1997 Budget Report

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CHAPTER I

REINTEGRATING INTO THE WORLD

In recent decades the world economy has undergone major structural changes, as the international markets for goods, services and capital became increasingly connected. This growing tendency for globalization has drastically altered the world economic environment. Trade and capital markets have become less restricted, corporate production and distribution strategies are being formulated with an international outlook, while technological advancements enhanced the tradability of goods and services and capital mobility. Today, the World Trade Organization (WTO), the third sibling of the Bretton Woods institutions, has finally been established and has rapidly begun to influence the global economic order. Regional trade arrangements are also mushrooming across the globe. European integration has evolved into a Union and the European Union (EU) is now extending its hand of cooperation to the rest of the Mediterranean basin.

During the years of conflict, Lebanon witnessed but could not participate in the globalization process. This is no longer affordable and the country must integrate itself in the international economic community and adjust to new economic realities. It is in this spirit that the Government is currently negotiating agreements with the European Union, and planning discussions with the World Trade Organization with a view to obtain the best possible conditions. Those agreements will potentially both contribute to globalization and expand opportunities for the country to participate in its benefits. Promoting efficiency and productivity and providing a friendlier environment for exports and for domestic and foreign investment will be the key to Lebanon’s future improvement and economic prospects.

Initially, enterprises will face intense and strong international competition. However, protectionist pressure will have to be resisted for international integration exacts adjustment as the price to share in its rewards. In the absence of significant positive externalities, a small open economy can ill afford to look inward and introduce import substituting measures that raise consumer prices and delay the adjustment of enterprises to new economic realities. Most significant, Lebanese enterprises will need to rapidly enhance their competitiveness by reforming their ownership and management structures, upgrading their human resources and modernizing their physical capital. Once fully adapted, however, both businesses and consumers will greatly benefit. Indeed countries are now competing through their economic policies in order to attract foreign investors. Therefore, sound economic policies will become crucial as markets, both domestic and international, will not tolerate policy inaction or errors. With greater capital mobility, international investors explore worldwide opportunities and will assess Lebanon’s policies not only in the absolute but also relative to other countries.

1.Requirements and Constraints

Seventeen years of war and turmoil have had a devastating effect on the Lebanese economy and society. The total damage of physical assets sustained during that period was estimated by the United Nations at USD 25 billion- and equivalent to more than eight times the size of Lebanon's GDP in 1990. The impact on social conditions and on human resources was equally grave, and by 1990 real per capita income was only about one third of its level in 1975. However, Lebanon, throughout its history and even during its darkest days never wavered from it long tradition of a democratic domestic political system, free exchange and trade regime, liberal investment policies, and an open market economic system. These private sector friendly policies have always represented Lebanon's comparative advantage, and have underscored its economic potential. Indeed, it is these policies that truly underpin our reconstruction and modernization strategy.

At the end of 1992 with very limited resources the Government was confronted with the daunting challenges of converting a devastated, demoralized, economically contracting hyper-inflationary situation into one of macroeconomic stability and reconstruction. Simultaneously, the Government was also required to improve markedly the living conditions of the Lebanese people, spend on social and economic stability, enhance security and embark on a comprehensive human resources and physical infrastructure development program. This necessitated progress on, and thus investments in, all socioeconomic fronts including:

- *human development:*

health, education, vocational training, environment, housing, social safety nets and the provision of basic needs.

- *economic and productive rejuvenation:*

employment generation, enhancement of industry, agriculture, services, tourism with particular emphasis on small and medium size enterprises, and the establishment of new areas of comparative advantage.

- *rehabilitation of physical infrastructure:*

electricity, telecommunications, water, waste water, solid waste, roads, ports, airports.

- *administrative rehabilitation and reform:*

modernization of the legislative and regulatory framework, reform of tax system, creation of investment incentives, modernization of financial markets, overhaul of the civil service, streamlining of system and procedures and rendering the public sector user friendly.

- *macroeconomic stability:*

preserving price and exchange rate stability, controlling the budget deficit and containing the growth in public debt.

Clearly, the Government would not be able to finance these multiple objectives through its own resources or through internal borrowing alone. Consequently, the Government's strategy was geared towards rendering its own resources as catalytic funds that would be used to incorporate the domestic and foreign private sectors into the reconstruction and modernization program.

2. Government Priorities

The Government recognized that it was not possible to satisfy all the demands of the population within the time frame expected. Consequently, expectations must become consistent with reality, hard work, dedication, and massive efforts must be patiently exerted and choices must be made and adhered to. Indeed, the Government is unable to address all the above issues simultaneously and may not be suited to address some of them in any case. Therefore the crucial task ahead of us is to redefine the respective roles and responsibilities of the public and private sectors. In this regard, it is inevitable that the private sector will need to play an increasingly growing role through active participation in the reconstruction effort via Build Operate and Transfer (BOT) schemes, as well as through well targeted and well monitored introduction of commercialization. Consequently, the Government must concentrate its attention on those areas that would induce other actors to play a larger role in the overall economic revival effort. Hence, the Government must create the necessary conditions to increase the participation of the Lebanese private sector, the non-governmental organizations' community and foreign investors. Indeed, this is the only way to ensure that much of the above mentioned agenda is achieved in a timely fashion.

In this context, it is important to highlight that the Government's strategy to finance the economy's revival is based on: first, increased reliance on growing public revenues; second, continued, albeit slightly declining, recourse to domestic borrowing; third, greater mobilization of foreign concessional financing; fourth, major expansion in the role of the domestic and foreign private sectors through foreign direct investment including BOTs, FOTs (Finance Operate and Transfer), BOOs (Build Operate and Own), and even commercialization of some public sector activities whereby a true separation occurs between management and ownership in order to improve performance, as well as through an inevitable restructuring of the public sector balance sheet.

With this in mind, the Government's first priority was to restore and maintain confidence in the economy by rendering the Lebanese Lira as a nominal anchor thereby markedly reducing inflation. This coupled with an initial fiscal stabilization effort led to macroeconomic stability, the linchpin of any reconstruction and modernization effort. Next, the Government embarked on an emergency infrastructure development program that primarily targeted the enhanced provision of public services. In addition, the Government initiated significant social service programs including the expansion of services for health, education, vocational training, the return of the displaced, support for the South and improvement in real incomes. These were essential to maintain economic and social stability as well as jump-start the economy and consolidate confidence in the economic future of Lebanon. The Government also embarked on projects encompassing a wide spectrum of sectors including electricity, post and telecommunications, roads and highways, public health and social affairs, education, water supply and waste water, solid waste, public transport, ports and airport, agriculture and irrigation, industry, environment, housing and resettlement.

In parallel to these efforts, the Government took upon itself the creation of a regulatory and tax environment conducive to private sector activity thereby rendering the private sector as the main locomotive for growth. The Government subjected the tax system to sweeping reforms with a view to encourage private sector investment, enhance revenue collection and ease the tax burden on the poorer segments of society. As a result, personal income tax rates range from 2 to 10% progressively, while the corporate income tax rate has become a flat 10% rate with a 5% tax on dividends. Taxes on inheritance and income from rental property have also been reduced along the lines of income taxes. Also, a new customs tariff was adopted with a view to streamline the number and level of duties.

Moreover, and in order to enhance foreign investment further, Lebanon joined the Multilateral Investment Guarantee Agency (MIGA). The Government reformed the National Institute for the Guarantee of Investments which was set up to provide insurance coverage in the form of compensation for losses resulting from non commercial risk. The Government also established, the Lebanese investment promotion agency (IDAL). In addition, the Government is reestablishing the free zone areas which promises to enhance Lebanon's transit and entrepôt trade potential and is introducing industrial zones so as to enhance industrial output and increase domestic employment opportunities. Most important, the Government has reopened the Beirut Stock Exchange and is overhauling the relevant regulatory procedures and public accounting laws. Also, a law on the revaluation of assets to allow corporations to account for the current value of assets, along with laws on fiduciary deposits, the diversification of the investor base of banks, and new regulation for the issuance of debt instruments by banks, have all been approved by Parliament. Furthermore, the Government negotiated treaties with many friendly countries on trade agreements and on the promotion and protection of investments as well as the avoidance of double taxation.

Table 1-1. Economic Treaties, Signed or Initialed

	Investment Promotion		Avoidance of Double Taxation	
Country	Initialed	Signed	Initialed	Signed
Armenia		x		
Canada	I		I	
China		x		
Cuba		x		
Czech Republic	I			
Egypt		x		x
Finland	I			
France		x		x
Germany	I			
Poland	I		I	
Romania		x		x
Russia	I		I	
Spain		x		
Turkey			I	
Syria		x		x
Ukraine		x	I	
Zanzibar	I			

As indicated in the above table, the Government has already signed nine agreements, initialed seven, and is actively negotiating five investment promotion and protection treaties. It has also signed four, initialed five, and is actively negotiating two avoidance of double taxation treaties.

3. The Road Ahead

Naturally, the above-mentioned achievements were not without cost as public expenditures had to markedly increase in order to finance the requirements of the modernization effort. Given the limited availability of resources, and despite a significant improvement in revenue collection, the Government was forced to maintain large budget deficits which in turn led to a continuous build up in public debt. Moreover, during the period 1992-1996, Lebanon was subjected to many highly challenging exogenous shocks that necessitated an unanticipated expansion in public expenditure, and at times led to a decline in market confidence. The most recent and dramatic example of such shocks was the Israeli aggression on Lebanon in April 1996. This led to a fiscal outcome dramatically different than initially envisaged at the time of the preparation and approval of the 1996 Budget. In this regard, Lebanon's ability to withstand and absorb exogenous shocks has rapidly and markedly increased. Indeed, only two days after the end of the April aggression, Lebanon was able to launch an additional Eurobond issue at improved interest rate spreads.

Looking ahead, Lebanon is facing unprecedented challenges, internally as well as externally. Naturally, after seventeen years of turmoil, the country has numerous needs and requirements, and limited means to tackle them all at once. The Government has successfully addressed essential issues and is fully aware of the remaining tasks. These efforts did not go unnoticed. The world community has recognized and embraced the many achievements, as evidenced by the success of the Friends of Lebanon Conference. Nevertheless, the road ahead is not free of obstacles. To surmount these obstacles, the Lebanese must exhibit determination, hard work, unity and perseverance. Only then will Lebanon enter, what could very well be, its most prosperous period.

The following chapters elaborate on the economic developments that took place in the period 1992-1996, and map out the 1997 Budget as well as the economic context within which it was constructed. Moreover, a comparison of Lebanon's economic indicators with those of other countries, as well as, other post-war economies is also presented. Finally, the developments leading up to the positive consequences of the Friends of Lebanon Conference are also discussed.

CHAPTER II

RECENT ECONOMIC DEVELOPMENTS

By 1992, the Lebanese economy was devastated due to fifteen years of civil strife and was faced with a number of serious predicaments. The country witnessed heavy migration of skilled labor and extensive capital flight. At the same time, the public finance situation deteriorated due to the lack of Government authority in the country and the consequent inability to collect revenues while continuing to provide a minimum level of public services. The resulting budget deficits were primarily financed through monetization which increased liquidity and lead to massive pressures on the Lebanese Lira, high and increasing rates of inflation and, rising dollarization.

Since October 1992, the Government has strived to, and succeeded in restoring macroeconomic stability by containing the budget deficit, curbing inflation, and reversing the trend of exchange rate depreciation of the Lebanese Lira as the Lebanese people regained confidence in their national currency and the future of the Lebanese economy.

It is against this background that this section briefly sheds light on the recent past, present and near future, of the macroeconomic position in the country. The analysis encompasses an overview of the actual economic and financial performance from 1992 up to 1996 followed by a synopsis of the 1997 Budget. The section is divided into the following seven parts:

Part 1: Movements in Gross Domestic Product

Part 2: Fiscal Developments

Part 3: Outstanding Debt

Part 4: Balance of Payments

Part 5: Inflation and Price Levels

Part 6: Exchange Rate and International Reserves

Part 7: Monetary Developments

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1. Movements in Gross Domestic Product

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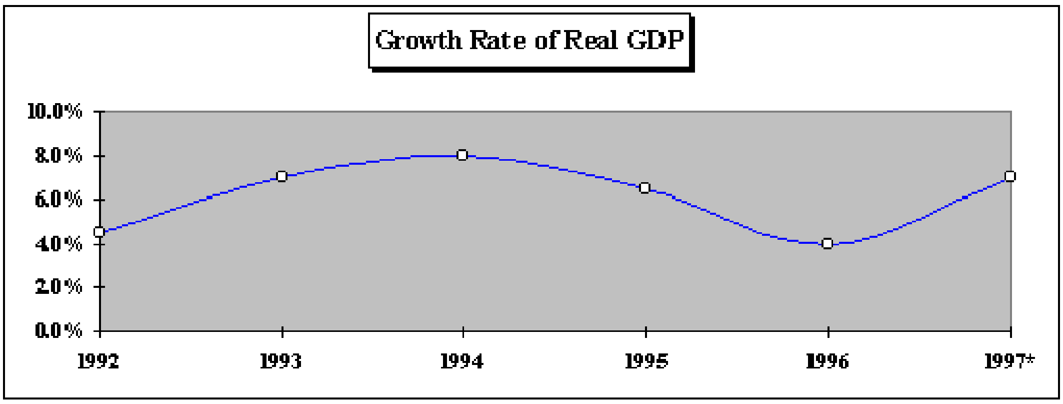
With the restoration of peace and stability, GDP has registered high growth rates throughout the period extending from 1992 to 1995, averaging a real growth rate of 6.5 percent per annum. Moreover, the recovery has brought annual per capita incomes from less than USD 1,000 in 1990 to an estimated USD 2,600 in 1995. In 1996, real economic growth is estimated at 4.0 percent amounting to LL 20,552 billion in nominal terms. In 1997, the economy is expected to resume its previous medium-term growth rates of 7 percent as it rebounds from the exogenous effects of 1996.

Table 2-1. Real GDP Growth, 1992 - 1997

	1992	1993	1994	1995	1996	1997*
Growth Rate of Real GDP	4.5%	7.0%	8.0%	6.5%	4.0%	7.0%
*Ministry of Finance estimates						

Chart 2-1



**Ministry of Finance estimates*

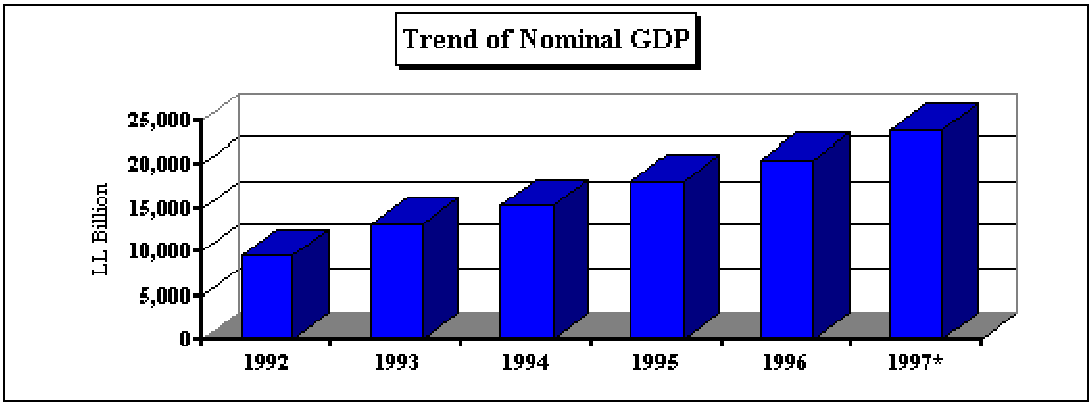
Table 2-2a. Nominal GDP Growth (LL), 1992 - 1997

	1992	1993	1994	1995	1996	1997*
Nominal GDP (bn LL)	9,409	13,122	15,305	18,028	20,552	23,840
*Ministry of Finance estimates						

Table 2-2b. Nominal GDP Growth (USD), 1992 - 1997

	1992	1993	1994	1995	1996	1997*
Nominal GDP (bn USD)	5,17	7,67	9,29	11,30	13,24	15,36
*Ministry of Finance estimates						
NB: Exchange rate used is end of period till December '96 (1,552)						

Chart 2-2



**Ministry of Finance estimates*

2. Fiscal Developments*

Turning to the fiscal front, the Lebanese Government has been confronted with the difficult tasks of macroeconomic stabilization and fiscal consolidation on the one hand, and reconstruction expenditures and greater resource allocation to social services on the other while avoiding a dramatic increase in taxation after more than fifteen years of suffering. Consequently, the Government initially stabilized the macroeconomic situation then began to increase reconstruction expenditures and social services as well as emergency expenditures due to exogenous shocks. All this was occurring at a time when revenue collection was continuously increasing at a significant pace.

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Table 2-3. Public Finances - Budget 1992-1997

(LL Billion)

	1992	1993	1994	1995	1996	1997
Total Expenditures (a+b)	1,654	3,400	4,106	5,630	6,458	6,433
a. Current Expenditures	1,424	2,909	3,309	4,583	5,588	5,825
-Interest Expenditures	405	840	920	1,610	2,600	2,700
b. Capital Expenditures	230	491	797	1,047	870	608
Total Revenues	972	1,701	2,246	3,150	4,025	4,100
Total Deficit	682	1,699	1,860	2,480	2,433	2,333
Deficit to Expenditure Ratio	41,23%	49,97%	45,30%	44,05%	37,67%	36,27%
Primary Deficit / Surplus (-)	277	859	940	870	-167	-367

Chart 2-3

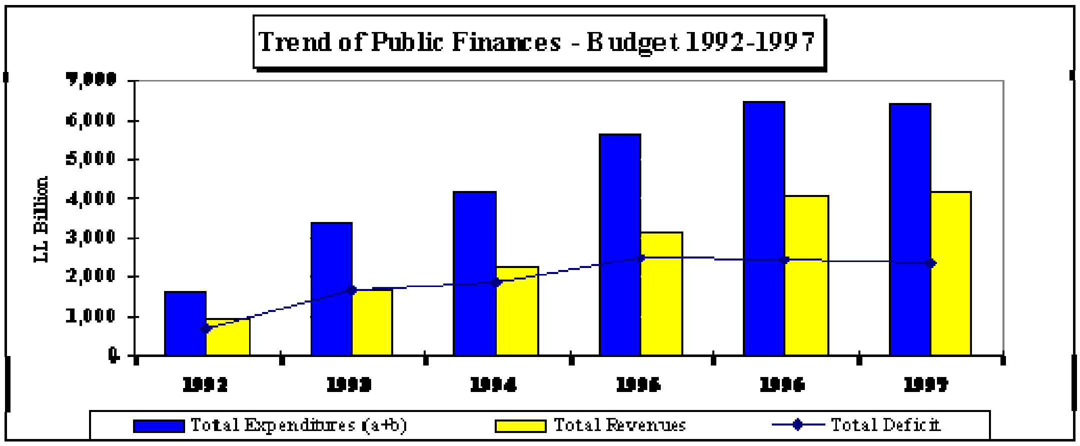
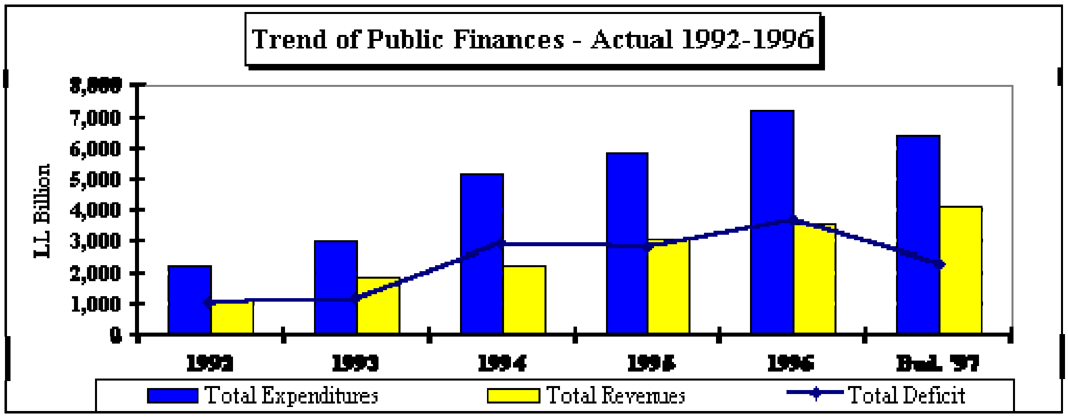


Table 2-4. Public Finances - Actual 1992-1996

(LL Billion)

	1992	1993	1994	1995	1996	Bud. '97
Total Expenditures	2,219	3,017	5,204	5,856	7,225	6,433
-Interest Expenditures	*518*	*784*	*1,488*	*1,875*	*2,653*	*2,700*
Total Revenues	1,138	1,855	2,241	3,033	3,533	4,100
Total Deficit	1,081	1,162	2,963	2,823	3,692	2,333
Primary Deficit / Surplus (-)	563	378	1,475	948	1,039	-367
Deficit to Expenditure Ratio	48,72%	38,52%	56,94%	48,21%	51,10%	36,27%
Ratio Interest Exp \ Total Exp	23,34%	25,99%	28,59%	32,02%	36,72%	41,97%

Chart 2-4



During 1992, as can be seen in the table below, treasury revenues covered 51 percent of expenditures, with custom duties accounting for 28 percent of total revenues. On the other hand, treasury expenditures increased to LL 2,219 billion in 1992 with the share of wages and salaries constituting around 30 percent of total expenditures.

Table 2-5. Summary of Public Finances - Actual 92-95

(LL Billion)

	1992	1993	1994	1995
Revenues	1,138	1,855	2,241	3,033
Indirect Taxes, of which	**467**	**743**	**921**	**1,483**
Custom Duties	**323**	**663**	**791**	**1,320**
Direct Taxes & other revenues	**671**	**1,112**	**1,320**	**1,550**
Expenditures	2,219	3,017	5,204	5,856
Current Expenditures	**2,073**	**2,624**	**3,954**	**4,640**
Wages and Salaries	**680**	**1,295**	**1,710**	**1,869**
Interest Expenditures	**518**	**784**	**1,488**	**1,875**
Other	**875**	**545**	**756**	**896**
Capital Expenditures	**146**	**393**	**1,250**	**1,216**
Deficit	1,081	1,162	2,963	2,823

During 1993, total treasury revenues increased from 12 percent of GDP in 1992 to 14 percent and by 63 percent in absolute terms. During that year, import duties more than doubledpartly due to administrative improvements and tighter control over ports of entry. The year 1993 also witnessed a slight deceleration in treasury expenditures (around 23 percent of GDP), which proved essential and allowed for an expansion in investment outlays in the following years. Another reason behind this containment is the late approval of the 1993 budget (in December 1993) which caused expenditures, during that year, to be implemented according to the 1992 budget appropriations. Interest payments rose from 23 to 26 percent of total expenditures in 1993. This increase in domestic interest payments was due to the Government's on-going policy of non-inflationary financing of the deficit through the issuance of domestic treasury bills. Also, given that treasury bills were the main tool used by the Bank of Lebanon for Open Market Operations, domestic debt increased to maintain monetary stability. Most significantly, the fiscal outcome in 1993 was tighter than projected in the 1993 Budget law. Accordingly, the budget deficit declined from 13 to less than 9 percent of GDP.

In 1994, the overall fiscal deficit more than doubled to about 19 percent of GDP. This expansion in the fiscal deficit, caused by the 72 percent rise in expenditures, is explained by the late Parliamentary approval of the 1993 budget. Therefore, in 1994, spending for both the 1993 and 1994 budgets occurred with only revenues for 1994 being collected. This, along with the intensification of the reconstruction effort and the increase in current expenditures, rendered fiscal policy more expansionary. As can be seen below, taking the 1993 and 1994 budgets together, actual treasury revenues exceeded budget revenues by 4 percent while actual expenditures outstripped budgeted expenditures by 9.5

percent. This was primarily due to higher than expected interest payments. As a result, the overall fiscal deficit was 16 percent above budgeted levels.

Table 2-6. Public Finances - Budget 93+94 vs. Actual 93+94

(LL Billion)

	Budget (1993+1994)	Actual (1993+1994)
Total Expenditures	7,506	8,221
o/w Interest Expenditures	1,760	2,272
Total Revenues	3,947	4,096
Total Deficit	-3,559	-4,125
Primary Deficit	-1,799	-1,853

In 1995, the budget deficit was expected to represent 14 percent of GDP and 44 percent of expenditures. However, the outcome for 1995 was somewhat different. Indeed, treasury expenditures increased by 12 percent compared to 1994, partly due to the increase in the weighted average yield on treasury bills which reflected the uncertainty that surrounded the Presidential elections and the resulting decline in confidence. Nevertheless, revenues grew by 35 percent, albeit slightly lower than anticipated in the budget. As a result, the deficit to expenditure ratio declined by around 9 percentage points when compared to 1994. The overall fiscal deficit in 1995 declined by 4 percentage points relative to GDP reaching 15.6 percent.

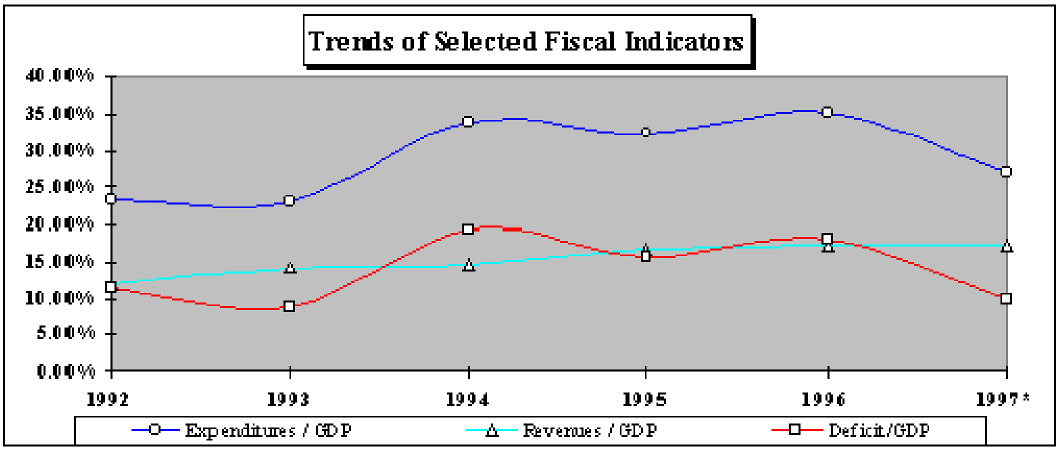
During 1996, fiscal developments have not emerged as initially expected due to a decline in revenues caused by slow economic growth and an unanticipated increase in public expenditures. The main cause of these developments was the Israeli aggression on Lebanon in April, the regional political situation, and the Lebanese Parliamentary elections. As a result, some domestic and foreign investors postponed investment decisions and avoided major expenditures. Consequently, as mentioned above, overall economic growth is estimated to be in the range of 4 percent which adversely affects total revenues. Indeed, revenues have registered a 12 percent shortfall. On the other hand, largely due to the Israeli aggression, public expenditures had to be increased by LL 767 billion. Overall public expenditures in 1996 have reached LL 7,225 billion while revenues have reached only LL 3,533 billion, thereby rendering a deficit to expenditure ratio of about 51 percent and a primary deficit of LL 1,039 billion.

Table 2-7. GDP and Fiscal Performance, 1992-1997

(LL Billion)

	1992	1993	1994	1995	1996	1997*
Nominal GDP	9,499	13,122	15,305	18,028	20,552	23,840
Expenditures	2,219	3,017	5,204	5,856	7,225	6,433
Expenditures / GDP	23,36%	22,99%	34,00%	32,48%	35,15%	26,98%
Revenues	1,138	1,855	2,240	3,033	3,533	4,100
Revenues / GDP	11,98%	14,14%	14,64%	16,82%	17,19%	17,20%
Budget Deficit	1,081	1,162	2,963	2,823	3,692	2,333
Deficit/GDP	11,38%	8,86%	19,36%	15,66%	17,96%	9,79%
*Budget 1997						

Chart 2-5



3. Outstanding Debt

With the deficit largely financed through borrowing and specifically through the issuance of treasury bills, total net public debt increased from around 46 percent of GDP in 1992 to about 78 percent of GDP by December 1996, of which approximately 17 percent (out of total debt) is external debt. As can be seen in the graphs below, the weighted average yield on short-term treasury bills (3 months, 6 months and 12 months) and the weighted average yield on treasury bonds (24 months) increased at a fast pace during 1995 reflecting the uncertainty that accompanied the Presidential elections and the resulting decline in confidence. This naturally resulted in economic costs in terms of reduced growth and higher government expenditures as debt service obligations increased markedly. This trend was reversed gradually around October-November 1995 with the extension of the Presidential term which led to a decline in the weighted average yields and eventually their return to their pre-1995 levels in early 1996.

Chart 2-6

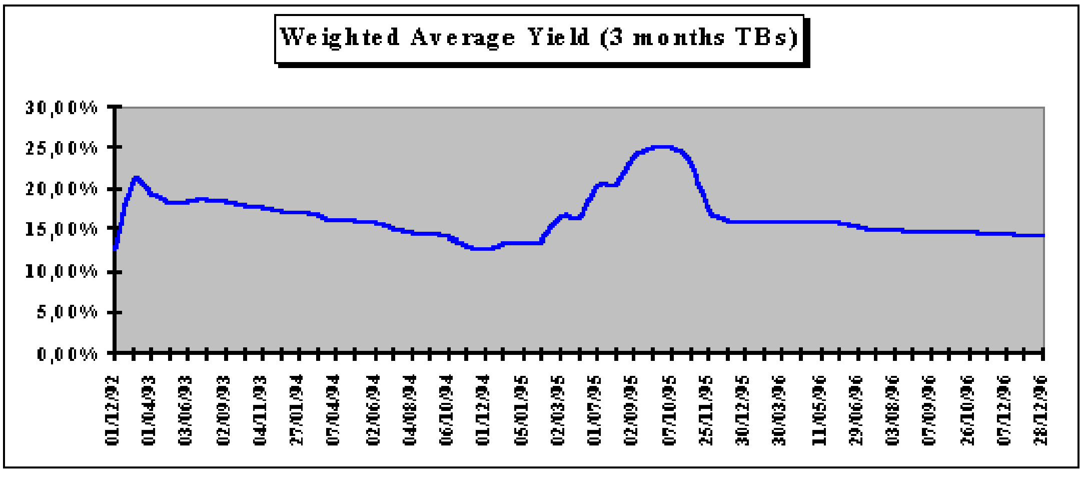


Chart 2-7

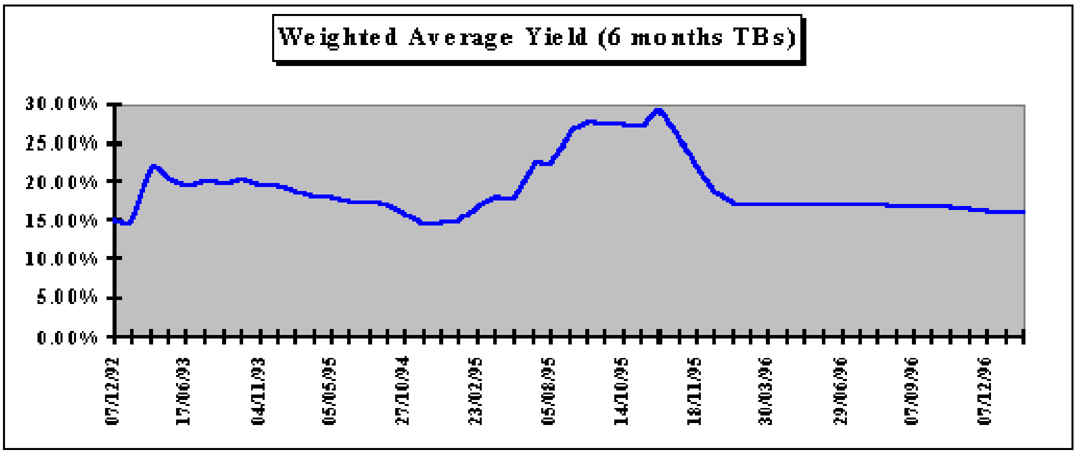


Chart 2-8

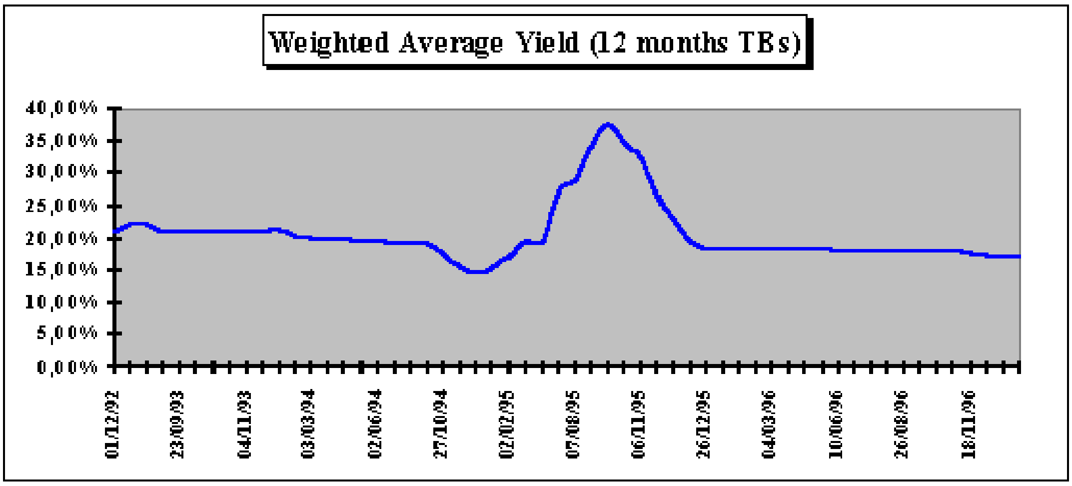


Chart 2-9

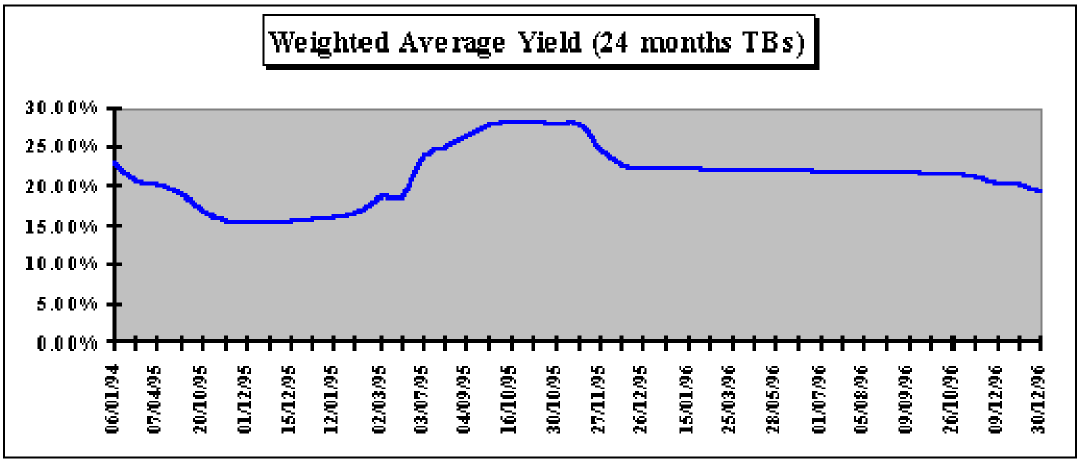


Table 2-8. Outstanding Debt, 1992-1997

(LL Billion)

	1992	1993	1994	1995	1996	1997*
Deficit	1,089	1,162	2,963	2,829	3,682	2,333
Net Domestic Debt	n.a.	4,407	6,712	9,287	13,315	15,648
Foreign Debt	n.a.	559	1,271	2,083	2,745	3,987
Net Public Debt	4,383	4,966	7,983	11,370	16,060	19,635
* Estimates						
Exchange Rate used is e.o.p. (31 Dec. '96 (1,552)) / Net Public Debt 1992 is by assumption						
Net Domestic Debt '97 = Budget Deficit '97 + Net Domestic Debt '96						
Foreign Debt '97 = Foreign Debt '96 + USD 800 million						

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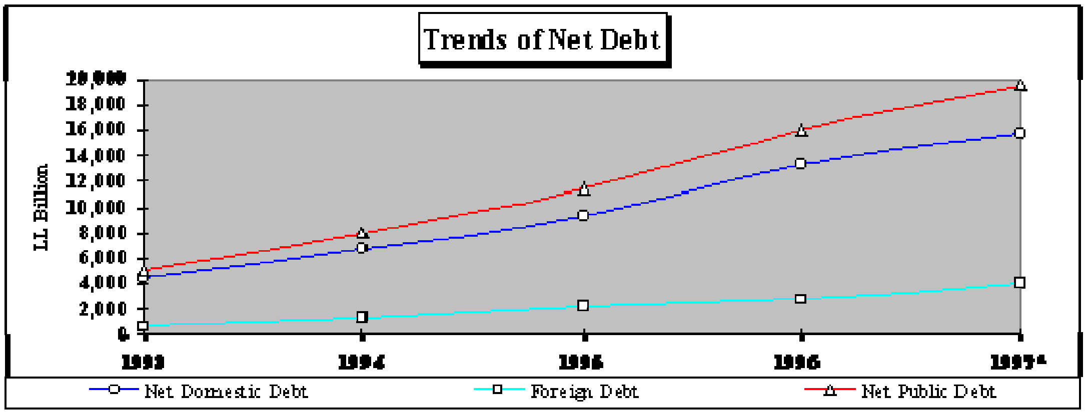
Chart 2-10



In view of the need to avoid a dramatic increase in taxes and in order to avoid inflationary pressures, the Government has chosen to finance the budget deficit primarily through the issuance of domestic treasury bills, which prevents money creation and thus preserves price stability. Naturally, an expansion in domestic public debt results from this policy option. In addition, foreign borrowing has been partly used to fund investment expenditures.

The figures below show that, as a percentage of GDP, the budget deficit has been fluctuating throughout the period with a sizable decline in 1997 while net public debt has been steadily increasing albeit at a slowing pace to attain a relatively stable level by 1997.

Table 2-9. GDP, Fiscal Performance and Outstanding Debt

(LL Billion)

	1992	1993	1994	1995	1996	1997 *
Nominal GDP	9,497	13,122	15,305	18,028	20,552	23,840
Budget Deficit	1,081	1,162	2,963	2,823	3,692	2,333
Deficit/GDP	11,38%	8,86%	19,36%	15,66%	17,96%	9,79%
Net Public Debt / GDP	46,14%	37,84%	52,16%	63,07%	78,15%	82,36%

*Budget 1997 in addition to an estimated USD [illegible] million increase in foreign debt.

Chart 2-11

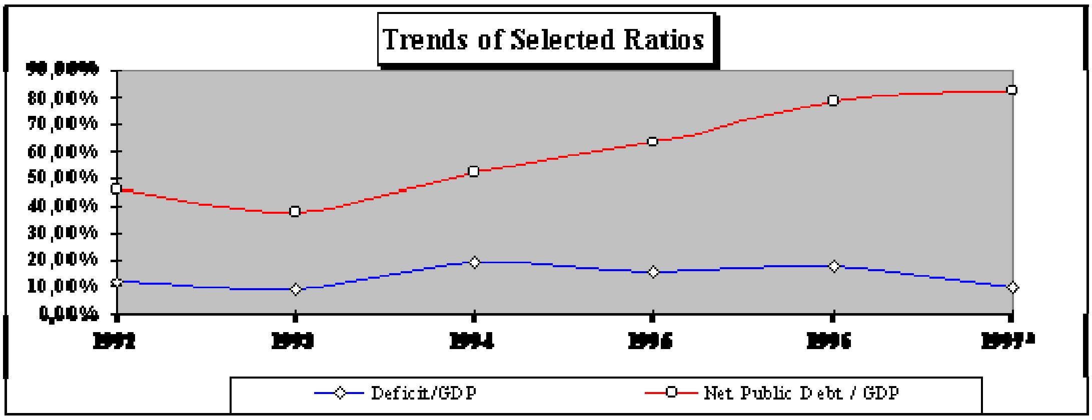
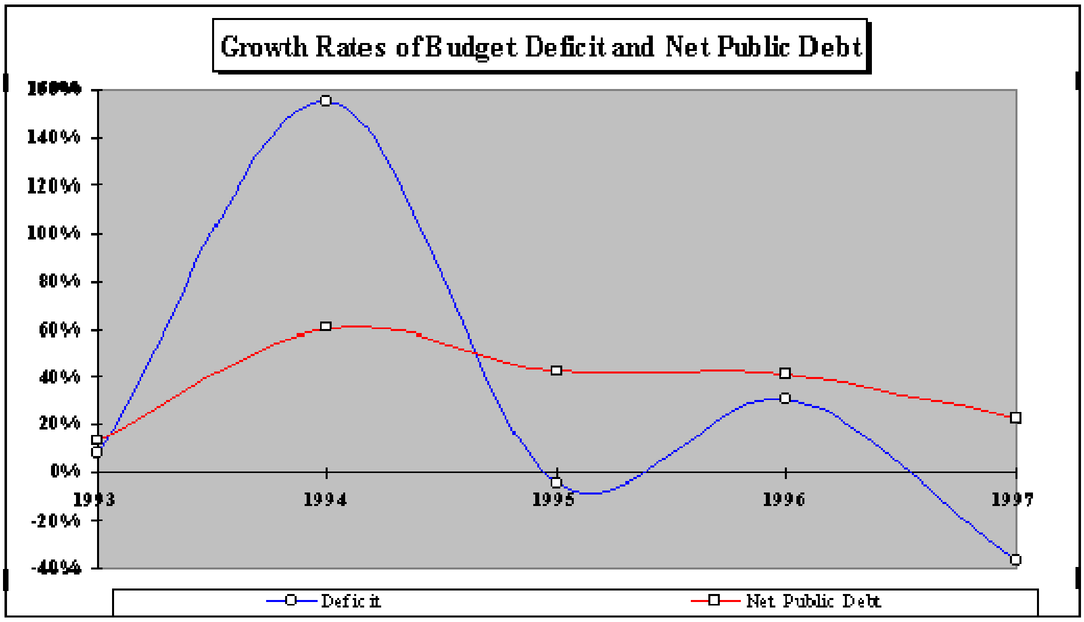


Chart 2-12



4. Balance of Payments

In general, the balance of payments was in overall surplus over the past five years despite growing trade deficits (see below figures and graph). The balance of payments surpluses were generally sustained by emigrants' remittances and capital inflows.

In 1992, as a result of the large wage augmentation which led to an increase in the budget deficit and to speculation against the Lebanese Lira, the country witnessed enormous capital flight. This capital flight was offset by the large capital inflows that accompanied the conclusion of the Parliamentary elections and the renewed confidence brought about by the formation of the Government headed by Prime Minister Hariri. The renewed confidence stood as the major cause of the large surplus on the capital account (around USD 2.8 billion) that succeeded to offset the widening external current account deficit (around USD 2.7 billion). Overall, the balance of payments was marginally in surplus.

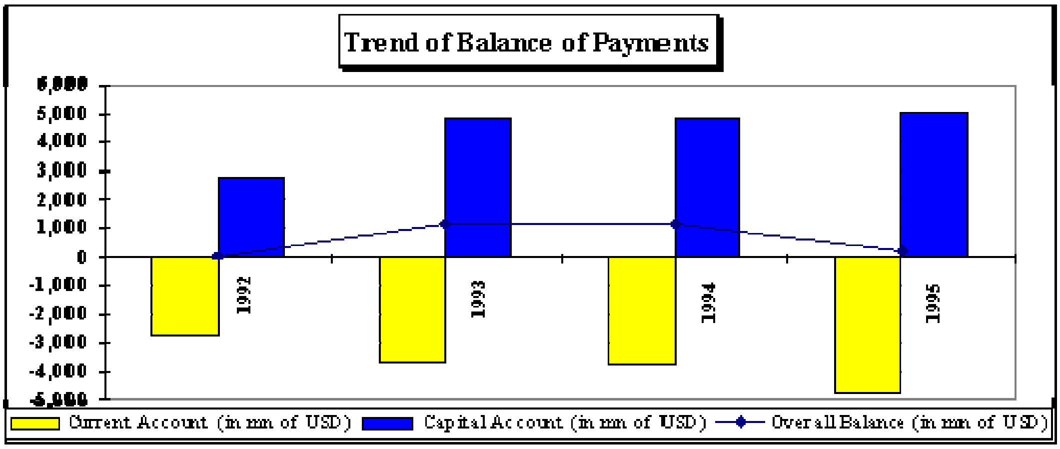
In 1993 and 1994, mounting imports which were not fully matched by an improvement in exports were more than offset by capital inflows, thereby rendering a balance of payments surplus of more than USD 1 billion in each year.

Nevertheless, in 1995, the balance of payments situation temporarily deteriorated as a result of the uncertainty that encircled the Presidential elections. However, the overall surplus of USD 256 million was the result of the renewed confidence and the subsequent large capital inflows that followed the extension of the President's term. It is also worth noting that the balance of payments registered a surplus of USD 846 million during the first eleven months of 1996.

Table 2-10. Summary of Balance of Payments, 1992-1996

	1992	1993	1994	1995	1996
Current Account (in mn of USD)	-2,763	-3,692	-3,751	-4,812	n.a.
o/w Balance of Trade	-3,185	-4,221	-4,804	-5,759	n.a.
Exports, f.o.b.	601	686	737	962	n.a.
Imports, f.o.b.	3,786	4,907	5,541	6,721	n.a.
Capital Account (in mn of USD)	2,817	4,861	4,882	5,068	n.a.
Overall Balance (in mn of USD)	54	1,169	1,131	256	846

Chart 2-13



5. Inflation and Price Levels

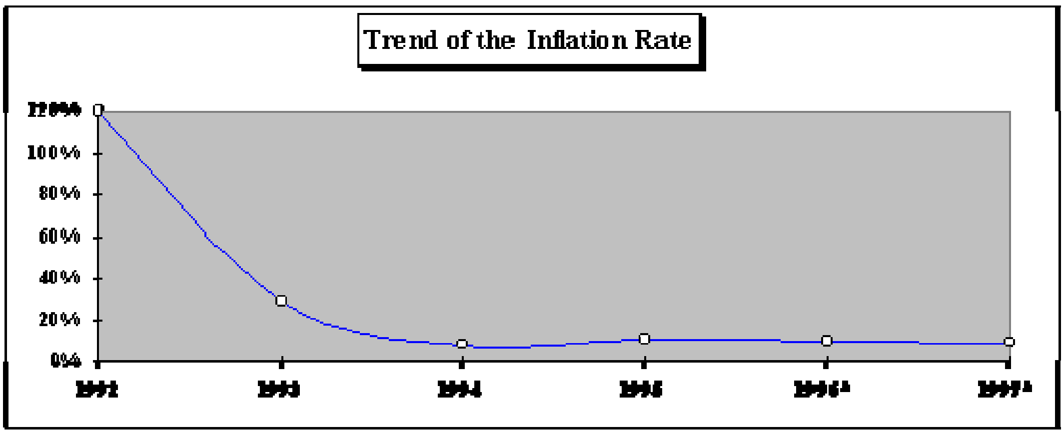
Since the mid-1980s Lebanon has suffered from rapid increases in prices, peaking at 500 per cent in 1987. This trend was reversed with the renewed confidence brought about by the appointment of a new Government headed by Prime Minister Hariri in

October 1992. Although there are still no official inflation statistics in Lebanon, proxy indicators show that a gradual return to relative price stability is slowly occurring:

Table 2-11. Inflation Rates, 1992-1997

	1992	1993	1994	1995	1996*	1997*
Inflation Rate (%)	120%	29%	8%	11%	10%	9%
*Estimates						

Chart 2-14



Despite the budget deficit, inflation in Lebanon has been relatively low for the last three years for the following main reasons:

1. The issuance of treasury bills which cause a monetary contraction by absorbing liquidity from the market;

2. The use of the exchange rate as a nominal anchor which forms the backbone of the present Government's macroeconomic policy;

3. The openness of the Lebanese economy which ensures that the excess demand witnessed on the domestic market is matched by a corresponding supply of imports thus leading to relative price stability.

Here, it is important to distinguish between inflation and the price level in certain sectors. Clearly, inflation has been brought down markedly and has stabilized. However, the current price level in some sectors remains high, due to supply bottlenecks, economic rigidities and the absence of effective competition in several sectors. The decline in the price level in those sectors requires increased competition, greater openness of the Lebanese market and the elimination of supply bottlenecks and economic rigidities. This can be achieved through the implementation of infrastructure projects and administrative reform with a view to increase productivity and improve public services.

6. Exchange Rate and International Reserves

At the beginning of 1992, public confidence in economic management was shaken by what was perceived as a weak budget, incorporating very large wage awards to the public sector and a large deficit. This, together with political uncertainty triggered renewed speculation and continued capital outflows which contributed to a slide in the external value of the Lebanese Lira that reached LL 2,830 per USD by September 1992. However, in the last quarter of 1992, the newly formed Government adopted a package of measures designed to contain the fiscal deficit, reduce credit creation, and re-establish financial stability. The consequent return of confidence, attractive interest rates on Lebanese Government securities and favorable prospects in the real estate and construction sectors all led to a surge in capital inflows which exerted upward pressure on the exchange rate (it appreciated from LL 2,830 per USD in September 1992 to LL 1,838 per USD by the end of 1992). Since October 1992, the Lebanese Lira has been moderately appreciating as can be seen in the table and graphs below.

Table 2-12. Exchange Rate Movements, 1992-1996

	1992	1993	1994	1995	1996
Exchange Rate LL per USD (e.o.p.)	1,838	1,711	1,647	1,596	1,552
Exchange Rate LL per USD (avg.)	1,713	1,741	1,680	1,621	1,571

Chart 2-15

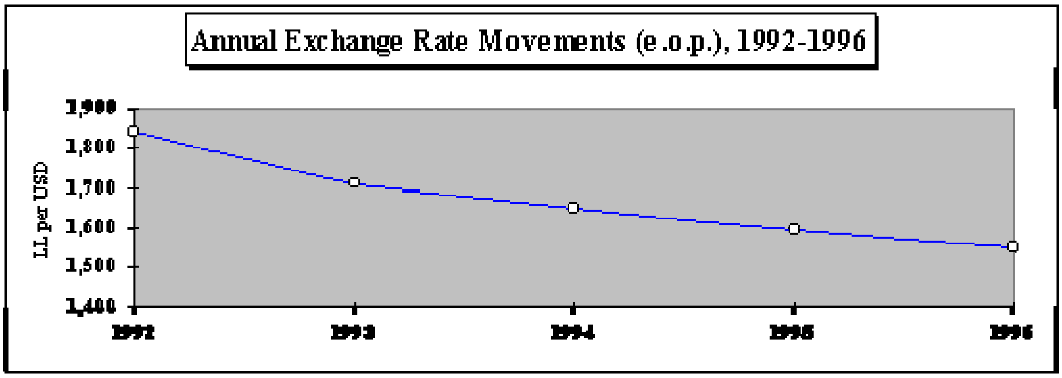
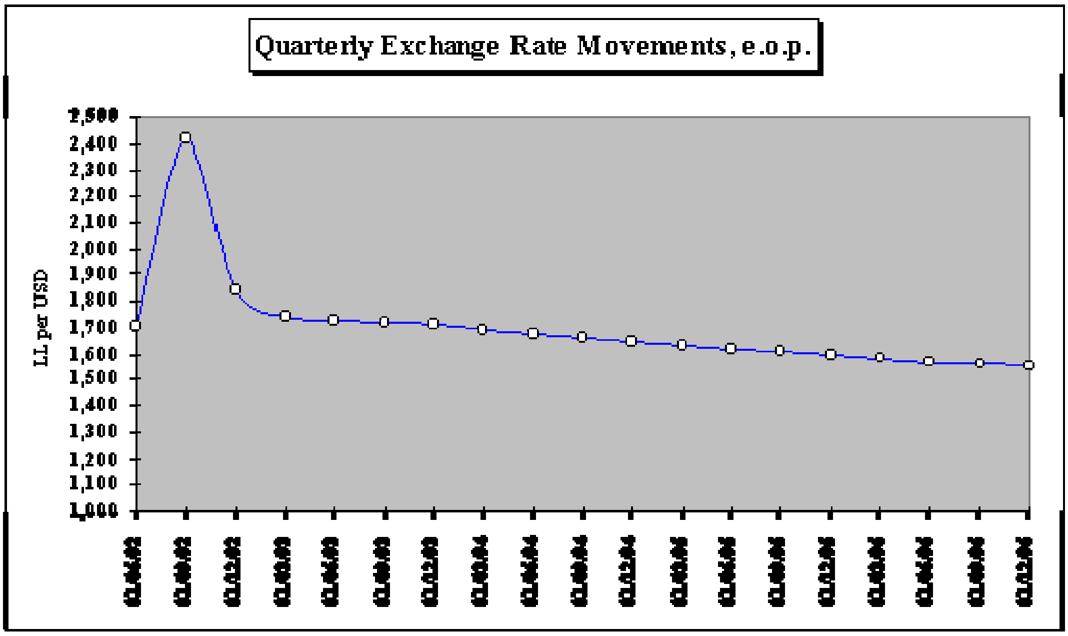


Chart 2-16



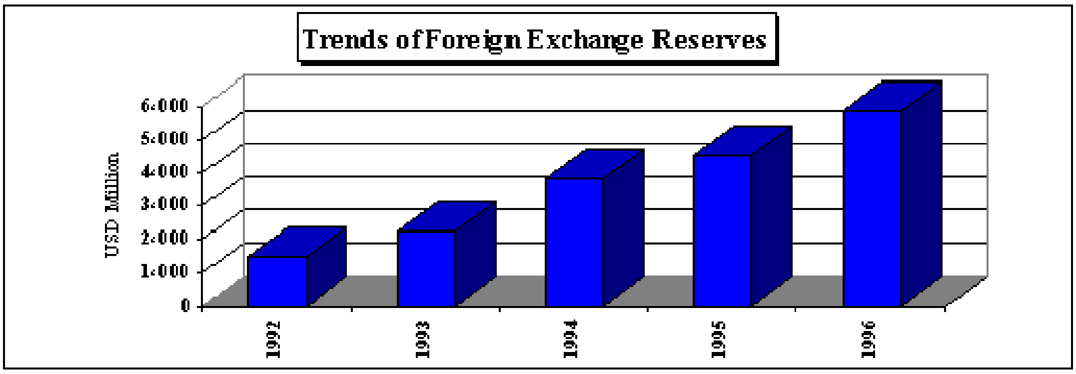
In sum, the Government's exchange-based stabilization policy has led to an appreciating currency and has brought inflation down considerably. Foreign exchange reserves have been replenished, with gross reserves (excluding gold), at the Bank of Lebanon rising from around USD 1,448 million in 1992 to USD 5,885 million by end 1996.

Table 2-13. Gross Foreign Exchange Reserves, 1992-1996

(USD Million)

	1992	1993	1994	1995	1996
Gross Foreign Exchange Reserves	1,448	2,220	3,840	4,487	5,885

Chart 2-17



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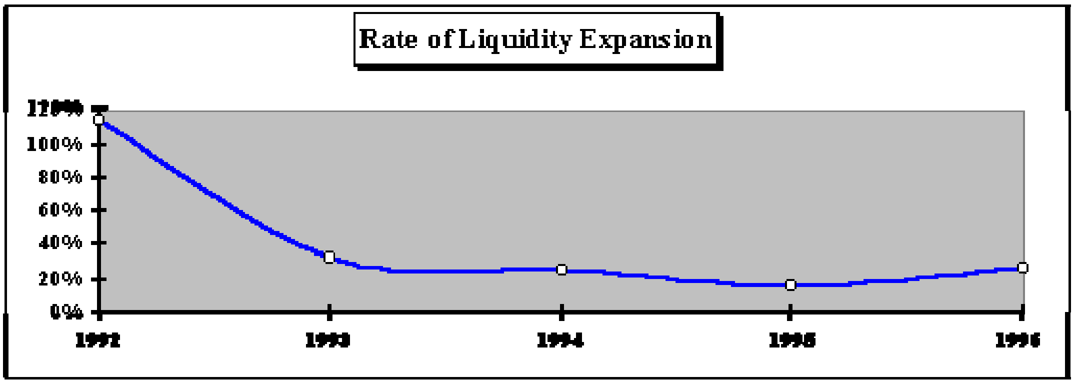
7. Monetary Developments

The pace of liquidity expansion since 1992 reflects the policy of macroeconomic stabilization and the deceleration of inflation as well as external capital inflows. Accordingly, after recording a 114 percent increase in 1992, M3* grew by 32 percent in 1993 and decelerated thereafter to 25 percent in 1994. In 1995, the relatively low rate of monetary growth of 16 percent is associated mainly with the political environment prior to the presidential elections and the temporary but sharp rise in interest rates on treasury bills. In 1996, monetary growth returned to its pre-1995 levels, reaching 27 percent by November.

Table 2-14. Liquidity Expansion, 1992-1996

	1992	1993	1994	1995	1996
Rate of Liquidity Expansion	114%	32%	25%	16%	26%

Chart 2-18



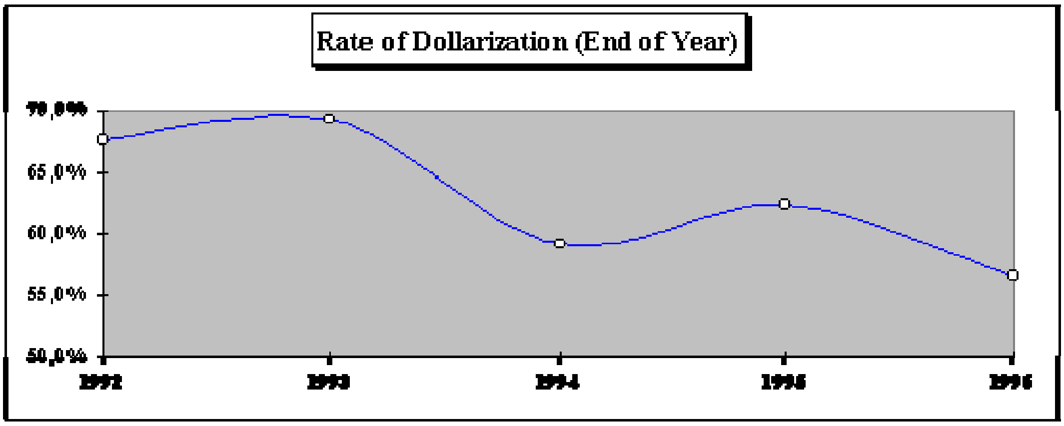
The degree of dollarization of commercial bank deposits resumed its declining trend over the past year after a temporary reversal for the reasons mentioned earlier. The ratio of foreign exchange deposits to total deposits declined to 56.5 percent in December 1996 which is about 6 percentage points lower than a year earlier and the lowest level in years.

Table 2-15. Dollarization, 1992-1996

	1992	1993	1994	1995	1996
Rate of Dollarization*	67,5%	69,3%	59,1%	62,3%	56,5%

*Dollarization = Foreign Exchange Deposits / Total Deposits

Chart 2-19



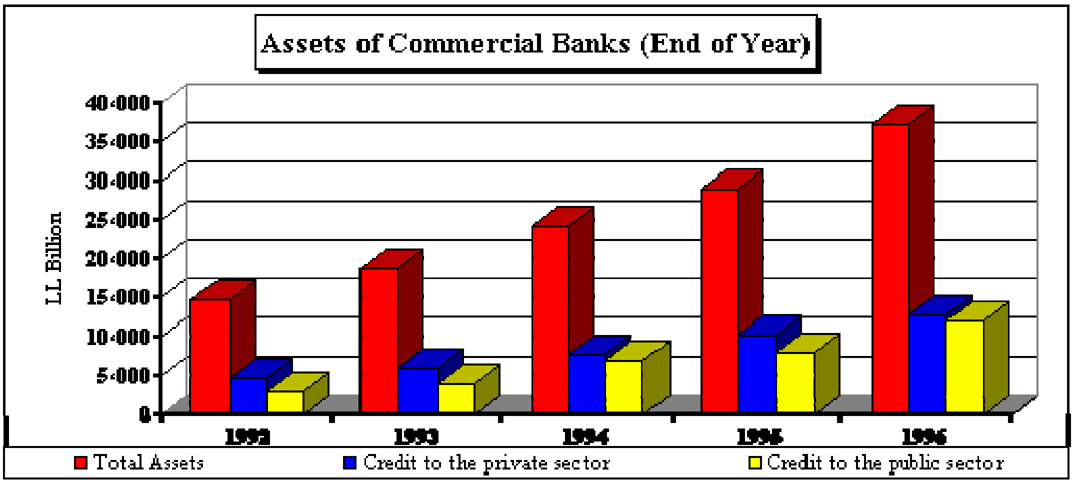
The total balance sheet of commercial banks grew from LL 14.6 trillion at end 1992 to about LL 36 trillion by November 1996. This growth has allowed a substantial increase in credit to the private sector ranging between 21 and 32 percent annually over the past four years, while at the same time providing resources to finance the fiscal deficit. Annual growth in credit to the public sector has hovered between 27 percent and 29 percent over the past three years.

Table 2-16. Assets of Commercial Banks, 1992-1996

(LL Billion)

	1992	1993	1994	1995	1996
Total Assets	14,634	18,809	24,285	29,055	37,183
Credit to the private sector	4,804	5,898	7,800	10,320	12,687
Credit to the public sector	3,098	4,013	6,908	7,949	12,060

Chart 2-20



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*All fiscal data are based on Bank of Lebanon statistics covering the treasury accounts.

* M3 = M1 + M2 + Deposits in foreign currencies

(M1 = Currency in Circulation + Sight Deposits in LL.)

(M2 = Other Deposits in LL.)

CHAPTER III

THE ECONOMIC CONTEXT

OF THE 1997 BUDGET

1. Addressing the Budget Deficit

Since the end of 1992, the Government's economic strategy aimed at transforming the Lebanese economy from a war economy to a normal post war economy, capable of adjusting to economic realities of the 1990s and the beginning of the 21st century, while simultaneously improving the standards and quality of life for the Lebanese people. The linchpin of this strategy has been the creation of a conducive environment for private sector investment with a view to generate significant employment opportunities and hence increase the level of income to the Lebanese people, increase production and productivity, and consequently enhance the competitiveness of the Lebanese economy in the context of massive international economic and social developments.

In its attempt to achieve these objectives, the Government initially focused on regaining and maintaining public confidence in the economic future of Lebanon through introducing and maintaining macroeconomic stability, markedly reducing inflation and containing the fiscal deficit. In parallel to these measures, the Government mobilized sufficient internal and external resources to embark on a major reconstruction and rehabilitation program, thereby establishing the necessary preconditions for reclaiming an economic role for Lebanon within a changing regional and global economy.

Indeed, the Budget Laws for 1993, 1994 and 1995 reflected fully this approach. However, actual outcomes for these years highlight the degree of influence that the war years had on public finance and the structure of public expenditures whereby the bulk of total expenditures constituted fixed recurrent expenditures including interest payments, wages and salaries, and direct and indirect social transfers. Accordingly, the Government's ability to react to exogenous economic shocks became severely restrained.

Here, it is important to recall that with the breakout of hostilities in the mid 1970s, public debt began to accumulate. This was due to the decline in Government control over public ports and revenue sources and the expansion of public expenditures which led in turn to large and growing budget deficits. In this context, it should be noted that the growth in public debt results from two reasons: first, due to the Government's inability to cover its operational and investment expenditures from its ordinary revenues (primary budget balance) and second, due to debt service obligations.

In this regard, the 1996 Budget Law represented an important step towards addressing the public debt issue. For the first time in several years, the 1996 budget projected a decline in the absolute level of the budget deficit and a major decline in the deficit to expenditure and deficit to GDP ratios (refer to Table 2-3). Also, the 1996 budget projected a transformation in the primary budget from historical deficits to a small surplus.

The fiscal developments in 1996 have not emerged as initially expected due to an unanticipated increase in public expenditures and a decline in revenues resulting from a slow economic growth. The main cause of these developments was the Israeli aggression on Lebanon in April and its negative impact on economic recovery, as well as the regional political developments. Subsequently, some domestic and foreign investors postponed investment decisions and avoided major expenditures. This situation was further affected by the high interest rates registered in 1995 and the Parliamentary elections.

As a result, overall public expenditures exceeded the budget figure of 1996 by LL 767 billion while revenues reached only LL 3,533 billion thereby rendering a deficit to expenditure ratio of about 51.1 percent and a primary deficit of LL 1,039 billion. Faced with these temporary fiscal setbacks, and given the importance of maintaining the fiscal consolidation path, it is imperative to make up, in 1997, for the deviation that took place in 1996. Consequently, expenditures in 1997 must be contained with a view to having the 1997 Budget almost at the same level of the 1996 Budget.

To achieve this result at a time when interest payments are expected to increase by LL 100 billion (from LL 2,600 billion to LL 2,700 billion) and rents have already increased, all discretionary expenditures would need to undergo severe cuts. This is also true for investment expenditures in Part II of the budget.

Accordingly, the preparation of the 1997 Budget was based on the following principles:

1. The 1996 salaries and wages would remain constant after reallocating the 230 billion LL from the budget reserve to the various Ministries. This amount represents the 20 percent increase that came into effect on 1/1/95.
2. All discretionary recurrent expenditures are to be reduced below the 1996 budget level.
3. Capital expenditures are to be reduced below their 1996 levels.

2. Fiscal Consolidation

Based on the above principles, the Government attempted to tackle the budget deficit challenge through rationalizing expenditures by containing them and redirecting them towards productive spending thereby avoiding any additional expenditures that are not justified or not coupled with appropriate and additional revenue streams. This is undertaken to avoid adverse effects on the economic and financial situation of the country.

In 1996, a shortfall of about 12 percent between budgeted and actual revenues (LL 4,025 billion to LL 3,533 billion, respectively) was realized due to the reasons already mentioned above. Hence, the 1997 Budget projects an increase of 16 percent in revenues from the attained level of 1996 (from LL 3,533 billion to LL 4,100 billion) and only a 1.86 percent increase (from LL 4,025 billion to LL 4,100 billion) from the 1996 Budget Law. Given that 1996 represented a temporary set back in terms of revenue generation for reasons already explained above, revenue projections for 1997 are somewhat conservative.

Through the 1997 Budget, the Government is attempting to maintain the fiscal consolidation path it drew prior to the adverse economic and fiscal effects of 1996. In the 1996 Budget Law, a small primary surplus was to be realized which in turn would have increased sizably in 1997. The 1997 Budget attempts to do just that by targeting a primary surplus of LL 367 billion.

Indeed, for the first time in many years the 1997 Budget is lower in nominal terms than the 1996 Budget Law. Also, the overall deficit in the 1997 Budget is lower than the deficit in the 1996 Budget Law (LL 2,433 billion in 1996, LL 2,333 billion in 1997). Moreover, the 1997 Budget constitutes a substantial tightening of the fiscal position when compared to the actual outcome of 1996. Total expenditures are expected to decline by about 11 percent in nominal terms and by far more in real terms, while the overall deficit is projected to contract by 37 percent in nominal terms.

The main objective of this fiscal consolidation is to contain the growth of domestic public debt and reduce substantially the absorption of domestic resources by the public sector. As a result, the credit conditions are expected to ease, which in turn will allow the markets to realize an orderly decline in interest rates. This will naturally enhance private sector activity thereby rejuvenating economic growth.

More significantly, the containment of the public sector’s absorption of domestic resources will be enhanced through the greater reliance on foreign financing for investment expenditures. Consequently, the 1997 Budget entails a shift in the source of financing for investment projects from domestic to foreign resources, which led to a decline in the total amount of domestic resources allocated to investment expenditures. Also, minor non-project investment expenditures in Part II A of the budget have been cut substantially.

In sum, the reduction in the crowding out effect of the private sector along with the subsequent decline in domestic interest rates as well as the shift towards greater reliance on concessional foreign financing should enhance economic growth in 1997 and improve further the balance of payments. This decline in domestic interest rates along with the shift towards greater reliance on concessional foreign financing is essential since the expenditure side of the budget is dominated by two expenditure items, namely interest payments and wages and salaries. The exceptionally high ratio of non-discretionary expenditures-salaries and interest- in the budget amounting to 74.3 percent of total expenditure and representing 113 percent of total revenues renders the Government budget structure very rigid. Indeed, there is limited room for flexibility and for responding to exogenous shocks. More important, it is undesirable for an economy undergoing a major reconstruction and rehabilitation program to allocate 74 percent of its budgetary expenditure to salaries and debt servicing.

These structural problems in the fiscal situation of the Lebanese economy become even more apparent when Lebanon is compared to 80 countries grouped into high-income, middle income and low-income brackets. Similar to high income countries, Lebanon's current expenditure is about 90.55 percent of total budgeted expenditure. Moreover, compared to all 80 countries, Lebanon has the highest proportion of expenditures allocated to the sum of wages, salaries and interest payments. Hence, for a country that hopes to rapidly develop a redistribution between current and capital expenditures needs to be carefully balanced.

The structural rigidities mentioned above must be addressed aggressively in order to resolve the fiscal dilemma that confronts the Lebanese economy. In this regard, it is self-evident that Lebanon can no longer the inefficient, yet very expensive public sector. Indeed, a modern efficient administration constitutes a major catalyst to economic growth, development and prosperity.

Table 3-1. Breakdown of Government Expenditure For Countries, 1983-1990

	High-Income 1	**Middle Income 2**	**Low Income 3**	**All Countries**	**Lebanon 1997 Budget**
Current Expenditure	**92.90**	**79.00**	**64.70**	**90.50**	**90.55**
Goods and Services	26.90	33.30	25.10	27.40	44.51
Wages	11.90	21.20	11.50	12.80	35.15
Other G+S	15.0	12.20	13.60	14.60	9.36
Interest	11.50	18.60	14.00	12.40	41.97
Subsidies and Transfers	54.50	27.10	25.20	50.70	4.07
Capital Expenditure	**5.70**	**14.0**	**19.90**	**7.00**	**9.45**
Lending minus repayment	**1.40**	**7.00**	**15.40**	**2.50**	
TOTAL	**100**	**100**	**100**	**100**	**100**

Source: IMF Government Finance Statistics Yearbook, 1993

Note: The sums of the components do not necessarily equal the totals because some minor components are not shown.

Most significantly, the absolute level of the wage bill has become so large, that the economy can no longer afford or withstand substantial, across the board, wage and salary increases on a continuous basis. This is further aggravated by the impending introduction of new salary scales that will inevitably lead to a significant increase in the wage bill and will thus necessitate additional and corresponding revenues. As a result, a crucial requirement in the near future is to undertake a major overhaul of the public administration with a view to thoroughly re-examine the respective roles of the public and private sectors.

Turning to the high debt service burden, it is clear that this constitutes a significant challenge, even though the rate of growth of the debt service has declined markedly. Nonetheless, it is imperative to substantially restructure the debt with a view to reduce the interest burden and extend the debt maturities. The Government has already embarked on this path through the introduction of a strict budget in 1997 and through the envisaged increased reliance of lower cost foreign financing. Nonetheless, Lebanon will still need to address the existing stock of debt with a view to gradually reduce it. This can best be achieved through a restructuring of the public sector's balance sheet. Once again, a thorough examination of the respective roles of the public and private sectors is required.

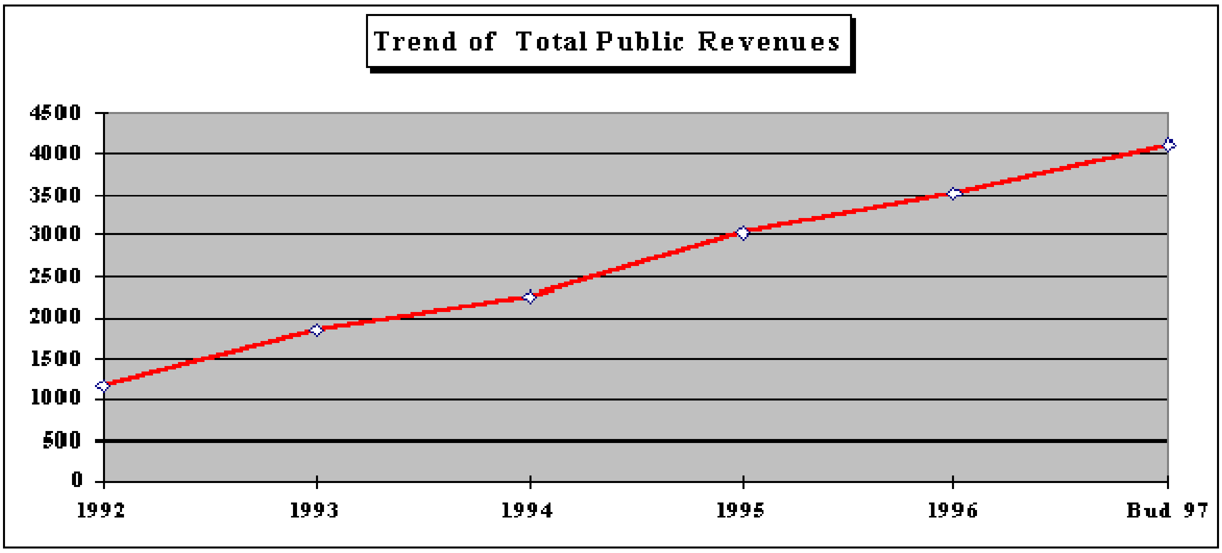
3.Revenue Enhancement

Obviously, deficit reduction cannot rely solely on expenditure containment, for revenue enhancement must play a critical role in this regard . Here it is important to recall that due to the severe reduction in revenues during the years of turmoil where the Government apparatus was completely incapacitated, Lebanon is now faced with the challenging task of rebuilding the State's collection efforts and agencies. The Government is well aware of the urgent need to increase its revenues to first redress the fiscal position, and second to ensure that the reconstruction and development effort continues unabated. Beginning with the premise that taxes play a double role, revenue generation on the one hand, consumption and investment discouragement on the other; the Government is left with the difficult task of maximizing the first role while minimizing the second. The Government's guiding tax policy principle has been to lower the tax rates in order to reduce the burden on lower income groups and provide investment incentives on the one hand, and to step-up the collection effort on the other. To this end, the Government has benefited from the assistance of the IMF, World Bank, United Nations Development Program (UNDP), United Nations Conference on Trade and Development (UNCTAD), the Canadian Government and the French Government.

Due to the vast amount of work to be completed and the complexity of implementation, projects have been divided into short and long-term time frames. In its efforts to modernize and computerize the collection process and to recuperate from the damages caused by the civil strife, the Ministry of Finance had to prioritize project implementation from the most to the least urgent. A substantial number of goals have been realized, with more, as important, to follow in the future. The end result of these efforts will be the enhancement of public revenues and the smooth and efficient collection operation from the points of view of the tax payer and collector.

The whole revenue collection process has been examined and reforms will eventually touch the entire range of operations. Three revenue areas, however, that together constitute the largest revenue source, deserve special mention.

Chart 3-1



a) Income Tax

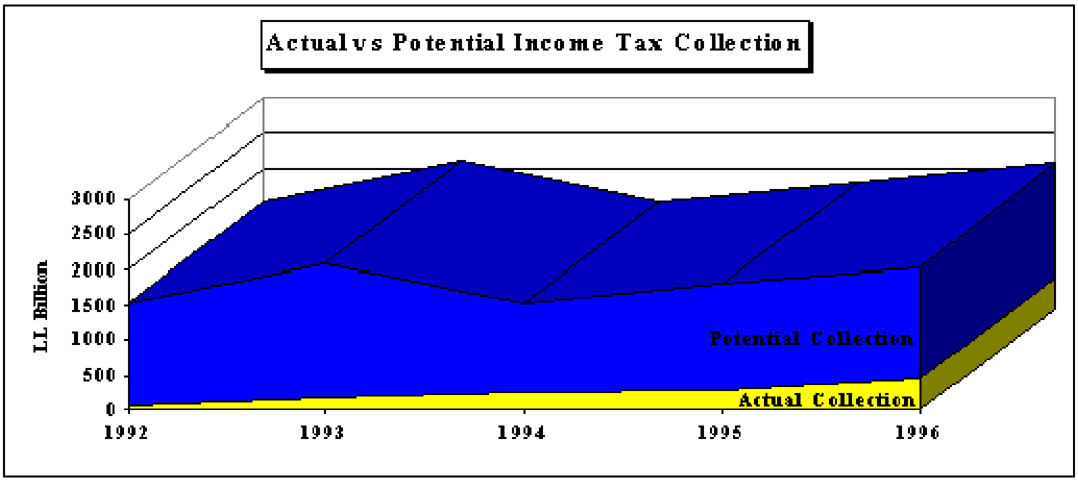
For the last few years, the Government has systematically followed a tax rate reduction policy. A reform law, introduced in 1993 (effective 1994), stipulated a lowering of both the tax rates and the number of tax brackets on personal as well as corporate income. The number of personal income tax brackets were reduced from 13 to 5 with marginal tax rates ranging from 2 to 10 percent - previously they ranged from 2 to 32 percent. While corporate income tax has become a flat tax of 10 percent with a 5 percent tax on dividends. Previously, corporate tax rates ranged from 6 to 50 percent.

The benefits of the income tax reform law are three-fold:

a. Significant reductions in income tax rates are aimed at easing the burden of tax payments especially on low income earners. Left with a higher level of disposable income, demand for goods and services, including those that are locally produced, is expected to rise thereby stimulating economic activity.
b. Reducing corporate income tax provides incentive for businesses to increase their level of investment thereby creating job opportunities and stimulating GDP growth.

c. Revenue collection will increase as lower taxes provide a lesser incentive for evasion. In fact, with better administrative procedures, income tax revenues increased following the implementation of the new law.

Chart 3-2



NB:

· ***The Ministry of Finance, with the assistance of the Canadian Government, has embarked on an extensive tax administrative reform program specifically to increase actual collections and redress the situation depicted in the graph above.***

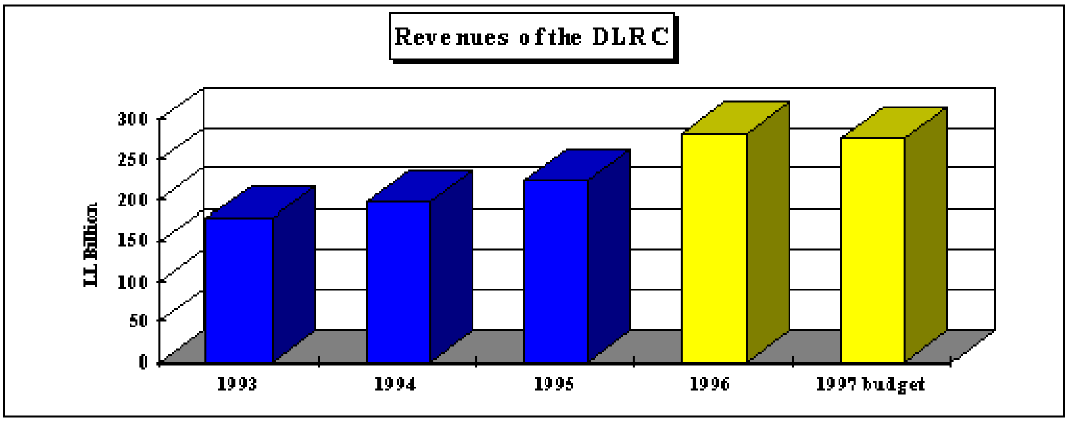
· ***Potential collections are calculated by multiplying the weighted average index of nominal tax rates by the level of GDP of each year. The decline in potential collections between 1993 and 1994 is due to the decrease in tax rates, while the rise from 1994 onwards is due to the increase in GDP level.***

Although tax collections have increased substantially over the last few years, a large gap still exists between what is currently being collected and what could be. To bridge this gap the Government, with the assistance of the Canadian Government, has launched a tax administrative reform program. Work has already commenced on creating a comprehensive database that will include all relevant information on all income earners. To insure better compliance with income declarations, an amendment of the law has been proposed to increase the fines on non-reporting tax payers. In this regard, the Revenue Department has 300 tax auditors, which is approximately one auditor per 13,000 residents; whereas, the ratio, in European countries, is one tax auditor per 300 to 500 residents. Clearly, this has been a handicap in collecting public revenues and the reform program will address this deficiency. The reform program will, also, computerize all tax revenue procedures, train all the Revenue Department employees with a special emphasis on providing tax auditors with the latest auditing skills. Also, the Revenue Department database will be linked to the Customs and Land Registration databases. It is expected that once the tax reform program is implemented and the training cycle completed, potential public revenues will become far more collectable.

b) Land Registration and Cadastre

The Directorate of Land Registry and Cadastre (DLRC) suffered considerably during the years of conflict. Maintaining existing maps and records, as well as surveying and recording transactions became problematic at best. Years of destruction and dis-investment left their mark on the quality and efficiency of the service. Due to the importance of the Registry and Cadastre Directorate, the Ministry of Finance launched a program to completely overhaul the outdated system. Important changes have already been achieved and implemented; here, however, only those that directly lead to revenue enhancement will be elaborated upon.

Chart 3-3



One) It became apparent, rather quickly, that sale value declarations were consistently underestimated and underrepresented about 30 percent of the real market value. A survey, therefore, was undertaken and real property market prices were recorded based on location, neighborhood, district and region. Once completed, this effort instantly led to revenue growth even though the number of property transactions decreased.

Chart 3-4

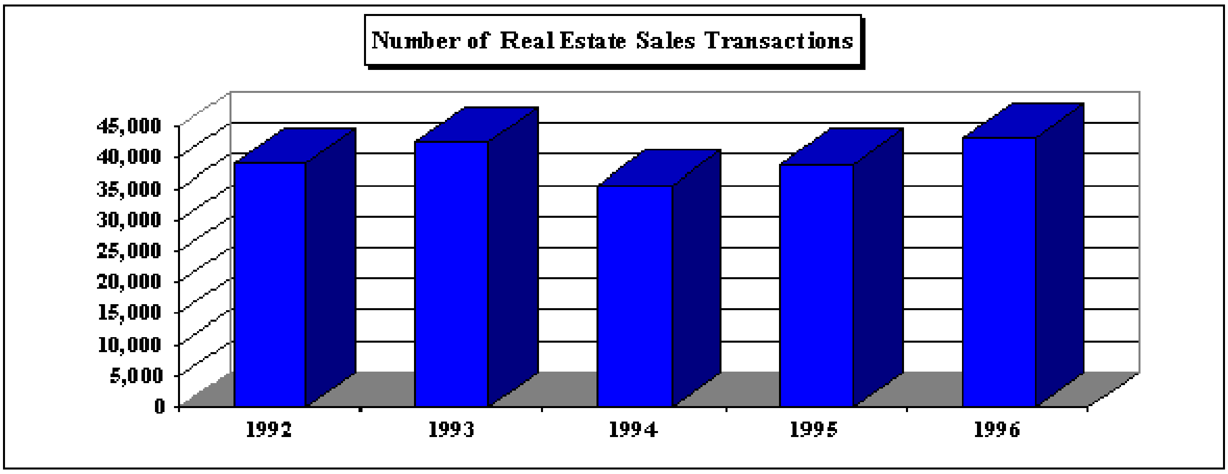
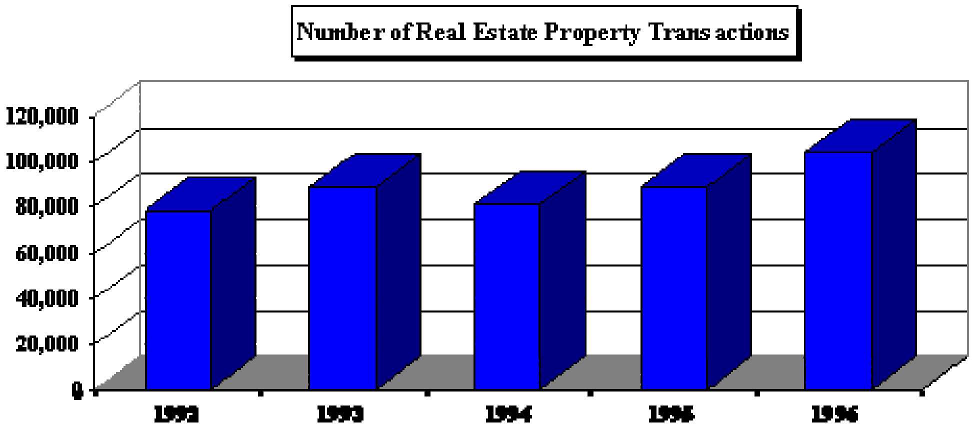


Chart 3-5



b) Taxes on rental income rates have been revised and reduced by about two thirds. The previous tax rates were calculated as 11 percent of the actual or equivalent rental value, increasing progressively to reach a maximum of 23 percent. The new rates start at 4 percent and reach a maximum of 10 percent.

c) The Ministry of Finance with the assistance of the World Bank has embarked on an extensive project to modernize and automate the operations of the Registry and Cadastre Directorate. The core mission of this project is to replace outdated work processes by creating electronic (digital) information and technology infrastructure that will support the effective and efficient management of real property records in Lebanon. Work has already started on computerizing the Title Registers and constructing an up-to-date electronic database. Effort will be extended to preserve existing, reconstruct missing, complete and create unavailable records of ownership. A second geographically intelligent graphic database will be developed and will include existing surveyed maps of all the properties. For non-surveyed properties, an infrastructure of information will be provided to complete the surveying work and produce high quality surveyed maps. In the long run, both computerized databases will be integrated into one comprehensive geographical information system (GIS).

Not least among the many benefits, derived from modernizing and streamlining the Registry and Cadastre Directorate, is lower customer transaction fees and better and faster service. Processing real property-related transactions electronically, rather than manually, will lead to a simplification of those transactions. Needless to say, this will reduce transaction completion time and the role of middlemen and ‘transaction facilitators’.

The revenue enhancement potential of the World Bank project is both, short term and long term. Revenue enhancement in the short run is expected to result from more efficient record keeping that will eliminate or close loopholes currently existing in the system, some of which are:

- unreported built property;
- under-reporting of density of built-up property;
- under-reporting of prices: partial improvements have already been achieved but there is still room for more;
- untitled real properties: unregistered and only recorded in notary public; and
- illegal buildings.

It estimated that the magnitude of revenue contribution expected following the closure of these loopholes will range from 10 to 30 percent. The long term revenue enhancement potential of the project, based on experience elsewhere in the world, (e.g. Sweden, Thailand, Denmark, etc.) promises to be even greater. Given the vibrant real estate market in Lebanon and the financial services orientation of the country, the potential for this kind of real estate information systems promises to be significant.

At the outset, the Ministry of Finance was aware that such an ambitious project cannot be instantly implemented. In fact, it is projected that system development for Registry automation will begin in 1997 and will be fully operational for the whole of the country by 2001 or 2002. Given the complexity of this task, a phased implementation plan was adopted to ensure that the public starts to receive the benefits of automation, in terms of savings and streamlined transactions, as soon as possible, and prior to the completion of the whole project. The current implementation plan is composed of three components:

- The <u>first</u> component consists of automating the legal and financial information recorded on the 'Title Registers' that support daily transactions;
- The <u>second</u> component consists of automating the property maps and all supporting graphic information, including the basis for completing the survey of all non-surveyed properties in the country;
- The <u>third</u> component consists of linking the automated Title Registers and automated maps within one Land Information System that provides transaction support as well as analytical and policy support capabilities.

Under this plan, each component will result in a complete information management system that can be utilized as stand-alone, but is designed in a manner to allow it to integrate with the other components. Individual Registers will be able to provide streamlined services as each Registry is separately automated and will go on-line as the records for that Registry are totally computerized along with the work processes that the registries use in record keeping. The public will be able to benefit from enhanced services, like faster and better managed daily transactions upon the completion of phase one, while work continues on phases two and three of the project.

c) Customs

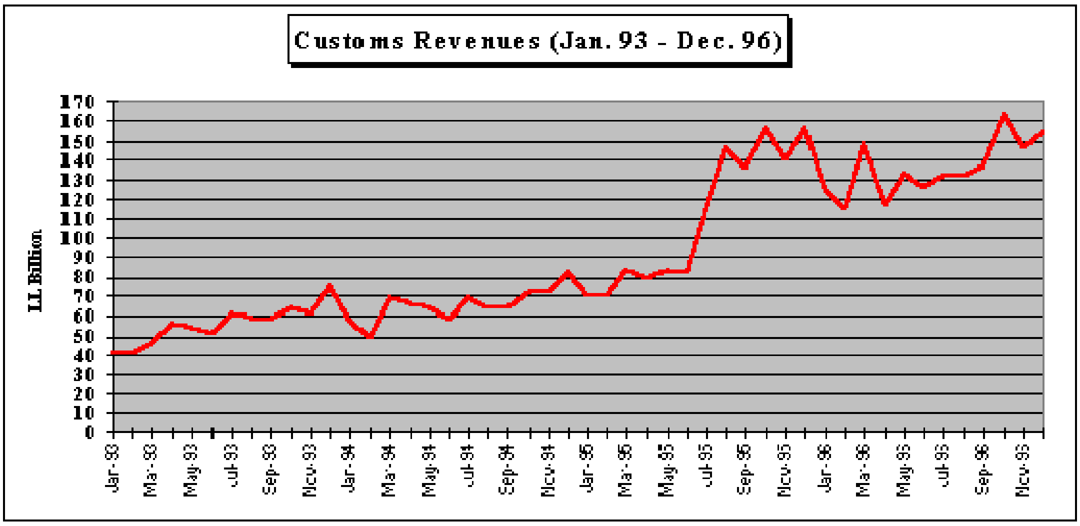
Historically, due to its strategic location, Lebanon by nature was always a trading nation. This is still true today, due to the free trade and exchange systems and the lack of restriction on capital mobility. Following the hostility period, the volume of trade, both into and out of the country, dramatically increased. Consequently customs revenues also rose. In fact, customs revenues still constitute the largest source of public income. The years of conflict, however, have taken their toll on the operations of the General Directorate of Customs (GDC). The GDC is responsible for import and export clearance, control procedures, and the collection of customs duties. As a result, the Ministry of Finance has scrutinized the GDC operations, and with the assistance of UNCTAD has launched a rehabilitation program. The program will modernize and streamline the GDC procedures, and train its employees. The expected benefits from implementing the project are:

- Improved customs operations, characterized by increased efficiency and productivity.
- Faster trade transaction processes and customs clearance procedures.
- Better data analysis due to reliable trade statistics will become available which allows for better data analysis.
- Increased custom revenues due to proper inspection and valuation techniques.

Following the recommendations made by a series of UNDP/IMF technical assistance missions, the structure of import taxation and its administration is being improved. Work has already started on rehabilitating the GDC, and several operational steps have already been implemented. Only those that directly have, or will, lead to revenue enhancement shall be elaborated upon below.

a) A tariff reform law was adopted by the government and became effective on July 7, 1995. The reform dealt mainly with the concentration and consolidation of tariff rates, removal of the customs dollar and the proportional reduction of tariff rates with the exception of certain items, and the application of generalized ad valorem rates. The reform also specified that excise duties on certain items like tobacco, cement, and some petroleum products among others, will be collected at the point of entry. Previously, excises were collected post-entry, which rendered accounting and collection procedures more difficult. Furthermore, the reform adopted the Harmonized System of tariff classification, which enhances transparency and applies internationally recognized import codes. As the graph below clearly demonstrates, once the reform became effective, import revenues increased. Of course the reform is not the sole factor responsible for this increase. To measure the true effect of the reform on revenues, GDP and subsequently import growth rates, as well as better administrative measures for excise tax collection must be factored out.

Chart 3-6



b) The harmonized system of classification was adopted as a first step in implementing the Automated System of Customs Data Entry (ASYCUDA) computer system. The second step which came into effect on January 2,1997, was the introduction of the new customs Declaration Form. This new form, which confirms to the international Single Administrative Document is a crucial step in the automation process and markedly improves information collection. Most significantly the 16 forms of customs clearance have been streamlined into one form.

c) The third step is the pilot introduction of ASYCUDA. ASYCUDA would be used to provide an integrated computer-based system for all data required for processing import and export declarations. It would include modules for manifest clearance, licensing, import and export risk assessment and revenue management. A substantial amount of work has gone into implementing the system. In fact, the first pilot unit will soon be installed at the Beirut Port. Other major ports and land entry locations and the Beirut Airport will gradually be introduced to the new system.

As soon as all the reforms mentioned above are implemented in full, and collection and auditing techniques are improved, public revenues are expected to increase at an increasing rate. Furthermore, the revenue enhancement measures will have the added benefit of rendering the public sector more efficient.

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1 Weighted average of data for Australia, Austria, Bahrain, Belgium, Canada, Denmark, Finland, Germany, Greece, Iceland, Ireland, Israel, Italy, Korea, Kuwait, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, United Kingdom, and United States.

2 Weighted average of data for: Argentina, Barbados, Bolivia, Botswana, Brazil, Chile, Colombia, Costa Rica, Cyprus, Dominican Republic, Egypt, El-Salvador, Fiji, Guatemala, Iran, IR. of Jordan, Malaysia, Malta, Mexico, Morocco, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Romania, Swaziland, Thailand, Turkey, Uruguay, Venezuela, and Zimbabwe.

3 Weighted average of data for: Burkina Faso, Cameroon, the Gambia, Ghana, India, Indonesia, Kenya, Lesotho,Liberia, Malawi, Maldives, Mali, Nigeria, Pakistan, Sierra Leone, Sri Lanka, Zaire, and Zambia.

CHAPTER IV

THE NEW BUDGET NOMENCLATURE

The nomenclature previously used in the budgetary accounts classified the Central Government's operations in accordance with the February 28, 1966 Decision of the Ministry of Finance. Needless to say, the old nomenclature was not conducive to meet the needs of the national accounts and the introduction of computerization on the one hand, and to improve the analysis of public expenditure on the other. Therefore, an effort was undertaken to revise the budget nomenclature on the basis of administrative, functional and economic classifications rather than purely administrative classification as was the case.

The new classification should make it possible to conduct proper analysis of policy and administrative aspects of the government budget as well as its execution. In addition, the new classification enables the Ministry of Finance to better control treasury accounts and render them in conformity with modern public accounting norms and international accounting standards. The new classifications will also constitute a substantial part of the structure of the newly introduced Government's Chart of Accounts.

Most important, the new nomenclature enhances the transparency and clarification of the budget, its objectives and the public services that are provided through it. It also indicates the effects of the budget on the macroeconomy and the sectoral distribution of expenditures. Indeed, the 1997 Budget was prepared on this basis despite the substantial effort this required in terms of training all the staff of all the spending agencies responsible for budget preparation and execution. Here, it is important to note that the new nomenclature was the subject of substantive discussions among all those involved in budget preparation in all the spending agencies. Various comments and suggestions were incorporated in the final product.

1.Revenue Classification and Nomenclature

The previously used classification of revenues and other receipts in Lebanon needed to be revised, and in certain areas replaced by a new classification. The classification used in the budgets prior to 1997 was not sufficient for a proper revenue management in terms of technical aspects of revenue collection, budget formulation, accounting, and auditing. This is because revenues were not adequately detailed for these purposes. Moreover, without having a clearly defined and detailed revenue items and sub-items, a meaningful compilation of data was not possible.

The policy analysis aspect of revenue classification therefore required the assembly of data in terms of meaningful groupings from the standpoint of macroeconomics and fiscal management. For example, tax revenues are now distinctly separated from non-tax revenues; and similarly both of them as revenue items are grouped in a different category than deficit financing items, that is, domestic and external borrowing.

The new classification of revenues and other receipts adopted the same classification at category and sub-category levels which has been standardized in the International Monetary Fund's Government Finance Statistics (GFS) manual. However, the details of revenue at sub item level were carefully studied in terms of their nature and origin as well as their legal and administrative features, and then classified under appropriate headings. The items were then incorporated into the sub-categories and categories suggested by the GFS.

Accordingly, a five-digit coding system was adopted for the revenue nomenclature as follows:

Table 4-1.

CODE	REVENUES AND OTHER RECEIPTS
1	TAX REVENUES
11	TAXES ON INCOME, PROFITS AND CAPITAL GAINS
12	TAXES ON PROPERTY
13	DOMESTIC TAXES ON GOODS AND SERVICES
14	TAXES ON INTERNATIONAL TRADE AND TRANSACTIONS
15	OTHER TAXES

Table 4-2.

CODE	REVENUES AND OTHER RECEIPTS
2	NON-TAX REVENUES
26	ENTREPRENEURIAL AND PROPERTY INCOME
27	ADMINISTRATIVE FEES & CHARGES, NON INDUSTRIAL & INCIDENTAL SALES
28	FINES AND CONFISCATIONS
29	OTHER NON TAX REVENUE

Table 4-3.

CODE					REVENUES AND OTHER RECEIPTS
1					REVENUES
	12				TAXES ON PROPERTY
		123			Non recurrent taxes on property
			1231		Property fees
				12311	Property registration fees
				12319	Other property fees

2.Expenditure Classification and Nomenclature

An administrative, functional, and economic classification of budget expenditure nomenclature was adopted using three coding modules. The first module is that of an administrative classification in which the coding varies according to the government structure. The other two modules involve functional coding and coding by economic nature.

a) Administrative Classification

The Administrative classification of expenditures identifies which ministry or other Government organization is responsible for committing and spending government funds. It also identifies transactions with the responsible units and sub units within the organizational hierarchy.

b) Functional Classification

The functional classification indicates the main sectors and the areas of the Government's involvement in the provision of services. This classification groups the expenditures according to the Government's functions rather than its administrative units, such as health services, public order and safety, housing and amenity services. For political, administrative, and technical reasons some functions may be implemented by two or more spending ministries. With the functional classification, however, trends in Government outlays on particular functions, regardless to changes that might take place in the organizational structures of Government, can be examined over time and thus aid in the analysis and forecasting of expenditures.

Hence, a three-digit coding system has been adopted for the functional classification as follows:

Table 4-4.

CODE		MAIN FUNCTIONS AND FUNCTIONS
1		GENERAL GOVERNMENTAL SERVICES
	11	GENERAL PUBLIC SERVICES
	12	DEFENSE AFFAIRS AND SERVICES
	13	PUBLIC ORDER AND SAFETY AFFAIRS
2		COMMUNITY AND SOCIAL SERVICES
	21	EDUCATION AFFAIRS AND SERVICES
	22	HEALTH AFFAIRS AND SERVICES
	23	SOCIAL AND WELFARE AFFAIRS AND SERVICES
	24	HOUSING AND COMMUNITY AMENITY AFFAIRS AND SERVICES
	25	RECREATIONAL AND CULTURAL AFFAIRS AND SERVICES
	26	RELIGIOUS AFFAIRS AND SERVICES
3		ECONOMIC SERVICES
	31	AGRICULTURE AFFAIRS AND SERVICES
	32	MANUFACTURING, FUEL AND ENERGY AFFAIRS AND SERVICES
	33	TRANSPORTATION AND COMMUNICATION AFFAIRS AND SERVICES
	34	OTHER ECONOMIC AFFAIRS AND SERVICES
4		MULTI-FUNCTIONAL EXPENDITURES
	41	PUBLIC DEBT TRANSACTIONS
	42	NON-CLASSIFIED BUDGETARY EXPENDITURES
	43	RESERVES

Table 4-5.

CODE			MAIN FUNCTIONS AND FUNCTIONS
2			**COMMUNITY AND SOCIAL SERVICES**
	21		**EDUCATION AFFAIRS AND SERVICES**
		211	**General Management Affairs**
		212	**Primary and Middle Education Affairs and Services**
		213	**Secondary Education, General Program**
		214	**Vocational and Technical Education Affairs and Services**
		215	**Tertiary Education**
		217	**Teaching Training**

c) Economic Classification

The economic classification of government expenditures by their economic characteristics indicates the kind of transactions by which the Government performs its functions, and their impact outside Government in the market for goods and services, in financial markets, and in the distribution of income. There can be significant differences, in the extent to which Government outlays are allocated among salaries and wages, purchase of goods and services from others, interest on the debt, subsidies to enterprises, transfers to households or other levels of Government, and lending.

The economic classification of expenditures will be further extended for usage in the budget preparation (estimation of costs of inputs to be used in the provision of Government services) as well as in the budget execution and control (accounting, reporting, auditing of financial transactions). The classification, therefore, was detailed and adjusted for three purposes: economic analysis, budgeting, and accounting.

Similar to the revenue side, the new expenditure classification is based on the GFS manual, and is compatible with Lebanon's 1982 accounting plan. It consists of categories, sub-categories items and sub items. Each category is divided into sub-categories, and each sub-category is further divided into items.

The new classification was used for both the operational or recurrent budget and investment projects.

In the new economic classification, a four-digit coding system was used as follows:

Table 4-6.

CODE			
1			**CURRENT EXPENDITURES**
	11		**MATERIALS AND SUPPLIES**
		111	**Office Materials and Supplies**
		112	**Operational Materials and Supplies**
		119	**Other Materials and Supplies**

Table 4-7.

CO DE				
1				**CURRENT EXPENDITURES**
	11			**MATERIALS AND SUPPLIES**
		111		**Office Materials and Supplies**
			1111	**Office stationary**
			1112	**Books, periodicals and newspapers**
			1119	**Other office materials and supplies**

CHAPTER V

BUDGET STRUCTURE

ANALYSIS

Table 5-1. 1997 Budget

in billion LL	**1997**
Total Deficit (a+b)	6.433
a. Current Expenditures	*5.824*
-Interest Expenditures	*2.700*
b. Capital Expenditures	*608*
Total Revenues	4.100
Total Deficit	2.333
Deficit to Expenditures ratios	36.26%
Primary Surplus	367

1. Revenues

The 1997 Budget projects that revenues will approximately reach LL 4,100 billion. This represents an increase of LL 568 billion over the actual revenues for 1996.Due to the introduction of the new nomenclature, it is now possible to classify revenues and receipts by source and category. Revenues can now be divided into three categories capital revenue, tax and non tax revenue. Their projected levels for 1997 are:

Table 5-2. Breakdown of Total Revenues

in billion LL	1997
Total Tax Revenues	3,152
Total Non-Tax Revenues	708
Total Capital Revenue	240
Total	4,100

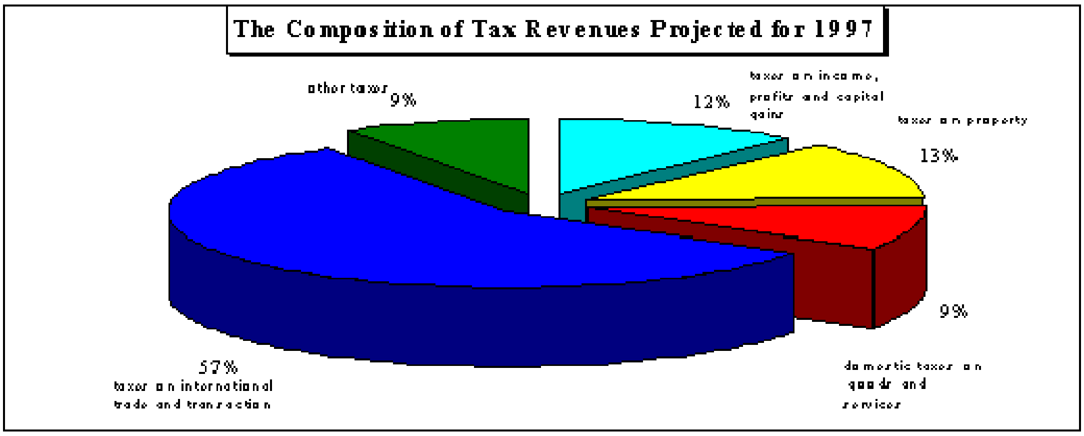
a) Tax revenues

Tax revenues are broken down into:

Table 5-3. Breakdown of Tax Revenues

in billion LL	**1996 Budget Law**	**1997 Budget Law**
Tax on income, profits and capital gains	350	375
Tax on property	440	405
Domestic taxes on goods and services	185	292
Taxes on international trade and transactions	1,800	1,800
Other taxes	280	280
Total	3,055	3,152

Chart 5-1.



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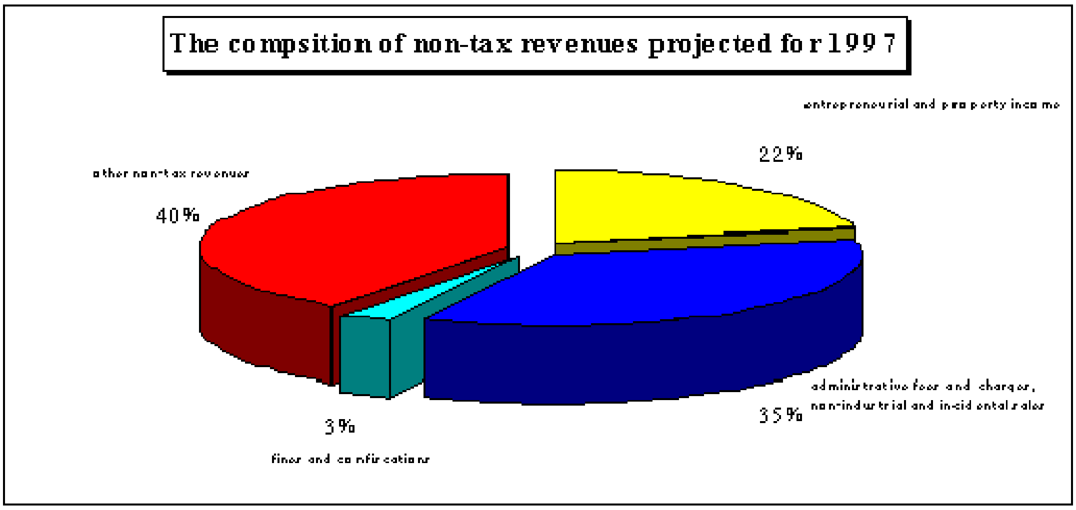
b) Non-Tax Revenues

Non tax revenues are broken down into:

Table 5-4. Breakdown of Non-Tax Revenues

in billion LL	1996	1997
Entrepreneurial and property income	176	154
Administrative fees and charges, non-industrial and incidental sales	219	250
Fines and confiscations	20	20
Other non-tax revenue	326	285
Total	740	708

Chart 5-2.



c) Capital revenues

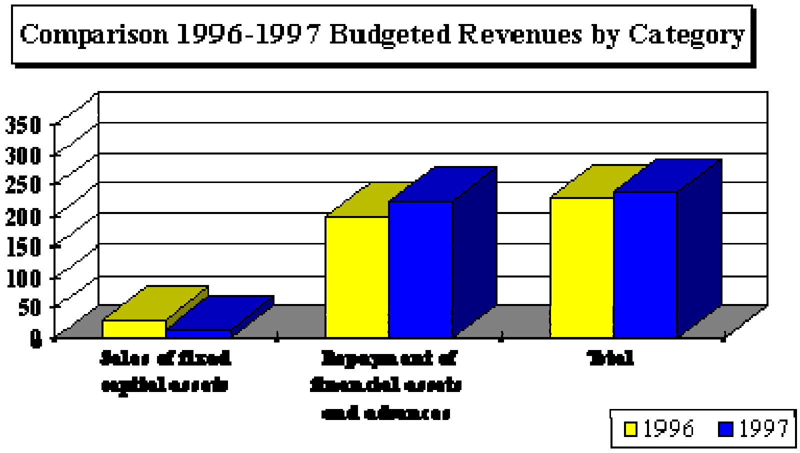
Capital revenues are broken down into:

Table 5-5. Breakdown of Capital Revenues

-

In Billion LL	1996	1997
Sales of fixed capital assets	30	15
Repayment of financial assets and advances	200	225
Total	230	240

Chart 5-3.



2. Expenditures

-

a). Administrative classification

-

In preparing the 1997 Budget, the Government extended a great effort to rationalize and limit expenditures in order to meet the targets set for the 1997 Budget. Therefore, since debt service expenditures are expected to increase by LL 100 billion, all outlays, other than wages and salaries, have been reduced to a minimum. The figures of recent budgets as well as the current budget, indicate the extent to which the public finance position and the structure have been influenced by the previous events. Fixed expenditure items such as interest payments, wages and salaries and direct and indirect social contributions continue to dominate the expenditure side of the budget. This leaves the Government little room for maneuver and limits its ability to respond to exogenous shocks.

Table 5-6. Part I and Part II Expenditure figures for the 1996 Budget Law and 1997 Budget Law:

(in billion LL)

Year	Part I	Part II	Total
1996	5,588,180,277	869,820,723	6,458,001,000
1997	5,824,907,857	608,092,143	6,433,000,000
percentage increase	4,24%	-30,09%	-0,39%

Chart 5-4.

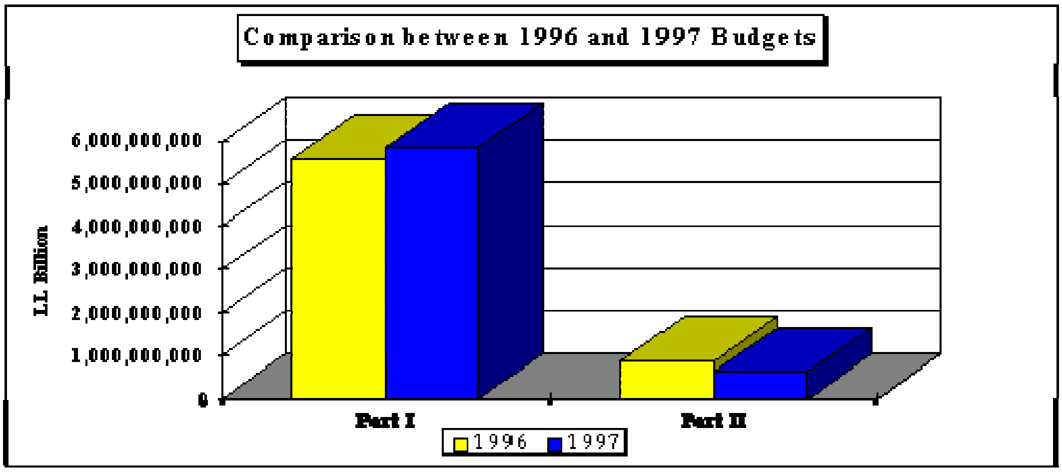


Table 5-7. Proposed Expenditures for 1997 Distributed by Sections

(000 LL)

Section no.	Sections	Expenditures (part 1)	Expenditures (part 2)	Total Expenditures (Part 1 + Part 2)	Every Section's percent of total *
1	Presidency of the Republic	2.465.000	267.000	2,732,000	0,07%
2	Parliament	29.424.000	9.742.000	39,166,000	1,03%
3	Presidency of Council of Ministers	285,104,034	127,653,498	412,757,532	11,08%
4	Ministry of Justice	30,398,429	998,630	31,397,059	0,84%
5	Ministry of Foreign Affairs	74,906,954	4,520,000	79,426,954	2,13%
6	Ministry of the Interior	329,776,942	19,429,000	349,205,942	9,38%
7	Ministry of Finance	41.342.669	2.629.450	43,972,119	1,18%
8	Ministry of National Defense	702.181.240	36,950,700	739,131,940	19,77%
9	Ministry of Education & Fine Arts	359,621,300	28,262,000	387,883,300	10,39%
10	Ministry of Public Health	156,576,029	3.070.000	159,646,029	4,26%
11	Ministry of Labour	3,733,113	62.300	3,795,413	0,10%
12	Ministry of Information	21,246,607	950.000	22,196,607	0,59%
13	Ministry of Public Works	16.010.202	129,628,750	145,638,952	3,90%
14	Ministry of Agriculture	43,154,818	4.294.845	47,449,663	1,27%
15	Ministry of Economy & Trade	4,591,401	57.100	4,648,501	0,12%
16	Ministry of Post & Telecommunications	13.197.274	2.661.000	15,858,274	0,42%
17	Constitutional Council	1.208.100	0	1,208,100	0,03%
18	Ministry of Hydraulic & Electric Resources	6.214.540	137,143,750	143,358,290	3,84%
19	Ministry of Tourism	7,774,280	5.310.000	13,084,280	0,35%
20	Ministry of Industry & Oil	1,907,498	170.000	2,077,498	0,06%
21	Ministry of Housing & Cooperatives	3.597.500	143.000	3,740,500	0,10%
22	Ministry of Displaced Affairs	6.831.900	446.000	7,277,900	0,19%
23	Ministry of Municipal & Rural Affairs	408.704	141.100	549,804	0,01%
24	Ministry of Vocational & Technical Training	23.901.200	16.002.500	39,903,700	1,07%
25	Ministry of Social Affairs	94,124,075	389.000	94,513,075	2,53%
26	Ministy of Emigrant Affairs	6.368.776	375.000	6,743,776	0,18%
27	Ministry of Transportation	25.514.300	65,119,000	90,633,300	2,43%
28	Ministry of Culture & Higher Education	138,663,417	11,184,500	149,847,917	4,01%
29	Ministry of the Environment	3.238.089	2,302,000	5,540,089	0,15%
30	Debt Servicing	2700.000.000	0	2,700,000,000	
31	Budget Reserves	490,675,336	0	490,675,336	18,50%
	TOTAL (LBP)	5,824,907,857	608,092,143	6,433,000,000	100,00%

It is important to note, that certain allocations that were previously recorded in Part II-A of the budget have been moved to Part I. This transfer which totals LL 144,489,783,000 is mostly responsible for the increase in Part I from 1996 to 1997.

Table 5-8. Appropriations moved from Part I to Part II of the Budget:

Administrative Codes	Titles	Total
1	Presidency of the Republic	67,500,000
3	Presidency of Council of Ministers	56,308,000,000
6	Ministry of the Interior	21,206,728,000
7	Ministry of Finance	879,840,000
10	Ministry of Public Health	12,897,200,000
11	Ministry of Labour	359,165,000
14	Ministry of Agriculture	21,001,510,000
15	Ministry of Economy & Trade	810,000,000
18	Ministry of Hydraulic & Electric Resources	2,430,000,000
20	Ministry of Industry & Oil	486,000,000
21	Ministry of Housing & Cooperatives	10,530,000,000
22	Ministry of Displaced Affairs	976,000,000
23	Ministry of Municipal & Rural Affairs	3,393,090,000
27	Ministry of Transportation	13,344,750,000
	TOTAL	**144,689,783,000**

As for Annex Budgets, the expenditure figures of 1997 compared with those of 1996 total:

Table 5-9. Expenditure Figures of the 1996 and 1997 Annex Budgets

in million LL	**1996**	**1997**
Telecommunications	475,000	66,000
National lottery	62,160	177,000
Grains and sugar beet office	96,018	527,000
Total	**633,178**	**770,000**

-

The main chapters of the 1997 Budget are detailed as follows:

1. Debt Servicing

The debt servicing burden for 1997 reached LL 2,700 billion, which represents 42 percent of budget expenditure and is composed of two components:

- Interest on treasury bills amounting to LL 2,500 billion.

- Interest on external debt amounting to LL 200 billion.

-

2. Budgetary Reserves

Total budgetary reserves reached LL 690 billion, of which the most important are:

- LL 10 billion towards filling job vacancies
- LL 452 billion for pensions and end of service indemnity
- LL 8 billion for judicial arbitration and amicable settlements
- LL 64 billion as reserves for all budget lines
- LL 40 billion for the National Institution for Deposit Insurance
- LL 55 billion allocated to social security payments

It is important to note that the 1997 Budget does not include in its revenues any provisions for the introduction of new salary scales or costs of living adjustments. Should the need arise, new additional sources of revenue, compatible in their amount and nature to any new expenditure, will have to be allocated to cover the expenditure increase.

3. Presidency of the Council of Ministers

The most important expenditure items in this category are:

- LL 64 billion for the Central Fund for the Displaced
- LL 6 billion to the Council for Development and Reconstruction
- LL 64 billion to the Council of the South
- LL 4.1 billion to the Institution for Consumption Cooperatives
- LL 3 billion for the Investment and Development Authority of Lebanon (IDAL)
- LL 4.1 billion to the National Council for Scientific Research
- LL 4 billion for Administrative Reform

4. Expenditure Allocations for Large Ministries

Most Ministries have substantial carry overs from previous budgets for investment expenditures and do not require additional appropriations to fulfill their responsibilities. Non-fixed recurrent expenditures in Part I of the budget have been cut substantially, also in line with the Government's attempt to rationalize expenditures.

Table 5-10.

	Titles	Total (LL million)	% of Total Budget (Excluding Debt Servicing)
MND	Ministry of National Defense	738,132	20%
PCM	Presidency of Council of Ministries	412,757	11%
MEFA	Ministry of Education & Fine Arts	387,883	10%
MI	Ministry of the Interior	349,206	9%
MPW	Ministry of Public Works	145,659	4%
MPH	Ministry of Public Health	159,646	4%
MFA	Ministry of Foreign Affairs	79,427	2%
MCHE	Ministry of Culture & Higher Education	149,848	4%
OT	Other Titles	619,767	17%
BR	Budget Reserves	690,675	19%
	Total	3,733,000	100%

Chart 5-5.

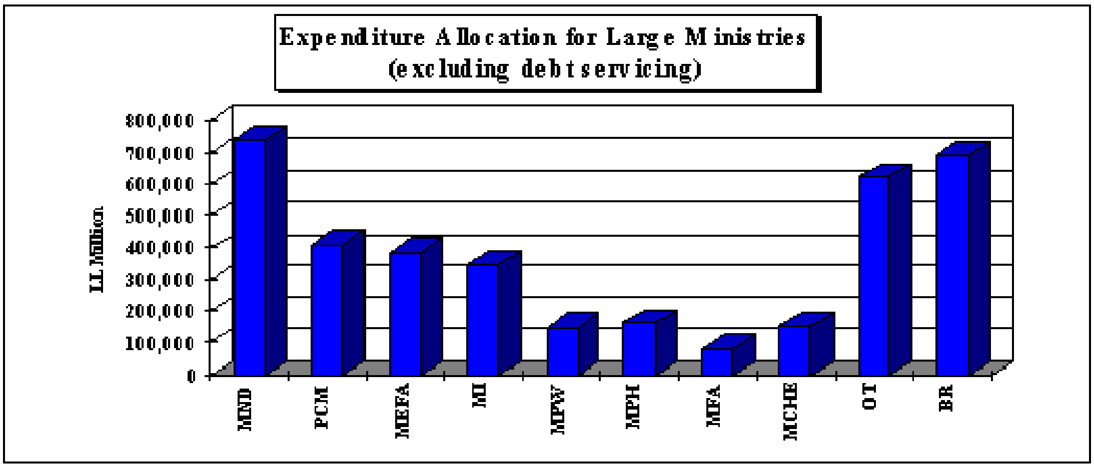
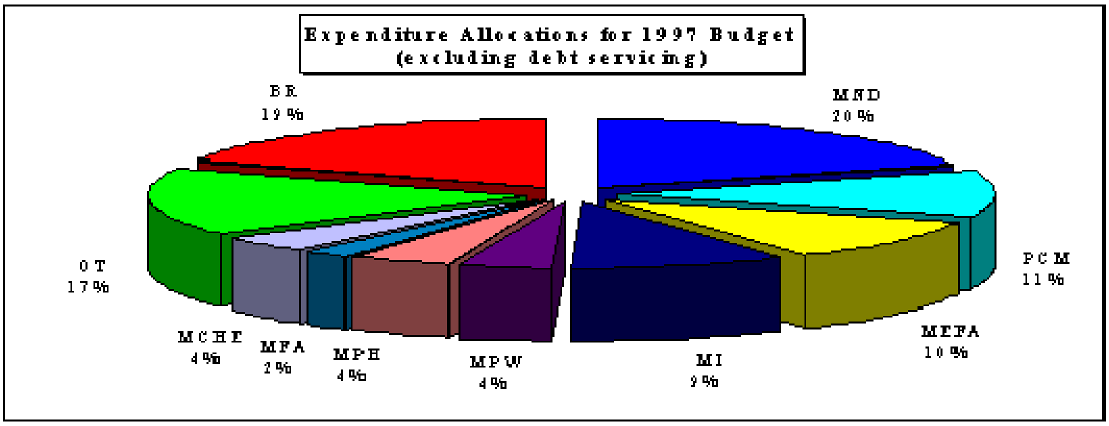


Chart 5-6.



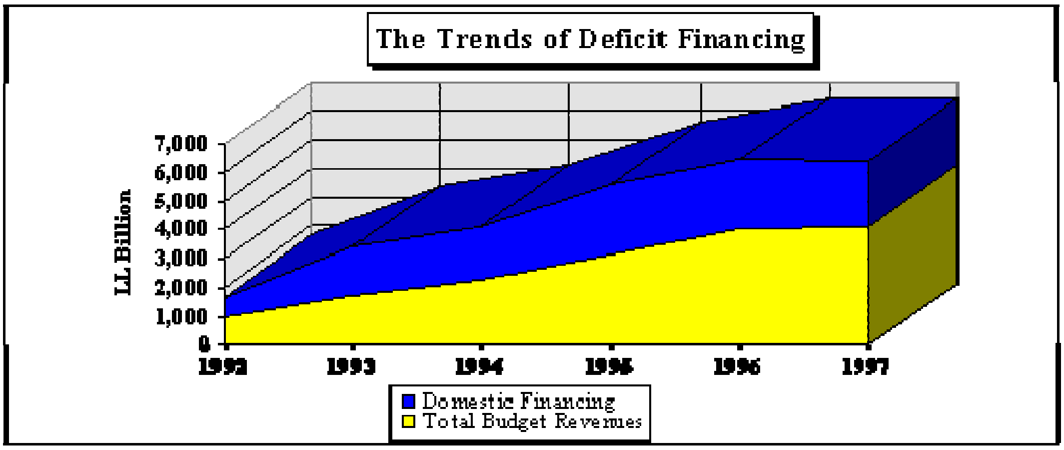
The above mentioned total expenditures exceeded total revenues by LL 2333 billion rendering the need to increase domestic borrowing by the full amount of this budget deficit. Here, it is important to recall from the previous sections that the Government is attempting to enhance its collection of revenues through the reform programs in the entire Ministry of Finance, including Customs, Land Registration and Internal Revenues.

Moreover, the 1997 Budget anticipates a decline, albeit slight, in total expenditures and a decrease in the budget deficit as compared to the previous year. As indicated below, the deficit began increasing in 1992, peaked, and began to decline thereafter.

Table 5-11. Trends of Public Finances

in billion LL	1992	1993	1994	1995	1996	1997
Total Budget Revenues	972	1,701	2,246	3,150	4025	4,100
Total Budget Expenditures	1,654	3,400	4,106	5,630	6,458	6,433
Domestic Financing	682	1,699	1,860	2,480	2,433	2,333

Chart 5-7.



B. Economic Classification

Presented below, is the economic classification of the budget which indicates the expenditure items by type.

Table 5-12. Economic Classification of the Budget:

Code	**TOTAL EXPENDITURES**	**1997** **(in 000 LL)**
11	Materials and Supplies	147,268,517
12	External Services	100,349,089
13	Salaries and Wages	1,555,876,158
14	Subsidies and Transfers	999,777,381
16	Other Expenses	141,961,376
17	Interest Payments and Financial Charges	2,700,000,000
18	Unallocated General Reserves	179,675,336
	TOTAL CURRENT EXPENDITURES	5,824,907,857
221	Acquisitions of Land	250,000
222	Acquisition of Buildings	5,000,000
223	Acquisition for the Construction of Roads, Ports and Airports	2,000,000

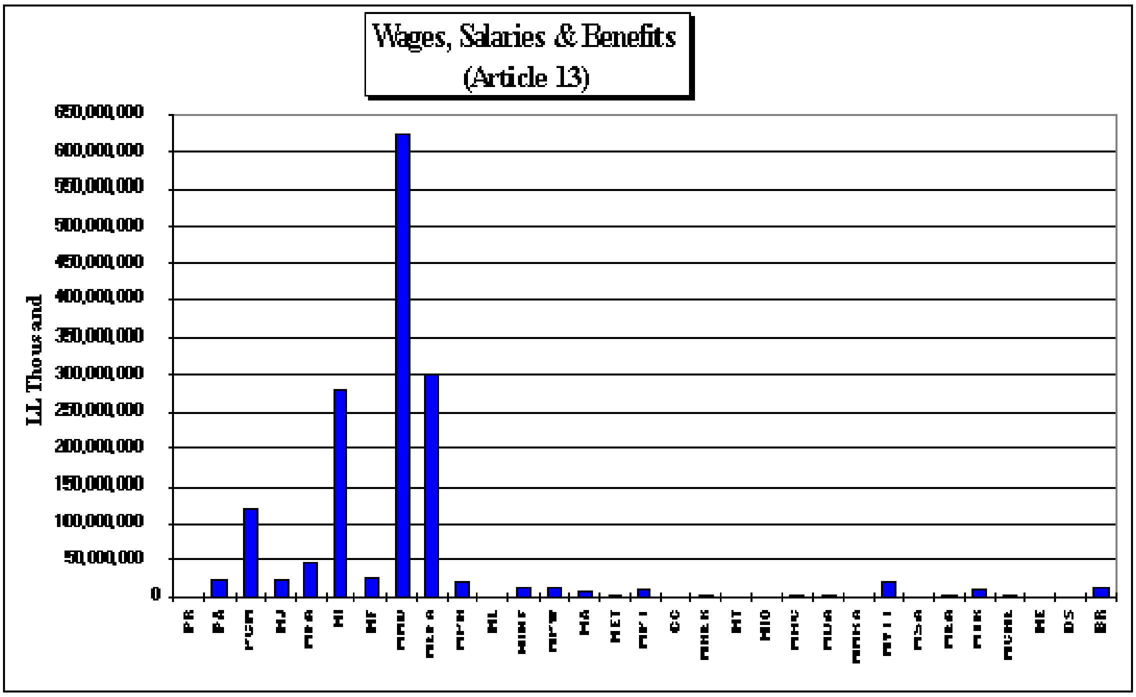
224	Acquisitions for the Construction of Water Networks	3,700,000
225	Acquisitions for the Construction of Electricity Networks	100,000
226	Equipment	79,100,843
227	Construction in Progress	432,030,000
228	Maintenance	68,631,300
229	Other Expenditures Related To Fixed Capital Assets	17,280,000
	TOTAL CAPITAL EXPENDITURES	608,092,143
	GRAND TOTAL	6,433,000,000

The economic classification clearly demonstrates how each Ministry allocates its expenditures, which helps in identifying expenditure behavior and patterns. As an example, the total sum of wages and salaries paid by each ministry amounts to LL 1,556 billion. This figure, however, underestimates the total wages and salaries bill; since transfer payments that equal LL 999 billion, include LL 705 billion in wage and salary supplements (650+55). Including the LL 705 billion, total wage and salary and other benefits payments amount to LL 2,261 billion, which represents 35 percent of budget expenditure.

Table 5-13. Wages, Salaries and Benefits, Grand Total

[illegible]	1997 Budget
1. Transers and Subsidies (Article 14)	999,777,381
2. Share of Wages, Salaries and Benefits out of Article 14	650,285,837
3. Reserves for Social Security Contributions	55,000,000
4. Wages, Salaries and Benefits according to Article 13	1,555,876,158
Wages, Salaries and Benefits, Grand Total (2+3+4)	2,261,161,995

Chart 5-8.


Wages, Salaries & Benefits
(Article 13)
LL Thousand
650,000,000
600,000,000
550,000,000
500,000,000
450,000,000
400,000,000
350,000,000
300,000,000
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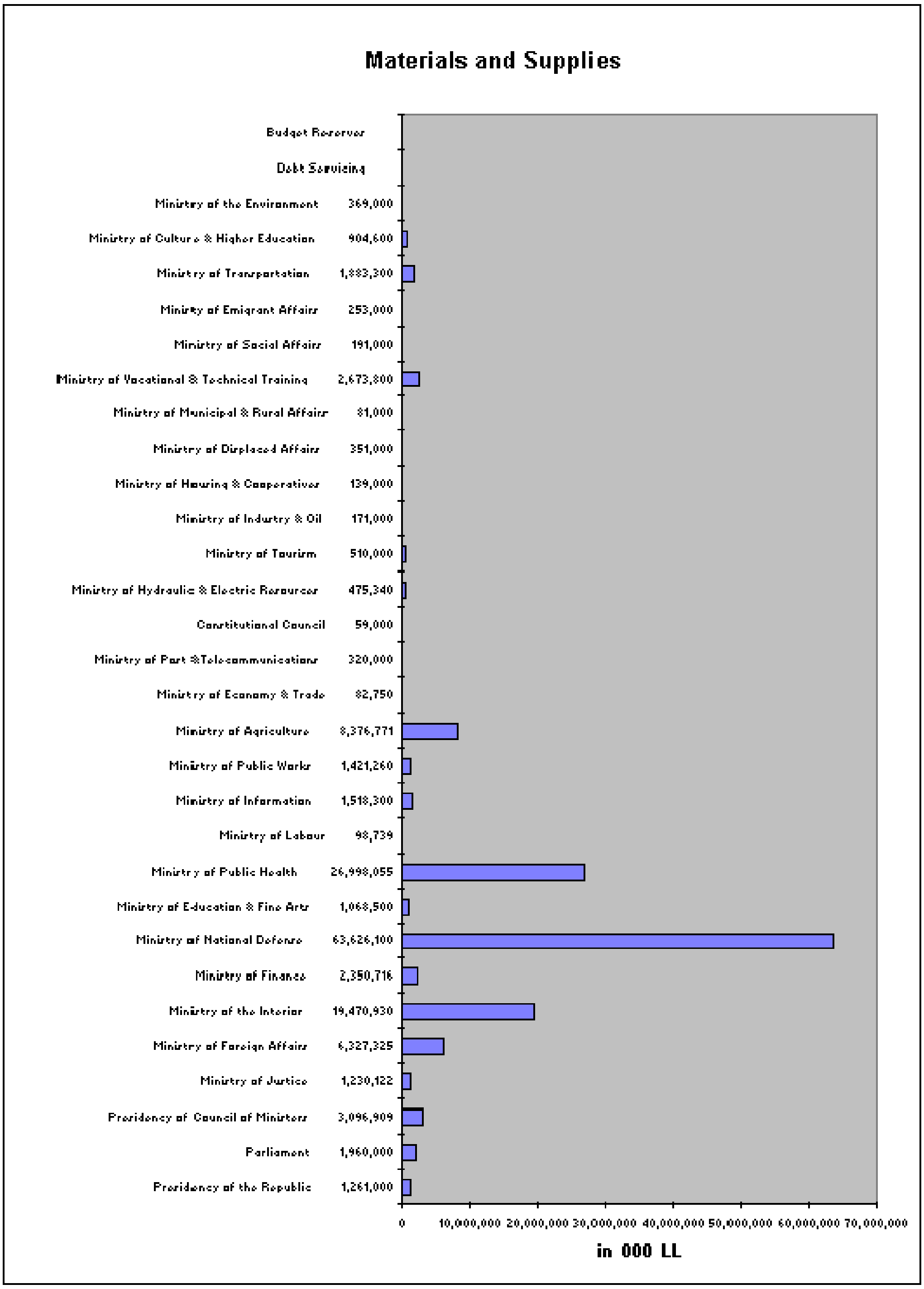
Materials and Supplies
Budget Reserves
Debt Servicing
Ministry of the Environment 369,000
Ministry of Culture & Higher Education 904,600
Ministry of Transportation 1,883,300
Ministry of Emigrant Affairs 253,000
Ministry of Social Affairs 191,000
Ministry of Vocational & Technical Training 2,673,800
Ministry of Municipal & Rural Affairs 81,000
Ministry of Displaced Affairs 351,000
Ministry of Housing & Cooperatives 139,000
Ministry of Industry & Oil 171,000
Ministry of Tourism 510,000
Ministry of Hydraulic & Electric Resources 475,340
Constitutional Council 59,000
Ministry of Post &Telecommunications 320,000
Ministry of Economy & Trade 82,750
Ministry of Agriculture 8,376,771
Ministry of Public Works 1,421,260
Ministry of Information 1,518,300
Ministry of Labour 98,739
Ministry of Public Health 26,998,055
Ministry of Education & Fine Arts 1,068,500
Ministry of National Defense 63,626,100
Ministry of Finance 2,350,716
Ministry of the Interior 19,470,930
Ministry of Foreign Affairs 6,327,325
Ministry of Justice 1,230,122
Presidency of Council of Ministers 3,096,909
Parliament 1,960,000
Presidency of the Republic 1,261,000
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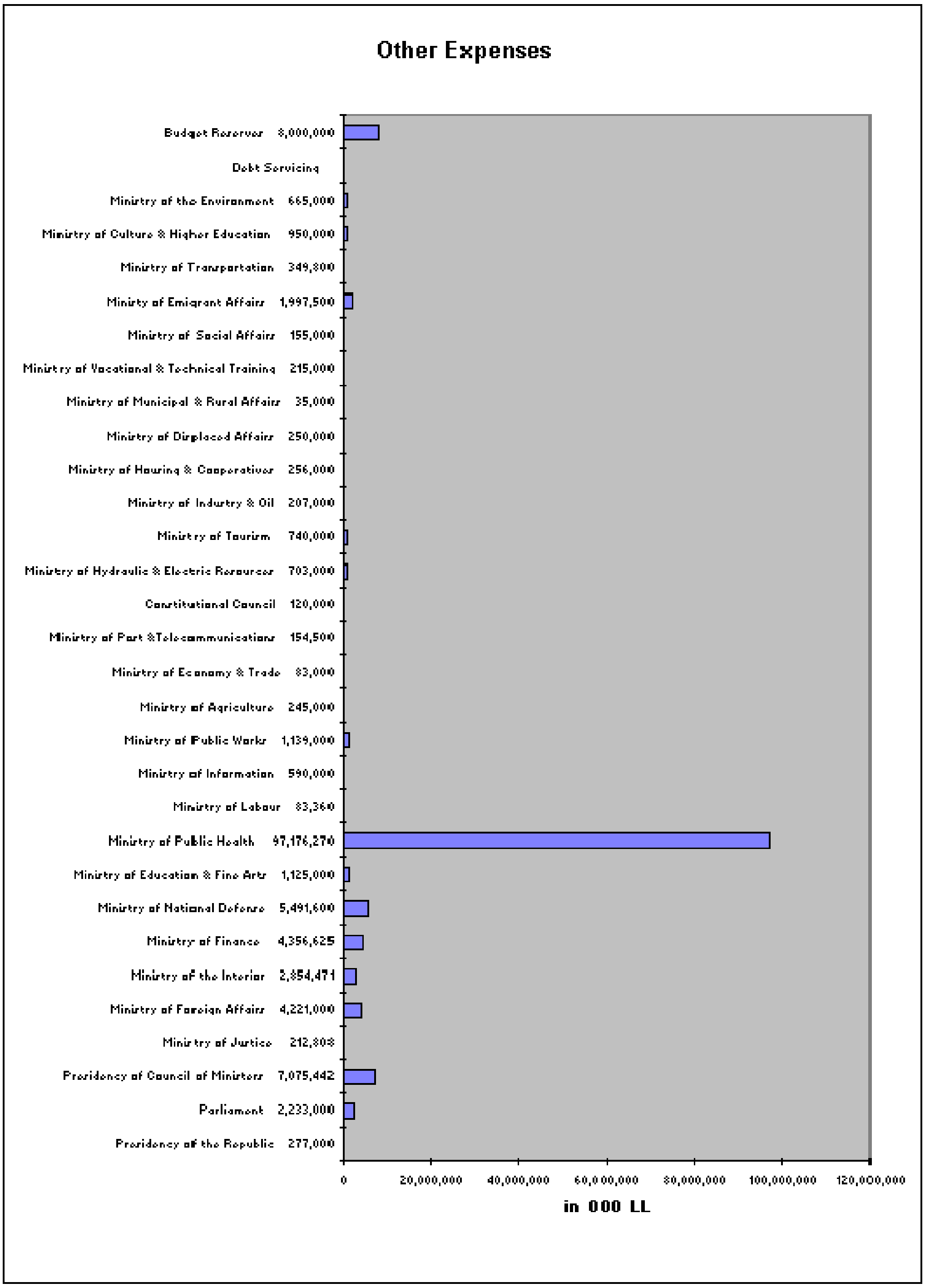

Other Expenses
Budget Reserves 8,000,000
Debt Servicing
Ministry of the Environment 665,000
Ministry of Culture & Higher Education 950,000
Ministry of Transportation 349,800
Minirty of Emigrant Affairs 1,997,500
Ministry of Social Affairs 155,000
Ministry of Vocational & Technical Training 215,000
Ministry of Municipal & Rural Affairs 35,000
Ministry of Displaced Affairs 250,000
Ministry of Housing & Cooperatives 256,000
Ministry of Industry & Oil 207,000
Ministry of Tourism 740,000
Ministry of Hydraulic & Electric Resources 703,000
Constitutional Council 120,000
Ministry of Post &Telecommunications 154,500
Ministry of Economy & Trade 83,000
Ministry of Agriculture 245,000
Ministry of Public Works 1,139,000
Ministry of Information 590,000
Ministry of Labour 83,360
Ministry of Public Health 97,176,270
Ministry of Education & Fine Arts 1,125,000
Ministry of National Defense 5,491,600
Ministry of Finance 4,356,625
Ministry of the Interior 2,854,471
Ministry of Foreign Affairs 4,221,000
Ministry of Justice 212,808
Presidency of Council of Ministers 7,075,442
Parliament 2,233,000
Presidency of the Republic 277,000
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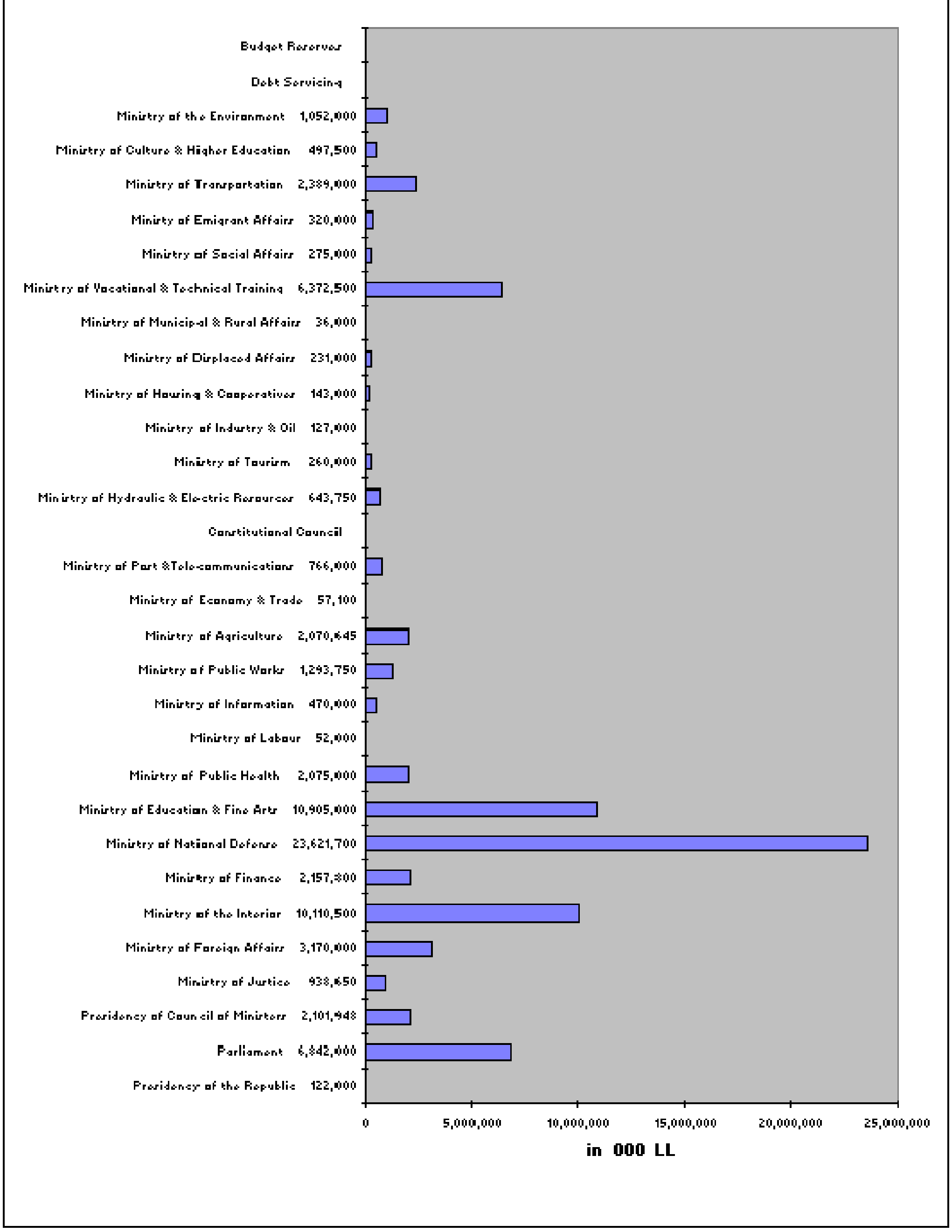
Equipment



Budget Reserves
Debt Servicing
Ministry of the Environment 1,052,000
Ministry of Culture & Higher Education 497,500
Ministry of Transportation 2,389,000
Ministy of Emigrant Affairs 320,000
Ministry of Social Affairs 275,000
Ministry of Vocational & Technical Training 6,372,500
Ministry of Municipal & Rural Affairs 36,000
Ministry of Displaced Affairs 231,000
Ministry of Housing & Cooperatives 143,000
Ministry of Industry & Oil 127,000
Ministry of Tourism 260,000
Ministry of Hydraulic & Electric Resources 643,750
Constitutional Council
Ministry of Post &Tele-communications 766,000
Ministry of Economy & Trade 57,100
Ministry of Agriculture 2,070,645
Ministry of Public Works 1,293,750
Ministry of Information 470,000
Ministry of Labour 52,000
Ministry of Public Health 2,075,000
Ministry of Education & Fine Arts 10,905,000
Ministry of National Defense 23,621,700
Ministry of Finance 2,157,300
Ministry of the Interior 10,110,500
Ministry of Foreign Affairs 3,170,000
Ministry of Justice 938,650
Presidency of Council of Ministers 2,101,948
Parliament 6,842,000
Presidency of the Republic 122,000
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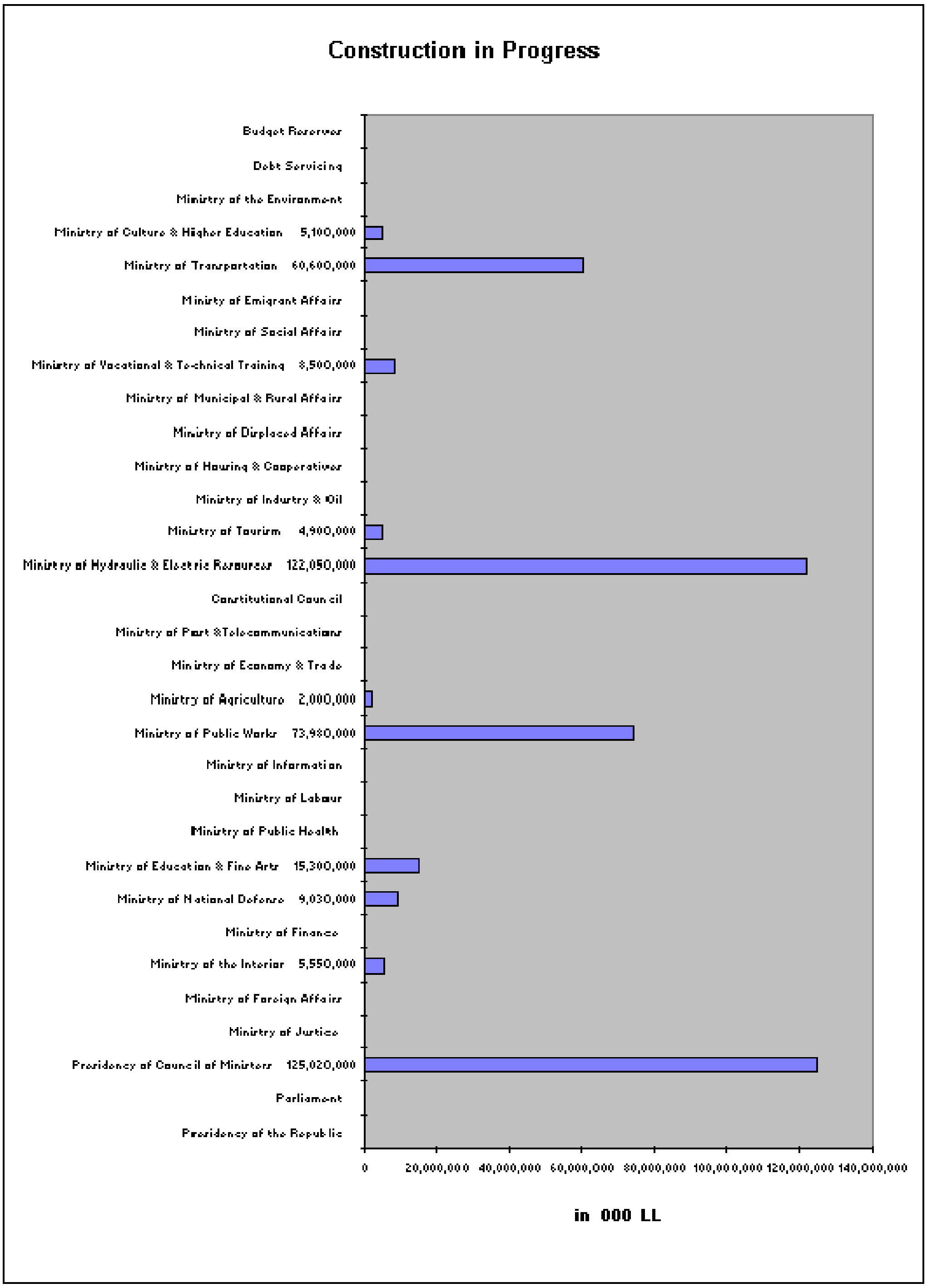
Construction in Progress
Budget Reserves
Debt Servicing
Ministry of the Environment
Ministry of Culture & Higher Education 5,100,000
Ministry of Transportation 60,600,000
Ministry of Emigrant Affairs
Ministry of Social Affairs
Ministry of Vocational & Technical Training 8,500,000
Ministry of Municipal & Rural Affairs
Ministry of Displaced Affairs
Ministry of Housing & Cooperatives
Ministry of Industry & Oil
Ministry of Tourism 4,900,000
Ministry of Hydraulic & Electric Resources 122,050,000
Constitutional Council
Ministry of Post & Telecommunications
Ministry of Economy & Trade
Ministry of Agriculture 2,000,000
Ministry of Public Works 73,980,000
Ministry of Information
Ministry of Labour
Ministry of Public Health
Ministry of Education & Fine Arts 15,300,000
Ministry of National Defense 9,030,000
Ministry of Finance
Ministry of the Interior 5,550,000
Ministry of Foreign Affairs
Ministry of Justice
Presidency of Council of Ministers 125,020,000
Parliament
Presidency of the Republic
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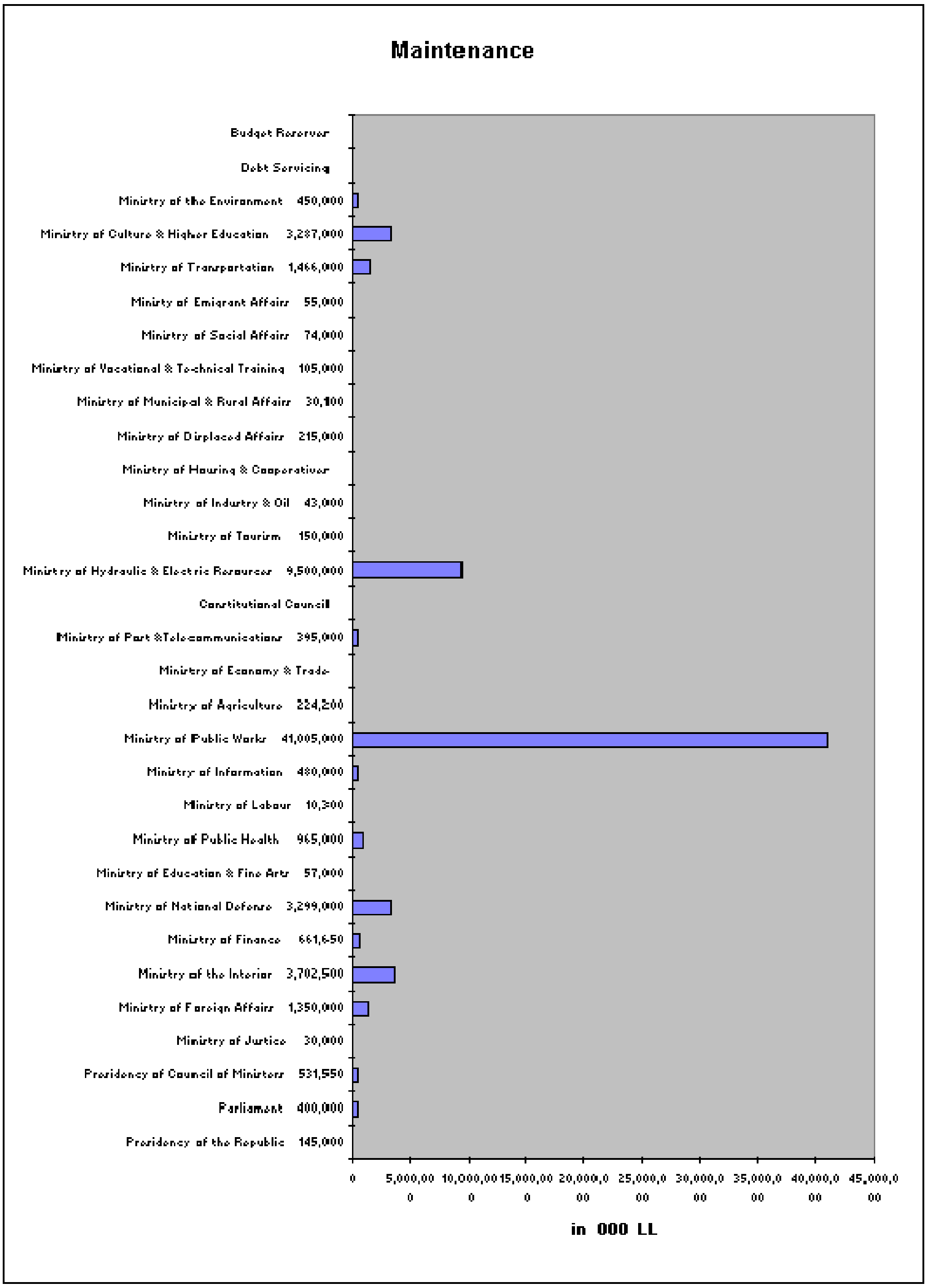


C. Functional Classification

The functional classification highlights sectoral expenditures and accordingly, shows the shares of General Government Services, Community and Social Services and Economic Services out of total expenditures. The General Governmental Services, including debt servicing, represents 22 percent of total expenditure and is composed of: General Public Services, Defense Affairs and Services and Public Order and Safety Affairs, of which Defense Affairs and Services alone represents 12.72 percent.

Community and Social Services comprise 18 percent of total expenditure, of which the most important components are: Education Affairs and Services (8.40 percent), Health Affairs and Services (2.49 percent), Social and Welfare Affairs and Services (3.95 percent), Housing and Community Amenity Affairs and Services (2.56 percent).

Economic Services takes up 6 percent of total expenditure, and its major components are Transportation and Communication Affairs and Services, as well as Other Economic Affairs and Services. The latter category includes among others: Tourism, Hotel and Restaurant Affairs and Services and General Labor Affairs and Services.

Table 5-14. Functional Classification:

(000 LL)

Code	FUNCTION	BUDGET 97	% OF TOTAL 97
1	General Governmental Services	1,426,196,428	22,17%
11	General Public Services	286,684,645	4,46%
12	Defence Affairs and Services	818,579,892	12,72%
13	Public Order and Safety Affairs	320,931,891	4,99%
2	Community and Social Services	1,181,667,697	18,37%
21	Education Affairs and Services	541,917,209	8,42%
22	Health Affairs and Services	159,646,020	2,48%
23	Social and Welfare Affairs and Services	253,934,794	3,95%
24	Housing and Community Amenity Affairs and Services	164,374,651	2,56%
25	Recreational and Cultural Affairs and Services	60,724,024	0,94%
26	Religious Affairs and Services	1,070,999	0,02%
3	Economic Services	434,460,539	6,75%
31	Agriculture Affairs and Services	48,149,663	0,75%
32	Manufacturing, Fuel and Energy Affairs and Services	2,627,000	0,04%
33	Transportation and Communication Affairs and Services	236,855,254	3,68%
34	Other Economic Affairs and Services	146,320,124	2,27%
4	Multi-Functional Expenditures	3,390,675,336	52,71%
41	Public Debt Transactions	2,700,000,000	41,97%
42	Non-Classified Budgetary Expenditures	470,000,000	7,31%
43	Reserves	220,675,336	3,43%
	TOTAL	6,433,000,000	100,00%

Chart 5-9.

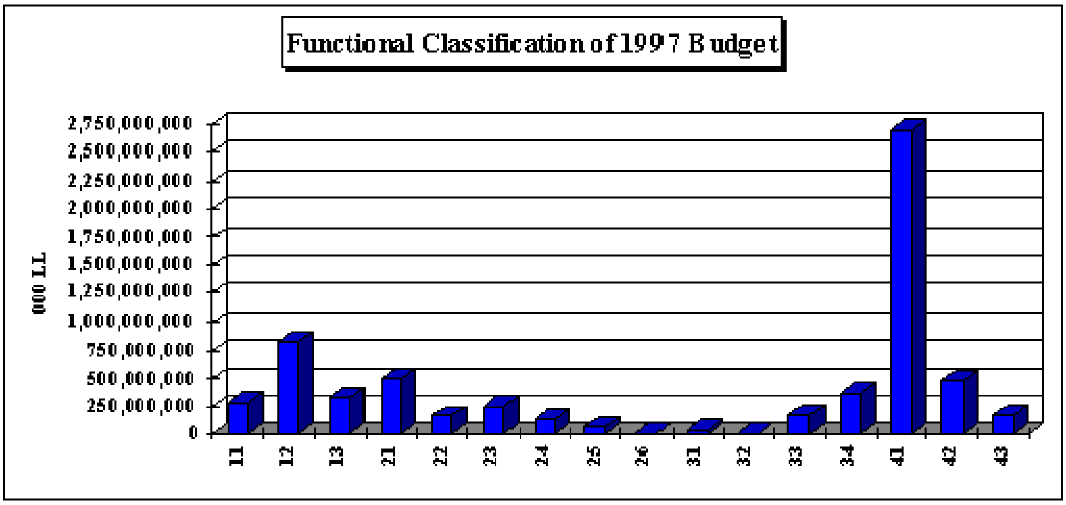
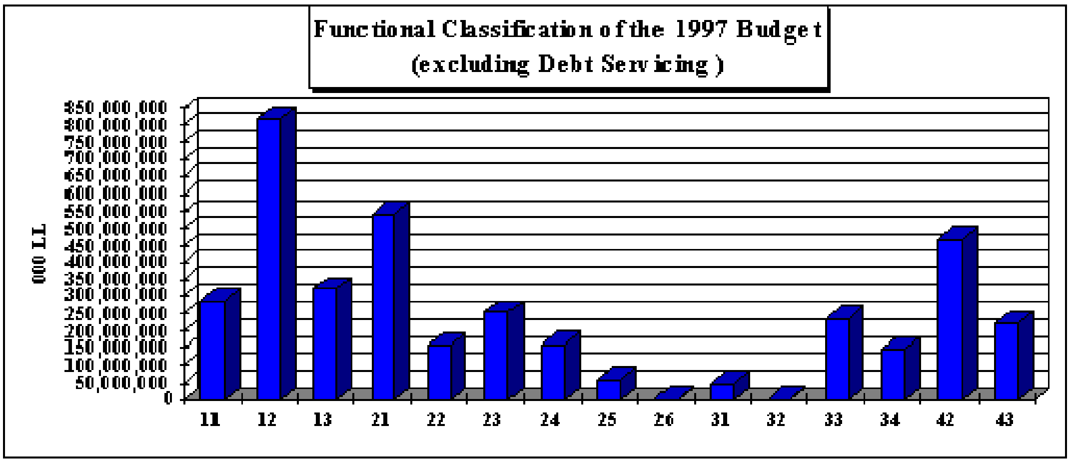


Chart 5-10.


Functional Classification of the 1997 Budget
(excluding Debt Servicing)
000 LL
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CHAPTER VI

LEBANON IN COMPARISON

TO OTHER ECONOMIES

A description of recent economic developments along with the 1997 Budget and its economic rationale remains incomplete unless it is placed within an international context. To gain a better understanding of the current economic situation, Lebanon's economic performance should be compared to that of other countries. Below, Lebanon's main economic indicators will be compared to those of a sample of 20 countries including 5 major industrial countries (USA, United Kingdom, France, Germany, Canada), 3 small industrial countries (Sweden, Belgium, Greece), 4 Latin American countries (Brazil, Mexico, Columbia, Venezuela), 7 Middle Eastern countries (Jordan, Kuwait, Tunisia, Egypt, Morocco, Cyprus, Turkey) and one rapidly developing country, namely Thailand.

The countries selected constitute a diverse group. Each differs with respect to: the availability of productive resources, natural resource endowment, social makeup, managerial skills, attitude towards work, type of government, size, history, climate, etc. This diversity renders the comparison rather limited, and should only serve as a rough guide to Lebanon's economic ranking within a group of countries.

International Monetary Fund (IMF) data of the average outcome for 1990-1995 of the selected countries is compared to Lebanon's 1995 data and the expected outcome of 1997 if the 1997 Budget is fully implemented and respected. Based on the above, we find that Lebanon is characterized by the following features:

1. A low government revenues to GDP (low tax burden) ratio with slightly high proportion of non-tax revenues to total revenues, and a somewhat low proportion of tax revenues to total revenues.

2. A high expenditures to GDP ratio with a high proportion of wages and salaries to total expenditures and very high and growing proportion of interest payments to total expenditures.

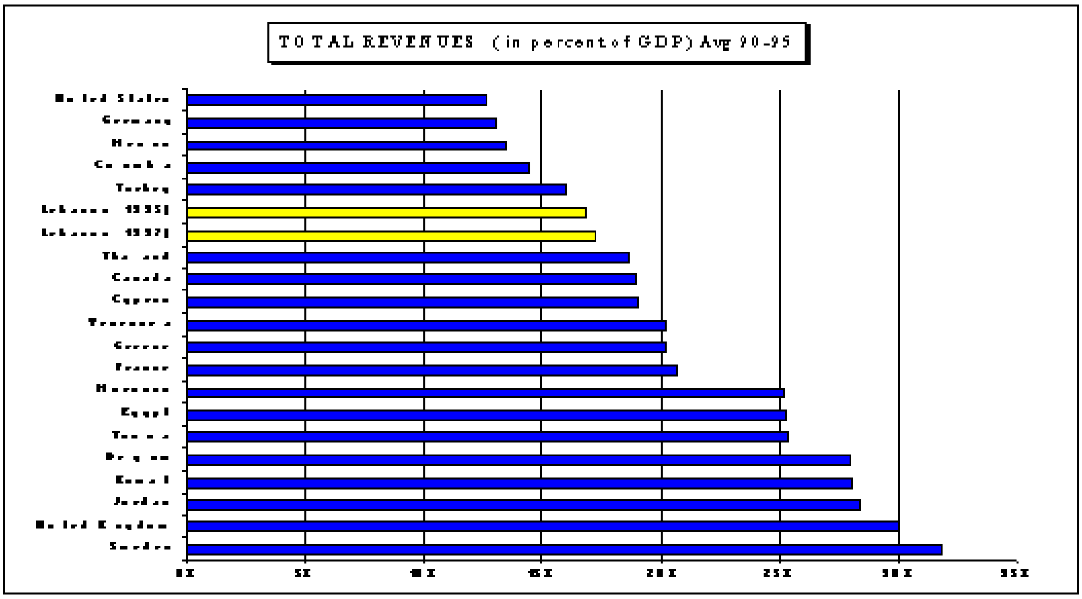
3. A large, albeit declining, ratio of deficit to GDP.

4. A relatively large but stabilizing level of debt to GDP ratio with low foreign debt and high domestic debt thereby resembling the debt structure of industrial rather than developing countries

1. **Comparative Revenue Structure**

As can be seen below, when compared to the group of 20 countries mentioned above, Lebanon ranks 15th in terms of its revenue to GDP ratio. Clearly this indicates that Lebanon is a lightly taxed economy with revenues to GDP only registering 16.8% in 1995.

Chart 6-1



Moreover it is noted that Lebanon ranks eighth in terms of the proportion of non-tax revenues and fifteenth in terms of its tax share of revenues in total revenues.

Chart 6-2

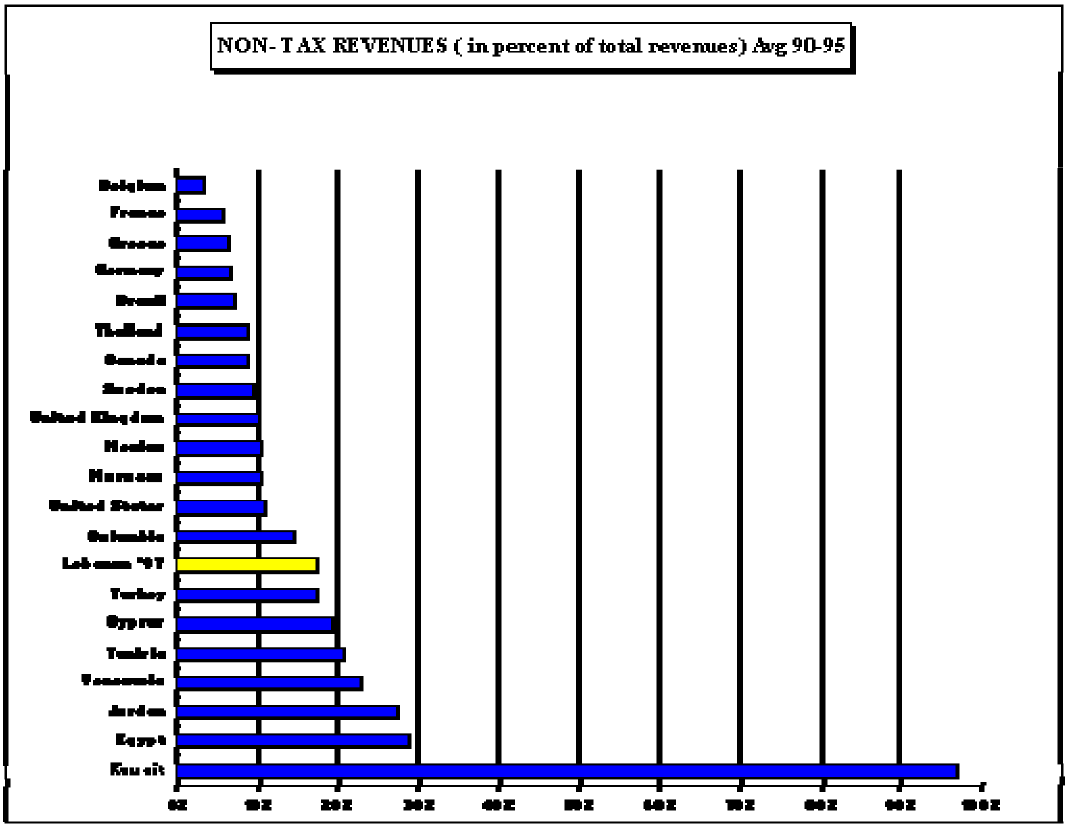
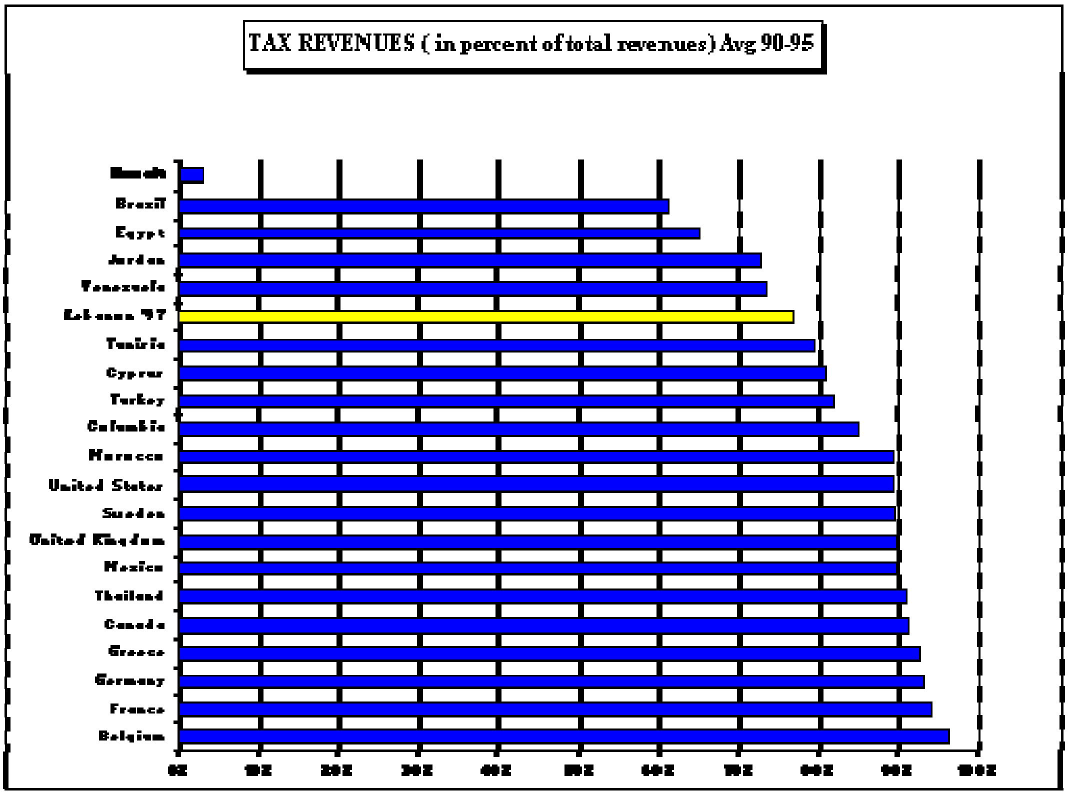


Chart 6-3



Hence, it is obvious that further efforts are needed to raise revenues to GDP and to enhance the role of tax revenues in total revenues. However, major strides have already been achieved over the past four years with revenue to GDP increasing from 10.34% in 1992 to 16.82% in 1995 and is expected to reach 17.2% in 1997. This increase occurred at a time when GDP was rising and tax rates were stable, which indicates better collection measures and procedures. The adopted measures and procedures which have, or will lead, to revenue enhancement will be discussed in detail below.

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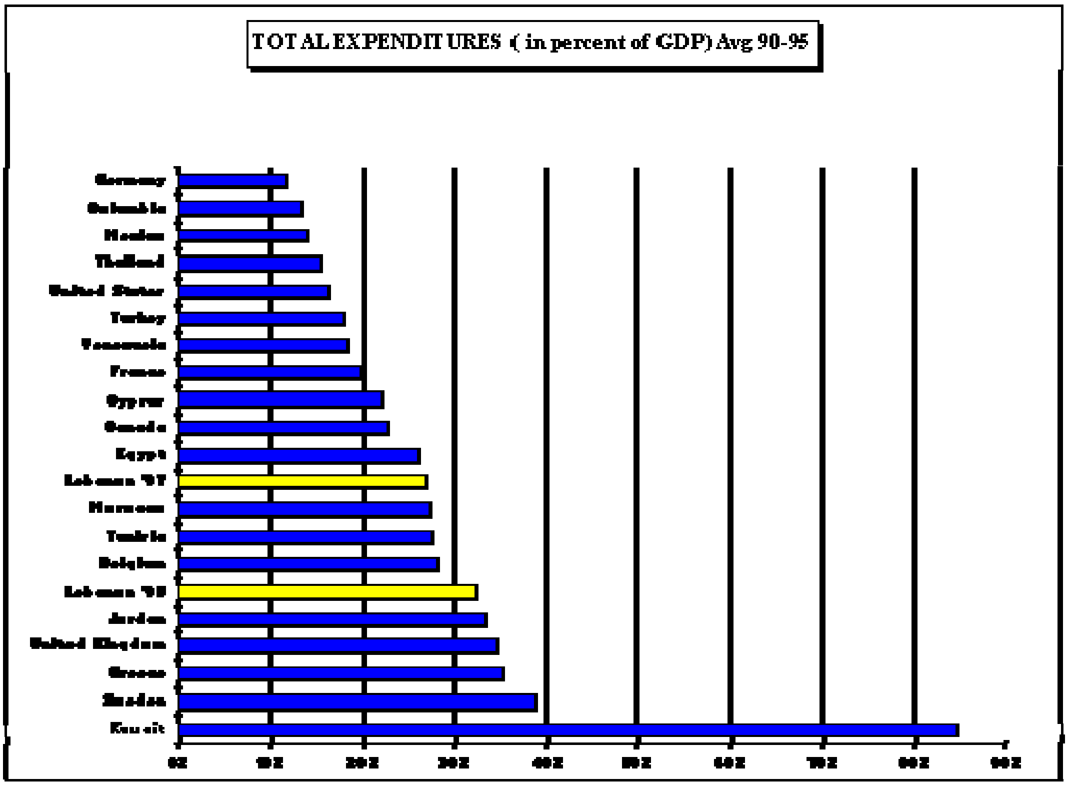
<u>2. Comparative Expenditure Structure</u>

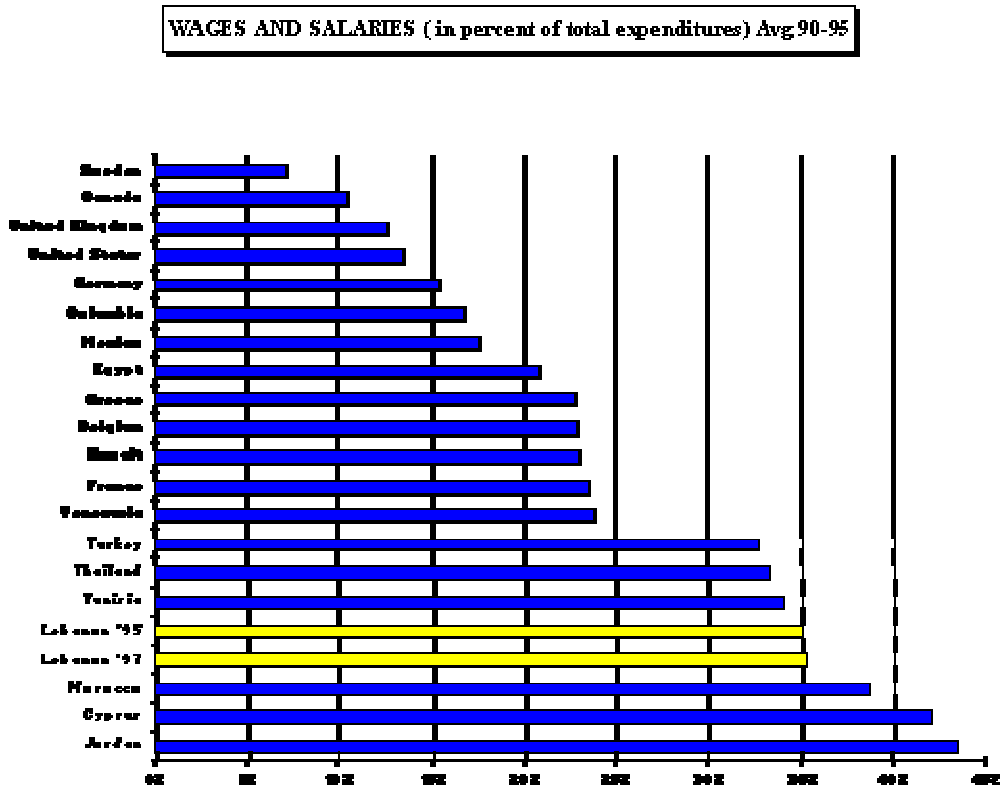
In 1995, Lebanon's expenditure to GDP ratio registered 32.48%, which ranks as the sixth highest ratio among the group of 20. With the full implementation of the 1997 Budget this ratio could drop to 26.85% and Lebanon's ranking to nine.

Chart 6-4



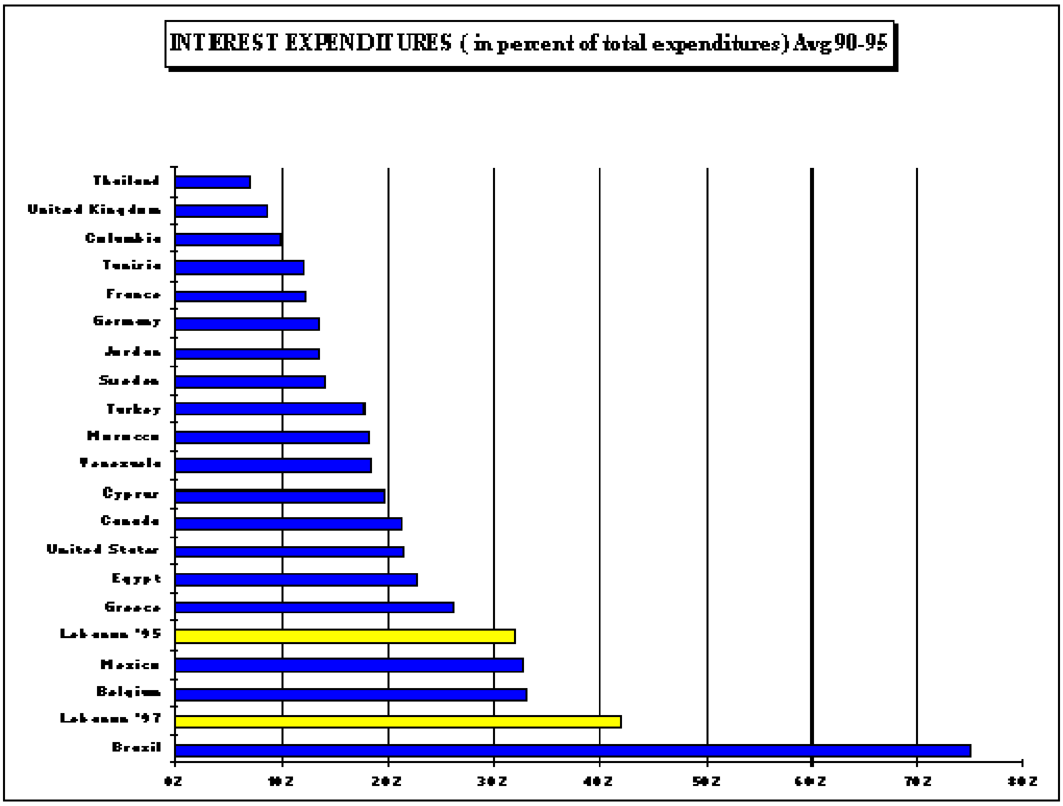
Despite this potential improvement in Lebanon's expenditure indicator, the structure of Lebanon's expenditure remains heavily skewed towards salaries and wages, and interest payments. In a sense, Lebanon's expenditure dilemma is not only one of magnitude, but rather, of distribution with the overwhelming majority of resources going towards covering non-discretionary expenditure items. Interest expenditure and wages and salaries together exhaust 74.2% of total expenditures. Wages and salaries alone represented 35% in 1995 and will increase by 0.25% in 1997.

Chart 6-5



Unlike wages and salaries, interest payments are expected to increase further. It is anticipated that the interest expenditure to total expenditure ratio will rise from 32.02% in 1995 to 42.19% in 1997. Lebanon, therefore, will become second only to Brazil in terms of the proportion of interest expenditures.

Chart 6-6



3. Comparative Deficit and Debt Structure

The current level of revenues and expenditures to GDP has rendered Lebanon with a very large albeit declining budget deficit. Naturally, these budget deficits lead to an accumulation of public debt primarily in high interest domestic debt. As a result, Lebanon has a large debt to GDP ratio. However, the growth rate of debt has been significantly reduced. Furthermore, it is noteworthy that foreign debt constitutes only a small proportion (18%) of total debt.

Chart 6-7

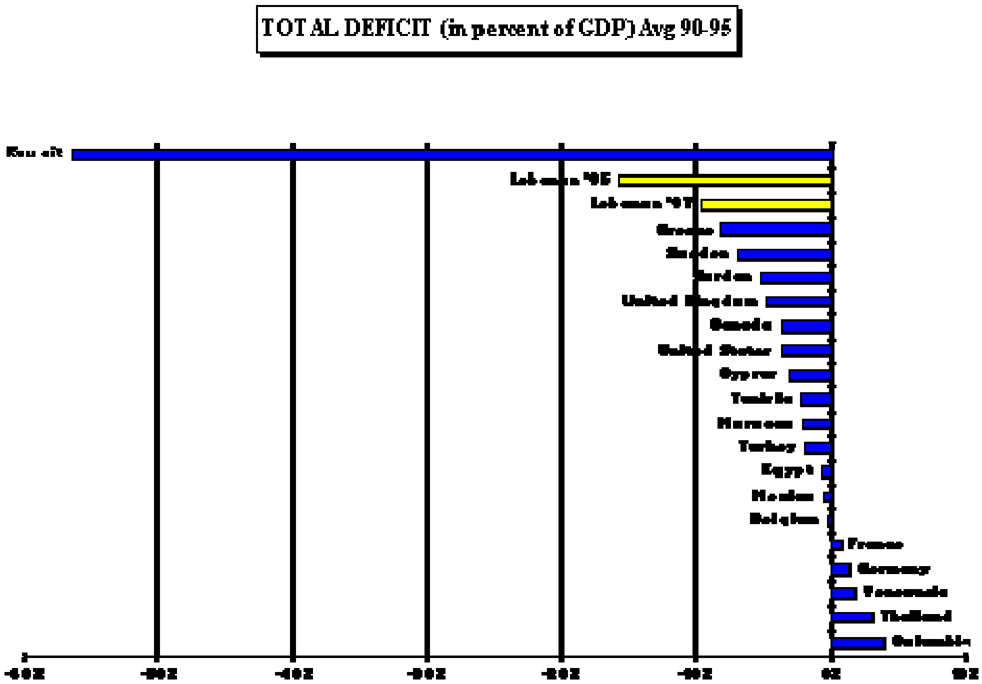
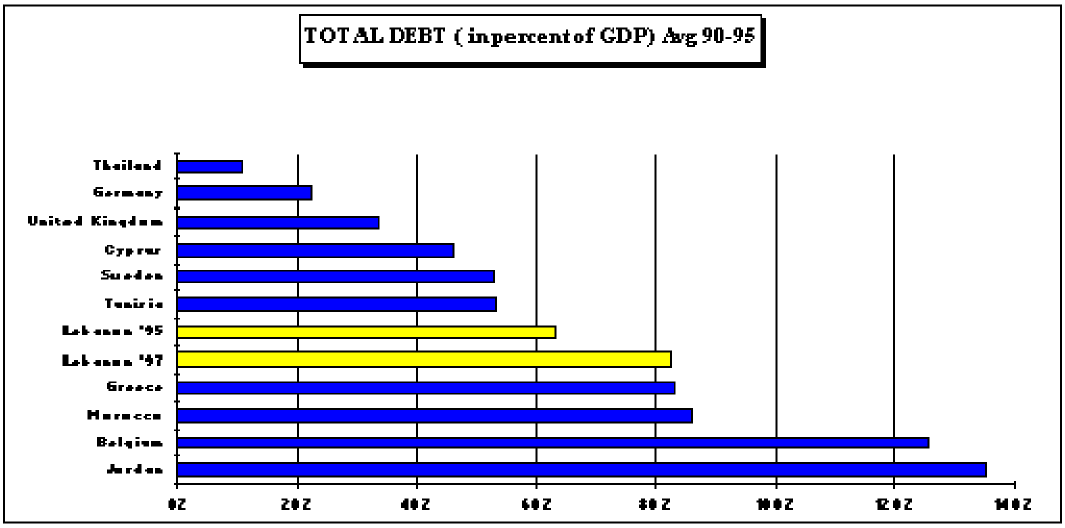


Chart 6-8



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4. Lebanon Compared to other Post-War Economies

Above, the current economic indicators of Lebanon were contrasted with those of other countries. A major flaw in such a comparison is that, unlike the other countries, the Lebanese Government today is managing an economy emerging from a violent and protracted series of events, that lasted almost two decades.

The economic ramifications of such events cannot be easily discounted. It is, therefore, useful to compare Lebanon today with other countries that faced the challenge of managing a war damaged economy. The list of countries is large and has been reduced to five; namely the United Kingdom, France, Italy, Germany, and Japan as they struggled to overcome the effects of the second world war. Of course, Lebanon today differs fundamentally from the group of countries mentioned above, and this, admittedly, limits the benefits of such an exercise. Nevertheless, the countries were selected because of their ability to recover, albeit-slowly, from the effects of war, and due to the availability of both, data and hindsight.

In the immediate post-1945 period, when the fighting ceased, the European countries and Japan faced a host of crippling economic realities. The magnitude of the problems faced by each nation varied; accordingly, so did each country's pattern of recovery. In their effort to convert their respective industries to peacetime uses, some were more successful than others. In doing so, the United Kingdom was the most successful, with France and especially Italy, running a distant second. Germany and Japan made little, if any, progress.

In the immediate aftermath of World War II, Japan experienced a severe economic regression. Real national income in 1946 was only 57 percent that of 1934-1936; foreign trade was so minimal that even two years later, exports were only 8 percent and imports 18 percent of the prewar figure. In 1947, the price level increased a hundred times; with wages down to only 30 percent of their 1936 level, the purchasing power of wages in Japan was less than one-tenth of the prewar level. In sum, the situation in 1946 and 1947 did not provide a stable and healthy basis for reconstruction. High inflation, rampant speculation, high government and balance of payments deficits, were symptoms of instability (shared with Italy and France). With a relatively low level of aid coming into the country, the Japanese Government found great difficulty in tackling such economic problems.

The German economy's gradual emergence from the chaos of the summer of 1945 showed no more sense of direction than did the Japanese. German national income and output in 1946 was less than one-third that of 1938. In 1947, industrial production was approximately one-third, and average productivity around one-half their prewar levels. A severe shortage of raw materials and export markets was compounded by strict controls upon industry. This control was often blamed for the loss of foreign exchange earnings and the flourishing of barter and the black market. It is especially difficult to chart the exact course of recovery in Germany at least not until massive aid started pouring into the country, the monetary reform implemented and the national debt canceled.

As the European countries emerged from the second World War, it was difficult to differentiate, in economic terms, between France and Germany. France witnessed large-scale fighting in 1944 which destroyed much of its infrastructure and rendered its transport system virtually unusable. By the end of the war, French imports and exports plunged to almost nothing, and the national income stood at half its 1938 level; foreign currency reserves were depleted, and the French Franc was not accepted on the foreign exchange markets. Furthermore, prices doubled between 1945 and 1946. According to official indices, real wages fell to only 60 percent of prewar levels. Because of the black market, these figures overestimate real purchasing power.

Italy's economic fate seemed almost as grim. At the end of the war, Italy's gross national product was equal to its 1911 level, and was less by 40 percent in real terms its prewar level. Real wages were down to 26.7 percent of their 1913 value. Extremely low wages coupled with a rapid inflation prevented increases in the standard of living. By 1947, price increases were running at nearly 100 percent according to the official cost of living index, and rather more if the black market is taken into account. The gravity of Italy's economic position can be better understood, when one considers that in 1947, productivity was slightly more than half its prewar level, and the country was running a deficit in both the government budget and the balance of payments. Faced with the above problems the government, at the time, seemed to have very few solutions.

The United Kingdom faired best in its post-war recovery period. Still the country faced a host of economic difficulties. By the end of the war, the national debt was approaching three year's GDP (twice the 1930's level). Gold and dollar reserves were run down, and domestic machinery worn out. The country faced difficulties in financing its imports bill; the balance of payments deficit of 4 percent of GDP had to be cut, and the constantly present inflationary threat eliminated. In fact, one of the very first documents the new Labor Government, that took office in 1945, had to read was a memorandum written by J.M. Keynes that warned of the "financial Dunkirk" that was facing the nation if aid was not quickly provided. Without such help Keynes warned, "…a greater degree of austerity would be necessary than we have experienced at any time during the war . . .". The economic situation in Britain would have been much worse, and the economic recovery delayed further, had it not been for the USD 3.5 billion loan that Keynes himself negotiated in Washington in 1945.

The post-war economic experience of Europe and Japan was characterized by rising unemployment, cuts in consumption, accelerating inflation, rampant speculation, budget and balance of payments deficits, and lack of effective planning. To the European and Japanese population, reality had conspicuously failed to live up to the expectations held at the end of the war. Help, however, was at hand.

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5. The Post-World War II Recovery Program

On June 5, U.S. Secretary of State Marshall proposed a European Recovery Program (ERP). The ERP, which became known as the Marshall Plan, was a massive program of economic aid to western Europe. Initially, Marshall suggested that USD 5 or USD 6 billion a year might be required from the United States; the final aid package amounted to about USD 30 billion, a huge sum in the late 1940's. While the Marshall Plan was confined to Europe, a similar shift of policy towards Japan soon followed.

These shifts in U.S thinking were to decisively influence the reconstruction effort in Europe and Japan. As soon as the Marshall Plan was announced, the International Monetary Fund and the World Bank eased their tough lending conditions; together they lent more than USD 1 billion to Europe in the next twelve months. Furthermore, the US congress agreed to extend a USD 600 million in emergency aid for France, Italy and Austria to tide them over until Marshall aid funds became available. By 1949, total net ERP aid after utilization of drawing rights to only five European countries represented about 9 percent of those countries' GDP.

Table 6-1. Receipts of US non-military grants and government long-term capital, 1946-50

(USD Million)

	U.K.	**France**	**Germany**	**Italy**	**Japan**
1946-1947	1722	948	371	474	419
1948-1950	857	668	847	378	373

Even with all the available funds, economic recovery in Europe and Japan was not immediate. Complete recovery did not occur until the mid-1950’s, and after undertaking several drastic measures. In most countries in general, and the U.K in particular, labor unions cooperated with the governments and accepted wage sacrifices. Indeed, all sectors sacrificed because of the war. Through hard work and perseverance, however, they were able to surmount the social and economic difficulties they faced.

The classification of the multinational conflict of 1939-45 as a World War is semantic liberty, for not all the world participated in it. All the economic powers, however, did, and all, with the exception of the US emerged weaker. In 1990, with the end of the hostilities period, Lebanon emerged to find itself left behind world progress in the last two decades. This rendered the challenge of recovery and catching up even more acute.

Furthermore, at the end of World War II, while European productivity greatly diminished, the continent’s productive capacity did not. This was mainly due to the large investment in capital necessary to fuel the war machine, as well as labor force stability. With the influx of aid, western European countries were able to recoup lost ground quite easily. Lebanon’s economy by contrast, has traditionally depended on tourism, services and trade. Rebuilding those sectors requires financial investments, and more importantly, time.

Another hindering variable faced by Lebanon and not the European countries, is that Lebanon, during the period of turmoil, did not benefit from the presence of a fully functioning public administration. In fact, Lebanon emerged in 1990 with its state apparatus dismantled and ineffective. This administrative weakness was, and to this day remains, one of the major challenging tasks facing Lebanon.

War recovery periods differ from country to country; it took the European countries a decade and a half to fully offset the damages of war, and Japan even more. Today Lebanon is confronting some of the same difficulties that those countries experienced. The Government has so far successfully tackled many of the more difficult problems, and sees no other course but to continue its determined assault on the obstacles to recovery.

CHAPTER VII

FRIENDS OF LEBANON

AND BEYOND

Seventeen years of chaos and destruction have had a devastating effect on the Lebanese economy; whether in terms of physical destruction, loss of human capital, decline in production potential or a massive contraction in per capita income. Naturally, Lebanon is not unique in this regard as all post war economies have had similar characteristics in terms of the effects of turmoil on economic activity. Once security and political stability were restored in 1992, the newly formed Lebanese Government was confronted with the challenging task of rebuilding the economy and making up for lost ground in an era of globalization and a rapidly changing world economic environment.

As indicated in the section on post war economies, the historical experience of other countries emerging from turmoil highlights the daunting challenges of reconstruction and economic normalization. Indeed, the experience of post-war Europe and Japan underscores the potential difficulties of these tasks particularly in the absence of adequate resources to finance the reconstruction and rehabilitation agenda. Post-war Europe represented a catastrophe in the making had it not been for the mobilization of massive foreign aid and external assistance that was provided on a continuous basis over the medium-term. Post-war Europe was provided with more than 9 percent of GDP in grants coupled with far greater concessional financing that enabled it to rapidly overcome its reconstruction pains.

Successive Lebanese Governments, since the first apparent end of hostilities in 1977, have recognized this important fact and have actively pursued foreign aid to help rehabilitate and reconstruct the Lebanese economy. Unfortunately, however, the donor community was not as responsive as initially envisaged and only a trickle of grants and concessional financing was provided. In the late 1980's and early 1990's and as the years of turmoil finally came to an end, Lebanon was once again promised over USD 2 billion in grants to help initiate the reconstruction process. However, regional political developments and the consequent drain on public resources in the Arab Gulf States prevented the realization of these commitments to Lebanon.

With this in mind, the new Lebanese Government was confronted with the challenge of eliminating the vistages of almost two decades of chaos and destruction, while simultaneously reintegrating Lebanon into the world economy. In order to achieve these objectives, the Government could have decided to wait for foreign aid to become available before embarking on a massive reconstruction program. This strategy, however, would have led to a continuous decline in economic activity and quality of life along with a rapidly growing and widening gap between Lebanon and the world economy until adequate grants were made available.

The Lebanese Government chose the alternative path of consistently searching for financial assistance but actively relying on its own efforts to initiate the reconstruction program in the hope of proving to the international financial community that Lebanon was adamant about reviving its economy, reclaiming its role in the Arab and world economies and improving the living conditions of the Lebanese people. The Government also set out to signal its ability to design and implement sophisticated, multifaceted and multibillion physical and human infrastructure investments programs, through the establishment of a solid track record in the implementation of investment projects.

As indicated in the main body of this report, the Government's strategy to achieve these objectives was predicated on the crucial importance of placing Lebanon, once again, on the global economic map. To do so, it was first essential to establish political and economic stability. Indeed, after the introduction of a new Constitution, the restoration of Parliamentary elections for the first time in 20 years and the formation of a new Government, economic policies that reintroduced and maintained macroeconomic stability were pursued. Also, the Government began to overhaul its tax and regulatory system with a view to render it even more investor friendly and to position the private sector as the main locomotive for growth. The Government also embarked on a major effort to enhance economic relations with the international financial institutions and to conclude investment promotion and protection agreements as well as avoidance of double taxation treaties with friendly countries.

In a parallel effort, the Government initiated an emergency infrastructure development program that primarily targeted the enhanced provision of public services. In addition, the Government initiated significant social services programs including the expansion of services for health, education, vocational training, the return of the displaced, support for the South and improvement in real incomes. These were essential to maintain economic and social stability as well as jump-start the economy and consolidate confidence in the economic future of Lebanon. The Government embarked on projects encompassing a wide spectrum of sectors including electricity, post and telecommunications, roads and highways, public health and social affairs, education, water supply and waste water, solid waste, public transport, ports and airport, agriculture and irrigation, industry, environment, housing and resettlement. The Government also encouraged the development of small and medium enterprises (SME's) which constitute the backbone of any economy. To this end, it undertook to sponsor the establishment of an institution that insures commercial risk for credit to such SME's.

Here, it is important to highlight that major strides have been taken in several important infrastructure areas: 24 hour electricity supplies are provided to most users, telecommunication systems are functioning properly, more than 1100 public schools have been rehabilitated, emergency water supply repairs have been undertaken, road networks are being upgraded, and collection of solid waste has markedly improved. To date, the Council of Development and Reconstruction (CDR) over the past four years has awarded contracts totaling USD 3.28 billion.

Naturally, these achievements required a major resource mobilization effort to finance the country's reconstruction and modernization needs. Of the USD 3.28 billion contracts awarded USD 1.4 billion was funded through external resources. About 35 percent has come from regional donors, and about 40 percent from Europe- of which over half in the form of loans from the European Investment Bank and export credits. Overall, about half of the funding was on concessional terms, with grants representing about one-third of total concessional funding.

Given the magnitude of damage, the needs for initial reconstruction and recovery far exceeded the support extended by donors and official lenders. Thus, funding of the initial phase of post-war reconstruction and recovery was to a large extent based on a domestic effort. Despite the depressed post-war income levels, government total revenues have risen from just 6.5 percent of GDP in 1990 to 17 percent in 1995. At the same time, the Government has contained non-interest current expenditures, and as a result the primary current fiscal balance has moved from a deficit of 4.4 percent of GDP in 1992 to a surplus of 1.5 percent in 1995. Tariffs for public services have been raised in a manner commensurate with the services rendered from their 1990 levels. The Government also used USD 1 billion in commercial external borrowing to meet post-war financing needs. In addition, the multibillion task of rebuilding downtown Beirut, the cellular telephone networks, and some of the airport facilities have all been financed by the private sector.

Four years into the effort, the defense and internal security forces are being modernized and expanded with a view to ensure the ability of the Lebanese Government to extend its full control on the South of Lebanon and Western Bekaa once Israel ends its occupation of our territory. Also, a multibillion, multidimensional human resources and physical infrastructure, rehabilitation and restructuring projects have been initiated. Moreover, sustained medium term growth has been realized, foreign reserves are steadily increasing, and a conducive environment to foreign direct investment is being strengthened.

Naturally, given that the funding for the initial phase of post-war reconstruction and recovery was largely based on a domestic effort, domestic debt increased significantly while foreign debt began to accumulate albeit at a much slower pace. As indicated in previous sections this has led to a structural problem in the Governments budget with fixed expenditure items such as interest payments, wages and salaries as well as direct and indirect social contributions dominating the expenditure side of the budget. Of course, this reduces the Government's room for maneuver and constrains its flexibility in responding to exogenous shocks. Most significantly the resulting structural rigidities in the budget complicate further the Government's task of reviving the economy while maintaining macroeconomic stability. Indeed, the set backs in the 1996 fiscal outcome have rendered the task even more challenging.

With this in mind, the Government put forward the 1997 Budget in an effort to maintain its initial fiscal consolidation path and recover the lost ground of 1996. Indeed, the 1997 Budget aims at tackling the structural rigidities of the budget by containing the growth of domestic public debt and reducing substantially the absorption of domestic resources by the public sector thereby leading to an orderly decline in market interest rates. This would naturally lead to a virtuous circle of lower interest rates therefore, lower debt service, lower budget deficits, and most important higher economic growth.

Furthermore, and in order to strengthen the likelihood of inducing a virtuous circle it was necessary to begin to restructure the existing stock of debt in the hope of extending maturities and reducing interest rates. At this stage, the best way to achieve this objective is through increased reliance on concessional foreign financing.

As highlighted above, the growing debt stock and the heavy debt service burden that the Government is forced to bear, leaves very little flexibility to undertake the additional medium-term requirements and may even derail some of the achievements to date. Hence, after having relied on its own efforts and after establishing a strong track record in planning, designing and implementing multifaceted investment projects, Lebanon redoubled its efforts to mobilize foreign assistance by pressing the international donor community, the Friends of Lebanon, to undertake a one-time exceptional effort to help preserve Lebanon’s achievements and to invest in Lebanon’s promising economic potential. Needless to say, the Government will continue to rely on domestic effort, including future fiscal adjustment and cost recovery, and on non-concessional and private sources of funding for sectors where this is feasible. However, the need in other sectors, which are less likely to attract commercial or private interest in the medium term, remains very large.

To this end, the Government actively mobilized support for a set of high priority projects with a cost of about USD 5 billion in the form of loans at concessional terms and grants over the coming five years. These projects are focused in particular on: roads (USD 1.25 billion), water (USD 1.2 billion), the environment (USD 0.85 billion), education (USD 0.8 billion), agriculture (USD 0.4 billion), health (USD 0.1 billion) and other (USD 0.4 billion). In addition, the government is seeking to mobilize loan guarantee facilities in the amount of USD 1 billion in order to reduce the cost of supplementary borrowing in the international capital markets. Here, it is important to note that Lebanon’s request for international support over the medium-term represents in terms of GDP the same support that post war economies received on a grant basis, discounting Special Drawing Rights.

In response to Lebanon’s call for support from the international financial community a Friends of Lebanon Donor Conference was held in Washington D.C. on December 16, 1996. At that Conference which was jointly chaired by United States Secretary of State Mr. Warren Christopher and the Lebanese President of the Council of Ministers, Mr. Rafic Hariri, twenty nine countries and eight international institutions pledged international support for Lebanon’s reconstruction program.

All of the conference participants stressed their strong support for Lebanon and its development goals and commended the Government of Lebanon on its economic achievements to date. The participants reviewed their existing assistance programs and stated their willingness to provide funding for the various sectors highlighted in the Lebanese presentation. Future bilateral contacts will elaborate funding for specific projects. Meanwhile, the participants announced that more than USD 1 billion in official flows were available immediately for Lebanon. Also, a number of participants outlined additional multi-year programs exceeding USD 2.2 billion. Furthermore, many participants indicated that Lebanon would also have access to substantial concessional export credit facilities and loan guarantees. Other countries and institutions, including Japan and the Islamic Development Bank, are still formulating their response to the Lebanese appeal and will send technical missions early in 1997 to work directly with the Government of Lebanon on the specifics of their programs. All participants expressed their commitment to continuing to work with Lebanon as it rebuilds and discussed possibilities for follow-up to this successful conference.

In this regard, it is crucial to highlight that the convening of the conference was a result of dedicated work and painstaking effort that the Lebanese people and Government exhibited through their unwavering dedication to rebuild their country and revive its economy. The main objective of the Lebanese Government has been to place Lebanon, once again, on the world economic map. The successful conclusion of the Conference is a clear reaffirmation from the international community that Lebanon is indeed back on that map. Most important, the USD 3.2 billion mobilized in support of Lebanon's efforts to help itself are not the final amount that will be provided to Lebanon. Indeed, all countries provided commitments for one year due to the fact that their national budgets are determined annually. However, they did indicate their intention to support Lebanon over the medium-term as well. In addition, Japan the major donor country in the world expressed its strong support for Lebanon's reconstruction program and its intention to outline its assistance to Lebanon in the near future. Furthermore, many countries took the decision to include Lebanon on its list of eligible countries for their highly concessional export credit facilities. Finally, the World Bank after agreeing to double its annual assistance to Lebanon provided a floor rather than a ceiling to the resources it is willing to provide to Lebanon's reconstruction program.

Looking ahead, the Government intends to hold bilateral discussions with each conference participant in order to define in detail the mechanism with which they intend to support Lebanon and the sectors into which they are ready to channel their resources. Naturally, this entails a continuous medium-term process that includes active cooperation between Lebanon and the international financial community.

In sum, primarily through its own domestic efforts and against great odds Lebanon has succeeded in placing itself once again on the world economic map and has made significant progress towards economic revival and modernization. In relying on itself to attain these achievements, Lebanon has necessarily incurred a large stock of debt and a heavy debt service burden which in turn aggravated the structural rigidities in its budget. Consequently, its flexibility to undertake additional projects and its ability to preserve its achievements to date in the face of new exogenous shocks have been constrained. While the success of the Friends of Lebanon Conference will not solve all of Lebanon's problems, it will certainly allow Lebanon to implement the investment program it requires and will strengthen its ability to withstand additional shocks. Nevertheless, Lebanon will have to continue to rely on its own efforts and in particular it will need to maintain its fiscal consolidation path through a gradual reduction in the budget deficit. Indeed, the success of the Friends of Lebanon Conference promises to ease the structural rigidities in the national budget as long as non-investment expenditures remain under tight control and revenues are consistently increased.