 3-month Treasury bills in a multiple price auction. The authorities subsequently extended this system to 6- and 12-month Treasury bills in June and September 1993, respectively. In October 1994, the auction system was extended to 24-month Treasury notes. Interest rates declined significantly in 1993 and 1994 in response to increased domestic and external demand for Lebanese Pound assets. The first three quarters of 1995 witnessed an increase in interest rates, reflecting a number of factors, including the policy objective of maintaining stability in the foreign exchange market in the face of political uncertainties associated with the end of the President's term of office. Interest rates experienced a steady decline from the fourth quarter of 1995 to the end of October 1999, remained stable between November 1999 and November 2002 and, following the Paris II Conference, have declined and are currently at a historical low. *Banque du Liban* also affects interest rates through its treasury bill discount and repurchase operations on the secondary market. In November 2003, 36-month Treasury notes were introduced to the Treasury bill auctions. In March and April 2005, 48-month and 60-month notes were introduced for a limited purpose. The issuance of these longer-dated Notes has been discontinued.

The gradual decline in interest rates on Treasury bills has been accompanied by a decrease in the spread between U.S. Dollar and Lebanese Pound lending and deposit rates. The spread between deposit rates in Lebanese Pounds and in U.S. Dollars narrowed from 11.7 per cent. in December 1995 to 6.94 per cent. in December 1998, further declining to 5.67 per cent. in December 1999 and 4.41 per cent. in December 2000 only to increase to 5.94 per cent. in December 2001 following sharp cuts in U.S. interest rates. Following the Paris II Conference, interest rates on Lebanese Pound lending and deposit

rates declined, narrowing the spread between deposit rates in Lebanese Pounds and in US Dollars to 5.83 per cent. in December 2002, 4.36 per cent. In December 2003, and 3.76 per cent. in December 2004. The spread between lending rates in Lebanese Pounds and in U.S. Dollars narrowed from 16.8 per cent. in December 1995 to 8.74 per cent. in December 1998, 7.51 per cent. in December 1999, 6.97 per cent. in December 2000, 6.61 per cent. in December 2001 and 6.48 per cent. in December 2002. By December 2003, the spread between lending rates in Lebanese Pounds and in U.S. Dollars narrowed to 4.36 per cent, and by December 2004, the spread narrowed further to 3.76 per cent.

The following table sets forth the Treasury bill yields at primary auction at the end of each quarter in the years 2001 to 2005:

### Treasury Bill Yields

Calendar Quarters or Months	3-month Bill	6-month Bill	12-month Bill (per cent.)	24-month Bill	36-month Bill
2001 I.....	11.18	12.12	13.43	14.64	-
2001 II.....	11.18	12.12	13.43	14.64	-
2001 III.....	11.18	12.12	13.43	14.64	-
2001 IV.....	11.18	12.12	13.43	14.64	-
2002 I.....	11.18	12.12	13.43	14.64	-
2002 II.....	11.18	12.12	13.43	14.64	-
2002 III.....	11.18	12.12	13.43	14.64	-
2002 IV.....	7.77	9.15	9.13	9.41	-
2003 I.....	6.96	8.18	9.13	9.41	-
2003 II.....	6.96	8.18	9.13	9.41	-
2003 III.....	6.96	8.18	9.13	9.41	-
2003 IV.....	5.44	6.53	6.87	7.99	8.85
2004 I.....	5.29	6.40	6.76	7.95	8.87
2004 II.....	5.20	6.32	6.69	7.89	8.87
2004 III.....	5.22	6.31	6.68	7.89	8.87
2004 IV.....	5.22	6.31	6.69	7.89	8.87
2005 I.....	5.22	6.31	6.69	7.89	8.87
2005 II.....	5.22	7.24	7.75	8.68	9.56
2005 III.....	5.22	7.24	7.75	8.68	9.56
2005 IV.....	5.22	7.24	7.75	8.68	9.56

Source: Ministry of Finance/Banque du Liban.

The following tables set forth commercial bank deposits and lending rates at the average Lebanese Pound and U.S. Dollar rates across the banking system for the stated type of account at the end of each quarter for the years 2001 to 2005. The stated quarterly rates are the average rate for the last month of the quarter. Time deposits range from one day to no stated maturity and savings accounts are current accounts without a checking facility.

#### Lebanese Pound Deposit and Lending Rates of Commercial Banks

Calendar Quarters or Months	Debitor Rate	Creditor Rate	Current Account (per cent.)	Savings Deposit	Time Deposit
2001 I.....	17.46	10.33	3.38	7.95	10.93
2001 II .....	17.16	10.16	3.51	7.56	10.84
2001 III.....	17.15	9.99	3.23	7.32	10.73
2001 IV .....	16.76	10.15	3.31	7.01	10.82
2002 I.....	16.77	10.16	3.84	7.07	10.79
2002 II .....	16.89	10.22	2.27	6.46	11.20
2002 III.....	16.57	10.55	2.51	7.03	11.32
2002 IV.....	16.10	9.83	3.04	6.36	10.46
2003 I.....	15.01	8.73	2.24	5.67	9.24
2003 II .....	13.52	8.30	3.48	5.23	8.65
2003 III.....	12.04	7.93	2.91	5.14	8.31
2003 IV .....	11.32	7.79	2.69	4.89	8.19
2004 I.....	11.10	7.26	3.15	4.91	7.39
2004 II .....	10.95	6.92	2.28	4.49	7.25
2004 III.....	10.55	6.87	3.75	4.39	7.18
2004 IV .....	10.48	7.01	2.74	4.12	7.38
2005 I.....	10.98	7.97	2.80	4.58	8.50
2005 II .....	10.97	8.19	2.44	4.55	8.73
2005 III.....	10.69	7.61	3.44	3.94	8.02
2005 IV.....	10.12	7.70	2.56	3.58	8.11

Source: Ministry of Finance/Banque du Liban.

#### U.S. Dollar Deposit and Lending Rates of Commercial Banks

Calendar Quarters or Months	Debitor Rate	Creditor Rate	Current Account (per cent.)	Savings Deposit	Time Deposit
2001 I.....	11.01	5.67	1.92	2.99	6.12
2001 II .....	10.63	4.88	1.49	2.54	5.33
2001 III.....	10.56	4.57	1.43	2.36	5.01
2001 IV .....	10.14	4.21	1.01	1.91	4.63
2002 I.....	10.24	4.16	0.93	1.81	4.61
2002 II .....	10.06	4.19	0.93	1.73	4.70
2002 III.....	9.83	4.19	0.85	1.71	4.66
2002 IV.....	9.62	4.00	0.74	1.46	4.51
2003 I.....	9.34	3.74	0.63	1.43	4.19
2003 II .....	9.13	3.53	0.64	1.30	3.93
2003 III.....	8.63	3.48	0.69	1.28	3.92
2003 IV .....	8.81	3.43	0.70	1.21	3.85
2004 I.....	8.55	3.32	0.61	1.12	3.63
2004 II .....	8.41	3.17	0.52	1.09	3.55
2004 III.....	8.22	3.27	0.51	1.09	3.65
2004 IV .....	7.98	3.25	0.61	1.06	3.66
2005 I.....	8.22	3.46	0.63	1.25	3.80
2005 II .....	8.20	3.62	0.75	1.26	4.00
2005 III.....	8.31	3.78	0.79	1.20	4.19
2005 IV.....	8.38	4.09	1.16	1.26	4.52

Source: Ministry of Finance/Banque du Liban.

## Foreign Exchange Rates and International Reserves

The currency of the Republic is the Lebanese Pound. The Lebanese Pound is convertible and its exchange rate is generally determined on the basis of demand and supply conditions in the exchange market. Bankers are allowed to engage in spot transactions in any currency. However, they are prohibited from engaging in forward transactions in Lebanese Pounds for speculative purposes. Banque du Liban intervenes when necessary in order to maintain orderly conditions in the foreign exchange market. There are no taxes or subsidies on purchases or sales of foreign exchange.

Foreign exchange rate stability is a primary policy objective of the Government and of Banque du Liban. Banque du Liban's exchange rate policy since October 1992 has been to anchor the Lebanese Pound nominal exchange rate to the U.S. Dollar. This appreciation was limited to 0.03 per cent. in 1999 and the Lebanese Pound exchange rate has remained unchanged since 2000. Although several external factors can influence the exchange rate, including general investor confidence in the economy, the authorities expect to continue to gear their monetary policy towards maintaining strength and stability in the exchange rate. Direct intervention in the currency markets supplements this policy when necessary to smooth excessive volatility of the exchange rate.

The following table sets forth the gold and gross foreign currency reserves of Banque du Liban in millions of U.S. Dollars as at December 31, in each of the years 2001 to 2005:

## Foreign Exchange Rates and International Reserves

	<b>Gold</b> (millions of U.S. Dollars)	<b>Foreign Currency<sup>(1)</sup></b> (millions of U.S. Dollars)
2001 .....	2,561.0	4,361
2002 .....	3,216.3	5,070
2003 .....	3,833.5	10,197
2004 .....	4,006.0	9,494
2005 .....	4,736.4	9,845

Source: Banque du Liban.

Note:

(1) Excluding gold reserves.

Foreign currency reserves are generally placed by Banque du Liban outside the Republic with other central banks or with highly rated international banks. They include a limited amount of highly rated foreign debt securities. Although not legally obligated to do so, Banque du Liban has been pursuing a policy of setting aside, and segregating from its foreign exchange reserves, certain foreign currency amounts corresponding to the maturing external public debt obligations of the Republic. These foreign currency amounts are being made available to the Republic for payment of its external public debt obligations, against payment to Banque du Liban of equivalent amounts in Lebanese Pounds. See "*Monetary System—Role of Banque du Liban*".

The following table sets forth the Lebanese Pound/ U.S. Dollar closing exchange rate at the end of each quarter for the years 1992 to 2005:

<b>End of Period</b>	<b>(in LL per U.S. \$)</b>	<b>% Change in Dollar Exchange Rate over Previous Period<sup>(1)</sup></b>
1992:		
March.....	1,280.0	(45.6)
June.....	1,705.0	(33.2)
September .....	2,420.0	(41.9)
December .....	1,838.0	24.0
1993:		
March.....	1,742.0	5.2
June.....	1,731.0	0.6
September.....	1,732.5	0.4
December .....	1,711.0	0.7
1994:		
March.....	1,694.5	1.0
June.....	1,680.0	0.9
September .....	1,666.0	0.8
December .....	1,647.0	1.1
1995:		
March.....	1,634.5	0.8
June.....	1,620.5	0.9
September .....	1,610.5	0.6
December .....	1,596.0	0.9
1996:		
March.....	1,583.5	0.8
June.....	1,571.0	0.8
September .....	1,558.5	0.8
December .....	1,552.0	0.4
1997:		
March.....	1,545.8	0.4
June.....	1,539.8	0.4
September .....	1,533.3	0.4
December .....	1,527.0	0.4
1998:		
March.....	1,521.3	0.4
June.....	1,516.3	0.3
September .....	1,509.7	0.4
December .....	1,508.0	0.1
1999:		
March.....	1,508.0	0.0
June.....	1,508.0	0.0
September .....	1,507.5	0.3
December .....	1,507.5	0.0
2000:		
March.....	1,507.5	0.0
June.....	1,507.5	0.0
September .....	1,507.5	0.0
December .....	1,507.5	0.0
2001:		
March.....	1,507.5	0.0
June.....	1,507.5	0.0
September .....	1,507.5	0.0
December .....	1,507.5	0.0
2002:		
March.....	1,507.5	0.0
June.....	1,507.5	0.0
September .....	1,507.5	0.0
December .....	1,507.5	0.0
2003:		
March.....	1,507.5	0.0
June.....	1,507.5	0.0
September .....	1,507.5	0.0
December .....	1,507.5	0.0
2004:		
March.....	1,507.5	0.0
June.....	1,507.5	0.0
September .....	1,507.5	0.0
December .....	1,507.5	0.0
2005:		
March.....	1,507.5	0.0
June.....	1,507.5	0.0

<b>End of Period</b>	<b>(in LL per U.S. \$)</b>	<b>% Change in Dollar Exchange Rate over Previous Period<sup>(1)</sup></b>
September .....	1,507.5	0.0
December .....	1,507.5	0.0

Source: Ministry of Finance/Banque du Liban.

Note:

(1) Negative percentage change signifies depreciation of Lebanese Pound in U.S. Dollar terms.

## **Securities Markets**

The Beirut Stock Exchange was created in 1920 by the French mandate authorities in order to privatize public utilities, railways, telecommunications and the post office. Companies from the industrial, banking and tourism sectors were gradually added. The Beirut Stock Exchange flourished from 1954 to 1975. It ceased trading in 1983.

In August 1994, the Government set up the Beirut Stock Exchange Committee to supervise and manage the reopening of the Beirut Stock Exchange. Trading on the Stock Exchange commenced on January 22, 1996 when the shares of three previously listed Lebanese companies were re-admitted for trading. On September 30, 1996, the shares of SOLIDERE, previously listed on the Beirut Secondary Market, were listed and began trading on the Beirut Stock Exchange.

The Beirut Stock Exchange's capitalization, which includes the value of the securities listed on the Beirut Stock Exchange, (excluding Lebanese Republic Eurobonds) rose from approximately US\$ 386 million in January 1996 to U.S. \$2,331 million at the end of December 2004. The number of authorized brokers rose from five to thirteen and the number of listed companies rose from three to sixteen (including five mutual funds) by the end of December 2004.

Commencing in 2004, Eurobonds issued by the Republic have been listed on the Beirut Stock Exchange. To date, 11 issues of Eurobonds were listed on the Beirut Stock Exchange during 2004 and five during 2005.

The Government regards the re-establishment and development of organized capital markets, including markets for the issue and secondary trading of equity and debt securities, as being of significant importance for the financing of Lebanon's reconstruction and economic expansion.

In addition, since 1996, several Lebanese companies have raised funds (both equity and debt) in the international capital markets.

## **PUBLIC FINANCE**

### **The Budget Process**

The budget preparation and adoption process is governed by relevant provisions of the Constitution and the Law on Public Accounting, implemented by Decree No. 14969 dated December 30, 1963, as amended.

The laws governing the budget preparation provide that the proposed budget for each year is prepared by the Ministry of Finance (after review of the estimates prepared by the various Ministries) and submitted to the Council of Ministers by September 1 of the preceding year. The proposed budget, after review by the Council of Ministers, must then be forwarded to Parliament by October 15 for review and approval.

The budget is then approved by Parliament, through specific voting for each article in the budget, after review and debate during a general session to be held between October 15 and December 31.

If Parliament fails to approve a budget, the President of the Republic, with the approval of the Prime Minister, must convene a special session of Parliament to be held no later than January 31 of the relevant year. If no budget is approved during the special session, the President of the Republic has the power, after approval of the Council of Ministers, to adopt the budget submitted to Parliament by the

Council of Ministers (Articles 86 of the Lebanese Constitution and 120 of Parliament's internal regulations).

Once the budget law is enacted, the Ministry of Finance becomes responsible for its execution.

### **Operations of the Central Government**

Prior to the conflict, Lebanon seldom ran budget deficits. The conflict, especially from the early 1980s, led to widespread tax evasion and non-payment of public utility bills. Revenues dropped to very low levels and at one time were not sufficient to cover interest payments on the Republic's internal debt. The Republic resorted to increasing its borrowings from Banque du Liban, leading to monetary expansion.

Analysis of central Government finances must take account of the following:

- The CDR is a public institution which is distinct from any ministry within the central Government. Its financial situation is not wholly consolidated in the public accounts. CDR expenditures on reconstruction programs are financed partly by grants and borrowings from international development agencies and other overseas entities and partly by appropriations from the budget. These appropriations are included as capital expenditures in the public accounts, but expenditures financed by borrowings as described above are not included in the public accounts (but are included in foreign debt figures). However, interest and principal in respect of these borrowings are included in the national budget for the year in which it is scheduled to be repaid. The borrowings are obligations of the Republic. Foreign indebtedness incurred by the CDR is approved by the Government and by Parliament.
- The budget consists of the general budget and of three annex budgets, relating to Post and Telecommunications, National Lottery and the Grain & Sugar Beet Office. Information included in this Offering Circular relates only to the general budget. Projected deficits or surpluses in the annex budgets are accounted for in the general budget. Actual results for each year also reflect the deficit or surplus of each annex budget.
- Beginning with the 1997 Budget, a new classification, which is substantially in accordance with the guidelines and definitions set forth in the IMF's manual of "Government Finance Statistics", was adopted. The Government believes that this classification makes it easier to conduct a proper analysis of the policy, administration and monitoring phases of the budget. The classification used for prior years did not provide a sufficient basis for proper revenue and expenditure management and did not appropriately identify line item expenditures. Therefore, a detailed breakdown of revenues and expenditures is not provided for those years.
- In 1998, the Ministry of Finance developed an updated reporting system for public finance data, principally in the form of a monthly Fiscal Performance Report which presents revenues and expenditures on a transaction basis, distinguishing between budget transactions and the treasury transactions. On the revenue side, budget transactions include all tax and non tax revenues; and on the expenditure side, budget transactions account for all debt related expenses and expenditures pertaining to the execution of the Budget Law for the year under consideration. Revenues classified as treasury transactions include municipalities' revenues and other inflows in Treasury accounts under guarantees and deposit. Expenditures classified as Treasury transactions include (i) payments not related to Budget Law articles, such as municipalities' spending and transfers to EDL (ii) expenditures drawn from previous year or future years' budgets, and (iii) expenditures paid through withdrawals from guarantees and/or deposits accounts.
- Starting in 2002, the Ministry of Finance further refined the presentation of the expenditures data and introduced an economic classification of expenditures which

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 other treasury expenditures.

The following table shows a summary of central Government operations for the period from 2001 to 2005:

<b>Revenues (in billion of Lebanese Pounds)</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>I. Tax revenues .....</b>	2,961	3,995	4,502	5,169	4,867
<b>II. Non-tax revenues .....</b>	1,302	1,390	1,717	1,907	2,117
<b>III. Budget revenues (I+II) .....</b>	4,263	5,385	6,219	7,075	6,984
<b>IV. Treasury revenues .....</b>	386	445	436	439	
<b>V. Total revenues (III+IV) .....</b>	4,649	5,830	6,654	7,514	7,405
<b>Expenditures</b>					
<b>I. Current expenditures .....</b>	7,930	8,321	8,820	8,051	7,925
Personnel cost <sup>(1)</sup> .....	2,992	3,008	3,078	3,094	3,193
Debt service .....	4,312	4,622	4,874	4,021	3,534
Other current .....	626	691	868	936	1,197
<b>II. Capital expenditures<sup>(2)</sup> .....</b>	325	610	713	817	534
<b>III. Other treasury expenditures .....</b>	624	1,208	1,058	1,477	1,701
<b>IV. Total expenditures<sup>(3) (4)</sup> .....</b>	8,879	10,139	10,592	10,540	10,203
<b>Total Deficit .....</b>	<b>4,230</b>	<b>4,308</b>	<b>3,938</b>	<b>3,026</b>	<b>2,798</b>
Budget balance .....	(3,459)	(3,101)	(2,591)	(1,231)	(818)
Budgetary revenues .....	4,289	5,385	6,219	7,075	6,984
Budgetary expenditures .....	(7,748)	8,487	8,810	8,306	7,802
Net treasury operations .....	(771)	(1,207)	(1,347)	(1,796)	(1,980)
Treasury receipts .....	359	445	436	439	421
Treasury outlays .....	(1,130)	1,652	1,783	2,235	2,401
<b>% of GDP</b>					
Total deficit <sup>(5)</sup> .....	16.84%	16.53%	14.52%	10.29%	8.42%
Total revenues <sup>(5)</sup> .....	18.51%	22.36%	24.53%	25.54%	22.28%
Total expenditures <sup>(5)</sup> .....	35.35%	38.89%	39.05%	35.83%	30.69%
Nominal GDP (in billions of Lebanese Pounds) <sup>(6)</sup> .....	25,726	27,832	29,991	32,815	33,243

Source: Ministry of Finance/Banque du Liban.

Notes:

- (1) Including wage and salary related payments, e.g. pensions to civil servants and end of service indemnities to government employees
- (2) Expenditure does not include capital expenditures of CDR financed with foreign funds, consisting of LL 310 billion in 2000, LL 292 billion in 2001, LL 195 million in 2002, LL 201 million in 2003 and LL 235 billion in 2004.
- (3) On May 27, 1999, Parliament ratified a law regarding the settlement of arrears. This law allows the Government to issue debt (in local and/or foreign currency up to a ceiling of LL 1,242 billion in principal amount to settle arrears incurred during previous years. These arrears are not included in this table which reflects expenditures on a cash basis.
- (4) Prior to 2002, the breakdown of expenditures was based on estimates derived from the reconciliation of payment order data and cash payment data. Beginning 2002, the breakdown of expenditures has been based exclusively on cash payment data. Certain treasury expenditures are classified as current or capital expenditures and the balance of treasury expenditures appear under other treasury expenditures.
- (5) Not including CDR capital expenditures financed externally (referred to in note (2) above).
- (6) Estimates.

The main sources of budget revenues are income taxes (including, from February 2003, tax on interest income), capital gains and dividend taxes, taxes on property, domestic taxes on goods and services (including, from February 2002, VAT revenues), taxes on international trade and transactions and other tax revenues. Non-tax revenues consist principally of entrepreneurial and property income, such as surplus transfers from the Post and Telecommunications and other annex budgets and distributions and remittances, on account of profits or otherwise, from Banque du Liban and in respect of the Republic's ownership of various assets. Additionally, non-tax revenues include administrative fees and charges, fines and confiscated assets.

Total revenues (including revenues from treasury operations) declined between 2000 and 2001, from LL 4,749 billion in 2000 to LL 4,649 billion in 2001, but increased to LL 5,830 billion in 2002, to LL 6,654 billion in 2003 and LL 7,514 billion in 2004. As a percentage of GDP, total revenues decreased from 19.21 per cent. in 2000 to 18.51 per cent. in 2001 but increased to 22.36 per cent. in 2002, to 24.53 per cent. in 2003 and to 25.54 per cent. in 2004.

Budget expenditures are divided into current expenditures and capital expenditures. Current expenditures consist primarily of debt service in respect of public debt and personnel costs, including salaries, wages and end of service indemnities and other retirement benefits.

Total expenditures (including expenditures from treasury operations but excluding foreign financed CDR expenditures) decreased from LL 10,622 billion in 2000 to LL 8,879 billion in 2001, increased in 2002 to LL 10,139 billion, in 2003 to LL 10,592 billion and decreased in 2004 to LL 10,540 billion and to LL 10,203 billion in 2005. Debt servicing expenditures rose significantly between 2000 and 2003, increasing from LL 4,197 billion in 2000 to LL 4,312 billion in 2001, LL 4,622 billion in 2002, and LL 4,874 billion in 2003. In 2004, however, debt service decreased to LL 4,021 billion and to LL 3,534 billion in 2005. Personnel costs also rose, although more moderately, over the period, from LL 2,908 billion in 2000 to LL 3,534 billion in 2005.

### The Fiscal Deficit

The table below shows the fiscal deficit (including the budget deficit and the results of treasury operations) and the ratios of deficit to GDP and net public debt to GDP for the years 2001 to 2005:

	2001	2002	2003	2004	2005
GDP (at current market prices in billions of Lebanese Pounds).....	25,726	27,832	29,991	32,815	33,243
Total Deficit <sup>(1)</sup> .....	4,230	4,308	3,938	3,026	2,798
Deficit/GDP <sup>(1)</sup> .....	16.44%	15.48%	13.13%	9.2%	8.42%
Net Public Debt/GDP .....	158%	159%	158%	151%	158%

Source: Ministry of Finance.

Note:

(1) Excluding foreign financed CDR expenditure.

Since 1992, the focus of the Government has been on regaining public confidence in the economic future of Lebanon through macroeconomic stability and a significant reduction of inflation, while embarking on a major rehabilitation and reconstruction program. However, the Government has had to contend with the effects of the prolonged period of conflict on the Government's expenditures and ability to collect revenues. Public debt began to accumulate in the mid 1970s, as a result of the decline in the Government's control over revenue sources and the expansion of the public deficit. The growth in the public debt resulted from the Government's inability to cover its expenditures from ordinary revenues (the primary budget balance) and growing debt service obligations. As a result, the Government has been running budget deficits financed mainly through borrowing in Lebanese Pounds and foreign currency.

The primary balance, representing total revenues less primary expenditures (i.e. total expenditures excluding debt service) has improved by more than 10 per cent. of GDP between the years 2001 and 2005. This improvement is considered significant when compared to other countries.

The table below shows the evolution of primary surplus over the last five years:

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<i>(in billions of Lebanese Pounds)</i>				
Total Revenues .....	4,646	5,830	6,654	7,515	7,405
Total Expenditures .....	8,875	10,139	10,592	10,541	10,203
Debt Service .....	4,312	4,622	4,874	4,021	3,534
Primary Surplus .....	82	314	936	996	737
% of GDP .....	0.3%	1.1%	3.1%	3.0%	2.2%
Nominal GDP .....	25,726	27,832	29,991	32,815	33,243

Source: Ministry of Finance.

### ***The 2006 Budget***

The 2006 budget proposal has not yet been presented to the Council of Ministers. Instead, since the 2006 budget constitutes a part of the first year of the government's economic plan, it has been agreed that it will be presented to the Cabinet following the approval of the economic plan by the Cabinet.

### ***The 2005 Budget***

Because of the successive changes in Government during 2005 following the assassination of Mr Hariri, the 2005 budget proposal had not been approved by the Council of Ministers and submitted to Parliament during 2005. The 2005 Budget was approved by Parliament on February 3, 2006, following completion of the 2005 budget year. The 2005 Budget includes total revenues of LL 6,197 billion, consisting of LL 4,961 billion of total tax revenues and LL 1,956 billion of non-tax revenues. Expenditures are LL 10 trillion.

### **Actual Results for 2005**

The following table sets forth summaries of the actual results for the years ended December 31, 2004 and 2005:

	<b>2004 (Actual)</b>	<b>2005 (Actual)</b>
	<i>(in billions of Lebanese Pounds)</i>	
Total Revenues .....	7,515	7,405
Budget Revenues .....	7,075	6,984
Treasury Revenues .....	439	421
Total Expenditures <sup>(1)</sup> .....	10,541	10,203
Budget Expenditures <sup>(1)</sup> .....	8,306	7,802
Treasury Expenditures .....	2,235	2,401
Total Deficit .....	(3,026)	(2,798)
Total Primary Surplus .....	996	737

Source: Ministry of Finance.

Note:

(1) Excluding foreign financed CDR capital expenditures.

Total revenues in 2005 were LL 7,405 billion as compared to LL 7,515 in 2004, representing a decrease of 1.5 per cent. The decline in total revenues resulted primarily from a decrease of 5.8 per cent. in tax revenues, which was only partially offset by an 11 per cent. increase in non-tax revenues. While revenues from taxes on income, profits and capital gains increased by 15 per cent. in 2005, this was not sufficient to compensate for the 22 per cent. decrease in revenues from taxes on international trade (customs and excise) which was caused by a loss of excise tax revenues resulting from the cap on gasoline prices which has been in effect since May 2004 and a decline in imports.

Total expenditures in 2005 were LL 10,203 billion as compared to LL 10,540 billion in 2004, representing a decrease of 3.2 per cent. This was principally due to a 12 per cent. decline in debt service expenditures as a result of reduced interest payments on debt incurred pursuant to the Paris II conference. Primary expenditures increased by LL 150 billion in 2005, as compared to 2004, despite a decline of almost 35 per cent. in capital expenditures. This increase was primarily due to higher transfers to the National Social Security Fund (LL 290 billion in 2005 as compared to LL 89 billion in 2004) and a 69 per cent. increase in payments to Electricité du Liban (LL 974 billion in 2005, as compared to LL 577 billion in 2004). EDL's total deficit during 2005 amounted to LL 1,212 billion (excluding delayed payments to suppliers and other counterparties), of which LL 974 billion was covered from treasury accounts and the balance funded through loan agreements with Algeria and Kuwait.

In 2005 the total budget balance registered a deficit of LL 2,798 billion, as compared to a deficit of LL 3,026 billion in 2004, representing an improvement of 7.5 per cent. The primary balance registered a surplus of LL 737 billion, as compared to a surplus of LL 995 billion in 2004, representing a decrease of 26 per cent.

## **TAX SYSTEM AND TAX REFORM**

The tax system in the Republic has been subject to sweeping reforms. During the period of conflict, the record of revenue collection was extremely poor, with widespread tax evasion and weak administration. An Income Tax Law was promulgated on December 30, 1993 (Law No. 282 published in the Official Gazette No. 1 dated January 6, 1994) and became effective as of the beginning of fiscal year 1994. This law amended the old income tax law and introduced new provisions aimed at reducing tax rates, improving tax implementation and receipts and stimulating private investment. This law was modified in certain respects in the 1999 Budget, which increased income tax rates and dividend tax rates. Currently, the maximum income tax rate for individuals is 21 per cent. (excluding certain categories of professionals) and for corporations is 15 per cent (other than holding companies and off-shore companies incorporated in the Republic, which are not subject to income tax). The 2000 Budget reduced tax on dividends to 5 per cent. (from 10 per cent.) for companies listed on the Beirut Stock Exchange. Capital gains on disposal of shares for individuals and for marketable securities are currently generally exempt from tax.

In December 2001, Parliament adopted the VAT law, which became effective on February 1, 2002. VAT is levied at a single rate of 10 per cent. on all goods and services, subject to certain exemptions, such as medical and educational services. In addition to its direct impact on revenues, implementation of the VAT is expected to result in enhanced tax collection.

In January 2003, Parliament adopted the 2003 Budget Law, pursuant to which, among other things, interest paid in respect of bonds issued by the Lebanese Republic after January 31, 2003 is subject to withholding tax at the rate of five per cent. No assurances can be given that this rate will not change in the future. See "Taxation - Lebanese Taxation".

## **SOCIAL POLICIES**

The process of reconstruction does not neglect the social repercussions and problems resulting from the conflict. One of the basic social crises which the Government had to face is related to forced internal migration and displacement. A Ministry for Displaced Persons was created and started sponsoring the return of displaced families to their homes. The Ministry and the Fund for Displaced Persons have been contributing to the costs of rebuilding or refurbishing damaged houses.

The Government funded the construction of two regional public hospitals in the northern part of the Republic, one in the south and a major public hospital in the southern suburbs of Beirut. In addition, the uncompleted works at Baabdah Hospital will be resumed and this hospital will be put at the Lebanese University's disposal. All of these health facilities will offer free treatment. The Government has also accomplished major steps in the health sector. Low-income persons are now able to undergo open heart surgical operations and dialysis at the Government's expense. Cancer treatment is free for needy persons. The private sector and religious authorities have also established complimentary non-profit centers for disabled persons, the elderly, orphans and specialized centers for fatal diseases such as thalassemia. The Government has activated the National Social Security Fund, which provides

private-sector employees with end-of-service indemnity, family allowances and medical insurance and aims at implementing the already existing legal provisions to the pension plan for the elderly.