



Lebanon – Country Profile 2007¹

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 National Survey of Household Living Conditions 2004" survey dated July 7, 2005 (the "Multipurpose 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 3,755,034, 93.40 per cent. of whom were Lebanese. This figure does not include temporary residents such as migrant workers and those residing in the Palestinian camps.

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

	Total <i>(per cent.)</i>
Under 20	37.2
20-59	51.9
60 and over	10.8

Source: 2004-2005 Multipurpose Survey (CAS, Ministry of Social Affairs and UNDP).

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.

¹ As published in the Base Prospectus dated April 4th, 2007.

The main cities are Beirut, the capital, Tripoli, Sidon, Jounieh, Zahle and Tyre. The Multipurpose Survey shows that approximately 50.4 per cent. of the population lives in Lebanon's middle regions consisting of Beirut and Mount Lebanon.

TABLE OF SELECTED LEBANESE ECONOMIC INDICATORS⁽¹⁾

Set forth below is a summary of certain information contained elsewhere in this Country Profile. 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 Country Profile.

	2002	2003	2004	2005	2006
The Economy					
GDP ⁽²⁾ (at current market prices in billions of					
Lebanese Pounds).....	28,209	29,846	32,214	32,303	34,111
GDP ⁽³⁾ (at current market prices in millions of					
U.S. Dollars).....	18,712	19,798	21,369	21,428	22,628
Real Growth Rate (per cent.) ⁽⁴⁾	3.3	4.1	7.0	1.0	0.0
Balance of Payments					
(in millions of U.S. Dollars)					
Current account.....	(4,353)	(5,014)	(4,117)	(2,045)	N/A
Capital and Financial account.....	2,826	11,729	7,291	7,042	N/A
Net Change in Foreign Assets ⁽⁵⁾	1,564	3,386 ⁽⁵⁾	169	747	2,794.5
Reserves					
(in millions of U.S. Dollars)					
Gross Foreign currency reserves.....	5,070	10,197	9,494	9,845	10,207
Gold ⁽⁶⁾	3,216	3,834	4,006	4,736	5,807
Gold (Thousands of Troy Ounces).....	9,222	9,222	9,222	9,222	9,222
Public Finance					
(in billions of Lebanese Pounds)					
Government Revenues.....	5,830	6,654	7,514	7,405	7,295
Government Expenditures ⁽⁷⁾	10,139	10,592	10,540	10,203	11,877
Government Overall Deficit.....	(4,308)	(3,938)	(3,026)	(2,798)	(4,582)
Primary Deficit/Surplus ⁽⁸⁾	314	936	995	736	(25)
Public Debt					
Net Domestic Public Debt					
(in billions of Lebanese Pounds).....	22,338	23,824	22,011	23,551	25,880
Public External Debt					
(in millions of U.S. Dollars) ⁽⁹⁾	14,576	15,550	18,368	19,133	20,349
Gross Public Debt as a % of GDP.....	168	168	168	180	178

Notes:

- (1) Certain figures differ from previously published data.
- (2) The GDP figures included in this table are based on the following: 1993-1996 GDPs are based on IMF estimates; the 1997-2003 figures are from the national accounts data published by the National Accounts Committee; and the 2004-2006 GDP figures are based on BDL estimates.
- (3) Translated at period average exchange rates.
- (4) The real growth figure for 2006 is an estimate. Preliminary estimates showed a real growth rate of negative 5.0 per cent. for 2006 which was subsequently revised upward to 0 per cent.
- (5) Please note that the basis for calculation of BOP figures have changed according to the IMF BPM5 manual (see "Risk Factors - Accuracy of Financial and Statistical Information"). Therefore, figures may differ from previously published data. 2006 figures are not available as of the date of this Country Profile. Figures for first quarter 2006 are included in "External Sector - Balance of Payments and Foreign Trade" section of this Country Profile.
- (5) Includes proceeds from loans and bonds issued in connection with the Paris II Conference and deposits from Saudi Arabia and Kuwait following the July 2006 War.
- (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 Government").
- (8) Surplus or deficit, excluding domestic and external debt service.
- (9) Calculated at end of period exchange rates, commencing in 2002.

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 and reconstruction 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, one of the largest demonstrations 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.

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 has 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 30, 2005, the 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 then 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 formed pursuant to Security Council Resolution 1595 to assist the Lebanese authorities in their investigation of all aspects of Mr. Hariri's assassination, which was then headed by Mr. Detlev Mehlis, 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".

On October 31, 2005, the Security Council adopted Resolution 1636, which, among other matters, requires Member 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, the Republic witnessed a series of bombings, assassinations and attempted assassinations of politicians, journalists and public figures, including the assassinations, on December 12, 2005, of Mr. Gebrane Tuani, a member of Parliament and newspaper editor and on November 21, 2006, of Mr. Pierre Gemayel, the Minister of Industry, a member of Parliament and the son of Amine Gemayel, the former President of the Republic. Messrs. Tuani and Gemayel were public critics of Syria's actions in Lebanon.

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 General Secretary of the United Nations appointed Mr. Serge Brammertz as the head of the international independent investigation Commission, replacing Mr. Detlev Mehlis. To date, the Commission has issued seven reports, two while headed by Mr. Mehlis and five while headed by Mr. Brammertz. Mr. Brammertz's reports have contained less disclosure regarding the progress of the investigation on the grounds that Mr. Brammertz does not wish to jeopardize any future prosecutions before the Special Tribunal. Mr. Brammertz stated that the Commission is receiving support from Syria in providing information and facilitating interviews with individuals located on Syrian territory.

On June 15, 2006, the Security Council adopted Resolution 1686 which supports the Commission's intention to extend technical assistance to the Lebanese authorities with regard to their investigations into terrorist attacks (other than Mr. Hariri's assassination) perpetrated in Lebanon since October 1, 2004 and extends the Commission's mandate until June 15, 2007.

On July 13, 2006, Israel commenced war on Lebanon, following the kidnapping by Hizbollah of two Israeli soldiers. Attacks were launched against Lebanon and its population by land, sea and air resulting in loss of human life, large scale displacement and significant damage to private and public infrastructure. Israel invaded a portion of territory in southern Lebanon. A cessation of hostilities was reached on August 14, 2006. However the air and sea blockade on Lebanon lasted for a month after the cessation of hostilities. It is estimated that, as a result of the war, Lebanon suffered 1,200 deaths, of whom one-third were children, and approximately 4,400 injuries. Approximately one-quarter of Lebanon's population was displaced during the war and 100,000 housing units were destroyed or damaged. Additional deaths and injuries have resulted, and continue to be caused, by unexploded ordinances as a consequence of the estimated 1.2 million cluster bombs that were fired into Lebanon during the final days of hostilities. The economic impact of the conflict is substantial and is likely to span over the short and medium term. The impact of the war on public finances resulted in a worsening in the fiscal dynamics and the emergence of a primary deficit for the first time in six years. The Ministry of Finance estimates that the war resulted in a net decline of LL 1,270 billion in the primary balance for 2006.

On August 7, 2006, the Government adopted a unanimous decision to deploy 15,000 troops from the Lebanese army in southern Lebanon as the Israeli army withdrew. The deployment has taken place and represents the first presence of the Lebanese army south of the Litani River in more than 30 years.

On August 11, 2006, the Security Council adopted Resolution 1701 which instituted cessation of hostilities based on full respect of the Blue Line by Israel and Lebanon, the establishment between the Blue Line and the Litani River of an area free of any armed personnel and weapons other than those of the Government of Lebanon and of UNIFIL (United Nations International Force in Lebanon), full implementation of the relevant provisions of the Taif Accords and of Resolutions 1559 and 1680 requiring the disarmament of all armed groups in Lebanon, and increased the number of UNIFIL troops to a maximum of 15,000.

On November 11, 2006, five ministers representing Hizbollah and the Amal party, comprising all of the ministers from the Shiite community, resigned from the Government. This was followed a few days later by the resignation of a minister from the Orthodox Christian community who is an ally of the President. The initial reason given for the resignations was the lack of sufficient prior notice given to the ministers to analyze and debate the proposed legal framework and statute for the Special Tribunal to be established to try those responsible for the terrorist bombing that killed former Prime Minister Hariri. The dispute between opposition parties, led by Hizbollah and including General Michel Aoun and his allies, and the majority escalated. Opposition parties requested an expansion of the Cabinet so that the opposition would be represented by a minimum of one-third of all the ministers and, more recently, the holding of early Parliamentary elections on the basis of a new electoral law. The President has publicly stated that, following the resignation of all the ministers representing the Shiite community, the Government is no longer constitutional and has been refusing to countersign any decrees relating to resolutions adopted by the Government. The Government does not accept this position on the basis, among other grounds, that the Constitution does not authorize the President to pass upon the constitutionality of laws and governmental actions, that the resignation was a voluntary, unilateral act and that Parliament has not withdrawn its vote of confidence in favor of the Government. The Prime Minister did not accept the resignation of the ministers. The Government has continued to meet and adopt resolutions despite the absence of the resigning ministers and has invited those ministers to resume their functions. The Government continues to be recognized by all countries with which Lebanon maintains diplomatic relations as the constitutional Government of the Republic.

As part of its efforts to achieve its objectives, on December 1, 2006, the opposition commenced a sit-in in the Beirut Central District, which is continuing, as well as a number of large demonstrations and a general strike, which the opposition sought to enforce by blocking public roads. This has generated sporadic clashes between opposition and majority forces, resulting in a limited number of deaths and injuries and an increase in sectarian tension, especially among the Shiite and Sunni communities. However, this escalation which peaked in late January 2007 has largely subsided since then.

On March 27, 2007, the Security Council adopted Resolution 1748 which extended the Commission's mandate until June 15, 2008.

Domestic and international efforts to resolve the crisis are taking place, the most prominent of which are mediations conducted by the Secretary General of the Arab League and the Saudi Ambassador to Lebanon.

The full text of the Security Council Resolutions and the reports of the International Independent Investigation Commission are publicly available from the United Nations website (<http://www.un.org>).

Description of the 1975-1990 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 Multinational 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 one of 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.

Relations between Lebanon and Syria are currently tense, with the Government accusing Syria of continuing to meddle in Lebanon's internal affairs and Syria's leaders publicly supporting the opposition's efforts to topple the Government. The Government's position is that it welcomes friendly relations with Syria on the basis of mutual respect for the independence and sovereignty of each country, the establishment of diplomatic relations between the two countries and the exchange of ambassadors and formal agreement regarding boundaries.

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 is 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. 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.

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.

As discussed earlier in this Country Profile, in July 2006, Israel waged war on Lebanon following the kidnapping by Hizbollah of two Israeli soldiers from inside Israeli territory. The war resulted in significant casualties and damage to Lebanon and only ceased following adoption by the Security Council of Resolution 1701.

The 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 was reinforced in terms of forces and arms following adoption of Resolution 1701. The number of UNIFIL personnel is currently approximately 12,500.

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 Constitutional Council is currently inoperative. 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 and the Progressive Socialist Party, and the Free Patriotic Movement (headed by General Michel Aoun), respectively. Elections in Mount Lebanon resulted in success for the alliance among 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 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.

<u>Political Party</u>	<u>Number of seats</u>
Future Movement, Progressive Socialist Party, Lebanese Forces and members of the Qornet Shahwan Gathering, collectively known as the March 14 Coalition	71
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.

As stated above, following the resignation of all the ministers representing the Shiite community, the President considers that the Government is no longer constitutional and has been refusing to countersign any decrees relating to resolutions adopted by the Government. The Government has rejected this position on the basis, among other grounds, that the Constitution does not authorize the President to pass upon the constitutionality of laws and governmental actions and that the resignation was a voluntary, unilateral act and that Parliament has not withdrawn its vote of confidence in favor of the Government. The Government has continued to meet and adopt resolutions despite the absence of the resigning ministers and has invited those ministers to resume their functions. The Government continues to be recognized by all countries with which Lebanon maintains diplomatic relations as the constitutional Government of the Republic.

The opposition is calling for early Parliamentary elections. This has been rejected by the majority in Parliament.

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 in 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 March 14 Coalition. 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.

See "*History–Overview*" for a discussion of more recent political developments.

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 the Central Bank 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, a law regulating the issuance of notes and other debt securities by banks and securitization and fund management laws. The Government has also submitted a series of draft laws to Parliament, including drafts of a capital market reform law providing for the establishment of an independent regulator, a Treasury single account law, a tax procedure code and a debt management office law.

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 cooperation in various areas. These treaties include the Treaty of Fraternity, Cooperation and Coordination, which was entered into on May 22, 1991 and ratified by Parliament on May 29, 1991. This treaty provides for coordination between the two countries in economic, social, foreign and military affairs and establishes a number of high level joint commissions to implement such coordination. Relations between Lebanon and Syria are currently tense, with the Government accusing Syria of continuing to meddle in Lebanon's internal affairs and Syria's leaders publicly

supporting the opposition's efforts to topple the Government. The Government's position is that it welcomes friendly relations with Syria on the basis of mutual respect for the independence and sovereignty of each country, the establishment of diplomatic relations between the two countries, including through the exchange of ambassadors and formal agreement regarding boundaries.

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 Great Arab Free Trade Agreement governs the Republic's trade relations with most of the Arab countries members of the Arab League, pursuant to which, commencing in 1998, tariffs on all agricultural and industrial goods between 17 Arab countries were progressively reduced and subsequently eliminated by January 2005. This Agreement excludes a list of goods that are forbidden to enter some Arab countries for environmental, religious, and sanitary reasons.

Since 1992, the Republic has ratified 47 treaties for the promotion and protection of investments. The Republic has ratified such treaties with each of Armenia, Austria, Azerbaijan, Bahrain, Belarus, Belgium, Luxembourg, Bulgaria, Canada, Chile, China, Croatia, Cuba, Cyprus, Czech Republic, Egypt, Finland, France, Gabon, Germany, Greece, Guinea, Hungary, Iceland, Iran, Italy, Jordan, South Korea, Kuwait, Malaysia, Mauritania, Morocco, the Netherlands, the OPEC Fund, Pakistan, Romania, Russia, Slovakia, Spain, Sudan, Sweden, Switzerland, Syria, Tunisia, Turkey, Ukraine, Uruguay, the United Arab Emirates, the United Kingdom and Yemen. The Republic has also signed such a treaty with the Sultanate of Oman. The Republic has also ratified or signed treaties for the avoidance of double taxation with 33 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. An Interim Agreement on trade and trade-related provisions entered into effect in March 2003. As a result, since that date, Lebanese industrial and most agricultural products (within the limits of tariff quotas) enjoy free access to the EU market, while the progressive elimination of tariffs on EU imports into Lebanon is to occur between 2008 and 2014. The ratification of the EU-Lebanon Association Agreement by the EU Member States was completed in April 2006 and accordingly it has replaced the Interim Agreement. The EU is one of the Republic's major trading partners. The Association Agreement establishes, among other areas of cooperation, the necessary conditions for progressive and reciprocal liberalization of trade in goods with a view to establishing a bilateral free trade area, and includes relevant provisions on customs cooperation, competition, protection of intellectual, industrial and commercial property, and services. Negotiations on the liberalization of agricultural and fishery products will start in due course in the context of the Rabat roadmap and the Euromed work program, thus leading to the establishment of the free trade area in 2010. Under the Neighbourhood Policy Action Plan, adopted in January 2007, a number of specific trade and trade-related actions have been agreed upon between the Republic and the EU with the objective of further liberalization and development of sectoral policies with the aim to upgrade Lebanese standards and facilitate the implementation of the EU Association Agreement.

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. In 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. To date, four Working Party meetings have taken place in Geneva in which the Working Party examined the Republic's replies to the issues raised by WTO Members.

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 entered into force on January 1, 2007. 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 the 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, the Central Bank 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 21.46 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 per cent. and 23.6 per cent., respectively, of GDP and debt service represented approximately 74.4 per cent. and 89.6 per cent., respectively, of total revenues. Net Public Debt (consisting of Net Domestic Debt and Public External Debt) represented approximately 116 per cent. of GDP as at December 31, 1999 and 141 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 the Central Bank 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 7.2 percentage points of GDP. to 16.4 per cent. of GDP and, in 2002, a real growth rate of 2.6 per cent., a 1.8 per cent. inflation rate and a decline in the fiscal deficit by 1.2 percentage point of GDP. to 15.3 per cent. of GDP. In 2001, debt service represented 92.8 per cent. of total revenues and Net Public Debt rose to 158 per cent. of GDP and, in 2002, debt service represented 79.3 per cent. of total revenues and Net Public Debt was at 157 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, the Central Bank 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 the Central Bank. The Central Bank 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, the Central Bank 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 was able to re-profile 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 the Central Bank, 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. Interest payments declined sharply from approximately 16% of GDP in 2002 to approximately 11% in 2005. In 2004, real growth reached more than 7%, the overall deficit declined to less than 10% of GDP (as compared to 24% in 2000) and the primary surplus improved to 3% of GDP.

Eurobond issuances of market debt ceased from the Paris II Conference until May 2004 (see "*Public Finance – The Budget Deficit*"). Additionally, the average cost of public debt (in Lebanese Pound and foreign currency) was 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. The Central Bank 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 70.01 per cent. in December 2004. See "*External Sector -- Foreign Borrowings and Grants*".

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 the Central Bank 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 a significant portion of the economic and fiscal reforms described above, which were included in the fiscal reform program submitted by the Government during the Paris II Conference, such as privatization and securitization, did not take place because of differences in views between political leaders.

Strong economic performance in 2004 was cut short by political tensions that began in late 2004 with the extension of the Presidential mandate and the assassination of Prime Minister Hariri. The period following the assassination of Mr. 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 the Central Bank on the foreign exchange markets.

Despite the serious political and economic difficulties that followed the assassination of Prime Minister Hariri, the Siniora Government exerted significant efforts to redress the fiscal situation and rejuvenate the economy. The growth rate for 2006 was expected to reach 5-6%, exports were expected to increase by more than 30% and the Republic was expecting a record tourist season. The balance of payments recorded a surplus of U.S. \$2.6 billion as at June 30, 2006, as compared to a deficit of U.S. \$1.5 billion for the corresponding period in 2005. The primary surplus more than quadrupled during the first half of 2006, as compared to the first half of 2005.

The total direct cost of the July 2006 War to the Government of early recovery, reconstruction of public infrastructure and housing compensations to be covered by the budget is currently estimated at approximately U.S. \$1.84 billion.

The international community reacted quickly and generously to support Lebanon during the July 2006 War and after the cessation of hostilities. Immediately after the outbreak of the war, Saudi Arabia and Kuwait provided commitments of U.S. \$500 million and U.S. \$300 million respectively as grants for reconstruction. In addition, Saudi Arabia and Kuwait deposited U.S. \$1 billion and U.S. \$500 million respectively with BDL to help maintain confidence and monetary stability.

On August 31, 2006, the Swedish government hosted a Conference for Lebanon's Early Recovery in Stockholm. At that Conference, Lebanon received indications of support amounting to approximately U.S. \$900 million for humanitarian assistance needs and early recovery efforts, in the form of financial assistance, in kind contributions to specific reconstruction activities and others. This financial support provided the conditions for the return of the quarter of the population that was displaced, and restoring minimum capacity in terms of infrastructure, access to basic social services and income generating activities, pending full reconstruction. The Ministry of Finance estimate that a total amount of U.S. \$613 million has been committed, of which U.S. \$289 million was disbursed.

In addition to the Kingdom of Saudi Arabia, Kuwait and countries that contributed during the Stockholm Conference, many countries pledged their support to Lebanon. In total and since the beginning of the July 2006 War (but excluding commitments and disbursements as a result of the Paris III Conference), a total of U.S. \$2.1 billion has been pledged in grants (in addition to in-kind relief contributions that were sent during the war), of which U.S. \$1.6 billion has been formally committed.

Following the July 2006 War, the Government had to readjust its reform program. As amended, the reform program, as adopted by the Council of Ministers and presented at the Paris III Conference, consists of the following:

- growth-enhancing reforms encompassing a number of measures and laws aimed at increasing productivity and reducing costs, which would enhance the competitiveness of the Lebanese economy; these comprise:
 - governance and administrative reforms to develop a transparent, accountable and effective administration, including the reduction in the size and cost of the public administration (principally through attrition), modernizing legislation relating to public procurement and accounting and simplifying administrative procedures;
 - financial sector reforms and improvement of debt management, through the preparation and submission to Parliament of draft laws relating to capital markets, insider trading and securities lending, aiming to develop capital markets in the Republic, as well as a draft law establishing a modern debt office at the Ministry of Finance; and
 - improving the business environment to enhance the competitiveness of the Lebanese economy and reducing the cost of doing business in Lebanon through a range of business laws and regulations.
- a social sector reform program to improve social indicators and strengthen social safety nets to protect the most vulnerable segments of the population. Specifically, this program aims at containing social spending and improving social indicators through a series of reform measures at the social ministries level, and at developing and strengthening social safety net programs for the poor and vulnerable groups through targeting mechanisms and benefit criteria. The program further seeks pension reform, as the current defined benefit schemes impose a heavy burden on the budget and have an implicit debt of close to 60% of GDP; the Government is working on the draft law which integrate the three existing systems and convert them into one fully-funded defined contribution plan by 2008;
- a fiscal adjustment plan that aims at increasing the primary surplus through streamlining expenditures – including by reducing waste (including legalized waste) and reforming state owned enterprises ("SOEs"), including principally EDL – and raising revenues in ways that minimize the negative impact on the poor;
- a privatization program directed primarily at increasing investment, reducing the stock of public debt, and spurring economic growth;
- a prudent monetary and exchange rate policy aimed at maintaining price stability (and with it social stability), facilitating credit to the private sector, and maintaining a sound banking system; and

- international financial assistance to help Lebanon finance the direct and indirect cost of the July 2006 War as well as to complement the domestic adjustment efforts, primarily by reducing interest payments on public debt and creating the kind of confidence that would encourage private sector investment and ease the pain of a domestic adjustment after the war.

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. In 2005, despite the then difficult political situation, the balance of payments registered a surplus of U.S. \$747.25 million. As at the end of July 2005 (for the first seven months of 2005), the balance of payments recorded a deficit of U.S. \$748.45 million as compared to a surplus of U.S. \$577.6 million for the same period in 2004. The deficit in the balance of payments was mainly due to a moderate increase in the trade deficit as well as a net decrease in the capital account balance, particularly in February and April, during which significant deficits were recorded. Despite the July 2006 War and the political tensions that followed during the remainder of 2006, the balance of payments registered a surplus of US\$ 2,794.5 million by the end of December 2006 mainly as a result of the Kingdom of Saudi Arabia and the Kuwait deposits at BDL totaling U.S. \$ 1.5 billion as well as other inflows following the war.

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 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 ("*HCP*") 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. The Central Bank also owns significant commercial assets, including substantially all of the shares of the national air carrier, Middle East Airlines.

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 Government believes that the privatization component of its reform program is key to the objective of promoting growth and of reducing debt and the fiscal deficit. It would also contribute to the deepening and expansion of the Republic's capital markets, improving the reliability, quality and costs of public services, reducing operating costs through increased efficiency of operations, expanding the range of products and

services offered to customers and introducing competition, which will improve the competitiveness of the economy.

The Government has reactivated the HCP and appointed a General Secretary through a transparent and public selection process.

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 ("*TRA*") whose functions include tariff monitoring and encouraging competition and transparency.

The members of the TRA have been appointed by the Government and it is expected that the TRA will be operational by June 2007.

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 will 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. 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 an agreed indemnity.

The HCP, in coordination with the Ministry of Telecommunications ("*MOT*"), has been preparing for the sale of the two mobile businesses currently operated on behalf of the MOT pursuant to the management contracts. It is expected that each of the businesses will be offered for sale with a long-term licence.

In addition, the corporatization of Liban Telecom is in progress.

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 Government has developed an initial plan for the reform of the energy sector. The Government has entered into long-term fuel supply agreements with the Kuwait Petroleum Corporation and Algeria's Sonatrach, which have generated some savings. A steering committee consisting of representatives of the Office of the Prime Minister, the Ministry of Finance, the Higher Council for Privatization ("*HCP*"), the Council for Development and Reconstruction ("*CDR*") and EDL has been formed to finalize and implement the plan.

The energy sector reform program includes the following:

- appointing qualified advisors to the Ministry of Energy and Water, EDL and the HCP;
- completing the audit of EDL's financial statements for 2001 through 2006;
- appointing a new Board of Directors for EDL;
- working on corporatizing EDL;
- unbundling the generation, transmission and distribution functions of EDL;
- establishing an Electricity Regulatory Authority;
- completing the establishment of a National Control Centre to audit volumes and performance;
- licensing private companies to install and operate remote meters;
- reducing illegal network connections and enforcing bill collection with the support of security forces;
- securing the supply of natural gas or liquefied natural gas to the Zahrani and Deir Ammar plants;
- building a gas pipeline between the Zahrani and Baddawi plants; and
- encouraging the establishment of independent power producers.

Water sector

A reform of the water sector was commenced by the last Hariri Government. Law 221 was enacted; it provides for the consolidation of the twenty-one water authorities which were merged into three water and wastewater public establishments responsible for water supply, wastewater and irrigation management. In addition, a draft sector law was in progress and work on the privatization of the sector had commenced. A plan for sector modernization and private sector participation is being formulated.

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 the Central Bank, 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. In May 2006, the Presidency of the Council of Ministers, National Accounts Committee released revised GDP figures for 2002 and 2003.

The following table shows GDP figures for the years 1999-2003⁽¹⁾:

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
GDP (at market prices), billions of LL	25,647	25,143	25,726	28,209	29,846
Exchange rate, LL per U.S. \$ (period average).....	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5
GDP (at market prices), millions of U.S. Dollars.....	17,003	17,013	16,679	18,712	19,798
Growth of Real GDP	-0.8%	0.9%	4.4%	2.6%	4.1%
Growth of Nominal GDP.....	0.0%	-2.0%	2.3%	8.2%	5.8%
GDP Deflator.....	0.8%	-2.8%	-2.0%	5.4%	1.6%

Source: Ministry of Economy and Trade, National Accounts Committee, Economic Accounts: 1999-2002 and Economic Accounts 2003.

Notes:

(1) The newly published GDP figures for 2002 are higher than the previously published estimate of GDP for that year.

The following table shows GDP figures by sector for the years 1999-2003:

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Agriculture and livestock.....	1,584	1,614	1,546	1,627	1,640
Energy and water supply.....	372	221	297	267	187
Industry.....	3,249	3,027	3,159	3,254	3,510
Construction.....	2,239	2,000	2,099	2,136	2,201
Transport and communication	1,551	1,643	1,715	1,973	2,096
Services.....	8,306	8,491	8,559	9,408	9,979
Trade.....	5,233	5,003	5,070	6,092	6,699
Public Administration.....	3,113	3,143	3,281	3,452	3,535
Total GDP (at market prices), billions of LL	25,647	25,143	25,726	28,209	29,846

Source: Ministry of Economy and Trade, National Accounts Committee, Economic Accounts: 1999-2002 and Economic Accounts 2003.

The GDP figures, the ratios which include GDP figures and the statements regarding GDP evolution presented in this Country Profile differ from previously published data due to the update made on the basis of the new official GDP time series released by the Ministry of Economy and Trade, National Accounts Committee.

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, (0.8) per cent. in 1999 and 0.9 per cent. in 2000. Real GDP growth was 4.0 per cent. in 2001, 2.6 per cent. in 2002, and 4.1 per cent. in 2003.

The following table shows GDP estimates⁽¹⁾ for the years 2004-2005:

	<u>2004</u>	<u>2005</u>
GDP (at market prices), billions of LL	32,214	32,303
Exchange rate, LL per U.S. \$ (period average).....	1,507.5	1,507.5
GDP (at market prices), millions of U.S. Dollars ...	21,369	21,428
Growth of Real GDP	7.0%	1.0%
Growth of Nominal GDP.....	7.9%	0.3%
Estimated GDP deflator.....	0.9%	-0.7%

Source: Ministry of Finance, BDL 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. The Government extended the duration of the project to include national account database for the years 2003 and 2004 headed by the Presidency of the Council of Ministers. 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. Since then, the National Account Committee has published GDP figures for the period 1998-2003 and is in the process of publishing GDP figures for 2004.

The following table shows the composition and the evolution of the Republic's GDP for the years 1997 and 2003, as published by the National Account committee

Composition of 1997 GDP by Sector <i>(per cent.)</i>	1997	2003
Agriculture and livestock	6.3	5.5
Energy and water supply	1.5	0.6
Industry	13.5	11.8
Construction.....	9.4	7.4
Transport and communications	5.3	7.0
Services.....	31.1	33.4
Trade.....	21.3	22.4
Non-market services	11.6	11.8
Total	100.0	100.0

Source: Ministry of Economy and Trade.

Principal Sectors of the Economy

At the end of the 1975/1990 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 recovered in 2001 and 2002. Growth continued in 2003 and 2004 with real GDP growth rates of 4.1 per cent. and 7.0 per cent. respectively. In 2005, growth witnessed a slowdown following the aftermath of Prime Minister Hariri's assassination, with real GDP growth estimated at 1 per cent. The first half of 2006 was characterized by a strong revival of the Lebanese economy with real GDP growth estimated at approximately 5 to 6 per cent. However, the impact of the July 2006 War on the economy, as well as the political tensions that started after the war, are likely to bring the end year growth rate to approximately 0 per cent. The real growth figure for 2006 is an estimate. Preliminary estimates showed a real growth rate of negative 5.0 per cent. for 2006 which was subsequently revised upward to 0 per cent.

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

Selected Indicators of Economic Activity

	2001	2002	2003	2004	2005
Industry					
Recorded Exports (million of U.S. Dollars)	889	1,045	1,524	1,747	1,880
Electricity Production (million kwh)	9,437	10,193	10,547	10,491	10,581
Cement Deliveries ('000 tons).....	2,715	2,601	2,704	2,729	3,040
Construction					
Construction Permits ⁽¹⁾	10,249	11,704	11,384	11,258	11,709
Area ('000 sq. meters)	6,854	7,896	8,807	9,166	8,710
Commerce					
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	3,200	3,177
Documentary Credits for Imports (million of U.S. Dollars)					
	2,592	2,728	3,273	3,852	3,637

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.

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.

The port of Beirut has completed the construction of a new container terminal, equipped with advanced container handling equipment and operating systems software. The management of this container terminal has been subcontracted through an international bid to a consortium formed by private international companies. The container terminal started its operations in the beginning of 2005. The terminal succeeded in attracting international carriers wishing to use the terminal as their main trans-shipment hub for the East Mediterranean region.

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

Trade Activity at Beirut Port

	2001	2002	2003	2004	2005
No. of ships	2,647	2,526	2,333	2,366	2,229
Incoming freight ⁽¹⁾	5,134	4,713	4,294	4,334	3,722
Outgoing freight ⁽¹⁾	329	383	472	727	753
Freight in transit ⁽¹⁾	163	173	227	433	330

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, with a total of 1,139,524 incoming tourists in 2005. The first part of 2006 registered strong growth in tourism activities; however, the July 2006 War and subsequent political tensions led to a slight decrease in tourism for the year, with a total of 1,062,635 tourists in 2006.

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. \$63.5 billion at the end of December 2006. In addition, since 1996, Lebanese banks have been successfully accessing the international capital markets. Since 1996, Lebanese banks have raised approximately U.S. \$3.0 billion on the international debt markets and over U.S. \$600 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, a more diversified financial sector. New laws relating to collective investment schemes, asset securitization, and Islamic banking were enacted in 2004 and 2005. 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 re-establishing Beirut as a regional financial services center, the Central Bank 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.

Industry

In 2001, the industrial sector (mainly production of cement, furniture, paper products, printing and packaging, detergents, fertilizers, cosmetics, pharmaceuticals, jewellery, 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.

The EIB has also agreed to extend a Euro 60 million loan to 10 Lebanese banks.

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 (35 MW installed capacity in each), 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.

For the past several years, the Ministry of Finance has made large contributions to EDL to fund significant continuing losses, with transfers in 2006 amounting to LBP 1,370 billion.

As discussed elsewhere in this Country Profile, the Government has prepared a comprehensive energy reform plan.

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, 1.7 per cent. in 2004 and 0.7 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 the Central Bank 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 3,292 contracts with a total value of approximately U.S. \$7.94 billion were awarded by the CDR for the period since reconstruction efforts started in 1992 to the end of 2005.

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 program 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: electricity is available on a 24-hour basis to most users; 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 2008.

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, Saide and Sour).

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 800,000 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 and the Government resulted two arbitration awards in favor of the former operators in the amount of approximately U.S. \$270 million each. The disputes between the former operators and the Republic have been settled.

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. Contracts relating to the purchase of handling equipment for this project were awarded in 2002 for an amount of U.S. \$30 million.

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.

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 Depository 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 the 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 education 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.

The Multipurpose Survey estimated the official unemployment rate at 8.0 per cent.. The actual unemployment rate is likely to be higher and to have been exacerbated by the July 2006 War.

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 for the 2005-2006 academic year:

Age	Male		Female		Total	
	(number)	(per cent.)	(number)	(per cent.)	(number)	(per cent.)
< 5 years	49,989	11%	47,622	10%	97,611	11%
5 – 9 years	132,487	29%	126,611	28%	259,098	28%
10 - 14 years	173,350	38%	169,631	37%	342,981	38%
15 - 19 years	94,977	21%	107,106	23%	202,083	22%
20 years and above	3,665	1%	5,876	1%	9,541	1%
	454,467	100%	456,847	100%	911,314	100%

Source: The Ministry of Education and Higher Education, Center for Educational Research and Development, Statistical bulletin 2005-2007

Based on information in the 2004 Multipurpose 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 education structure, and well-trained technicians and engineers. Prior to the conflict, Beirut served as an education center for the region. However, a substantial part of this human capital was lost during the conflict, and the education system and infrastructure suffered damage and lack of investment. In spite of the turmoil, however, the education system has survived and still retains high standards.

The following table gives a summary of the school system during the academic years 2005-2006:

School System

	2005-2006
Total number of schools	2,788
Public schools (as a percentage of total).....	50.2%
Private commercial schools (as a percentage of total).....	36.7%
Private non-commercial schools (as a percentage of total).....	13.1%
Total number of students in schools	911,314

Source: The Ministry of Education and Higher Education, Center for Educational Research and Development, Statistical bulletin 2005-2007

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.

Lebanon's universities had a total of 146,961 students during the academic year 2005-2006. Approximately 10.8 per cent. of university students are foreigners 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 (70,627 enrolments in 2005-2006), Université Saint Joseph (USJ) (founded and run by French Jesuits) (9,718 enrolments in 2005-2006), the Arab University (sponsored by the Egyptian University of Alexandria) 13,653 enrolments in 2005-2006), the American University of Beirut (AUB) (6,944 enrolments in 2005-2006), the Lebanese American University (4,569 enrolments in 2005-2006), Notre Dame University (4,677 enrolments in 2005-2006), Université Saint Esprit de Kaslik (5,949 enrolments in 2005-2006), the Balamand University (Hybrid System) (2,813 enrolments in 2005-2006) and Haigazian University (700 enrolments in 2005-2006). Each of the Lebanese University, the USJ, The Beirut Arab University, Balamand 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, the Central Bank of Lebanon 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.

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 characterized by large trade deficits; however, these deficits are mostly offset by capital account inflows as well as by inflows from remittances, income earnings, tourism and other services. The trade balance recorded deficits of approximately U.S. \$5,919 million in 2001, U.S. \$4,721 million in 2002, U.S. \$5,089 in 2003, U.S. \$6,507 in 2004 and U.S. \$6,043 in 2005. Even during the conflicts, there was generally a surplus in the balance of payments. It showed minor deficits in 1979, 1983, 1984 and 1986, but larger deficits occurred in 1989 and 1990. All other years in the period 1975-1997 showed a surplus 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. In 2005, despite the difficult political situation, the balance of payments registered a surplus of U.S. \$747.25 million. As at the end of July 2005 (for the first seven months of 2005), the balance of payments recorded a deficit of U.S. \$748.45 million as compared to a surplus of U.S. \$577.6 million for the same period in 2004. The deficit in the balance of payments was mainly due to a moderate increase in the trade deficit as well as a net decrease in the capital account balance, particularly in February and April, during which significant deficits were recorded. The year ended with a U.S. \$598.10 million surplus in December 2005. Despite the July 2006 War and the political tensions that followed during the year 2006, the balance of payments registered a surplus of US\$ 2,794.5 million by the end of December 2006 mainly as a result of the Kingdom of Saudi Arabia and the Kuwait deposits at BDL totaling U.S. \$ 1.5 billion as well as other inflows following the July 2006 War.

The following table sets out information relating to the Republic's foreign trade for the years 2002-2005 and for the three months ended March 31, 2006:

	2002	2003	2004	2005	Q1-2006
	<i>(In millions of U.S. Dollars)</i>				
Current Account	(4,352.7)	(5,013.9)	(4,116.5)	(2,044.9)	(354.1)
Goods.....	(4,700.1)	(4,794.4)	(6,452.4)	(6,118.3)	(1,438.6)
Credit.....	1,210.2	1,733.1	2,050.0	2,278.2	654.1
Debit.....	(5,910.3)	(6,527.6)	(8,502.5)	(8,396.6)	(2,092.7)
General merchandise.....	(4,720.7)	(5,088.8)	(6,506.9)	(6,043.0)	(1,540.0)
Exports FOB ⁽²⁾	1,018.2	1,272.8	1,661.4	2,017.6	513.3
Imports FOB ⁽²⁾	(5,738.9)	(6,361.7)	(8,168.3)	(8,060.6)	(2,053.4)
Goods for processing.....	62.8	104.9	206.6	140.2	42.4
Repairs on goods.....	(5.2)	(2.3)	(2.3)	(1.7)	(0.1)
Nonmonetary gold.....	(37.0)	191.8	(149.8)	(213.8)	59.1
Services.....	1,075.1	2,973.8	1,474.3	2,904.6	445.6
Credit.....	4,429.3	9,462.0	9,703.9	10,758.4	2,358.8
Debit.....	(3,354.2)	(6,488.1)	(8,229.6)	(7,853.7)	(1,913.2)
Transportation.....	(470.7)	(493.5)	(708.9)	(894.5)	(201.5)
Travel.....	1,600.8	3,430.9	2,241.4	2,554.0	399.3
Communication services.....	55.9	66.1	26.3	102.1	(8.4)
Insurance services.....	(52.9)	(93.4)	(35.3)	(27.9)	(6.8)
Financial services (other than.....)	(1.2)	20.6	30.4	32.5	7.7
Misc. business, professional.....	(59.7)	40.3	(85.3)	1,135.5	253.3
Government services, n.i.e.....	3.2	2.8	5.8	3.0	2.0
Income.....	(805.4)	(3,521.8)	(854.2)	112.2	131.5
Credit.....	609.0	1,490.9	1,294.6	2,432.0	765.8
Debit.....	(1,414.4)	(5,012.7)	(2,148.8)	(2,319.8)	(634.2)
Compensation of employees.....	(10.9)	391.9	(250.7)	(63.8)	(55.3)
Investment income.....	(794.5)	(3,913.7)	(603.5)	176.0	186.8
Direct investment.....	0.0	17.9	(27.3)	26.0	(12.2)
Portfolio investment.....	(709.8)	(3,663.2)	(438.1)	(383.5)	(74.6)
Other investment.....	(84.7)	(268.3)	(138.1)	533.2	273.6
Current transfers.....	77.6	328.5	1,715.9	1,056.5	507.5
Credit.....	2,591.1	4,079.1	5,325.2	4,399.4	1,169.7
Debit.....	(2,513.4)	(3,750.7)	(3,609.4)	(3,342.9)	(662.2)
General government.....	42.9	3.7	6.0	0.1	0.3
Other sectors.....	34.7	324.8	1,709.9	1,056.4	507.2
Workers' remittances.....	34.7	270.0	1,609.5	970.2	494.9
Other transfers ⁽⁵⁾	0.0	54.8	100.4	86.2	12.3
Credit.....	0.0	107.7	131.7	134.3	22.3
Debit.....	0.0	(53.0)	(31.3)	(48.0)	(10.0)
Capital and financial account.....	2,826.4	11,729.0	7,290.5	7,041.8	3,191.1
Capital account	12.8	29.3	50.4	27.4	48.2
Credit.....	12.8	30.0	53.7	27.4	51.7
Debit.....	(0.0)	(0.7)	(3.3)	(0.0)	(3.5)
Capital transfers.....	12.8	29.3	50.4	27.4	48.2
Financial account.....	2,813.7	11,699.7	7,240.1	7,014.4	3,142.9
Direct investment.....					
Abroad.....	(0.2)	(40.0)	(212.9)	(122.0)	(62.9)
In reporting economy.....	1,336.0	2,977.0	1,993.1	2,751.3	821.7
Portfolio investment.....					
Assets.....	100.9	(558.6)	(613.7)	(91.4)	(660.4)
Equity securities.....	157.5	(39.9)	(348.8)	(137.9)	(503.5)
Debt securities.....	(56.6)	(518.7)	(265.0)	46.4)	(156.9)
Liabilities.....	748.6	644.0	(93.0)	647.7	175.1
Equity securities.....	0.0	207.4	147.6	1,435.6	171.0
Debt securities.....	748.6	436.6	(240.6)	(788.0)	4.1
Other investment.....					
Assets.....	57.8	1,713.8	5,734.6	3,315.1	1,912.4
Loans.....	0.0	3,614.9	5,232.1	4,648.7	989.1
Currency and deposits.....	57.8	(1,901.1)	502.5	(1,333.6)	923.3
Liabilities.....	(93.7)	1,926.2	1,212.1	56.3	951.7
Loans.....	(16.2)	992.5	285.1	982.6	52.8
Currency and deposits.....	(77.4)	933.7	927.0	(926.3)	898.9
Reserve Assets.....	664.2	5,037.3	(780.0)	457.5	5.2
Net errors and omissions.....	1,526.2	(6,715.1)	(3,173.9)	(4,996.9)	(2,837.0)

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.

The following table indicates the principal destinations of exports for the years 2001-2005 and for the nine months ended September 30, 2006:

Destination of Exports

	2001	2002	2003	2004	2005	Q3-2006
	In per cent. of total exports					
Industrialized countries	36.2%	33.2%	39.5%	23.2%	20.2%	35.6%
EU 15	18.6%	14.4%	9.4%	9.0%	9.5%	9.3%
Italy	2.9%	2.2%	1.9%	1.1%	0.9%	0.9%
France	4.3%	1.9%	1.6%	2.0%	1.7%	1.6%
Germany	1.9%	1.3%	1.3%	1.3%	1.0%	0.9%
United States	6.8%	5.1%	4.3%	2.8%	3.1%	2.1%
Japan.....	0.6%	0.4%	0.3%	0.3%	0.2%	0.3%
United Kingdom.....	1.7%	2.1%	1.1%	1.3%	1.7%	1.3%
Switzerland.....	7.1%	12.6%	24.9%	10.7%	6.7%	23.4%
Belgium-Luxembourg	1.4%	2.1%	0.7%	0.9%	1.2%	1.9%
Other.....	3.1%	0.7%	0.5%	0.4%	0.8%	0.4%
Developing countries	63.8%	66.8%	60.5%	76.8%	79.8%	64.4%
Middle East and North						
Africa	44.6%	48.3%	41.8%	53.6%	54.0%	44.2%
<i>of which: GAFTA</i>	42.2%	46.2%	39.2%	51.0%	51.3%	41.9%
Middle East	42.0%	44.6%	39.4%	51.3%	51.8%	42.7%
Saudi Arabia.....	9.6%	9.2%	6.8%	6.5%	7.4%	6.6%
Syria	4.0%	7.2%	6.5%	8.3%	10.0%	7.4%
Jordan	3.5%	3.4%	3.2%	3.6%	4.0%	3.7%
Kuwait	3.1%	3.1%	3.3%	3.9%	4.3%	3.6%
U.A.E.....	8.2%	9.1%	6.8%	7.7%	8.2%	7.3%
Egypt	2.7%	2.6%	1.8%	2.3%	2.9%	1.6%
Iraq	7.6%	6.8%	8.0%	14.6%	9.5%	6.9%
Other.....	2.6%	3.8%	2.4%	2.3%	2.3%	1.5%
Africa.....	4.9%	5.7%	6.2%	7.4%	9.0%	7.6%
Other Europe	4.6%	4.5%	5.9%	8.5%	8.1%	5.6%
Other developing countries and emerging markets	9.6%	8.2%	6.6%	7.3%	8.6%	7.0%

Source: Higher Council of Customs/BDL and IMF estimates.

The following table shows the composition of exports for the years 2001-2005 and for the nine months ended September 30, 2006:

Composition of Exports

	2001	2002	2003	2004	2005	Q-3 2006
	In per cent. of total exports					
Live animals; animal products	0.7%	0.8%	0.8%	0.5%	0.5%	0.4%
Vegetable products	5.6%	5.5%	4.2%	4.7%	4.1%	3.4%
Animal or vegetable fats and oils	1.1%	0.7%	0.6%	0.9%	0.7%	0.5%
Prepared foodstuffs; beverages, tobacco	11.2%	9.8%	9.8%	8.5%	10.2%	8.2%
Mineral products	3.6%	3.9%	4.2%	6.2%	6.7%	3.3%
<i>Of which: mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes</i>	<i>0.0%</i>	<i>0.0%</i>	<i>0.1%</i>	<i>0.2%</i>	<i>0.3%</i>	<i>0.4%</i>
Products of the chemical or allied industries	9.9%	10.3%	7.5%	8.5%	8.7%	6.5%
Plastics and articles thereof; rubber	2.9%	3.3%	2.4%	3.4%	4.1%	3.7%
Raw hides and skins, leather, furskins	3.3%	1.3%	0.9%	0.9%	0.7%	0.6%
Wood and articles of wood; wood charcoal; cork	1.0%	1.2%	1.1%	1.2%	1.2%	0.9%
Pulp of wood; paper and paperboard	6.8%	9.4%	5.9%	5.8%	6.2%	5.7%
Textiles and textile articles	8.7%	5.8%	4.2%	4.5%	4.3%	3.8%
Footwear, umbrellas, artificial flowers	1.7%	0.8%	0.7%	0.8%	0.9%	0.7%
Articles of stone, plaster, cement, glass	2.5%	2.5%	2.5%	3.2%	2.7%	2.1%
Pearls, precious stones and metals	15.8%	20.5%	30.5%	16.4%	11.9%	27.5%
<i>Of which: gold (including gold plated with platinum) unwrought or in semi-manufactured forms, or in powder form.</i>	<i>6.9%</i>	<i>12.2%</i>	<i>23.4%</i>	<i>10.3%</i>	<i>6.4%</i>	<i>23.1%</i>
Base metals and articles of base metal	7.3%	7.5%	7.6%	13.0%	14.7%	12.2%
Machinery; electrical instruments	12.9%	11.4%	11.8%	15.7%	16.7%	14.6%
Vehicles, aircraft, vessels, transport equipment	1.3%	1.3%	1.2%	1.2%	1.2%	1.3%
Optical, photographic, medical, musical instruments	0.8%	1.0%	0.6%	0.8%	0.9%	0.9%
Arms and ammunition; parts and accessories	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Miscellaneous manufactured articles	2.7%	2.6%	3.0%	3.2%	3.1%	3.0%
Works of art, collectors' pieces and antiques	0.1%	0.3%	0.5%	0.7%	0.5%	0.5%

Source: Higher Council of Customs and Banque du Liban.

The following table shows the composition of imports for the years 2001-2005 and for the nine months ended September 30, 2006:

Composition of Imports

	2001	2002	2003	2004	2005	Q-3 2006
	In per cent. of total imports					
Live animals; animal products	4.9%	5.9%	5.8%	4.8%	4.6%	4.6%
Vegetable products	5.0%	5.2%	5.3%	4.7%	4.1%	3.7%
Animal or vegetable fats and oils	0.6%	0.7%	0.7%	0.8%	0.9%	1.0%
Prepared foodstuffs; beverages, tobacco	6.9%	7.4%	6.6%	5.6%	5.7%	5.4%
Mineral products	18.4%	15.1%	16.6%	22.0%	23.8%	26.7%
<i>Of which: is mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes</i>	<i>17.2%</i>	<i>13.9%</i>	<i>15.2%</i>	<i>20.6%</i>	<i>22.4%</i>	<i>25.6%</i>
Products of the chemical or allied industries	8.2%	9.8%	10.0%	8.8%	8.8%	9.4%
Plastics and articles thereof; rubber	3.5%	3.7%	3.6%	3.7%	3.8%	3.8%
Raw hides and skins, leather, furskins	0.4%	0.5%	0.5%	0.4%	0.4%	0.4%
Wood and articles of wood; wood charcoal; cork	1.4%	1.6%	1.5%	1.5%	1.5%	1.3%
Pulp of wood; paper and paperboard	2.7%	2.9%	3.2%	2.9%	2.8%	2.5%
Textiles and textile articles	6.4%	6.6%	6.1%	5.4%	5.2%	4.8%
Footwear, umbrellas, artificial flowers	1.0%	1.1%	1.0%	0.9%	0.7%	0.7%
Articles of stone, plaster, cement, glass	2.0%	2.0%	1.9%	1.8%	1.7%	1.5%
Pearls, precious stones and metals	5.0%	4.7%	4.2%	5.6%	5.3%	3.2%
<i>Of which: is gold (including gold plated with platinum) unwrought or in semi-manufactured forms, or in powder form.</i>	<i>3.5%</i>	<i>2.6%</i>	<i>2.3%</i>	<i>3.5%</i>	<i>3.6%</i>	<i>1.5%</i>
Base metals and articles of base metal	5.9%	5.9%	6.6%	6.3%	7.0%	7.4%
Machinery; electrical instruments	13.7%	13.4%	12.2%	11.8%	11.4%	11.5%
Vehicles, aircraft, vessels, transport equipment	9.8%	8.9%	9.7%	9.0%	8.7%	8.4%
Optical, photographic, medical, musical instruments	1.9%	2.1%	2.2%	1.9%	1.7%	2.0%
Arms and ammunition; parts and accessories	0.1%	0.1%	0.1%	0.1%	0.1%	0.0%
Miscellaneous manufactured articles	2.2%	2.4%	2.0%	2.0%	1.8%	1.6%
Works of art, collectors' pieces and antiques	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Higher Council of Customs and Banque du Liban.

The following table sets out the major sources of imports for the 2001 through the period ending September 30, 2006:

Origin of Imports						
	2001	2002	2003	2004	2005	Q-3 2006
	In per cent. of total imports					
Industrialized countries	57.4%	58.7%	56.0%	53.0%	52.7%	51.4%
EU 15	41.7%	43.0%	42.4%	38.4%	38.2%	35.5%
Italy	9.7%	10.8%	9.4%	9.9%	10.4%	7.4%
France	8.4%	8.0%	8.1%	7.8%	8.4%	8.2%
Germany	8.5%	9.0%	8.1%	7.8%	7.0%	7.0%
United States	7.1%	7.2%	6.0%	5.9%	5.9%	9.7%
Japan.....	3.2%	3.4%	3.8%	3.7%	3.3%	3.2%
United Kingdom.....	4.6%	4.8%	5.2%	4.7%	4.0%	4.7%
Switzerland.....	4.6%	4.1%	3.0%	4.2%	4.5%	2.2%
Belgium-Luxembourg	1.9%	2.2%	2.3%	1.8%	1.9%	1.6%
Other.....	0.9%	1.0%	0.8%	0.8%	0.8%	0.8%
Developing countries	42.6%	41.3%	44.0%	47.0%	47.3%	48.6%
Middle East and North Africa	13.2%	11.1%	13.2%	14.7%	14.2%	15.3%
<i>of which: GAFTA</i>	<i>12.6%</i>	<i>10.5%</i>	<i>12.5%</i>	<i>14.0%</i>	<i>13.8%</i>	<i>14.9%</i>
Middle East	12.6%	10.5%	12.4%	14.0%	13.2%	14.4%
Saudi Arabia.....	3.6%	2.2%	3.1%	4.4%	3.5%	3.2%
Syria	4.5%	3.2%	3.6%	2.6%	2.1%	1.8%
Jordan	0.5%	0.7%	0.6%	0.6%	0.7%	0.8%
Kuwait	0.2%	0.2%	0.2%	0.2%	1.1%	1.7%
U.A.E.....	0.8%	0.9%	1.3%	1.6%	1.5%	1.4%
Egypt	1.5%	2.1%	2.4%	3.1%	3.2%	4.1%
Iraq	0.2%	0.1%	0.2%	0.1%	0.0%	0.0%
Other.....	0.5%	0.6%	0.8%	0.7%	1.0%	0.9%
Africa.....	0.5%	0.5%	0.5%	0.7%	0.5%	0.7%
Other Europe	5.6%	7.0%	6.2%	6.0%	6.4%	8.0%
Other developing countries and emerging markets	23.3%	22.7%	24.1%	25.6%	26.2%	24.7%

Source: Higher Council of Customs and BDL and IMF Staff estimates.

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

At the end of 2006, the Republic's outstanding principal amounts under foreign financing facilities in the form of contracted loans (excluding outstanding Eurobonds and Paris II loans) were approximately U.S. \$1.9 billion. In 2006, disbursements from foreign financing loans were approximately U.S. \$227 million. These facilities 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

Creditor	Amounts Received
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 in Beirut (the "*Beirut Conference*").

At that time, the Government decided to first seek broad national consensus on this program before holding the Beirut Conference. Given the nature, the magnitude and the scope of the reform measures of the actions that were envisaged, more time than had originally been anticipated was needed to complete the consensus building process, which was also complicated by some political tensions early in the year and the resignation of some ministers. The process was reaching its final stages when the July 2006 War began.

The international community reacted quickly and generously to support Lebanon during the July 2006 War and after the cessation of hostilities. Immediately after the outbreak of the war, Saudi Arabia and Kuwait provided commitments of \$500 million and \$300 million respectively as grants for reconstruction. In addition, Saudi Arabia and Kuwait deposited U.S. \$1 billion and US\$500 million respectively with BDL to help maintain confidence and monetary stability.

On August 31, 2006, the Swedish government hosted a Conference for Lebanon's Early Recovery in Stockholm. At that Conference, Lebanon received indications of support amounting to over U.S. \$900 million for humanitarian assistance needs and early recovery efforts, in the form of financial assistance, in kind contributions to specific reconstruction activities and others. This financial support provided the conditions for the return of the quarter of the population that was displaced, and restoring minimum capacity in terms of infrastructure, access to basic social services and income generating activities, pending full reconstruction. The Ministry of Finance estimates a total of U.S. \$613 million have been committed, of which U.S. \$289 million has been fulfilled.

In addition to Saudi Arabia, Kuwait and countries that contributed during the Stockholm Conference, many countries pledged their support to Lebanon. In total and since the beginning of the July 2006 War a total of U.S. \$2.1 billion has been pledged in grants (in addition to in-kind relief contributions that were sent during the War), of which U.S. \$1.6 billion has been formally committed.

On January 25, 2007, the "International Conference for Support to Lebanon", known as the Paris III Conference and named after the late Prime Minister Rafik Hariri, was held in Paris at the invitation of the President of France. It was attended by representatives of 36 countries and 14 multilateral and supranational institutions, including the United Nations, the European Union, the World Bank, the IMF and the Arab League and resulted in pledges of financial assistance to Lebanon of approximately U.S. \$7.6 billion. The Government is actively pursuing finalization and collections of these pledges.

PUBLIC DEBT

General

As at December 31, 2006, the Republic's gross public debt was LBP 60,880 billion (U.S. \$40.38 billion) consisting of LBP 30,204 billion of gross domestic debt and LBP 30,676 billion of public external debt. Net outstanding public debt of the Republic was LBP 56,556 billion (U.S. \$37.51 billion) as of December 31, 2006.

The table below shows the Republic's gross and net public sector debt for the periods indicated below⁽¹⁾.

	2002	2003	2004	2005	2006
	<i>(in billions of Lebanese Pounds)</i>				
I. Gross Domestic Debt.....	25,302	26,843	26,371	29,141	30,204
II. Public External Debt ⁽²⁾	21,974	23,442	27,677	28,844	30,676
III. Gross Public Debt (I + II)	47,276	50,285	54,048	57,985	60,880
IV. Public Sector Deposits ⁽³⁾	2,964	3,019	4,360	5,590	4,324
V. Net Domestic Debt (I – IV).....	22,338	23,824	22,011	23,551	25,880
VI. Net Public Debt (III – IV)	44,312	47,266	49,688	52,395	56,556

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 BDL 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.

	2002	2003	2004	2005	2006
Gross Public Debt	168%	168%	168%	180%	178%
Net Public Debt.....	157%	158%	154%	162%	166%

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, 141 per cent. in 2000, 158 per cent. in 2001, 157 per cent. in 2002, 158 per cent. in 2003 and decreased to 154 per cent in 2004, and increased to 162 per cent in 2005, and 166 per cent in 2006.

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 and 5 years). 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 the Central Bank 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. In March 2005, the Ministry of Finance established a medium term note program, complying with best international standards, for the issuance of LL denominated bonds, directly or through managers and issued a five year bond. The new bond lengthened maturities for LL instruments, widened distribution and set a new benchmark.

The table below shows the Republic's composition of domestic debt as of December 31, 2005 and December 31, 2006:

	2005		2006	
	<i>(in billions of Lebanese Pounds)</i>	<i>(in millions of U.S. Dollars)</i>	<i>(in billions of Lebanese Pounds)</i>	<i>(in millions of U.S. Dollars)</i>
Long term bonds⁽¹⁾	23,384	15,512	26,862	17,819
60 months	1,772	1,175	2,172	1,441
54 months	616	409	616	409
48 months	633	420	633	420
36 months	14,520	9,632	21,093	13,992
30 months	3,033	2,012	-	-
24 months	2,385	1,582	1,751	1,162
Accrued interest	425	282	597	396
Short term bills	5,246	3,480	2,839	1,883
12 months	3,023	2,005	1,579	1,047
6 months	2,067	1,371	1,117	741
3 months	156	103	143	95
Accrued interest	92	61	88	58
Other domestic debt	511	339	503	334
Total Domestic Debt	29,141	19,331	30,204	20,036

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, 2006, the outstanding public external debt of the Republic reached a value of approximately U.S. \$ 20.35 billion.

The table below shows the composition of the Republic's foreign debt as at December 31, 2005, and December 31, 2006:

	2005		2006	
	<i>(in billions of Lebanese Pounds)</i>	<i>(in millions of U.S. Dollars)</i>	<i>(in billions of Lebanese Pounds)</i>	<i>(in millions of U.S. Dollars)</i>
Eurobonds.....	24,743	16,413	26,441	17,540
Paris II Conference Eurobonds ⁽¹⁾	2,789	1,850	2,789	1,850
Loans	4,101	2,720	4,235	2,809
Paris II Conference concessional loans ⁽²⁾	893	592	932	618
Bilateral and multilateral loans	2,626	1,742	2,763	1,833
Foreign private sector loans	163	108	121	80
Special Treasury bills in foreign currency ⁽³⁾	419	278	419	278
Total Foreign Debt⁽⁴⁾	28,844	19,134	30,676	20,349

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) U.S. \$ denominated bonds issued in satisfaction of expropriation claims.
- (4) Includes accrued interest.

The following table shows the Republic's outstanding Eurobonds as at the date hereof, excluding Eurobonds issued in connection with the Paris II Conference and Eurobonds issued as part of the commercial bank debt service reduction measure:

Year of Issue	Maturity	Original Principal Amount	Outstanding Principal Amount⁽¹⁾	Coupon
1997	2007	U.S. \$100 million	U.S. \$100 million	7.500%
1997	2007	U.S. \$400 million	U.S. \$369 million	8.625%
1999	2009	U.S. \$650 million	U.S. \$636 million	10.250%
2001	2008	U.S. \$750 million	U.S. \$750 million	10.125%
2001	2016	U.S. \$400 million	U.S. \$400 million	11.625%
2004 ⁽⁴⁾	2010	U.S. \$1,265 million	U.S. \$1,265 million	7.125%
2004 ⁽⁴⁾	2012	U.S. \$ 600 million	U.S. \$ 600 million	7.750%
2004	2009	U.S. \$ 625 million	U.S. \$ 625 million	6 mo L + 325bp
2004	2009	U.S. \$ 425 million	U.S. \$ 425 million	7.000%
2004	2011	U.S. \$ 1,000 million	U.S. \$ 1,000 million	7.875%
2004	2009	Euro 225 million	Euro 225 million	7.250%
2004 ⁽²⁾	2008	U.S. \$ 700 million	U.S. \$ 700 million	6.375%
2004 ⁽²⁾	2010	U.S. \$ 300 million	U.S. \$ 300 million	6.875%
2005 ⁽²⁾	2007	U.S. \$ 1,000 million	U.S. \$ 1,000 million	6.500%
2005 ⁽²⁾	2008	U.S. \$250 million	U.S. \$250 million	7.000%
2005	2008	U.S. \$250 million	U.S. \$250 million	7.375%
2005	2013	U.S. \$250 million	U.S. \$250 million	8.625%
2005	2016	U.S. \$750 million	U.S. \$750 million	8.500%
2006 ⁽⁵⁾	2014	U.S. \$677 million	U.S. \$677 million	7.375%
2006 ⁽⁵⁾	2021	U.S. \$1,661 million	U.S. \$1,661 million	8.250%
2006 ⁽⁵⁾	2012	Euro 325 million	Euro 325 million	5.875%
2006 ⁽⁶⁾	2011	U.S. \$450 million	U.S. \$450 million	7.500%
2006 ⁽⁷⁾	2009	U.S. \$352 million	U.S. \$352 million	7.500%
2007 ⁽⁸⁾	2008	U.S. \$569 million	U.S. \$569 million	6.375%
2007 ⁽⁸⁾	2021	U.S. \$431 million	U.S. \$431 million	8.250%

Source: Ministry of Finance.

Notes:

- (1) The outstanding amount of some Eurobonds is less than the original amount due to the cancellation of a portion of such Eurobonds in connection with the Central Bank and commercial bank debt service reduction measures. See "The Economy -- Recent Economic History".
- (2) Eurobonds issued and initially transferred to the Central Bank in consideration for the cancellation of an equivalent amount of Treasury bills and bonds held by the Central Bank.
- (3) Eurobonds issued and initially delivered to holders of U.S. Dollar-denominated notes maturing on August 2, 2002 to refinance such notes. See "Public Debt – Issuance of Dollar-denominated Notes in Satisfaction of Certain Claims".
- (4) Originally issued as part of an exchange transaction, in which bonds maturing in 2005 were offered for exchange into two new bonds maturing in 2010 and 2012. Include U.S. \$ 354 million of new cash subscriptions. Bonds maturing in 2012 were reopened in November 2004 for an additional amount of U.S. \$ 325 million
- (5) Originally issued as part of an exchange transaction, in which bonds maturing in 2006 were offered for exchange into three new bonds maturing in 2012, 2014 and 2021. Include U.S. \$ 750 million and Euro 175 million of new cash subscriptions.
- (6) Eurobonds issued and initially transferred to the Central Bank in consideration for the cancellation of an equivalent amount of Treasury bills and bonds held by the Central Bank.
- (7) A first tranche of 206.591 million USD was issued on August 2, 2006, as a direct subscription agreement with BDL. On December 27, 2006 the series was reopened for an additional amount of USD 145 million and initially transferred to the Central Bank in consideration for the cancellation of an equivalent amount of Treasury bills and bonds held by the Central Bank.
- (8) Subscribed for cash by the Central Bank.

The following table shows the Republic's outstanding Eurobonds issued in connection with the Paris II Conference as at December 31, 2006:

Year of Issue	Maturity	Original Principal Amount	Outstanding Principal Amount	Coupon
		<i>(in U.S. Dollars)</i>		
2002	2017	950 million	950 million	5.0%
2002	2017	1,870 million	1,870 million	4.0%
2003	2018	700 million	700 million	5.0%
2003	2018	200 million	200 million	5.0%

Source: Ministry of Finance.

In addition, in 2003, the Republic issued Eurobonds in an aggregate principal amount of U.S. \$422,905,000 and Euro 236,250,000 as part of the commercial bank debt service reduction measure described in this Country Profile.

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⁽¹⁾⁽²⁾

	2002	2003	2004	2005	2006
<i>(in millions of U.S. dollars)</i>					
Bilateral.....	469	1,123	1,184	1,060	1,094
Abu Dhabi Fund for Development	16	14	11	9	6
Agence Française de Développement(AFD)		629	689	602	631
Austrian Government	29	31	31	25	24
Government of Belgium.....	2	2	2	2	2
Government of China	6	6	6	6	6
Exim Bank.....	5	4	3	3	1
Fortis Bank.....	1	1	1	1	1
Italian Government.....	25	29	30	26	28
Kerditanstalt Fur Wiederaufbau	32	33	30	20	20
Kuwaiti Fund for Arab Economic Development	140	140	137	138	140
Mediocredito Centrale.....	16	15	14	13	12
Natexis Banque	83	99	109	96	105
Overseas Econ. Coop. Fund (OECF).....	10	20	25	24	23
The Saudi Fund for Development.....	102	99	96	94	94
Multilateral	1,072	1,236	1,319	1,277	1,421
Arab Fund for Economic and Social Development	328	344	357	362	387
Communaute Economique Europeenne.....	4	6	7	6	7
European Investment Bank.....	277	347	352	304	410
International Bank for Reconstruction and Development	321	345	365	362	375
International Fund for Agricultural Development	8	9	11	9	9
Islamic Development Bank	127	176	214	219	215
The OPEC Fund for International Development	8	9	13	14	18
Commercial Banks	289	224	169	108	85
Eurobonds	12,484	12,762	15,452	16,144	17,252
Special t-bills in foreign currency (expropriations)				278	278
TOTAL⁽³⁾	14,314	15,346	18,124	18,867	20,130

Source: Ministry of Finance.

Notes:

- (1) Certain figures in this table differ from previously published data due to continuous implementation of the new 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 Program in an aggregate principal amount of U.S. \$5.22 billion¹, divided as follows:

- 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. \$2,163,995,000² 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 the Central Bank of Lebanon pursuant to which the Central Bank exchanged certain Treasury bills denominated in Lebanese Pound for the Series 32 Notes and the Series 33 Notes. The transaction was part of the Republic's ongoing debt management program.
- 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 Program in an aggregate principal amount of U.S. \$2.5 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 the Central Bank of Lebanon pursuant to which the Central Bank exchanged certain Treasury bills denominated in Lebanese Pound for the Series 36 Notes. The transaction was part of the Republic's ongoing debt management program.
- 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 the Central Bank of Lebanon pursuant to which the Central Bank exchanged certain Treasury bills denominated in Lebanese Pound for the Series 36 Notes.
- 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 the Central Bank of Lebanon pursuant to which the Central Bank exchanged certain Treasury bills denominated in Lebanese Pound for the Series 37 Notes.

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

² 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 7.375 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 8.500 per cent. Notes due 2016 (Series 40) were issued on October 18, 2005.

In 2006, the Republic issued Eurobonds under the Program in an aggregate principal amount equivalent to U.S. \$3.57 billion², divided as follows:

- U.S. \$676,902,000 7.375 per cent. Notes due 2014 (Series 41), U.S. \$911,469,000 8.250 per cent. Notes due 2021 (Series 42), and EUR 149,542,000 5.875 per cent. Notes due 2012 (Series 43) were issued on April 12, 2006. The Series 41, Series 42 Notes were issued as part of an exchange offer pursuant to which the Republic offered to exchange any and all of its outstanding U.S. \$1,150,000,000 9.875 per cent. Notes due 2006, U.S. \$350,000,000 10.50 per cent. Notes due 2006, U.S. \$500,000,000 10.50 per cent. Notes due 2006, and U.S. \$750,000,000 10.50 per cent. Notes due 2006. The Series 43 Notes were issued as part of an exchange offer pursuant to which the Republic offered to exchange any and all of its outstanding Euro 300,000,000 8.875 per cent. Notes due 2006.
- U.S. \$750,000,000 8.250 per cent. Notes due 2021 (Series 42, Tranche 2) and Euro 175,000,000 5.875 per cent. Notes due 2012 (Series 43, Tranche 2) were issued on April 25, 2006. The Series 42, Tranche 2 Notes were issued as part of a reopening transaction and were consolidated and form a single series with the U.S. \$911,469,000 8.250 per cent. Notes due 2021 (Series 42) issued by the Republic on April 12, 2006. The Series 43, Tranche 2 Notes were issued as part of a reopening transaction and were consolidated and form a single series with the Euro 149,542,000 5.875 per cent. Notes due 2012 (Series 43) issued by the Republic on April 12, 2006.
- U.S. \$450,000,000 7.500 per cent. Notes due 2011 (Series 45) were issued on August 2, 2006. These Notes were issued pursuant to a debt replacement transaction between the Ministry of Finance and the Central Bank of Lebanon pursuant to which the Central Bank exchanged certain Treasury bills denominated in Lebanese Pound for the Series 45 Notes
- U.S. \$206,591,000 7.500 per cent. Notes due 2009 (Series 44, Tranche 1) were issued on August 2, 2006.
- U.S. \$145,000,000 7.500 per cent. Notes due 2009 (Series 44, Tranche 2) were issued on December 27, 2006. These Notes were issued pursuant to a debt replacement transaction between the Ministry of Finance and the BDL pursuant to which the Central Bank exchanged certain Treasury bills denominated in Lebanese Pound for the Series 44 Notes. These Notes were issued as part of a reopening transaction and were consolidated and form a single series with the U.S. \$206,591,000 7.500 per cent. Notes due 2009 (Series 44, Tranche 1) issued by the Republic on August 2, 2006.

To date in 2007, the Republic issued Eurobonds under the Program, divided as follows:

- U.S. \$431,000,000 8.250 per cent. Notes due 2021 (Series 42, Tranche 3), were issued on February 26, 2007. The Notes were issued as part of a reopening transaction and were consolidated and form a single series with the U.S. \$911,469,000 8.250 per cent. Notes due 2021 issued by the Republic on April 12, 2006 and the U.S. \$750,000,000 8.250 per cent. Notes due 2021 issued by the Republic on April 25, 2006.
- U.S. \$569,000,000 6.375 per cent. Notes due 2008 (Series 32, Tranche 2), were issued on February 26, 2007. The Notes were issued as part of a reopening transaction and were consolidated and form a single series with the U.S. \$700,000,000 6.375 per cent. Notes due 2008 issued by the Republic on November 12, 2004.

The Eurobonds issued in 2007 as described above have been subscribed by the Central Bank for cash.

In addition, on April 25, 2005, the Central Bank 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

² Based on exchange rate of 1 USD = 0.7603 Euro as of December 28, 2006. Includes US\$ 1,771,249,675 issued pursuant to an exchange transaction.

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. The Certificates are not listed and this was the first issuance by the Central Bank of securities 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(1)(2)

	2002	%	2003	%	2004	%	2005	%	2006	%
Arab Emirates										
Dirhams	16	0.11	14	0.09	11	0.06	9	0.05	6	0.03
Swiss Francs	12	0.08	12	0.08	12	0.07	9	0.05	10	0.05
China Yuan										
Renmimbi	6	0.04	6	0.04	6	0.03	6	0.03	6	0.03
Euros ⁽³⁾	1,184	8.27	2,051	13.37	2,113	11.66	1,538	8.15	1,824	9.06
Pounds Sterling..	0.9	0.01	0.92	0.01	1	0.00	1	0	1	0
Islamic Dinars....	77	0.54	88	0.57	95	0.53	94	0.5	88	0.44
Japanese Yen	25	0.18	36	0.24	40	0.22	37	0.19	34	0.17
Kuwaiti Dinars...	468	3.27	484	3.15	495	2.73	500	2.65	528	2.62
Saudi Arabian										
Riyals.....	102	0.71	99	0.64	96	0.53	94	0.50	94	0.47
Special Drawing										
Rights.....	8	0.06	9	0.06	11	0.06	9	0.05	9	0.04
U.S. Dollars	12,414	86.73	12,546	81.76	15,244	84.11	16,570	87.82	17,530	87.08
Total	14,314	100.00	15,345	100	18,124	100.00	18,867	100.00	20,130	100.00

Source:

- (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 January 26, 2007

	2007	2008	2009	2010	2011
		<i>(in millions of U.S. Dollars)(1)</i>			
Estimated Disbursements ⁽²⁾	1,136	333	132	16	16
Principal Payments	1,812	2,639	3,103	2,597	2,178
Principal Repayment-Loans	343	362	398	382	356
Principal Repayment- Expropriation bonds	-	-	-	278	-
Principal Repayment-Eurobonds	1,469	2,277	2,705	1,937	1,822
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 (USD) 2009.....	-	-	250	-	-
Eurobond (USD) 2009.....	-	-	625	-	-
Eurobond (USD) 2009.....	-	-	425	-	-
Eurobond (Euro) 2009.....	-	-	296	-	-
Eurobond (USD) 2009.....	-	-	207	-	-
Eurobond (USD) 2009.....	-	-	145	-	-
Eurobond (USD) 2010.....	-	-	-	1,265	-
Eurobond (USD) 2010.....	-	-	-	300	-
Eurobond (USD) 2011	-	-	-	-	1,000
Eurobond (USD) 2011	-	-	-	-	450
Eurobond (USD) 2012.....	-	-	-	-	-
Eurobond (USD) 2012.....	-	-	-	-	-
Eurobond (USD) 2016.....	-	-	-	-	-
Eurobond (USD) 2017.....	-	187	187	187	187
Eurobond (USD) 2017.....	-	95	95	95	95
Eurobond (USD) 2018.....	-	35	70	70	70
Eurobond (USD) 2018.....	-	10	20	20	20
Interest & Commissions	1,354	1,237	1,103	831	675
Loans.....	135	133	131	114	96
Expropriation bonds	17	17	17	17	-
Coupon Payments	1,202	1,087	955	700	579
Eurobond (USD) 2007.....	24	-	-	-	-
Eurobond (USD) 2007.....	8	-	-	-	-
Eurobond (USD) 2007.....	8	-	-	-	-
Eurobond (USD) 2007.....	32	-	-	-	-
Eurobond (USD) 2008.....	76	76	-	-	-
Eurobond (USD) 2008.....	45	22	-	-	-
Eurobond (USD) 2008.....	18	9	-	-	-
Eurobond (USD) 2008.....	18	9	-	-	-
Eurobond (USD) 2009.....	40	40	40	-	-
Eurobond (Euro) 2009.....	21	21	21	-	-
Eurobond (USD) 2009.....	26	26	26	-	-
Eurobond (USD) 2009.....	30	30	30	-	-
Eurobond (USD) 2009.....	50	50	50	-	-
Eurobond (USD) 2009.....	15	15	15	-	-
Eurobond (USD) 2009.....	11	11	11	-	-
Eurobond (USD) 2010.....	90	90	90	45	-
Eurobond (USD) 2010.....	21	21	21	21	-
Eurobond (USD) 2011	79	79	79	79	39
Eurobond (USD) 2011.....	34	34	34	34	34
Eurobond (USD) 2012.....	21	21	21	21	21
Eurobond (USD) 2012.....	25	25	25	25	25
Eurobond (Euro) 2012.....	12	12	12	12	12
Eurobond (Euro) 2012.....	14	14	14	14	14
Eurobond (USD) 2013.....	22	22	22	22	22
Eurobond (USD) 2014.....	50	50	50	50	50
Eurobond (USD) 2016.....	64	64	64	64	64
Eurobond (USD) 2016.....	47	47	47	47	47
Eurobond (USD) 2017.....	75	73	65	58	50
Eurobond (USD) 2017.....	48	46	42	37	32
Eurobond (USD) 2018.....	35	35	32	29	25
Eurobond (USD) 2018.....	10	10	9	8	7
Eurobond (USD) 2021.....	75	75	75	75	75
Eurobond (USD) 2021.....	62	62	62	62	62
Total External Debt Service	4,302	4,209	4,338	3,444	2,869

Source: Ministry of Finance

Notes:

- (1) Amounts translated into U.S. Dollars at the rate of U.S. \$1 = Euro 0.7603, the U.S. Dollar/Euro rate of exchange as at December 29, 2006.
- (2) Estimated disbursements in respect of financing arrangements (excluding Eurobonds) entered into by the Republic or its agencies and in effect on December 31, 2006. 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

Issuance of Dollar-Denominated Notes in Satisfaction of Certain Claims

Following its appointment, the Government of Prime Minister Al Hoss resolved to settle outstanding amounts due from the Republic and its agencies resulting from hospital claims, contractors claims and expropriation of property claims on account of 1998 and preceding years. Such amounts lacked appropriate allocation in previous budgets. In June 1999, Parliament adopted Law No 95, which authorized the Government to issue foreign currency-denominated notes in an aggregate principal amount not exceeding LL 1,242 billion (U.S. \$824 million) in satisfaction of amounts due for the year 1998 and preceding years. The notes were deemed issued as at August 6, 1999 (regardless of their actual issue date or date of delivery) and had a maturity of three years. The notes carried interest at a rate of 5.63 per cent. per annum, payable annually. Principal was payable in full at maturity. With the exception of claims for expropriation of property, which have been the subject of judicial decisions, claimants submitted proof of claims to specialized commissions for confirmation of the amounts due from the Republic to be exchanged for notes. On August 2, 2002, pursuant to Law No 450 and the 2002 Budget Law, the Republic issued U.S. \$750 million in aggregate principal amount of notes at a rate of 10.5 per cent. per annum to the holders of these notes for refinancing of the notes issued on August 6, 1999. These refinancing notes matured on August 2, 2006 and were refinanced with notes, carrying interest at a rate of 7.5 per cent. per annum and maturing in August 2009. On December 22, 2005, pursuant to Law No 450, the Republic issued U.S. \$277.915 million in aggregate principal amount of notes to settle expropriation claims. The notes mature on December 22, 2010 and carry interest at a rate of 6 per cent.

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 Republic made payment on its Eurobonds during the July 2006 War. The only instance of arrears during the 1975-1990 period of 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

The Central Bank 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. The Central Bank's primary role is to safeguard the currency and promote monetary stability, thereby creating a favorable environment for economic and social progress. The Central Bank also advises the Government on various economic and financial matters. In conducting its monetary management function, the Central Bank 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. 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 79.20 per cent. as at end March 2005 but gradually decreased to 73.3 per cent. at the end of December 2005. During the first half of 2006 the dollarization rate continued to decrease reaching 72.76 per cent. at the end of June 2006. However, the July 2006 War and ensuing political tensions resulted in a increase in the dollarization level to approximately 76.21 per cent. by the end of December 2006.

The following table sets out the balance sheet of BDL as at December 31 for the years indicated:

	2002	2003	2004	2005	2006
	<i>(in billions of Lebanese Pounds)</i>				
Assets					
Gold	4,849	5,779	6,039	7,140	8,756
Foreign currencies	7,644	15,372	14,313	14,841	15,387
Other foreign assets	0	0	0	0	0
Claims on private sector	205	398	354	307	280
Loans to commercial banks	1,720	1,827	1,859	1,796	1,843
Claims on public sector.....	114	307	455	453	445
Securities portfolio.....	4,499	12,399	13,806	14,589	13,872
Fixed assets.....	222	266	384	465	434
Unclassified assets ⁽¹⁾	287	1,085	2,436	3,831	5,093
Total assets	19,540	37,433	39,646	43,423	46,107
Liabilities					
Currency in circulation outside BDL	1,542	1,717	1,783	1,736	2,010
Deposits of commercial banks	11,849	28,152	29,068	28,474	27,029
Deposits of financial corporations ⁽²⁾	288	1,287	1,260	1,136	920
Private sector deposits	63	27	45	55	59
Public sector accounts.....	2,373	1,693	2,879	3,885	2,865
Valuation adjustment	103	646	372	1,392	3,126
Securities other than shares ⁽³⁾				3,015	3,015
Foreign liabilities	239	204	195	161	164
Special long-term liabilities	1,419	1,343	961	490	3,131
Capital accounts.....	1,256	1,914	1,900	1,616	1,974
Unclassified liabilities ⁽⁴⁾	407	450	1,181	1,463	1,814
Total liabilities.....	19,539	37,433	39,644	43,423	46,107

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) Includes investment banks and financial institutions.
- (3) Certificates of Deposit issued by BDL in April 2005, for an amount of USD 2 billion with a maturity of 10 years.
- (4) Unclassified liabilities include the following items: notes payable, other creditor accounts and a regularization account.

Banking Sector

As at the end of September 2006, there were 37 active commercial banks and 10 specialized medium and long term credit banks, with 831 branches, 30 financial institutions, nine financial intermediaries, and three leasing companies in the Republic. Foreign banks were well represented, maintaining 10 entities with 34 branches. 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 approximately 351.4 per cent in December 2006, 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, the Central Bank 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. During the past three years, banks' capital has increased substantially and, at December 31, 2005, the average capital adequacy ratio of the Lebanese banks was approximately 23.0 per cent., and 25 per cent. at September 30, 2006. 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 the Central Bank, 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 enables the enhancement of Islamic banking activities in Lebanon while assuring a well modern regulation and good supervision for such activities.

Efforts undertaken by the regulatory and supervisory authorities, the Association of Banks in Lebanon, the Central Bank 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 Lebanese banks have started to enter new markets and have received licenses to operate in a number of Arab and North African countries, including Egypt, Saudi Arabia, Syria, Jordan, Sudan, Algeria, the United Arab Emirates, Bahrain, Qatar, Oman and Iraq.

The following table sets out the combined balance sheet of the commercial banks as at the periods indicated:

Balance Sheet of Commercial Banks in Lebanon

	2002	2003	2004	2005	2006
	<i>(in billions of Lebanese Pounds)</i>				
Assets					
Reserves.....	11,960	28,332	29,879	30,917	29,338
Currency.....	166	186	197	201	201
Deposits with Banque du Liban.....	11,794	28,146	29,682	30,716	29,137
Claims on Private Sector.....	22,927	22,836	24,021	24,467	25,930
Lebanese Pounds	4,139	3,856	4,268	4,306	4,768
Foreign Currency.....	18,788	18,980	19,752	20,161	21,162
Claims on Public Sector.....	26,577	21,006	24,155	26,697	31,193
Treasury Bills	26,523	20,961	24,106	26,638	31,134
Other.....	55	45	49	58	59
Foreign Assets	14,327	14,937	20,431	20,017	24,784
Fixed Assets.....	2,884	2,932	3,131	3,458	3,240
Unclassified Assets.....	561	581	571	458	356
Total assets	79,236	90,624	102,188	106,014	114,841
Liabilities					
Residential Private Sector Deposits, of which:	55,451	61,791	68,268	71,632	77,366
Lebanese Pounds	19,092	23,649	23,347	22,042	21,081
Sight.....	1,094	1,277	1,389	1,359	1,450
Term	17,998	22,372	21,958	20,684	19,631
Foreign currency	36,359	38,142	44,921	49,590	56,285
Public Sector deposits	591	1,325	1,480	1,705	1,579
Non Resident Private Sector Deposits	9,237	11,663	14,422	14,274	14,128
Bonds.....	157	58	150	88	95
Deposits of Non Resident Financial Sector.....	1,859	2,398	3,813	3,263	4,236
Capital accounts.....	5,023	5,499	5,809	6,411	8,718
Unclassified liabilities.....	6,918	7,889	8,244	8,641	8,718
Total liabilities.....	79,236	90,623	102,186	106,014	114,840

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, the Central Bank 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. 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. In March 2005, the Ministry of Finance established a medium term note program, in accordance with international capital markets standards, for the issuance of LL denominated bonds, directly or through managers and issued a five year benchmark bond. The new bond lengthened maturities for LL instruments, widened distribution and set a new benchmark.

The Central Bank 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.

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 Pound 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 Pounds lending and deposit rates declined, narrowing the spread between deposit rates in Lebanese Pounds and in U.S. Dollars to 5.83 per cent. in December 2002, 4.36 per cent. in December 2003, 3.76 per cent. in December 2004, 3.61 per cent. in December 2005, 2.75 per cent. in November 2006 and 2.73 per cent. in December 2006. 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 2.51 per cent. and to 2.50 per cent. in December 2004. By end 2005, the spread narrowed further to 1.74 per cent. The spread widened slightly to 1.78 per cent in November 2006 and to 1.82 per cent. in December 2006.

The following table sets forth the Treasury bill yields at primary auction at the end of each quarter in the years 2000 to 2005:

Treasury Bill Yields

Calendar Quarters or Months	3-month	6-month Bill	12-month (per cent.)	24-month Bill	36-month Bill
2000 I.....	11.18	12.12	13.43	14.64	-
2000 II.....	11.18	12.12	13.43	14.64	-
2000 III.....	11.18	12.12	13.43	14.64	-
2000 IV.....	11.18	12.12	13.43	14.64	-
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	8.87
2004 I.....	5.29	6.40	6.76	7.95	8.85
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	7.24	7.75	8.68	9.56
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
2006 I.....	5.22	7.24	7.75	8.68	9.54
2006 II.....	5.22	7.24	7.75	8.68	9.54
2006 III.....	5.22	7.24	7.75	8.68	9.54
2006 IV.....	5.22	7.24	7.75	8.68	9.54

Source: Ministry of Finance/Banque du Liban.

The following tables set forth commercial bank deposits and lending rates at the average Lebanese Pounds and U.S. Dollar rates across the banking system for the stated type of account for the quarters shown. 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	Lending Rate	Creditor Rate	Current Account (per cent.)	Savings Deposit	Time Deposit
2000 I.....	18.26	10.90	3.08	8.81	11.35
2000 II.....	18.02	10.67	2.87	8.72	11.14
2000 III.....	17.96	10.44	4.50	8.03	11.04
2000 IV.....	17.94	10.44	3.57	7.90	11.06
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	7.53
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
2006 I.....	10.18	7.64	3.96	3.93	8.02
2006 II.....	10.24	7.56	2.79	3.93	7.99
2006 III.....	10.24	7.43	3.38	4.54	7.96
2006 IV.....	10.37	7.49	3.18	4.68	8.02

Source: Ministry of Finance/Banque du Liban.

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

Calendar Quarters or Months	Lending Rate	Creditor Rate	Current Account	Savings Deposit	Time Deposit <i>(per cent.)</i>
2000 I.....	11.01	5.72	1.99	2.94	6.16
2000 II.....	11.43	5.99	2.06	3.05	6.44
2000 III.....	11.41	5.98	1.94	2.96	6.56
2000 IV.....	11.15	6.03	2.01	3.20	6.56
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
2006 I.....	8.39	4.20	0.99	1.36	4.65
2006 II.....	8.45	4.39	0.96	1.42	4.89
2006 III.....	8.59	4.61	1.03	1.65	5.10
2006 IV.....	8.55	4.76	1.13	1.77	5.30

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. BDL 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 BDL in millions of U.S. Dollars from 2000 to 2005, and as at December 31, 2006:

	Gold <i>(millions of U.S. Dollars)</i>	Foreign Currency⁽¹⁾ <i>(millions of U.S. Dollars)</i>
2000	2,524.6	5,748.0
2001	2,561.0	4,361.0
2002	3,216.3	5,070.4
2003	3,833.5	10,197.2
2004	4,006.0	9,494.0
2005	4,736.4	9,844.9
2006	5,807.3	10,207.0

Source: Banque du Liban.

Note:

(1) Excluding gold reserves.

Foreign currency reserves are generally placed by BDL 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, BDL 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 BDL 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 2006:

End of Period	(in LL per U.S. \$)	% Change in Dollar Exchange Rate over Previous Period ⁽¹⁾
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
2000-2006 (each quarter):	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 to 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 in January 1996 to U.S. \$8,304 million at the end of December 2006. The number of authorized brokers rose from five to sixteen and the number of listed companies rose from three to 25 (including five mutual funds) by the end of December 2006.

Commencing in 2004, Eurobonds issued by the Republic have been listed on the Beirut Stock Exchange. To date, 16 issues of Eurobonds were listed on the Beirut Stock Exchange.

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 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 Government finances must take account of the following:

- The CDR is a public institution which is distinct from any ministry within the 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

Country Profile 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 Government operations for the period from 2002 to 2006:

Revenues (in billions of Lebanese Pounds)	2002	2003	2004	2005	2006
I. Tax revenues	3,995	4,502	5,169	4,867	4,922
II. Non-tax revenues	1,390	1,717	1,907	2,117	1,945
III. Budget revenues (I+II)	5,385	6,219	7,075	6,984	6,867
IV. Treasury revenues	445	436	439	421	427
V. Total revenues (III+IV)	5,830	6,654	7,514	7,405	7,295
Expenditures					
I. Current expenditures	8,321	8,820	8,051	7,924	8,927
Personnel cost ⁽¹⁾	3,008	3,087	3,094	3,193	3,307
Debt service	4,622	4,874	4,021	3,534	4,557
Other current	691	871	936	1,197	1,063
II. Capital expenditures⁽²⁾	610	714	817	534	551
III. Other Treasury expenditures	1,208	1,047	1,672	1,745	2,399
IV. Total expenditures^{(3) (4)}	10,139	10,592	10,540	10,203	11,877
Total Deficit	4,308	3,938	3,026	2,798	4,582
Budget balance	(3,101)	(2,591)	(1,231)	(818)	(1,773)
Budgetary revenues	5,385	6,219	7,075	6,984	6,867
Budgetary expenditures	8,487	8,810	8,306	7,802	8,641
Net Treasury operations	(1,207)	(1,347)	(1,796)	(1,980)	(2,808)
Treasury receipts	445	436	439	421	427
Treasury outlays	1,652	1,783	2,235	2,401	3,236
% of GDP					
Total deficit ⁽⁵⁾	15.28%	13.19%	9.39%	8.66%	13.43%
Total revenues ⁽⁵⁾	20.67%	22.30%	23.33%	22.92%	21.39%
Total expenditures ⁽⁵⁾	35.94%	35.49%	32.72%	31.59%	34.82%
Nominal GDP (in billions of Lebanese Pounds) ⁽⁶⁾	28,209	29,846	32,214	32,303	34,111

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 195 billion in 2002, LL 201 billion in 2003, LL 235 billion in 2004, LL 150 billion in 2005 and LL 300 billion in 2006.
- (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 BDL 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) increased from LL 5,830 billion in 2002 to LL 6,654 billion in 2003 and LL 7,514 billion in 2004. Revenues decreased to LL 7,405 billion in 2005 and LL 7,295 billion in 2006. As a percentage of GDP, total revenues increased from 20.67 per cent. in 2002 to 22.30 per cent. in 2003 and to 23.33 per cent. in 2004. Revenues represented 22.92 per cent. and 21.39 per cent. of GDP in 2005 and 2006, respectively.

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) increased from LL 10,139 billion in 2002 to LL 10,592 billion in 2003 and decreased to LL 10,540 billion in 2004 and LL 10,203 billion in 2005, but increased to LL 11,877 billion in 2006. Debt servicing expenditures increased from LL 4,622 billion in 2002 to LL 4,874 billion in 2003 but decreased to LL 4,021 billion in 2004 and LL 3,534 billion in 2005 as a direct impact of Paris II and the debt management operations that ensued. However, debt service increased to LL 4,557 billion in 2006 following the maturity of the zero coupon LL and foreign currency denominated bonds issued to commercial banks in the context of their contribution to the Paris II Conference. Personnel costs also rose, although more moderately, over the period, from LL 3,008 billion in 2002 to LL 3,193 billion in 2005 and LL 3,307 billion in 2006.

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 2002 to 2006:

	2002	2003	2004	2005	2006
GDP (at current market prices in billions of Lebanese Pounds)	28,209	29,846	32,214	32,303	34,111
Total Deficit ⁽¹⁾	4,308	3,938	3,026	2,798	4,582
Deficit/GDP ⁽¹⁾	15.28%	13.19%	9.39%	8.66%	13.43%
Net Public Debt/GDP	172%	168%	166%	163%	166%

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 domestic borrowing.

The primary balance, representing total revenues less primary expenditures (i.e. total expenditures excluding debt service) has improved by 10 per cent. of GDP between the years 2000 and 2004. This improvement is considered significant when compared to other countries. However, the years 2005 and 2006 witnessed a slowdown in that trend due to the impact of Prime Minister Hariri's assassination in February 2005 and the July 2006 War.

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

	2002	2003	2004	2005	2006
(in billions of Lebanese Pounds)					
Total Revenues	5,830	6,654	7,514	7,405	7,295
Total Expenditures	10,139	10,592	10,540	10,203	11,877
Debt Service	4,622	4,874	4,021	3,534	4,557
Primary Surplus	314	936	995	736	(25)
% of GDP	1.11%	3.14%	3.09%	2.28%	(0.07)%
Nominal GDP	28,209	29,846	32,214	32,303	34,111

Source: Ministry of Finance.

The 2005 Budget

A first draft budget proposal was prepared under the Government of Mr. Hariri and sent to the Council of Ministers on September 27, 2004 to be discussed. The draft budget proposal included a comprehensive set of reforms. However, the resignation of the Hariri Government on October 20, 2004 did not permit completion of the process. A second draft budget proposal was prepared by the Karami Government and sent to the Council of Ministers on February 25, 2005. The resignation of the Karami Government on February 28, 2005 also prevented completion of the process. After the formation of the Mikati Government, the draft budget proposal prepared under the Karami Government was sent to the Ministries in order to allow the then newly appointed Ministers to review their budget allocations. Comments were sent back to the Ministry of Finance, however, due to the short tenure of the Mikati Government (which constitutionally ended on June 20, 2005), no budget proposals was sent to the Council of Ministers. A third draft budget proposal was prepared under the Siniora Government and sent to the Council of Ministers on September 14, 2005 for review and adoption. On November 24, 2005 budget proposal was submitted to Parliament and approved by Parliament on February 2, 2006 as Budget Law 715. Although the 2005 Budget was approved outside the constitutional deadline, the Government believed it was necessary for formal approval to take place so that approval of the 2006 Budget and subsequent budgets were not affected.

The 2006 Budget

The 2005 budget approval delay led to a delay in the preparation and adoption of the 2006 Budget as the former had to be approved by the Council of Ministers and Parliament prior to the 2006 Budget. Two other factors contributed to the delay:

- 2006 was the first year of the reform program and as such the budget contained measures that required separate approval and adoption by Parliament; and
- The July 2006 War required amendments to the budget proposal and accordingly, its submission to the Council of Ministers and Parliament had to be postponed.

On January 1, 2007, The Council of Ministers approved the 2006 budget proposal and submitted it to Parliament.

In the absence of Budgets for 2005 and 2006, Government expenditures took place in accordance with the "one-twelfth" rule whereby the Government is authorized to spend monthly one-twelfth of the previous Budget (i.e. the 2004 Budget).

Actual Results for 2004-2006

The following table sets forth summaries of the actual results for the years ended December 31, 2004; December 31, 2005, and December 31, 2006 respectively:

<i>(in billions of Lebanese Pounds)</i>	2004	2005	2006
Total Revenues	7,515	7,405	7,295
Budget Revenues	7,075	6,984	6,867
Treasury Revenues	439	421	427
Total Expenditures ⁽¹⁾	10,541	10,203	11,877
Budget Expenditures ⁽¹⁾	8,306	7,802	8,641
Treasury Expenditures	2,235	2,401	3,236
Total Deficit	(3,026)	(2,798)	(4,582)
Total Primary Surplus	996	736	(25)

Source: Ministry of Finance.

Note:

- (1) Excluding foreign financed CDR capital expenditures, and in 2006 further excludes the reconstruction of war damaged infrastructure financed by grants, which are also netted out from the revenues.

Total revenues were LL 7,405 billion in 2005, as compared to LL 7,515 billion in 2004, representing a decline of slightly over 1 per cent.. Tax revenues decreased by 6 per cent. in 2005 due to a large extent to a decrease in revenues from international trade taxes and, to a lesser extent, decreases in revenues from domestic taxes on goods and services and fiscal stamp fees. Non-tax revenues increased by 11 per cent. as compared to 2004, mainly as a result of an increase of nearly 15 per cent. in revenues from public institutions and Government properties.

Total expenditures (budget and Treasury) were LL 10,203 billion in 2005, as compared to 10,540 billion in 2004, representing a decrease of 3.2 per cent.. The principal reason for the decrease in expenditures is lower debt service payments which were at their lowest level since 1998. The reduction in debt service was mainly due to a near 32 per cent. decline in the servicing of the domestic debt. The decline in the debt service bill was due to the persistent positive impact of Paris II transactions and the overall decline in interest rates.

Total deficit was LL 2,798 billion in 2005, as compared to LL 3,026 billion in 2004, an improvement of 7.5 per cent.. The primary surplus decreased in 2005 to LL 736 billion, as compared to LL 996 billion in 2004, a decline of 26 per cent..

Total revenues for 2006 were impacted by the July 2006 War, the subsequent near two months blockade, the subsequent political instability and the increase in international oil prices during the second and the third quarter of the year. As a result, total revenues were LL 7,295 billion, reflecting a 2 per cent. decrease as compared to 2005 revenues. An 8 per cent. decrease in non tax revenue was partially offset by 1 per cent. and 2 per cent. increases in tax revenues and Treasury receipts respectively. Domestic taxes on goods and services (namely VAT) and taxes on international trade declined by 3 per cent. and 15 per cent. respectively, which were offset by increases of 11 per cent. in revenues from income taxes and 40 per cent. in revenues from property taxes. The decrease in non-tax revenue resulted from a 14 per cent. decline in income from public institutions and Government properties which, in turn, was caused to a large extent by an 11 per cent. decline in the transfer from the telecom budget surplus (due to the costs of repairing damage to the fixed and mobile networks caused by the July 2006 War and to the settlement amounts paid to the previous mobile operators) and the absence of transfers from the Port of Beirut.

Total expenditures for 2006 were LL 11,877 billion, as compared to LL 10,203 billion in 2005, representing an increase of 16 per cent. (this expenditure figure does not account for the LL 298 billion of reconstruction spending on war damaged infrastructure financed by grants, which are also not recorded under revenues). This increase is mainly due to increases of approximately 29 per cent. and 10 per cent. in interest payments and non-interest expenditures, respectively. The increase in the debt service expenditures in 2006 results from an approximately 55 per cent. increase in debt service on LL-denominated Treasury obligations and a 9 per cent. increase in debt service on foreign currency denominated Treasury obligations. These increases result from maturities in 2005 and the subsequent refinancing of the zero coupon bonds issued to commercial banks in the

context of the Paris II Conference. The increase in non-interest bearing expenditures is due principally to a 64 per cent. increase in transfers to EDL and a 4 per cent. increase in personnel cost spending related to security measures under UN resolution 1701.

Due to the increases in interest and non-interest expenditures and lower revenues, the fiscal balance registered a deficit of LL 4,582 billion in 2006, as compared to a deficit of LL 2,798 billion in 2005, a deterioration of 64 per cent.. The primary balance registered a deficit of LL 25 billion for 2006 as compared to a surplus of LL 736 billion in 2005 a deterioration of 103 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. A new 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 collection of income tax.

In January 2003, Parliament adopted the 2003 Budget Law, pursuant to which interest paid in respect of bonds issued by the Lebanese Republic after January 31, 2003 and by private entities as well as interest paid in respect of bank deposits and other interest bearing assets is subject to withholding tax at the rate of five per cent. *See "Taxation - Lebanese Taxation"*.

The Government is engaged in a series of reforms to strengthen and modernize tax administration. These reforms include, among others, (i) the creation of a specialized unit to manage the withholding tax on wages and salaries (in 2003); (ii) a Tax Roll Department to update and manage the taxpayers identification database (in 2003); and (iii) the establishment of a Large Taxpayers' Office (in 2005). The Government is currently working on the reorganization of the revenue administration along a function-based structure with strong headquarters and operational regional offices. On the legal side, a tax procedure code has been prepared and work on a Global Income Tax is underway.

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. 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.

As discussed elsewhere in this Country Profile, the Government's economic reform program includes a restructuring of the pension system.

