



Public Finance Prospects 2004 Ministry of Finance Yearly Report

☒ **General Fiscal Developments:** The total deficit¹ declined from LL 3,938 billion in 2003 to LL 3,026 billion in 2004. In terms of GDP, the total deficit reached one of its lowest post-war levels at 10.3 percent of GDP, down from 14.5 percent in 2003. The year 2004 sustained a primary surplus of LL 335 billion, or 3.4 percent of GDP, remaining almost stable when compared to 2003 ([section 1](#)).

☒ **Revenues and Expenditures:** The LL 912 billion decline registered in the total deficit between 2003 and 2004 was due to two main reasons:

(i) an increase in revenues from 24.5 percent of GDP in 2003 to 25.5 percent in 2004, owing to across-the-board stronger tax revenues, especially VAT² and income tax in addition to a rise in non-tax revenues, more specifically the transfer from the telecom surplus³,

(ii) a decline in total expenditures from 38.9 percent of GDP in 2003 to 35.8 percent in 2004, which resulted from the sharp decrease in debt service, a direct result of the Paris II conference ([section 2 and 3](#)).

☒ **Public Debt Developments:** By the end of 2004, debt ratios declined for the first time in the post-war era. Indeed, net debt declined to 168.9 percent of GDP from 173.8 percent by the end of 2003. The gross stock of debt, which cumulated at LL

54,048 billion, also declined from 184.9 percent of GDP in 2003 to 183.7 percent. Foreign debt amounted to LL 27,677 billion by year end, marking a total rise of LL 4,235 billion from the year end 2003 outcome ([section 4](#)).

☒ **External Trade:** The deficit in the trade balance reached USD 7,650 million by year end 2004, increasing by 36 percent when compared to the previous year. A USD 2,229 million, or 31 percent increase in imports, which could not be offset by the USD 233 million increase in exports, stands behind the rise in the balance of trade deficit ([section 5](#)).

☒ **VAT Developments:** On the VAT front, the year 2004 witnessed: (i) a 9 percent rise in the amount of internal VAT declared by businesses where trade and services were the highest contributors to the VAT. (ii) A 31 percent rise in the amount of VAT declared at customs from the import of merchandise, namely from fuel import ([section 6](#)).

Contents

| | |
|----------------------------------|---------|
| Fiscal Overview..... | Page 2 |
| Revenue Outcome..... | Page 3 |
| Expenditure Outcome..... | Page 9 |
| Public Debt..... | Page 14 |
| Evolution of External Trade..... | Page 19 |
| Value Added Tax..... | Page 26 |

¹ Public finance numbers are on a cash basis.

² Owing to higher growth rates, higher gasoline prices, and the Euro appreciation.

³ Partly due to the new management contracts.

Section I: Fiscal Overview 2004

Table 1. Summary of Fiscal Performance

| (LL billion) | 2003 | 2004 | 2003 | 2004 | Change | % |
|---------------------------------------|-------------|-------------|---------------|---------------|--------------|----------------|
| | December | December | Jan-Dec | Jan-Dec | 2003-2004 | Change |
| Budget Revenues | 578 | 721 | 6,219 | 7,075 | 857 | 13.78% |
| Budget Expenditures <i>of which:</i> | 732 | 638 | 8,810 | 8,306 | -504 | -5.72% |
| <i>Debt Service</i> | 487 | 389 | 4,874 | 4,021 | -853 | -17.50% |
| Budget Deficit/Surplus | -155 | 83 | -2,591 | -1,231 | 1,361 | -52.51% |
| in % of Budget Expenditures | -21.10% | 13.05% | -29.41% | -14.82% | | |
| Budget Primary Deficit/Surplus | 333 | 472 | 2,283 | 2,791 | 508 | 22.24% |
| in % of Budget Expenditures | 45.45% | 74.08% | 25.92% | 33.60% | | |
| Treasury Receipts | 47 | 31 | 436 | 439 | 3 | 0.72% |
| Treasury Payments | 258 | 385 | 1,783 | 2,235 | 452 | 25.36% |
| Total Budget and Treasury Receipts | 625 | 752 | 6,654 | 7,514 | 860 | 12.92% |
| Total Budget and Treasury Payments | 990 | 1,023 | 10,592 | 10,540 | -52 | -0.49% |
| Total Cash Deficit/Surplus | -365 | -271 | -3,938 | -3,026 | 912 | -23.15% |
| in % of Total Expenditures | -36.86% | -26.53% | -37.18% | -28.71% | | |
| Primary Deficit/Surplus | 122 | 118 | 936 | 995 | 59 | 6.29% |
| in % of Total Expenditures | 12.35% | 11.51% | 8.84% | 9.44% | | |

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

By year end 2004, the **total deficit** (budget and treasury) was equivalent to 10.3 percent of GDP⁴, declining from 14.5 percent of GDP and reaching one of its lowest post-war levels. This amelioration was made possible through parallel improvements in both revenues and expenditures. In fact, while revenues increased from 24.5 percent of GDP in 2003 to 25.5 percent in 2004, expenditures declined from 38.9 percent of GDP in 2003 to 35.8 percent in 2004. The year 2004 sustained a **primary surplus** of LL 995 billion, or 3.4 percent of GDP, remaining almost stable when compared to 2003.

The **budget deficit** improved by 52.5 percent compared to 2003. In terms of GDP, it ameliorated from 9.5 percent of GDP in 2003 to 4.1 percent in 2004. Behind this progress is a combination of budget revenue and expenditure improvements. Namely, tax revenues registered a 14.8 increase, and non tax revenues recorded an 11 percent increase, pulling **budget revenues** up by 13.78 percent, from a level of LL 6,219 billion in 2003 to LL 7,075 billion in 2004. Likewise, **budget expenditures** witnessed a 5.7 percent decrease from LL 8,810 billion in 2003 to LL 8,306 billion in 2004 as a result of the 17.5 percent decline in debt service.

⁴ As per the latest GDP estimates (MOF, BDL, & IMF), GDP for 2003 equals LL 27,198 billion, while GDP for 2004 equals LL 29,416 billion.

Section II: Revenue Outcome

Table 2. Total Revenue

| (LL billion) | 2003 December | 2004 December | 2003 Jan-Dec | 2004 Jan-Dec | % Change |
|-----------------------------------|------------------|------------------|-----------------|-----------------|---------------|
| Budget Revenues, of which: | 578 | 721 | 6,219 | 7,075 | 13.78% |
| <i>Tax Revenues</i> | 392 | 466 | 4,502 | 5,169 | 14.81% |
| <i>Non-Tax Revenues</i> | 185 | 256 | 1,717 | 1,907 | 11.06% |
| Treasury Receipts | 47 | 31 | 436 | 439 | 0.72% |
| Total Revenues | 625 | 752 | 6,654 | 7,514 | 12.92% |

Source: MOF, DGF

Tax revenues (as part of budget revenues) generated LL 5,169 billion in 2004, equivalent to 17.6 percent of GDP compared to 16.6 in 2003. This 15 percent spur in tax revenues in 2004 is a result of a) a more buoyant economic activity, indicated by the 5 percent estimated real growth rate for 2004 (compared to 3 percent in 2003) which has unfolded to an improvement in consumption, and b) improvements in income tax collection.

Tax on income, profits and capital gains generated LL 908 billion or 3.1 percent of GDP for 2004, compared to LL 783 billion or 2.9 percent of GDP in 2003. This 16 percent improvement in the collection of income taxes is attributed to ameliorations in most of its components, namely income taxes on profits, capital gains and dividends, interest income, and penalties. More specifically, the following developments were witnessed:

(a) Collection of **income tax on profits and on capital gains** in 2004 is applicable to profits and dividends realized one year earlier, i.e. in 2003. Since the year 2003 was positively impacted by improved economic activity in comparison with 2002 (nominal growth in 2003 was estimated at 4.3 percent compared to 3.8 percent in 2002), profits realized in 2003 which were filed and declared in 2004 registered an increase.

In fact, **income taxes on profits** filed and declared in 2004 grew by 5 percent, totaling LL 418 billion by year end.

Considering the amounts net of the regularization dues pertaining to the Tax Amnesty Law⁵, the year-on-year growth rate in income tax on profit collection has grown by around 13 percent.

With receipts totaling LL 79 billion in 2004, **income taxes on capital gains** witnessed a 56 percent rise when compared to the amount collected in 2003, somehow returning to 2001-2002 collection levels.

(b) The **5% tax on interest income**, which collected LL 229 billion by December 2004, yielded 58 percent higher revenues than in 2003, owing to a number of factors: a) the annualized effect of collecting the tax (compared to a 10 months collection in 2003⁶), b) the 14 percent year-on-year growth in private deposits in the banking sector and c) the increased volume of securities' issuance in 2004 compared to 2003⁷

⁵The Tax Amnesty Law was ratified in 2001 and resulted in a tax regularization assessment of LL 161 billion. It permitted the payment on installments of the regularization dues. Accordingly, LL 99 billion were collected in 2002, LL 32 billion in 2003 and LL 6 billion in 2004.

⁶Please note that the implementation of the 5% tax on interest income was effective in February 2003 as per the 2003 Budget Law (Law 497). Additionally, from a cash basis perspective, the tax in 2003 was effectively collected over 10 months only, as proceeds from the month of December were filed and paid in January of the following year.

⁷Please note that the 5% tax on interest is not levied on coupon payments pertaining to debt issued prior to the implementation of the tax.

Table 3. Tax Revenue

| (LL billion) | 2003 | 2004 | 2003 | 2004 | % |
|---|------------|------------|--------------|--------------|---------------|
| | December | December | Jan-Dec | Jan-Dec | Change |
| Tax Revenues: | 392 | 466 | 4,502 | 5,169 | 14.81% |
| Taxes on Income, Profits, & Capital Gains, of which: | 53 | 52 | 783 | 908 | 15.92% |
| Income Tax on Profits | 25 | 23 | 397 | 418 | 5.34% |
| Income Tax on Wages and Salaries | 5 | 4 | 173 | 160 | -7.65% |
| Income Tax on Capital Gains & Dividends | 2 | 2 | 51 | 79 | 55.87% |
| Tax on Interest Income (5%) | 17 | 19 | 145 | 229 | 57.87% |
| Penalties on Income Tax | 4 | 3 | 15 | 19 | 28.12% |
| Taxes on Property, of which: | 47 | 59 | 321 | 405 | 26.00% |
| Built Property Tax | 10 | 13 | 82 | 106 | 29.36% |
| Real Estate Registration Fees | 32 | 42 | 203 | 261 | 28.59% |
| Domestic Taxes on Goods & Services, of which: | 118 | 185 | 1,537 | 1,971 | 28.26% |
| Value Added Tax | 100 | 165 | 1,361 | 1,763 | 29.55% |
| Other Taxes on Goods and Services, of which: | 17 | 20 | 166 | 194 | 17.06% |
| Private Car Registration Fees | 10 | 11 | 92 | 109 | 19.50% |
| Passenger Departure Tax | 7 | 9 | 71 | 82 | 15.45% |
| Taxes on International Trade, of which: | 155 | 149 | 1,643 | 1,617 | -1.61% |
| Customs | 50 | 51 | 475 | 530 | 11.41% |
| Excises, of which: | 105 | 98 | 1,168 | 1,087 | -6.90% |
| Petroleum Tax | 72 | 52 | 819 | 644 | -21.30% |
| Tobacco Tax | 16 | 15 | 185 | 197 | 6.57% |
| Tax on Cars | 16 | 31 | 161 | 241 | 49.96% |
| Other Tax Revenues, of which: | 19 | 20 | 217 | 268 | 23.31% |
| Fiscal Stamp Fees | 19 | 20 | 216 | 267 | 23.40% |

Source: MOF, DGF

(c) **The income tax on wages and salaries** collected LL 160 billion in 2004 compared to LL 173 billion in 2003. The 8 percent lower collection in 2004 is explained by the changed schedule of payment of the tax in 2003, from semi annual to quarterly⁸, resulting in one quarter extra collection during 2003.

When neutralizing the cash impact of the changed schedule of payment, the collection of the withheld tax on wages and salaries in 2004 shows a 10 percent higher collection than its level in 2003, owing to the *Deduction At*

Source on wages and Salaries (DASS) reform effort⁹. In fact, comparing the yield of the wages and salaries tax post DASS reform (i.e. in 2003-2004) as opposed to that of earlier years (2001-2002), reveals an approximate 24 percent rise in average yearly receipts, owing to: (1) the enlargement of the tax base through the construction of an exhaustive public sector and private sector employee database, and (2) the improvement in tax procedures and tax collection.

⁸ By virtue of Article 21 of Budget Law 2003, the schedule of payment of the tax was amended.

⁹ For further details on the DASS reform of the Wages and Salaries tax please refers to "Reform Program @ the Ministry of Finance" November 2004, on the Ministry's web-site.

Proceeds from the **built property tax** cumulated at LL 405 billion by the end of December 2004, accounting for 26 percent more revenues than the collection level in 2003. Out of the total amount, LL 106 billion represents the yield from the **recurrent tax on built property** which witnessed a 29 percent rise in collection in 2004. Similarly, **real estate registration fees**, totaling LL 261 billion in 2004, recorded 29 percent higher collection, reflecting enhanced activity in the real estate sector.

Total receipts from **domestic taxes on goods and services** amounted to LL 1,971 billion in 2004. This 28 percent rise was mainly due to a better performance by the VAT which accounts for nearly 90 percent of all proceeds from domestic taxes on goods and services. With LL 1,763 billion collected by December 2004¹⁰, the VAT generated 6 percent of GDP in 2004 against 5 percent in 2003 and 3.8 percent in 2002, its first year of implementation. Of total VAT collected in 2004, LL 515 billion represents VAT collected internally from domestic activities. This number has increased by 12 percent compared to internal VAT collection in 2003, reflecting more buoyant economic activity in the country, and confirming higher growth estimates for 2004. In fact, whereas quarterly declarations generated on average LL 109 billion in 2003, they amounted to LL 121 billion on average in 2004. Reflecting the usual trend, October declarations, pertaining to the busiest summer months of July-September, account for 28 percent to 30 percent of total internal VAT collection, compared to an average share of 22 percent - 24 percent for the remaining quarters. It is worth noting that VAT refunds paid by the Treasury in 2004 amounted to LL 75 billion, compared to LL 38 billion paid in 2003¹¹.

¹⁰ On a cash basis.

¹¹ The VAT incurred is refunded to exporters, exempt sectors, diplomats and international organizations, and VAT

VAT revenues collected at imports in 2004 amounted to LL 1,248 billion compared to LL 903 billion in 2003, representing a 28 percent year-on-year increase and thereby capturing, to a large extent, the 31 percent rise in imports¹².

Domestic taxes on goods and services also include: (1) private car registration fees¹³ in the amount of LL 109 billion, rising by approximately 20 percent from their collection level in 2003, and mirroring the boost in the car market as indicated by an approximate 42 percent rise in car imports¹⁴; and (2) the passenger departure tax which collected LL 82 billion in 2004, compared to LL 71 billion in 2003, indicating more passenger flows in 2004 as evidenced by the 26 percent rise in the number of tourists in 2004 compared to 2003 (1,278,469 incoming tourists in 2004).

Taxes on international trade (custom duties and excises) generated LL 1,617 billion by the end of December 2004 compared to LL 1,643 billion collected in 2003. In 2004, revenues from excises made up 67 percent of the LL 1,617 billion while revenues from custom duties constituted the remaining 33 percent. In 2003, the share of excise revenues was even higher at 71 percent while that of custom duties amounted to 29 percent. The LL 28 billion decline in taxes on international trade is a direct result of the capping of car fuel prices

creditors. Please refer to the VAT section for further details on Refund. However, note that the above mentioned figures are computed on a cash basis, whereas figures in the VAT section are claimed amounts as per declaration forms.

¹² Please note that of the LL 1,248 billion of VAT at customs in 2004, an amount equivalent to approximately LL 90 billion pertains to VAT on fuel imports already collected in 2002 and in 2003, and recorded as "guarantees" under Treasury revenues, and reclassified in 2004 as VAT revenues. Therefore, for a more accurate analysis, the LL 90 billion should be netted out from the total VAT collected at imports in 2004. Accordingly, import VAT in 2004 became LL1,158 billion, representing a 28% increase over the previous year's collection level.

¹³ One time fee paid upon the purchase of a car.

¹⁴ For further details, please refer to the External Trade Section.

at pump stations starting May 2004, following a Council of Ministers' decision,

in response to increasing international oil prices. This capping translated into a lower fuel excise rate levied by the Treasury. In fact, with LL 1,087 billion collected in 2004, total **excise revenues**¹⁵ witnessed an approximate 7 percent decrease compared to their collection level in 2003.

Despite a 33 percent rise in the effective import price of car fuel, its consumption did not witness any set back in 2004. On the contrary, the quantity of car fuel imported registered a 1 percent increase, as explained by (a) higher consumption in the economy in 2004 as suggested by the various economic indicators, (b) relatively inelastic demand for fuel products, and (c) the capping of the fuel price at LL 23,000 per gallon at pump stations as of May 2004, safeguarding consumers from rising oil prices. As a result, the Treasury bore the cost of lowering the excise rate in terms of forgone revenues. In fact, the effective tariff rate was reduced from 166 percent in 2003, to 103 percent in 2004. With LL 644 billion **fuel excise** revenues collected in 2004 compared to LL 819 billion in 2003, the loss incurred by the Treasury may be calculated at LL 109 per liter of car fuel imported.

The loss from fuel excise was however compensated, to a certain extent, by higher receipts from tobacco and car excises. By year end 2004, **excises levied from tobacco** imports registered LL 12 billion additional revenues over the amount collected in 2003. This is explained by an approximate 9 percent rise in tobacco imports. Additional evidence of a more profitable tobacco market in 2004 is apparent from the transfer to the Treasury of the Régie Des Tabacs' surplus, which amounted to LL 5 billion in

2004, significantly higher than previous years' transfers¹⁶.

Similarly, with LL 241 billion of receipts in 2004, **car excises** achieved a 50 percent higher collection compared to the previous year's collection, mirroring the 42 percent rise in car imports¹⁷.

Besides the revenues from excises, the Treasury collected LL 530 billion from **customs duties** in 2004, approximately 12 percent higher than 2003 receipts, owing to 31 percent higher imports¹⁸. Following several drops in the effective customs rate, witnessed during the period 2000-2003¹⁹; the effective customs rate in 2004 stabilized at 5 percent.

Other tax revenues, namely fiscal stamp duties, collected LL 268 billion in 2004, adding LL 51 billion (equivalent to 23 percent) over the 2003 level of collection, reflecting more active transactions in the economy in 2004.

¹⁶ Over the period 2000-2003 the transfers to the Treasury from the Régie des Tabacs have been minimal, often well below the hundred millions Lebanese pounds.

¹⁷ As has been witnessed in 2003, and despite the appreciation of the Euro, the number of cars imported in 2004 increased from 31,294 in 2003 to 45,969 cars in 2004, but the average price per car dropped by approximately 3.6 percent, suggesting that the Lebanese car market has engaged in a substitution process towards cheaper cars.

¹⁸ Please note that the 5% effective customs duties rate did not reap the inflation at imports caused by rising oil prices and Euro appreciation in the same magnitude as the 10% VAT, due to the fact that barely any custom duties are levied on fuel products (the number one import category), and that custom duties on cars (among the top five import categories) are levied only partly ad-valorem (and partly as a fixed amount per car according to a set of qualifications), unlike the VAT which collects 10% on all values.

¹⁹ Due to two factors: (a) the year 2000 customs policy which reduced tariff rates along a vast variety of goods and (b) the reclassification process of customs duties into excises for fuel and tobacco products in 2002.

¹⁵ Excises are collected at imports on car fuel, tobacco and cars mainly, and on alcoholic beverages.

Table 4. Non-Tax Revenue

| (LL billion) | 2003 | 2004 | 2003 | 2004 | % |
|---|------------|------------|--------------|--------------|----------------|
| | December | December | Jan-Dec | Jan-Dec | Change |
| Non-Tax Revenues | 186 | 255 | 1,717 | 1,907 | 11.06% |
| Income from Public Institutions and Government Properties, of which: | 142 | 206 | 1,252 | 1,448 | 15.65% |
| Income from Non-Financial Public Enterprises, of which: | 137 | 202 | 1,182 | 1,391 | 17.72% |
| <i>Revenues from Casino Du Liban</i> | 2 | 9 | 39 | 42 | 8.87% |
| <i>Budget Surplus of National Lottery</i> | 3 | 3 | 35 | 37 | 4.29% |
| <i>Transfer from the Telecom Surplus</i> | 111 | 190 | 1,086 | 1,310 | 20.61% |
| Property Income (namely rent of Beirut International Airport) | 3 | 3 | 58 | 48 | -16.86% |
| Other Income from Public Institutions (interests) | 2 | 1 | 12 | 8 | -30.64% |
| Administrative Fees & Charges, of which: | 36 | 42 | 383 | 365 | -4.68% |
| Administrative Fees, of which: | 24 | 32 | 299 | 284 | -5.13% |
| <i>Notary Fees</i> | 2 | 2 | 16 | 17 | 7.53% |
| <i>Passport Fees/ Public Security</i> | 8 | 8 | 87 | 90 | 3.14% |
| <i>Vehicle Control Fees</i> | 9 | 17 | 146 | 129 | -11.95% |
| <i>Judicial Fees</i> | 2 | 2 | 20 | 20 | -0.69% |
| <i>Driving License Fees</i> | 2 | 1 | 14 | 15 | 4.67% |
| Administrative Charges | 5 | 4 | 26 | 28 | 9.52% |
| Sales (Official Gazette and License Number) | 2 | 1 | 9 | 4 | -54.36% |
| Permit Fees (mostly work permit fees) | 4 | 4 | 41 | 41 | -0.58% |
| Other Administrative Fees & Charges | 1 | 1 | 8 | 8 | -0.12% |
| Penalties & Confiscations | 0 | 0 | 6 | 5 | -12.33% |
| Other Non-Tax Revenues (mostly retirement deductibles) | 7 | 7 | 75 | 88 | 16.57% |

Source: MOF, DGF

Maintaining the same share of total revenues (approximately 27 percent), and the same ratio over GDP (around 6 percent) as in 2003, **non-tax revenues** generated LL 1,907 billion, 11 percent higher than the amount collected in 2003, emanating solely from increased revenues from government owned properties.

Income from public institutions and government property generated LL 1,448 billion by December 2004; registering an approximate 16 percent rise from the level achieved in 2003. A total of LL 1,310 billion, equivalent to 90 percent of total

revenues from government properties, is transferred to the Treasury from the **budget surplus of telecommunications** (both mobile and fixed lines), compared to LL 1,086 billion transferred in 2003, pulling the ratio to GDP from nearly 4 percent in 2003 to 4.5 percent in 2004. This 21 percent rise in receipts from the telecommunication sector²⁰ may be attributed to an enhanced growth in the sector, as witnessed by improved consumption indicators, and to

²⁰ The breakdown of telecom receipts by mobile and fixed line is not available.

less costly management contracts awarded to the two mobile licenses in March 2004.

The Government further received LL 42 billion from the **Casino du Liban** and LL 37 billion from the **budget surplus of the National Lottery**, registering 9 and 4 percent year-on-year increases respectively. With LL 48 billion collected in 2004, receipts from **Beirut International Airport** receded by almost 17 percent when compared to the previous year's receipt, due to the fact that, in QI 2003, the Treasury collected a lump-sum payment from BIA. There were no revenues from the **Port of Beirut** in 2004 compared to LL 20 billion in 2003.

Administrative fees and charges collected LL 365 billion in 2004, almost 5 percent less than their level in 2003. This is explained by a 12 percent drop in **vehicle control fees**²¹, which totaled LL 129 billion for 2004 compared to LL 146 billion for 2003. This may be due to delays in collection caused by the implementation of a new car checking system. In fact, starting the beginning of 2004, a private company has been contracted for a car security control process, as a prerequisite for the settlement of the vehicle control fees.

Other fees, namely **notary fees** and **passport fees** registered 7 and 3 percent year-on-year increases, cumulating at LL 17 billion and 90 billion respectively; while **judicial fees**, **driving license fees** and **permit fees** (mostly work permit) maintained their previous year's levels at LL 20 billion, around LL 14 billion, and LL 41 billion respectively.

Administrative charges (which include public exam fees, registration fees in public schools and the Lebanese University, and fees from port authorities) collected LL 28 billion in 2004, compared to LL 26 billion in 2003.

Treasury Revenues in 2004 cumulated at LL 439 billion, of which LL 109 billion constitute municipalities' revenues, LL 94 billion are guarantees, and LL 72 billion are deposits.

²¹ Also known as mechanic fees

Section III: Expenditure Outcome

Table 5. Expenditures by Transaction Classification

| (LL billion) | 2003 | 2004 | 2003 | 2004 | % |
|--|------------|--------------|---------------|---------------|---------------|
| | December | December | Jan-Dec | Jan-Dec | Change |
| Total Expenditures | 990 | 1,023 | 10,592 | 10,540 | -0.49% |
| Budget Expenditures | 732 | 638 | 8,810 | 8,306 | -5.72% |
| Expenditures Excluding Debt Service | 245 | 248 | 3,935 | 4,284 | 8.86% |
| Debt Service, of which: | 487 | 389 | 4,874 | 4,021 | -17.50% |
| Domestic Debt | 220 | 152 | 3,108 | 2,246 | -27.74% |
| Foreign Debt | 267 | 237 | 1,766 | 1,776 | 0.52% |
| Treasury Expenditures , of which: | 258 | 385 | 1,783 | 2,235 | 25.36% |
| Municipalities | 19 | 8 | 180 | 461 | 156.26% |
| Previous Years' Appropriations | 173 | 173 | 739 | 619 | -16.26% |
| Non-Interest Expenditures (Total Expenditures minus Debt Service) | 503 | 634 | 5,718 | 6,519 | 14.01% |

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

Total Expenditures (budget and treasury)

dropped from 38.9 percent of GDP in 2003 to 35.8 percent in 2004. In absolute terms, expenditures decreased slightly from LL 10,592 billion in 2003 to LL 10,540 billion in 2004.

Budget expenditures, amounting to LL 8,306 billion, registered a decline of LL 504 billion when compared to the preceding year. However, this fall was offset by the rise in treasury spending from LL 1,783 billion in 2003 compared to LL 2,235 billion in 2004. This balancing out effect led to the almost stable level of total spending, in absolute terms.

Non-interest expenditures (primary total expenditures) amounted to LL 6,519 billion in 2004, equivalent to 22 percent of GDP, increasing by LL 801 billion or 2.7 percent (of GDP) from their level in 2003, which was equivalent to 21 percent of GDP.

When expenditures are examined from an economic-oriented perspective, current expenditures are found to have declined while other types

of spending such as treasury and capital spending have risen.

Current expenditures cumulated at LL 8,051 billion in 2004, LL 692 billion below the amount budgeted in 2004 Budget Law (LL 8,743 billion), due to the lower than expected debt service and primary current expenditure spending. Between 2003 and 2004, current expenditures declined by LL 780 billion, in large part owing to the LL 853 billion drop in the debt service bill.

Primary current expenditures amounted to LL 4,030 billion, LL 413 billion below the budgeted LL 4,443 billion. The difference mainly comes from higher budgeted amounts for personnel costs. When comparing to 2003, primary current expenditures witnessed an augmentation amounting to LL 73 billion, largely explained by the hikes in 'various transfers' and 'external services'. The details of current expenditures are highlighted in what follows (*also please refer to table 5*):

Personnel cost amounted to LL 3,094 billion in 2004, below the budgeted level of LL 3,359 billion, mainly due to lower spending on retirement and end of service compensations. Personnel cost remained stable when compared to its outcome of LL 3,087 billion in 2003.

Interest payments for 2004 amounted to LL 4,021 billion, LL 279 billion below the budgeted LL 4,300 billion and LL 853 billion less than in 2003. This decline in contrast to 2003 can be mainly attributed to the large drop in domestic debt service which amounted to LL 2,246 billion compared to LL 3,108 billion a year earlier. Foreign currency debt service witnessed a negligible increase (by 0.5 percent) and amounted to LL 1,776 billion in 2004 compared to LL 1,766 billion in 2003. The major developments that contributed to this improvement on the interest payments' front are:

- (a) The large decline in the overall level of interest rates since end-November 2002. For example, interest rates on the 24-month category of Treasury Bills declined from 14.14 percent in November 2002 to 7.74 percent by the end of December 2004²².
- (b) The replacement of the high-cost debt maturing in 2003 with the USD 2.5 billion funds borrowed from Paris II donor countries (at 5 percent).

- (c) The special scheme conducted with the Lebanese Central Bank and the zero interest scheme conducted with the Lebanese commercial banks following the Paris II conference led to large savings in the interest bill for 2004²³.

- (d) Rising and sustained progress on achieving large primary surpluses through the realization of key fiscal adjustment policies such as the implementation of the VAT in 2002, and the 5 percent tax on interest in 2003 led to lower financing requirements. Primary surpluses in 2003 and 2004 amounted to LL 936 billion and LL 995 billion respectively.

²²For further details, please refer to the debt section.

²³For additional information of these transactions, kindly refer to the report entitled "One Year Progress after Paris II".

Table 6. Expenditures by Economic Classification 4/

| (LL Billion) | 2003 Jan-Dec | 2004 Jan-Dec | % Change | Budget Law 2004 |
|---|-----------------|-----------------|------------|--------------------|
| 1. Current Expenditures | 8,831 | 8,051 | -9% | 8,743 |
| 1.a Personnel Cost, of which: | 3,087 | 3,094 | 0% | 3,359 |
| <i>Article 13: Salaries and Wages 1/</i> | 2,040 | 2,071 | 2% | 2,162 |
| <i>Retirement and End of Service</i> | | | | |
| <i>Compensations</i> | 844 | 810 | -4% | 1,000 |
| 1.b Interest Payments | 4,874 | 4,021 | -18% | 4,300 |
| 1.c Materials and Supplies | 121 | 116 | -4% | 163 |
| 1.d External Services | 81 | 113 | 40% | 112 |
| 1.e Various Transfers, of which: | 272 | 360 | 32% | 386 |
| <i>NSSF</i> | 0 | 89 | 100% | 50 |
| 1.f Other Current, of which: | 330 | 275 | -17% | 265 |
| <i>Hospitals</i> | 267 | 236 | -12% | 232 |
| <i>Others</i> | 63 | 38 | -40% | 33 |
| 1.g Reserves, of which: | 66 | 72 | 8% | 158 |
| <i>Interest Subsidy</i> | 66 | 72 | 8% | 70 |
| 2. Capital Expenditures | 714 | 817 | 14% | 656 |
| 2.a Acquisitions of Land, Buildings, for the Construction of Roads, Ports, Airports, and Water Networks | 12 | 12 | -3% | 11 |
| 2.b Equipment | 57 | 49 | -14% | 56 |
| 2.c Construction in Progress | 561 | 646 | 15% | 491 |
| 2.d Maintenance | 61 | 60 | -1% | 64 |
| 2.e Other Expenditures Related to Fixed Capital Assets | 23 | 49 | 115% | 35 |
| 3. Other Treasury Expenditures | 1,014 | 1,477 | 46% | 900 |
| <i>Of which:</i> | | | | |
| Municipalities | 180 | 461 | 156% | |
| EDL | 413 | 492 | 19% | |
| Transfers to Water Authorities | 0 | 85 | 100% | |
| Treasury Advance for Diesel Oil Subsidy | 0 | 17 | 100% | |
| 4. Unclassified Expenditures 2/ | 1 | 69 | | |
| 5. Customs Cashiers 3/ | 32 | 126 | 294% | |
| 6. Total Expenditures 4/ | 10,592 | 10,540 | 0% | 10,300 |

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

1/ Includes the wages and salaries for the Council of the South, the Lebanese University, the Displaced Council, the Council for Reconstruction and Development, and the Educational Center for Research and Development.

2/ The unclassified expenditures includes: expenditures with no information on their economic classification and LL 38 billion representing the regularization of interest payments transactions - is also accounted for under treasury revenues.

3/ LL 90 billion of custom cashier expenditure are also recorded as VAT revenues in Jan-December 2004.

4/ Excluding foreign financed capital spending.

Materials and supplies amounted to LL 116 billion in 2004, decreasing by LL 5 billion compared to their 2003 level.

External services (rent, postal services, insurance, advertisement and public relations) amounted to LL 113 billion in 2004, a 40 percent increase compared to 2003. The bulk of the increase is mainly due to the payments of LL 23.5 billion of government rental charges to house international organizations.

Various transfers reached LL 360 billion in 2004, rising by LL 88 billion or 32 percent from 2003. Of this amount, LL 89 billion constitutes transfers to the National Social Security Fund, of which LL 59 billion represents settlements for previous years' budgets and LL 30 billion transfers from the 2004 budget (for further details about the settlements, please refer to box number 2).

Other current expenditures totaled LL 275 billion in 2004, decreasing by LL 55 billion from their 2003 level. This decrease resulted from lower transfers to private hospitals.

Interest subsidies for loans to the productive sectors (agriculture, industry, tourism, technology and crafts) increased by LL 6 billion or by 9 percent from their level in 2003, reaching LL 72 billion in 2004, almost equivalent to their budgeted level (LL 70 billion).

Capital expenditures reached LL 817 billion in 2004, LL 103 billion above their 2003 level. Of this amount:

-**Construction in progress**, which represented 79 percent of the total amount of capital expenditures in 2004, increased by 15 percent, or LL 85 billion. The increase is attributable to the higher transfer to the Displaced Fund reaching an amount of LL 158 billion in 2004 compared to LL 73 billion in 2003. The remaining amounts were allocated to:

- The Council for Development and Reconstruction (CDR): LL 247 billion in 2004 compared to LL 241 billion in 2003,
- The Council of the South: LL 116 billion in 2004 compared to LL 113 billion in 2003 ,
- The Ministry of Public Works and Transport: LL 70 billion in 2004 compared to LL 76 billion in 2003 ,
- Other construction in progress: LL 53 billion in 2003 compared to LL 59 billion in 2004.

-**Other Expenditures Related to Fixed Capital Assets** increased by LL 26 billion, reflecting higher transfers to the Investment Development Authority Lebanon, IDAL, as part of "The Export Plus Program"²⁴. In fact, LL 37 billion was transferred to IDAL in 2004 compared to LL 5 billion in 2003.

²⁴ For more details on the "Export Plus" Program, please refer to "Public Finance Prospects 2001" on www.finance.gov.lb.

Table 7. Transfers to EDL

| (LL billion) | 2003 Jan-Dec* | 2004 Jan-Dec | % Change |
|---|------------------|-----------------|---------------|
| EDL of which: | 413 | 492 | 19.2% |
| Debt service of which: | 338 | 341 | 0.9% |
| C-Loans and Eurobonds | 239 | 205 | -14% |
| Loans for Fuel Oil Payment | 99 | 33 | -66% |
| BDL Guaranteed Loan Payment | 0 | 103 | 100% |
| Treasury advance for fuel purchase | 75 | 150 | 101.9% |
| Expropriations | 0 | 1.8 | 0.0% |

Source: MOF, DGF

* Includes principal, LL 39 billion of which was paid in January 2003 to settle a maturing loan initially issued for fuel purchases.

Other treasury expenditures witnessed a 46 percent increase, reaching LL 1,477 billion by December 2004 compared to LL 1,014 billion in 2003. This large rise, equivalent to LL 463 billion, pertains to:

- (a) Higher **treasury transfers to municipalities** which reached LL 461 billion by the end of December 2004, increasing by 156 percent. This was mainly due to payments made for solid waste management on behalf of the municipalities.
- (b) Higher transfers to **EDL** which amounted to LL 492 billion by the end of 2004 compared to LL 413 billion for 2003. This increase mainly resulted from (i) the LL 103 billion payment of a BDL loan guaranteed by the government, which was issued in 1992 and matured in 2004 and, (ii) the LL 150 billion advance granted by the treasury for fuel purchase compared to

LL 75 billion in 2003 (please refer to Table 7 for details).

- (c) Treasury advances of LL 85 billion to the **water authorities** for the settlement of accrued electricity bills to Electricity du Liban, EDL (for further details, please refer to box number 2).
- (d) In order to cap the price for consumers until the end of 2004, on the 18th of November 2004, the Council of Ministers decided to subsidize the price of diesel oil. The payment mechanism of the subsidy stated in decree no. 13651, authorized the Ministry of Finance to grant a treasury advance amounting to LL 40 billion. The treasury advance is to be regularized through additional allocations in Budget Law 2005. By the end of December 2004, transfers for **diesel oil subsidies** reached LL 17 billion.

Box 2. Settlement of the Government's Subscription Fees in the NSSF for 2003 and 2004 and the Unpaid Electricity Bills to EDL on Behalf of Public Institutions

Summary of New Laws

1. **On February 17, 2005**, Law # 671 authorized the opening of additional allocations in Budget 2004 to reimburse the government's subscription in NSSF. The Law stipulates the opening of an additional allocation amounting to LL 240 billion in the 2004 Budget Law. This allocation is earmarked to reimburse government subscription fees in the National Social Security Fund on account of 2003 and 2004.
2. **On February 17, 2005**, Law # 672 authorized the opening of additional allocations amounting to LL 228 billion in Budget 2004 to reimburse treasury advances provided to public administration and Water Authorities for the payment of accrued electricity bills. The Law stipulates the opening of an additional allocation in 2004 Budget Law, under the budget of the Ministry of Finance, amounting to LL 228 billion. This allocation is divided as follows: (a) LL 134 billion is to be paid for the regularization of treasury advances given to Water Authorities to pay their electricity bills to EDL, (b) The remaining LL 94 billion is for public administration to pay their electricity bills to EDL.

Box 3 The Re-Creation of a Treasury Single Account at the BDL

Summary of the New Proposed Law

Background and Original Law: According to the Public Accounting Law, dated 1963 (Article 242), all public funds have to be deposited at the Treasury Single Account (TSA) at the BDL. Public agencies, municipalities, and public institutions, are therefore strictly forbidden to open accounts at commercial banks or to open special accounts in their own name at the BDL. Public funds are defined to be the funds of the government, municipalities, public institutions attached to the government or to municipalities, and the funds of all legal persons endowed a public purpose.

During the Years of War, and specifically in 1987, Law Number 78/49 (Article 3), modified the above by allowing public agencies with an annex budget, public institutions, and municipalities to open special accounts at the BDL.

Therefore, there is a fragmentation of the TSA through the existence of separate bank accounts of public institutions in the BDL, separate bank accounts of the treasury used for specific purposes, and, sometimes, commercial bank accounts to channel donor funds.

New Proposed Law proposes to amend the existing 1987 Law through the re-creation of a Treasury Single Account. More specifically, the proposed Law stipulates the re-creation of a TSA at the BDL where all public funds have to be deposited. Exceptions are made for municipalities and the Ministry of Telecom, until the creation of Liban Telecom and the transfer of the fixed line network to it. The latter will continue to be allowed to open special accounts in their names at the BDL. Public institutions and public agencies that have previously opened special accounts at the BDL will be given a period of 6 months to close these accounts and transfer the residual to the TSA.

Section IV: Public Debt Developments

Table 8. Public Debt Outstanding by Holder as of End-December 2004

(in LL Billion)

| | Dec-02 | Dec-03 | Dec-04 | Change Year- to-date | % change Year- to-date |
|--|---------------|---------------|---------------|----------------------------|---------------------------------|
| Total debt (1) | 47,276 | 50,285 | 54,048 | 3,763 | 7.5% |
| Domestic debt | 25,302 | 26,843 | 26,371 | -472 | -1.8% |
| a. Central Bank | 723 | 8,938 | 10,652 | 1,714 | 19.2% |
| <i>o/w Zero Interest T-bills (2)</i> | | 3,508 | 3,508 | | |
| <i>o/w Special T-bills issued at 4%</i> | | 4,299 | 4,299 | | |
| b. Commercial Banks | 17,211 | 12,303 | 12,220 | -83 | -0.7% |
| <i>o/w Zero coupon T-bills</i> | | 880 | 880 | | |
| c. Other Domestic Debt (T-bills) | 7,368 | 5,603 | 3,500 | -2,103 | -37.5% |
| <i>o/w Public entities</i> | 3,221 | 2,564 | 2,187 | -377 | -14.7% |
| Foreign debt | 21,974 | 23,442 | 27,677 | 4,235 | 18.1% |
| a. Bilateral and Multilateral | 2,316 | 2,595 | 2,700 | 105 | 4.0% |
| b. Paris II related debt | 1,432 | 3,731 | 3,814 | 83 | 2.2% |
| c. BDL Eurobond | 2,819 | 2,819 | 2,819 | 0 | 0.0% |
| d. Market Eurobonds | 14,569 | 13,631 | 17,686 | 4,055 | 29.7% |
| <i>o/w Zero interest Eurobonds issued to Lebanese Commercial Banks</i> | | 1,083 | 1,122 | 39 | 3.6% |
| e. Other foreign Debt (3) | 838 | 665 | 657 | -8 | -1.1% |
| Public sector deposits | 2,964 | 3,019 | 4,360 | 1,341 | 44.4% |
| Net debt (4) | 44,312 | 47,266 | 49,688 | 2,422 | 5.1% |
| Gross market debt (5) | 36,765 | 29,638 | 31,875 | 2,238 | 7.6% |
| % of total debt | 78% | 59% | 59% | | |

Source: MOF, BDL

(1) Total debt equals domestic debt plus foreign debt

(2) Zero interest T-bills in the portfolio of the Banque du Liban represents its intervention in the zero-interest scheme of commercial banks issued within the Paris II context.

(3) Includes accrued interest and foreign currency private sector loans.

(4) Net public debt is defined as the gross public debt less public sector deposits.

(5) Gross market debt equals gross debt less the portfolios of the BDL, NSSF, bilateral and multilateral loans, and Paris II related debt.

As of end-2004, **gross public debt** amounted to LL 54,048 billion (USD 35.85 billion), registering an increase of LL 3,763 billion or 7.5 percent over the December 2003 level. In an environment where domestic debt declined, this rise in gross debt entirely ensued from the rise in foreign debt. However, a more accurate assessment of the growth of public debt would be performed by studying the *evolution of net public debt*, especially following the over-financing in both Lebanese Pounds and foreign currencies conducted during the months of November and December 2004 which artificially inflated the gross public debt figure. In fact, the Treasury resorted to pre-funding during the last two months of the year to benefit from the high liquidity of the domestic banking sector and the renewed interest following political uncertainty in September and October 2004.

Net public debt amounted to LL 49,688 billion (USD 32.96 billion) registering an increase of LL 2,422 billion or 5.1 percent since end-December 2003. The growth in net public debt has decelerated over that witnessed in 2003 when it had amounted to 6.7 percent.

The decline in the growth rate of public debt in 2004 was mainly due to the continued progress on achieving primary surpluses and lower interest payments, which declined further over the 2003 level.

The debt related transactions conducted within the context of the Paris II conference in 2002 and 2003 (namely the transactions with the Paris II lenders, the Banque du Liban and the zero interest special scheme with commercial banks) coupled with the sustained decline in interest rates continued to lower the interest bill in 2004²⁵.

The impact of these transactions could also be demonstrated by studying the evolution of the weighted average cost of outstanding debt at the end of 2004. As shown in the table below, both the domestic and foreign currency components have declined, with the largest decline in the domestic component (by 7.77 percent between November 2002 and December 2004). This was mainly due to the fact that the high coupon Treasury Bills issued prior to the Paris II conference (24-month 14.14 percent) have entirely matured and have been replaced by Treasury Bills with much lower coupons.

²⁵ Kindly refer to the report entitled "One Year Progress after Paris II" for additional information on the transactions executed within the context of the Paris II conference. The report is posted on the Ministry of Finance website.

Table 9. Evolution of Weighted Average Cost of Public Debt

| Date | Total Debt | Domestic Debt | Foreign Debt |
|-----------------------------|--------------|---------------|--------------|
| Nov-02 | 11.97% | 13.82% | 9.21% |
| Dec-03 | 8.34% | 9.18% | 7.39% |
| Dec-04 | 6.56% | 6.04% | 7.05% |
| Decline 03-04 | 1.78% | 3.13% | 0.34% |
| Decline since Nov-02 | 5.41% | 7.77% | 2.16% |

Source: MOF calculations

Domestic currency debt as of end-December 2004 amounted to LL 26,371 billion, registering a decline of LL 472 billion (or approximately 1.8 percent) over the end-2003 level. This was mainly due to the decline in the Lebanese Pound Treasury bill portfolios of public sector entities (NSSF) and the public. Also, the portfolio of commercial banks in Lebanese Pound Treasury bills slightly declined over the end-2003 level. However, the Central Bank's portfolio of Treasury Bills increased by approximately LL 1,700 billion, most notably between September and mid-November 2004, during a period of political uncertainty and a concentrated amortization schedule of Lebanese Pound Treasury Bills. The BDL did not subscribe to additional Treasury Bills in December 2004. In order to encourage participation in the Treasury bill auctions during the last quarter of the year, the Ministry of Finance introduced a scheme offering a one-time buy-back cash premium on the 6, 12, 24 and 36 month categories starting with the October 21, 2004 auction²⁶. This scheme was extended twice: once until end-December 2004 and then until end-March 2005²⁷. Primary market rates during this period were kept unchanged.

The decline in the share of domestic currency debt was offset by an 18 percent increase in **foreign currency debt** (equivalent to a net increase of US\$ 2.5 billion). This was mainly due to an increase in the level of dollarization in deposits with the domestic

banking system, especially in the last quarter of the year. The dollarization rate of deposits at the Lebanese commercial banks amounted to 70.01 percent at end-December 2004 compared to 66.14 percent at end-December 2003. The year 2004 was characterized by the Treasury's return to the Eurobond market after two years of interruption following the various issuances to the Paris II participant countries on one side, and the BDL and commercial banks' special schemes on the other.

During 2004, the Ministry of Finance issued an aggregate amount of Eurobonds equivalent to approximately US\$ 5.2 billion. Of this amount, around US\$ 1.2 billion were exchanged and US\$ 1.4 billion were paid at maturity. As such, net issuance of Eurobonds amounted to US\$ 2.6 billion during the year. In September 2004, the Republic executed its first exchange transaction, consisting of Eurobonds maturing in 2005²⁸. The success rate of this exchange reached 55 percent and helped alleviate a large portion of foreign currency financing requirements in 2005. The new foreign currency debt raised during May (US\$ 1 billion and Euro 225 million) and November 2004 (US\$ 1 billion issued to BDL on November 12, 2004 which was subsequently off-sold to market participants on the secondary market and a three-tranche US\$ 1.375 billion Eurobond transaction executed on November 30, 2004) were opportunistic in nature and represented pre-funding transactions to benefit from increased liquidity in US Dollars in the domestic banking system.

²⁶ Note that auctions of October 21 until November 4, 2004 only extended the buy back offer to 6 and 12 month maturities.

²⁷ Please refer to www.finance.gov.lb for further details of this scheme.

²⁸ For further details, kindly refer to "Public Finance Prospects QIII 2004".

Table 10. Net Issuance of Eurobonds in 2004

| <i>US\$ million</i> | |
|-----------------------------|--------------|
| Eurobonds Issued | 5,184 |
| Eurobonds Redeemed | 2,613 |
| Exchanged &/or re-purchased | 1,214 |
| Paid at maturity | 1,399 |
| Net Issuance | 2,570 |

Source: Ministry of Finance

Table 11. Terms and Conditions of Eurobonds issued in 2004

| | Issue Size | Curr | Coupon | Issue Date | Maturity Date |
|---------------|---------------|------|--------|------------|---------------|
| May-04 | | | | | |
| | 1,000,000,000 | USD | 7.875% | 05/20/04 | 05/20/11 |
| | 225,000,000 | Euro | 7.250% | 05/20/04 | 05/20/09 |
| Sep-04 | | | | | |
| | 1,265,000,000 | USD | 7.125% | 09/07/04 | 03/05/10 |
| | 275,000,000 | USD | 7.750% | 09/07/04 | 09/07/12 |
| Nov-04 | | | | | |
| | 700,000,000 | USD | 6.375% | 11/12/04 | 03/12/08 |
| | 300,000,000 | USD | 6.875% | 11/12/04 | 11/12/10 |
| | 625,000,000 | USD | FRN* | 11/30/04 | 11/30/09 |
| | 425,000,000 | USD | 7.000% | 12/14/04 | 12/14/09 |
| | 325,000,000 | USD | 7.750% | 09/07/04 | 09/07/12 |

- FRN issued at 6-month Libor + 325 bps

The three-tranche Eurobond amounting to US\$ 1.375 billion issued on November 30, 2004 attracted significant subscriptions from international investors who showed renewed interest in Lebanon. Approximately 5.5 percent of gross public debt as of end-December 2004 was denominated in Euros.

Therefore, the continued appreciation of the value of the Euro in 2004 (by more than 8 percent year-on-year) also contributed to an increase in the foreign currency debt figure, by approximately US\$ 110 million.

Table 12. Evolution of Primary Market Treasury Bill Yields

| | Pre-Paris II (End-Oct. 2002) | Post Paris II (Jan/Feb 2003) | Dec. 31 st , 2003 | Dec. 31 st , 2004 | One-time Buy- Back Cash Premium* |
|-------------------|------------------------------------|------------------------------------|---------------------------------|---------------------------------|--|
| 3-months T-Bills | 11.18% | 6.96% | 5.48% | 5.22% | Not applicable |
| 6-months T-Bills | 12.12% | 8.18% | 6.53% | 6.31% | 0.4% |
| 12-months T-Bills | 13.43% | 9.13% | 6.87% | 6.69% | 1.0% |
| 24-months T-Bills | 14.64% | 9.41% | 7.99% | 7.74% | 1.5% |
| 36-months T-Bills | | | 8.68% | 8.68% | 2.0% |

Source: MOF

Note: Applicable since October 21, 2004 and paid only at issuance. Please refer to <http://www.finance.gov.lb/LLSWAPNOV04.pdf> for further details about this scheme.

Box 4. The Creation of a Public Debt Department at the Ministry of Finance

Summary Points of the Draft Law

The draft law stipulates the creation of a Public Debt Department (PDD) at the Directorate General of Finance. The new PDD will comprise three divisions, namely the Capital Markets' division, the Strategic and Risk Management division, and the Operations' division. More specifically, the functions of each division are explained here-below:

1. Functions of the **Financial Markets'** Division (Front Office):

- Execution of all transactions in including borrowing transactions in the financial and markets (Treasury bills and other financing operations);
- Monitoring and recording of foreign exchange operations in the financial and money markets;
- Monitoring of financial transactions and market movements;
- Supervision of the treasury bill auctions of the various maturities; and
- Supervision of the adequacy of loan agreements in terms of the borrowed amounts, terms and conditions, disbursements and repayment schedule.

2. Functions of the **Strategic and Risk Management** division (Middle Office):

- Preparing detailed statistical statements on government borrowing and drafting the accompanying financial analysis;
- Articulating a debt strategy and issuing studies describing the Government's borrowing activities and the administration of financing activities in all currencies. These financing activities should take into consideration the risks associated with changes in international interest rates, exchange rate movements, and the maturity profile of the existing debt portfolio;
- Drafting studies and issuing reports regarding the composition of outstanding public debt in both local and foreign currencies as well as the forecasted debt. In addition, these reports should provide information on the various instruments and maturity structures available for borrowing; and
- Providing advice on matters related to external loan agreements;

3. Function of the **Operation** Division (Back Office):

- Ensuring that the debt servicing obligations of the Government are met by setting up the yearly loan repayment schedule of outstanding principal and interest on local and foreign currency loans and preparing the related paperwork necessary to enact settlement;
- Administering all public debt accounts, including loans and debt instruments (LL Treasury bills and Eurobonds) issued by the Government;
- Managing the accounting records of government guaranteed loans in coordination with public administrations and institutions by which these loans were contracted;
- Administering the accounts related to local currency borrowing from the Central Bank, in accordance with the Lebanese Code of Money and Credit;
- Supervising the settlement activities of public debt service according to the repayment schedule and to the allocations provided in the relevant budget laws;
- Providing official reporting and managing a computerized program for public debt management and financial analysis

Technical positions in the PDD can be filled either on a contractual basis or on an appointment basis.

The law also stipulates the creation of a "Higher Council for Debt Management" under the direction of the Minister of Finance and the following members: (1) Central Bank Governor or his representative, (2) Director General of the Ministry of Finance, (3) Director of Public Debt Department, (4) Director of the Treasury Department, (5) Director of the Budget Department. This Council will specify the choices available for debt management and will present suggestions to the Council of Ministers relating to public debt policies.

Section V: Evolution of External Trade

Table 13. External Trade

| (USD Million) | 2003 | 2004 | 2003 | 2004 | | |
|----------------------|-------------|-------------|---------------|---------------|---------------|-------------|
| | December | December | Jan-Dec | Jan-Dec | Change | % Change |
| Exports | 193 | 176 | 1,524 | 1,747 | 223 | 15% |
| Imports, of which: | 723 | 860 | 7,168 | 9,397 | 2,229 | 31% |
| Mineral Products | 129 | 298 | 1,121 | 1,981 | 861 | 77% |
| Trade Balance | -529 | -684 | -5,644 | -7,650 | -2,006 | 36% |

Source: MOF, Directorate General of Customs (DGC)

Balance of trade: In 2004, the trade deficit widened by 36 percent. This took place despite the 15 percent amelioration of exports which did not offset the 31 percent growth in imports. The upsurge in imports is due to three main factors, namely, an increased domestic demand, higher crude oil average prices by 33 percent²⁹, and the appreciation of the Euro by 8.6 percent between 2003 and 2004. The rise in exports is due in large part to the continuous surge in exports to Iraq.

By the end of 2004, **imports** amounted to USD 9,397 million, compared to USD 7,168 million one year earlier. From a product perspective, the increase in imports reflects (1) a USD 878 million increase in the value of the imports of mineral products resulting in one hand from the 33 percent increase in the price of crude oil and on the other from the significant increase in the demand for gas oils and other fuel oils, (2) a USD 237 million increase in the imports of machinery and mechanical appliances, (3) a USD 225 million increase in the imports of pearls, precious and semi precious stones, (4) a USD 147 million increase in the imports of transport equipment, (5) a USD 126 million increase in the imports of base metals and articles of base metals and (6) a USD 113

million increase in the imports of products of the chemicals.

From a regional perspective, the augmentation in the value of imports reflects (1) a USD 492 million increase in imports from the Euro-zone partly due to the appreciation of the Euro, (2) a USD 424 million rise in imports from Arab Countries, (3) a USD 187 million upsurge in imports from China, (4) a USD 180 million increase in imports from Switzerland and (5) USD 122 million additional imports from the United States.

By the end of 2004, **exports** reached USD 1,747 million, increasing by USD 223 million with respect to 2003. From a product perspective, the increase in exports is mainly owed to (1) a USD 95 million augmentation in the exports of machinery and mechanical appliances and (2) a USD 113 million upsurge in the exports of base metals and articles of base metals. Both rises countered the USD 177 million decrease in the exports of pearls, precious or semi precious stones. From a regional perspective, the augmentation in the value of exports reflects a USD 288 million increase in exports to Arab Countries in general and to Iraq in particular which offset the USD 192 million decrease of exports to Switzerland.

²⁹ This estimation was based on Europe Brent spot price FOB. This data is compiled and published by the U.S. Department for Energy.

Table 14. Imports Distribution by Product

| (USD million) | 2003 | 2004 | 2003 | | 2004 | | Change | % Change |
|---|------------|------------|--------------|-------------|--------------|-------------|--------------|------------|
| | December | December | Jan-Dec | % Share | Jan-Dec | % Share | | |
| Mineral Products | 134 | 175 | 1,190 | 17% | 2,068 | 22% | 878 | 74% |
| Machinery and Mechanical Appliances | 95 | 110 | 873 | 12% | 1,109 | 12% | 237 | 27% |
| Transport Equipment | 73 | 94 | 696 | 10% | 843 | 9% | 147 | 21% |
| Products of the Chemical | 67 | 85 | 716 | 10% | 828 | 9% | 113 | 16% |
| Base Metals and Articles of Base Metals | 53 | 50 | 471 | 7% | 596 | 6% | 126 | 27% |
| Other Goods | 301 | 346 | 3,223 | 45% | 3,952 | 42% | 729 | 23% |
| Total | 723 | 860 | 7,168 | 100% | 9,397 | 100% | 2,229 | 31% |

Source: MOF, DGC

• Import Distribution by Product:

Imports of **mineral products** increased by 74 percent and cumulated at USD 2,068 million as opposed to USD 1,190 million a year earlier. The increase in the import value of mineral products mainly resulted from:

1)- A USD 130 million increase in the imports of **car gasoline** which reached USD 510 million by the end of December 2004. This increase resulted from the 29 percent increase in the average price, at imports, of car gasoline from LL 347 per liter in January-December 2003 to LL 462 per liter in January-December 2004. Quantities imported remained stable around 1.665 billion liters and hence the increase in the value of car gasoline imports was nominal. Car gasoline in 2004 was mainly imported from France, Italy, Turkey, Egypt and Bulgaria.

2)- A USD 510 million or 134 percent increase in the imports of **gas oils** (gas oil or diesel oil, or what is commonly known as "Mazout", is mainly imported for use at EDL's plants in Zahrani and Deir Ammar) which reached USD 891 million in 2004 compared to USD 381 million in 2003. Of this USD 510 million increase:

a) - USD 437 million is due to a 115 percent increase in the quantity of gas oils imported.

Quantities of gas oils imported reached 3.12 billion liters by the end of December 2004 compared to 0.984 billion liters in January-December 2003.

b)- USD 73 million is due to the 9 percent increase in the average price of gas oils imported from LL 395 per liter in January-December 2003 to LL 431 per liter January-December 2004.

Gas oils in 2004 were imported mainly from Saudi Arabia, Italy, the Russian Federation, the United Kingdom and Bahrain.

3)- A USD 197 million increase in the imports of **other fuel oils** (fuel oil is imported for the consumption of EDL plants in Zouk, Jiyeh, Tyre, and Baalbeck) which amounted to USD 425 million in 2004 compared to USD 228 million in 2003. Of this USD 197 million increase:

a)- USD 177 million was due to the 53 percent increase in the quantity of fuel oil imported which reached 2.226 billion liters by the end of 2004 compared to 1.253 billion liters in 2003.

b)- USD 20 million was due to the 5 percent increase in the price of fuel oil at imports which increased from LL 274 per liter in 2003 to LL 288 per liter in 2004. 74 percent of other fuel oils were imported from the Russian Federation.

Table 15. Mineral Products Import Breakdown

| | Jan-Dec 2003 | Jan-Dec 2004 | Change | % Change |
|--|-----------------|-----------------|--------|-------------|
| Import Value Details (in USD Million): | | | | |
| - Car Gasoline | 380 | 510 | 130 | 34% |
| - Gas Oil | 381 | 891 | 510 | 134% |
| - Fuel Oil | 228 | 425 | 197 | 86% |
| Imports Quantity Details (in Million Liters): | | | | |
| - Car Gasoline | 1,651 | 1,665 | 14 | 1% |
| - Gas Oil | 1,453 | 3,120 | 1,667 | 115% |
| - Fuel Oil | 1,253 | 2,226 | 973 | 78% |
| Imports Price Details (in LL per Liter): | | | | |
| - Car Gasoline | 347 | 462 | 115 | 33% |
| - Gas Oil | 395 | 431 | 36 | 9% |
| - Fuel Oil | 274 | 288 | 14 | 5% |

Source: MOF, DGC,

The 27 percent increase in **machinery and mechanical appliances** imports, which reached USD 1,109 million by the end of December 2004 in contrast with USD 873 million in 2003, is the consequence of (1) a USD 114 million increase in the imports of **reactors, boilers, machinery and mechanical appliances** (or what can be described as electrical material for industrial use) which cumulated at USD 622 million in 2004 (they were mainly imported from China, Germany, Italy, and the United States) and (2) a USD 122 million augmentation in the imports of **electrical machinery and equipment and parts thereof** (or what can be described as electrical appliances for household use) which totaled USD 487 million during 2004. They were mainly imported from China, Germany, the United Kingdom and France.

Transport Equipment imports were worth USD 843 million in 2004 as opposed to USD 696 million one year earlier, witnessing a 21 percent increase compared to 2003. This growth was fueled by the increase in the imports of **vehicles** which rose by USD 225 million during 2004, cumulating at USD 829 million. The

increase in the value of vehicles imported can be attributed to the surge in the value of cars imported by USD 177 million, reaching USD 603 million by the end of 2004. This was mainly due to the higher quantity of cars imported which reached 45,969 units in 2004 increasing by 47 percent from 31,294 units in 2003. Vehicles were mainly imported from Germany, Japan, the United-States, and France.

Imports of **products of the chemical** reached USD 828 million 2004 compared to USD 716 million in 2003 or a 16 percent increase. This upsurge can be attributed to (1) a USD 43 million increase in the imports of **pharmaceutical products** driven by the increase in the quantity of medicine imported from 2870 tons in 2003 to 3900 tons in 2004 (imported mainly from France, Germany, the United Kingdom, and Switzerland) and (2) a USD 21 million increase in the imports of **soap and organic surface-active agents** (imported mainly from Egypt, Syria, Germany, and Italy).

Base metals and articles of base metals imports cumulated at USD 596 million by the end of 2004 compared to USD 471 million by the end of 2003, increasing by 27 percent. This increase was due to (1) a USD

80 million increase in **iron and steel** (mainly imported from Ukraine, Egypt, and Syria) and (2) a USD 14 million increase in **aluminum and articles thereof** (mainly imported from the United Arab Emirates, Italy, Saudi Arabia, and Greece) .

Table 16. Exports Distribution by Product

| (USD million) | 2003 | 2004 | 2003 | 2004 | | | | |
|--|------------|------------|--------------|-------------|--------------|-------------|------------|------------|
| | December | December | Jan-Dec | % Share | Jan-Dec | % Share | Change | % Change |
| Pearls, Precious or Semi-Precious Stones | 64 | 23 | 464 | 30% | 287 | 16% | -177 | -38% |
| Machinery and Mechanical Appliances | 24 | 25 | 179 | 12% | 274 | 16% | 95 | 53% |
| Base Metals and Articles of Base Metals | 12 | 25 | 115 | 8% | 228 | 13% | 113 | 97% |
| Products of the Chemical | 14 | 22 | 115 | 8% | 149 | 9% | 35 | 30% |
| Prepared Foodstuffs | 18 | 13 | 150 | 10% | 148 | 8% | -1 | -1% |
| Other Exports | 62 | 68 | 501 | 33% | 661 | 38% | 160 | 32% |
| Total | 193 | 176 | 1,524 | 100% | 1,747 | 100% | 223 | 15% |

Source: MOF, DGC

- Export Distribution by Product:**

Exports of **pearls, precious or semi-precious stones** decreased by 38 percent and totaled USD 287 million during 2004 as opposed to USD 464 million in 2003. Pearls, precious and semi precious stones were principally exported to Switzerland, the United Arab Emirates, and Libya.

Machinery and mechanical appliances exports increased by 53 percent, cumulating at USD 274 million during 2004 in contrast to USD 179 million a year earlier. This increase resulted from (1) a USD 27 million rise in the exports of **reactors, boilers, machinery and mechanical appliances** which amounted to USD 97 million by the end of 2004 (they were mainly exported to Iraq, Saudi Arabia, and Syria) and (2) a USD 68 million increase in the exports of **electrical machinery and equipment and parts thereof** which became worth USD 177 million during 2004. They were

principally exported to Iraq, Kuwait, Algeria, and Syria.

Exports of **base metals and articles of base metals** nearly doubled, reaching USD 228 million compared to USD 115 million during 2003. This is mainly due to a USD 65 million increase in **iron and steel** exports (mainly exported to Turkey and India), a USD 18 million increase in **articles of iron and steel** exports (mainly exported to Iraq, Kuwait, and United Arab Emirates) and a USD 14 million increase in **copper and articles thereof** exports (mainly exported to China, Sri Lanka, Southern Korea, and India).

Products of the chemical exports progressed by 30 percent totaling USD 149 million in 2004 compared to USD 115 million in 2003. The increase was the outcome of a USD 24 million upsurge in the exports of **fertilizers**. They were mainly exported to Iran, Syria and Brazil.

Table 17. Regional Distribution of Imports

| (USD million) | 2003 | 2004 | 2003 | | 2004 | | | |
|-------------------------------|------------|------------|--------------|-------------|--------------|-------------|--------------|------------|
| | December | December | Jan-Dec | % Share | Jan-Dec | % Share | Change | % Change |
| European Union (1), of which: | 316 | 309 | 3,066 | 43% | 3,637 | 39% | 571 | 19% |
| Euro zone (2) | 270 | 262 | 2,654 | 37% | 3,146 | 33% | 492 | 19% |
| Arab Countries | 100 | 151 | 920 | 13% | 1,344 | 14% | 424 | 46% |
| China | 53 | 63 | 531 | 7% | 718 | 8% | 187 | 35% |
| United States | 38 | 47 | 431 | 6% | 553 | 6% | 122 | 28% |
| Switzerland | 11 | 20 | 216 | 3% | 396 | 4% | 180 | 83% |
| Other | 205 | 270 | 2,004 | 28% | 2,749 | 29% | 746 | 37% |
| Total | 723 | 860 | 7,168 | 100% | 9,397 | 100% | 2,229 | 31% |

(1)-The European Union included until the 30th of April 2004, the following countries: Austria, Belgium, Denmark, Finland, France, Germany and Greece, Ireland, Italy, Luxemburg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom. Ten new countries have joined the EU on the 1st of May 2004. To facilitate comparisons with 2003 and preserve the cohesion with the trade figures published in 2004, the old nomenclature was preserved.

(2)-The Euro-zone (according to the nomenclature valid until the 30th of April 2004) included all EU members with the exception of Denmark, Sweden and the United Kingdom.

• Regional Distribution of Imports:

Imports from the **European Union** increased by 19 percent, cumulating at USD 3,637 million in 2004 compared to USD 3,066 million one year earlier. This increase is the outcome of two factors:

(a)- A USD 492 million or 19 percent increase in the value of imports from the **Euro-zone** which reached USD 3,146 billion in 2004 compared to USD 2,654 million in 2003. Lebanon imported principally from the Euro-zone USD 647 million of mineral oils and fuels, USD 352 million of vehicles, USD 239 million of pharmaceutical products, and USD 238 million of reactors, boilers, machinery and mechanical appliances and parts thereof.

(b)-A USD 70 million or a 22 percent increase in the imports from the **United Kingdom** which reached USD 386 million in 2004 compared to USD 316 million in 2003. Lebanon imported from the United Kingdom the following products: machinery and mechanical appliances for a total amount of USD 75 million, pharmaceutical products for a total value of USD 54 million, as well as USD 53 million worth of mineral oils and fuels.

Imports from **Arab countries** augmented by USD 424 million or 46 percent, reaching USD 1,344 million in 2004 compared to USD 920 million one year earlier. The main imports from Arab countries for 2004 were (1) mineral fuels and oils which were worth USD 504 million, (2) plastics and articles thereof whose imports from Arab countries reached USD 98 million, (3) iron and steel whose imports attained USD 93 million and USD 49 million of aluminum and articles thereof .

Imports from **China** registered a 35 percent increase and rose from USD 531 million in 2003 up to USD 718 million in 2004. The main imports from China were reactors and boilers, machinery and mechanical appliances as well as articles of apparels and clothing accessories for USD 123 million, USD 94 million and USD 41 million respectively.

Imports from the **United States** increased by 28 percent, amounting to USD 553 million compared to USD 431 million in 2003. Lebanon's main imports from the United States for 2004 consisted of USD 82 million of vehicles, USD 81 million of tobacco and manufactured tobacco substitutes, USD 63 million of cereals, and USD 50 million of boilers and reactors.

Imports from **Switzerland** increased by 83 percent and reached USD 396 million in 2004 compared to USD 216 million one year earlier. The main imports from Switzerland for 2004 were pearls, precious and semi precious stones for a total import value of USD 288 million and pharmaceuticals worth USD 50 million.

• **Regional Distribution of Exports:**

Exports to **Arab countries** increased by 45 percent, totaling USD 925 million in 2004 compared to USD 638 million in 2003 as a result of export increases to Iraq, Syria and the United Arab Emirates by USD 134 million, USD 45 million, and USD 31

million respectively ³⁰. Lebanon's exports to Iraq more than doubled and reached USD 255 million during 2004 compared to USD 121 million in 2003.

The main exports to Iraq were machinery and mechanical appliances which amounted to USD 91 million as well as USD 65 million worth of salt, sulphur, earths and stone; plastering materials, lime and cement. Lebanese exports to Syria progressed by 45 percent, reaching USD 145 million in 2004 compared to USD 100 million a year earlier. Lebanese exports to Syria consisted mainly of salt; sulfur; earths and stone; plastering materials, lime and cement which amounted to USD 31 million, paper, paperboard and articles of paper pulp, of paper or of paperboard which amounted to USD 18 million as well as fertilizers for USD 10 million. Exports to the United Arab Emirates cumulated at USD 135 million in 2004 compared to USD 104 million in 2003 and consisted of pearls, precious and semi precious stones worth USD 48 million, articles of apparel and clothing accessories not knitted or crocheted furniture worth USD 8 million as well as bedding and mattresses worth USD 8 million.

Exports to **Switzerland** receded by 51 percent, amounting to USD 187 million in by the end of December 2004 compared to USD 379 million a year earlier.

³⁰ Iraq, Syria and the United Arab Emirates emerged respectively as our first, second and third top three export partners in 2004 replacing thereby, Iraq, the United Arab Emirates and Saudi Arabia respectively for the same period in 2003.

Box 5. Imports from Arab Countries: The Sharp Increase

Imports from Arab countries augmented by USD 424 million or 46 percent, reaching USD 1,344 million in 2004 compared to USD 920 million last in 2003.

This increase resulted from:

- 1)-Saudi Arabia: A USD 193 million increase in the value of imports from Saudi Arabia which reached USD 413 million by the end of December 2004 mainly as a result of (i) a USD 161 million increase in the value of mineral oils and fuels (ii) a USD 22 million increase in the value of plastics and articles thereof.
- 2)-Egypt: A USD 121 million increase in the value of imports from Egypt which reached USD 295 million by the end of December 2004 mainly as a result of (i) a USD 68 million increase in the imports of mineral oils and fuels and (ii) a USD 13 million increase in the imports of iron and steel.
- 3)-UAE: A USD 55 million increase in the value of imports from United Arab Emirates which reached USD 151 million by the end of December 2004 mainly as a result of (i) USD 17 million increase in the imports of pearls, precious and semi precious stones and (ii) USD 8 million increase in the imports of aluminums and articles thereof.

Table 15. Regional Distribution of Exports

| (USD million) | 2003 | 2004 | 2003 | | 2004 | | | |
|----------------|------------|------------|--------------|-------------|--------------|-------------|------------|------------|
| | December | December | Jan-Dec | % | Jan-Dec | % | Change | % |
| Arab Countries | 76 | 91 | 638 | 42% | 925 | 53% | 288 | 45% |
| Switzerland | 58 | 15 | 379 | 25% | 187 | 11% | -192 | -51% |
| European Union | 18 | 14 | 143 | 9% | 156 | 9% | 13 | 9% |
| United States | 6 | 4 | 66 | 4% | 49 | 3% | -18 | -27% |
| China | 1 | 1 | 8 | 0% | 12 | 1% | 5 | 63% |
| Other | 35 | 51 | 291 | 19% | 417 | 24% | 127 | 44% |
| Total | 193 | 176 | 1,524 | 100% | 1,747 | 100% | 223 | 15% |

Source: MOF, DGC

Lebanese exports to the **European Union** slightly increased from USD 143 million to USD 156 million. Lebanon's main exports to the European Union for 2004 consisted mainly of USD 14 million worth of tobacco and manufactured tobacco substitutes, USD 13 million worth of aluminum and articles thereof, and USD 11 million worth of pearls, precious and semi precious stones.

Exports to the **United States** receded by 27 percent, reaching USD 49 million in 2004 compared to USD 66 million in 2003. Lebanese exports consisted mainly of furniture, bedding and mattresses for USD 9 million, pearls, precious and semi precious stones for USD 9 million and preparation of vegetables, fruits and nuts for USD 6 million.

Section VII: Value Added Tax Developments

The analysis of the **VAT collected internally, broken-down by economic activity**³¹ generally provides an indication about the most contributing sectors to the Lebanese economy. Data for 2004, extracted from declaration forms, reveals that the VAT generated from internal activities witnessed an approximate 4 percent rise.

As has been the case in the past, **trade** (both wholesale and retail, but mostly retail) ranks first amongst the top ten list of the highest VAT-generating economic activities. Retail trade accounted for 20 percent of total VAT collection in 2004 and wholesale trade made-up around 10 percent. They both preserved the same shares as in 2003.

With a 23 percent rise in the VAT generated in 2004, **hotels and restaurants** saw their share of total VAT collected increase by one percentage point, reaching 10 percent of total internally collected VAT.

Business activities, namely advertising, architectural, and engineering works registered a 25 percent increase in the amount of VAT generated in 2004, rising from 8 percent of total internal VAT in 2003 to 9 percent in 2004.

While preserving its share of total internally collected VAT (9 percent), **construction** work also witnessed enhanced activity in 2004, registering 2 percent higher VAT collection.

VAT generated by the internal **sale of cars**, which also includes the

maintenance and repair of cars and fuel sales at pump stations³², rose by 24 percent, thereby constituting an additional indicator of an improved activity in the car market, besides car excises and car registration fees (*please refer to the revenue section*).

Although partly exempt³³, **real estate** transactions recorded a 42 percent augmentation in the amount of VAT generated, raising their VAT contribution by one percentage point (from 2 percent in 2003 to 3 percent of total internal VAT in 2004), entering the top 10 ranking.

Ranked in the 8th position and with a 4 percent share of total internally collected VAT in 2003 and 2004, **manufacturing of food products**, namely non alcoholic beverages and sweet confectionaries, accounted for 6 percent additional VAT collection in 2004.

Some sectors saw their contributions to the VAT collected internally decline. In fact, as part of the top ten list of the most VAT generating activities, the **telecommunication** sector (radio, TV broadcasting and telecom resellers) and the **manufacturing of non-metallic mineral products** (cement, concrete and plaster) saw their VAT contributions recede by 21 percent and 31 percent respectively, and their shares of total internal VAT drop by one percentage point each, reaching 5 percent and 2 percent, respectively.

³¹ Economic activity is classified along the ISIC nomenclature.

³² Please note that part of this increase may originate from the euro appreciation and the rising price of fuel.

³³ The sale of real estate is VAT exempt. Only commercial rent is subject to 10 percent VAT.

Table 18. VAT Revenues from Internal Operations (10 Largest Contributing Activities)

| (LL millions) | 2003 | % Share | 2004 | % Share | % Change |
|--|----------------|-------------|----------------|-------------|-----------|
| Economic Activity (ISIC Nomenclature) | | | | | |
| VAT from internal activity | 479,299 | 100% | 497,515 | 100% | 4% |
| Retail Trade (<i>except for motor vehicles</i>) | 93,786 | 20% | 101,574 | 20% | 8% |
| Hotels and Restaurants | 40,771 | 9% | 49,972 | 10% | 23% |
| Wholesale Trade (<i>except for motor vehicles</i>) | 48,311 | 10% | 49,565 | 10% | 3% |
| Business Activities (<i>namely advertising, architectural & engineering activities</i>) | 37,440 | 8% | 46,878 | 9% | 25% |
| Construction (<i>including airport & road paving</i>) | 45,006 | 9% | 45,770 | 9% | 2% |
| Telecommunications (<i>radio, TV broadcasting & telecom resellers</i>) | 30,179 | 6% | 23,775 | 5% | -21% |
| Sales, maintenance, & repair of motor vehicles and sales of fuel at pump stations | 18,895 | 4% | 23,368 | 5% | 24% |
| Manufacturing of food products (<i>namely non alcoholic beverages & sweet confectionaries, also including pastry shops & bakeries</i>) | 20,671 | 4% | 21,845 | 4% | 6% |
| Real estate Activities | 11,833 | 2% | 16,789 | 3% | 42% |
| Manufacture of non-metallic mineral products (<i>concrete, cement and plaster</i>) | 15,248 | 3% | 10,534 | 2% | -31% |
| Other | 117,159 | 24% | 107,445 | 22% | -8% |

Source: MOF, VAT Directorate, VAT Declaration Forms

Please note that VAT figures in this table may differ to a certain extent from figures in the following table depending on the number of processed declarations at a given date..

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

| (LL billion) | 2003 | % | 2004 | % | % |
|--|------------|-------------|--------------|-------------|------------|
| | Jan-Dec | Share | Jan-Dec | Share | Change |
| VAT customs collection , of which | 922 | 100% | 1,204 | 100% | 31% |
| Mineral products | 249 | 27% | 362 | 30% | 45% |
| Machinery and mechanical appliances | 130 | 14% | 166 | 14% | 28% |
| Transports equipment | 111 | 12% | 154 | 13% | 39% |
| Base metals & art of base metal | 73 | 8% | 93 | 8% | 27% |
| Prepared foodstuffs | 84 | 9% | 93 | 8% | 10% |
| Others | 275 | 30% | 336 | 28% | 22% |

Source: Directorate General of customs (DGC)

The VAT collected at imports amounted to LL 1,204 billion in 2004 compared to LL 922 billion in 2003, representing a 31 percent increase, mirroring the 31 percent rise in imports. The top five contributing

products in terms of VAT collections at imports reflects the highest imported goods (*please refer to the trade section*).

As usual, **mineral products**, being the top imported product category raised the highest share of VAT at customs. With a 45 percent increase in collected VAT, the contribution of mineral products to total VAT pulled up from 27 percent in 2003 to 30 percent in 2004. The main reasons behind this increase are higher consumption and more elevated oil prices.

A 27 percent increase in the import of **machineries and mechanical appliances** in 2004 explains the 28 percent rise in the VAT collected from the importation of these products.

Transport equipment, the third most imported product category, ranks also third in its level of contribution to VAT collection at imports. With a 39 percent rise in the

amount of VAT generated in 2004, transport equipment saw their share of total VAT rise by one percentage point, reaching 13 percent.

Base metals and articles of base metals registered a 27 percent rise in imports and a similar 27 percent rise in the amount of VAT collected in 2004, preserving their 8 percent share of total VAT collected at customs.

Despite a 10 percent increase in the amount of VAT generated at imports, **prepared foodstuff** lost a one percentage point share of total VAT collected at imports.

For further details on trade performance, please refer to Section V.

Table 20. Statistics from VAT Declaration Forms

| (LL billion) | 2002* | 2003 | 2004 | 02-03 % Change | 03-04 % Change |
|---|--------|--------|--------|----------------------|----------------------|
| Number of Declarations Received | 33,881 | 42,223 | 62,217 | 25% | 47% |
| Amount of VAT Declared | 402 | 475 | 520 | 18% | 9% |
| Total Amount of VAT Claimed for Refund | 56 | 77 | 178 | 38% | 131% |
| <i>Diplomats & Int. organization</i> | 2 | 3 | 5 | 50% | 67% |
| <i>Exempted sectors**</i> | 12 | 14 | 21 | 17% | 50% |
| <i>Exporters***</i> | 20 | 41 | 71 | 105% | 73% |
| <i>Semi Annual and Annual Refund claims****</i> | 22 | 19 | 81 | -14% | 326% |
| VAT Tourist Refund | 3 | 6 | 11 | 100% | 83% |

Source: MOF, VAT Directorate, VAT Declaration Forms

* Please note that the VAT was implemented on a 11 months basis in 2002.

VAT revenue figures in this table are based on quarterly VAT declaration forms, whereas the VAT revenue figures in the Fiscal Performance represent cash collections.

**Under Article 59 of VAT Law and its amendment in 2004, exempted sectors are granted 100% refund.

*** Exports are zero-rated

**** By virtue of VAT Law and its amendment in 2004, VAT creditors/carry forwarders can refund their VAT twice each year.

VAT Declarations: Since the VAT's introduction in February 2002, the total number of declarations received per year

steadily rose from 33,881 declarations in 2002 to 42,223 declarations in 2003, and

finally to 62,217 declarations in 2004, owing largely to the successive lowering of the mandatory registration threshold from an initial LL 500 million of annual turnover in 2002 to LL 300 million a year later, and to LL 225 million in 2004³⁴.

Likewise, the total aggregate amount of VAT filed and declared by businesses rose from LL 402 billion in 2002 to LL 475 billion in 2003 to LL 520 billion in 2004. This is explained on the one hand, by the rising number of VAT registrants which may be approximated with the average number of declarations received per quarter, which rose from 8,470 declarations on average per quarter in 2002 to 10,556 declarations on average per quarter in 2003, and to 15,554 declarations received on average per quarter in 2004. The growth in the amount of VAT declared in 2003 and in 2004 may also be attributed to higher levels of economic activity as indicated by rising real growth rates from 2 percent in 2002 to 3 percent in 2003 and 5 percent in 2004³⁵.

VAT tourist refund figures constituted an additional indicator of more buoyant economic activity in the last couple of years by registering consecutive increases amounting to 100 percent in 2003 and 83 percent in 2004. Indeed, the number of tourists has been continuously climbing, reaching 1,278,469 incoming tourists by year end 2004.

Total VAT Claimed for Refund (excluding tourist refund³⁶): The total amount of VAT claimed for refund registered a 131 percent rise in 2004 due to a rise, across the board, in all of its components:

Exporters' Refunds: On the exports side, VAT refund claims for exporters³⁷ rose considerably, by 105 percent in 2003 and 73 percent in 2004, mirroring the 46 percent and the 15 percent export boosts in 2003 and in 2004 respectively.

The 50 percent rise in the amount of **refund claims granted to exempt businesses³⁸** by virtue of Article 59 of VAT Law is explained by the modification of the rate of refunds from 50 percent on all operating expenses to 100 percent as per Article 25 of Budget Law 2004³⁹.

Refund claims from VAT creditors/carry forwarders registered a 326 percent hike in 2004 as well, due to Article 22 of Budget Law 2004 which granted VAT creditors refund twice per year instead of only at year end as was previously the case⁴⁰.

³⁴ Please note that Article 20 of Budget Law 2004 lowered the mandatory registration threshold to LL 150 million of annual turnover, to be effective as of the first January 2005; which was later amended by parliamentary decision to the first of January 2007. Further note that Budget Law 2004 has cancelled the voluntary registration threshold, granting businesses and individuals the right to register in the VAT regardless of the level of their annual turnover.

³⁵ As per MOF, BDL, and IMF estimates.

³⁶ Note that tourist refund operations are effected by an international company "Global Refund"; and not by the Treasury, and hence tourist refund figures are accounted for separately.

³⁷ As is consistent with a destination based VAT, the Lebanese VAT Law zero-rate Exports.

³⁸ Article 59 of VAT Law 379 granted exempt activities, namely exempt industries such as agro food, pharmaceutical, agricultural chemicals, printing and publishing, etc..., and exempt services such as education and medical services, etc..., the right to refund the VAT incurred, in order not to add burden on their operating costs.

³⁹ Note that the rate of refund of VAT incurred on capital investment was initially set at 100 percent as per Article 59 of VAT Law 379.

⁴⁰ Previously, VAT creditors used to carry forward their VAT credit until year end before being refunded.



For further information please contact:

Ministry of Finance

UNDP Project

Fax: 961 1 981059

E-mail: infocenter@finance.gov.lb

Website: www.finance.gov.lb