NOTRE DAME UNIVESRSITY

RESOLVING THE LEBANESE PUBLIC DEBT

by

NIZAR FARHAN SLEEM

A THESIS

Submitted in partial fulfillment of the requirements
for the degree of Master of Business Administration
to the Department of Finance and Economics
Faculty of Business Administration and Economics

ZOUK MOSBEH, LEBANON

APRIL 2006

NOTRE DAME UNIVESRSITY

RESOLVING THE LEBANESE PUBLIC DEBT

by

NIZAR FARHAN SLEEM

APPROVED

by

Dr. Elie Yachouei, Dean
Faculty of Business Administration and Economics

Dr. Atef Harb, First Reader
Faculty of Business Administration and Economics

Raja Shaffu

Mr. Raja Shaffu, Advisor
Faculty of Business Administration and Economics

To NAWAL, my Beloved Mother

CONTENTS

FIGURES

TABLES

EXECUTIVE SUMMARY

Preamble

Lebanon traditionally enjoyed a strong, healthy and dynamic economy that was heavily oriented towards services. Lebanese GDP growth was 5.8 percent per year from 1964 to 1974 (Ref. chapter 2 section 2.4 page 10), and Beirut had the prominence as a center for finance, commerce and tourism. The Lebanese civil war started in 1975 and for over 15 years the widespread destruction of infrastructure and services had a dramatic and negative impact on the economy that continues to plague the Lebanese economy today in the form of absence of effective and functioning services, as well as infrastructure rehabilitation spending that led to cumulative state deficit and accordingly a huge external and domestic public debt.

As the civil war started to have its toll on the economy during the 1980s, the Central Bank (also referred to as Bank of Lebanon or Banque du Liban) tried to maintain sizable financial reserves. However, due to key critical political developments dominating economic affairs during the war era, these reserves declined sharply in the mid-1980s and eventually neither the Central Bank nor the Lebanese government were able to prevent the Lebanese Pound from uncontrollable erosion. The collapse of the national currency combined with severe lack of economic control and swelling inflation eventually led to spiraling budget deficits that continued through the 1990s as the government initiated a massive spending scheme on construction, military, health, education, as well as other social services.

Today, restoring the financial health of the country and creating a steady growth of the economy are still the major challenges for the Lebanese government including the need for a robust and durable strategy for bringing Lebanon back to a sustainable and manageable debt position.

This thesis explores the major determinants of economic growth and relationships that impact the Lebanese fiscal budget today and that consequently have long-term implications on the Lebanese public debt and economy in general in order to recommend fiscal policies and strategies that should effectively reduce the public debt and provide a stable path for recovery and healthy economic growth.

Background

Lebanon's public debt as of end of August 2005 amounted to USD 36,480 million (around 170 percent of GDP). The "Domestic debt" amounted to USD 18,410 million (50.5 percent of total debt) and the "External debt" amounted to USD 18,070 million (49.5 percent of total debt). (Ref. table 4.1 page 61).

The Majority of "domestic debt" comprises of treasury bills issued in Lebanese Lira (Ref. table 4.3 page 64) and is financed by:

- Lebanese Commercial Banks (45.8 percent),
- Central Bank (42.3 percent), and
- Lebanese Citizens (11.9 percent).

The Majority of "External debt" comprises of Eurobonds issued in US Dollars and in Euros. Around 55 percent of external debt (Ref. tables 4.10 and 4.11 pages 82 and 83) is financed locally (local banks and the Central Bank jointly).

The weighted average cost of:

- Domestic debt is around **8.75 percent** (Ref. table 4.4 page 64), and
- External debt is around **7.35 percent** (Ref. table 4.7 page 68).

On the economic front, real growth rates for the years 1993 until 2004 posted on average 3.8 percent per annum (Ref. figure 3.1 page 52). Parallel to the slow economic growth, public debt was increasing at accelerating rates which led to a big gap between debt size and economy size to characterize Lebanon with one of the highest ratios of debt to economy in the world. Average debt growth from 1993 until 2004 was 23.48 percent per annum (Ref. table 4.15 page 15). In addition, inflation, interest rates, and unemployment rose in a manner that led to deteriorated social and living conditions.

All this occurred with absence of any economic plan drawn by the Lebanese Governments to reform their policies and save the country from an unknown financial and economic future.

On the "public finance" front, during the previous 15 years, each annual budget resulted in a public deficit of more than USD 2 billion. On average, from 1993 until 2004, public deficit was around **USD 2.4 billion** per annum (Ref. table 3.8 page 30). Accumulated state deficit from 1993 until 2004 inclusive amounted to around **USD 29 billion** (Ref. table 3.8 page 30). This explains the accumulation of huge public debt that was borrowed in order to finance government expenditures. Those expenditures were primarily designated for (Ref. table 2.10 page 35):

- Construction,
- Personnel cost,

- Military and security,
- Health and social affairs,
- Education,
- Electricity deficit,
- Debt service, and
- Waste.

The waste in public expenditures can be attributed to several factors. Some expenses were a result of overpriced contracts while others were due to corruption and fraud in the form of funds funneled to questionable and suspicious deals at the expense of the public.

On the technical front, Lebanon's public sector employs around 220,000 people of which the majority are non productive and are compensated with a diverse assortments of benefits and pension schemes (Ref. chapter 5 section 5.2.1.1 page 106). In addition, waste was shown in the establishment of several funds that cost the treasury tremendous amounts of money during the previous years. It is also worth mentioning that the government finances EDL losses that exceeded in some years USD 300 million per annum (Ref. chapter 3 section 3.4.4.6 page 43) and reached to USD 804 million in 2005 (Ref. chapter 4 section 4.1.4 page 99).

As for public revenues, major sources are generated from taxes including Value Added Tax (VAT) that was initiated in February 2002. Non tax revenues are mainly generated from surplus of the telecom sector. Such revenues would have been managed in a more efficient and effective way if the responsible people in charge of state assets were better qualified.

Lebanon enjoys a dynamic and superior bank sector. However, the major barrier facing the banks is the government's reliance on funding from these banks in the form of treasury bills i.e. public debt in order to finance its public deficit. Around 71.76 percent of total public debt is financed internally from customers' deposits in Lebanese banks (Ref. chapter 4 section 4.7.3 page 84). Regarding the Central Bank of Lebanon, financial analysts on numerous occasions have expressed a great deal of criticism against its tightened monetary policy that is based on fixation of exchange rate instead of valuation that is determined by supply and demand of funds in the market. This policy in part has led to increase in interest rates and unemployment and influenced the economy negatively.

Conclusions

This thesis concludes that the current situation of the Lebanese economy and the accumulation of huge public debt is a result of a combination of factors some of which (Ref. chapter 3 section 3.5 page 56):

- Syrian tutelage,
- Political conflicts,
- Corruption, and
- False governmental policies.

Solutions

It is also concluded that resolving the Lebanese public debt and activating the economy can not be achieved without an **overall economic plan** with **clear objectives and timetable** that shall address the following issues:

1. **Controlling Public Expenditures:** Government's priority should be to decrease the unfruitful expenditures. Personnel expenses must be cut and public labor performance must be assessed and improved. In addition, expenditures on politicized "funds" and "councils" should be ceased immediately. Moreover, certain ministries should be dismantled at the current time due to inability of the government to finance their annual budget. EDL's deficit should be ceased immediately by reforming and then privatizing this company. Interest cost should also be diminished by repaying principal amounts of public debt from the funds generated via privatizing the telecom sector.

2. **Increasing Public Revenues:** Lebanon owns a wide range of assets that were managed improperly. Therefore, new revenues should be generated by assessing all assets' values and privatize underperformed ones including the electricity sector. It is also recommended to privatize the telecom sector (GSM, landlines, and other services) which value is estimated by around USD 8.7 billion and use these funds immediately to settle principal amounts of public debt. Customs' tariffs should be increased in order to increase revenues and protect local industries. It should be noted that in the context of increasing revenues, NO tax increase is recommended because such a step would

threaten the social and daily life of citizens and deteriorate the economy as well.

3. **Achieving Economic Growth:** Achieving economic growth is the major solution for debt and its consequences. Three case growth scenarios are modeled for the next five year horizon. On average, it is estimated to achieve 5 percent constant real growth for the years 2006 until 2010 inclusive if required reform is conducted. This reform should address the following:

    - Draw and monitor an economic plan,
    - Correct the monetary policy and decrease interest rates,
    - Reinforce the role of the private sector,
    - Activate the stock market,
    - Increase investments incentives,
    - Release the banking sector from lending the government to focus on lending the private sector in order to increase investments,
    - Conduct budget reform and consolidate all expenditures under one realistic and feasible budget in context of the economic plan,
    - Reform tax bases to ensure equality among different layers of the society,
    - Activate general inspection authorities and roles to monitor public sector performance,

- Organize private labor force issues and document the affairs of foreign labor working in Lebanon and levy tax on their income,
- Ensure transparency in public sector work and full disclosure of information,
- Reinforce statistics institutions and conduct census among different economic, social, and other sectors.

In addition to the above, it is also recommended that the media sector (televisions, newspapers, and radios) highlight economic developments in the country and follow up on government's economic plan on a daily basis. Such step would give the public a confidence benchmark to encourage investments and growth.

In case the aforementioned reform package is put in place for execution, a projected GDP, private investments, public debt, and state budget are estimated in a simulated economic module that would lead to the following figures for 2006 until 2010 inclusive:

Amounts in USD Million	Actual	Projected				
	2005	2006	2007	2008	2009	2010
GDP	22,210	**23,876**	**25,666**	**27,591**	**29,661**	**31,885**
Private Investments	4,442	**5,175**	**6,029**	**6,999**	**8,126**	**9,435**
Public Debt	38,507	**32,337**	**32,632**	**32,504**	**32,282**	**31,950**
Public Debt / GDP	173.4%	**135.4%**	**127.1%**	**117.8%**	**108.8%**	**100.2%**
State Revenues	4,984	**4,796**	**4,882**	**4,955**	**5,034**	**5,122**
State Expenditures	6,992	**5,151**	**5,177**	**4,827**	**4,812**	**4,790**
State (Deficit) / Surplus	(2,008)	**(355)**	**(295)**	**128**	**222**	**332**

The main targets for the next five years should be to increase private investments, increase the economy size and achieve economic growth, ensure repayment of principal amounts of debt and contain this debt to a level that is close to the economy size.

Finally, it is worth mentioning that the current political, social, and economic situation of the country and its management of economic affairs and its method of operation are detrimental to the overall economic health and stability and will sooner or later backfire. Therefore, reform should start immediately because each day of delay is passing at an average cost of debt per day estimated at USD 6.4 million.

A courageous leap and advancement in operations is a must. Unless the authorities realize these dangerous economic pitfalls, the country will undoubtedly face an irreversible economic meltdown.

To this effect, this thesis is drawn up as a waking call in which a number of issues were discussed to deter this ultimate burst.

ACKNOWLEDGMENTS

I would like to express my gratitude to a number of people who contributed to the completion of this thesis. Those people who work in different public and private institutions provided assistance in several manners including access to data and valuable suggestions in academic respect.

I highly appreciate the assistance provided by:

Josian Saad *Directorate of Budget, Ministry of Finance.*

Amin Saleh Directorate *of General Accounting, Ministry of Finance.*

I would like to express my sincerest gratitude to Mr. Raja Shaffu for his valuable support throughout my stay at NDU and particularly for his efforts and guidance in completion of this thesis.

I also want to thank Dr. Atef Harb and Dr. Elie Yachouei for their review and evaluation.

ABBREVIATIONS

BDL	Banque Du Liban
BIS	Bank for International Settlement
BSE	Beirut Stock Exchange
CAS	Central Administration for Statistics
CDs	Certificate of Deposits
CSFB	Credit Suisse First Boston
DB	Deutsche Bank
DSL	Digital Subscriber Line
EDL	Electricitè Du Liban
EOSI	End of Service Indemnity
FC	Foreign Currencies
FF	French Frank
GSM	Global System for Mobile Communications
HCP	Higher Council for Privatization
HS	Harmonized System
IMF	International Monetary Fund
LL	Lebanese Lira
MENA	Middle East North Africa
ML	Merrill Lynch
MOF	Ministry of Finance

MSDW	Morgan Stanley Dean Witter
ROA	Return on Assets
ROE	Return on Equity
ROL	Republic of Lebanon
SBC	Singapore Banking Corporation
SSSB	South Shore Savings Bank
TBs	Treasury Bills
USD	United States Dollar
VAT	Value Added Tax

CHAPTER 1

INTRODUCTION

Lebanon traditionally enjoyed a strong, healthy and dynamic economy that was heavily oriented towards services. Lebanese GDP growth was 5.8 percent per year from 1964 to 1974 (Ref. chapter 2 section 2.4 page 11), and Beirut had the prominence as a center for finance, commerce and tourism.

However, for the previous three decades, Lebanon has witnessed severe conflicts in its home land that destroyed its infrastructure, economy and social welfare. The consequences of war were tragic. Besides the fact that an unaccountable number people died, poverty and disease spread, tourism, trade and other sectors of the economy were dismantled thus paralyzing the Lebanese economy and its potential growth.

On November 5, 1989, an agreement between local parties with the support of the international community came to put an end to this destructive war. That agreement is called the "Taef Accord" because it took place at the Taef town in Saudi Arabia. In addition, the Taef released several legislations and modified laws and new regulations that altered the way Lebanon was governed such as the Parliament, the Presidency, and the Government. However, some local parties did not accept this rapid change nor the structure of the Accord and accordingly refused to sign it.

What was relevant in the "Taef Accord" in as far as this thesis is concerned was the fact that the Syrian army would retrieve from the Lebanese lands after two years of the agreement (i.e. 1991), a step that was not concluded until April 26 of 2005. i.e. 14 years of occupation that affected the structure of the Lebanese society, along with the economic and financial development that led to a huge budget deficit that was funded by various means of borrowing. The subject of this thesis then is to determine the origin of the debt and its treatment.

On the economic front, conditions in the previous years deteriorated at an unprecedented manner. Real growth rates for the period between 1993 until 2004 posted on average 3.8 percent per annum (Ref. figure 3.1 page 21). Public finance performance witnessed continuous deficit that averaged from 1993 until 2004 around USD 2.4 billion per annum (Ref. table 3.7 page 31). The total public deficit to total expenditures for the years 1993 until 2004 posted on average 44 percent per annum (Ref. table 3.7 page 31). The said deficit was financed by huge borrowing, a matter that led to accumulation of the current public debt that amounted to at the end of **August 2005 USD 36,480 million** which is equivalent to approximately 170 percent of GDP. The Domestic debt by the end of August 2005 amounted to USD 18,410 million (50.5 percent of total debt) and the external debt amounted to USD 18,070 million (49.5 percent of total debt) (Ref. table 4.1 page 62). Public debt growth for the period between 1993 and 2004 posted on average 23.48 percent (Ref. table 4.1 page 62).

The said economic deterioration ceased the activity at almost all economic sectors in the country. Unemployment rose, so did inflation and interest rates. In addition, that period witnessed capital outflows from the country due to the unfavorable investment framework, lack of accountability, transparency and political stability.

1.1 Problems and Objectives

Lebanon has a huge public debt that exceeds GPD by almost twice with an unbearable annual servicing cost that amounts to USD 2.6 billion per year (Ref. table 3.19 page 55). With the absence of a clear, credible, and feasible economic plan, the country is left with a hazy economic and financial direction. Hence,

- The public debt and its consequences on the Lebanese economy are the problems to be studied through out the thesis.
- Objectives are directed towards detecting the sources that inflated the public debt through out the previous years and deriving out a set of solutions that shall deal with this huge debt.

1.2 Importance of Topic

In Lebanon, the severe public debt has led to tragic results, which sum up to but not limited to the following:

- Outflow of investments;
- Destruction of the private sector;
- Increase in unemployment rate, inflation, and interest rates;
- Increase in the government expenditures;
- Increase in the burdens of servicing the debt;
- Emigration of the Lebanese people especially young talented ones.

In view of the fact that a healthy economy is the main driver for growth, development, and prosperity of the country, therefore, implementing a reform agenda that shall contain the public debt and activities of the Lebanese economy is crucial to draw in order to arrive at a modern and developed state.

1.3 Research Methodology

1.3.1 Secondary Data

Secondary data were collected from websites, books, publications, reports, and files of different governmental, international, and private institutions. Main governmental entities were the Ministry of Finance and the Central Bank of Lebanon and data were extracted from their monthly, quarterly, and annually publications such as monthly bulletins, public finance monitors, public finance prospects, and else. International organizations were the World Bank and the International Monetary Fund and data collected were searched from monthly and quarterly publications such as the quarterly economic update and other articles about the Lebanese economy.

1.3.2 Primary Data

Primary data were collected via direct interviews conducted with employees and directors at several ministries and public entities including but not limited to the Ministry of Finance, the Ministry of Post and Telecommunications, and the Central Bank of Lebanon.

1.3.3 Tools of Analysis

The majority of statistical data was analyzed and processed via spreadsheets and other part of data was processed in SPSS "Statistical Packages for Social Sciences". Regression Analysis was used to determine relationships among variables.

1.4 Limitations of the Study

Conducting a research that involves the public sector has a major limitation which is access to required data. The previous 15 years were characterized with vague disclosure of information at different levels. Data were not published, other data were manipulated and not to mention local and foreign political interference in the general public affairs of the country.

Data gathering was facilitated from some people inside public entities while blocked from others. Part of the data was provided directly and in some instances required letters to general directors. It should be noted that part of requested information was not provided because related public entities did not agree to make available such data due to confidentiality and work preparation limitation.

Limitations are also related to the availability of statistics. The absence of solid and credible statistics is a major barrier in conducting a fruitful research. "The Central Administration of Statistics" is the public entity responsible for conducting public statistical reports in Lebanon. However, research conducted is nor sufficient neither comprehensive.

Should the aforementioned limitations not exist, a better assessment of the study problems would have been accomplished and no doubt better results would have been generated.

1.5 Outline

This thesis is divided into six chapters briefed as follows:

Chapter 1: Introduction that includes a general overview of thesis problems and objectives next to limitations and an outline.

Chapter 2: Lebanon Background that includes an overview of political and economic situation in Lebanon that prevailed in the previous 15 years. In addition, the chapter stresses the issue of the Syrian occupation and its influences on local political conflicts and economic dilemma.

Chapter 3: The Lebanese Economy that includes details on different economic sectors of the country. The chapter discusses gross domestic product, trade figures, and public finance performance including state revenues, expenditures, and deficit. In addition, the relationship between different economic variables is revealed as well as causes and effects of deteriorated economy.

Chapter 4: The Lebanese Public Debt that includes the details of public debt, its emergence, cost, sources, and other characteristics such as holders and type of instruments. In addition, the chapter discusses the banking sector due to its relevance in the debt issue. Also, monetary policy is discussed along with its influence on the economy. Links between huge debt and economy situation are revealed. Finally, the chapter discusses privatization background and current status and the stock market.

Chapter 5: Data Findings and Solutions that includes analysis of data collected as well as assessment of topics under consideration. The chapter derives a set of solutions in a reform package that if implemented shall contain debt and activate the Lebanese economy. Solutions include drafting an overall economic plan that shall address current problems such as controlling state expenditures, improving state revenues, conducting budget reform, modifying monetary policy, lowering interest rates and unemployment, privatizing the telecom and electricity sectors and reforming other different public entities. The ultimate goal is to increase the economy size and achieve real growth. Parallel to economic growth, public debt should be contained to a normal level.

Chapter 6: Conclusions and Recommendations that includes general conclusions and recommendations derived from the analysis of the study. In addition, the chapter discusses potential future studies to be conducted in this respect.

CHAPTER 2

LEBANON BACKGROUND

2.1 Introduction

In order to comprehend the overall position of the Lebanese deficit and its origin, it is then imperative that this chapter provides a general overview of Lebanon in terms of political system, economic background, economic historical trend, as well as the major political events that occurred during the previous 15 years especially consequences of the Syrian occupation. In addition, this chapter briefs the major events of the year 2005 and the related international resolutions that embraced Lebanon.

2.2 Political System

Lebanon's political system is based on separation of executive, legislative, and judiciary powers. The Council of Ministers determines overall policy, appoints senior administrators, and submits potential legislation to Parliament. The Parliament on the other hand, issues laws and regulations with the power to monitor government policy. The Judicial powers remain within the control of the courts. The legislative branch consists of a single chamber Parliament of 128 seats, distributed among different sects. Members are elected for four-year terms in regional polls, with the number of seat determined according to population.

The executive branch includes in addition to the President, the Council of Ministers. The President is the head of the state. He is elected for a six year term and his functions include being chairman of the High Defense Council, Commander in Chief of the Army, and chairing the Council of Ministers whenever he attends its meetings, although he has no voting power.

It a common practice among various political parties in Lebanon that the President is a Christian Maronite, the Speaker of the Parliament is a Shiite Muslim, the Prime Minister is a Sunni Muslim, the Vice Speaker and the Vice Premier are from the Orthodox.

Legal system is based on laws that date back to the beginning of the 20th century, mainly the French laws. No major amendments occurred to the old laws. The court system consists of one administrative court, the State Council Court and Civil Courts. The Supreme Court is the highest court of appeal for civil and commercial matters. Judges are appointed by the Government after recommendation of the Supreme Council of Justice.

2.3 Economic Overview

Lebanon enjoys a democratic political regime with a liberal economy characterized with a free market with no governmental controls, and a flexible foreign exchange structure with free flow of capital and direct investments;

The private sector contributes to around 75 percent of aggregate demand and is a major pillar for growth and recovery;

The Lebanese banking sector is large and dynamic. This sector is equivalent to more than 2.5 times its economic sector (Customers' deposits amounted to at end of 2004

USD 54,853 Ref. table 3.15 page 50) and provides an important support to aggregate demand;

The Ministry of Economy and Trade governs the Lebanese economic policy and is responsible of measuring the economic activities and publishing the economic figures on a monthly, quarterly and yearly basis;

Free enterprise, private initiatives, liberal investment policies, and banking and financial facilities make Lebanon one of the important commercial centers in the region;

Lebanon represents a point of entry to a large regional market encompassing major Arab countries and other European and African countries. This is why trade shows in the region are organized and promoted in Lebanon;

Lebanon is an importing country creating huge opportunities for international exporters who find tremendous potential in the Lebanese market;

In order to achieve a trade liberalization strategy, the Lebanese government has concluded free trade agreements with the European Union (EU), the European Free Trade Association (EFTA), and the Gulf Cooperation Countries (GCC). Lebanon is also a member of the Grater Arab Free Trade Area (GAFTA), and currently Lebanon is negotiating accession to the World Trade Organization (WTO);

Lebanon has bilateral agreements with more than 35 countries including the Arab Countries related to economic cooperation, trade liberalization, double taxation treaties, defense and other issues.

2.4 Economic Historical Trend

Lebanon witnessed a prosperous economic period between 1960s and 1970s, and the country recorded considerable real economic growth rates averaging 5.8 percent per annum between 1964 and 1974[1]. Those favorable economic conditions were also supported by the prevailing economic and historical regional context at the time including the Arab-Israeli conflict that Lebanon was isolated from. The economy witnessed low inflation rates, large balance of payments surpluses, stable domestic currency, solid monetary and financial conditions and a dynamic financial system. All these favorable conditions vanished during the civil war which lasted from 1975 until 1991.

The war entailed severe human and material damages. According to the United Nations, the overall damage to infrastructure and physical assets amounted to USD 25 billion.[2] In addition, investment climate was disrupted and currency stability vanished. The existence at that time of external forces weakened the government's ability to maintain authority on all Lebanese lands and tax base narrowed in that respect. Public expenditures increased, revenues declined and deficit grew leading to higher inflation, dollarization, and capital outflow.

The 1982 – 1990 period witnessed a 50 percent drop in GDP, inflation rate of around 80 percent, and 76 percent drop in the Central Bank's foreign exchange reserves. A cumulative deficit in the balance of payment of USD 1.7 billion, and a big capital outflow led to 62 percent fall in bank deposits. After Civil war, the economy recovered slightly as well as the currency and monetary position. However, deficit and public debt started increasing on a yearly basis[3]. During the years 1993 until

2004, average real economic growth rates posted 3.8 percent per annum (Ref. figure 3.1 page 21).

In recent years, economic growth has been driven by external factors such as tourist movement to Lebanon. Money spent by tourists annually contributes to around 2.5 percent of nominal GDP. Exports also constitute a major economic growth and its figures were increasing the past five years. In 2004 only, exports increased 15 percent from 2003 and accounted for around 10 percent of GDP[4].

In 2004, economic figures outperformed previous years. Real growth rate reached around 5 percent, a growth that wasn't realized since 1995. This increase came on parallel grounds with a decrease in the public sector share of the GDP, which indicates the relevance and the essential activities of the private sector[5].

In 2005, economic performance deteriorated due to the significant political incident that took place throughout the year. A number of industries realized losses and bankruptcies especially within the tourism, catering, and similar services. GPD in 2005 is expected to drop to a level that ranges between zero and 2 percent maximum.[6]

2.5 Syrian Occupation

As noted earlier, the conclusion of the Lebanese civil war in 1990 was a promising period for a rejuvenation of the Lebanese economy for an eventual development and prosperous phase for the country. However, the fact remained that the after effect of the sever fighting had destroyed the Lebanese infrastructure, the new era came to destroy its public institutions, private dynamic sector, freedom of expression, as well as other unique characteristics of Lebanon. All that occurred under the supervision and custody of the Syrian regime that transferred the country into a small Syrian territory and used it as a tool to obtain financial and political benefits.[7]

Within the period ranging from (1990 – 1992), total public debt was around USD 2 billion[8]. The major problem the country was facing was the Syrian interference in almost all affairs. With the help of their counterparties in Lebanon (the Lebanese Officials), the Syrian Regime was able to penetrate all governmental institutions and they used their authority to employ and fire people, pass preferential laws and legislations, and implement certain projects to their advantage. The said practices developed a corrupt and wrecked country.

The Syrians first invaded the Parliament and from there they were able to control the political scene in the country. When most of the deputies were not more than stooges to the Syrian regime, every law issued was drafted and originated in Damascus. In order that the Syrian regime would be able to continue their dominance, they always manipulated the electoral laws to ensure that their allies are retained in the Parliament.

For throughout the previous 15 years, four elections were concluded. In the four instances; the electoral law was designed in Syria. They mainly counted on enlarging the administrative region in a way that allowed their allies to win the seats.[9] Violations took different shapes also such as threatening candidates and their supporters, manipulating results and other illegal practices that ensured owning the majority of the Parliament.

Lebanon is a Parliamentary Republic and that's why controlling the Parliament Members ensures reaching the various institutions inside the republic including the Presidency of the Republic and the Government. All legislations issued by the

Parliament were in favor of the Syrian Regime. From here, they had the power and almost all politicians were directed to satisfy the Syrian occupation and its demands.

Year after year, political events consequently passed in a manner that depressed the Lebanese ability to have a free and democratic country. Probably the last official important event that Syrians interfered in its preparation was the renewal of the Lebanese President in September 3, 2004. The said incident that occurred by force cited a wide objection from the Lebanese counterparties and attracted the attention of the international community which in its turn expressed deep worries about the significant Syrian role in Lebanon. As a result of that forceful renewal and in response to some diplomatic endeavors, the famous resolution 1559 was issued by the Security Council on September 2, 2004. Resolution 1559 calls for the following four point:

- Withdrawal of the Syrian military and intelligence forces from Lebanon and ceasing the Syrian interference in the Lebanese political life,
- Considering the renewal decision for the President of the Republic as illegal because it was undertaken in a manner that violated the Constitution and due to Syrian obvious pressures on Lebanese Deputies at the time,
- Handing Over the weapons of all non-governmental parties particularly Hezbollah party and the Palestinians to the Lebanese government, and
- Sending the Lebanese Army to the borders.

The Resolution 1559 represents a historical attention from the United Nations to the Lebanese political affairs. It is also considered as a major motive to the achieving of Lebanese sovereignty on April 26, 2005, date of retrieval of the Syrian military forces. However, the rest three clauses of the Resolution were not executed yet.

Following the Resolution 1559, a series of political assassinations was executed and important characters went victims and are the former Prime Minister Rafic Hariri, the journalist Samir Qasir, Mr. George Hawi, and the journalist and deputy Gobran Twaini. In addition, other politicians and journalists survived similar terrorist bombs. [10] On parallel with the above-mentioned terrorist incidents, an internal public support emerged from the unity of most of the Lebanese people on the Lebanese sovereignty and independence. Several manifestations were planned to reveal to the international community the people's insistence on the withdrawal of the Syrian Regime.

Under the Resolution 1559 supported with internal and external public demand for withdrawing the Syrian Army and after diplomatic pressures from the United States, France and other European countries, Syria left Lebanon on April 26, 2005. However, political problems still exist between the two countries on different issues including diplomatic representation and setting the boundaries.

On April 7, 2005, the Resolution 1595 was issued by the Security Council to form an independent investigation commission to lead investigations in the assassination of the former Premier Hariri. The German Judge Detlev Mehlis, the Commissioner of the said commission issued two reports listing the findings of the investigations. Both reports contained serious allegations against the Syrian Regime.

In the beginning of January 2006, the Belgium Judge Serge Bremeretz replaced Judge Mehlis in leading the independent investigation. To the date of this thesis, investigations are still in progress and it is expected at the end of this investigation that an international court to be formed to hear in the commission's allegations.

Meanwhile, political situation in Lebanon is still unstable with several arguments persisting especially regarding the implementation of Resolution 1559, the relation between Lebanon and Syria, as well as to other points under discussion.

2.6 Effects of Occupation and Politics

The purpose behind rapping up the historical events during the previous fifteen years is to pinpoint the influence of these events on the economic status of the country. A stable political environment provides a potential prosperous economy. Therefore, the deteriorated economy in Lebanon is a result of the corrupt political environment which in a way or another led to the huge public debt.

Chapters 3 and 4 discuss the economic and financial dilemma of the country in figures starting from the GDP, trade figures, state revenues, expenditures and deficit, ministries' expenditures, public debt growth versus economic growth, banking sector, stock market, as well as monetary and fiscal policy implemented by the government in the previous 15 years.

CHAPTER 3

THE LEBANESE ECONOMY

3.1 Introduction

Chapter 2 discussed Lebanon's background including the political events and the role of Syrian occupation and its influences on the Lebanese economic status. This chapter briefs the details of the Lebanese economy. This chapter details gross domestic product, its growth stages, inflation, trade figures, trade deficit and its influence on economy. In addition, government revenues and expenditures are broken down and analyzed, state deficit, sources and finances of deficit and its relation with public debt.

3.2 Gross Domestic Product (GDP)

The gross domestic product is the most comprehensive measure of a nation's total output of goods and services. It is the sum of dollar value of consumption (C), investment (I), government purchases of goods and services (G), and net exports (X) produced within a nation during a given year. [1]

Table 3.1 shows the breakdown of Lebanon's GDP:

Table 3.1 Lebanon's GDP Breakdown in USD Million (1997-2002)

	1997	1998	1999	2000	2001	2002
Consumption	**13,863**	**14,295**	**14,318**	**14,275**	**14,549**	**15,621**
Government expenditures	**2,592**	**2,671**	**2,877**	**2,938**	**3,003**	**3,187**
Private investments	**4,640**	**4,924**	**3,934**	**3,388**	**3,929**	**3,395**
Net exports	**(5,373)**	**(4,889)**	**(4,115)**	**(3,923)**	**(4,423)**	**(3,741)**
Exports*	2,180	2,206	2,264	2,261	2,578	2,927
Imports**	7,553	7,095	6,379	6,184	7,001	6,669
GDP	**15,722**	**17,001**	**17,014**	**16,678**	**17,058**	**18,462**

Source: Ministry of Trade and Economy, *Lebanon's Economic Accounts 1997 – 2002, 11.*

The above table clearly shows the reliance of the Lebanese economy on its private sector (85 percent contribution in 2002). Government expenditures accounted for 17 percent of GDP in 2002. With respect to investments, it contributes around 18 percent of GDP value in 2002. Finally, net exports that is represented in the trade deficit accounted for 20 percent of GDP value in 2002. *Refer to Appendix A page 164 for breakdown of consumption and private investments by sector.*

Table 3.2 below compares the breakdown of Lebanese GDP vs. the breakdown of United States of America (USA) GDP for the year 2002:

Table 3.2 GDP of Lebanon vs. GDP of USA in 2002

	USA	Lebanon
Consumption	70%	85%
Government expenditures	20%	17%
Investments	15%	18%
Net exports	-5%	-20%

Source: Compiled from data published by the Ministry of Trade and Economy / World Fact Book USA.

Table 3.2 indicates that 70 percent of USA's GDP is related to private consumption, while in Lebanon, private consumption comprises 85 percent of total GDP. The

* Exports include expenditures of tourists.
** Imports include expenditures abroad.

government expenditures comprise 20 percent of USA's GDP and 17 percent of Lebanon's GDP. Investment comprises 15 percent of USA's GDP and 18 percent of Lebanon's GDP. Finally, percentage of net exports differs considerably between the two economies. Net exports that are the trade deficit are discussed in section 3.3.3 page 28.

3.2.1 GDP Breakdown by Sector

In the previous section, GDP components of Lebanon were discussed. This section breaks down GDP by sectors. Table 3.3 shows GDP breakdown by sector for the years 1997 until 2002 inclusive.

Table 3.3 Lebanon's GDP by Sector in USD Million (1997-2002)

	1997		1998		1999		2000		2001		2002	
Agriculture	1,018	6.5%	1,023	6.0%	1,052	6.2%	1,071	6.4%	1,018	6.0%	1,076	5.8%
Energy and water supply	148	0.9%	262	1.5%	247	1.5%	147	0.9%	197	1.2%	180	1.0%
Industry	2,117	13.5%	2,271	13.4%	2,155	12.7%	2,008	12.0%	2,096	12.3%	2,155	11.7%
Construction	1,477	9.4%	1,777	10.4%	1,485	8.7%	1,327	8.0%	1,392	8.2%	1,422	7.7%
Transport and communication	823	5.2%	884	5.2%	1,029	6.0%	1,090	6.5%	1,138	6.7%	1,197	6.5%
Services	4,976	31.7%	5,389	31.7%	5,510	32.4%	5,633	33.8%	5,678	33.3%	6,077	32.9%
Trade	3,352	21.3%	3,542	20.8%	3,471	20.4%	3,319	19.9%	3,363	19.7%	4,027	21.8%
Public administration	1,811	11.5%	1,853	10.9%	2,065	12.1%	2,085	12.5%	2,176	12.8%	2,328	12.6%
Total	**15,722**	**100.0%**	**17,001**	**100.0%**	**17,014**	**100.0%**	**16,678**	**100.0%**	**17,058**	**100.0%**	**18,462**	**100.0%**

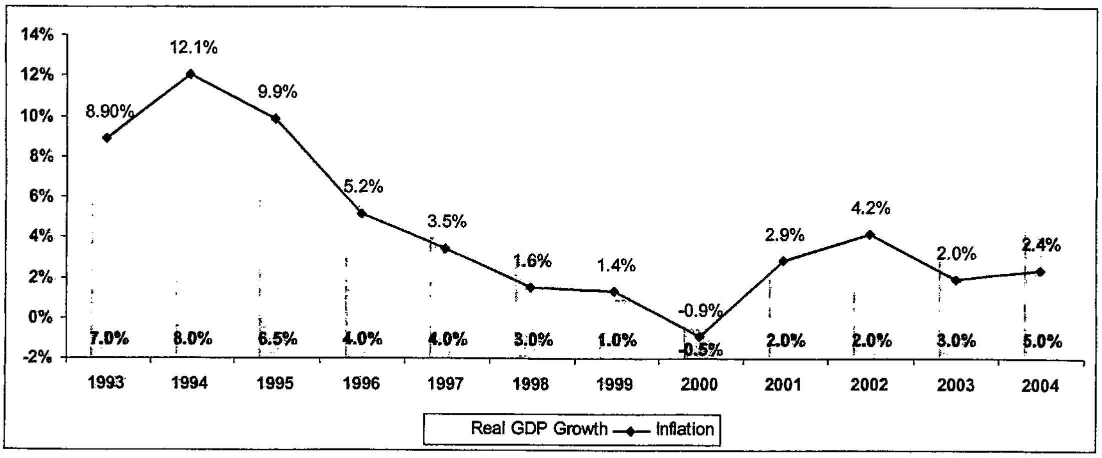
Source: Ministry of Trade and Economy, *Lebanon's Economic Accounts 1997 – 2002, 13.*

Table 3.3 shows that services sector (32.9 percent of total GDP in 2002) have the major contribution to GDP. Followed by trade (21.8 percent), public administration (12.6 percent), industry (11.7 percent), construction (7.7 percent), transport and communication (6.5 percent), agriculture (5.8 percent), and finally energy and water (1 percent).

3.2.2 Real GDP Growth Rates

Figure 3.1 below shows real growth rates of the Lebanese economy for the years 1993 until 2004 inclusive:

Figure 3.1 Real GDP Growth Rates vs. Inflation (1993-2004)



Source: Bank Audi, *Country and Market Update 2005,* 42.

Real GDP growth rates averaged around **3.8 percent** for the period covering 1994 until 2004 inclusive. Growth rates for the years 1993 until 1995 posted significant growth and this was related to the positive expectations of the after war era. During the years 1996 and 1997, the economy witnessed a slow down and rates dropped to 4 percent. After 1998, economic performance deteriorated considerably to reach -0.5 percent in 2000. Such drop in real growth rates was related to several factors including the tightened monetary policy of the Central Bank, high interest rates and the decrease in private investments. After 2001 and until 2004, the economy posted a slight recovery and this was related to the fiscal adjustments of the government and the slight decrease in interest rates after the Paris II Conference. Causes and effects of slow growth are discussed next.

3.2.3 Causes and Effects of Slow Growth

3.2.3.1 Causes

The economy is a cycle that flows simultaneously by the contribution of different related public and private institutions. What affects a sector of the economy affects the other positively or negatively. There are various reasons behind the economic deterioration in Lebanon of which:

- The absence of solid economic policies: Countries enjoying prosperous economies draft policies that improve economic efficiency, reduce economic inequality, stabilize the economy, and conduct international economic policy.[2] In Lebanon such policies do not exist. In fact, the Lebanese government is currently in process of issuing an economic policy to save the economy.[3] In a normal situation, economic policies should be there before the crisis not after.

- Poor monetary policy: In a free and liberal economy, local currency exchange rate is determined by the supply and demand of funds. However, the Central Bank of Lebanon interferes routinely in an attempt to fix the rate of Lebanese Lira. The Monetary policy is discussed in details in chapter 4 section 4.8 page 86.

- Lack of investment incentives: For the previous years, investments in Lebanon were nil due to political and security instability from one hand and to improper implemented economic policies from the other.[4]

- Huge state deficit: Cumulative deficit (Ref. table 3.7 page 31) has been an additional burden on the Lebanese economy especially that this deficit was financed by public debt (Ref. chapter 4 section 4.2 page 59).

3.2.3.2 Effects

Slow economic growth reflects the slow down of different sectors of the economy and thus low profits, less job opportunities, and deteriorated social and living conditions. In addition, slow growth reflects the failure of the Lebanese government to plan and draft proper fiscal policies. Furthermore, slow growth increases the gap between debt size and economy size and accordingly prevents resolving the Lebanese public debt.

Over the past 9 years, the fiscal year 2004 witnessed the highest growth in real GDP with 5 percent. However, GPD in 2005 posted no growth reflecting the deteriorated political and economic situation in the fiscal year 2005. This deterioration is no doubt not in favor of the economic current situation because it negatively influences collected taxes for the government thus decreasing total state revenues (Ref. table I.1 page 179) and accordingly increasing the government deficit.

Section 3.3 below discusses trade figures, imports, exports, and trade deficit and its influence on GDP and general economic conditions. Section 3.4 discuses state revenues, expenditures and deficit.

3.3 Trade Figures

In the previous section, production (GDP) components and economic growth rates were discussed in all aspects as well as their economic impact on the huge public debt. This section presents trade figures (exports, imports and trade balance) in details and reveals the impact of trade balance on the level of GDP.

3.3.1 Exports

Table 3.4 below shows Lebanon's exports by sector for the years 1997 until 2002 inclusive:

Table 3.4 Lebanon's Exports by Product in USD Million (1997 – 2002)

	1997		1998		1999		2000		2001		2002	
Agricultural products	200	11.3%	181	10.2%	159	9.1%	132	7.5%	144	7.3%	135	6.1%
Livestock products	16	0.9%	17	1.0%	11	0.6%	10	0.6%	12	0.6%	15	0.7%
Total agricultural products	**216**	**12.2%**	**198**	**11.2%**	**170**	**9.7%**	**142**	**8.1%**	**156**	**7.9%**	**150**	**6.8%**
Food	114	6.4%	92	5.2%	78	4.5%	86	4.9%	96	4.9%	110	5.0%
Textiles	170	9.6%	160	9.0%	107	6.1%	113	6.5%	209	10.6%	193	8.8%
Non metallic ores	47	2.6%	53	3.0%	60	3.4%	53	3.0%	62	3.1%	76	3.5%
Metals, machines & equip.	308	17.3%	298	16.8%	294	16.8%	280	16.0%	433	22.0%	446	20.3%
Wood, rubber, chemicals	117	6.6%	133	7.5%	138	7.9%	135	7.7%	155	7.9%	201	9.1%
Furniture	9	0.5%	10	0.6%	12	0.7%	15	0.9%	20	1.0%	21	1.0%
Others	170	9.6%	174	9.8%	176	10.1%	224	12.8%	224	11.4%	295	13.4%
Total industrial products	**935**	**53%**	**920**	**51.9%**	**865**	**49.4%**	**906**	**51.7%**	**1,199**	**60.9%**	**1,342**	**60.9%**
Telecommunications	92	5.2%	145	8.2%	210	12.0%	177	10.1%	107	5%	111	5.0%
Business services	42	2.4%	43	2.4%	44	2.5%	46	2.6%	33	2%	34	1.5%
Trade	491	27.6%	468	26.4%	462	26.4%	436	24.9%	474	24%	565	25.7%
Total services	**625**	**35.2%**	**656**	**37.0%**	**716**	**40.9%**	**659**	**37.6%**	**614**	**31%**	**710**	**32.2%**
Total Exports	**1,776**	**100.0%**	**1,774**	**100.0%**	**1,751**	**100.0%**	**1,707**	**100.0%**	**1,969**	**100.0%**	**2,202**	**100.0%**
Change			**-0.10%**		**-1.30%**		**-2.50%**		**15.30%**		**11.80%**	

Source: Ministry of Trade and Economy, *Lebanon's Economic Accounts 1997 – 2002,* 51.

The Lebanese exports increased from around USD 1.8 billion in 1997 to around USD 2.2 billion in 2002 growing at a compound annual growth rate (CAGR) of 4.39 over the period. From the year 1997 until the year 2000, exports declined around 1.31 percent on average per annum to recover in the years 2001 (15.4 percent increase from 2000) and 2002 (11.8 percent increase from 2001). The Lebanese exports are divided into the following three sectors:

- Agricultural products: Exports of agricultural products decreased from USD 216 million in 1997 to USD 150 million in 2002 posting 7.12 percent compound average decline per annum.

- Industrial products: Exports of industrial nature comprise the majority of the Lebanese exports. Such exports increased from USD 935 million in 1997 to around 1,342 million in 2002 posting a CAGR of 7.49 percent over the period.

- Services: Exports of services increased from USD 625 million in 1997 to around USD 710 million in 2002 posting a CAGR of 2.58 percent over the period.

3.3.2 Imports

Table 3.5 below shows Lebanon's imports by sector for the years 1997 until 2002 inclusive:

Table 3.5 Lebanon's Imports by Product in USD Million (1997 – 2002)

	1997		1998		1999		2000		2001		2002	
Agricultural products	478	6.5%	411	6.0%	356	5.8%	326	5.4%	361	5.3%	337	5.2%
Livestock products	196	2.7%	180	2.6%	167	2.7%	159	2.7%	198	2.9%	202	3.1%
Oil products	883	12.0%	665	9.6%	823	13.5%	1,133	18.9%	1,022	15.0%	1,030	16.0%
Food products	831	11.3%	845	12.2%	708	11.6%	646	10.8%	711	10.5%	723	11.2%
Textiles	580	7.9%	582	8.4%	464	7.6%	428	7.1%	559	8.2%	526	8.2%
Non metallic ores	312	4.2%	263	3.8%	226	3.7%	226	3.8%	253	3.7%	239	3.7%
Metals, machinery, equip	2,594	35.2%	2,452	35.5%	1,986	32.5%	1,789	29.9%	2,204	32.4%	1,889	29.4%
Wood, rubber, and chemicals	1,060	14.4%	1,090	15.8%	1,030	16.9%	974	16.3%	1,099	16.2%	1,108	17.2%
Furniture	60	0.8%	64	0.9%	58	0.9%	54	0.9%	63	0.9%	62	1.0%
Other	384	5.2%	353	5.1%	289	4.7%	254	4.2%	329	4.8%	316	4.9%
Total Imports	**7,378**	**100.0%**	**6,905**	**100.0%**	**6,107**	**100.0%**	**5,989**	**100.0%**	**6,799**	**100.0%**	**6,432**	**100.0%**
Change			**-6.4%**		**-11.6%**		**-1.9%**		**13.5%**		**-5.4%**	

Source: Ministry of Trade and Economy, *Lebanon's Economic Accounts 1997 – 2002,* 35.

The Lebanese imports decreased from around USD 7.4 billion in 1997 to around USD 6.4 billion in 2002 posting 2.71 percent compound average decline per annum. Except for the year 2001 that posted 14 percent increase from 2000, imports decreased from 1997 to 2002 at different rates ranging from 2 to 12 percent annually. The Lebanese imports are classified into 7 product categories. Major products (comprise more than 10 percent of total imports) are the following:

- Metals, machinery, and equipment: Imports of metals, machinery, and equipment decreased from USD 2,594 million in 1997 to USD 1,889 million in 2002 (6.15 percent compound average decline per annum). These imports are the most imported products forming around 29.4 percent of the total Lebanese imports in 2002.

- Wood, rubber, and chemicals: Imports of wood, rubber, and chemicals increased from USD 1,060 million in 1997 to USD 1,108 million in 2002 (0.89 percent of CAGR). These imports comprised 17.2 percent of total Lebanese imports in 2002.

- Oil Products: Imports of oil products increased from USD 883 million in 1997 to USD 1,030 million in 2002 (3.13 percent of CAGR). These imports comprised 16 percent of total Lebanese imports in 2002.

- Food Products: Imports of food products decreased from USD 831 million in 1997 to USD 723 million in 2002 (2.75 percent compound average decline per annum). These imports comprised 11.2 percent of total Lebanese imports in 2002.

3.3.3 Trade Deficit

Table 3.6 below shows the Lebanese imports, exports, and trade deficit for the years 1997 until 2002 inclusive:

Table 3.6 Lebanon's Trade Deficit in USD Million (1997 – 2002)

	1997	1998	1999	2000	2001	2002
Imports	7,378	6,905	6,107	5,989	6,799	6,432
Exports	1,776	1,774	1,751	1,707	1,969	2,202
Trade Deficit	**(5,602)**	**(5,131)**	**(4,356)**	**(4,282)**	**(4,830)**	**(4,230)**

Source: Ministry of Trade and Economy, *Lebanon's Economic Accounts 1997 – 2002,* 2: 35 and 51.

Table 3.6 clearly shows the large trade deficit in Lebanon. As Lebanon does not have economically sufficient raw materials to produce and (or) export these products, the country is then obliged to import massively in order to satisfy local consumption. Trade deficit decreased from around USD 5.6 billion to around USD 4.2 billion in 2002.

The condensed imports of consumed products that the Lebanese economy is characterized with are a source of poorness not richness because the value of trade deficit is deducted from the value of domestic product.[5]

The reason behind listing sections 3.3.1 (exports), 3.3.2 (imports), and 3.3.3 (trade deficit) is due to the fact that the balance of imports and exports is an essential part of GDP (Ref. table 3.1 page 18)*. Trade deficit that is represented in GDP as net exports slows down the growth of GDP. Net exports can be positive (if exports > imports), or negative (exports < imports) such as the case in Lebanon. Therefore, the important issue is to generate exports from produced goods and services. This is the economic cycle that starts from investing, producing then consuming and exporting the excess.[6]

* Trade deficit mentioned in table 3.6 is slightly different than table 3.1 because it includes expenses of tourists and expenses abroad.

Therefore, it is concluded that part of GDP slow growth rates is related to trade deficit, which is related to low exports that is related to low production that in turn is related to low investments.

3.4 State Deficit

3.4.1 Budget Preparation

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

The laws governing the budget preparation provide that the proposed budget for each year is prepared by the Ministry of Finance (after review of the estimates prepared by the various Ministries) and submitted to the Council of Ministers by September 1 of the preceding year. The proposed budget, after review by the Council of Ministers, must then be forwarded to Parliament by October 15 for review and approval. The budget is then approved by Parliament, through voting for each article in the budget. Thereafter, pursuing the deliberation, a general session is to be held between October 15 and December 31.

If Parliament fails to approve a budget, the President of the Republic, with the approval of the Prime Minister, must convene a special session of Parliament to be held no later than January 31 of the relevant year. If no budget is approved during the special session, the President of the Republic has the power, after approval of the Council of Ministers, to adopt the budget submitted to Parliament by the Council of Ministers (Articles 86 of the Lebanese constitution and 120 of Parliament internal regulations). Once the budget law is enacted, the Ministry of Finance becomes responsible for its execution.

Prior to fiscal 1997, revenues and expenditures classifications were not done in accordance to international classification standards. Ministry of Finance and in its presentation of the figures related to the said years did not give the proper breakdown of expenditures. However, starting 1998, the government implements an international classification that was set forth by the IMF in its manual of "Government Finance Statistics". Beginning with the 1998 Budget, presentation of fiscal data distinguishes between[7]:

1. Budget, and
2. Treasury operations.

"Treasury revenues" consist primarily of tax and other revenues collected by the Central Government for the account of municipalities and security and other guarantee-type deposits with the Ministry of Finance.

"Treasury expenditures" consist primarily of transfers to municipalities, payments on account of previous years' budgets and financial support to EDL.

3.4.2 State Revenues and Expenditures

Table 3.7 below is the summary of the fiscal performance of the Lebanese government since 1993 until 2004 inclusive:

Table 3.7 State Revenues and Expenditures in USD Million (1993-2004)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total Revenues	1,084	1,361	1,900	2,276	2,458	2,950	3,233	3,164	3,084	3,867	4,414	4,984
Change		25.5%	39.7%	19.8%	8.0%	20.0%	9.6%	-2.1%	-2.5%	25.4%	14.1%	12.9%
Expenditures excluding debt cost	1,573	2,191	2,318	1,930	3,302	3,226	3,018	4,276	3,076	3,598	3,790	4,339
Primary (deficit) / surplus	(489)	(830)	(418)	346	(844)	(276)	215	(1,112)	8	269	624	645
Primary (deficit) / surplus percentage	-27.7%	-26.3%	-11.4%	7.4%	-14.1%	-5.3%	3.8%	-15.8%	0.1%	4.0%	8.9%	9.2%
Total Expenditures	1,763	3,160	3,669	4,655	6,000	5,243	5,609	7,046	5,890	6,726	7,026	6,992
Change		79.2%	16.1%	26.9%	28.9%	-12.6%	7.0%	25.6%	-16.4%	14.2%	4.5%	-0.5%
Total (Deficit) / surplus	**(679)**	**(1,799)**	**(1,769)**	**(2,379)**	**(3,542)**	**(2,292)**	**(2,376)**	**(3,883)**	**(2,806)**	**(2,858)**	**(2,612)**	**(2,008)**
Change		164.9%	-1.7%	34.5%	48.9%	-35.3%	3.7%	63.4%	-27.7%	1.9%	-8.6%	-23.1%
Total (Deficit) / surplus percentage	**-38.5%**	**-56.9%**	**-48.2%**	**-51.1%**	**-59.0%**	**-43.7%**	**-42.4%**	**-55.1%**	**-47.6%**	**-42.5%**	**-37.2%**	**-28.7%**
Cumulative deficit		**(2,478)**	**(4,247)**	**(6,626)**	**(10,168)**	**(12,461)**	**(14,837)**	**(18,719)**	**(21,525)**	**(24,384)**	**(26,996)**	**(29,003)**

Source: Ministry of Finance, *Time Series Public Finance Data,* available from http://www.finance.gov.lb/Data+and+Statistics/Time+Series/; Internet.

Total state revenues increased from USD 1,084 million in 1993 to USD 4,984 million in 2004 posting a CAGR of 14.88 percent over the period. Total state expenditures increased from USD 1,763 million in 1993 to USD 6,992 million in 2004 posting a CAGR of 13.34 percent over the period. State deficit increased from USD 679 million in 1993 to USD 2,007 in 2004 posting a CAGR of 10.35 over the period.

Total state deficit for the years 1993 until 2004 amounted to **USD 2.4 billion** on average per annum. Total state deficit as percentage of total expenditures for the years 1993 until 2004 posted on average **46 percent** per annum.

Public finance performance of the Lebanese government during the years 1993 – 2004 proved the failure of budget decision maker to match expenditures with revenues. As a result, state deficit accumulated yearly to reach ***USD 29,003 million*** end of fiscal year 2004. On parallel, the Lebanese public debt (Ref. table 4.1 page 62) accumulated to reach ***USD 35,609 million*** at end of 2004. Normally, governments in case of deficit resort to: printing money (a matter that is related to a currency value against gold), or borrowing.[8] Hence, this incurred deficit was supported by borrowing. This is the normal economic definition of debt _ what governments spend on expenditures (state expenditures) from borrowing (public debt) rather than taxation (state revenues).

This is obvious with the continuous deterioration of fiscal performance. However, important legitimate question arises concerning the balance of the rest of the public debt. Subtracting 35,609 from 29,003 is **USD 6,606 million**.

Public mismanagement has resulted in a huge accumulated public debt, slow economic growth, weak public institutions and delayed structural reforms. While it has been very effective in maintaining peace and stability (no small accomplishment after 15 years of war), Lebanon's governance structure has proved unable to promote economic and social development in a sustainable manner. Overlapping powers and responsibilities, clientelism and limited accountability and transparency have often resulted in policy paralysis, weak institutional structures in both the public and private sectors and perceptions of high levels of corruption. In the absence of civil service reform, administrative reform and the revamping of control agencies, fiscal, structural and sector reforms are at risk of being unsustainable.[9]

3.4.3 Origins of State Expenditures (1993 – 2004)

Table 3.8 State Expenditures per Ministry in USD Million (1993 – 2004)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	93-04	of total
Presidency of Republic	2	3	2	4	3	2	3	4	6	6	7	3	45	0.1%
Parliament	9	18	19	21	27	20	27	26	28	29	28	29	281	0.4%
Council of Ministers of which	252	569	444	393	580	452	671	531	184	398	411	365	5,250	8.2%
Displaced Fund*	-	49	50	41	42	3	152	137	70	44	48	105	755	1.2%
Council of the South*	29	49	50	41	42	42	14	50	84	103	75	77	836	1.3%
Council for Development and Reconstruction	85	105	55	210	86	156	167	97	188	165	160	164	1,638	2.6%
General Directorate of State Security	5	11	11	12	13	13	16	16	16	16	16	17	162	0.3%
Ministry of Justice	8	13	17	21	20	21	27	25	26	31	30	30	269	0.4%
Ministry of Foreign Affairs	24	40	91	56	54	57	54	57	57	55	52	64	661	1.0%
Ministry of Interior and Municipal Affairs	116	170	170	226	225	224	246	252	246	274	266	269	2,684	4.2%
Ministry of Finance**	9	18	54	345	376	417	542	653	49	51	75	61	2,650	4.2%
Ministry of National Defense	274	388	434	514	493	491	572	559	583	557	538	543	5,946	9.3%
Ministry of Education and Youth, and Sports***	107	217	206	255	348	320	301	326	2	9	7	13	2,111	3.3%
Ministry of Public Health	62	94	101	108	145	147	126	172	166	198	228	229	1,776	2.8%
Ministry of Labor	4	37	40	2	75	3	43	44	4	4	5	39	300	0.5%
Ministry of Information	4	9	138	26	22	22	23	21	17	14	14	18	328	0.5%
Ministry of Public Works and Transportation	58	158	75	239	218	202	126	154	125	156	123	127	1,761	2.8%
Ministry of Agriculture	17	23	9	28	31	35	9	15	15	21	15	27	245	0.4%
Ministry of Trade and Economy	1	2	2	5	3	46	5	16	3	4	4	25	116	0.2%
Ministry of Post and Telecommunications	4	7	28	8	8	7	7	6	7	8	8	8	106	0.2%
Constitutional Council	-	-	-	1	1	1	1	1	1	1	1	1	9	0.0%
Ministry of Energy and Water	15	20	13	45	96	67	71	23	26	44	50	408	878	1.4%

* Allocated amounts each year were extracted from annual budget. Total expensed amount (1993 – 2004) was taken from the Ministry of Finance- Disbursements Department. The sum of each year's budget is different than total amount because of extra expenses during the year that are not included in the budget

** Includes retirement salaries for the years 1996 until 200 inclusive.

*** The Ministry of Education was stemmed from the Ministry of Youth and Sports in 2001.

Table 3.8 – continued	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	93-04	of total
Ministry of Tourism	1	3	9	8	8	6	4	5	5	5	6	9	69	0.1%
Ministry of Industry and Oil****	-	1	28	1	1	2	2	14	1	2	3	5	60	0.1%
Ministry of Housing	13	13	3	12	2	36	2	2	-	-	-	-	83	0.1%
Ministry of Displaced Affairs	0	4	4	5	6	6	3	4	4	4	4	4	48	0.1%
Ministry of Technical Education	7	12	13	20	30	28	22	32	-	-	-	-	164	0.3%
Ministry of Social Affairs	15	23	37	45	59	55	51	65	47	66	61	72	596	0.9%
Ministry of Culture and Higher Education	32	64	66	49	103	132	111	114	465	483	512	573	2,704	4.2%
Ministry of Environment	-	3	2	2	2	3	1	2	1	1	3	3	23	0.0%
Ministry of Education and Fine Arts	-	-	-	-	-	-	-	-	11	13	9	14	47	0.1%
Retirement Salaries	-	-	-	-	-	-	-	-	553	564	560	537	2,214	3.5%
Debt Service	190	969	1,351	2,725	2,698	2,017	2,591	2,770	2,814	3,128	3,236	2,653	27,142	42.6%
Sub total	**1,224**	**2,878**	**3,356**	**5,164**	**5,634**	**4,819**	**5,640**	**5,893**	**5,446**	**6,126**	**6,256**	**6,129**	**58,566**	**91.8%**
Other & Treasury Expenses / (Revenues)*****	539	282	313	-509	366	422	-31	1,153	444	600	770	863	5,212	8.2%
Total	**1,763**	**3,160**	**3,669**	**4,655**	**6,000**	**5,243**	**5,609**	**7,046**	**5,890**	**6,726**	**7,026**	**6,992**	**63,778**	**100.0%**

Source: Compiled from data of the Ministry of Finance *(General Accounting Directorate Files, Annual Public Finance Prospects, and Annual Budgets).*

**** The Ministry of Industry only starting from the fiscal year 2001.

***** Includes transfers to EDL.

Table 3.8 shows total expenditures of the Lebanese state from 1993 until 2004 per each ministry, fund, council, public institution, and debt service. Public deficit came from the money spent on the said public entities. Public debt accumulated from state deficit. Hence, public debt accumulated from figures and expenses of ministries indicated in table 3.8. Table 3.9 below shows major spending categories from 1993 until 2004 inclusive:

Table 3.9 Major Public Spending Categories in USD Million (1993 – 2004)

	1993 – 2004	of total
Debt service	27,142	42.6%
Military and security	8,792	13.8%
Construction	4,990	7.8%
Health and social affairs	2,372	3.7%
Education	4,979	7.8%
Other and treasury expenditures*	5,212	8.2%
Other expenditures	10,280	16.1%
Total	**63,778**	**100.0%**

Source: Table 3.8 page 34.

- **Debt service:** The Lebanese government paid a heavy bill of debt service from 1993 until 2004 amounting to USD 27,142 million. This bill accounted for 42.6 percent of total expenditures for the said period.

- **Military and security**: Military and security services cost was around USD 8,792 million for the period between 1993 until 2004. Military cost accounted for 13.8 percent of total expenditures of the said period (24 percent excluding debt service). This bill was divided into:

    - Ministry of National Defense (USD 5,946 million),
    - Ministry of Interior and Municipal affairs (USD 2,684 million), and
    - General Directorate of State Security (USD 162 million).

* Includes transfers to finance EDL losses.

- **Construction:** After forming the first government in 1992, construction of Beirut and suburbs was launched and total approximate bill amounted to around USD 4,990 million accounting for 7.8 percent of total expenditures for the years 1993 – 2004 (13.6 percent excluding debt service). This bill was divided into:
    - Council for Development and Reconstruction (USD 1,638 million),
    - Ministry of Public Works (USD 1,761 million),
    - Displaced Fund (USD 755 million), and
    - Council of the South (USD 836 million).

- **Health and Social Affairs:** This sector amounted for USD 2,372 million of total expenditures for the period between 1993 and 2004 accounting for 3.7 percent of total expenditures of the said period (6.5 percent excluding debt service). This bill was divided into:
    - Ministry of Public Health: (USD 1,776 million), and
    - Ministry of Social Affairs: (USD 596 million)

- **Education:** Education as other sectors caused the treasury a substantial amount of money in the period between 1993 and 2004 with its total expenses amounting to USD 4,979 million accounting for 7.8 percent of total expenditures of the said period (13.6 percent excluding debt service). This bill was divided into:
    - Ministry of Education and Youth (USD 2,111 million),
    - Ministry of Technical Education (USD 164 million), and
    - Ministry of Culture and Higher Education (USD 2,704 million).

- **Other & Treasury Expenditures:** Such expenditures include but not limited to financing EDL losses, municipalities transfers, and other expenditures. These expenditures amounted to USD 5,212 million for the period between 1993 and 2004 accounting for 8.2 percent of total expenditures of the said period (14.2 percent excluding debt service).

3.4.4 Overview of the Major Ministries

The previous section detailed the government expenditures as per each ministry from 1993 until 2004. This section herewith introduces an overview of the major ministries in Lebanon; this review highlights some aspects of the performance of the public sector that led to a big deficit, deteriorated economy and a huge public debt.

3.4.4.1 Ministry of Trade and Economy

The Ministry of Trade and Economy was established on December 16, 1959 as per the Decree No. 2896. One of the main missions of the ministry is to "draft an overall economic plan" for the country, implement this plan and communicate with public and private institutions to make sure the plan is on the right track. Such plan in the testimony of several professors, journalists, and politicians did not exist and the ministry's role during the previous 15 years was directed towards administrative and other similar activities (Ref. section 3.2.3.1 page 22).

The ministry's actual expenditures for the years 1993 until 2004 were around USD 116 million and it employs around 248 people. *Chapter 5 section 5.4.1 page 125 discusses the future role of the Ministry of Trade and Economy in the overall process of activating the economy, achieving economic growth, and contributing to resolving the huge public debt.*

3.4.4.2 Ministry of Industry

The Ministry of Industry was established on June 2, 1997 as per the Law No. 643. The ministry is responsible of governing the "Lebanese industrial sector", developing and improving it, and issuing and monitoring laws and regulations related to the different issues of industry.

The Lebanese industry suffered gravely during and after war due to the following:

- Lack of governmental care and financial support,
- Increasing costs of raw materials especially energy costs,
- Lack of governmental protection against foreign products and services,
- Narrowing of the domestic and foreign market,
- Failure of the government to provide reasonable fairness in concluded agreements between Lebanon and other countries including Arabian countries.

The ministry's actual expenditures for the years 1993 until 2004 were around USD 60 million. The ministry employs 67 people in its administrative body.

3.4.4.3 Ministry of Labor

The Ministry of Labor was established on December 30, 1961 as per the Decree No. 8352. It should be noted that Ministry of Labor was totally controlled by pro-Syrians throughout the previous 15 years by handling responsibility of managing the ministry to Ministers of a specific political tendency.

Foreigner workers' affairs were not regulated. Most of foreign labor used and still work without a legal residency permit and accordingly no fees were collected from their income. This is an opportunity cost for the Lebanese treasury. Syrian workers, whose average annual count is around 200,000 persons, [10] should be subject to the

Lebanese laws that govern the foreigner workers. As a result, Lebanese educated people had no choice but to leave the country and those who are working locally suffer from unsuitable working environment and low income.

The ministry's actual expenditures for the years 1993 until 2004 were around USD 300 million. The ministry employs 200 people. *Chapter 5 section 5.5 page 140 discusses suggested plans to organize the labor force in Lebanon.*

3.4.4.4 Ministry of National Defense

The ministry consumes around 17 percent (USD 543 million) of the total annual general budget. For the years from 1993 until 2004, total actual expenditures of the ministry amounted to USD 5,946 million. Ministry of defense along with Ministry of Interior and Municipal affairs comprise the basic spending in security in Lebanon.

Number of soldiers volunteered in the Ministry of Defense is estimated around 62,000[11] in different logistic and administrative bodies of the army. Discussing the effectiveness of the output of the ministry is outside the scope of this thesis; therefore, military expenditures in Lebanon will be handled from a general perspective which is related to the inflated public sector size and its burden on the Lebanese treasury not from a security one.

3.4.4.5 Ministry of Interior and Municipal affairs

This ministry is one of the major ministries in Lebanon due to its vital role in providing internal security and organizing the different internal laws. In addition, the ministry handles municipalities' affairs which is also an important issue and integrates all towns and villages in Lebanon. Moreover, the ministry suggests and implements "the electoral law" that applies to Lebanon.

Total ministry's expenditures for the period from 1993 until 2004 amounted to USD 2,684 million. The ministry employs around 18,000[12] volunteers in its various entities. Again discussing the effectiveness and contribution of the ministry in the national economy is outside the scope. However, figures are mentioned to pinpoint the share of this security expense on the treasury.

3.4.4.6 Ministry of Energy and Water

This ministry is of major importance to the Lebanese economy since it includes two utilities: electricity and water. Both utilities should be addressed from the following two perspectives:

a. Economic perspective: Since the availability of electricity and water sectors is vital for different economic fields in the country especially the industry, both utilities should be provided to the public in a manner that reflects reasonable economic prices and equality among all cities and towns in Lebanon.

b. Revenue perspective: Both utilities should in a normal manner generate tremendous amount of money to the government as treasury revenues. Therefore, under normal conditions, the Minister of "Energy and Water" should take into consideration that the responsibility of managing one of the major assets of the government and accordingly operating the ministry should be conducted in a highly professional and productive manner.

Unfortunately, the electricity sector in Lebanon suffered gravely during the previous years and was operated at a high cost. Over and above that, the power is not available on all the Lebanese territories and is only provided for a specified number of hours a day only (Ref. chapter 4 section 4.10.4.1 page 100).

"Lebanon's political elites are so protective of a state enterprise that ranks as one of the world's least profitable companies may seem puzzling to outsiders, but the reason is not difficult to discern. In addition to being the country's primary conduit for electricity, EDL has been a conduit for distributing billions of dollars in kickbacks to pro-Syrian political figures in Lebanon over the last decade. One reason for the short return on EDL is that much of the money was siphoned off by corrupt politicians. More than $500 million ended up in the pockets of leaders, ministers, and entrepreneurs. An even bigger problem is that EDL has been used by political elites to distribute free electricity to their constituents. According to official sources, around 55 percent of EDL bills are not collected. Moreover, around 45 percent of electricity generated by EDL is not even billed - it is estimated that tens of thousands of people get electricity free by illegally tapping into power lines."[13]

Cost of Electricity Sector (1993 – 2004)

As mentioned earlier, expenditures of the government include expenses listed in the *annual budget* and *treasury expenses.*

A. Budget expenses: Expenses listed in the annual budgets of each year are mentioned in table 3.9 page 36 and amount to **USD 878 million*** for the years 1993 until 2004 inclusive.

* Note that part of these expenses covers the water sector also.

B. Treasury Expenditures:* Treasury expenditures are disbursed to cover EDL losses. This money is paid on behalf of EDL according to the following process:

1. EDL concludes loans agreements with parties such as countries and banks to grant the former loans in order to purchase fuel or other equipments, called *concessional loans.*

2. BDL and MOF sign the said loans in order to guarantee the third party rights,

3. When loans mature and EDL can not pay, the Lebanese government endorses decrees to grant EDL money from the treasury to finance the principal and interest cost of the said loans. In addition, the government also endorses decrees to pay for fuel costs after EDL concludes agreements with related countries providing the fuel. The said money is paid directly from MOF to third parties.

The Lebanese government transferred to EDL from the year 1994 until 1999 inclusive the amounts of money listed in table 3.10 below:

Table 3.10 EDL's Deficit in USD Million (1994 – 1999)

	1994-1996	1997	1998	1999	1994-1999
Debt service	419	10	-	91	520
Fuel	377	86	-	.-	464
Other	-	5	5	5	15
Total	**797**	**101**	**5**	**96**	**999**

Source: Rania Ali, Public Debt Department, Ministry of Finance, interview by Nizar Sleem, Riad Solh, 16 March 2006.

* Treasury expenditures are considered by MOF as loans to EDL that should be reimbursed. However, due to the severe loses of EDL; this money is considered as expenses.

The Lebanese government transferred to EDL from the year 2000 until 2004 inclusive the amounts of money listed in table 3.11 below:

Table 3.11 EDL's Deficit in USD Million (2000 – 2004)

	2000	2001	2002	2003	2004	2000 - 2004
Debt service	198	131	202	224	226	981
Fuel	185	40	-	50	100	375
Expropriations	3	17	-	-	-	20
Total	**386**	**188**	**202**	**274**	**382**	**1,432**

Source: Ministry of Finance, *Public Finance Prospects 2000, 2001, 2002, 2003, 2004.*

Total treasury expenditures related to finance EDL losses for the years 1994 until 2004 inclusive amounts to USD 999 million + USD 1,432 million = **USD 2,431 million.**

C. Total Expenditures: Total expenditures (budget and treasury) related to the Ministry of Energy and Water and EDL for the years 1993 until 2004 inclusive amounts to USD 878 million + USD 2,375 million = **USD 3,309 million.**

It should be noted that the possibility of existence of other expenditures for the above period still prevails due to the fact that environment around EDL is vague and thus a fully correct image of the sector cannot be revealed unless a thorough due diligence is conducted.

The Ministry of Energy and Water employs around 231 people in its different administrative bodies. *Electricity of Lebanon establishment is mentioned in chapter 4 section 4.10.4 page 100 and in chapter 5 section 5.3.1.2 page 120 in a privatization plan.*

3.4.4.7 Ministry of Post and Telecommunications

The ministry was established on May 17, 1980 as per the Law No. 11. The ministry manages the "telecommunications" and "postal" sectors in Lebanon and generates a considerable amount of revenue to the treasury annually which amounted to USD 869 million in 2004. The telecommunications sector is considered as one of the major sources of money in the country.

During the previous years, Ministers of the telecom sector were accused of concluding contracts with GSM companies in which they had a stake. Since 1996, two companies (Cellis and Libancell) dominated the mobile sector and managed to make millions of dollars.[14] In addition, mobile cost in Lebanon is the highest in the region. The table below shows a comparison between Lebanon and other countries in the region:

Table 3.12 Cost of Mobile Calls: Lebanon vs. the Region

Country	Rate / minute in USD
Lebanon	0.40
Jordan	0.22
Syria	0.22
Cyprus	0.16
Egypt	0.14
United Arab Emirates	0.13

Source: Alin Halaq, *AlFasad Talk Show,* New Television. NTV, 3 March 2006.

Bottom line is that the government could have earned tremendous amount of revenue from the telecommunications sector if they had managed it in a professional manner. The ministry's budgeted expenditures for the fiscal year 2004 were around USD 8.2 million and it employs around 3,151 people. *The ministry has other potential sources of revenues discussed in the telecommunication sector proposed new services and privatization plan in chapter 5 section 5.3.1.1 page 114.*

3.4.4.8 Ministry of Displaced Affairs

The ministry was established on December 4, 1993 as per the Law No. 190. This ministry was made to fund people who had to leave their homes during the civil war. A considerable amount of money was spent throughout the previous 12 years for its operation. The ministry is responsible for the Displaced Fund, whose expenses for the years 1993 until 2004 inclusive amounted to around **USD 755 million** (Ref. table 3.8 page 34).

Chapter 5 section 5.2.2 page 111 discusses a plan to dismantle the Ministry of Displaced Affairs along with the Displaced Fund and save extra expenditures on the treasury.

3.4.4.9 Other Funds

During the previous 15 years, several funds were a big burden on the Lebanese treasury. Those funds were under the administrative supervision of the Council of Ministers. The funds with major cost on the treasury are:

- The Council of the South Fund, and
- The Council for Development and Reconstruction.

The table below summarizes approximate expenditures of those two funds from 1993 until 2004 inclusive:

Table 3.13 Transfers to Funds in USD Million (1993 – 2004)

Fund	Cost from 1993 - 2004
Council for the South	836
Council for Development and Reconstruction	1,638

Source: Table 3.8 page 34.

The Council of the South was established to support living conditions of people suffered from Israeli occupation.

Chapter 5 section 5.2.2 page 111 discusses a dismantling plan for this fund.

The Council for Reconstruction and Development "CDR" was established in 1977 as per the Decree No. 5 to be the government unit responsible of reconstruction and development. CDR's main functions are:

- Prepare general plan for the country, investment and implementation programs for reconstruction and development projects,
- Mobilize external financing for priority projects within the investment plans,
- Implement projects appointed by the Council of Ministers, and
- Take actions in rehabilitating the public administration and reconstruction of the infrastructure and negotiating foreign financing agreements.

CDR has mobilized over USD 3 billion of external financing mostly from Arab Countries, Europe, and the World Bank. The disbursed funds were designated to sectors including power, health, education, water and waste water, telecommunications, transportations, roads, and highways.

3.4.5 Revenues and Expenditures Analysis for 2003 and 2004

3.4.5.1 Revenues

3.4.5.1.A Tax Revenues

Table 3.14 Tax Government Revenues in USD Million for 2003 and 2004

	2003	of total	2004	of total	change
Tax on Income, Profits and Capital Gains	**519**	**17.4%**	**602**	**17.6%**	**16.0%**
Income Tax on Profits	263	8.8%	277	**8.1%**	5.3%
Income Tax on Wages and Salaries	115	3.8%	106	3.1%	-7.8%
Income Tax on Capital Gains & Dividends	34	1.1%	52	1.5%	52.9%
Tax on Interest Income (5%)	96	3.2%	152	4.4%	58.3%
Penalties on Income Tax	10	0.3%	13	0.4%	30.0%
Other	1	0.0%	2	0.0%	100.0%
Taxes on Property	**213**	**7.1%**	**269**	**7.9%**	**26.3%**
Built Property Tax	54	1.8%	70	2.0%	29.6%
Real Estate Registration Fees	135	4.5%	173	5.1%	28.1%
Other	24	0.8%	26	0.8%	8.3%
Domestic Taxes on Goods & Service	**1,019**	**34.1%**	**1,307**	**38.1%**	**28.3%**
Value Added Tax	903	30.3%	1,169	34.1%	29.5%
Private Car Registration Fees	61	2.0%	72	2.1%	18.0%
Other Taxes on Goods and Services	47	1.6%	54	1.6%	14.9%
Other	8	0.2%	12	0.4%	50.0%
Taxes on International Trade	**1,090**	**36.5%**	**1,072**	**31.3%**	**-1.7%**
Customs	315	10.6%	351	10.2%	11.4%
Excise Petroleum Tax	543	18.2%	427	12.5%	-21.4%
Excise Tobacco Tax	123	4.1%	131	3.8%	6.5%
Excise Tax on Cars	107	3.6%	160	4.7%	49.5%
Other	2	0.0%	3	0.1%	50.0%
Other Tax Revenue (Fiscal Stamp Fees)	**144**	**4.8%**	**178**	**5.2%**	**23.6%**
Total	**2,985**	**100.0%**	**3,428**	**100.0%**	**14.8%**

Source: Ministry of Finance, *Public Finance Prospects for 2004,* 4.

1. Income Tax on Profits:

Income tax on profits collected in 2004 is applied to the profit generated by companies in 2003. The increase in collection of income tax on profits is due to returns to the fact that the economic activity in 2003 improved over the 2002 (nominal growth in 2003 was estimated at 4.3 percent compared to 3.8 percent in 2002).[15]

Income tax on profits in Lebanon is divided into three categories:

- Real profit: This tax is declared and paid on an annual basis and its rate is 15 percent of a company's net income before tax "EBT".
- Estimated profit: This tax is collected every three years and covers small business and shops. No percentage rate applies but a lump sum amount that is calculated by the Income Tax Department randomly based on the estimated income of the taxpayer.
- Lump sum profits: This tax is declared and paid on an annual basis and applies to doctors, lawyers, consultants, and small and medium enterprises. Rates range between 4 to 21 percent. Tax base is the annual turnover of the taxpayer.

2. Income Tax on Salaries and Wages:

Collected income tax on salaries and wages dropped 7.8 percent in 2004 to USD 106 million. As explained by the MOF, the reason was mainly related to change in the schedule of payment of the tax from semi annual to quarterly.[16] Income tax on salaries and wages is declared and paid by employers on a monthly basis. Tax rates are progressive and range from 2 to 20 percent.

3. Tax on Interest Income

Tax on "interest income" generated through deposits or money market tools became effective in February 2003 as per the Law No. 497 in the 2003 Budget Law. The big increase in collection of tax on interest income is related to several factors including increase in customer deposits in 2004 and increase in issuance of securities. In addition, the collection process also improved in 2004. Total collected tax on interest income amounted to USD 152 million in 2004 recording 58.3 percent increase from 2003. The tax on interest income is under the jurisdiction of the MOF.

Deposits in commercial banks local and foreign currency for 2003 and 2004 were as follows:

Table 3.15 Customers' Deposits (2003 – 2004)

	2003	2004
Deposits in USD million	48,726	54,853
Change		12.6%

Source: Banque Du Liban, *Economic and Financial Data: Deposits.*

4. Value Added Tax "VAT"

The Lebanese government initiated "Value Added Tax" on February 1, 2002 as per the law No. 63 dated December 24, 2001. Since initiation, this tax generated a major source of income for the treasury. VAT collection in 2004 amounted to USD 1,169 million recording 29.5 percent increase from 2003.

VAT is a multistage, general, indirect tax on consumption. VAT is charged by a trader on his supply of goods and services. VAT is charged to a trader on his purchase of goods and services. Therefore, a trader recovers VAT but the final consumer cannot recover VAT. The VAT Department in the MOF collects and reimburses the VAT from and to traders.

VAT is collected at the 10 percent rate. Companies with annual turnover exceeding LBP 150 million are obliged to register in VAT. It should be noted that MOF currently is recommending an increase to the VAT rate, a step that is not recommended in this thesis.

5. Custom Duties

Customs' proceeds increased 11.4 percent in 2004 to reach around USD 351 million from USD 315 million in 2003 which was due to increasing in imports. Imports increased from USD 7,168 million in 2003 to USD 9,397 million in 2004 recording 31 percent growth from 2003.

Refer to chapter 5 section 5.3.2 page 120 for analysis regarding the potential future proceeds from custom duties.

6. Petroleum Tax

Background on Energy Sector

Lebanon does not have natural oil resources and is not an energy producer. Lebanon imports all of its needs in terms of petroleum and petroleum derivatives. The country's energy imports consist of diesel, fuel oil, gasoline, kerosene, liquid gas, and asphalt. Major source of imports is Europe. Russia was the single largest source of petroleum products in 2004 accounting for 22.8 percent of Lebanon's energy imports, while the Arab countries supply 20.8 percent the country's needs. Imports of energy amounted to 4.78 million tons (USD 1,239 million) in 2003 and 4.82 million tons in 2004 (USD 1,583 million).[17]

Private sector consumption of energy was equivalent to 3.02 million tons in 2004 and accounted for 62.6 percent of overall demand, with EDL accounting for the remaining 37.4 percent. The structure of energy consumption in Lebanon is as follows:

- Transportation (41 percent),
- Industry (24.6 percent),
- Household (22.9 percent),
- Commercial and public services (2.8 percent), and
- Other (8.7 percent).

Petroleum

Few years ago, the government used a variable scale system to determine fees on gasoline, setting retail prices base on cost of imports, transportation costs, the profit margin of the distributor companies and gas stations. Any rise in international prices resulted in a rise on the final retail price. Hence, due to rise in world crude oil prices over the past two years from USD 31 per barrel in 2003[18] to USD 70 per barrel in 2005,[19] the Ministry of Energy and Water has imposed price ceilings on retail gasoline prices since May 2004. The new fixed scale is composed of a customs fee, excise tax, and VAT, all set at a constant rate. Under the terms of the new gasoline price structure, the government absorbs any rise in import prices by reducing its excise fee.[20]

The Lebanese treasury revenues from petroleum tax for the years 2003 and 2004 were as follows:

Table 3.16 Petroleum Consumption and Tax (2003 – 2004)

	2003	**2004**
Consumption in *Million Liter*	1,000	1,060
Petroleum Tax in *USD Million*	543	427

Source: compiled from data published by the Ministry of Finance, *Public Finance Prospects 2004*, 6.

Despite increase in consumption, petroleum tax decreased in 2004 due to increase in world oil prices.

3.4.5.1.B Non-Tax revenues

Table 3.17 Non Tax Government Revenues in USD Million for 2003 and 2004

	2003	of total	2004	of total	change
Income from Public Institutions	**830**	**72.9%**	**960**	**75.9%**	**15.7%**
Revenues from Casino Du Liban	26	2.3%	28	2.2%	7.7%
Budget Surplus of National Lottery	23	2.0%	25	2.0%	8.7%
Transfer from Telecom Surplus	720	63.3%	869	68.8%	20.7%
Rent of Beirut Airport	38	3.3%	32	2.5%	-15.8%
Other	23	2.0%	6	0.6%	-69.6%
Administrative Fees and Charges	**254**	**22.3%**	**242**	**19.1%**	**-4.7%**
Notary Fees	11	1.0%	11	0.9%	0.0%
Passport Fees	58	5.1%	60	4.7%	3.4%
Vehicle Control Fees	97	8.5%	86	6.8%	-11.3%
Judicial Fees	13	1.1%	13	1.0%	0.0%
Driving License Fees	9	0.8%	10	0.8%	11.1%
Official Gazette	6	0.5%	3	0.2%	-50.0%
Work Permit Fees	27	2.4%	27	2.1%	0.0%
Other	33	2.9%	32	2.5%	-3.0%
Penalties and Confiscations	**4**	**0.4%**	**3**	**0.2%**	**-25.0%**
Other Non-Tax Revenues	**50**	**4.4%**	**59**	**4.6%**	**16.0%**
Total	**1,138**	**100.0%**	**1,264**	**100.0%**	**11.1%**

Source: Ministry of Finance, *Public Finance Prospects for 2004*, 7.

Revenues from the Telecom Sector

The telecommunications sector governed by the Ministry of Post and Telecommunications is the primary source of non tax revenues in Lebanon. USD 869 million (69 percent of total non tax revenues and 19 percent of total state revenues) were generated in 2004 posting 20.7 percent increase from 2003.

Revenues from the telecom sector are divided as follows:

Table 3.18 Telecom Revenues in USD Million (2003 – 2004)

	2003	2004	change
Land lines	468	486	3.8%
Mobile	216	341	57.9%
Other	36	42	16.7%
Total	**720**	**869**	**20.7%**

Source: Compiled from data published by the Ministry of Finance, *Actual and Budget Revenues for 2003 and 2004.*

The major increase in telecom revenues is related to increase in revenues of the mobile sector. This is related to concluding contracts with two new operating companies of the mobile sector in March 2004.

3.4.5.1.C Treasury Receipts

Treasury revenues in 2004 amounted to around USD 292 million. These revenues were generated mainly from municipalities' proceeds, guarantees, and other sources.

3.4.5.2 Expenditures

Table 3.19 Total Government Expenditures in USD Million for 2003 and 2004

	2003	of total	2004	of total	change
Current Expenditures	**5,857**	**83.4%**	**5,342**	**76.4%**	**-8.8%**
Salaries and Wages	1,353	19.3%	1,373	19.6%	1.5%
Retirement and Indemnity	560	8.0%	537	7.7%	-4.1%
Other Personal Benefits	135	1.9%	141	2.0%	4.4%
Interest Payment	3,232	46.0%	2,666	38.1%	-17.5%
Materials and Supplies	80	1.1%	79	1.1%	-1.3%
External Services	55	0.8%	77	1.1%	40.0%
Hospitals	177	2.5%	156	2.2%	-11.9%
Other	41	0.6%	26	0.4%	-36.6%
Reserves	44	0.6%	48	0.7%	9.1%
Other Transfers	180	2.6%	239	3.4%	32.8%
Capital expenditures	**474**	**6.7%**	**541**	**7.7%**	**14.1%**
Acquisitions of Land, Buildings, & Roads	8	0.1%	8	0.1%	0.0%
Equipment	38	0.5%	32	0.5%	-15.8%
Construction in Progress	373	5.3%	428	6.1%	14.7%
Displaced Fund	48	0.7%	105	1.5%	118.8%
Council for Development & Reconstruction	160	2.3%	164	2.3%	2.5%
Council of the South	75	1.1%	77	1.1%	2.7%
Ministry of Public Works	50	0.7%	46	0.7%	-8.0%
Other	40	0.6%	36	0.5%	-10.0%
Maintenance	40	0.6%	40	0.6%	0.0%
Other	15	0.2%	33	0.5%	120.0%
Treasury Expenditures	**672**	**9.6%**	**979**	**14.0%**	**45.7%**
Municipalities	119	1.7%	306	4.4%	157.1%
EDL	274	3.9%	326	4.7%	19.0%
Transfers to Water	0	0.0%	56	0.8%	100.0%
Advance to Diesel Oil Subsidy	0	0.0%	11	0.2%	100.0%
Other	279	4.0%	280	4.0%	0.4%
Unclassified Expenditures	**2**	**0.0%**	**46**	**0.7%**	**2200.0%**
Customs Cashiers	**21**	**0.3%**	**84**	**1.2%**	**300.0%**
Total Expenditures	**7,026**	**100.0%**	**6,992**	**100.0%**	**-0.50%**

Source: Ministry of Finance, *Public Finance Prospects for 2004, 11.*

1. Personnel Costs

The Lebanese government pays annually around USD 2 billion to employees and retirees. In 2004, this amount was distributed as follows:

- Salaries and Wages (USD 1,373 million),
- Retirement and Indemnity (USD 537 million), and
- Other personal benefits (USD 141 million).

This amount includes a major waste because the public sector is non-productive and inefficient. In addition, during the previous 15 years, politicians employed a huge number of people who work without productivity. Around 22 percent of labor force in Lebanon is in the public sector.[21] *Chapter 5 section 5. 2.1 page 107 discusses a plan to cut personal costs.*

2. *Interest Payment*

Debt servicing that amounted to USD 2,666 million decreased 18 percent in 2004 due to funds generated from the Paris II Club that made available to the government loans with average rates between 4 to 5 percent interest. Full details about interest rates are discussed in chapter 4 section 4.2 page 59.

3. *Construction in Progress*

These expenses in 2004 went mainly to the following public entities:

- Displaced fund **(USD 105 million),**
- Council for Development and Reconstruction **(USD 164 million),**
- Council of the South **(USD 77 million)**, and
- Ministry of Public Works **(USD 46 million)**.

4. *Other Treasury Expenditures*

The breakdown of these expenses is spelled as follows:

- Municipalities **(USD 306 million),**
- EDL **(USD 326 million),**
- Transfers to water **(USD 56 million),**
- Transfers to Diesel **(USD 11 million)**, and
- Other **(USD 280 million)**.

3.5 Concluding Remarks

The Lebanese economy for the previous 15 years was deteriorating yearly in a manner that stretched to almost all its sectors that led to actual deficiencies. Real economic growth averaged 3.8 percent per annum. On top of that, the Lebanese government spent billions of dollars annually on a non productive public sector in absence of any incentives to activate the economy. As a result, state deficit accumulated to reach around USD 29 billion from 1993 until end of 2004. To finance its deficit, the government initiated a borrowing scheme that accumulated a huge public debt that amounted to around USD 37 billion end of 2004 (Ref. chapter 4 section 4.2 page 59).

The deficit dilemma that the economy arrived to is due to several flaws of which some of them but not limited to the following:

a. Syrian Occupation: Syrian occupation of Lebanon and the Syrian interference in the political, economic, social, educational, and other aspects of the Lebanese life have led to cumulative deficits, unfruitful spending, and squandering of money by local politicians and officials to support the invasion (Ref. chapter 2 section 2.5 page 12).

b. Political Conflicts: Local Lebanese parties who lived within the context of Syrian tutelage coordinated at different levels with Syrian Officials. In addition, conflicts between the parties led each one to control a specific asset of the government on the account of the general public interest.

c. Corruption: Corruption in Lebanon existed in different shapes and at almost all levels of responsibility. Ministers, deputies, general directors, and ordinary employees were accused of concluding deals that led to improper use of public money.

d. Improper Policies: The economic and monetary policies implemented by the Lebanese government during the previous 15 years failed. On the economic front, low growth rates prevailed and on the monetary front, inflation, interest rates, and unemployment rose (Ref. chapter 4 section 4.8 page 86).

Chapter 4 details the public debt in Lebanon along with its rates, sources, types, and holders. In addition, the said chapter mentions the Lebanese banking sector (both public and private) and its interrelationship with public debt. The chapter also discusses monetary policy, privatization and the stock market in context of public debt.

CHAPTER 4

THE LEBANESE PUBLIC DEBT

4.1 Introduction

In chapter 3, the Lebanese economy was thoroughly analyzed in all its aspects starting from GDP, trade deficit, public finance as well as other related economic and financial matters. This chapter discusses the Lebanese "public debt" in details such as its emergence during the previous fifteen years, its breakdown, interest rates, government's management of the debt, sources and uses of debt and its relation with state deficit. In addition, this chapter handles issues related to public debt such as the banking sector, monetary policy and finally, privatization and its types are briefed hereto.

4.2 Overview of the Lebanese Public Debt

The Lebanese public debt that amounted to approximately **USD 37 billion** by the end of August 2005 is one of the highest in the world in terms of the economic size of the country in relation to GDP. The Lebanese government has chosen debt to finance the galloping deficit (Ref. chapter 3 section 3.4.2 page 32). Thereafter, debt went into an escalating phenomenon and became beyond control with the continuous deficit of the treasury and in absence of economic growth that was stagnated by the prevailing implemented policies then.

"Lebanon's debt dynamics since 1990 are largely explained by the fiscal shortfall accumulated in an effort to rebuild infrastructure after the country's protracted civil war. Massive public investment programs have pushed the government fiscal deficit well into double digits every year for over a decade. While these investment programs might be justified by the extent of devastation after the war, successive governments have been unable to meet budget targets and overruns have been frequent. The reasons are mainly due to the Syrian occupation and the unstable situation in the South of Lebanon. In addition to this situation there is the matter of the hundreds of thousands of Palestinian refugees living in camps."[1]

The following facts prevailed about the status of the Lebanese public debt as of end of August 2005:

- Total public debt amounted to USD 36,480 million, of which USD 18,410 million (51 percent of total) were domestic and USD 18,070 million (49 percent of total) were external (Ref. table 4.1 page 62).
- The annual weighted average cost of domestic debt was around 8.75 percent (Ref. table 4.4 page 65) and annual weighted average cost of external debt was around 7.35 percent (Ref. table 4.7 page 69).
- The majority of "domestic debt" comprised of "treasury bills" issued in Lebanese Lira and is financed by Lebanese commercial banks (45.8 percent), the Central Bank (42.3 percent), and Lebanese Citizens (11.9 percent) (Ref. table 4.3 page 65).
- The majority of "external debt" comprised of Eurobonds issued in US Dollar and in Euros. Around 55.18 percent of external debt were financed locally (local banks and the Central Bank jointly) (Ref. section 4.4.3 page 70).

- Around 71.81 percent of total debt was financed internally by customers' deposits from the local commercial banks (Ref. section 4.7.3 page 85).
- From the year 1993 until 2004 inclusive, the Lebanese government paid around USD 27,142 million to service its debt (Ref. table 3.8 page 34).

Table 4.1 Lebanon's Total Public Debt in USD Million (1993-2005)

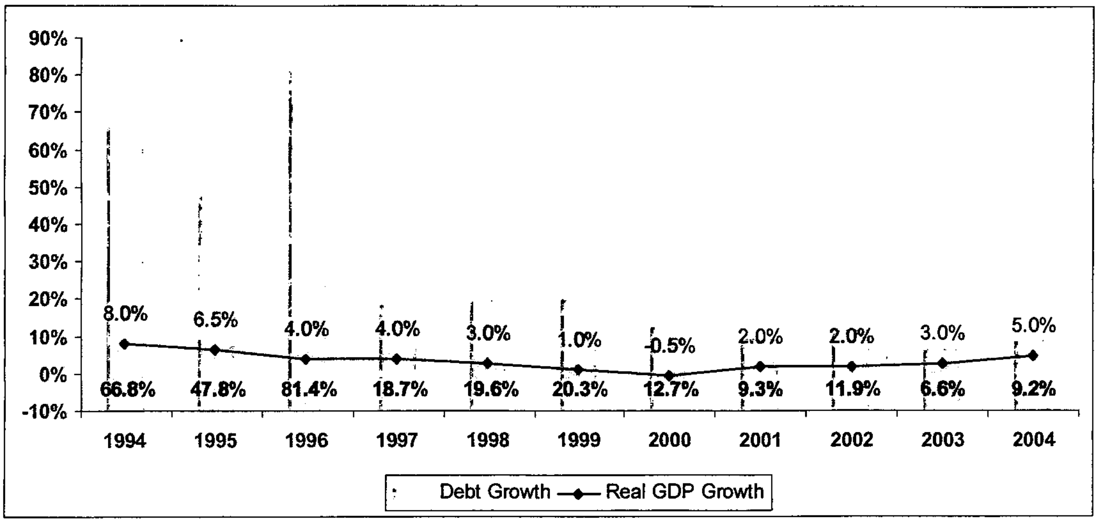
	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Aug-05
Domestic debt	2,475	3,972	5,834	11,110	13,001	14,314	16,766	18,011	17,964	16,277	17,261	17,493	18,410
External debt	429	872	1,324	1,877	2,416	4,126	5,418	6,999	9,384	14,314	15,342	18,116	18,070
Total public debt	**2,904**	**4,844**	**7,158**	**12,987**	**15,417**	**18,440**	**22,184**	**25,010**	**27,348**	**30,591**	**32,603**	**35,609**	**36,480**
Change		66.8%	47.8%	81.4%	18.7%	19.6%	20.3%	12.7%	9.3%	11.9%	6.6%	9.2%	2.4%

Source: Ministry of Finance, online database; available from http://www.finance.gov.lb/Public+Finances/Public+Debt/Public+Debt+Overview/General+Overview+%28end+March+2005%29.htm; Internet.

The above table summarizes the accumulation of the huge Lebanese public debt throughout the previous 13 years. From around USD 3 billion in 1993 to around USD 37 billion in 2005, the debt increased at an accelerating rate (i.e. CAGR of 23.48 percent over the period). The fiscal year 1996 was a milestone because total debt almost doubled from fiscal 1995 (i.e. from USD 7,158 million to USD 12,987 million).

Figure 4.1 below shows real GDP growth versus total debt growth for the years 1994 until 2004 inclusive:

Figure 4.1 Real GDP Growth vs. Total Debt Growth (1994 – 2004)



Source: Bank Audi, *Country and Market Update 2005 - Lebanon*, 40 / Figure 3.1 page 21.

The above figure clearly shows the huge increase in total debt versus the slight increase in gross domestic product. This reflects the inability of the economy to progress with the present country's indebtness and it also indicates that such outstanding debt can not be repaid with the current deteriorated economic situation. Therefore, it is concluded that resolving the Lebanese public debt should pass by serious reforms at the economic level. Such reforms are discussed in chapter 5.

Table 4.2 compares the indebtness of MENA (Middle East North Africa) countries in value and as percentage of GDP for the year 2005.

Table 4.2 Debt of MENA Countries for 2005

	USD billion GDP	*USD* GDP per capita	*USD billion* Public debt	*%* Debt / GDP
Lebanon	19.49	5,100	39.12	200.7*
Israel	139.20	22,200	140.59	101.0
Egypt	337.90	4,400	316.27	93.6
Iraq	94.10	3,400	77.26	82.1
Jordan	27.70	4,800	21.52	77.7
Morocco	139.50	4,300	100.86	72.3
Tunisia	76.91	7,600	45.15	58.7
Saudi Arabia	340.50	12,900	193.06	56.7
Bahrain	14.08	20,500	7.25	51.5
Syria	63.86	3,500	28.74	45.0
Qatar	22.47	26,000	8.25	36.7
Yemen	17.20	800	6.17	35.9
Iran	551.60	8,100	151.69	27.5
Kuwait	51.62	22,100	9.09	17.6
United Arab Emirates	74.51	29,100	13.04	17.5
Algeria	237.00	7,300	35.08	14.8
Libya	48.19	8,400	3.86	8.0
Oman	40.14	13,400	3.01	7.5

Source: World Fact Book; *Country Annual Fact book.*

The above table shows that Lebanon is the most indebted country in the region with total public debt reaching 200 percent of its GDP in 2005. In addition, it is also noted that the second indebted country (Israel) has a debt to GDP ratio of 101 percent. This means that all countries of the region have a debt that is equal or less than the size of their economy, while Lebanon's debt is twice that of its economy.

4.3 Domestic Debt

The Lebanese domestic debt is denominated in local currency. The majority of domestic debt comprises of "Treasury Bills" (TBs) and the balance is "loans" to public entities.

* Note that these figures are estimates. Actual debt / GDP ratio end of 2005 was around 173 percent.

(TBs) are issued by the Lebanese Ministry of Finance (MOF) and underwritten by the Central Bank of Lebanon. The Central Bank not only underwrites MOF but also is a holder of around 40 percent of TBs. The Lebanese commercial banks hold around 45 percent of TBs and Lebanese citizens hold around 11 percent. Table 4.3 shows total domestic public debt by type of holder.

Table 4.3 Lebanon's Domestic Debt by Holder

	USD Million Aug-05	*of total* Aug-05
Central bank	**7,789**	**42.30%**
Treasury bills portfolio	7,490	40.70%
Loans to public entities	299	1.60%
Banks	**8,436**	**45.80%**
Treasury bills	8,400	45.60%
Loans to public entities	35.36	0.20%
Non banks TBs	**2,184**	**11.90%**
Total Gross Domestic Debt	**18,410**	**100.00%**

Source: Banque Du Liban, *Economic and Financial Data: Public Debt.*

4.3.1 Domestic Debt Instrument and Cost

Table 4.4 lists the domestic debt by type of instrument and cost.

Table 4.4 Lebanon's Domestic Debt by Type of Instrument

	USD Million Aug -05	Debt Cost
1. Long term bonds	**14,324**	
over 24 months bonds*	12,353	9.30%
24 months bonds	1,654	8.50%
Coupon interest	317	
Weighted average cost**		**9.20%**
2. Short term bonds	**3,752**	
12 months bonds	2,686	7.20%
6 months bonds	997	7.00%
3 months bonds	69	5.20%
Weighted average cost**		**7.10%**
3. Loans	**334**	
Total Gross domestic debt	**18,410**	**8.75%**

Source: Banque Du Liban, *Economic and Financial Data: Public Debt.*

* The majority of the long-term bills are of 36 months duration. The balance is 48 and 60 months.

** Calculated from outstanding amounts and their related interest cost.

The majority of domestic debt (around 70 percent) is issued with long-term bonds (36 months), and the rest is distributed among 24, 12, 6, and 3 months. All mentioned t-bills are issued in Lebanese Lira.

T-bills for a duration of 24 months and above pay coupon interest of a weighted average of **9.2 percent.** However, short-term bills are zero discounted bills at a weighted average rate of **7.1 percent.** The weighted average cost of total domestic debt as of August 2005 was around **8.75 percent.**

4.3.2 Exposure of Domestic Debt

88.1 percent of domestic debt is borrowed from the Lebanese Central Bank and the Lebanese commercial banks jointly i.e. an amount equal to USD 16,225 million (Ref. table 4.3 page 65). However, it is an important issue to determine the actual "sources" of these funds. Sections 4.7.1 page 83 and 4.7.2 page 84 provide such data.

4.4 External Debt

The external or foreign debt is all debt denominated in foreign currencies and is composed of "Loans" and "Eurobonds".

The majority of the external debt is Eurobonds, whereas the loans are of a bilateral and multilateral nature.

Table 4.5 shows the Lebanese external debt breakdown between loans and Eurobonds from 1993 until August 2005 inclusive.

Table 4.5 Lebanon's External Debt in USD Million (1993-2005)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Aug-05
Contracted loans	**429**	**472**	**624**	**1,077**	**1,375**	**1,627**	**1,733**	**1,739**	**1,771**	**1,830**	**2,580**	**2,664**	**2,519**
Disbursements	126	105	246	488	380	305	290	215	201	164	785	186	65
Principal repayments	42	88	105	21	39	80	131	176	147	180	202	197	92
Commission & charges	22	25	34	50	81	81	87	118	82	92	102	111	62
Eurobonds outstanding	**0**	**406**	**700**	**800**	**1,041**	**2,499**	**3,685**	**5,260**	**7,613**	**12,484**	**12,762**	**15,452**	**15,551**
Issued amount	0	400	300	100	644	1,450	1,251	2,013	2,900	5,892	1,592	5,184	1,750
Principal repayments	0	0	0	0	400	0	0	400	500	1,165	1,479	2,583	1,565
Coupon payment	0	0	41	69	44	88	210	344	551	801	1,055	1,002	645
Commission & charges	0	6	3	1	7	13	9	33	11	4	2	13	6
Total external debt	**429**	**878**	**1,324**	**1,877**	**2,416**	**4,126**	**5,418**	**6,999**	**9,384**	**14,314**	**15,342**	**18,116**	**18,070**
Change		104.7%	50.8%	41.8%	28.7%	70.8%	31.3%	29.2%	34.1%	52.5%	7.2%	18.1%	- 0.3%

Source: Ministry of Finance, *Public Debt.*

The total External Debt increased from USD 429 million in 1993 to USD 18,070 million by the end of August 2005 posting a CAGR of 36.58 over the period. "Contracted Loans" increased from USD 429 million in 1993 to USD 2,519 billion in August 2005 posting a CAGR of 15.89 percent over the period. Contracted loans are of multilateral and bilateral nature. "Eurobonds" that were initiated in 1994 increased from USD 406 million to USD 15,551 million by the end of August 2005 posting a CAGR of 39.29 percent over the period. Eurobonds are issued by MOF, underwrote by investment banks, and are listed on the Luxembourg Stock Exchange.

4.4.1 Contracted Loans

Table 4.6 divides total "Contracted Loans" by type of agreement:

Table 4.6 Lebanon's Contracted Loans in USD Million (August 2005)

Bilateral	Outstanding
Abu Dhabi Fund	11
Agence Francaise du Dev.(AFD)	620
Austrian Government	26
Belgian Government	2
China Government	6
Dexia	
Eximbank	3
Fortis Bank	1
Italian Government	27
Kreditanstalt Fur Wiederaufbau (KFW)	21
Kuwaiti Fund	138
Mediocredito Centrale	14
Natexis Bank	97
Oversea Econ. Coop. Fund (OECF)	27
Saudi Fund	92
Total	**1,085**
Multilateral	
Arab Fund (AFESD)	376
Communaute Econ. Europ. (CEE)	7
Europe Investment Bank (EIB)	332
IBRD	362
IFAD	10
Islamic Development Bank	197
OPEC	14
Total	**1,298**
Private Bank	
BNP-Paribas	46
CIC.et Union Europe	7
Calyon	27
Commerzbank	4
Credit Indust. Et Comm.	1
Rigg National Bank	14
San Paolo	31
Societe Generale	6
Total	**136**
Total Contracted Loans	**2,519**

Source: Ministry of Finance, *Public Debt.*

4.4.2 Eurobonds

Table 4.7 below shows the outstanding "Eurobonds" along with issuance date, issuance price, maturity, coupon rate, and the underwriter:

Table 4.7 Lebanon's Eurobonds in USD Million (August 2005)

Issuance Date	Outstanding	Maturity	Coupon %	Lead Manager
July-2-97	100	July-2-07	7.50	Merrill Lynch
Oct-6-99	330	Oct-6-06	8.88	CSFB – MSDW
Oct-6-99	636	Oct-6-09	10.25	CSFB – MSDW
April-23-01	1,110	April-23-06	9.88	BNP Paribas - ABN Amro
Nov-5-01	400	Nov-5-06	11.63	CSFB
Aug-6-01	750	Aug-6-08	10.13	ML – SSSB
May-15-02	321	May-15-06	10.50	ROL
June-27-02	105	June-26-06	10.50	ROL
August-2-02	641	August-2-06	10.50	ROL
May-20-04	405	May-20-09	7.25	CSFB - BNP Paribas
July-9-04	1,265	March-5-10	7.13	MS – Citigroup
May-20-04	1,000	May-20-11	7.88	CSFB - BNP Paribas
July-9-04	600	July-9-12	7.75	MS – Citigroup
Nov-30-05	625	Nov-30-09	Libor+3.25	CSFB/DB/BLOM
Dec-14-04	425	Dec-14-09	7.00	CSFB/DB/BLOM
June-20-05	250	June-20-13	8.63	CSFB – BLOM
Dec-27-02	950	Dec-27-17	5.00	ROL
Dec-31-02	1,870	Dec-31-17	4.00	ROL
March-7-03	700	March-7-18	5.00	ROL
May-27-03	200	May-27-18	4.00	ROL
Dec-11-04	700	Dec-11-08	6.38	ROL
Dec-11-04	300	Dec-11-10	6.88	ROL
June-20-05	250	June-20-08	7.38	CSFB – BLOM
Nov-5-05	250	Nov-5-08	7.00	ROL
Oct-31-97	369	Oct-31-07	8.63	CSFB – SBC
Feb-25-05	1,000	Feb-25-07	6.50	ROL
Total	**15,551**			

Source: Ministry of Finance, *Eurobonds.*

Coupon rates on the Eurobonds were highly priced due to the ratings of Lebanon which averages approximately 9 percent until the issuance related to Paris Club II. Thereafter, rates dropped considerably to around 7 percent. On average, total annual average cost of Eurobonds was **around 7.35 percent** by the end of August 2005.

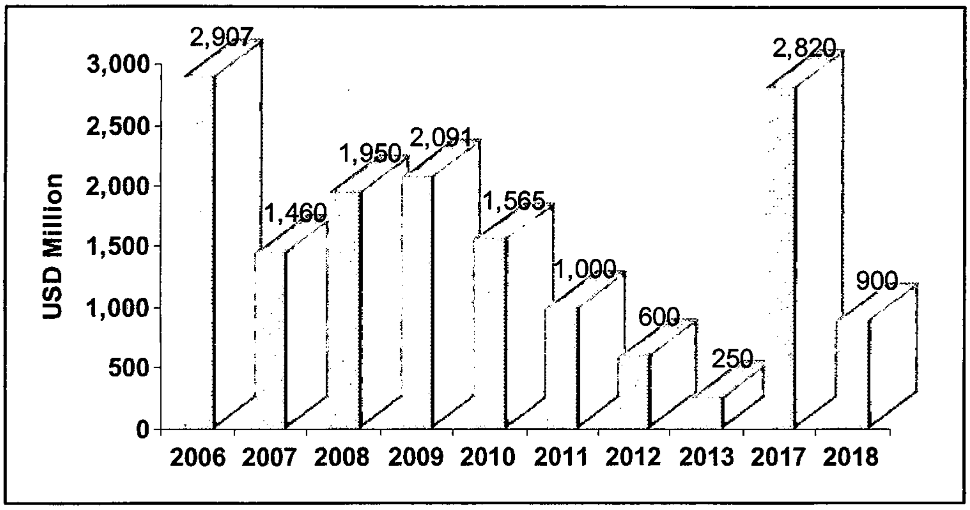
Lebanon's rating by Fitch on November 18, 2005 was as follows:[2]

- Long-term foreign and local currency rating: B minus, and
- Short-term foreign currency rating: B

Fitch defines B rating as "highly speculative."

Figure 4.2 below shows maturities of Eurobonds per year:

Figure 4.2 Maturities of Lebanon's Eurobonds



Source: Table 4.7 page 69.

4.4.3 Exposure of External Debt

55.18 percent of the external debt is financed by the Lebanese banks and the Central Bank of Lebanon jointly i.e. an amount equal to USD 9,971 million (Ref. tables 4.10 page 83 and 4.11 page 84). Sources of these funds are shown in section 4.7 page 83.

Since the Lebanese public debt is interacted in different ways with the Central Bank of Lebanon as well as with the Lebanese commercial banks, its is then imperative to explore the venues of these financial institutions to realize the interaction between them and the overall effect. These institutions are described in the next three sections:

a. The role of the Central Bank (regulatory framework, functions, and figures)

b. The status of commercial banks (regulatory framework and figures)

c. Debt relation between MOF, BDL, and commercial banks.

4.5 Central Bank of Lebanon

4.5.1 Historical Overview

After the departure of the Turkish forces in October 1918, the Lebanese were governed by Britain and France whom in an attempt to organize the economic affairs decided that the Egyptian Pound will be the official currency in Syria and Lebanon. In September 1920, The Bank of Syria was granted the concession of issuing the Syrian currency. On January 23, 1924, a convention was signed between the French, Lebanese, and Syrian governments. In accordance to this convention, the Bank of Syria became the Bank of Syria and Great Lebanon and was the sole issuer of currency for a 15 years period. The currency unit, the Syrian Pound became the Syrian-Lebanese Pound equivalent to 20 FF (French Frank). On May 29, 1937, a new convention was concluded between France and Lebanon for a 25 years period in which a Lebanese Pound is issued in Lebanon, again at the same rate: 20 FF.

In 1941, the FF was pegged against the Sterling (£1 = 8.125831). As a result, the Lebanese Pound was pegged to. On April 1947, Lebanon became a member of the International Monetary Fund and of the World Bank. As a member, a country should set the parity of its currency related to gold or US Dollar. Hence, the parity of the Lebanese Pound was set in gold at:

54.35*0.00746113 = gram 0.405512

and in Dollar terms at:

100:2.19148 = cents:45.6313

On January 24, 1948, Lebanon signed an agreement with France to terminate the Lebanese Pound coverage in French Franc and to have a Lebanese Pound independent of the Syrian Pound. Henceforth, Lebanon created the foreign exchange office to control exchange operations. On August 1, 1963, Lebanon succeeded in establishing a Central Bank. The Banque Du Liban (BDL) became the sole issuer of Lebanese currency which was set then at rate called the "provisional legal rate" of the Lebanese Pound - was to be adopted against the dollar whose rate was set at 0.888671 gram of pure gold.

4.5.2 Role of the Central Bank of Lebanon (BDL)

The BDL is vested by law with the exclusive right to issue the national currency. As stipulated by Article 70 of the Code of Money and Credit, the BDL is entrusted with the general mission of safeguarding the national currency in order to ensure the basis for sustained social and economic growth. This mission consists specifically in:

- The safeguard of monetary and economic stability,
- The safeguard of the soundness of the banking sector,
- The development of money and financial markets,
- The development and regulation of the payment systems and instruments,
- The development and regulation of money transfer operations including electronic transfers,
- Development and regulation of the clearing and settlement operations relative to different financial and payment instruments and marketable bonds.

The BDL is endowed by law, with the prerogatives to fulfill its mission. It can use all measures it deems appropriate to ensure exchange rate stability, specifically the intervention in the foreign exchange market by buying and selling foreign currencies.

The BDL controls bank liquidity by adjusting discount rates, by intervening in the open market, as well as by determining credit facilities to banks and financial institutions *(Refer to Appendix B page 165 for lending and borrowing rates).*

The BDL regulates commercial banks' credit in terms of volume and types of credit, by imposing credit ceiling, by directing credits towards specific purposes or sectors and setting the terms and regulations governing credits in general.

The BDL grants licenses for the establishment of banks, financial institutions, brokerage firms, money dealers, foreign banks, leasing companies and mutual funds in Lebanon. The Banking Control Commission controls and supervises these institutions.

There is a regular coordination between the BDL and the government in order to ensure consistency between BDL's objectives and those of the government. Cooperation with the government implies coordinating the fiscal and monetary policy measures such that the BDL informs the government on economic matters that might negatively affect the national economy and currency and suggests measures that might benefit the balance of payments, the price level, public finance and offers advice on how to promote economic growth.

4.5.3 Balance Sheet of BDL

Table 4.8 below shows the balance sheet of the BDL for 2004 and 2005:

Table 4.8 Banque Du Liban Balance Sheet in USD Million

	Aug-04	of total	Aug-05	of total	change
Assets					
Foreign assets	**14,185**	**54.0%**	**12,858**	**46.7%**	**-9.4%**
Gold	3,769	14.4%	3,983	14.5%	5.7%
Foreign currencies	10,416	39.7%	8,875	32.2%	-14.8%
Claims on private sector	266	1.0%	222	0.8%	-16.5%
Loans to commercial banks	1,271	4.8%	1,236	4.5%	-2.8%
Loans to public sector	301	1.1%	300	1.1%	-0.3%
Securities portfolio	8,194	31.2%	9,721	35.3%	18.6%
Fixed assets	223	0.8%	303	1.1%	35.9%
Unclassified assets	1,813	6.9%	2,913	10.6%	60.7%
Total	**26,253**	**100.0%**	**27,553**	**100.0%**	**5.0%**
Liabilities					
Currency in circulation	1,183	4.5%	1,114	4.0%	-5.8%
Commercial banks deposits	**19,770**	**75.3%**	**18,519**	**67.2%**	**-6.3%**
Specialized banks and financial	731	2.8%	832	3.0%	13.8%
Private sector deposits	28	0.1%	40	0.1%	42.9%
Public sector accounts	1,364	5.2%	1,821	6.6%	33.5%
Valuation adjustment	0	0.0%	175	0.6%	100.0%
Foreign liabilities	139	0.5%	132	0.5%	-5.0%
Special long term liabilities	764	2.9%	413	1.5%	-45.9%
Securities other than shares	0	0.0%	2,000	7.3%	100.0%
Capital accounts	1,200	4.6%	1,180	4.3%	-1.7%
Unclassified liabilities	1,074	4.1%	1,327	4.8%	23.6%
Total	**26,253**	**100.0%**	**27,553**	**100.0%**	**5.0%**

Source: Banque Du Liban, *Monthly Bulletin August 2005.*

A thorough and detailed breakdown of the assets and liabilities of the BDL was not possible due to lack of disclosure of information at the Lebanese governmental level.

However, a meeting with Ms. Layla Kazma, the deputy of the Director of the Financial Operations in the BDL provided a notion of the aforementioned breakdown that is defined below as follows:

1. Assets (2004)

⇒ Foreign assets are composed of gold (14.5 percent of total assets) and foreign currencies (32.2 percent of total assets).

⇒ Claims on private sector are loans to private institutions and represent around 1 percent of total assets.

⇒ Loans to commercial banks represent around 4.5 percent of total assets.

⇒ Loans to the public sector are mainly loans provided to finance expenses of EDL for fuel and other purchases.

⇒ Securities portfolio represents the major asset of the bank (Refer to section 4.7.2 page 84).

⇒ Fixed assets of the bank are related to different buildings and other properties directly owned or are mortgaged or managed by the bank.

⇒ Finally, 10.6 percent of the assets are classified as unclassified assets.

2. Liabilities (2004)

The major component of the Central Bank's liabilities is what its accounting department classifies as "deposits from commercial banks", that amount to USD 18,519 million (67.2 percent of total assets). These deposits are very important because they represent a portion of the total deposits that the commercial banks hold (refer to section 4.7.3 page 85).

Reserve requirements on deposits are specified at the rate of 15 to 25 percent. The BDL holds on its liabilities USD 18,519 million as reserve requirements from commercial banks. However, total deposits in commercial banks by the end of August 2005 were around USD 55 billion (Ref. table 4.9 page 82). Therefore, total reserve requirements according to the law should not exceed USD 10 billion. Therefore, the balance should then be related to the following:

1. In 2002, the BDL issued a 2 year period law urging commercial banks to deposit in addition to the reserve requirements 10 percent of customers' deposits at zero rated CDs and TBs.

2. At end of 2004, the above mentioned law ended, however, deposits remained at same level because commercial banks are supporting the BDL's monetary policy.

4.6 Lebanese Banks

4.6.1 Overview of the Lebanese Banks

As at June 2005, 64 banks, 7 representative offices, and more than 800 branches officially operate in Lebanon.[3] The banks are classified based on the size of deposits. Accordingly, banks are divided into four categories with the following specifications:

- Alpha group: includes banks with deposits over USD 2 billion,
- Beta group: includes banks with deposits between USD 500 million and USD 2 billion,
- Gamma group: includes banks with deposits between USD 200 million and USD 500 million, and
- Delta group: includes banks with deposits under USD 200 million.

Appendix C page 166 lists banks' names, groups, and figures.

4.6.2 Regulatory Framework

Banking activities in Lebanon are governed by the Code of Commerce (1942) and by the Code of Money and Credit (1963) as well as by their successive amendments. The banking (1956) and the laws for bank merger (1993) and fiduciary contracts (1998) represent important supplements to the legal framework. Banking regulation and supervision is set out by the Central Bank of Lebanon and the Banking Control Commission, which has the responsibility to supervise banking activities and ensure compliance with regulations and legislations.

The Central Bank of Lebanon issues licenses for local branches and branches of foreign banks and is engaged in determination of rules and regulations, notably these related to prudential ratios and sound management. The Banking Control Commission has the responsibility to supervise the functions and operations of the commercial banks and to ensure the banks' adherence to the principal applied rules and regulations. The Banking Control Commission undertakes both off-site reviews and on-site examination to assess compliance with regulations, reliability of bank reporting, and levels of liquidity, capital adequacy and lending to deposit ratios.

The on-site control is done twice a year and covers generally the following:

- Financial operations and management performance,
- The respect of the institution to its prudential ratios and management standards,
- The financial standing of the bank, transparency and integrity of accounts,
- The asset quality and the provisioning level.

The off-site control complements the on-site control and covers the following:

- Analysis of reports submitted by banks,
- Control of the banks' compliance with the directives of the Banking Control Commission,
- Revision of the Auditors' reports on the banks' accounts,
- Study of banks' reports on the opening of new branches,
- Control of foreign currency operations and foreign exchange positions.

The reports of auditors are analyzed in detail. The Banking Control Commission and the Central Council of the Central Bank of Lebanon headed by the Central Bank Governor and including the Banking Control Commission can take sanctions against the auditors and impose their replacement. Banks submit periodic statements to the Central Bank of Lebanon, including reports on daily foreign exchange positions, weekly reports on the portfolio of treasury bills, monthly reports on customers' deposits and inter-bank deposits. Audited financial statements are also required. The Banking Control Commission produces reports on the profitability of banks in order to assess eventual anomalies and take the required corrective measures. Concerning doubtful debt, the Banking and Control Commission considers a deferral of 90 days in the payment of interest as good classification measurement. It has to approve all provision suggestion on behalf of the concerned bank in order for the latter to be not exposed. The examination of loan portfolio is accordingly comprehensive and covers in most of the cases 90 percent of outstanding credits.

The Banking and Control Commission has thus wide control powers. It has the duty to permanently inform the Central Council on the status of operating banks. It is also required to defer to the Central Council any bank that is not in line with applied regulation. Disciplinary measures are then taken by the Central Council ranging from a simple advice to the replacement of a director The Central Council has the authority to withdraw a license from and delete a bank from the Central Bank of Lebanon's official list. The decisions of the Central Council are final and irrevocable.

4.6.3 Prudential Rules and Regulations

The banking industry is regulated by the Central Bank of Lebanon which imposes on banks a series of prudential rules related to liquidity, capital adequacy, asset quality, and profitability.

Liquidity Requirements

Required reserves are:

- 15 percent on L.L. time deposits,
- 25 percent on L.L. demand deposits, and
- 15 percent on foreign currency deposits.

Lending limits are imposed on foreign currency loans. The ratio foreign currency loans to foreign currency deposits shall not exceed 70 percent.

Capital Adequacy

From March 1995, all commercial banks were required to meet a minimum risk adjusted capital to asset ratio of 8 percent in line with the guidelines of the Committee of Banking Regulation and Supervisory Practices of the Bank for International Settlements (The Basle Agreement). A more recent circular issued by the Central Bank of Lebanon (1999) raises the ratio to 12 percent in two steps (10 percent at end of year 2000 and 12 percent at end of year 2001). The aim is to push under-capitalized banks to merge with other banks. Since end of 2001, the average capital adequacy ratio in the Lebanese banking sector stood at around 19 percent.

Risk Diversification

a. Related party transactions: Advances and credit facilities to directors, managers, and companies having common directors with the bank should not exceed 10 percent of shareholders' equity.

b. Advances and loans: The maximum allowable credit limit to a single borrower is 20 percent of bank's shareholders' equity or 10 percent of its shareholders' equity plus 1 percent of its deposits whichever is the lower (Article 152 of the Code of Money and Credit).

c. Working capital: The bank's fixed assets as well as the participation share and the equity portfolios cannot exceed at any time the value of shareholders' net of deficits in provisions and eventual goodwill. (Article 153 of the Code of Money and Credit).

Asset Quality

a. Provisions for doubtful debt: A circular issued in 1998 obliges banks to classify their credits in five categories. As per the Central Bank Circular No. 58 dated November 10, 1998, the five loans categories are the following:

    1. Normal debt: Principal and interest payments are collected on schedule.
    2. Debt for follow up: Is debt that includes gaps such as an unqualified collateral, and violations of due dates.
    3. Under normal debt: Is debt that its returns have deteriorated considerably, its mortgages have declined in value, and its principal has not been paid often.

4. Doubtful debt: Is characterized with same conditions mentioned in "3" but with higher risk. In addition, deposits in this account has been ceased during six month and due payments of the rescheduled debt have not been paid during three months.
5. Bad debt: Is characterized with same conditions mentioned in "4" next to the inability of the debtor to repay any of his/her obligations.

b. Provisions for general risks: Since 1996, banks are required to constitute an annual provision for general banking risk amounting to 0.2 percent of risk weighted assets. This reserve is included in Tier 1 capital.

c. Foreign exchange position: Propriety foreign exchange trading against Lebanese Pounds is restricted by the Central Bank of Lebanon, in terms of daily closing position market to market, to 1 percent of the bank's shareholders' equity.

d. Provision for foreign exchange position: Banks are required to provision 5 percent of their overall position at each end of period (i.e. take a provision that is equal to 5 percent of their portfolio value).

e. Branch opening: The Central Bank of Lebanon restricts new branch openings to two per annum to control the expansion of banks and its impact on operating conditions.

4.6.4 Balance Sheet of all Banks

Table 4.9 shows consolidated assets and liabilities of all banks in USD Million:

Table 4.9 Consolidated Balance Sheet of Lebanese Commercial Banks in USD Million

	Aug-04	of total	Aug-05	of total	change
Assets					
Reserves	**20,046**	**31.3%**	**20,146**	**30.0%**	**0.5%**
Vault cash	147	0.2%	155	0.2%	5.4%
Deposits at Central Bank	19,899	31.1%	19,993	29.7%	0.5%
Claims on private sector	**15,605**	**24.4%**	**15,852**	**23.6%**	**1.6%**
In Lebanese pounds	2,780	4.3%	2,880	4.3%	3.6%
In foreign currencies	12,825	20.0%	12,972	19.3%	1.1%
Claims on public sector	**14,889**	**23.3%**	**16,475**	**24.5%**	**10.7%**
Claims on foreign sector	11,067	17.3%	12,116	18.0%	9.5%
Fixed assets	2,011	3.1%	2,254	3.4%	12.1%
Unclassified assets	408	0.6%	393	0.6%	-3.7%
Total	**64,026**	**100.0%**	**67,236**	**100.0%**	**5.0%**
Liabilities					
Resident private sector deposits	**43,570**	**68.1%**	**45,708**	**68.0%**	**4.9%**
Demand deposits in L.L.	976	1.5%	934	1.4%	-4.3%
Time and saving deposits in L.L.	15,134	23.6%	12,876	19.2%	-14.9%
Deposits in foreign currencies	27,460	42.9%	31,898	47.4%	16.2%
Non-resident private sector deposits	8,673	13.5%	8,753	13.0%	0.9%
Total Deposits	**52,243**	**81.6%**	**54,461**	**81.0%**	**4.2%**
Public sector deposits	809	1.3%	967	1.4%	19.5%
Non-resident financial sector deposits	1,656	2.6%	1,705	2.5%	3.0%
Other financial liabilities	44	0.1%	105	0.2%	138.6%
Capital accounts	3,932	6.1%	3,820	5.7%	-2.8%
Unclassified liabilities	5,342	8.3%	6,178	9.2%	15.6%
Total	**64,026**	**100.0%**	**67,236**	**100.0%**	**5.0%**

Source: Banque Du Liban, *Monthly Bulletin August 2005.*

Refer to Appendix D page 170 for detailed consolidated balance sheets and income statements of all commercial banks for the years 2003 and 2004 as well as detailed analysis regarding profitability, liquidity, and solvency.

4.7 Interrelationship between MOF (Debt), Lebanese Banks, and the BDL

This section highlights the sources of financing the Lebanese public debt and the correlation between the Ministry of Finance (i.e. the Lebanese government) on the one hand and the Lebanese banks and Central Bank of Lebanon on the other.

4.7.1 Lebanese Commercial Banks

The accounts that are obtained from the consolidated balance sheets of commercial banks below shows the portion of public debt financed by commercial banks (asset side) and the source of these funds (liabilities side).

All amounts are in USD million

Assets		Liabilities	
Claims on Government	16,475*	Customers' Deposits	54,461**

Customers' deposits that form around 280 percent of GDP are under management of commercial banks. In turn, commercial banks lent out USD 16,475 million of these deposits to the Lebanese government i.e. 30.3 percent of total customers' deposits. Recalling from table 4.1 page 62, total public debt as of end of August 2005 was USD 36,480 million.

Table 4.10 Exposure of Lebanese Banks (August 2005)

All amounts are in USD million except when mentioned

		Lebanese banks' exposure	of total
Domestic debt	18,410	8,436	45.82%
External debt	18,070	8,039	44.49%
Total public debt	**36,480**	**16,475**	**45.16%**

* USD 8,436 million of domestic debt (Ref. table 4.3 page 65) and USD 8,039 million of Eurobonds stock.

** Ref. table 4.9 page 82.

Therefore, 45.16 percent of the Lebanese public debt is financed by commercial banks.... Fact No. 1.

4.7.2 Central Bank of Lebanon

The accounts below show the portion of public debt financed by the Central Bank of Lebanon (asset side) and the source of these funds (liabilities side).

All amounts are in USD million

Assets		Liabilities	
Securities Portfolio	9,721*	Commercial Banks' Deposits	18,519**

Securities portfolio of the BDL is mostly of "treasury bills." This amount is financed by commercial banks' deposits which are basically the "reserve requirements" that are placed at the BDL against customers' deposits in the banks i.e. reflecting a 52.5 percent ratio of utilization of the commercial banks' reserves.

Recalling from table 4.1 page 62, total public debt as of end of August 2005 was USD 36,480 million.

Table 4.11 Exposure of Central Bank of Lebanon (August 2005)

All amounts are in USD million except when mentioned

		Central Bank's exposure	of total
Domestic debt	18,410	7,789	42.31%
External debt	18,070	1,932	10.69%
Total public debt	**36,480**	**9,721**	**26.65%**

Therefore, 26.65 percent of the Lebanese public debt is financed by the Central Bank .... Fact No. 2

* Ref. table 4.8 page 74.

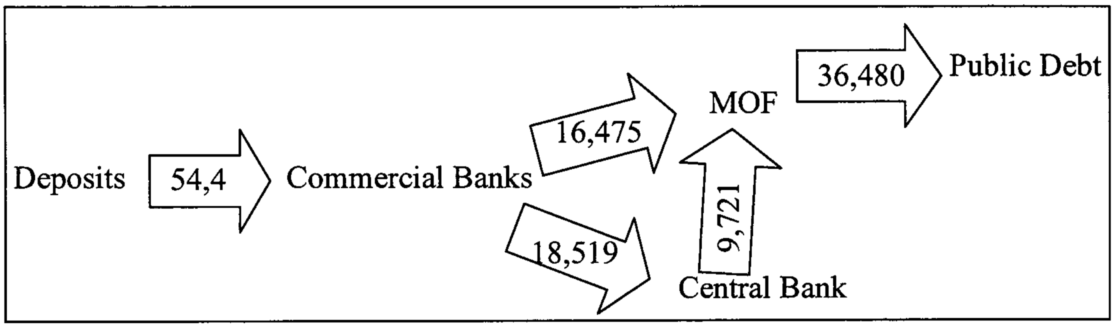
** Ref. table 4.8 page 74.

4.7.3 Customers' Deposits

Customers' deposits that amounted to USD 54,461 million by the end of August 2005 constitute the essence of source of funds to finance the Lebanese public debt. Reclassifying the previous figures concludes the following:

71.81 percent of the Lebanese public debt is financed from customers' deposits (45.16 percent via commercial banks and 26.65 percent via the Central Bank of Lebanon)…. Fact No. 3

The figure below illustrates the path of money form the Lebanese citizens to MOF:



It is concluded from the above figure that the Lebanese government is mainly indebted to the Lebanese people and its commercial banks who bear the big exposure with its money being held as a fiduciary in the form of deposits to be lent out to a paralyzed government that rolls up its debt year after year through claimed swap operations.

This chapter so far discussed the trend of Lebanese public debt, its break down, cost, type, maturities, as well as the interrelation with the Lebanese banking sector (both public and private). The rest of this chapter discusses three major issues:

a. Monetary policy and its impact on economic conditions,

b. The Lebanese stock market, and

c. Current privatization framework.

4.8 Monetary policy

Monetary policy – the governments' decisions as to how much money to supply the economy – is the primary function of modern day central banks. It is one of the two principle tools available for affecting macroeconomic behavior. Monetary policy is conducted by the nation's Central Bank, which has at its disposal a number of policy instruments for this purpose. These instruments can affect certain intermediate targets (such as reserves, money supply and interest rates) in order to help achieve the ultimate objectives of a healthy economy – growth in output, low unemployment, low inflation and a satisfactory balance of payments.[4]

In Lebanon, the monetary policy has been based on fixation of the Lebanese Lira whereby the Central Bank used to liquidate "Borrowed Funds" from the Reserves of the market for that purpose. This policy has proven its failure within the deteriorated economy and the huge increase in public debt for the previous years. The Central Bank is implementing a pegged exchange rate that required maintaining a tightened monetary policy that in turn led to decrease in money supply and increase in interest rates. The cost of pegging the Lebanese Lira to the US Dollar has been high interest rates, the loss of competitiveness, and the appreciation in value of public debt.[5] *Refer to Appendix E page 175 for Money Supply and Counterparts Figures.*

"The alarming financial position that Lebanon has reached was a result of economic, fiscal, and monetary mistakes from 1992 through linking interest rates with the fixation of exchange rate instead of economic growth in a real monetary policy where the Central Bank plays a supervisory role. This policy has accumulated the huge public debt."[6]

Interest rates that increased as high as 30 percent in 1992 and 11 percent in 2001 were depressive policy to the Lebanese economy is several manners. Debt service bill assumed by the treasury increased which thus directly increased the state deficit. *Refer to Appendix F page 176 for interest rates on treasury bills.*

High interest rates discouraged investments in private projects that normally and under normal conditions are the activators of economic growth. Instead, holders of LL deposited money in banks and with the government in the form of treasury bills. From its perspective, the government used the money to finance its huge debt service and to finance the construction and other non productive public projects as well as to specifically support the severe losses in the electricity sector. All this occurred on the account of the Lebanese economy that witnessed very slow growth in the previous years at an average of around 3.8 percent per annum from the year 1994 until 2004 inclusive.

The monetary policy stipulated by the Central Bank of Lebanon is based on a number of issues that showed unsuccessfulness before and after Paris Club II including[7]:

- Fixation of the Lebanese Lira rate versus the US Dollar,

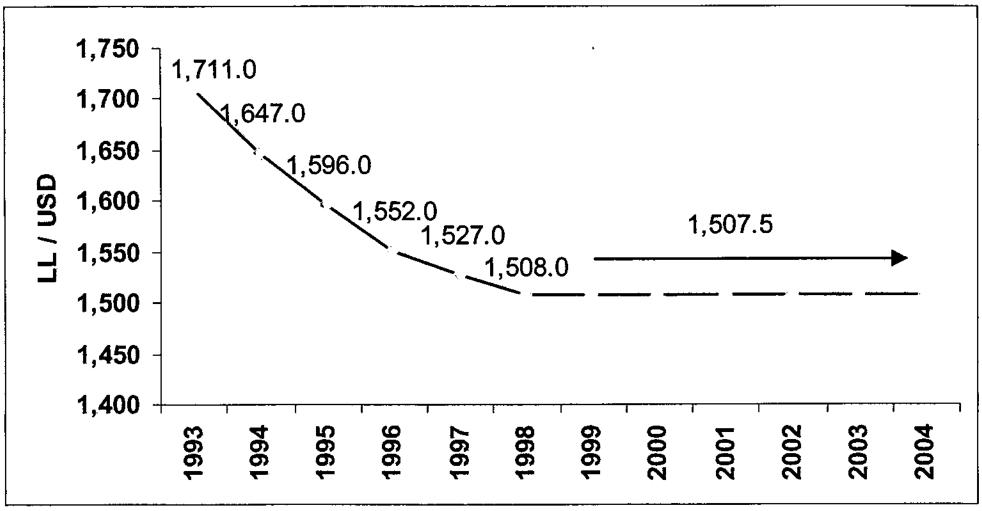
- Reliance on the Lebanese banks to support the deficit of government by lending the Central Bank at zero coupon rates,
- Counting on the international community to support Lebanon wave its public debt (such as Paris II Club),
- Conducting reform through **only** privatizing some of publicly owned companies (telecommunication and electricity).

The above directions proved to fail and nothing was left except empty slogans of officials at the government. Lot of talk was broadcasted about the solid financial policy! the investments coming forth to Lebanon! the economic growth! Nothing of the above was achieved.

a. Fixation of the Lebanese Lira: Exchange rate should be determined by the supply and demand of funds within the context of a natural economy and not by fixation. This policy proved counter productive in different Latin American Countries such as Argentina when the Peso plunged after several years of fixation. By then, the Argentinean economy and its financial system collapsed.

   It should be noted that in Lebanon, the situation is similar somehow to that in Argentina with an exception; **ratio of debt to GDP** in Lebanon exceeds the ratio that was prevailing in Argentina prior to its collapse. This signal is serious and raises doubts about the future and direction of the Lebanese economy.

Figure 4.3 Lebanese Pound Exchange Rate



Source: Bank Audi, *Country and Market Update 2005 - Lebanon*, 103.

b. Reliance on Lebanese Banks: Reliance on commercial banks' deposits in the Central Bank to finance the government deficit led to lack of available funds that would have been utilized to enhance the economy through the private sector. The private sector on the other hand and as evidenced in table 3.1 page 18 is the driving force that activates the economy. Hence, when the squeeze in funds has been enforced by the issuance of the TBs and the policy of the BDL, the aftereffect is then recession.

Commercial banks' deposits in the Central Bank in the form of reserve requirement comprised around 30 percent of their total assets end of August 2005 and around 100 percent of GDP, while loans to customers comprised only around 24 percent of banks' assets. This policy has frozen the money and led to lack in investments thus resulting in forming a stagnated economy.

c. International Community Support: International community represented by the International Monetary Fund "IMF" and the World Bank has shown intentions to help Lebanon, but the international community is not a Non Profit

Organization and therefore, these anticipated assistances are further costs to the economy. Needless to say, these organizations will help Lebanon only if the Lebanese government executed required reform plans noted in chapter 5. Therefore, counting on the international community to waive the Lebanese public debt is neither an easy way out of the debt nor applicable under the present political circumstances.

d. Privatization: Again, privatization should be performed parallel to a reform agenda and plan recognized by the international financial world that will be willing to invest in Lebanon under a reliable law and regulation protected by the legislative body. However, privatizing the government assets to finance its deficit is not a solid policy because privatization proceeds will dissolve very soon within the huge continuous state deficit. Therefore, privatization should be conducted in the context of an overall reform policy.

4.9 The Lebanese Stock Market

4.9.1 Regulatory Framework

The Beirut Stock Exchange is the official and only exchange in Lebanon. It was established on September 16, 1983 by the legislative Decree No. 120. The BSE operates under the direction of the Stock Exchange Committee, and under the supervision of the Ministry of Finance. The Stock Exchange Committee is formed from a Chairman, a Vice-Chairman and eight members appointed by virtue of a decree issued by the Council of Ministers, in accordance with a proposal by the Minister of Finance.

The Committee's mandate is of four years duration. Main functions of the committee are:

- Audit at any time the internal records and accounts of the Stock Exchange, and request any related clarifications, explanations, or documents,
- Participate with the Chairman in the preparation of the draft budget of the following fiscal year, and the quarterly accounts and the draft balance sheet and accounts of the previous fiscal year,
- Protecting the interest of the investors trading at the Stock Exchange,
- Monitoring the activities of the issuing companies, and providing information to the issuers and traders at the Stock Exchange on an equal footing, and
- In general, supervise all financial issues.

4.9.2 Registering Companies

In order for a company to register in BSE, it should meet the following conditions:

- It should have distributed at least 25 percent of its capital to the public, on the first day of pricing at the latest,
- Its capital is the equivalent of at least USD 3 million in Lebanese pounds,
- The number of shareholders holding 25 percent of the company's capital should be at least 50 shareholders, and
- It should have been incorporated at least three years earlier.

4.9.3 Listed Companies

Table 4.12 shows listed companies at BSE, type of shares, price and number of shares as well as market capitalization as of December 31, 2005.

Table 4.12 Listed Companies at BSE

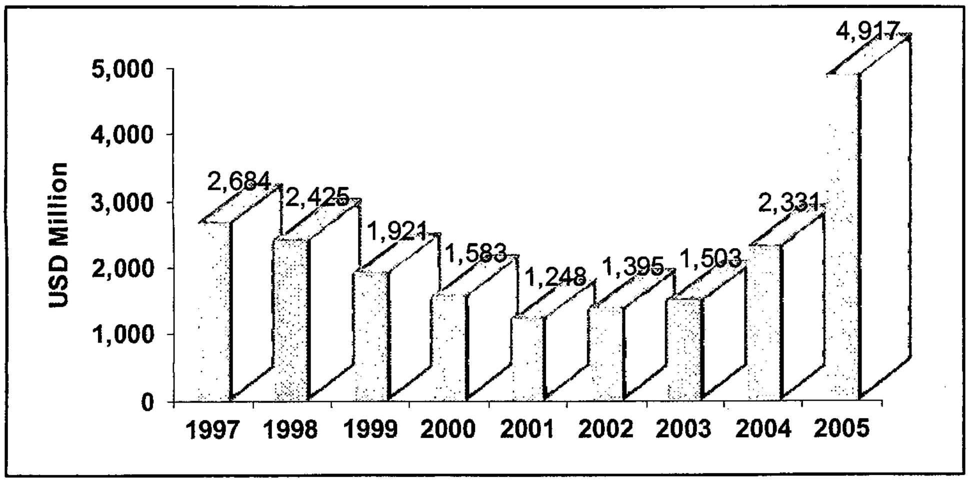
Industry	Type	Share Price	No. of Shares	Market Cap
		USD	*Million*	*USD Million*
Development & Reconstruction				
Solidere	A	17.98	100	1,798
Solidere	B	17.98	65	1,169
Banking				
BLC Bank	Common Shares	7.01	14	96
Bank Audi	GDR	59.85	6	371
Bank of Beirut	Common Shares	9.9	14	134
Bank of Beirut	Preferred Callable B	12.1	3	36
Bank of Beirut	Preferred Callable C	25	3	73
Byblos Bank	Common Shares	2.36	68	161
Byblos Bank	Preferred Callable	111	0	37
Byblos Bank	Priority	2.3	69	158
BEMO Bank	Common Shares	3.5	5	19
BLOM Bank	GDR	66.5	4	292
Investment Funds				
Beirut Interbank Fund		107	0.2	21
Beirut Global Income		105.2	0.34	36
Beirut Lira Fund *LBP*		108,500	0.28	29,838
Beirut Global Income *LBP*		111,700	0.41	45,797
Trading				
Rasamny Younis Motor Co.	B	1.12	10	11
Industrial				
Holcim Liban		1.8	234	422
Ciments Blancs	Bearer	1.25	6	8
Ciments Blanks	Nominal	1.5	3	5
Uniceramic	Bearer	1.75	9	15
Uniceramic	Nominal	1.4	4.29	6
Total Capitalization *USD billion*				**4,917**

Source: Beirut Stock Exchange, *Facts and Figures Bulletin 2005.*

4.9.4 Market Cap and Traded Value

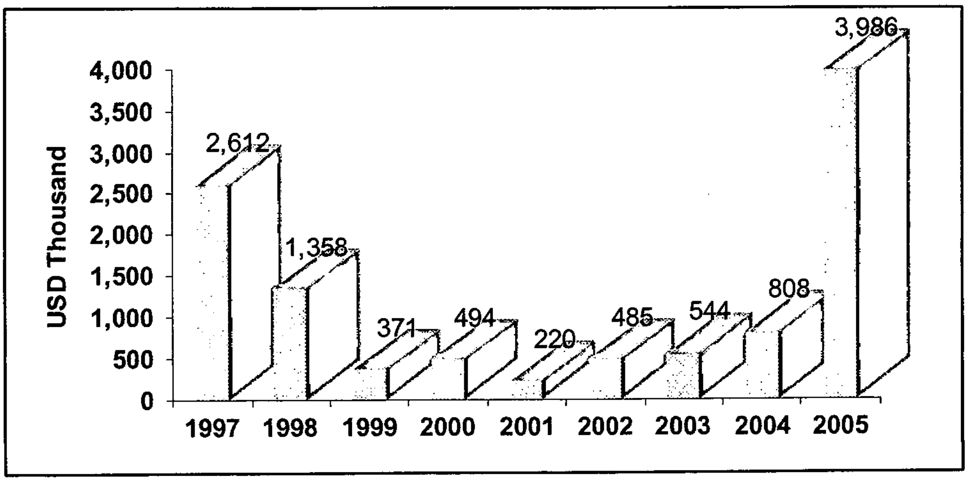
The two figures below show market cap and average traded value of shares at BSE for the years 1997 until 2005 inclusive:

Figure 4.4 Market Cap at BSE (1997 – 2005)



Source: Beirut Stock Exchange, *Facts and Figures Bulletin 2005.*

Figure 4.5 Daily Average Value at BSE (1997 – 2005)



Source: Beirut Stock Exchange, *Facts and Figures Bulletin 2005.*

Figures of Beirut Stock Exchange have shown reasonable growth in the previous years specifically in 2005, where market cap increased from USD 2,331 million in 2004 to USD 4,917. In addition, average daily traded value increased from USD 808 thousands in 2004 to USD 3,896 thousands in 2005. However, despite the noted progress, the stock market in Lebanon is still modest and ineffective due to the following reasons:

- Restriction of private sector capital on investments funded by companies owned by families and persons,
- Lack of transparency and disclosure of information at the corporate level,
- The inexistence of foreign direct investments in Lebanon,
- The difficulty for entrepreneurs to obtain credit facilities from the Lebanese banks to fund their investments, and
- The inexistence of an advanced online system that shall enable BSE to clear with the Arab World and other markets online.

Chapter 5 section 5.4.3 page 126 discusses solutions to improve the stock market in Lebanon.

4.10 Privatization

4.10.1 Overview

Privatization has been an important source of reform and debt recovery in several countries such as Ukraine, Russia, Italy and others because it enabled governments to reduce their debts by cash tender offers from one side and to enhance performance of the public sector from the other.

Privatization in Lebanon is recommended as **part** of the solutions required to resolve its public debt (Ref. chapter 5 section 5.3.1 page 114). For that reason, this section introduces the rules and regulations governing privatization in Lebanon and the progress that has been achieved in this respect to date.

4.10.2 Regulatory Framework

On May 31, 2000, the Lebanese Parliament issued the Law No. 228 that was published in the official gazette on June 2, 2000, regulated the privatization future operations and defined its terms and field of implementation. According to the said law, privatization is defined as follows:

"Transferring the public project by a legal procedure, totally or partially, or transferring its management, totally or partially, to the private sector, including the concession structure or similar modern structures designed to implement and manage economic projects over a certain period."

The noted law established the Higher Council of privatization **(HCP)** which was denoted by the governing and supervision of privatization in Lebanon. HCP consists of:

- The Prime Minister…………… The President

- The Minister of Justice
- The Minister of Finance
- The Minister of Trade and Economy
- The Minister of Labor

Members

HCP functions include the following:

- Put forward the general privatization policy and the means of its implementation and submission to the Cabinet for approval,

- Set up a timetable for the public projects to be privatized and submit it to the Cabinet for adoption,
- Issue the necessary decisions in order to complete the privatization operations and their procedures according to the timetable adopted and supervise the implementation,
- Evaluate the assets and properties of the public project, according to the financial and economic basic standards internationally approved; establish the productive budget of privatized projects and submit it to the Cabinet for approval, and
- Prepare the draft laws and decrees if required; and present the necessary recommendations to guarantee the implementation of privatization programs and operations.

To date, the HCP has concluded privatization studies related to the four economic sectors listed in table 4.13 below:

Table 4.13 Sectors for Potential Privatization

Sector	Status
Telecommunications	Law No. 431 dated July 23, 2002
Electricity	Law No. 462 dated September 5, 2002
Water	In process
Gas Exploration	In process

Source: Higher Council for Privatization.

The progress and current status of the aforementioned four economic sectors are discussed next.

4.10.3 Telecommunications Sector

4.10.3.1 Overview

The telecom sector in Lebanon is a major source of income to the treasury with revenues amounted to USD 869 million in 2004 (Ref. table 3.18 page 53). This sector has grown tremendously in the previous years (around 15.83 percent on average from 2003 until 2005 inclusive) and currently there are around 1,000,000 users* in the mobile sector and around 680,000 users* registered in the land lines.

4.10.3.1.A Telecommunications Law

On July 22, 2002, the Lebanese Parliament issued "The Telecommunications Law" No. 431 that was published in the Official Gazette on July 23, 2002. As per the Article 4 of the law, the Telecommunications Authority was formed** to govern the telecommunications sector in Lebanon. The Authority shall be responsible for the following non-cumulative functions:

- Prepare decrees and regulations to implement the law,
- Encourage competition in the telecommunications field,
- Organize concessions, issue licenses, amend, suspend, withdraw and supervise execution in accordance with the provisions of the law and its implementing legislative decrees,
- Collect tariffs and fees,
- Monitor tariffs of Providers with significant market power,
- Formulate the technical standards and procedures for monitoring compliance with the law.

---

* These figures were provided by the Ministry of Post and Telecommunications.
** To date this Authority has not been formed.

4.10.3.1.B Potential Privatized Services under the Law

Licenses shall be granted to Providers, by decree of the Council of Ministers, upon recommendation of the Minister and after the conduct of an international public auction, and pursuant to the terms of reference prepared by the Authority, in respect of the following public telecommunications services:

a. Basic telephony services,
b. Cellular telecommunications services,
c. International telecommunications services,
d. Private line services,
e. Offices of telecommunications and public payphone services,
f. Service of leased lines,
g. Service of telex and telegraph, both domestic and international,
h. Internet services,
i. Data services.

The previous two sub-sections discussed the telecommunication law and the services that could be privatized under the law. The sub-section below discusses the Company that is authorized the ownership and operation of the telecommunications sector according to the provision of the noted law.

4.10.3.1.C Liban Telecom

As per Article 44 of the Telecommunications Law, a joint-stock company, governed by statutes of the Code of Commerce under the name of "Liban Telecom", was formed. The Company was formed with subject of providing Telecommunications Services for a 20 years period, in accordance with provisions of the said law.

Liban Telecom was formed with the intention of selling 40 percent of its shares to the private sector within 2 years of formation. In addition, the shares of the said company shall be traded in Beirut Stock Exchange (BSE). According to the law, the government has the right later on to sell more the company's shares to the private sector.

4.10.3.2 Current Status of the Telecom Sector

***4.10.3.2.A** Mobile Sector*

In March 2004 two contracts were concluded with Alfa and MtcTouch to run the management of the mobile sector in Lebanon for a period of four years.[8] After that agreement, revenues from the telecommunications sector increased slightly in 2004 because the outcome of the two companies became a deemed income for the government and the latter pays the companies their operating expenses. The outcome of mobile sector to the government in 2004 was around USD 341 million (Ref. table 3.18 page 53).

***4.10.3.2.B** Land Lines and Other Related Services*

OGERO (Organisme de Gestion et d'Exploitation de l'ex Radio Orient) was established in 1972 to manage and operate the telegraph and submarine telecommunications of Radio Orient (the early 1900's company). It is 100 percent owned by the government and acts under the supervision of the Minister of Post abd Telecommunications. OGERO's role today includes the operations, maintenance, sales, marketing, billing and management of the Ministry of Post and Telecommunications fixed network in Lebanon. The outcome of Land lines and similar services in 2004 was around USD 528 million (Ref. table 3.18 page 53). *Refer*

to chapter 5 section 5.3.1.1 page 114 for a suggested privatization plan of the telecom sector in Lebanon.

4.10.4 Electricity Sector

4.10.4.1 Overview

As mentioned in chapter 3 section 3.4.4.6 page 41, the electricity sector is managed by Electricitè Du Liban (EDL) under the supervision of the Ministry of Energy and Water. EDL is costing the treasury tremendous amount of funds annually for fuel purchases, debt service and maintenance. EDL's deficit in 2005 amounted to **USD 804 million** of which USD 646 million was directly transferred from the treasury and the rest (USD 158 million) was spent through agreements signed with Algeria and Kuwait.[9]

EDL generates electrical power from thermal and hydraulic thermal sources:

- "**Thermal sources**" consist of 7 stations generating 7,840 GWH (2001 figures),
- "**Hydraulic sources**" consist of 3 stations and 2 plants generating 330 GWH (2001 figures),
- Total generation of electrical power was around 8,170 GWH in 2001. EDL billed only 5,303 GWH (65 percent of total production).[10]
- Annual energy imports from Syria range between 100 MW to 200 MW to meet the sector demand.

Distribution of power covers the five districts of Lebanon according to table 4.14 below:

Table 4.14 Registered Customers at EDL (2001)

District	No. of Customers	of total
Beirut	455,925	44.7 %
Mount Lebanon	230,274	22.6 %
South	194,719	19.0 %
North	71,648	7.0 %
Bekaa	68,280	6.7 %
Total	**1,020,846**	**100.0%**

Source: Higher Council for Privatization, online database; available from http://www.hcp.gov.lb /electricity/index.htm; Internet.

The above table clearly shows improper collection of EDL fees from its customers (the Lebanese citizens). This means the following:

- Some people use the country resources without paying their related fees,
- This improper collection increased the burden on the Lebanese treasury and thus increased the Lebanese public debt,
- People who regularly pay their electricity bill pay it twice (for their usage and on behalf of those who don't pay).

4.10.4.2 Electricity Organizing Law

On September 2, 2002, the Lebanese Parliament passed the Law No. 462 "Organizing the Electricity Sector" that was published in the Official Gazette on September 9, 2002. The law aimed at regulating the electricity sector which, among other matters, provides for the establishment of an independent regulator, the separation of production, transmission and distribution activities, the privatization of production and distribution activities through the granting of concessions and/or the formation of new entities whose shares will be initially owned by the government and subsequently transferred to strategic and other private investors.

4.10.4.2.A National Electricity Regulatory Authority

A regulatory authority referred "The Electricity Regulatory Authority" shall be created by virtue of the Electricity Law and shall be in charge of regulating and controlling the electricity sector in accordance with the provisions of the law, and shall enjoy the legal personality and technical, administrative and financial autonomy. It shall have its quarters in Beirut. The Authority has the following functions:

a. Prepare studies related to the general plan for the sector in the production, distribution and transmission fields,
b. Promote the investment in the electricity sector, work on improving the operational efficiency and guarantee the quality of the services and its good performance.
c. Determine the ceiling of the prices of Production services, tariffs applied on the various services of electricity transmission and distribution, subscription fees, service fees, fines and other fees, and their method of collection,
d. Set the technical and environmental standards and rules governing the verification of compliance with said standards and control their implementation. The Authority shall take into consideration upon assuming its responsibilities, the best international standards regarding the regulation of the electricity sector.
e. Determine the rules and standards of the Licenses and Authorizations, and
f. Issue, renew, suspend, amend and cancel Licenses and Authorizations.

***4.10.4.2.B** Privatization Procedure*

The law states that the Electricity Authority has the right of granting the license of operating the electricity sector in Lebanon for a 50 years period. The law grants the government the right to sell 40 percent of the formed company to the private sector within 2 years of establishment. The shares of the said company shall be traded at Beirut Stock Exchange.

As of the date of this thesis, the Lebanese government has not yet actively pursued the privatization of this sector but rather concentrating its efforts on reducing losses at EDL. *Chapter 5 section 5.3.1.2 page 120 discuses a suggested privatization plan of the electricity sector.*

It should be noted that although a decision of privatization is taken, major reforms should be conducted in EDL especially in terms of the collection process. Otherwise, this company is not attractive to bidders who will obviously not be willing to pay any dollar premiums in return of its license.

4.10.5 Water and Gas Sectors

HCP is currently in process of conducting studies to analyze and evaluate the possibility of privatizing water and gas exploration sectors.

4.11 Concluding Remarks

The Lebanese public debt has been accumulating heavily during the previous years in a manner that exceeded the growth of the Lebanese economy. A matter that left the country vulnerable to economic and financial crises. Unless the government takes immediate actions to cut its debt and perform necceary reforms at the economic level, a greave economic gap and financial difficulties will arise.

The increasing burden of debt principal and its service has had crucial influence on all economic sectors that witnessed almost no growth. This unbalanced situation of different sectors in the country caused the Lebanese people to face economic and social problems. Big companies shut down their operations, other companies are subject to losses, job opportunities almost vanished, social and health problems speeded, and local labor force migrated or in planning to migrate.

Reasons behind this deterioration in economy are mentioned in chapter 3 section 3.5 page 57 and are summarized by political conflicts, corruption, and improper governmental policies. All those stated reasons and the lack of trust in the government transparency, accountability, and ability to resolve its problems is leading towards economic catastrophes.

Chapter 5 analyzes data mentioned in chapters 2, 3, and 4 and presents necessary solutions to cut down public debt and conduct required reform at the economic and financial level. It should be noted that the solutions are not dependant on a single action or reform in a particular sector, but entails a reform agenda that deals with all economic conditions.

CHAPTER 5

DATA FINDINGS AND SOLUTIONS

5.1 Introduction

In chapters 2, 3, and 4, the background of the study was discussed and supported with figures and examples and covered the different aspects of the current status of the Lebanese economy. The texts of the said chapters were directed towards highlighting the actual performance of the Lebanese government in all aspects. This diagnosis lays the foundations of the analysis conducted in this chapter.

Analysis and findings presented in this chapter are concluded from the available data. Part of this data was mentioned in the previous chapters and other part was calculated separately on spreadsheets.

Chapter 5 is divided as follows:

Section 2: Controlling Public Expenditures that includes suggestions to reduce and control the government expenditures in different areas such as:

⇒ Public labor force,

⇒ Ministerial expenditures,

⇒ Funds budget, and

⇒ Other treasury expenditures.

<u>Section 3: Increasing Public Revenues</u> that should include:

⇒ Privatization plan proceeds, and

⇒ New suggested customs' tariffs.

<u>Section 4: Achieving Economic Growth</u> by including an overall reform plan to improve economic conditions in the country such as:

⇒ Drawing and monitoring the said plan,

⇒ Adjusting monetary policy,

⇒ Increasing private investments incentives

⇒ Conducting tax and budget reform,

⇒ Increasing transparency and other reform procedures.

<u>Section 5: Labor Force Plan</u> that includes reform at the Ministry of Labor level in order to:

⇒ Improve labor environment,

⇒ Increase employment opportunities, and

⇒ Organize the affairs of foreign labor working in Lebanon.

<u>Section 6: Media</u> that includes a suggestion to increase the media's concern in highlighting the economic conditions and to follow up the suggested economic plan mentioned in section 4.

<u>Section 7: Debt Service</u> that includes projected interest costs under the reschedule of public debt in context of paying principal amounts of debt from privatization proceeds and decreasing interest rates after 2008 through modifying the monetary policy.

Section 8: Projected Budget that includes projected revenues and expenditures of the government after achieving the recommended solutions of the reform agenda.

Section 9: Projected Public Debt vs. GDP that includes the new projected debt vs. projected GDP for the next 5 years.

5.2 Controlling Public Expenditures

5.2.1 Public Sector Size

It is a very well known fact all around the world that the public sector is inefficient.[1] Simply because waste in a public sector is not absorbed by shareholders, or managers that need to answer to shareholders but rather by employees in public institutions who tend to not perform efficiently. The rate of waste differs from one country to another depending on the political and legal framework that each country adopts. Developed countries allow low levels of waste and corruption in their public sector. This is due to "sound legal" system supported by firm "accountability" that are two issues missing in developing countries such as Lebanon.

5.2.1.1 Current Employees

Lebanon's public labor force is large, underpaid and unmotivated, prone to corruption and unresponsive to the people's needs, which is a major source of the citizens' dissatisfaction with the state. On the whole, it is safe to say that the Government in Lebanon is severely overstaffed for the functions it currently performs.[2]

Different Lebanese public ministries and entities employ around 220,000 people, of which around 95,000 are military.[3] *Appendix G page 177 lists number of employees per each ministry.* The Lebanese government spent around **USD 1,514 million** in fiscal year 2004 as salaries, wages, and benefits for its employees, a figure that is approximately 21 percent of total expenditures (Ref. table 3.19 page 55). This averages out to approximately **USD 6,882 per employee per year** or roughly **USD 575 per month.**

5.2.1.2 Retirement and End of Service Indemnity (EOSI)

The cost of salaries and wages for retirees and end of service indemnity for fiscal 2004 amounted to around USD 537 million, a figure that is approximately 7 percent of total expenditures (Ref. table 3.19 page 55).

In the Lebanese public sector, there are two pension schemes, one for civil servants and the other for military and security personnel. Both schemes offer to the average full-career worker a pension equivalent to 85 percent of pre-retirement income – among the most generous in the world.[4]

This high level of income replacement is not only unaffordable, but also reduces incentives to diversify sources of savings for retirement outside the public system – particularly among middle- and high-income workers. This is unfortunate, as it is known that the development of contractual savings outside the public system could contribute to financial sector development and economic growth.

In addition, the system offers a series of ad-hoc benefits including lump sums and extra credits for each year of contribution (in the case of the military scheme). At the same time, the process used to index pensions is discretionary. This exposes retirees to the risk of inflation while making the system vulnerable to adjustments that are too high.

The two schemes are already displaying an aggregate deficit of 2.6 percent of GDP that is expected to continue to grow.[5]

5.2.1.3 Solutions

Reshaping current and retired labor force in the Lebanese public sector has become a necessity to reduce its bill, increase its productivity, and contribute to a normal prosperous economy.

Recommendation # 1

The set of recommendations below should be implemented by the government to reform the public labor force:

Regarding Current Employees

a. Determine criteria to assess employees' performance and productivity,
b. Assess current employees' performance and productivity according to defined criteria in (a) above,
c. Specify different public entities' needs for employees, contractors, and other temporary personnel,
d. Reallocate current employees according to the needs defined in (c) above,
e. Determine the excess number of employees and plan an appropriate action (e.g. half salaries, no transportation allowance and other fringe benefits),
f. Re-study the nature and rate of benefits granted and link it to performance,
g. Attain employees required training courses according to different specializations and eliminate unnecessary training costs,
h. Increase daily work hours from 6 to 8 in a step aimed at:
    - Increasing productivity, and

- Satisfying private sector administrative work (i.e. when ministries and public entities open until 5 pm alike with different private companies, the former will be able to process public documents and deeds in a better manner and this will accelerate the daily business activity).

i. Educate public employees on the fact that their job is to process and deal with citizens' needs and requirements according to endorsed laws.

j. Automate all processes and procedures in order to eliminate tasks and generate a better output.

Regarding Retirees and End of Service Indemnity

a. Unifying the two pension schemes (civil servants and military),
b. Conversion of EOSI into a fully funded contribution pension system,
c. Recalculating pension rates in a manner that reduces its cost and is sustainable for the long term.

5.2.1.4 Financial Result vs. Reforming Public Labor Force

Conducting the above mentioned reform recommendations will no doubt downsize the current bill of salaries, wages, and retirement funds. At this stage, and before putting reform package in place, accurate financial costs saved is not possible to determine. The following two examples reduce personnel costs on the short-term:

1. Early Retirement: In the next 10 years, up to 45 percent of the current public labor force will retire.[6] i.e. 99,000 employees. If the government reduced retirement age by five years, 99,000 employees will retire in the next five years i.e. from 2006 until 2010. Note that upon retirement, an employee is

granted 85 percent of his/her salary as well as zero transportation allowance. Therefore, total savings per year is estimated to be equal to **USD 44 million.**

2. Reforming Pension Schemes: The current two schemes of civil servants and military and security personal cost around 2.6 percent of GDP (Ref. section 5.2.1.2 page 108) i.e. equivalent to approximately **USD 520 million**. In 2005, a law which would transform the end-of-service indemnity program into a "defined contribution" fully funded scheme was drafted. Under this option, a worker would put aside a percentage of each paycheck into a pension plan, which is usually mandated by the government. This law is the right step towards reforming the pension schemes in Lebanon. If implemented next to other reform decisions, total pension costs would decrease to a reasonable level of approximately 2 percent of GDP. [7] i.e. equivalent to **USD 400 million**. Therefore, annual savings would be **USD 120 million.**

Summing the results of the above two recommended short-term solutions save **USD 166 million per annum.** Table 5.1 below projects personnel costs for the years 2006 until 2010 inclusive:

Table 5.1 Projected Personnel Costs in USD Million (2006 – 2010)

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
Personnel Cost	2,051*	1,885	1,885	1,885	1,885	1,885

5.2.2 Dismantling Ministries and Other Funds

In the previous 15 years, several ministries were established and others were dismantled (Ref. table 3.8 page 34). Each ministry has an annual budget financed from the government general budget. Therefore, a decision to establish a ministry

* Ref. table 3.19 page 55.

should be based on what this ministry shall contribute to the Lebanese society and economy and in context of the government's financial ability to finance the costs of establishment and operating.

Recommendation # 2

Based on the huge deficit of the Lebanese government and on the priorities in expenditures for the forth coming years, it is recommended to relinquish public entities that have already exhausted the treasury and that have no current economic and social necessity. The ministries, funds, and councils listed in table 5.2 **are assumed** to enjoy the said criteria:

Table 5.2 Estimated Savings from Dismantling Current Public Entities

Description	Annual Savings *USD Million*[*]
Ministry of Youth and Sports	13
Ministry of Displaced Affairs	4
Ministry of Information	18
Ministry of Education and Fine Arts	14
Displaced Fund	105
Council of the South	77
Total	**231**

5.2.3 Transfers to Municipalities

The Lebanese government transferred to municipalities for the years 2000 until 2005 inclusive the amounts of money listed in table 5.3 below:

Table 5.3 Transfers to Municipalities in USD Million (2000 – 2005)

	2000	2001	2002	2003	2004	2005	Average
Transfers to municipalities	288	73	229	119	306	255	**212**
of total state expenditures	2.7%	0.8%	2.3%	1.1%	2.9%	2.5%	**2.1%**

Source: Ministry of Finance, *Public Finance Prospects 2001, 2002, 2003, 2004, and 2005.*

[*] Ref. table 3.19 page 55 (2004 figures) and table 3.8 page 34.

As the table 5.3 shows, transfers to municipalities ranged between low of USD 73 million in 2001 to high of USD 306 million in 2004 with an average of USD 212 million for the 2000 – 2005 period. The said transfers accounted on average 2.1 percent of total government expenditures.

It should be noted that high transfers of money to municipalities can not prevail if the Lebanese government decided an economic policy for the next years. Therefore, municipalities' budget and its finances should be reconsidered in a feasible manner that maintains its operations. Hence, the government should contain its transfers to municipalities and search for alternative finances. Such alternative sources of funds should be through improving the municipal fees collection process.

Recommendation # 4

Based on the above, it is recommended that:

a. The Lebanese government reduces its transfers to municipalities by 50 percent **(assumption)**. Table 5.4 shows projected transfers to municipalities for the years 2006 until 2010 inclusive.

Table 5.4 Projected Transfers to Municipalities in USD Million (2006 – 2010)

	Actual	Projected				
	2000-2005	2006	2007	2008	2009	2010
Transfers to Municipalities	212	106	106	106	106	106

b. Accordingly, the municipalities enhance their tax collection to make up for less transfers from the government.

5.3 Increasing Public Revenues

5.3.1 Privatization

As mentioned earlier in chapter 5 section 10, privatization is part of the recommended solutions to resolve the Lebanese public debt. Suggested privatization plan includes "telecommunications" and "electricity" sectors.

5.3.1.1 Telecommunications Sector

The telecom sector in Lebanon as stated in the report of the "Arab Advisors Group" on September 19, 2005 is one of the low competitive sectors in the Arab World.[8] The said report ranked Arab Countries in terms of competitiveness (i.e. number of operating companies) and level of privatization (i.e. share of government vs. share of private sector). Lebanon was ranked 11 out of 18 countries in terms of competitiveness and 18 out of 18 in terms of privatization (since the Lebanese government currently owns 100 percent of the telecom sector). Table 5.5 illustrates.

Table 5.5 Competitive Index of the Arab Telecom Sector

		Competition Index	Government Ownership
1	Jordan	84%	23%
2	Palestine	73%	0%
3	Algeria	66%	41%
4	Iraq	62%	-
5	Morocco	60%	55%
6	Saudi Arabia	55%	70%
7	Yemen	54%	39%
8	Egypt	51%	47%
9	Tunisia	49%	80%
10	Kuwait	43%	45%
11	**Lebanon**	**42%**	**100%**
12	Syria	41%	40%
13	Bahrain	36%	34%
14	Sudan	32%	27%
15	Libya	29%	100%
16	Oman	26%	100%
17	Qatar	18%	55%
18	United Arab Emirates	13%	60%

Source: Arab Advisors Group, *Competition Levels in Arab Cellular Markets & Privatization levels in Arab Cellular and Fixed Markets,* 19 September 2005.

The majority of Arab Countries have privatized partial or their whole telecom sector and majority of those countries have granted licenses to several companies in order to increase competition and decrease prices. The presented plan of this section is to privatize 75 percent of the telecom sector (i.e. retain only 25 percent under government's ownership). The said plan is based on:

⇒ Consolidating the telecom services under one company,

⇒ Calculating the intrinsic value of this company via a discounted cash flow module, and

⇒ Selling 75 percent of the shares.

Privatizing the telecommunications sector is recorded in the Law No. 431 mentioned in chapter 4 section 4.10.3.1.A page 97. "Liban Telecom" is the sole provider of licenses under the provisions of the said law. Calculating the intrinsic value of Liban Telecom is based on three primary services:

a. GSM,
b. DSL, and
c. Land Line and Related Services.

<u>GSM</u>: The GSM is a promising sector in Lebanon with currently around one million users* constituting around 17 percent penetration rate.[9] For fiscal 2005, the total revenues from the telecom sector amounted to USD 966 million.[10]

* 1,000,000 approximate actual number of users provided by Ministry of Post and Telecommunications.

Table 5.6 Telecom Revenues in USD Million (2005)

	2005	of total
GSM	544	56.3%
Land line and related services	422	43.7%
Total	**966**	**100%**

Source: Compiled from data published by the MOF, *Public Finance Monitor* and *General Budget of Ministry of Post and Telecommunications 2005.*

Table 5.7 below shows estimated revenues of the GSM sector for the next 5 years period:

Table 5.7 Estimated GSM Revenues in USD Million (2006 – 2010)

	2005	2006	2007	2008	2009	2010
Mobile users	1,000,000	1,100,000	1,210,000	1,331,000	1,464,100	1,610,510
GSM revenues	**544**	**598**	**658**	**724**	**796**	**876**

Assumptions of table 5.7:

10 percent annual increase in No. of users and accordingly 10 percent increase in profits.

DSL: Digital Subscriber Line "DSL" is a technology for bringing high-bandwidth information to homes and small businesses over ordinary copper telephone lines. DSL service will be launched by OGERO in mid of 2006 is expected to yield tremendous additional revenues for the Government due to the vital market size of such service in Lebanon and its potential growth estimates for the next five years. It should be noted that DSL will be a substitute service for "cables internet connection" because DSL provides a faster internet connection that reaches 6.1 megabits per second with additional services such as motion video, audio, and 3-D effects.

Table 5.8 Estimated DSL Revenues (2006 – 2010)

Amounts are in USD Thousands except when mentioned

		2006	2007	2008	2009	2010
1	**No. of Subscribers in DSL**	**120,000**	**144,000**	**172,800**	**207,360**	**248,832**
2	Annual Fee in *USD*	600	600	600	600	600
3	Total Revenues	36,000*	86,400	103,680	124,416	149,299
4	**Government Share**	**25,200**	**60,480**	**72,576**	**87,091**	**104,509**

Assumptions of table 5.8:

1. No. of subscribers will increase 20 percent per annum,
2. Subscription Fee is fixed @ USD 50 / month,
3. The government (OGERO) will sell 70 percent of the market size.

Land Lines and Related Services: Revenues from these services amounted to around USD 422 million in 2005. For the coming 5 years, this amount is expected to be constant.

5.3.1.1.A Total Telecom Estimated Revenues

Summing table 5.7 (GSM), and table 5.8 (DSL), and revenues of land line and related services for the next 5 years derives table 5.9 below:

Table 5.9 Estimated Telecom Revenues (2006 – 2010)

Amounts are in USD Million

	2006	2007	2008	2009	2010
GSM	598	658	724	796	876
DSL	25	60	72.567	87.091	104.509
Land lines and related	422	422	422	422	422
Total	**1,045**	**1,140**	**1,218**	**1,305**	**1,402**

* 2006 revenues are divided by 2 because the service is expected to be launched in mid of the year.

5.3.1.1.B Intrinsic Value of Liban Telecom

Since Liban Telecom will be the owner of the telecom sector after its establishment, its intrinsic value is the discounted cash flows expected to be generated from table 5.9. It is recommended upon establishment to underwrite with the capital of 1,000,000,000 shares. Recalling from chapter 4 section *4.10.3.1.C* page 98, Liban Telecom has the right to give a license for a 20 years period. Therefore, discounted cash flow will cover the period from 2006 until 2025 inclusive.

Financials until the year 2010 were presented up with their assumptions. Financials from 2011 until 2025 will be considered with zero growth rates for the sake of simplicity and risk.

Discounted rate for cash flows is taken from Moody's rating and adjusted for premium country risk and is calculated at 13.8 percent.[11]

Discounted cash flow for Liban Telecom is calculated equal to **USD 8,698 million**. *Refer to Appendix H page 178 for calculation sheet.*

Therefore, the price per share of Liban Telecom is 8,698,000,000 / 1,000,000,000 = around USD 8.7.

Recommendation # 5

The Ministry of Post and Telecommunications should suggest amending Law No. 431 to allow the government to sell 75 percent of Liban Telecom instead of 40 percent. By doing so, the ministry will be able to sell the 750,000,000 shares of Liban Telecom with the value of **USD 6,525 million**.

This amount should be paid directly to settle principal debt maturing in 2006 and preferably treasury bills in Lebanese Lira. Two main reasons for settling amount of the domestic debt rather than the external debt in the short term:

⇒ Interest rates: Recall from chapter 4 section 4.2 page 60 that the weighted average interest rates on the domestic debt (8.75 percent) are higher than those of the external debt (7.35 percent).

⇒ Liquidity: By repaying treasury bills held by Lebanese commercial banks, the latter will be able to further lend the private sector that in turn will activate the business cycle by increasing investments.

Recommendation # 6

As per the Law 431, Liban Telecom shares should be listed on BSE. Therefore, it is recommended to comply by this clause of the said Law.

5.3.1.1.C Results of Privatizing Liban Telecom

a. Cash inflow of USD 6,525 million, and
b. Future income equal to the 25 percent shares of the government according to table 5.10.

Table 5.10 Government's Share of Telecom Revenues in USD Million (2006 – 2010)

	2006	2007	2008	2009	2010
Total revenues	1,045	1,140	1,218	1,305	1,402
Government's share	**261**	**285**	**305**	**326**	**351**

5.3.1.2 Electricity Sector

Recalling from chapter 4 section 4.10.3.2, the Electricity Law No. 462 dated September 9, 2002 laid the foundation to privatize the electricity sector in Lebanon and to form the Electricity Authority, whereby a license is provided for bidders interested in operating EDL.

Determining an intrinsic value of EDL is outside the scope of this thesis and is not an easy exercise due to:

- Continuous losses of EDL, and
- Difficulty of accessing required data to conduct such a study.

Recommendation # 7

The Lebanese government should immediately activate the Law No. 462, establish the Electricity Authority, privatize the sector and sell at least 75 percent of its shares which should be traded at BSE.

Results

Since neither a feasibility study nor a due diligence study are at hand, results of privatizing EDL should be ceasing immediately and finally the annual treasury transfers that used to finance EDL's losses. Such losses amounted to **USD 382 million** in 2004 (Ref. table 3.11 page 44). Therefore, in the projected state expenditures (section 5.8.2 page 145), transfers to finance EDL losses should appear zero.

5.3.2 Customs

The Lebanese customs collect tariffs on imports divided between three main Sea Ports and One Airport that are categorized according to a coded harmonized system.

Basis of assessment

Customs' tariffs are decided by the "General Directorate of Customs" to encourage the domestic Lebanese industries that are facing unfair competition due to foreign dumping that penetrate the Lebanese market bearing cheap prices.

In order to combat this unfair trading, the trend should be towards increasing tariffs on some of these products that compete directly with the Lebanese produce in a manner that shall provide the following two advantages:

a. Increase annual returns to the Lebanese treasury, and
b. Enable local industries to compete with foreign cheap products.

Table 5.11 lists imported products for 2004, tariffs' rates on the said products, total customs generated, and the new suggested tariffs' rates and new returns.

Table 5.11 Suggested New Customs' Tariff Rates

Amounts are in USD million except when mentioned

HS*		Imports	Current Tariff Rate[12]	Total Duty	Suggested Tariff Rate	Suggested Total Duty	Increase in Duty
5	Mineral products	2,068	4.0%	82.7	4.0%	82.7	0.0
16	Machinery; electrical instruments	1,109	5.0%	55.5	10.0%	110.9	55.5
17	Vehicles, aircraft, vessels, transport equipment	843	5.0%	42.2	7.5%	63.3	21.1
6	Products of the chemical or allied industries	829	5.0%	41.4	5.0%	41.4	0.0
15	Base metals and articles of base metal	596	2.0%	11.9	5.0%	29.8	17.9
4	Prepared foodstuffs; beverages, tobacco	527	5.0%	26.3	15.0%	79.0	52.7
14	Pearls, precious stones and metals	527	0.0%	0.0	5.0%	26.3	26.3
11	Textiles and textile articles	508	2.5%	12.7	5.0%	25.4	12.7
1	Live animals; animal products	453	0.0%	0.0	10.0%	45.3	45.3
2	Vegetable products	441	1.0%	4.4	10.0%	44.1	39.7
7	Plastics and articles thereof; rubber	349	0.0%	0.0	5.0%	17.5	17.5
10	Pulp of wood; paper and paperboard	272	0.0%	0.0	10.0%	27.2	27.2
20	Miscellaneous manufactured articles	185	20.0%	37.0	25.0%	46.2	9.2
18	Optical, photographic,medical, musical instruments	175	2.5%	4.4	5.0%	8.7	4.4
13	Articles of stone, plaster, cement, glass	168	10.0%	16.8	20.0%	33.5	16.8
9	Wood and articles of wood; wood charcoal; cork	139	2.0%	2.8	2.5%	3.5	0.7
12	Footwear, umbrellas, artificial flowers	83	10.0%	8.3	20.0%	16.6	8.3
3	Animal or vegetable fats and oils	74	5.0%	3.7	10.0%	7.4	3.7
8	Raw hides and skins, leather, furskins	40	0.0%	0.0	0.0%	0.0	0.0
19	Arms and ammunition; parts and accessories	7	2.5%	0.2	5.0%	0.4	0.2
21	Works of art, collectors' pieces and antiques	5	15.0%	0.8	25.0%	1.3	0.5
		9,397	**5.0%**	**351**	**10.0%**	**710**	**359**

* Harmonized coded system.

Table 5.12 shows the estimated additional revenues that are generated from the new suggested customs for the years 2006 until 2010 inclusive:

Table 5.12 Estimated Marginal Revenues from Customs in USD Thousands (2006 – 2010)

	2006	2007	2008	2009	2010
Customs of 2004	351,000	351,000	351,000	351,000	351,000
Suggested customs	710,000	710,000	710,000	710,000	710,000
Marginal customs	**359,000**	**359,000**	**359,000**	**359,000**	**359,000**
Marginal VAT	**35,900**	**35,900**	**35,900**	**35,900**	**35,900**

Assumptions of Table 5.12

1. Imports of 2004 are considered to be constant for the next 5 years,
2. Suggested new customs' tariffs are implemented by the Lebanese government.

In short, the Lebanese treasury will then generate marginal returns up to USD 359 million annually from the anticipated increase in customs' tariffs.

Recommendation # 8

The Lebanese government is recommended to draft a decree that enables the "General Directorate of Customs" to increase tariffs in accordance with table 5.11 and to achieve financial results mentioned in table 5.12.

5.4 Achieving Economic growth

Economic growth is the major goal of a prosperous country and achieving this growth should be the ultimate goal of the reform plan that should be implemented by the government for both the public and private sectors. As mentioned earlier in the previous chapters, economic slow down was a result of several factors including huge governmental deficit, huge public debt, and improper economic, financial, and monetary policies. Slow economic growth has led to severe financial and social problems such as lower purchasing power and lack of job opportunities. Hence, achieving economic growth requires an overall strategy that touches different aspects of the Lebanese economy.

In their quarterly economic report, Bank Audi Research Department has drafted a module of economic growth for the coming years of **6 percent per annum** in real terms equivalent to **8.5 percent in nominal terms**.[13] Their module was based primarily on securing an overall environment supportive for private investments. Recall from figure 3.1 page 21 that real GDP growth for 2004 was **5 percent** equivalent to **8 percent in nominal terms**. It should be noted that real growth of 2004 was recorded within the current status of the Lebanese economy (i.e. in the absence of economic and fiscal reform).

Based on the above, three growth scenarios are estimated as follows:

1. **Optimistic scenario**: Real growth: 6 percent. Nominal growth: 8.5 percent
2. **Most likely scenario**: Real growth: 5 percent. Nominal growth: 7.5 percent
3. **Pessimistic scenario**: Real growth: 4 percent. Nominal growth: 6.5 percent

Table 5.13 Projected GDP Growth in USD Million (2006 – 2010). Most Likely Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Nominal GDP	22,210[14]	**23,876**	**25,666**	**27,591**	**29,661**	**31,885**
Nominal growth		**7.5%**	**7.5%**	**7.5%**	**7.5%**	**7.5%**
Real growth		**5%**	**5%**	**5%**	**5%**	**5%**

Refer to Appendix J tables J.1 and J.2 page 182 for GDP projections under the optimistic and pessimistic scenarios.

The set of recommendations below are presented to assist the Lebanese government achieving economic growth for the next five years.

5.4.1 Economic plan

The existence of an urgent economic plan is a necessity to shift Lebanon from this stagnated stage to a rather prosperous one. This plan should be drafted in coordination with the Ministry of Trade and Economy, Ministry of Finance, Central Bank of Lebanon as well as other related public and private institutions.

Recommendation # 9

It is recommended to:

a. Draw an overall economic policy,
b. Determine the responsibility and role of each ministry and each public institution within the context of the policy,
c. Communicate plan orders and directions across all levels of responsibility within related public entities,
d. Establish a Committee whose responsibility is to implement the agreed upon economic policy with a president preferably the Minister of Finance,

e. Determine a timetable for achieving the plan preferably a five years period,

f. Publish all plan aspects to the public directly after its completion,

g. Publish to the public quarterly reports on the status of the plan, achievements, as well any obstacles or any recommended changes,

h. Conduct continuous feedback and adjust plan actions accordingly.

5.4.2 Corrective Monetary Policy

As mentioned in chapter 4 section 4.8 page 86, the Central Bank of Lebanon is conducting a monetary policy based on fixation of the Lebanese Lira. Such policy provided negative results on the overall financial and economic situation through out the previous years. In addition, the said tightened monetary policy contributed to increasing inflation, interest rates, and unemployment.

Recommendation # 10

It is recommended that the Central Bank of Lebanon releases the Lebanese Lira in order to be priced in the market according to supply and demand of funds. Such an adjusted monetary policy should provide the actual value of the Lebanese currency, decrease interest rates and unemployment.

5.4.3 Activating the Stock Market

The Lebanese stock market although surged at end of 2005 and beginning of 2006 still lacks the necessary liquidity and is hence, considered as a very thin market that requires important reform.

Recommendation # 11

The following actions should be concluded in order to improve and activate the stock market in Lebanon:

a. **Rules and regulations**: Under current listing rules, a company should offer 25 percent of its shares to the public. This leaves companies closely owned by Lebanese traditional families, which means closed inefficient, management, and misallocation of capital in the economy. It is recommended to increase the said percentage to 49 percent in the short term in order to encourage further investments and participation on wider range of a shareholders base.

b. **Transparency**: Investors do avoid purchasing shares of companies listed at the BSE due to lack of information at the corporate level. Listed companies should publish their financials and update them on a monthly basis. In addition, all share owners should be revealed, insider trading, as well as all stock related matters in a manner that is accessible by all investors and analysts.

c. **Supervision**: The "Stock Exchange Committee" is the legitimate body supervising companies' publications and financials. This committee should be activated and given full authority to access all companies' files, audit these files, and take actions accordingly. Investors need to be sure before they invest their money and conducting such a transparent check on companies is encouraging to investors to inject their money with companies traded at BSE.

d. **Monitoring performance:** Listed companies should be monitored continuously regarding liquidity, capital adequacy, and solvency. Standard international accepted ratios should be determined as a guideline for companies to adopt and comply with. According to the said ratios, companies should be ranked on a monthly basis. Companies with questionable performances should be placed on a probation period and should be monitored closely either to improve or to be delisted.

e. **Information Technology:** Information technology **"IT"** is a major success factor that should be taken into consideration at BSE. Despite all recent upgrades at BSE's IT department, yet, management has not captured the core of this tool. Examples of advanced IT tools includes but not limited to trading online, viewing all companies' profiles, financials, and charts on the spot. Therefore, it is recommended that BSE initiates an advanced IT website that enables investors to view online all options of the market. It is also highly recommended to establish a trading network with the Middle East Stock Market.

Finally, it should be noted that the stock market is a key issue in the reform process of the Lebanese economy and major importance should be given to this sector.

5.4.4 Banking sector

The Lebanese banking sector has a vital role in the country's economic cycle due to the sector's active role and due to the size of customers' deposits that accounted 277 percent of GDP in 2004. However, during the previous decade, the banks' funds were utilized to finance the government deficit (Ref. chapter 4 section 4.7.3 page 85). This led to freezing the available funds and preventing investors from operating the said funds to increase the country's output.

Recommendation # 12

Based on the above, it is recommended to release the Lebanese commercial banks from:

- depositing in the Central Bank of Lebanon amounts other than the compulsory reserve requirement , and
- Holding excess of government' treasury bills.

The first recommendation would be executed by a decision from the Central Bank in the context of adjusting it monetary policy.

The second recommendation would be executed if the government uses privatization proceeds to settle due treasury bills held by commercial banks.

Recommendation # 13

After releasing commercial banks' money, it is recommended that banks reconsider their lending policy in a manner that increases liquidity in hands of investors so as to increase investments and accordingly achieve economic growth.

5.4.5 Budget Reform

During the previous 15 years, the general budgets drafted by the Lebanese government have resulted in a deficit (Ref. table 3.7 page 31). In addition, the Lebanese government used to enclose with the general budget annex budgets of other economic sectors such as the budget of the Ministry of Post and Telecommunications. Moreover, the Government used the treasury expenditure to finance ministries' losses outside the contents of the general budget such as EDL losses (Ref. chapter 3 section 3.4.4.6 page 41).

Recommendation # 14

It is recommended to:

a. Consolidate the government revenues and expenditures in one budget,
b. Plan and calculate budget estimates in a well defined and scientific manner,
c. Submit the annual budget on time, and
d. Closely track budget execution.

5.4.6 Tax Reform

Taxes are the backbone of the fiscal policy that covers the government needs and regulate the economy. Governments use taxes to finance public expenditures. On the other hand, taxes affect to a large extent individuals and businesses alike especially attraction of foreign investments. Therefore, the government's decisions on taxes directly and indirectly influence the economy.

Recommendation # 15

It is recommended to:

a. **Not to increase** current taxes under any situation due to the tough economic conditions and due to its impact on unprivileged sectors of society,
b. Redefine tax bases after concluding a comprehensive study on the different business sectors,
c. Improve tax collection process and make it reachable to all individuals and companies.
d. Have more than one value added tax rate on different products and services (i.e. some products may be taxed at 5 percent, 7 percent, or other rate according to the nature and need of each product).

5.4.7 Transparency

Transparency is a major factor that creates confidence which ultimately attracts investments and thus increases economic output. Transparency should not be just a slogan, but rather an enforceable practice.

Transparency reveals performance, enables accurate assessment, and provides safe grounds for attracting investments. In addition, it provides trust and confidence in the Lebanese system, currency, bills, and agreements. Transparency also encourages investors to work in Lebanon and thus indirectly increases output, decreases inflation, interest rates and unemployment.

Recommendation # 16

Public sector entities should publish their results to the public on a monthly basis, and disclosed information should include their expenditures, revenues, number of employees and their responsibilities, undertaken projects, and so on.

5.4.8 Statistics

Statistics in Lebanon is very weak. On the public front, the government did not establish statistics institutions responsible for conducting census regarding different economic, social, demographic and other fields. The Central Administration of Statistics "CAS" that was established by Ministerial Decree No. 1793 dated February 22, 1979 is the governmental official institution responsible for conducting research and statistics. CAS is created under the administrative body of the Council of Ministers assumes the following functions:

a. To set forth all statistics related to the economical and social life of the country.

b. To unify the databases related to institutions or individuals used in the administrations to extract the statistical data from it, and to supervise technically the statistics that the administrations lay down and to centralize and coordinate it.
c. To set up the internal economical accountings (the national accounts), the balance of payments, and the other annual statement regarding the economical and social activities of the country.
d. To carry out the statistics, investigations, and studies requested by the Council of Development and Reconstruction, and the other economical studies requested by the other administrations.
e. To carry out mandatory statistical surveying , should be considered as mandatory any statistical survey carried out by the central administrations of statistics directly, or through another institution, and published in the official journal.
f. Analysis and publication of the statistics that are laid down.
g. To contribute, with the Civil Service Council, to the preparation and training of the employees working with statistical units related to the administrations

Data published by this administration are restricted to some insufficient issues and its publications are not comprehensive neither up to date. An obvious example is that to date, the Lebanese government has not conducted a census on the Lebanese population and its development.

On the private front, there are several institutions including banks and financial institutions that conduct research but only in specific fields and in a limited perspective.

Lack of solid statistics and databases is a major barrier facing the development of different economic sectors.

Recommendation # 17

It is recommended that the Lebanese government represented by the Central Administration of Statistics does a census on different sectors of the country including population, agriculture, society, employment, and other vital sectors of the economy.

5.4.9 Private Investments

Capital formation ratio (ratio of private investment to GDP) in Lebanon in 2005 was approximately 20 percent.[15] In addition, those 70 percent of private investments were self financed (i.e. financed by investors themselves).

Besides the fact that 20 percent is rather limited, the fact remains that 30 percent of the said percentage of private investments is financed by the market (i.e. banks and equity). This lack of funds within the Lebanese economy is a cause of a tightened monetary policy implemented by the Central Bank (discussed in chapter 4 section 4.8 page 86).

Investments in Lebanon will surge and investors will be encouraged to finance business in the country only if the following is adopted:

- ⇒ Adjusting monetary policy (Ref. section 5.4.2 page 126),
- ⇒ Improving the stock market (Ref. section 5.4.3 page 126),
- ⇒ Releasing the private banking sector (Ref. section 5.4.4 page 128),
- ⇒ Conducting budget reform (Ref. section 5.4.5 page 129), and
- ⇒ Reforming tax principles (Ref. section 5.4.6 page 130).

Should the indicated reforms take place, private investments shall increase to reach around 30 percent of GDP in 2010 and the ratio of self financing shall decrease to 50 percent in favor of funds supplied by banks and equity market.[16]

Table 5.14 below shows private investments projections until 2010.

Table 5.14 Private Investments Projections (2006 – 2010). Most Likely Scenario

All amounts are in USD million except when mentioned

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Nominal GDP*	22,210	**23,876**	**25,666**	**27,591**	**29,661**	**31,885**
Private Investments	4,442	**5,175**	**6,029**	**6,999**	**8,126**	**9,435**
Private Investments / GDP	20%	22%	23%	25%	27%	30%
Self financed	3,109	2,587	3,014	3,500	4,063	4,717
Self financed / Investments	70%	50%	50%	50%	50%	50%
Market financed	1,333	2,587	3,014	3,500	4,063	4,717
Market financed / Investments	30%	50%	50%	50%	50%	50%

Refer to Appendix J tables J.3 and J.4 pages 182 and 183 for investments projections under the optimistic and pessimistic scenarios.

5.4.10 Projected Tax

As mentioned earlier, increasing taxes is not a recommended solution to generate revenues. Yet the fact remains that once the economy grows, generated tax for the government will grow accordingly. This section is aimed at calculating projected tax revenues that shall be generated according to the projected GDP values (Ref. table 5.13 page 125) for the next five years. "Simple Regression Analysis" is the statistical method used for the said calculation. "Simple Regression Analysis" determines the relationship between two variables; an independent and a dependant variable.[17]

* Ref. table 5.13 page 125.

The regression module uses historical relationship between the two variables to determine the following equation:

$$Y = a + \beta X + e$$

Where Y is the dependent variable
a is the intercept and Y is equal to a when X is zero
ß is the coefficient of the independent variable
X is the independent variable
e is the error and is assumed to be zero for simplicity

Three major tax revenues are considered below:

⇒ Value Added Tax,

⇒ Income Tax on Profits, and

⇒ Income Tax on Wages and Salaries.

Each of the above three taxes is a dependant variable and an equation is to be extracted from SPSS "Statistical Packages for Social Sciences" Software. GDP is the independent variable.

Historical relationship between the variables is presented in the table below:

Table 5.15 GDP vs. Taxes in USD Million (2002 – 2005)

	2002	2003	2004	2005
GDP	18,462	19,980	21,870	22,210
VAT	659	903	1,169	1,123
Income tax on profits	320	263	277	271
Income tax on wages and salaries	91	115	106	123

Source: The World Bank Group / Ministry of Finance.

The amounts of taxes listed in the above table are based on collection basis i.e. cash basis. However, these amounts should be adjusted to reflect taxes that are levied upon economic activity.

Table 5.16 below shows tax values adjusted to reflect economic activities rather than cash basis. These figures are the input data of the regression module.

Table 5.16 Adjusted Tax Values in USD Million (2002 – 2005)

	2002	2003	2004	2005
VAT	843	925	1,144	n/a
Internal activities	296	313	345	349*
Imports	547	612	799	n/a
Income tax on profits	242	273	271	n/a
Income tax on wages and salaries	90	95	106	115

The figures of table 5.16 were adjusted according to the following:

Value Added Tax: This tax is collected on a quarterly basis i.e. taxes raised in the 4th quarter of a given year are levied in the 1st quarter of the following year. Therefore, in order to account for the economic activity in specific year, data are extracted from the actual declared VAT.

VAT is collected from the:

- Imports of goods, and
- Internal activities.

In this regression module, VAT under consideration is only the VAT related to the internal activities. VAT collected from imports is considered to be constant for the next five years.

Income Tax on Profits: This tax is collected in a given year for the results achieved in the previous year. In addition, there are tax amnesty regularizations that affect the collected tax in specific years.

* VAT collected from internal activities is estimated at 1 percent increase from 2004 and is due to the significant events that prevailed during 2005.

Income Tax on Wages and Salaries: This tax prior to 2003 was collected on a semi-annual basis and starting 2003 has been collected on a quarterly basis. For that reason, taxes collected in 2003 are inflated. In addition, since the launch of the *Deduction At Source on Wages and Salaries* "DASS" by the MOF, collection of income tax on wages and salaries improved considerably.

Values of table 5.16 were entered into SPSS window and the following tables were extracted:

Section (I)

1. **Independent variable**: GDP.
2. **Dependant variable**: VAT.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	25.215	19.083		1.321	.317
	GDP	1.457E-02	.001	.996	15.791	.004

a. Dependent Variable: VAT

Equation is as follows: $Y = 25.215 + 0.01457X$.

The coefficient of determination R^2 is equal to 0.992, which means that around 93 percent of the data are explained by the regression module. As for the significance of ß, it is significant at the 0.05 level. However, a test does not show significance, and accordingly a is not relevant in the module.

Section (II)

1. **Independent variable**: GDP.
2. **Dependant variable**: Income Tax on Profits.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	98.659	122.981		.802	.570
	GDP	8.125E-03	.006	.800	1.331	.410

a. Dependent Variable: PROFITS

Equation is as follows: $Y = 98.658 + 0.008125\,X.$

This module despite adjusting data for bias does not show significance for the results. This is related to the continues improvements in the tax collection process throughout the studied years.

Section (III)

1. **Independent variable**: GDP.
2. **Dependant variable**: Income Tax on Wages and Salaries.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-24.821	28.061		-.885	.470
	GDP	6.123E-03	.001	.954	4.514	.046

a. Dependent Variable: SALARIES

Equation is as follows: $Y = -24.821 + 0.006123\,X.$

R^2 for the module is 0.911 which reflects significant explanations of the variables. In addition, ß is significant at the 0.05 level. However, a test does not show significance. Again, despite adjusting data for bias, other adjustments should be conducted in order to reflect greater accuracy. Such a step requires a detailed and comprehensive analysis of taxes and its interrelation with the economy. It should be noted that such a study should be concluded by the Lebanese government and requires the efforts of several expert in the tax departments in order to calculate tax elasticities and accordingly obtain tax forecasts for a specific future period.

Table 5.17 below shows the values of taxes according to the aforementioned equations extracted from SPSS.

Table 5.17 Tax Projections in USD Million (2006 – 2010). Most Likely Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
GDP*	22,210	23,876	25,666	27,591	29,661	31,885
VAT	1,158	1,208	1,234	1,262	1,292	1,325
Internal activities	359	373	399	427	457	490
Imports	799	799	799	799	799	799
Marginal customs**	0	36	36	36	36	36
Income tax on profits***	279	293	307	323	340	358
Income tax on wages and salaries	115	146	157	169	182	195

Table 5.17 projected data for taxes that should be collected upon economic activity. However, in order to reflect the projected cash collections, again adjustments were done in accordance of the economic versus cash basis for the three taxes under consideration. Table 5.18 shows tax projections that should be collected from 2006 until 2010.

Table 5.18 Projected Tax Collection in USD Million (2006 – 2010). Most Likely Scenario

	2006	2007	2008	2009	2010
GDP	23,876	25,666	27,591	29,661	31,885
VAT	1,196	1,228	1,255	1,285	1,317
Income tax on profits	279	293	307	323	340
Income tax on wages and salaries	138	154	166	178	192

* Ref. table 5.13 page 125.
** Ref. table 5.11 page 122.
*** Income tax for 2005 is projected not actual. This tax will be collected in 2006.

Refer to Appendix J table J.5 and J.6 page183 for tax projections under the optimistic and pessimistic scenarios.

5.5 Private Labor force plan

5.5.1 Current Status

As mentioned in chapter 3 section 3.4.4.3 page 39, private labor force in Lebanon was not properly planned. Labor laws were and are still not applied, unions are not activated, illegal labor come in and out of the country without any objection, excess of foreign labor invade the local markets on the account of the Lebanese employees, and other deadly mistakes.

Those erroneous practices severely influenced the private labor force and drove the majority of educated labor to immigrate to foreign countries searching for a decent rewarding work environment. People who remained in the country are working either in the government and its related public institutions (around 22 percent of labor force) that has become overloaded by employees or in the private sector but with low salaries and wages that do not match with their educational qualifications.

5.5.2 Solutions

Recommendation # 18

The Ministry of Labor in collaboration with Ministry of Culture and Higher Education and Ministry of Trade and Economy should build a plan that shall determine on an annual basis the estimated number of graduates whether academic, technical needed in the different fields and sectors of the Lebanese economy. This plan should be communicated to the public including students and employers and necessary feedback should be captured to update and correct the figures when received.

Recommendation # 19

The Ministry of Labor should organize the terms and conditions whereby foreign labor work. First, a maximum number of foreigner labor should be specified. In this respect also, the said employees should be fully known by the Lebanese authorities. Their files should be available and updated. They also should abide by the applicable labor laws in the country especially declaring their income and paying related taxes.

Recommendation # 20

The Ministry of Labor should conduct at the earliest a census that shall cover all the variables of the labor force in Lebanon including but not limited to number of employees, their distribution on the various economic sectors, their educational level, age, sex, income level, and other factors.

5.6 The Media

Lebanon's constitutional laws encourage freedom of expression and the media sector is active and reachable to all citizens inside the country and abroad as well. Therefore, this sector should publish and monitor the government's economic reform package.

Recommendation # 20

It is recommended that the Media particularly televisions, radios, and newspapers to:

a. Closely follow up the government's economic plan mentioned in section 5.4.1 above,
b. Continuously dig into published figures of ministries and different public entities and reveal any suspicious issues to the public,

c. Specify a portion of news to the economic conditions by showing change in public debt, country's GDP, deficit, and other figures.
d. Specify at least 50 percent of interviews done with Ministers to discuss the performance of their ministries, their projects, and so on,
e. Newspapers to publish economic developments on first pages not on third or fourth pages.

By doing the above, media will contribute to the success of economic plans and the economic reform and will bring to the public any deviation from the reform track. In addition, highlighting economic situation and performance within public institutions will reveal the performance of elected parties that is represented in the government.

5.7 Debt Service

Debt service despite interest rates decline after Paris II Club is the major burden that the treasury needs to resolve. As of December 31, 2005, the total public debt amounted to USD 38,507 million of which USD 19,330 million were domestic and USD 19,177 were external.[18]

Debt service bill is planned to be reduced through reducing the size public debt that is done via two ways:

1. Using telecom privatization proceeds to settle principal debt at the spot, and
2. Using projected annual budget surplus of the years 2006 until 2010 inclusive to settle principal amounts of debt (note that the projected surplus is a result of the aforementioned reform package at the level of controlling expenditures, increasing revenues, and achieving economic growth). In addition, it is also estimated that the Lebanese government in coordination with the Central Bank

will be able to decrease interest rates starting the years 2008 to between 1 to 2 percent through modifying the monetary policy and through the activation of the Lebanese economy and the reinforcement of the credibility of the Lebanese financial system.

Table 5.19 Public Debt Payments Projections in USD Million (2006 – 2010)

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Total Public Debt	**38,507**	**32,337**	**32,632**	**32,504**	**32,282**	**31,950**
Payments:						
Principal	0	6,170	(295)	128	222	332
Telecom Privatization Proceeds*	0	6,525	0	0	0	0
Budget Surplus / (Deficit)**	0	(355)	(295)	128	222	332
Interest Cost	2,344	1,804	1,830	1,480	1,465	1,443

<u>Assumptions of table 5.19:</u>

1. Proceeds from telecom privatization are paid immediately to settle principal amounts of the domestic debt,
2. Budget surplus / deficit of table 5.21 page 146 are used to decrease / increase principal amounts of the debt,
3. Interest saving each year is calculated at an annual 8.75 %, weighted average cost of the domestic debt,
4. Interest rate decrease of 1.5 percent starting 2008.

* Ref. section 5.3.1.1.C page 119.

** Ref. table 5.21 page 146.

5.8 Projected State Budget

The previous sections of this chapter recommended reform plan that basically covers:

- ⇒ Decreasing public expenditures (personnel cost, municipalities, dismantling public entities and funds, EDL, and other treasury expenditures).
- ⇒ Increasing public revenues (privatization of telecom sector and new customs' tariffs).
- ⇒ Surging economic growth (increases GDP and accordingly increases collected taxes).

This section projects for a five years period the revenues and expenditures of the Lebanese government in context of the aforementioned recommended reform package. Projections are based on the actual revenues and expenditures of the fiscal year 2004 (Ref. tables 3.14 page 48, 3.17 page 53, and 3.19 page 55).

5.8.1 Projected State Revenues

Table 5.20 projects a five year plan for the Lebanese government revenues:

Table 5.20 Projected State Revenues in USD Million (2006 – 2010). Most Likely Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
VAT*	1,169	1,196	1,228	1,255	1,285	1,317
Income Tax on Profits*	277	279	293	307	323	340
Income Tax on Salaries*	106	138	154	166	178	192
Customs**	351	710	710	710	710	710
Telecom***	869	261	285	305	326	351
Other Revenues	2,212	2,212	2,212	2,212	2,212	2,212
Total	**4,984**	**4,796**	**4,882**	**4,955**	**5,034**	**5,122**

* Ref. table 5.18 page 139.
** Ref. table 5.12 page 123.
*** Ref. table 5.10 page 119.

Refer to Appendix J tables J.7 and J.8 page 184 for projected state revenues under the optimistic and pessimistic scenarios.

5.8.2 Projected State Expenditures

Table 5.21 below projects a five year plan for the Lebanese government expenditures:

Table 5.21 Projected State Expenditures in USD Million (2006 – 2010). Most Likely Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
Personnel Cost[*]	2,051	1,885	1,885	1,885	1,885	1,885
Transfers to Municipalities[**]	306	106	106	106	106	106
Council of the South[***]	77	0	0	0	0	0
Ministry of Displaced Affairs[***]	4	0	0	0	0	0
Displaced Fund[***]	105	0	0	0	0	0
Ministry of Education and Fine Arts[***]	14	0	0	0	0	0
Ministry of Information[***]	18	0	0	0	0	0
Ministry of Youth and Sports	13	0	0	0	0	0
Transfers to EDL[****]	382	0	0	0	0	0
Interest Cost[*****]	2,666	1,804	1,830	1,480	1,465	1,443
Other Expenditures	1,356	1,356	1,356	1,356	1,356	1,356
Total	**6,992**	**5,151**	**5,177**	**4,827**	**4,812**	**4,790**

Refer to Appendix J tables J.9 and J.10 page 185 for projected state expenditures under the optimistic and pessimistic scenarios.

[*] Ref. table 5.1 page 111.
[**] Ref. table 5.4 page 113.
[***] Ref. table 5.2 page 112.
[****] Ref. section 5.3.1.2 page 120.
[*****] Ref. table 5.19 page 143.

5.8.3 Projected State Deficit / Surplus

Table 5.22 below sums tables 5.20 page 144 and 5.21 page 145 to derive Lebanon's projected surplus / deficit for the years 2006 until 2010 inclusive:

Table 5.22 Projected State Deficit / Surplus in USD Million (2006 – 2010). Most Likely Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
Revenues*	4,984	4,796	4,882	4,955	5,034	5,122
Expenditures**	6,992	5,151	5,177	4,827	4,812	4,790
Surplus / (Deficit)	**(2,008)**	**(355)**	**(295)**	**128**	**222**	**332**

Refer to Appendix J tables J.11 and J.12 page 186 for projected state surplus / deficit under the optimistic and pessimistic scenarios.

5.9 Projected Public Debt vs. GDP

Based on the aforementioned reform package that shall achieve economic growth, adjust fiscal and monetary policies, decrease interest cost and rates later on, control public expenditures, increase public revenues; the Lebanese government will be able to settle principal amounts of public debt. The latter will level approximately to stay in the size of economy that grew on its turn. Table 5.23 shows projected public debt versus projected GDP for the years 2006 until 2010 inclusive.

* Ref. table 5.20 page 144.
** Ref. table 5.21 page 145.

Table 5.23 Projected Public Debt vs. GDP in USD Million (2006 – 2010). Most Likely Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Total Public Debt*	38,507	**32,337**	**32,632**	**32,504**	**32,282**	**31,950**
GDP**	22,210	**23,876**	**25,666**	**27,591**	**29,661**	**31,885**
Debt / GDP	173.4%	**135.4%**	**127.1%**	**117.8%**	**108.8%**	**100.2%**

Refer to Appendix J tables J.13 and J.14 page 187 for projected public debt vs. GDP under the optimistic and pessimistic scenarios.

5.10 Concluding Remarks

The aforementioned recommendations should be achieved in one package because the situation in Lebanon does not tolerate half solutions. Only a complete reform package shall be able to shift Lebanon from the current situation to a prosperous one and shall contain public debt to a level that is close to its economic size as shown in table 5.23.

* Ref. table 5.19 page 143.
** Ref. table 5.13 page 125.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

6.1 Conclusions

Lebanon's public debt has been adding up from approximately **USD 3 billion** in 1993 to approximately **USD 39 billion** by the end of December 2005 posting a compound average growth rate of **23.48 percent** per annum. On the other hand, Lebanon's nominal GDP for 2005 amounted to around **USD 22 billion**, a fact that reflects the big gap between debt size and economy size with a debt to GDP ratio of around 173 percent. On average, real economic growth rates for the previous 12 years posted around **3.8 percent** per annum.

Basically, Lebanon's public debt was accumulated by borrowed funds to finance the public deficit of the government that has spirally increased out of proportion in respect to increasing expenditures that exceeded revenues by an average of approximately **USD 2.4 billion** per annum. Such expenditures were divided into several unproductive and non earning categories including construction, health, military, debt service, social affairs, and waste.

Parallel to the debt accumulation and state deficit, different economic sectors were immobilized in a manner that influenced the business activity and investment environment. Unemployment rose, so did inflation, interest rates, and financial and social burdens.

Lebanon reached the situation it is facing today basically due to a combination of factors including the Syrian occupation, corruption, political conflicts, improper governmental policies, and the absence of accountability and control. To what extent of damage each factor contributed is not possible to determine.

Lebanon has a dynamic banking sector with deposits amounting to USD 55 billion as of end of August 2005. However, around USD 35 billion of banks' assets are held with public sector (MOF and BDL) i.e. approximately 64 percent of total deposits. This dependence of the Lebanese government on banks to finance its deficit is causing lack of liquidity in the market. In addition, the tightened monetary policy implemented by the Central Bank has caused high interest rates and hence an increase in unemployment.

The private investments in Lebanon are limited to 20 percent of GDP. In addition, around 70 percent of investments are self financed. Therefore, the market (i.e. banks and stock market) are jointly financing only 30 percent of investments in the country. On top of that, the cost of borrowing to investors is high and risky. Those factors are driving investors to deposit money at banks rather than initiate new investments that are necessary to enhance the economy that is facing a deep recession which if not treated properly will ultimately backfire and create an irreversible turnaround.

The Lebanese government spends annually around **USD 7 billion** of which around **USD 2.5 billion** constitute debt service (35 percent of total expenditures). The other **USD 4.5 billion** are spent on the public sector that includes personnel cost, capital expenditures, machines, equipments, material, as well as to finance the losses of EDL, the state owned electricity company. The government revenues amount to around **USD 5 billion** and are divided into tax and non tax revenues. The regression module presented in chapter 5 concludes that tax revenues can be increased along with the increase of the economic size without increasing tax rates or imposing any new taxes.

Within all above mentioned dilemmas, Lebanon has a long list of problems to face and resolve. The road to recovery should start very soon because each day of delay passes at a higher cost (approximately USD 6.4 million per day). It should be noted that the said dilemmas would not be solved except with a **comprehensive reform package** that has clear objectives and timetable and that address each problem within the economy and sets its solutions.

6.2 Recommendations

After analyzing data collected and presented in the background of the study, a set of recommendations should be implemented at the earliest in order to resolve Lebanon's public debt and reactivate the economy. The said recommendations were discussed in chapter 5 that are based an overall economic plan that entails all aspects of the economy supported by clear responsibilities, objectives and a timetable. The direction of the plan should address the following points:

1. **Control Public Expenditures**
    a. Decrease personnel costs, assess employees' performance, improve productivity, and increase daily work hours, and launch automation to eliminate tasks and improve output.
    b. Unify pension and retirement schemes in order to lower costs and widen social benefits to citizens and increase safety nets.
    c. Determine the need and output of each ministry and public institution and the tradeoffs between its cost and benefits to economy and society.

d. Cease EDL's deficit by reforming and privatizing this sector.

e. Dismantle some ministries, councils and funds that cost millions of dollars in the previous 15 years.

2. Increase Public Revenues

a. Privatize the telecom and electricity sectors and use proceeds directly to pay debt principals.

b. List shares of privatized companies at BSE.

c. Conduct feasibility studies to detect under performed state companies and privatize its management or grant operating licenses to the private sector.

d. Increase customs' tariffs in a step aimed at generating new revenues to the treasury and protecting local industries.

e. Search for new sources of non tax revenues from services provided by state assets such as ports, airport, sea properties, and others.

3. Achieve Economic Growth

a. Adjust the monetary policy to liberate the Lebanese Lira and link its rate to the supply and demand of funds in the market and decrease interest rates.

b. Reinforce the role and contribution of the private sector by providing a supportive framework for private investments.

c. Activate the stock market by issuing new modern regulations, impose solid control, provide transparency, increase liquidity, and establish an advanced online trading module.

d. Release the Lebanese banks from financing public deficit to focus on lending the private sector in order to increase market financed investments.

e. Reform tax nature, base, and rates in more equitable manner without imposing any new taxes due to the tragic financial and social situation.

f. Conduct budget reform through consolidating public revenues and expenditures in one clear, feasible annual budget that is prepared and communicated on timely basis.

g. Conduct statistical studies that are comprehensive and available to all people.

h. Plan the private labor force in Lebanon by studying the overall working condition and requirements in the market, directing students on requested specializations, improving work environments, applying rules, and organizing foreigner labor affairs by documenting their files, locations, nature of job and impose taxes on their income.

4. Public Debt

a. Use the privatization proceeds to settle principal amounts of debt.

b. Decrease the interest bill by decreasing interest rates in the long-term.

c. Containing the public debt to a level that coincides with the economy size (GDP) by the end of 2010.

5. Media

a. Follow up the government's economic plan.

b. Highlight the economic developments by broadcasting and pinpointing economic figures.

6.3 Future Consideration

Conducting a study on the Lebanese public debt is comprehensive because it is linked to a various number of variables that in turn are correlated. Such variables include the general and legal framework in the country, financial institutions, banking sector, stock market, trade balance, state deficit / surplus, monetary policy, balance of payments, not to mention components of economy, growth rates, inflation, and interest rates, as noted in the previous chapters of this thesis. However, each variable if studied thoroughly may require a separate study. Therefore, potential future research is justified in this regard. Studies that may take some of these variables and determine its influence on public debt separately and when combined with other variables.

In addition, more research is required in terms of government's performance especially its public revenues. A better access to data particularly to state assets would detect new sources of non tax revenues that the government would generate and such solutions would give better results and thus a smoother gate to resolving the public debt. As mentioned earlier, access to data and files is a major barrier and if this issue is resolved, more alternatives would be generated and accordingly a better set of solutions would be derived.

GLOSSARY

Bearing liabilities: Includes all liabilities that bear interest.

Bilateral debt: Such debt is granted when creditor countries sign an Agreed Minute which is a recommendation to their governments to negotiate and sign a legally-binding bilateral agreement with the debtor country.

BIS ratio: Ratio of equity to average risk weighted assets.

Burden ratio: Measures the amount of non-interest expense covered by fees, service charges, securities gains, and other income as a fraction of average total assets.

Capital formation ratio: Is the ratio of private investments to GDP.

Domestic debt: The data on domestic debt cover loans to the central government granted by domestic banks or financial institutions. Government domestic debt is broken down by holder into: central bank, other banks and financials institutions, treasury bonds, and other.

Earning assets: Includes all assets that generate explicit interest income.

Economy: The process whereby societies use scare resources to produce valuable commodities and distribute them among different people.

Efficiency ratio: Measures bank's ability to control non interest expense relative to adjusted operating income.

Eurobond: bonds sold outside the country of currency domination.

Fixed exchange-rate system: A system where the value of exchange rate is officially set by the government. In such a system, the government announces an exchange rate or takes steps to enforce one.

Flexible exchange-rate system: When exchange rates move purely under the influence of supply and demand. In such a system, the government neither announces an exchange rate nor takes steps to enforce one.

Foreign debt: The data on foreign public debt are classified by borrower and creditor (multilateral, bilateral). Foreign debt is classified by maturity (short-, medium-, or long-term). Government foreign debt is broken down by holder into: multilateral, bilateral, OECD, Paris Club, and other.

GDP: The gross domestic product is the most comprehensive measure of a nation's total output of goods and services. It is the sum of dollar value of consumption (C), investment (I), government purchases of goods and services (G), and net exports (X) produced within a nation during a given year.

Multilateral debt: Is that portion of a country's external debt burden owed to international financial institutions such as the International Monetary Fund and the World bank.

Monetary policy: A central bank's actions to influence the availability and cost of money and credit, as a means of helping to promote national economic goals.

Net interest margin: A measure of the interest return on income producing assets.

Nominal GDP: Is measurement of GDP at the actual market prices disregarding changes in prices of goods and services.

OECD: Organization for Economic Cooperation and Development) is an international body composed of 24 member nations. Its objective is to coordinate economic and development policies of the member nations.

Paris Club: Term used to describe when a debtor nation meets with creditor nations to renegotiate its official debt. The name results from the fact that the meetings are often chaired by an official from the French treasury department

Primary data: Is data conducted directly by researcher and include interviews, surveys, focus groups, and else.

Public expenses: Expenditures are amounts paid during or in respect of a period to acquire goods and services, other than amounts spent to acquire things of value that the government recognizes as assets or spending to repay amounts due that the government recognizes as liabilities.

Public debt: the total of the nation's debts: debts of local and state and national governments; an indicator of how much public spending is financed by borrowing instead of taxation.

Public revenues: The income of a government from all sources appropriated for the payment of the public expenses.

Real GDP: Is measuring GDP taking into consideration changes in prices of goods and services.

Spread: Average yield on earning assets minus the average cost of interest bearing liabilities.

State deficit: When government spending overwhelms government revenue resulting in government borrowing.

Secondary data: Is data collected from a secondary source such as reports, publications, books, company files.

Tax: A fee charged ("levied") by a government on a product, income, or activity. If tax is levied directly on personal or corporate income, then it is a direct tax. If tax is levied on the price of a good or service, then it is called an indirect tax. The purpose of taxation is to finance government expenditure.

Treasury bills: short term obligations issued by Governments to finance their expenditures. TBs less than one year maturity are issued at zero coupon rates. More than one year maturities pay interim coupon payments.

Trade deficit: Balance of trade figures, also called net exports (NX), are the sum of the money gained by a given economy by selling exports, minus the cost of buying imports. A positive balance of trade is known as a trade surplus and consists of exporting more (in financial capital terms) than one import. A negative balance of trade is known as a trade deficit or, informally, as a trade gap.

End Notes

Chapter 2

[1] Bank Audi, *Country and Market Update 2005 - Lebanon*, 38; available from http://www.audi.com.lb/geteconomy/economic/c&m2005.pdf; Internet.

[2] Bank Audi, *Country and Market Update 2005 - Lebanon*, 38.

[3] Bank Audi, *Country and Market Update 2005 - Lebanon*, 38.

[4] Bank Audi, *Country and Market Update 2005 - Lebanon*, 40.

[5] Bank Audi, *Country and Market Update 2005 - Lebanon*, 40.

[6] Ossama Habib, "Seniora's Economic Program a Hard Sell," *Daily Star Newspaper*, 5 January 2006; available from http//:www.dailystar.com.lb; Internet.

[7] MP Walid Jumblat, *Kalam Ennas Talk Show*, Lebanese Broadcasting Corporation LBC, 12 February 2006.

[8] Ministry of Finance, online database; available from http://www.finance.gov .lb; Internet.

[9] Former Prime Minister Omar Karami, *Kollona LilWatan 2005? Program,* Lebanese Broadcasting Corporation LBC, 8 February 2006.

[10] George Ghanem, *Kollona LilWatan 2005? Program,* Lebanese Broadcasting Corporation LBC, 8 February 2006.

Chapter 3

[1] Paul A. Samuelson & William D. Nordhaus, *Economics* 17th ed. , (New York: Mc-Graw-Hill, 2001), 434.

[2] Paul A. Samuelson & William D. Nordhaus, *Economics* 17th ed. , 325.

[3] Ya Libnan, "PM Siniora heads to NY for Lebanon's Economic Rescue Plan," 13 September 2005; available from http://yalibnan.com/site/archives/2005/09/ pm_siniora_head.php; Internet.

[4] Hugh Jeffrey, "Lebanon: Unity at the Top," Business Week Online; available from http://www.businessweek.com/adsections/2002/country/lebanon.htm; Internet.

[5] Elie Yachouei, *Lebanon's Economy: Approach and Vision*, (Zouk Moukayel: Notre Dame University, 2005), 145.

[6] John Taylor, *Economics* 3rd ed., (Houghton, 2001), 16.

[7] Ministry of Finance, *Public Finance Overview*, available from http://www. finance.gov.lb; Internet.

[8] William Mitchell, *Divisions over Public Debt,* Evatt Foundation; available from http://evatt.org.au.

[9] The World Bank Group, Lebanon's Country Office, Third and Fourth Quarter Update, *Working Together for Lebanon's Transition from Reconstruction to Development,* 4.

[10] Yachouei, *Lebanon's Economy: Approach and Vision*, 61.

[11] Charl Ayoub, *Kalam Ennas Talk Show*, Lebanese Broadcasting Corporation LBC, 16 February 2006.

[12] Ahmed Fatfat, Interview by George Salibi, New Television NTV, 8 February 2006.

[13] Ziad K. Abdelnour, "The Corruption Behind Lebanon's Electricity Crisis," *United States Committee for a Free Lebanon and Middle East Forum*, August 2003, vol. 5, no.8-9; available from http://www.meib.org/articles/0308_l1.htm; Internet.

[14] MP George Qasarji, *Al Fasad Talk Show*, New Television NTV, 3 March 2006.

[15] Ministry of Finance, *Public Finance Prospects for 2004,* 3.

[16] Ministry of Finance, *Public Finance Prospects for 2004*, 4.

[17] Bank Audi, *Country and Market Update 2005 - Lebanon*, 2: 60 and 61.

[18] GOLIATH, "Crude Oil Futures Average Record $31 Per Barrel in 2003," 5 January 2004, available from http://goliath.ecnext.com/comsite5/bin/pdinventory.pl?pdlanding=1&referid=2750&item_id=0199-1238455; Internet.

[19] Business New, "Crude Oil Tops $70 Per Barrel," 29 August 2005; available from http://news.monstersandcritics.com/business/article_1044485.php/Crude_oil_tops_$70_per_barrel; Internet.

[20] Bank Audi, *Country and Market Update 2005 - Lebanon*, 61.

[21] Yachouei, *Lebanon's Economy: Approach and Vision*, 69.

Chapter 4

[1] International Maronite Foundation, *Economic Stability of Lebanon,* online database; available from http://www.maronet.org/economy.htm; Internet.

[2] Banque Du Liban, *Financial Markets Handbook,* 103.

[3] Association of Lebanese Banks, online database; available from http://www. abl.org.lb /ALMANAC; Internet.

[4] Nassar Daher, "Monetary Policy in Lebanon," (M.B.A. thesis, Notre Dame University 2003), 10.

[5] Hugh Jeffrey, "Lebanon: Unity at the Top," Business Week Online.

[6] Yachouei, *Lebanon's Economy: Approach and Vision*, 69.

[7] Banque Du Liban. *Lebanese Monetary Policy;* available from http://www. bdl.gov.lb/bdl/policy.htm; Internet.

[8] Gobran Khoury, Head of GSM section, Ministry of Post and Telecommunications, interview by Nizar Sleem, Riad Solh, 24 February 2006.

[9] Ministry of Finance, *Public Finance Monitor 2005,* 5.

[10] Higher Council for Privatization, online database; available from http://www.hcp.gov.lb; Internet.

Chapter 5

[1] Ann P. Bartel, *Ownership versus Environment: Why are Public Sector Firms Inefficient?,* National Bureau of Economic Research; available from http://ideas. repec.org/p/nbr/nberwo/7043.html; Internet.

[2] The World Bank Group, Lebanon's Country Office, Second Quarter Update 2005, *Lebanon's Road to Economic and Social Recovery: Two Fallacies and Two Lessons,* 4.

[3] Sèbastien Dessus, Sr. Country Economist; The World Bank; Lebanon's Country Office, Email.

[4] The World Bank Group, Lebanon's Country Office, First Quarter Update 2005, *Lebanon's Road to Economic and Social Recovery: Two Fallacies and Two Lessons,* 5.

[5] The World Bank Group, Lebanon's Country Office, First Quarter Update 2005, *Lebanon's Challenge: From Malaise to Renaissance,* 5.

[6] The World Bank Group, Lebanon's Country Office, Second Quarter Update 2005, *Lebanon's Road to Economic and Social Recovery: Two Fallacies and Two Lessons,* 4.

[7] The World Bank Group, Lebanon's Country Office, First Quarter Update 2005, *Lebanon's Challenge: From Malaise to Renaissance,* 5.

[8] HATIF telecom, "Jordan Has the Most Competitive Arab Cellular Market," 25 September 2005; available from http://www.hatiftelecom.com/news/jordan.html; Internet.

[9] Hayden Wetzel, "Lebanon Country Commercial Guide," U.S. & FOREIGN COMMERCIAL SERVICE AND U.S. DEPARTMENT OF STATE, 2003.

[10] Ministry of Finance, *Public Finance Monitor 2005,* 4.

[11] Aswath Demodaran, Professor of Finance. Stern School of Business at New York University. *Country Default Spreads and Risk Premiums*; available from http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/ctryprem.html; Internet.

[12] The Lebanese Customs, *National Tariffs*; available from http://www.customs.gov.lb/customs/tariffs/national/tariff1.asp; Internet.

[13] The World Bank Group, Lebanon's Country Office, First Quarter Update 2005, *As the Political Dialogue Continues, Advance the Social and Economic Reform,* 11.

[14] Bank Audi, *The private and Public Sector Requirements for a Smooth Soft-Landing*, 2.

[15] Bank Audi, *The private and Public Sector Requirements for a Smooth Soft-Landing*, 12.

[16] Bank Audi, *The private and Public Sector Requirements for a Smooth Soft-Landing*, 12.

[17] James R. McGuigan, R. Charles Moyer, and Frederick H. Harris, *Managerial Economics: Applications, Strategy, and Tactics,* (South-Western: International Thomson Publishing), 134.

BIBLIOGRAPHY

Books

Hosek William and Zahn Frank. *Monetary Theory, Policy, & Financial Markets.* (New York: Mc-Graw-Hill, 1977).

Musgrave Richard and Musgrave Peggy. *Public Finance In Theory & Practice.* (New York: Mc-Graw-Hill, 1989).

Premchand A. *Government Budgeting & Expenditures Controls: Theory & Practise.* (IMF 1989).

Samuelson Paul & Nordhaus William. *Economics* 17th ed.. (New York: Mc-Graw-Hill, 2001).

Taylor John. *Economics* 3rd ed., (Houghton, 2001).

Yachoui Elie. *Lebanon's Economy: Approach & Vision.* (Zouk Moukayel: Notre Dame University, 2005).

Publications

Association of Lebanese Banks. *Bilan Bank 2004.*

Banque Du Liban. *Monthly Bulletin June 2005.*

_________. *Monthly Bulletin July 2005.*

_________. *Monthly Bulletin August 2005.*

_________. *2nd Quarter Bulletin 2005.*

__________. *3rd Quarter Bulletin 2005.*

__________. *3rd Quarter Bulletin 2005.*

__________. *Financial Markets Handbook.*

Bank Audi. *Country and Market Update 2005 – Lebanon.*

__________. Fourth Quarter Update2005 – Lebanon: *The Private and Public Sector Requirements for a Smooth Soft-Landing.*

__________. Second Quarter Update2005 – Lebanon: *The Economic Cost of A Critical Political Transition.*

International Maronite Foundation. *Economic Stability of Lebanon.*

Ministry of Finance. *Public Finance Prospects 2000.*

__________. *Public Finance Prospects 2001.*

__________. *Public Finance Prospects 2002.*

__________. *Public Finance Prospects 2003.*

__________. *Public Finance Prospects 2004.*

__________. *Public Finance Monitor 2005.*

Ministry of Trade and Economy. *Lebanese Economic Accounts 1997 – 2002.*

Report of the International Independent Investigation Commission. Established Pursuant to Security Council *Resolution 1595.* By Detlev Mehlis, Commissioner. 19 October 2005.

The World Bank Group, Lebanon's Country Office. Third and Fourth Quarter Update 2005. *Working Together for Lebanon's Transition from Reconstruction to Development.*

_________. Second Quarter Update 2005. *Lebanon's Road to Economic and Social Recovery: Two Fallacies and Two Lessons.*

_________. First Quarter Update 2005. *Lebanon's Challenge: From Malaise to Renaissance.*

_________. Fourth Quarter Update 2004. *Perspectives for Pharmaceutical Reform in Lebanon.*

_________. First Quarter Update 2006. *As the Political Dialogue Continues, Advance the Social and Economic Reform.*

World Fact Book. United States of America, Lebanon, Israel, Bahrain, Egypt, Iraq, Jordan, Morocco, Tunisia, Saudi Arabia, Syria, Qatar, Yemen, Iran, Kuwait, United Arab Emirates, Algeria, Libya, Oman.

Media

Lebanese Broadcasting Corporation. *Kalam Ennas Talk Show.*

Lebanese Broadcasting Corporation. *Kollona LilWatan 2005?*

New Television. *Al Fasad Talk Show.*

Unpublished Materials

Daher Nassar. *"Monetary Policy in Lebanon."* (M.B.A. thesis, Notre Dame University 2003).

APPENDIX A

CONSUMPTION AND PRIVATE INVESTMENTS

Table A.1 Consumption Breakdown in USD Million (1997 – 2002)

	1997	1998	1999	2000	2001	2002
Food products	3,932	3,970	3,936	3,860	3,873	4,133
Tobacco	439	446	379	358	466	432
Textiles and clothing	904	956	941	957	969	1,043
Energy and water	916	950	992	994	1,029	1,188
Durables	1,309	1,270	1,131	1,055	1,073	1,189
Other manufactured products	1,225	1,277	1,229	1,136	1,238	1,329
Transport and communication	758	771	853	994	1,038	1,120
Housing rent	1,348	1,359	1,394	1,429	1,462	1,495
Education and health	2,064	2,286	2,362	2,467	2,474	2,776
Other services	1,199	1,253	1,341	1,384	1,331	1,406
Less: tourism expenditure	(231)	(243)	(240)	(359)	(404)	(490)
Total	**13,863**	**14,295**	**14,318**	**14,275**	**14,549**	**15,621**

Source: Ministry of Trade and Economy, *Lebanon's Economic Accounts 1997 – 2002,* 39.

Table A.2 Private Investments Breakdown in USD Million (1997 – 2002)

	1997	1998	1999	2000	2001	2002
Construction works	3,010	3,307	2,655	2,422	2,438	2,480
Machinery and equipment	1,241	1,182	915	740	712	777
Furniture	177	189	175	155	157	159
Other products	251	247	202	178	218	215
Change in inventories	(39)	(1)	(13)	(107)	404	(236)
Total	**4,640**	**4,924**	**3,934**	**3,388**	**3,929**	**3,395**

Source: Ministry of Trade and Economy, *Lebanon's Economic Accounts 1997 – 2002,* 48.

APPENDIX B

INTEREST RATES

Table B.1 Interest Rates – Commercial Banks in Percent

	Lending and Deposit Rate L.L.						Lending and Deposit Rate USD					
Period	Discount &loans	Checking & Current accounts	Saving at call	Term deposits	Average rate/deposits	**Interbank Rates on call L.L.**	Discount &loans	Checking & Current accounts	Saving at call	Term deposits	Average rate/deposits	Libor 3 - months
Jan-05	10.36	2.22	4.22	7.08	6.75	3.50	8.10	0.51	1.05	3.65	3.29	2.67
Feb-05	10.26	2.46	4.06	7.02	6.61	12.00	7.98	0.56	1.25	3.71	3.33	2.82
Mar-05	10.98	2.80	4.58	8.50	7.97	9.00	8.22	0.63	1.25	3.80	3.46	3.02
Apr-05	11.27	2.25	4.78	8.90	8.38	7.00	8.07	0.73	1.34	3.90	3.54	3.15
May-05	11.06	2.26	4.81	8.91	8.42	4.00	8.02	0.76	1.31	3.95	3.58	3.27
Jun-05	10.97	2.44	4.55	8.73	8.19	3.50	8.20	0.75	1.26	4.00	3.62	3.43
Jul-05	10.75	2.21	4.43	8.33	7.90	3.50	8.00	0.58	1.26	4.07	3.65	3.61
Aug-05	10.53	2.41	4.12	8.13	7.71	4.00	8.15	0.91	1.25	4.14	3.72	3.80
Sep-05	10.69	3.44	3.94	8.02	7.61	4.00	8.31	0.79	1.20	4.19	3.78	3.91
Oct-05	10.50	4.19	3.85	8.04	7.53	3.75	8.22	1.04	1.28	4.31	3.86	4.17
Nov-05	10.19	2.96	3.87	8.02	7.60	3.75	8.34	1.05	1.28	4.37	3.96	4.35

Source: Banque Du Liban, *Monthly Bulletin of November 2005,* 4.

APPENDIX C

LEBANESE BANKS' GROUPS

Table C.1 Alpha Group

	Alpha Group
1	Bank Audi Sal
2	Bank of Beirut Sal
3	Banque de la Mèditerranèe Sal
4	Banque Libano-Francaise Sal
5	BBAC Sal
6	BLOM Bank Sal
7	Byblos Bank Sal
8	Crèdit Lebanais Sal
9	Fransabank Sal
10	Sociètè Gènèrale de Banque au Liban Sal – SGBL

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 42.

Table C.2 Alpha Group Figures in USD Million

	2003	2004	change
Total assets	47,619	54,087	14%
Total deposits	38,950	43,894	13%
Shareholders' equity	3,271	3,661	12%

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 45.

Table C.3 Beta Group

	Beta Group
11	AL-Mawarid Bank Sal
12	Arab Bank Plc
13	Audi Saradar Private Bank Sal
14	B.L.C. Bank Sal
15	Banque Nationale de Paris "Intercontinentale"
16	Crèdit Libanais Investment Bank Sal
17	First National Bank Sal
18	HSBC Bank Middle East
19	Intercontinental Bank of Lebanon Sal
20	Lebanese Canadian Bank Sal
21	Lebanon and Gulf Bank Sal
22	Saudi Lebanese Bank Sal

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 48.

Table C.4 Beta Group Figures in USD Million

	2003	2004	change
Total assets	9,297	11,294	21%
Total deposits	7,988	9,560	20%
Shareholders' equity	327	370	13%

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 51.

Table C.5 Gamma Group

	Gamma Group
23	Al Ahli International Bank Sal
24	Allied Bank Sal
25	Audi Saradar Investment Bank Sal
26	Bank of Kuwait and the Arab World Sal
27	Banque de l'Industrie et du Travail Sal
28	Banque Misr Liban Sal
29	Banque Européenne pour le Moyen-Orient Sal
30	BlomInvest Bank Sal
31	Creditbank Sal
32	Federal Bank of Lebanon Sal
33	Jammal Trust Bank Sal
34	Lebanese Swiss Bank Sal
35	MEAB Sal
36	National Bank of Kuwait (Lebanon) Sal
37	North Africa Commerical Bank Sal
38	Sociètè Nouvelle de la Banque de Syrie et du Liban SAL
39	The Syrian Lebanese Commerical Bank Sal

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 54.

Table C.6 Gamma Group Figures in USD Million

	2003	2004	change
Total assets	5,114	5,760	13%
Total deposits	4,059	4,471	10%
Shareholders' equity	427	462	8%

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 57.

Table C.7 Delta Group

	Delta Group
40	Arab African International Bank
41	Arab Investment Bank Sal
42	Banca di Roma Spa
43	Bank Saderat Iran
44	Banque de Crèdit National Sal
45	Banque de la Bèkaa Sal
46	Banque de l'Habitat Sal
47	Banque Lati Sal
48	Banque Pharaon et Chiha Sal
49	Byblos Invest Bank Sal
50	Citibank N.A.
51	Finance Bank Sal
52	Fransa Invest Bank Sal
53	Habib Bank Limited
54	Mèditerranèe Investment Bank Sal
55	Near East Commerical Bank Sal
56	Rafidain Bank
57	Standard Chartered Bank Sal
58	The Saudi National Commercial Bank

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 60.

Table C.8 Delta Group Figures in USD Million

	2003	2004	change
Total assets	1,442	1,538	7%
Total deposits	948	1,028	8%
Shareholders' equity	231	253	10%

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 63.

APPENDIX D

LEBANESE BANKS' FIGURES

Table D.1 Assets in USD Million (2003 – 2004)

	2003	Of total	2004	of total	change
Cash and central bank	19,339	30.5%	20,623	28.4%	6.6%
Lebanese treasury bills & other government bills	15,128	23.8%	17,262	23.8%	14.1%
Bonds & financial instruments with fixed income	1,437	2.3%	1,886	2.6%	31.2%
Marketable securities and fin. instruments	230	0.4%	474	0.7%	106.1%
Banks and financial institutions	9,093	14.3%	12,740	17.5%	40.1%
- Current accounts	1,247	1.9%	1,464	2.0%	17.4%
- Time deposits	7,839	12.4%	11,269	15.5%	43.8%
- Securities purchased under resale agreements	7	0.0%	7	0.0%	0.0%
Branches, parent co., sister inst. & subsidiaries	1,627	2.6%	1,532	2.1%	-5.8%
- Current accounts	125	0.2%	75	0.1%	-40.0%
- Time deposits	1,502	2.4%	1,457	2.0%	-3.0%
Loans and advances to customers	13,532	21.3%	14,522	19.9%	7.3%
- Commercial loans	7,648	12.1%	8,515	11.7%	11.3%
- Other loans	2,900	4.6%	2,977	4.1%	2.7%
- Overdraft accounts	1,434	2.3%	1,643	2.3%	14.6%
- Net debtor accounts / credit accounts	28	0.0%	19	0.0%	-32.1%
- Loans and advances to related party	457	0.7%	479	0.7%	4.8%
- Doubtful loans	1,065	1.7%	889	1.2%	-16.5%
Bank acceptances	767	1.2%	1,059	1.5%	38.1%
Investments and loan to related parties	150	0.2%	185	0.3%	23.3%
Investments in related parties in equity methods	13	0.0%	15	0.0%	15.4%
- Non-financial	10	0.0%	12	0.0%	20.0%
- Financial	3	0.0%	3	0.0%	0.0%
Tangible fixed assets	1,296	2.0%	1,422	2.0%	9.7%
Intangible fixed assets	19	0.0%	22	0.0%	15.8%
Other assets	81	0.1%	138	0.2%	70.4%
Regularization accounts & mis. debtor accounts	531	0.8%	544	0.8%	2.4%
Revaluation variance of fixed assets	68	0.1%	65	0.1%	-4.4%
Goodwill	162	0.3%	189	0.3%	16.7%
Total Assets	**63,473**	**100.0%**	**72,678**	**100.0%**	**14.50%**

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 37.

Table D.2 Liabilities and Shareholders' Equity in USD Million (2003 – 2004)

	2003	of total	2004	of total	change
Central bank	1,185	1.9%	1,206	1.7%	1.8%
Banks and financial institutions	2,432	3.8%	3,504	4.8%	44.1%
- Current accounts	643	1.0%	854	1.2%	32.8%
- Tome deposits	1,789	2.8%	2,645	3.6%	47.8%
- Securities sold under repurchase agreements	0	0.0%	5	0.0%	100.0%
Branches, parent co., sister inst. & subsidiaries	373	0.6%	397	0.6%	6.4%
- Current accounts	155	0.2%	147	0.2%	-5.2%
- Time deposits	218	0.3%	250	0.3%	14.7%
Deposits from customers	51,945	81.8%	58,954	81.1%	13.5%
- Sight deposits	5,025	7.9%	6,092	8.4%	21.2%
- Time deposits	15,540	24.5%	18,687	25.7%	20.3%
- Saving deposits	29,711	46.8%	32,177	44.3%	8.3%
- Net debtor accounts / credit accounts	1,114	1.8%	1,370	1.9%	23.0%
- Related party accounts	555	0.9%	628	0.9%	13.2%
Engagements by acceptances	767	1.2%	1,059	1.5%	38.1%
Liabilities under financial instruments	966	1.5%	1,043	1.4%	8.0%
- Certificate of deposits	950	1.5%	987	1.4%	3.9%
- Debenture bonds	16	0.0%	7	0.0%	-56.3%
- Other liabilities under financial instruments	0	0.0%	49	0.1%	100.0%
Other liabilities	611	1.0%	835	1.2%	36.7%
Regularization accounts & mis. debtor accounts	328	0.5%	364	0.5%	11.0%
Provisions for risks and charges	223	0.4%	233	0.3%	4.5%
Subordinated loans (or notes)	272	0.4%	194	0.3%	-28.7%
Revaluation variance	118	0.2%	107	0.2%	-9.3%
Share capital and cash contribution	1,925	3.0%	2,144	3.0%	11.4%
Reserves for general banking risks	206	0.3%	240	0.3%	16.5%
Reserves and premiums and equity differences	1,461	2.3%	1,681	2.3%	15.1%
- Group share	1,431	2.3%	1,657	2.3%	15.8%
- Minority share	30	0.1%	24	0.0%	-20.0%
Balance carried forward	145	0.2%	129	0.2%	-11.0%
- Group share	141	0.2%	125	0.2%	-11.3%
- Minority share	4	0.0%	4	0.0%	0.0%
Net income (loss) for the year	404	0.6%	443	0.6%	9.7%
- Group share	402	0.6%	441	0.6%	9.7%
- Minority share	2	0.0%	2	0.0%	0.0%
Revaluation variance of other fixed assets	112	0.2%	145	0.2%	29.5%
Total Liabilities and Shareholders' Equity	**63,473**	**100.0%**	**72,678**	**100.0%**	**14.5%**

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 37.

Table D.3 Income Statement in USD Million (2003 – 2004)

	2003	2004	change
Interest and similar income	**4,069**	**3,963**	**-2.6%**
- Lebanese Treasury bills	1,901	1,360	-28.5%
- Deposits & similar accounts in banks & fin. institutions	821	1,146	39.6%
- Deposits in branches, parent co., & subsidiaries	24	26	8.3%
- Bonds & financial instruments with fixed income	289	443	53.3%
- Loan and advances to customers	983	941	-4.3%
- Loan and advances to related parties	31	28	-9.7%
- Other interest and similar income	17	16	-5.9%
- Interest on leasing contracts	3	3	0.0%
Interest and similar charges	**2,806**	**2,770**	**-1.3%**
- Deposits & similar accounts from banks & fin. institutions	135	134	-0.7%
- Deposits from branches, parent co., & subsidiaries	10	7	-30.0%
- Deposits from customers and other creditor accounts	2,491	2,474	-0.7%
- Deposits from related parties	44	43	-2.3%
- Cash contribution to capital and subordinated loans	21	18	-14.3%
- Certificates of deposits	86	75	-12.8%
- Bonds and financial instruments with fixed income	13	9	-30.8%
- Other interest and similar charges	6	10	66.7%
Net allocation to provisions for doubtful debts	**187**	**93**	**-50.3%**
Net interest received	**1,076**	**1,100**	**2.2%**
Income from variable income securities	**11**	**9**	**-18.2%**
Net commissions	**260**	**301**	**15.8%**
- Received	295	357	21.0%
- Paid	35	56	60.0%
Profit on financial operations	**213**	**217**	**1.9%**
- Marketable securities	61	70	14.8%
- Financial fixed assets	4	9	125.0%
- Foreign exchange transactions	72	73	1.4%
- Financial instruments	76	65	-14.5%
Loss on financial operations	**34**	**27**	**-20.6%**
- Marketable securities	4	5	25.0%
- Financial fixed assets	1	1	0.0%
- Foreign exchange transactions	19	16	-15.8%
- Financial instruments	10	5	-50.0%
Net profit (loss) on financial operations	**179**	**188**	**5.0%**
Other operating income	**47**	**47**	**0.0%**
Other operating charges	**17**	**16**	**-5.9%**
General operating expenses	**852**	**917**	**7.6%**
- Staff expenses	509	536	5.3%
- Other operating expenses	343	381	11.1%
Provision and depreciation of fixed assets	**124**	**131**	**5.6%**
Provision for financial fixed assets	**12**	**(1)**	**-108.3%**
Net income before tax	**568**	**584**	**2.8%**

Table D.3 – Continued	2003	2004	change
Net extraordinary income - before tax	**(25)**	**(20)**	**-20.0%**
- Extraordinary income	19	27	42.1%
- Extraordinary expense	44	47	6.8%
Income tax	**95**	**95**	**0.0%**
Net Income for the year	**448**	**469**	**4.7%**

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 38.

Table D.4 Performance (2003 – 2004)

	2003	2004
Interest earning assets / total assets	94.8%	94.3%
Interest bearing liabilities / total liabilities	90.1%	89.8%
Profitability		
ROA	0.8%	0.7%
ROE	11.1%	10.4%
Spread	2.1%	1.8%
Net interest margin	2.2%	1.9%
Burden ratio	1.1%	1.0%
Efficiency ratio	66.0%	67.0%
Liquidity		
Loans to deposits	26.1%	24.6%
Doubtful loans to gross loans	24.3%	21.3%
Loan loss provision to gross loans	19.1%	17.4%
Capital adequacy		
Equity to assets	6.7%	6.5%
BIS ratio	23.0%	21.0%

Source: Association of Lebanese Banks, *Bilan Bank 2004,* 2: 40 and 41.

APPENDIX E

MONEY SUPPLY AND COUNTERPARTS

Table E.1 Money Supply and Counterparts in USD Million (1996 – 2005)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Currency in Circulation	748	792	823	908	944	917	912	1,015	1,052	1,018
Sight Deposits in LBP	382	471	537	591	641	662	790	873	958	940
M1	**1,130**	**1,264**	**1,360**	**1,500**	**1,585**	**1,578**	**1,702**	**1,889**	**2,010**	**1,958**
Other Deposits in LBP	7,892	8,252	9,617	11,926	11,345	10,004	11,951	15,514	15,222	14,270
M2	**9,022**	**9,515**	**10,978**	**13,426**	**12,930**	**11,583**	**13,654**	**17,403**	**17,232**	**16,229**
Deposits in Foreign Currencies	9,609	13,124	15,640	16,309	19,729	23,793	24,275	25,474	29,971	33,097
Other Financial Liabilities	210	215	246	111	40	5	104	39	100	59
M3	**18,841**	**22,854**	**26,863**	**29,846**	**32,699**	**35,380**	**38,033**	**42,915**	**47,304**	**49,384**
Treasury Bills held by the Public	2,878	3,851	3,496	4,181	4,444	4,069	4,888	3,717	2,322	2,206
M4	**21,719**	**26,704**	**30,359**	**34,026**	**37,143**	**39,449**	**42,921**	**46,631**	**49,625**	**51,589**
Counterparts of Money Supply										
Net Foreign Assets	**10,571**	**10,269**	**9,697**	**9,767**	**9,250**	**8,087**	**10,295**	**14,491**	**14,846**	**16,127**
Net Claims on the Public Sector	**5,346**	**8,004**	**10,580**	**11,955**	**15,084**	**18,582**	**18,230**	**19,963**	**22,211**	**23,659**
Valuation Adjustment	**(3,365)**	**(2,368)**	**(2,020)**	**(1,936)**	**(1,673)**	**(1,819)**	**(68)**	**(428)**	**(247)**	**(923)**
Claims on the Private Sector	**8,393**	**10,504**	**12,813**	**14,310**	**15,172**	**15,293**	**15,815**	**15,794**	**16,531**	**16,748**
Other Items (Net)	**(2,103)**	**(3,555)**	**(4,206)**	**(4,250)**	**(5,134)**	**(4,762)**	**(6,239)**	**(6,905)**	**(6,037)**	**(6,227)**
Total	**18,841**	**22,854**	**26,863**	**29,846**	**32,699**	**35,380**	**38,033**	**42,915**	**47,304**	**49,384**

Source: Banque Du Liban, *Economic and Financial Data: Monetary Survey.*

APPENDIX F

TREASURY BILLS INTEREST RATES

Table F.1 Treasury Bills Interest Rates in Percent (1990 – 2005)

	3-months			6-months			12-months			24-months			36-months		
	low	average	high	low	average	high	low	average	high	Low	average	high	low	average	high
2005	5.15	5.15	5.15	6.12	6.85	6.99	6.27	7.04	7.19	7.74	8.37	8.50	8.68	9.23	9.34
2004	5.09	5.18	5.40	6.12	5.64	6.31	6.26	6.30	6.41	7.74	7.77	7.84	8.68	8.68	8.68
2003	5.41	6.60	6.84	6.32	7.60	7.86	6.43	8.05	8.37	7.84	8.97	9.20	8.68	8.68	8.68
2002	7.62	10.58	10.88	8.75	11.2	11.43	8.37	11.54	11.84	9.20	13.67	14.14	8.66	8.66	8.66
2001	10.88	10.88	10.88	11.43	11.43	11.43	11.84	11.84	11.84	14.14	14.14	14.14	8.68	8.68	8.68
2000	10.88	10.88	10.88	11.43	11.43	11.43	11.84	11.84	11.84	14.14	14.14	14.14	8.68	8.68	8.68
1999	10.88	11.25	11.40	11.43	11.98	12.21	11.84	12.58	12.93	14.14	15.30	16.02	8.68	8.68	8.68
1998	11.43	12.3	12.68	12.39	12.89	13.06	12.93	13.18	13.20	16.02	16.07	16.08	8.68	8.68	8.68
1997	12.68	12.99	13.6	13.06	13.34	13.62	13.2	13.24	13.68	16.08	16.17	17.14	8.68	8.68	8.68
1996	13.80	14.64	15.36	14.95	15.62	15.84	14.55	15.18	15.39	19.58	21.62	22.06	8.68	8.68	8.68
1995	13.17	18.00	23.8	14.28	18.66	24.08	13.86	19.49	27.48	16.02	22.10	28.00	8.68	8.68	8.68
1994	12.38	14.54	16.35	13.56	15.85	17.80	12.84	15.72	16.80	15.16	18.38	20.90	8.68	8.68	8.68
1993	12.59	17.46	19.96	13.96	18.13	19.83	17.36	17.65	18.05	22.70	23.90	24.50	8.68	8.68	8.68
1992	12.59	21.12	31.5	13.96	21.3	30.00	16.30	21.13	25.50	16.50	20.90	24.50	-	-	-
1991	14.5	16.75	18.00	15.50	18.67	20.00	16.30	18.84	20.50	16.50	17.00	18.00	-	-	-
1990	18.00	18.00	18.00	20.00	20.00	20.00	20.00	20.00	20.00	-	-	-	-	-	-

Source: Banque Du Liban, *Economic and Financial Data, Interest Rates*.

APPENDIX G

PUBLIC SECTOR EMPLOYEES

Table G.1 Public Sector Employees

Public Entity	No. of Employees
Agricultural Research	46
Central Statistics	40
Lebanese University	1,131
Public Housing Institute	84
Directorate of Academic and Technical Education	707
Directorate of Municipalities' Affairs	18
Directorate of Immigrants	63
Directorate of Fuel	23
Educational Center	55
Public Employees Administration	230
Presidency of Republic	1,356
Presidency of Cabinet	204
Parliament	688
Ministry of Public Works and Transportation	1,102
Ministry of Post and Telecommunications	3,151
Ministry of Information	664
Ministry of Economy and Trade	248
Ministry of Environment	61
Ministry of Culture and Higher Education	32,865
Ministry of Education and Fine Arts	106
Ministry of Foreign Affairs	542
Ministry of Interior and Municipal Affairs	994
Ministry of Agriculture	717
Ministry of Tourism	181
Ministry of Social Affairs	114
Ministry of Youth and Sports	18
Ministry of Public Health	1,940
Ministry of Industry	67
Ministry of Energy and Water	231
Ministry of Justice	1,941
Ministry of Labor	200
Ministry of Finance	4,231
Ministry of Displaced Affairs	228
Military Personnel	95,000
Other	70,754
Total	**220,000***

Source: Public Employees Administration.

* Ref. chapter 5 section 5.2.1.1 page 107.

APPENDIX H

DISCOUNTED CASH FLOW OF LIBAN TELECOM

Table H.1 Discounted Cash Flow of Liban Telecom in USD Million

Year	Revenues	Discounted Revenues @ 13.8 %
2006	1,045	918
2007	1,140	881
2008	1,219	827
2009	1,305	778
2010	1,403	735
2011	1,403	646
2012	1,403	567
2013	1,403	499
2014	1,403	438
2015	1,403	385
2016	1,403	338
2017	1,403	297
2018	1,403	261
2019	1,403	230
2020	1,403	202
2021	1,403	177
2022	1,403	156
2023	1,403	137
2024	1,403	120
2025	1,403	106
	Present Value	**8,698**

APPENDIX I

STATE REVENUES AND EXPENDITURES

Table I.1 Tax Revenues in USD Million for 2005

	2005	of total
Tax on Income, Profits and Capital Gains	**695**	**21.5%**
Income Tax on Profit	271	8.4%
Income Tax on Wages and Salaries	123	3.8%
Income Tax on Capital Gains & Dividends	63	2.0%
Tax on Interest Income (5%)	224	6.9%
Penalties on Income Tax	11	0.3%
Other	3	0.1%
Taxes on Property	**275**	**8.5%**
Built Property Tax	60	1.8%
Real Estate Registration Fees	193	6.0%
Other	22	0.7%
Domestic Taxes on Goods & Service	**1,257**	**39.0%**
Value Added Tax	1,123	34.8%
Private Car Registration Fees	72	2.2%
Passenger Departure Tax	55	1.7%
Other	7	0.2%
Taxes on International Trade	**841**	**26.1%**
Customs	319	9.9%
Excise Petroleum Tax	240	7.4%
Excise Tobacco Tax	125	3.9%
Excise Tax on Cars	153	4.7%
Other	2	0.1%
Other Tax Revenue (Fiscal stamp Fees)	**160**	**5.0%**
Total	**3,228**	**100.0%**

Source: Ministry of Finance, *Public Finance Monitor 2005,* 3.

Table I.2 Non Tax Revenues in USD Million for 2005

	2005	of total
Income from Public Institutions	**1,103**	**78.6%**
Revenues from Casino Du Liban	34	2.4%
Revenues from Port of Beirut	38	2.7%
Budget Surplus of National Lottery	31	2.2%
Transfer from Telecom Surplus	966	68.8%
Rent of Beirut Airport	29	2.1%
Other	5	0.3%
Administrative Fees and Charges	**242**	**17.2%**
Notary Fees	11	0.8%
Passport Fees	58	4.2%
Vehicle Control Fees	86	6.1%
Judicial Fees	13	0.9%
Driving License Fees	11	0.8%
Official Gazette	2	0.1%
Work Permit Fees	26	1.8%
Other	35	2.5%
Penalties and Confiscations	**3**	**0.2%**
Other Non-Tax Revenues	**56**	**4.0%**
Total	**1,404**	**100.0%**

Source: Ministry of Finance, *Public Finance Monitor 2005,* 4.

Table I.3 Expenditures in USD Million for 2005

	2005	of total
Current Expenditures	**5,255**	**77.7%**
Salaries and Wages	1,412	20.9%
Retirement and Indemnity	573	8.5%
Other Benefits	133	2.0%
Interest Payment	2,344	34.6%
Materials and Supplies	141	2.1%
External Services	54	0.8%
Hospitals	127	1.9%
Other	44	0.6%
Reserves	50	0.7%
Other Transfers	377	5.6%
Capital expenditures	**354**	**5.2%**
Acquisitions of Land, Buildings, Roads, etc...	10	0.1%
Equipment	17	0.2%
Construction in Progress	274	4.0%
Maintenance	31	0.5%
Other	22	0.3%
Treasury Expenditures	**1,128**	**16.7%**
Municipalities	255	3.8%
EDL	552	8.2%
Advances for Water Authorities	32	0.5%
Advance to Diesel Oil Subsidy	9	0.1%
Transfer to Telecom Companies	10	0.1%
Other	270	4.0%
Unclassified Expenditures	**3**	**0.05%**
Customs Cashiers	**26**	**0.4%**
Total Expenditures	**6,766**	**100%**

Source: Ministry of Finance, *Public Finance Monitor 2005*, 7.

APPENDIX J

ECONOMIC PROJECTED FIGURES

Table J.1 Projected GDP in USD Million (2006 – 2010). Optimistic Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Nominal GDP	22,210	**24,098**	**26,146**	**28,369**	**30,780**	**33,396**
Nominal growth		**8.5%**	**8.5%**	**8.5%**	**8.5%**	**8.5%**
Real growth		**6%**	**6%**	**6%**	**6%**	**6%**

Table J.2 Projected GDP in USD Million (2006 – 2010). Pessimistic Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Nominal GDP	22,210	**23,654**	**25,191**	**26,829**	**28,572**	**30,430**
Nominal growth		**6.5%**	**6.5%**	**6.5%**	**6.5%**	**6.5%**
Real growth		**4%**	**4%**	**4%**	**4%**	**4%**

Table J.3 Projected Private Investments in USD Million (2006 – 2010). Optimistic Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Nominal GDP	22,210	**24,098**	**26,146**	**28,369**	**30,780**	**33,396**
Private Investments	4,442	**5,175**	**6,029**	**6,999**	**8,126**	**9,435**
Private Investments / GDP	20%	21%	23%	25%	26%	28%
Self financed	3,109	2,587	3,014	3,500	4,063	4,717
Self financed / Investments	70%	50%	50%	50%	50%	50%
Market financed	1,333	2,587	3,014	3,500	4,063	4,717
Market financed / Investments	30%	50%	50%	50%	50%	50%

Table J.4 Projected Private Investments in USD Million (2006 – 2010). Pessimistic Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Nominal GDP	22,210	**23,654**	**25,191**	**26,829**	**28,572**	**30,430**
Private Investments	4,442	**5,175**	**6,029**	**6,999**	**8,126**	**9,435**
Private Investments / GDP	20%	22%	24%	26%	28%	31%
Self financed	3,109	2,587	3,014	3,500	4,063	4,717
Self financed / Investments	70%	50%	50%	50%	50%	50%
Market financed	1,333	2,587	3,014	3,500	4,063	4,717
Market financed / Investments	30%	50%	50%	50%	50%	50%

Table J.5 Projected Tax Collection in USD Million (2006 – 2010). Optimistic Scenario

	2006	2007	2008	2009	2010
GDP	24,098	26,146	28,369	30,780	33,396
VAT	1,198	1,234	1,265	1,300	1,337
Income tax on profits	279	294	311	329	349
Income tax on wages and salaries	139	157	170	185	200

Table J.6 Projected Tax Collection in USD Million (2006 – 2010). Pessimistic Scenario

	2006	2007	2008	2009	2010
GDP	23,654	25,191	26,829	28,572	30,430
VAT	1,193	1,222	1,245	1,270	1,297
Income tax on profits	279	291	303	317	331
Income tax on wages and salaries	137	152	162	172	183

Table J.7 Projected State Revenues in USD Million (2006 – 2010). Optimistic Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
VAT	1,169	1,198	1,234	1,265	1,300	1,337
Income Tax on Profits	277	279	294	311	329	349
Income Tax on Salaries	106	139	157	170	185	200
Customs	351	710	710	710	710	710
Telecom	869	261	285	305	326	351
Other Revenues	2,212	2,212	2,212	2,212	2,212	2,212
Total	**4,984**	**4,799**	**4,892**	**4,973**	**5,062**	**5,159**

Table J.8 Projected State Revenues in USD Million (2006 – 2010). Pessimistic Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
VAT	1,169	1,193	1,222	1,245	1,270	1,297
Income Tax on Profits	277	279	291	303	317	331
Income Tax on Salaries	106	137	152	162	172	183
Customs	351	710	710	710	710	710
Telecom	869	261	285	305	326	351
Other revenues	2,212	2,212	2,212	2,212	2,212	2,212
Total	**4,984**	**4,792**	**4,872**	**4,937**	**5,007**	**5,084**

Table J.9 Projected State Expenditures in USD Million (2006 – 2010). Optimistic Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
Personnel Cost	2,051	1,885	1,885	1,885	1,885	1,885
Transfers to Municipalities	306	106	106	106	106	106
Council of the South	77	0	0	0	0	0
Ministry of Displaced Affairs	4	0	0	0	0	0
Displaced Fund	105	0	0	0	0	0
Ministry of Education and Fine Arts	14	0	0	0	0	0
Ministry of Information	18	0	0	0	0	0
Ministry of Youth and Sports	13	0	0	0	0	0
Transfers to EDL	382	0	0	0	0	0
Interest Cost	2,666	1,804	1,829	1,478	1,461	1,435
Other Expenditures	1,356	1,356	1,356	1,356	1,356	1,356
Total	**6,992**	**5,151**	**5,176**	**4,825**	**4,808**	**4,782**

Table J.10 Projected State Expenditures in USD Million (2006 – 2010). Pessimistic Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
Personnel Cost	2,051	1,885	1,885	1,885	1,885	1,885
Transfers to Municipalities	306	106	106	106	106	106
Council of the South	77	0	0	0	0	0
Ministry of Displaced Affairs	4	0	0	0	0	0
Displaced Fund	105	0	0	0	0	0
Ministry of Education and Fine Arts	14	0	0	0	0	0
Ministry of Information	18	0	0	0	0	0
Ministry of Youth and Sports	13	0	0	0	0	0
Transfers to EDL	382	0	0	0	0	0
Interest Cost	2,666	1,805	1,831	1,482	1,470	1,450
Other Expenditures	1,356	1,356	1,356	1,356	1,356	1,356
Total	**6,992**	**5,152**	**5,178**	**4,829**	**4,817**	**4,797**

Table J.11 Projected State Surplus / Deficit in USD Million (2006 – 2010). Optimistic Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
Revenues	4,984	4,799	4,892	4,973	5,062	5,159
Expenditures	6,992	5,151	5,176	4,825	4,808	4,782
Surplus / (Deficit)	**(2,008)**	**(352)**	**(284)**	**148**	**254**	**377**

Table J.12 Projected State Surplus / Deficit in USD Million (2006 – 2010). Pessimistic Scenario

	Actual	Projected				
	2004	2006	2007	2008	2009	2010
Revenues	4,984	4,792	4,872	4,937	5,007	5,084
Expenditures	6,992	5,152	5,178	4,829	4,817	4,797
Surplus / (Deficit)	**(2,008)**	**(360)**	**(306)**	**108**	**190**	**287**

Table J.13 Projected Public Debt vs. GDP in USD Million (2006 – 2010). Optimistic Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Total Public Debt	38,507	32,334	32,618	32,470	32,216	31,839
GDP	22,210	24,098	26,146	28,369	30,780	33,396
Debt / GDP	173.4%	134.2%	124.8%	114.5%	104.7%	95.3%

Table J.14 Projected Public Debt vs. GDP in USD Million (2006 – 2010). Pessimistic Scenario

	Actual	Projected				
	2005	2006	2007	2008	2009	2010
Total Public Debt	38,507	32,342	32,648	32,540	32,350	32,063
GDP	22,210	23,654	25,191	26,829	28,572	30,430
Debt / GDP	173.4%	136.7%	129.6%	121.3%	113.2%	105.4%