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MINISTRY OF FINANCE

2007 BUDGET PROPOSAL

A BRIEF NOTE

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BUDGET PROPOSAL 2007 A BRIEF NOTE

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2007 BUDGET PROPOSAL A BRIEF NOTE

I. CONTEXT

The 2007 budget proposal was prepared in line with the socio-economic reform program adopted by the Government and presented at the International Conference for Support of Lebanon- "Paris III" held on January 25, 2007. The program spanned four critical areas for Lebanon's future growth prospects and fiscal stability: (i) fiscal adjustment through revenue and expenditure structural reforms, (ii) growth-enhancing structural reforms and privatization, (iii) monetary exchange policies and (iv) social sector reforms. Specifically, the aims of the program were to raise the real growth rate to a minimum of 4-5 percent until 2011, reduce the debt to GDP ratio from 180 percent at the end of 2006 to 145 percent (without external assistance), and improve social indicators. The program also sought to gradually improve the primary balance from a deficit of nearly 1 percent of GDP in 2006 to a surplus of 8 percent in 2010.

The 2007 budget proposal figures are consistent with the Government's Medium Term Economic Framework presented at Paris III and the targets of the Emergency Post Conflict Assistance (EPCA).¹ The proposal builds in significant reconstruction and relief spending and assumes that the protracted political stalemate and security challenges are expected to adversely affect economic activity and private capital inflows.

Underlying the projections for 2007 are the following macro-economic assumptions taken from the Paris III medium-term framework: real GDP growth is expected at 1 percent and inflation is projected to be 2.2 percent.

The 2007 budget proposal enlarges the scope of budget coverage by integrating, for the first time, the largest extra-budgetary entities, namely the Council for Development and Reconstruction (CDR) and the Higher Relief Committee (HRC). It also prohibits budget carry-overs for expenditures for which no third liability exists. The proposal also sets the legal ground for initiating tax reforms in 2008 namely precommitting to increase the value-added tax and the tax on interest-income.

¹ The authorities have requested Emergency Post Conflict Assistance (EPCA) in support of their 2007 economic program, with access of 25 percent of quota (SDR 51 million). EPCA is a key part of a concerned international effort to provide financial assistance to Lebanon.

The draft 2007 budget proposal was approved by the Council of Ministers on May 21, 2007 and sent to Parliament on June 13, 2007 through decree de-facto² implemented number 403. It was published in the Official Gazette number 36, dated June 20, 2007.

Data in this brief note corresponds to the information used at the time of preparation of budget proposal 2007.

II. MAIN FIGURES OF THE 2007 BUDGET PROPOSAL

The main figures of the 2007 budget proposal are as follows:

A. Budget revenues

Budget revenues (*excluding treasury revenues and budgetary support grants and loans*) are anticipated to amount to LL 7,675 billion in the 2007 budget proposal, as compared to LL 6,657 billion as per the 2006 budget proposal. This represents an increase of LL 1,018 billion, or 15 percent. In terms of GDP³, budget revenues are projected to rise by 2 percent in 2007, mostly on account of an improvement in tax and non-tax revenues by 14 percent and 18 percent respectively.

Including treasury, anticipated revenues are expected to add up to LL 8,100 billion in 2007, which constitutes 23 percent of GDP, as compared to LL 7,097 billion in 2006 budget proposal which constitutes 21 percent of GDP.

B. Budget Expenditures

Budget expenditures (*excluding treasury expenditures and HRC and CDR foreign financed*) are expected to increase to LL 11,840 billion in the 2007 budget proposal from LL 11,195 billion in the 2006 budget proposal, representing a LL 645 billion rise, or 6 percent. As a percentage of GDP, budget expenditures are expected to remain at an almost constant level of 33 percent.

As a result, the **budget deficit** is expected to decline from LL 4,538 billion, to LL 4,165 billion i.e. from around 13 percent of GDP in the 2006 budget proposal to around 12 percent of GDP in 2007.

² Decree implemented de-facto refers to de-facto implementation of decrees issued by the Council of Ministers, even after the refusal of the President of the Republic to sign these decrees. 2006 and 2007 budget proposals have been approved using this method.

³ Nominal GDP for 2006 and 2007 were estimated at LL 34,111 billion and LL 35,658 billion respectively.

The **primary budget balance** is anticipated to improve from a surplus of LL 115 billion in the 2006 budget proposal to a surplus of LL 735 billion. In terms of GDP, primary budget surplus is expected to increase from 0.3 percent of GDP to 2 percent of GDP.

Table 1. Comparison of 2006 and 2007 Budget Proposals

<i>(LL billion)</i>	2006 Budget Proposal	2007 Budget Proposal	Magnitude change over budget '06	Percentage change over budget '06
Budget Revenues	6,657	7,675	1,018	15%
1. Tax revenue	4,677	5,347	670	14%
2. Non-tax revenue	1,980	2,328	348	18%
Budget Expenditures	11,195	11,840	645	6%
1. Non-Interest	6,542	6,940	398	6%
2. Debt service bill	4,653	4,900	247	5%
Budget Balance	-4,538	-4,165	373	8%
Primary Budget Balance	115	735	620	539%

Source: Ministry of Finance

III. Main Changes in the 2007 Budget Proposal and underlying reasons

The main reasons behind the modifications on the revenue and expenditure fronts are highlighted below:

A. Budget Revenues

Budget revenues are expected to increase from a level of LL 6,867 billion for year-end 2006 to LL 7,675 billion in the 2007 budget proposal, representing a rise by LL 808 billion, or by around 12 percent. The 2007 budget proposal figure accounts for: (i) LL 5,347 billion of tax revenues, LL 425 billion or 9 percent higher tax collection when compared to the collection level of year-end 2006; and (ii) LL 2,328 billion of non-tax revenues, representing almost LL 383 billion or 20 percent higher receipts when compared to year-end 2006 figures.

The following table presents the itemized analysis of expected revenue performance in the 2007 budget proposal, compared to 2006 year-end actual outcomes.

Table 2. Budget Revenues in the 2007 Budget Proposal vs. the 2006 year-end outcomes

<i>(LL billion)</i>	2006 year-end outcomes	2007 Budget Proposal	Change over '06	Percent change over '06
Taxes on income, profits and capital gains	1,166	1,200	34	3%
Taxes on property	579	441	-138	-24%
Domestic taxes on goods and services, of which	2,457	2,942	485	20%
Excises	613	943	330	54%
VAT	1,659	1,805	146	9%
Taxes on international trade and transactions	461	493	32	7%
Other tax revenues	259	271	12	5%
Total Tax Revenues	4,922	5,347	425	9%
Income from Public Enterprises	1,428	1,843	415	29%
Administrative fees and charges	426	393	-33	-8%
Fines and confiscations	4	4	0	0%
Other non-tax revenues	87	88	1	1%
Total Non-Tax Revenues	1,945	2,328	383	20%
Budget Revenues	6,867	7,675	808	12%

Source: Ministry of Finance

A. 1. Tax revenues

Tax revenues are expected to amount to LL 5,347 billion in the 2007 budget proposal, up from LL 4,922 billion for the 2006 year-end outcome⁴, representing a LL 425 billion improvement.

It is worth to note that the adverse impact of the Israeli war on revenues has been contained due to the following reasons: (i) the Ministry of Finance has undertaken substantial measures to alleviate the negative consequences of the July war on the revenue flows through actions aimed at preserving the tax base; (ii) income taxes on profits and capital gains were largely collected during the first half of the year; and (iii) the 15 percent improvement in revenues witnessed during the first half of 2006 outweighed to a certain extent the deterioration for the remainder of the year.

⁴ For further details about the 2006 year-end performance, please refer to the Public Finance Monitor-December 2006 published on the Ministry of Finance website: www.finance.gov.lb

At the time of the preparation of the budget proposal in early 2007⁵, it was expected that the adverse effect of the July 2006 war, the political stalemate that started with demonstrators camped in Beirut Central District and the security outbreaks, will continue impacting the year 2007, mostly in its first half, which coincides with several tax filing and payments deadlines. Therefore projected figures for 2007 remained relatively conservative.

Behind the 9 percent improvement in tax receipts stands the following developments:

a. Tax on income, profits, and capital gains

The **tax on income, profits, and capital gains** is expected to amount to LL 1,200 billion in the 2007 budget proposal, up from LL 1,166 billion in the 2006 year-end outcome representing an increase of LL 34 billion, or by 3 percent. This is mainly attributed to LL 27 billion projected improvement in revenues from the 5 percent tax on interest income where collections are expected to increase from LL 415 billion recorded in 2006 to LL 442 billion in 2007.

In line with the Paris III socio-economic reform program, the 2007 budget proposal accounts, under Article 22, for an increase in the tax on interest income from 5 percent to 7 percent as of January 1, 2008.

b. Tax on property

The **tax on property** is projected at LL 441 billion in the 2007 budget proposal compared to LL 579 billion by year end 2006. This 24 percent difference is mainly attributed to the one time exceptional increase of LL 154 billion in the inheritance tax payment which occurred in April 2006. As such, if we remove this exceptional collection, projected overall built property tax revenues in the 2007 budget proposal becomes around 4 percent higher. This enhancement is attributed to the fact that in 2007, the property tax administration started the process of updating and building a comprehensive database on built properties to be achieved through a synchronization of information systems between the property tax database and Cadastre firstly, and with municipalities afterwards.

⁵ Please note that projections for 2007 budget proposal figures were prepared in March 2007, based on 2006 actual year end performance.

c. Domestic taxes on goods and services

Domestic taxes on goods and services are expected to amount to LL 2,942 billion, up from LL 2,457 billion for the year-end 2006, representing LL 485 billion additional revenues, or nearly 20 percent.

This improvement is mainly due to the following developments:

1. **Excise taxes** are expected to increase from LL 613 billion for year-end 2006, to a level of LL 943 billion in the 2007 budget proposal, representing an additional LL 330 billion, or 54 percent, mainly due to the following:
 - i. **Excise taxes on gasoline** are projected to rise by LL 268 billion, from LL 230 billion in the 2006 year-end outcome to LL 498 billion in the 2007 budget proposal. This significant 117 percent hike accounts for uncapping domestic retail prices of car gasoline, thereby allowing a complete pass from international prices to the domestic market, and setting an excise rate floor at LL 300 per liter compared to average excise rate of LL 145 per liter for 2006 .
 - ii. **Excise taxes on tobacco products** are expected to reach LL 198 billion in the 2007 budget proposal, compared to LL 162 billion actual 2006 year-end outcome, representing a LL 36 billion increase, or 22 percent.⁶
 - iii. **Excise taxes on cars** are projected to amount to LL 241 billion, recording a LL 24 billion over the 2006 actual outcome, or 11 percent. (Please refer to footnote 6).
2. The **VAT**⁷ is projected to yield LL 1,805 billion in 2007, increasing by LL 146 billion or by 9 percent, from the LL 1,659 billion in 2006 actual outcome. In fact, in line with Government's socio-economic reform program presented at Paris III, the 2007 budget proposal accounts for an increase in the VAT rate from 10 percent to 12 percent as of January 1, 2008 under Article 21.

⁶Note that for trade revenues (excises being mainly collected at imports), comparison to 2006 year-end outcome is misleading because international trade flows were highly disrupted with the break of the July war in 2006 and the two months sea and air blockade. Projections for the 2007 budget proposal assume the resumption of normal trade patterns; therefore, revenue estimates are in line with 2005 collection levels.

⁷ Decision number 826 dated September 14, 2006 postponed the deadline for the second quarter of the year internal VAT declaration and filing till September 19, 2006. In addition, this Decision granted taxpayers the possibility of settling their tax obligations in four instalments, November-December 2006 and February-March 2007; therefore, on actual basis, second quarter 2006 VAT dues were received by the Treasury in the first quarter of 2007.

d. Taxes on international trade (custom duties)

Taxes on international trade (custom duties) are anticipated to reach LL 493 billion in the 2007 budget proposal, up from LL 461 billion in 2006, representing a LL 32 billion rise, and constituting a catch up from the relatively low base in 2006 due to the two-month blockade which disrupted trade activity during the July war.

e. Other tax revenue

Other tax revenue is expected to amount to LL 271 billion, up from LL 259 billion for the 2006 year end outcome, representing an increase of LL 12 billion, or by 5 percent.

A. 2. Non-tax revenues

The 2007 budget proposal forecasts **non-tax revenues** to total LL 2,328 billion, a 20 percent increase from the LL 1,945 billion collected in 2006. This increase is mainly attributed to higher revenues from public institutions and government properties.

The following are the major components of non-tax revenues and their expected performance in the 2007 budget proposal as compared to year-end 2006 figures:

a. Income from enterprises

Income from public enterprises is projected to amount to LL 1,843 billion, up from LL 1,428 billion in the 2006 year actual outcome, representing an increase of LL 415 billion, or 29 percent. This is attributed to the following revenue components:

1. Revenue from the **surplus of Post and Telecommunications' budget** is projected to amount to LL 1,451 billion in the 2007 budget proposal, up from 1,298 billion collected in 2006, representing an increase of LL 153 billion or almost 12 percent. This projection is in line with the 2004-2005 level of transfers from the budget surplus of the post and telecommunication. ⁸
2. Revenues from **Casino du Liban** are expected to improve from 42 billion in the 2006 year end outcome to LL 120 billion in the 2007 budget proposal, representing a LL 78 billion increase, equivalent to 186 percent. The government has sought to strengthen its collection of revenues from the various public enterprises particularly from Casino

⁸ Please note that telecom transfers in 2006 were below the 2004 and 2005 levels due to two possible reasons: one reason may be due to the fact that the year 2006 witnessed losses caused by the damages to the telecommunication network during the Israeli bombing in the summer of 2006; another reason could be related to the mobile arbitration settlement payment of LL 274 billion.

Please note that impact of privatization on telecommunications revenues will be reflected as of 2008 onwards

du Liban through an agreed upon arrangement with its management. This arrangement stipulated that the government will start, as of 2007, collecting 40 percent of total net revenues from gambling for the next 10 years instead of 30 percent which was already collected during the first 10 years. This increase in revenues projected for 2007 further accounts for an arbitration settlement amount with Casino management on past dues.⁹

3. Revenues from **Lottery** operations are expected to yield LL 50 billion in the 2007 budget proposal, LL 3 billion below 2006 year end outcome but in line with previous years' outcomes.

4. Revenues from **Port of Beirut** are expected to amount to LL 60 billion in the 2007 budget proposal, of which LL 30 billion are Port revenues pertaining to the year 2006, but transferred in early 2007.

5. No transfers from **Central Bank's profits** were recorded in 2006 versus LL 113 billion in 2007 according to Article 113 of the Code of Money and Credit.

b. Administrative fees and charges

Administrative fees and charges are projected to amount to LL 393 billion in the 2007 budget proposal, LL 33 billion below the LL 426 billion recorded in 2006. This could be partly explained by the amnesty decision (as per 2005 Budget Law) on penalties on vehicle control fees (mechanic) past dues settled by May 2006.

c. Other non tax revenues

Other non tax revenues are projected to yield LL 88 billion in the 2007 budget proposal, remaining relatively stable compared to the expected LL 87 billion in the 2006 year end income.

Box 1: Translation of Selected Legal Articles Pertaining to the Main Tax Measures

Article 21: Amendments of Article 25 of Law 379 dated 14/12/2001 regarding the Value Added Tax (VAT). The rate of VAT shall be raised from 10 percent to 12 percent as of January 1, 2008.

Article 22: Amendments of Article 51 of Law 497 dated 30/1/2003: The tax of interest income shall be raised from 5 percent to 7 percent as of January 1, 2008.

⁹ The settlement in the amount of approximately LL 70 billion is to resolve a dispute over the scope of the gross revenues of Casino to which the government is entitled to receive a share.

B. Budget Expenditures

Budget expenditures in the 2007 budget proposal are expected to amount to LL 11,840 compared to LL 11,195 billion in the 2006 budget proposal, increasing by LL 645 billion, or 6 percent. The composition of budget expenditure in 2007 budget proposal is the following (*total expenditures excluding the loans to EDL*):

1. Around 36 percent of budget expenditures in the 2007 budget proposal are attributed to **personnel costs** (salaries and wages, transfers for personnel cost, retirement and end of service). In nominal terms, personnel costs are stable over the period under consideration. 68 percent of increase in budget expenditures in budget 2007 proposal is attributed to personnel costs.
2. 46 percent of budget expenditures are attributed to **debt service spending**.
3. This leaves a modest 18 percent of expenditures for capital spending and other current.

In line with reform program objectives, the 2007 budget proposal attempted to enlarge the scope of budget coverage by integrating the largest extra-budgetary entities, namely the Higher Council for Relief (HRC) (primarily funded through donors' grants) and the foreign financed part of the Council for Development and Reconstruction (CDR) spending. The Council of Ministers approved as per decision 51 dated 25 June, 2007 the projections of CDR and HRC foreign financed expenditures for 2007 as follows:

Table 3. The projections of CDR and HRC foreign financed expenditures

Expenditures 2007	L.L billion
Higher Council for Relief (HRC)	1,250
CDR foreign financed	380

Source: Ministry of Finance

These expenditures are financed through grants and/or foreign financed loans and not through budget appropriations. It should be noted that awaiting for the Higher Council for Relief (HRC) and Council for Development and Reconstruction (CDR) to perform their accounting in line with the budget, the respective institutions' projected expenditures are included as a single line entry in a separate table, as an addendum to the General Budget.

B.1. Main expenditure items

The main expenditures in the 2007 budget proposal are detailed below, in accordance with the economic classification of expenditures:

Table 4. Economic Classification of Expenditures in the 2007 Budget Proposal versus 2006 Budget Proposal

Code	(LL billion)	2006 Budget Proposal	2007 Budget Proposal	Magnitude change over budget '06	Percentage change over budget '06
11	Materials and supplies	237	315	78	33%
12	External Services	115	120	5	4%
13	Salaries and Wages	2,346	2,588	242	10%
14	Subsidies and Transfers	1,553	1,664	111	7%
16	Other Expenses	276	291	15	5%
17	Interest Payments and Financial	4,653	4,900	247	5%
18	Unallocated General Reserves	165	162	-3	-2%
	Total current expenditures (including debt service)	9,346	10,039	693	7%
	Total current expenditures (excluding debt service)	4,693	5,139	446	10%
221	Acquisitions of Land	0	0	0	0%
222	Acquisitions of Buildings	0	1	1	
223	Acquisitions for the Construction of Roads, Ports, and Airports	3	7	4	133%
224	Acquisitions for the Construction of Water and Electricity Networks	2	1	-1	
225	Equipment	39	45	5	13%
226	Construction in Progress	440	412	-27	6%
227	Maintenance	86	92	5	6%
228	Other Expenditures Related to Fixed Capital Assets	77	44	-33	43%
229	Total Capital Expenditures	649	601	-49	8%
252	Loans to EDL	1,200	1,200	0	0%
Grand Total		11,195	11,840	645	6%

Source: Ministry of Finance

a. Materials and supplies

Materials and supplies are expected to increase from a level of LL 237 billion in the 2006 budget proposal to LL 315 billion in the 2007 budget proposal. Part of this budget will be used to regularize treasury advances given in previous years. In fact, the expenditures that were paid in previous years through treasury advances, for which no budget appropriations were allocated, should be settled through an appropriation in the budget. Further, materials and supplies are kept at a higher level due to:

1. The ascending trend in fuel prices translating into higher transportation costs;
2. A higher budget allocation for medicine and medical supplies mainly due to the Euro appreciation and to the rise in the number of beneficiaries due to the recruitment of 15,000 additional recruits in 2006, in order to meet the requirements of UN security Council Resolution 1701;
3. A higher budget allocation for administrative supplies .

b. External services

External services include rents, postal services, insurance, advertisement & public relations. Total expenditures in this item are projected at LL 120 billion, compared to LL 115 billion in the 2006 budget proposal and exhibiting a LL 5 billion, or 4 percent increase.

c. Personnel Costs

Wages, salaries, and related benefits (Article 13) are projected to increase from LL 2,346 billion in the 2006 budget proposal to LL 2,588 billion in the 2007 budget proposal, representing a LL 242 billion, or 10 percent increase. This increase in spending on wages, salaries, and related benefits is due to the following:

1. In order to meet the requirements of UN security Council Resolution 1701, military spending was raised to accommodate 15,000 troops to the South through calling back some of the reservists (retired personnel), in addition to new recruits;
2. An additional salary (bonus), equivalent to around LL 58 billion was provided to the armed forces following the July war as per the decision taken by the Council of Ministers dated 04/01/2007 . It was thus accounted for in 2007 budget proposal;
3. The government's contribution to the Public Employees' Cooperatives increased by LL 6 billion from LL 159 billion in 2006 budget proposal to LL 165 billion in 2007 budget proposal due to additional allocation for medicines for chronic diseases;
4. Increase in spending on hospitals by LL 14 billion, or 14 percent due to the increase in the number of armed forces;
5. Increase in education allowances by LL 8 billion, or 7 percent, also related to the increase in the number of armed forces.

As to the total **personnel cost** which includes, in addition to the wages, salaries, and related benefits, **transfers** for personnel cost and **retirement and end of service indemnities**, it increased by around LL 304 billion from LL 3,499 billion in 2006 budget proposal to LL 3,803 billion. Retirement and end of service indemnities increased by LL 65 billion from LL 935 billion to LL 1000 billion, to account for the expected increase in the number of retirees.

The table below details the allocated spending on personnel in the 2007 budget proposal as compared to the 2006 budget proposal:

Table 5. Personnel Cost Details in the 2007 Budget Proposal versus 2006 Budget Proposal

<i>(LL billion)</i>	2006 Budget Proposal	2007 Budget Proposal	Magnitude of change over '06 budget	Percentage change over '06 budget
Personnel Cost	3,499	3,803	304	9%
1. Article 13: Wages, salaries, and related	2,346	2,588	242	10%
2. Transfers for personnel cost	218	215	-3	-1%
-Transfers to Council of the South	6	6	0	0%
-Transfers to CDR	23	22	-1	-4%
- Transfers to Displaced Fund	6	6	0	0%
-Transfers to Lebanese University	173	171	-2	-1%
-Transfers to the Educational Center for Research and Development	10	10	0	0%
3. Retirement and end of service	935	1,000	65	7%
- Retirement wages	765	800	35	5%
- End of service indemnities	170	200	30	18%

Source: Ministry of Finance

d. Subsidies and transfers

Subsidies and transfers are expected to amount to LL 1,664 billion, up from LL 1,553 billion in the 2006 budget proposal, representing an increase of LL 111 billion or by 7 percent. The main increases in subsidies and transfers are as follows:

1. This item includes **retirement wages** which increased by LL 35 billion from LL 765 billion in 2006 budget proposal to LL 800 billion in 2007 budget proposal. Also, a LL 30 billion increase in **end of service indemnities** are projected, from LL 170 billion in budget 2006 proposal to LL 200 billion in budget 2007 proposal. (retirement and end-of service indemnities are included under personnel cost in table 5);
2. **Transfers inside the public sector** which increased by LL 35 billion from LL 434 billion in the 2006 budget proposal to LL 469 billion in 2007 majorly due to the following:
 - i. **Transfers to the Ministry of Education and Higher Education** increased by LL 10 billion attributed to additional LL 6 billion as transfers to public schools and another LL 6 billion as transfers to subsidized schools against LL 2 billion lower transfers to salaries of the Lebanese University teachers;
 - ii. Around LL 5 billion increase in **transfers to the Ministry of Social Affairs**, representing a 6 percent increase;
 - iii. Contributions to the **Higher Council for Privatization** increased by around LL 8 billion, from LL 315 million to LL 8. 345 billion to accommodate the work required for the privatization process;
 - iv. **Transfers to Directorate of Wheat and Sugar Beet** increased by LL17 billion to subsidize wheat.

e. Other current expenditures

Other current expenditures are expected to amount to LL 291 billion, compared to LL 276 billion in 2006 budget proposal, exhibiting LL 15 billion increase, constituting 5 percent.

f. Interest payments

A total of LL 4,900 billion was provisioned for debt servicing in 2007 budget proposal, increasing by LL 247 billion as compared to the LL 4,653 billion for 2006. This stems from a LL 162 billion increase in interest payments of domestic debt and LL 85 billion foreign debt financing.

1. Interest payments on domestic currency are projected at LL 2,540 billion in 2007 as compared to LL 2,378 billion in the 2006 budget proposal. The interest payments for 2007 were projected assuming an average interest rate on domestic currency t-bills of 8 percent for the last three quarters of 2007 and the impact of the execution of the gold re-evaluation transaction on interest payments. The main increase in the interest payments on LL debt is coming from the increase in the stock of long term domestic currency debt at the end of 2006 compared to the end of 2005, in addition to the payment of accrued interest that was expected to result from the gold re-evaluation transaction.
2. Interest payments on foreign currency debt are projected at LL 2,360 billion¹⁰ in 2007 budget proposal as compared to LL 2,275 billion in 2006. The projection was based on the receipt of a certain amount of concessional loans from Paris III donors as well as on an assumed average FX borrowing rate of 7.8 percent for the last three quarter of 2007.

Table 6: Budget Allocation for Interest Payments in the 2007 Budget Proposal versus 2006 Budget Proposal

<i>(LL billion)</i>	Allocation for Budget 2006	Allocation for Budget 2007
Total Interest payments	4,653	4,900
Domestic currency Debt	2,378	2,540
Foreign currency Debt	2,275	2,360
Concessional loans-interest payments <i>(excluding EDL)</i>	155	115
Concessional payments-principal payments <i>(Excluding EDL and AFD loans)</i>	261	300
Coupons on Eurobond and special t-bills in FX	1,859	1,945

Source: Ministry of Finance calculations, DMFAS reports and BDL report.

g. Unallocated general reserves

Unallocated general reserves are expected to decrease by LL 3 billion from LL 165 billion to LL 162 billion.

¹⁰ Interest payments on foreign currency debt includes LL 1,945 billion for Eurobonds- LL 300 billion for principal C-Loans and LL 115 billion for C-loans interest

h. Capital expenditures

Capital expenditures are expected to decrease from LL 649 billion in the budget 2006 proposal to LL 601 billion in 2007 budget proposal, i.e. by LL 49 billion. This decline is mainly due to lower “Construction in Progress” and “Other Expenditures related to Fixed Capital Assets” by LL 27 billion and LL 33 billion respectively. The LL 33 billion change is mainly attributed to reduction in allocations to IDAL as its total appropriations totalled LL 70 billion in 2006 of which LL 20 billion were for regularizing a treasury advance spent in previous years. Meanwhile, total appropriations for IDAL reached LL 40 billion in 2007, as IDAL “Export Plus” program is being phased out and appropriations are being decreased by 20 percent annually (of total subsidy cost).

Those decreases offset the minor increases in “Equipment” by LL 5 billion, “Maintenance” by LL 5 billion and “Acquisitions for the Constructions of Roads, Ports and Airports” by LL 4 billion, between 2006 and 2007.

Box 2: Translation of Selected Legal Articles Pertaining to the Main Expenditure Measures

Article 33: Elimination of the rollover of any budget appropriation that has not been contracted until December 31st of the year. Only appropriations which are committed prior to December 31st, resulting in a 3rd party liability, could be carried over to next year’s budget.

B.2. Social Expenditures

Social spending is expected to remain at an almost constant level of 25 percent of the 2006 and 2007 budget proposals' total expenditures and also as a percentage of GDP registering 8 percent .

Table 7. Main Social Expenditure: 2006 Budget Proposal versus 2007 Budget Proposal

<i>(LL billion)</i>	2006 budget proposal	2007 budget proposal	Magnitude of change over '06 budget	Percentage change over '06 budget
Health				
Hospitalization in the private sector	241	252	11	5%
Purchase of Medication (11.4.1)	73	83	10	14%
Hospitalization of public sector employees (13.4.5+13.4.8)	106	121	15	14%
Maternity and sickness allowance	26	28	2	8%
Other (Adm.12)	60	62	2	3%
Sub-Total	506	546	40	8%
Education				
Ministry of Education and Higher Education allowance (13.4.6)	923	931	8	1%
Sub-Total	1,030	1,046	16	2%
Other Social Spending				
Ministry of Social Affairs (Adm. 24)	97	102	5	5%
Ministry of Displaced (Adm. 22)	6	6	0	0%
Transfers to employees' cooperative	159	165	6	4%
Pensions (14.7)	935	1,000	65	7%
NSSF (Adm. 16/14.1.9)	105	105	0	0%
Sub-Total	1,302	1,378	76	6%
Grand-Total	2,838	2,970	132	5%

Source: Ministry of Finance

C. Debt Articles

As in every year, 2007 budget proposal includes an article which sets the legal framework for the government's borrowing in domestic and foreign currencies.

The main points which are covered in Article 5 of 2007 budget proposal include the following:

- a. The permission for the government to issue **Treasury Bills in domestic currency**. This can take place in line with a ceiling which is governed by the actual fiscal deficit in addition to the rolled-forward budget allocations to year 2007 as well as any additional allocations. Domestic debt maturities can be long, medium, and short. As usual, Treasury Bills can be issued through decisions signed by the Minister of Finance.
- b. The permission for the government to issue **Treasury Bills / Bonds in foreign currency (Eurobonds)**. In the context of public debt refinancing, the government is permitted to issue Eurobonds within an overall ceiling of the equivalent of US\$ 3 billion. Borrowed funds should be used to refinance maturing foreign debt and / or to transform domestic debt to foreign currencies' debt. All Eurobonds should be repaid within a period of 30 years, counting from the starting date of their issuance. Interest rates on these Eurobonds should be set in accordance with rates prevailing on international capital markets of similarly rated bonds. In that context, the Minister of Finance issues decisions to set Eurobonds' interest rates.
- c. The amendment of paragraph 1 of article 1 and articles 2 and 4 of Law number 476 dated 12 December 2002 (Granting permission to the Government to borrow at lower interest rates in order to replace existing debts). These amendments aim at increasing the borrowing ceiling from US\$ 7 billion to US\$ 11 billion and to increase the repayment maximum period from fifteen years up to thirty years and to allow the possibility of refinancing for a maximum period of thirty years instead of fifteen years.



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