



## 2002 BUDGET PROPOSAL

### *A BRIEF NOTE*

#### **The main figures of 2002 budget proposal:**

The main objective of the 2002 budget proposal is to exert a concerted effort to correct the country's fiscal imbalances in line with the fiscal consolidation called for by the Government and presented in its policy statement and in the 2001 budget statement. This budget, therefore, relies on a dual track of:

(a) Decreasing **expenditures** from 39% of GDP in 2001 budget law to around 35% in 2002 budget proposal as well as rationalizing these expenditures in a more effective way (including the cost of debt service, where the increase is expected to be further contained due to privatization proceeds)

(b) Increasing **revenues** from an expected actual level of 17% of GDP to around 21% through introducing new measures, raising some of the existing tax and fee rates, widening the tax base, and improving collection.

**Consequently**, the **budget deficit** is anticipated to decline from around 20% of GDP in the 2001 budget law to around 14% in 2002 budget proposal. The **primary balance** will shift from a deficit of around 2.8% of GDP in 2001 budget law to a surplus of 2.7% in the proposal, equivalent to an improvement of 5.45 percentage points of GDP.

Below, please find table 1 comparing 2002 budget proposal to 2001 budget law:

**Table 1: Comparison of 2001 budget law versus 2002 budget proposal**

	Budget 2001	2002 budget proposal
<b>Budget revenues</b>	<b>4,900</b>	<b>5,650</b>
1. Tax revenues*	3,447	4,098
2. Non-tax revenues	1,453	1,552
<b>Budget expenditures</b>	<b>9,900</b>	<b>9,425</b>
1. Current expenditures	8,711	8,585
a. Debt service bill	4,300	4,500
b. Other current expenditures	4,411	4,085
2. Capital expenditures	1,188	840
<b>Budget deficit</b>	<b>-5,000</b>	<b>-3,775</b>
Primary deficit / surplus	-700	725
Deficit / Expenditures	-51%	-40%

\*including revenues from the VAT

### **Key objectives of 2002 budget proposal:**

1. The 2002 budget proposal constitutes the turning point to **reverse the country's debt dynamics**. The main objective of this serious attempt at fiscal consolidation is to contain the growth of domestic public debt and to reduce the absorption of domestic resources by the public sector
2. As can be seen in tables 1 and 2, the 2002 budget proposal projects a **primary budget surplus** equivalent to 7.7% of expenditures and representing an absolute increase of LL 1,425 billion when compared to Budget 2001. Primary budget surpluses will continue over the medium-term, also allowing for a reversal in the debt dynamics and a gradual reduction in interest rates
3. Through its aggressive attempt towards a sustained fiscal correction and broad-based structural reform, 2002 budget proposal will lay the foundations for enhancing both domestic and international **confidence**, for a recovery in growth, and for lower interest rates.
4. The 2002 budget proposal focuses on the provision of **more efficient services** to citizens through privatization and on a gradual decrease in the size of the public sector through cutting expenditures of most ministries and public entities

5. Although the overall level of spending was decreased by around 5 percentage points of GDP when compared to 2001 budget law, the level of **social spending** in the 2002 budget proposal was maintained at roughly the same level of the 2001 budget law.

**Table 2: Magnitude of adjustment**

	Magnitude of adjustment over '01 budget	Percentage of adjustment over '01 budget
<b>Budget revenues</b>	<b>750</b>	<b>15%</b>
1. Tax revenues*	651	19%
2. Non-tax revenues	99	7%
<b>Budget expenditures</b>	<b>-475</b>	<b>-5%</b>
1. Current expenditures	-126	-1%
a. Debt service bill	200	5%
b. Other current expenditures	-326	-7%
2. Capital expenditures	-348	-29%
<b>Budget deficit</b>	<b>1,225</b>	<b>-25%</b>
Primary deficit / surplus	1,425	204%

*\*including revenues from the VAT*

### **Main reasons behind the changes in revenues and expenditures:**

The 2002 budget proposal ushers in a decrease in the budget deficit to be attained through a reduction in expenditures, coupled with an augmentation of revenues. The main assumptions behind the modifications on the expenditure and revenue fronts are spelled out here below:

**I. On the budget revenues front** (please refer to table 4 for revenue details): Budget revenues are expected to amount to LL 5,650 billion, representing an increase of 3.43 percentage points of GDP or 29% compared to 2001 actual expected budget revenues. This increase is primarily due to the following causes:

#### **I.a Tax revenues**

1. The **tax on income, profits, and capital gains** is expected to increase by LL 40 billion or around 7%, which roughly corresponds to the nominal

rate of growth. The projected income from the tax regularization (expected to be ratified by Parliament in October 2001) is factored in the calculations in equal amounts of LL 52 billion for each of 2001 and 2002.

2. The **tax on property** is anticipated to rise by an absolute amount of LL 69 billion or by 26% mainly due to the 30% increase in the revenues from the non-recurrent real estate registration fees. This rise shall be affected by the enactment of the new legislation governing property ownership by non-Lebanese, which increases the legal limits on foreign ownership of property, and lowers real estate registration fees to 5% for both Lebanese and foreign investors. This rise is also precipitated by the expected higher rate of growth.
3. **Domestic taxes on goods and services** will increase by LL 777 billion mainly due to the introduction of the VAT, which is projected to yield a conservative income of LL 800 billion (around 3% of GDP). The LL 23 billion difference is due to the replacement of the 5% restaurant and hotel tax by the VAT.
4. **Taxes on international trade and transactions** are anticipated to increase by LL 290 billion compared to 2001. This is mainly due to the following:
  - a. The increase of LL 1,000 (per 20 liters) on two types of gasoline ('92 and '98 octane) effective August 2001, which is anticipated to produce a full-year effect of LL 60 billion
  - b. The increase of LL 3,000 (per 20 liters) on all types of gasoline effective September 14, 2001, which is estimated to generate an additional full-year impact of around LL 240 billion of revenues in 2002.
5. **Other tax revenues** will increase by LL 49 billion mainly owing to the following:
  - a. The professional tax is to become effective in October as soon as the tax regularization law is ratified. However, since the declaration for this tax is due in May of every year, incoming revenues will only be levied in 2002. Therefore, this tax is expected to yield LL 40 billion in 2002.
  - b. The increase in the stamp duties fees on "aggregate quarries" by 150%

#### **I.b Non-tax revenues:**

6. **Income from public enterprises** is estimated to fall off by LL 20 billion mainly due to the decrease in revenues from the cellular companies owing to the new licensing arrangement. This fall would be partly offset by

the projected growth in income from the fixed lines, the decrease in the overall expenditures on telecommunications budget, and the increase in revenues from BDL profits.

7. **Administrative fees and charges** are expected to grow by LL 119 billion in absolute terms or by 31%. This would be mainly attributable to the following wide-ranging modifications to a number of fees:
- a. License plates registration fees will increase by 50%
  - b. Annual road usage fees (“mecanique”) will increase by 50%
  - c. Driving license fees will increase by more than 53%
  - d. International driving license fees will increase by 53%
  - e. Passport fees (both 1 year and 5 years) will increase by 50%
  - f. Residence permit fees will increase between 50% and 100%
  - g. Foreigners’ work permits will increase by 50%

**Table 3: Expected 2001 versus 2002 Budget Proposal - Revenue Classification**

(LL billion)

Revenue	Expected 2001	Budget Proposal 2002	Magnitude of adjustment over expected '01	Percentage of adjustment
Tax on income, profits and capital gains	562	602	40	7%
Tax on property	263	332	69	26%
Domestic taxes on goods and services	252	1029	777	308%
Taxes on international trade and transactions*	1,680	1900	220	13%
Other tax revenues	186	235	49	26%
<b>Total Tax Revenues</b>	<b>2,943</b>	<b>4,098</b>	<b>1,155</b>	<b>39%</b>
Income from Public Enterprises	918	898	-20	-2%
Administrative fees and charges	433	552	119	27%
Fines and confiscations	10	10	0	0%
Other non-tax revenue**	82	92	10	12%
<b>Total Non-Tax Revenues</b>	<b>1,443</b>	<b>1,552</b>	<b>99</b>	<b>7%</b>
<b>Grand Total</b>	<b>4,386</b>	<b>5,650</b>	<b>1,264</b>	<b>29%</b>

\* Excises on gasoline are included under this category

\*\*Expected 2001 does not include the budgeted grants = LL 200 billion

**II. On the budget expenditures front** (please refer to attached tables 5 and 6): Budget expenditures are expected to amount to LL 9,425 billion, representing deep cuts of 4.8% when compared to 2001 budget law. Current expenditures were decreased by LL 326 billion (excluding debt service) mirroring the efforts of all ministries and public entities to contribute to the fiscal consolidation endeavor. The reduction is mainly due to the following factors:

1. A 17% **decrease in materials and supplies**, mainly due to a 15% decrease in the budget for materials and supplies across all ministries (excluding the electricity bill), as well as additional reductions in Ministry of Defense expenditures.
2. A 7% **decline in external services**, mainly due to the 15% decrease across all ministries, with the exception of rental allocations
3. A 1% **decrease in the wage bill** (article 13), mainly due to the decrease in benefits of the armed forces
4. A decrease of 11% to the item entitled “**subsidies and transfers**” mainly caused by the following:
  - (a) Elimination of subsidies to the tobacco monopoly (LL 60 billion) and the Sugar Beet Office (LL 13 billion),
  - (b) Reduction of transfers to the oil refineries, the Green Plan, the Institution for Deposit Guarantees, the Institution for Research and Development, the state-run television station (Tele-Liban), and the Council of the South as well as some transfers to non-profit organizations (among others).  
Some of these public entities / institutions are expected to be privatized while others still have some unused carried-over funds.
5. A decline of 10% in “**other current expenditures**” largely due to the decline in the allocation for hospitalization expenses in the private sector owing to the availability of funds from previous year (s) and better allocation.
6. A contained increase of 5% in **interest payments** due to two main reasons:
  - (a) The expected distribution of 2002 financing between foreign and domestic debt,
  - (b) Expected privatization proceeds during the first quarter of 2002
7. A decrease of 29% in **capital expenditures** mainly attributable to the 44% decline in capital spending (part 2a), including maintenance and equipment. On the other hand, an effort was exerted to limit the decrease in medium-term investment projects (part 2b) to 7% compared to 2001 budget law.

## **Treasury expenditures and revenues:**

The Ministry of Finance expects **treasury revenues** to amount to LL 350 billion, equal to the anticipated treasury revenues of 2001 (including municipalities' revenues). On the other hand, **treasury expenditures** are projected to amount to LL 750 billion.

## **Financing and debt management:**

The government is adopting the following **four measures** in order to reduce the level of the debt and its cost:

- 1- Improve debt management through legislation that allows the government to access the international capital markets in order to replace the existing short-term (average maturity = 20.8 months) high-cost domestic debt (average coupon payment = 14.25 percent) with a longer-term and lower-cost foreign debt.
- 2- Reduce the budget deficit by around 6 percentage points of GDP through decreasing expenditures as well as expanding revenues and improving their management.
- 3- Privatize certain public enterprises (such as Telecom, EDL, and Water utilities), with all proceeds to be used to decrease the principal of the debt, as stipulated by the privatization law. This would consequently reduce the cost of debt servicing.
- 4- Activate the usage of the available USD 2.89 billion worth of concessional loans bearing an interest rate of 6 percent. Indeed, to date, Lebanon has only spent around USD 1 billion of the USD 2.89 billion.

## **Macroeconomic assumptions underlying the 2002 budget proposal:**

The **macroeconomic assumptions** underlying the 2002 budget proposal are the following:

1. In the absence of data on national accounts, **real growth rate** is estimated to be equivalent to **2.5%** in 2002 mainly owing to the set of

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real sector measures already implemented or under preparation by the Government<sup>1</sup>

2. The introduction of the value added tax in January 2002 is expected to produce a temporary increase equivalent to **5%** in the **rate of inflation**, rendering the total expected inflation rate equal to 5%

### **Date of approval by the Cabinet:**

In compliance with the deadline stipulated by the public finance law, the 2002 budget proposal was distributed to the Council of Ministers on September 6, 2001. It was approved on the **13<sup>th</sup> of September**, and has been forwarded to Parliament and is expected to be ratified by year-end.

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<sup>1</sup> Those real estate measures are enumerated in the “Recent Economic Measures” published on the Ministry’s website.