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YEARLY REPORT 2001
FISCAL, TRADE, AND STRUCTURAL DEVELOPMENTS

- General fiscal: In an environment generally characterized by a slight improvement in economic activity as indicated by the 1.5 percent economic growth last year, the fiscal deficit has decreased from LL 5,872 billion in 2000 to LL 4,230 billion in 2001, by 7 percentage points of expenditures. In addition, the primary deficit of LL 1,676 billion in 2000 converted into a surplus of LL 82 billion in 2001 (section 1).
- Revenues and expenditures: The decline in the deficit was mainly due to the policy of tighter spending (from LL 10,622 billion in 2000 to LL 8,878 billion in 2001) that has characterized part of the current government's strategy targeted at deficit reduction (sections 2 and 3).
- Public debt: Over the year 2001, gross debt has increased by 13 percent, from LL 37,702 billion by the end of 2000 to LL 42,750 billion by the end of 2001. The deficit was financed by a share of 79 percent in foreign currency debt, mainly Eurobonds, while the rest was financed by domestic Treasury bills (section 4).
- Trade: Mainly owing to the December 2000 decrease in tariff rates, both imports and exports have increased by 17 percent and 25 percent respectively (section 5).
- Structural fiscal measures for 2002: As a clear indication that fiscal consolidation will continue throughout 2002, Parliament has legislated the VAT and tax regularization laws. As a direct consequence of the ratification of the tax regularization law, the professional tax has gone into effect. On February 1, 2002, the VAT was launched with 7,294 registered companies (sections 6 and 7).
- Budget law for 2002: Parliament had also voted on the 2002 budget law, with budget expenditures of LL 9,375 billion, budget revenues of LL 5,500 billion, and a deficit of LL 3,875 billion or 41 percent of expenditures. The primary budget surplus will, therefore, amount to LL 625 billion (a separate note describing the 2002 budget law was posted on the Ministry's website on February 20).
- Privatization: Developments have also taken place on the various sectors that are targeted for privatization, such as telecom, electricity, and water (section 8).
- Trade liberalization: On the trade liberalization front, the Euro-Med free trade agreement was initialed in January 2002 following six years of negotiations between Lebanon and the EU (section 9).
- Other structural reforms: In order to re-activate the real economy, the government also reduced firms' contributions to the NSSF, extended subsidized loans to small and medium enterprises, and provided support for investment promotion (section 10).

Contents

The Ministry of Finance will publish eight monthly reports on fiscal and external trade developments and four quarterly reports on fiscal and structural developments during a given year. This report was meant to be the 2001 Quarter Four report, however, given that 2001 did not have regular publications, this report is exceptional in providing a synopsis of the 2001 yearly developments.

Section 1: Fiscal overview

Fiscal data for the year 2001 indicates an overall improvement compared to the same period of 2000. Indeed, the total deficit has declined from LL 5,872 billion (23.6 percent of GDP) to LL 4,230 billion (16.7 percent of GDP), or from a ratio of 55 percent to 48 percent to expenditures. At the same time, the primary deficit, equivalent to around 16 percent of expenditures (or 6.7 percent of GDP), was converted into a primary surplus of 1 percent of expenditures (or 0.3 percent of GDP) as can be seen in Table 1.

Table 1. Summary of Fiscal Performance[1]

(LL billion)	2000	2001	% change	Budget Law 2001
Budget revenues	4,188	4,289	2.41%	4,900
o/w customs revenues	*1,750*	*1,632*	-6.74%	1,762
Budget expenditures	8,387	7,748	-7.62%	9,900
o/w Debt service	*4,197*	*4,312*	2.74%	4,300
Budget deficit/surplus	-4,199	-3,459	-17.62%	-5,000
in % of budget expenditures	-50.07%	-44.64%		-50.50%
Budget primary deficit/surplus	-1.7	852		-700
in % of budget expenditures	-0.02%	11.00%		-7.07%
Treasury receipts	561	359	-36.01%	
Treasury payments	2,234	1,130	-49.42%	
Total budget and treasury receipts	4,749	4,648	-2.13%	
Total budget and treasury payments	10,622	8,878	-16.42%	
Total cash deficit/surplus	-5,872	-4,230		
in % of total expenditures	-55.29%	-47.64%		
Primary deficit/surplus	-1,676	82		
in % of total expenditures	-15.78%	0.92%		

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

[1] For further information please refer to the detailed Fiscal Performance sheet published on the Ministry's website www.finance.gov.lb.

The **budget outcome** for 2001 indicated a lower deficit primarily due to the 22 percent decline in expenditures (please refer to Table 1), which was larger in absolute terms than the 12 percent decline in revenues. As a result, the budget deficit was 31 percent lower than anticipated and instead of the budgeted primary deficit of LL 700 billion, a surplus of LL 854 billion was achieved, equivalent to 11 percent of expenditures (further details will be provided in sections 2 and 3).

Section 2: Revenue outcome

Total revenues for 2001 amounted to LL 4,648 billion, of which budget revenues were LL 4,289 billion and Treasury revenues LL 359 billion. Comparatively, total revenues for 2000 amounted to LL 4,749 billion, with budget revenues equal to LL 4,188 billion and Treasury revenues LL 561 billion. Total revenues for 2001 were therefore less than those achieved in 2000 by LL 101 billion due to lower Treasury receipts.

On the other hand, **budget revenues** for 2001 were LL 101 billion more than budget revenues achieved in 2000. Overall, the budget revenue outcome of 2001 amounted to 88 percent of the budgeted amount.

Tax revenues in 2001 amounted to LL 2,961 billion compared to LL 2,936 billion in 2000 and LL 3,447 billion in budget 2001. Tax revenues for 2001 increased by 1 percent over the 2000 outcome. They, however, fell short of the 2001 budget allocation by LL 486 billion. Tax revenues in 2001 accounted for 69 percent of budget revenues.

The shortfall in tax revenues was partly due to the less-than expected performance of real estate and customs revenues as well as the delay in the passage of the tax regularization and professional tax laws (with budgeted amounts in 2001 of LL 120 billion and LL 40 billion respectively), the proceeds of which have been delayed to 2002. Low proceeds from property tax and customs receipts also resulted in lower tax revenues.

Taxes on income, profits, and capital gains increased by more than 25 percent over the outcome of 2000, with taxes on profits increasing by 17 percent, taxes on income by 13 percent and taxes on capital gains by 57 percent. This improvement is the result of audit operations performed by the Income Tax Department on some large taxpayers in various sectors.

Taxes on property fell short of the budgeted amount by LL 130 billion, partially due to the ratification of the new real estate law in March 2000, which lowered real estate registration fees to 5 percent for both Lebanese and foreign investors (registration fees were reduced by 1 percent for Lebanese investors and 11 percent for foreign investors). In addition, the change in the method of calculating the rental value of apartments also contributed to the drop in property taxes.

Customs revenues (including excises collected at customs) amounted to LL 1,632 billion in 2001 and LL 1,750 in 2000. The budgeted amount for 2001 was LL 1,762 billion. The shortfall in customs revenues, therefore, amounted to LL 118 billion over the 2000 outcome and LL 130 billion over the 2001 budget. Following the December 2000 tariff cuts, the average tariff rate dropped from 20 percent at year-end 2000 to 16 percent at year-end 2001.

Table 2. Tax Revenues

(LL billion)	2000	2001	Change yoy (%)	Budget Law 2001
Tax revenues	**2,936**	**2,961**	**0.9%**	**3,447**
Tax on income, profits, & capital gains	500	627	25.4%	758
Tax on property	274	273	-0.4%	403
Domestic taxes on goods & services	220	239	8.6%	265
Taxes on international trade	1,750	1,632	-6.7%	1,762
Other tax revenues	192	190	-1.0%	259

Source: MOF, DGF

NB: (1) Tax revenues are included within budget revenues, (2) Revenues from excise taxes are included within the "taxes on international trade" figure.

Non-tax revenues in 2001 amounted to LL 1,328 billion compared to LL 1,252 billion in 2000 and LL 1,453 billion allocated in budget 2001. They accounted for 31 percent of budget revenues in 2001.The increase in non-tax revenues in 2001 over the outcome of 2000 amounted to LL 76 billion. However, when LL 200 billion of unrealized grants expected in the 2001 budget law are excluded, the 2001 outcome for non-tax revenues shows a improvement of LL 75 billion, or 6 percent over the budget figure.

The main contributors to this increase are the revenues of the Port of Beirut, car usage fees, and penalties and confiscations for a cumulative value of LL 63 billion. Moreover, LL 20 billion of additional revenues were collected from the surplus of transfers from the Ministry of Post and Telecommunication, budgeted at LL 630 billion (please refer to Table 4).

It is noteworthy that, mainly owing to the 13 percent increase in the flow of tourists in 2001 over the previous year, tourism-related revenues, namely, passenger departure taxes, revenues from tourist sites, and revenues from the Beirut International Airport, increased by a total of 11 percent in 2001 over the preceding year.

Going forward, in addition to the implementation of value added tax, the tax regularization and professional tax laws, the government is embarking on a comprehensive plan to restructure the Income Tax Department in an effort to strengthen tax compliance and collection.

Table 3. Non-tax Revenues

(LL billion)	2000	2001	Change yoy (%)	Budget Law 2001
Non-tax revenues	**1,252**	**1,328**	**6.07%**	**1,453**
Entrepreneurial & property income	785	800	1.91%	737
Administrative fees & charges	362	386	6.63%	421
Penalties & confiscations	10	34	240.00%	10
Other non-tax revenues*	95	108	13.68%	285

Source: MOF, DGF

NB: Non-tax revenues are included within budget revenues

** LL 200 billion of other non-tax revenues were grants that were not realized.*

Table 4. Entrepreneurial and Property Income

(LL billion)	2000	2001	Change yoy (%)	Budget Law 2001
Entrepreneurial & property income, o/w	**785**	**800**	1.9%	**737**
Casino du Liban	37	52	40.5%	26
National Lottery	24	25	4.2%	29
Telecom	653	650	-0.5%	630
Central Bank	35	21	-40.0%	20

Source: MOF, DGF

NEW REAL ESTATE LAW
Summary Information

On March 20, 2001, Parliament endorsed the legislation on foreign ownership, which was proposed by the Cabinet on December 13, 2000. The law is meant to provide incentives for foreign investment in industry and tourism through reactivating the real estate sector by (a) easing the legal limits on foreign ownership of property, and (b) lowering real estate registration fees to 5% for both Lebanese and foreign investors. The law stipulates the following:

a. Whereas, the existing law limited the acquisition of land by foreigners to 5% in each Mohafazat, the new law allows foreigners to acquire 3% of the total area of Lebanon regardless of the geographic location subject to one condition: foreigners are not allowed to acquire more than 3% of the total area of the Caza. One exception to this law is Beirut, where foreigners are allowed to acquire up to 10% of the total area of the capital Beirut.

b. Foreigners can now acquire 3000 square meters of land without the passage of a decree by the Council of Ministers. The authorization to acquire a piece of land for a specified project has to be executed within a period of 5-years (extended only once for an additional 5 years if requested). It is legally allowed for foreigners to buy more than 3000 square meters subject to a Council of Ministers' decree.

c. The Government has also proposed to lower real estate registration fees to 5.8% for both Lebanese and foreign investors. Included in the registration fee of 5.8% are the municipality fee of 0.25%, the stamp duty of 0.30%, the lawyers' syndicate fee of 0.10%, and an additional 0.10% in case the registration took place through a notary's office rather than the land registry (these fees represent 0.80% of the 5.8% registration fee and have remained unchanged). Thus registration fees, net of the additional duties, have been reduced by 1% for Lebanese investors and 11% for foreign investors.

Section 3: Expenditure outcome

Total expenditures (budget and treasury) for 2001 declined by 16 percent over the year, from LL 10,622 billion in 2000 (43 percent of GDP) to LL 8,878 billion in 2001 (35 percent of GDP). This fall was due to the cutback in both budget and treasury expenditures from LL 8,387 billion to LL 7,748 billion for the former and from LL 2,234 billion to LL 1,130 billion for the latter.

Budget expenditures are mainly composed of debt service payments, the largest expenditure item, whose share has increased from 50 percent in 2000 to 56 percent in 2001, and personnel cost (composed of wages & salaries & related benefits, end of service, and retirement), the second largest expenditure item, whose portion of budget expenditures rose from 35 percent in 2000 to 38 percent in 2001 (please refer to Table 6).

Debt service payments were 3 percent higher than the previous year, mainly owing to the 35 percent rise in payments of foreign debt service, a direct implication of the government's policy to replace high cost, short-dated domestic debt with lower cost, longer-dated foreign debt. Moreover, personnel cost has increased by 2 percent when compared to 2000. Even though debt service and personnel cost have exceeded the previous year's levels, the main reason behind the decline in budget expenditures was the LL 817 billion reduction in expenditures, excluding debt service payments and personnel cost, due to two main reasons: the tighter expenditure policy that has been observed across all expenditure items and cost centers and the late ratification of the 2001 budget law on June 21, 2001. This trend is also revealed when comparing actual budget expenditures for 2001 with 2001 budgeted expenditures; indeed actual budget expenditures have constituted around 78 percent of the budgeted amounts.

Treasury expenditures were also 45 percent lower than the former year mainly due to the decline in transfers to institutions such as Electricité du Liban 'EDL' (please refer to Table 7) largely caused by lower fuel prices and two revolving credit lines for fuel purchases signed with the Arab Monetary Fund and the Islamic Development Bank. Although EDL expenditures have declined by 51 percent compared to the year 2000, they continued to constitute around 25 percent of Treasury expenditures. Treasury expenditures were also lower as a result of the 75 percent drop in payments to municipalities mainly due to the settlement of previous years' payments in 2000. The share of these payments out of Treasury expenditures dropped from 19 percent to 10 percent in 2001.

Going forward, there is strong political consensus towards scaling back the size of the public sector. Naturally, this endeavor will entail an even closer monitoring of expenditures in 2002 and expenditure cuts across all expenditure items and spending agencies.

Table 5. Expenditures

(LL billion)	2000	2001	Variation (%)
Total expenditures	**10,622**	**8,878**	-16.4%
Budget expenditures	8,387	7,748	-7.6%
Expenditures excluding debt service	4,190	3,437	-18.0%
Debt service	4,197	4,312	2.7%
Domestic debt	3,572	3,470	-2.9%
Foreign debt	625	842	34.7%
Treasury expenditures	2,234	1,130	-49.4%
o/w municipalities	434	110	-74.6%

Source: MOF, DGF

Table 6. Personnel cost

(LL billion)	2000 Jan-Dec	2001 Jan-Dec	% Variation
Personnel cost, *of which:*	**2,907**	**2,971**	**2.2%**
Wages, salaries, and related benefits*	2,063	2,137	3.6%
Retirement and end-of service	844	834	-1.2%

** Includes personnel cost for the Council of the South, Lebanese University, Displaced Council, Council for Reconstruction and Development, and the Educational Center for Research and Development.*

Note: Personnel cost numbers are based on liquidated payment orders.

Table 7. Transfers to EDL

(LL billion)	2000 Jan-Dec	2001 Jan-Dec	change
EDL	**582**	**283**	**-299**
Debt service	298	197	-101
Fuel	279	61	-218
Expropriations	5	25	20

Source: MOF, DGF

Section 4: Evolution of public debt

Gross public debt as of the end-2001 amounted to LL 42,750 billion, increasing by 13.4 percent over end-2000. Net debt as of end-2001 amounted to LL 40,847 billion, increasing by 16.5 percent over end-2000.

In terms of the composition of gross debt, domestic debt accounted for 66 percent of gross debt and foreign debt for the remaining 34 percent.

The growth of domestic debt slowed down to 4 percent from 7 percent in 2000, whereas the growth in foreign currency denominated debt (mainly issuance of Eurobonds) increased from 25 percent in 2000 to 34 percent in 2001. The utilization of concessional, or project-linked foreign currency loans from bilateral and multilateral sources, increased by 4.5 percent.

A total of six Eurobonds were issued in 2001 for a gross amount of US$ 3,100 million, or a net amount of US$ 2,600 million. Eurobond issues in 2001 were characterized both by their large size and extended maturity, with issues such as the single-tranche US$ 1,150 million Eurobond issued in April and the US$ 400 million, 15-year Eurobond issued in May.

The ratio of gross public debt to GDP at the end of 2001 stood at 170 percent, which the government expects to stabilize during 2002 and to see it decline thereafter, given the proceeds from privatization and the materialization of the various fiscal measures.

Table 8. Public Debt

(LL billion)	1998	1999	2000	2001	Variation* (yoy %)	% of total debt*	% of GDP*
Total debt	27,969	33,762	37,702	42,750	13%	100%	170%
Domestic debt	21,686	25,383	27,161	28,224	4%	66%	112%
Foreign debt	6,283	8,379	10,541	14,526	38%	34%	58%
a. Bilateral & multilateral	1,688	1,867	1,968	2,056	4%	5%	8%
b. Other foreign Debt	4,606	6,525	8,566	12,470	46%	29%	50%
of which Eurobonds	*3,915*	*5,746*	*7,867*	*11,788*	50%	28%	47%
Net domestic debt	19,544	21,377	24,530	26,321	7%	62%	104%
Net debt	25,839	29,768	35,063	40,847	16%	96%	162%

Source: Source: MOF, DGF

Note: Net public (and domestic) debt represent total (and domestic) debt less public sector deposits with the Central Bank and commercial banks.

** these indicators refer to the developments of 2001.*

Table 9. Eurobond Issues in 2001

Date of launch	Size (USD million)	Due	Coupon at issue
Feb-01*	200	2004	9.500%
Apr-01**	1,150	2006	9.875%
May-01	400	2016	11.625%
Aug-01	750	2008	10.125%
Sept-01*	350	2005	9.375%
Nov-01*	250	2004	9.500%
Total issue in 2001	**3,100**		

Source: MOF, DGF

**These Eurobonds are fungible with previously issued bonds*

***USD 500 million of this bond was used to repay a maturing bond*

Section 5: Evolution of external trade

During the fourth quarter of 2001, both imports and exports have maintained the increasing trend that had characterized the first three quarters of the year. It could be argued that the main catalyst for the improvement in the volumes of both imports and exports was the December 2000 decrease in tariff rates from an average of 20 percent in 2000 (including December) to an average of 16 percent in 2001 as well as the exemption of raw materials from custom duties. Following the tariff cuts, 83 percent of imported goods were either exempt or subject to a 5 percent rate whereas prior to the cut, 60 percent of imported goods were subject to tariff rates above 6 percent. Moreover, the expectations of the imminent passage of the VAT law and its subsequent ratification also generated a surge in imports, especially during the last two months of the year.

Although larger in percentage terms, the increase in the volume of exports was less in absolute terms than the increase in imports. As a result, the trade balance deteriorated by 16 percent.

Table 10. External Trade

(USD million)	2000 Jan-Dec	2001 Jan-Dec	% change
Exports	714	889	25%
Imports	6,228	7,291	17%
Trade balance	-5,514	-6,402	16%

Source: MOF, Directorate General of Customs (DGC)

Geographic distribution of imported and exported goods: European Union countries remained the predominant source of imports, although their share of total imports dropped by 2 percentage points compared to the same period of 2000 (please refer to Table 11). Italy ranked first, with a share of 10 percent of total imports, followed by Germany and France with shares of 9 and 8 percent respectively. Imports from Italy and France consisted primarily of mineral products, while transport equipment predominated imports from Germany.

Exports increased by 25 percent compared to the year 2000 (please refer to Table 10). In absolute terms, total exports for the period increased by USD 175 million. Arab countries remained the main destination of Lebanese exports with a 46 percent share, whereas exports to the European Union constituted 20 percent (please refer to Table 11). Saudi Arabia ranked first, with a share of 10 percent of total exports, the United Arab Emirates (UAE) ranked second, while Switzerland and the United States ranked third and fourth, with shares of around 8 and 7 percent respectively. Exports to Saudi Arabia were mainly composed of paper, paperboard and related articles, and fruits, while exports to the UAE and Switzerland were principally made-up of pearls, precious, or semi-precious stones. Lebanese exports to the United States were mainly tobacco and tobacco products.

Table 11. Regional Distribution of Imports and Exports

Imports

(USD million)	2000		2001	
	Jan-Dec	% share	Jan-Dec	% share
Total	6,228	100%	7,291	100%
Arab Countries	767	12%	943	13%
European Union	2,745	44%	3,065	42%
United States	457	7%	515	7%
Other	2,259	36%	2,768	38%

Exports

(USD million)	2000		2001	
	Jan-Dec	% share	Jan-Dec	% share
Total	714	100%	889	100%
Arab Countries	327	46%	395	45%
European Union	142	20%	171	19%
United States	46	6%	61	7%
Other	199	28%	262	29%

Source: MOF, DGC

Composition of imported and exported goods: More than 70 percent of the USD 1,063 million increase in the value of imports between 2001 and 2000 can be attributed to the increase in the five largest imported products highlighted in Table 12, namely mineral products, machinery and mechanical appliances, transport equipment, products of the chemical, and prepared foodstuffs. Imports of these products increased by 22 percent in 2001 mainly as a result of the decrease in custom duties that occurred in December of 2000 and, to a lesser extent, by the anticipated introduction of the VAT in February 2002.

Indeed, as previously expected, mineral products constituted the largest share of total imports for the year. This import category, which includes gasoline and other oil products, increased by 22 percent compared to the same period of 2000, despite two consecutive increases on the gasoline excise rates during the summer of 2001[2]. As a result of these rate hikes and the rise in international oil prices, the price of gasoline, as at the end of 2001, was 18 percent higher than the year-end 2000.

The import of machinery and mechanical appliances were also augmented by 25 percent compared to the previous year, indicating a capital formation that will affect the economy's growth going forward. Information technology products, which make-up the main portion of this item, have been positively affected by their

[2] Excises on gasoline first increased by LL 1,000 (per 20 liters) on two types of gasoline (‘92 and ‘98 octane) effective August 2001, and then, increased by LL 3,000 (per 20 liters) on all types of gasoline effective September 14, 2001. Moreover, effective January 2002, excises on gasoline increased by another LL 1,000 (per 20 liters) on two types of gasoline (‘92 and ‘98 octane).

exemption from custom duties back in December of 2000.

Similarly, the import of transport equipment, which is in large part composed of vehicles, rose by 28 percent compared to last year. This could be partly explained by the sharp increase in vehicle sales in light of the introduction of the VAT.

Compared to the previous year, products of the chemical (mainly made up of pharmaceuticals as well as perfumery and cosmetics) also rose by 13 percent, mainly due to the December 2000 decrease in the tariff rates on perfumery and cosmetics (on average, their rates have declined from 55 percent to 15 percent).

Imports of prepared foodstuffs, which principally include tobacco and its products, increased by 21 percent compared to the former year, despite leaving the rates of tobacco products unchanged back in December 2000.

Table 12. Imports Composition by Product

(USD million)	2000		2001	
	Jan-Dec	% share	Jan-Dec	% share
Mineral products	1,096	18%	1,341	18%
Machinery and mechanical appliances	800	13%	999	14%
Transport equipment	555	9%	713	10%
Products of the chemical	525	8%	595	8%
Prepared foodstuffs	415	7%	503	7%
Other goods	2,837	46%	3,140	43%
Total	**6,228**	**100%**	**7,291**	**100%**

Source: MOF, DGC

As for exports, approximately 66 percent of the USD 175 million increase is attributed to the increase in the levels of four out of Lebanon's five main export items (please refer to Table 13), namely, pearls, precious or semi-precious stones, machinery and mechanical appliances, prepared foodstuffs (where the rise was mainly due to the higher level of tobacco, vegetables, and fruits exports), and textiles and textile articles. These products have mainly benefited from the December 2000 tariff exemptions that impacted items such as gold, live animals, raw materials for industrial usage, textiles, and technological products.

Table 13. Exports Composition by Product

(USD million)	2000		2001	
	Jan-Dec	% share	Jan-Dec	% share
Pearls, precious or semi-precious stones	127	18%	141	16%
Machinery and mechanical appliances	75	11%	114	13%
Prepared foodstuffs	72	10%	100	11%
Products of the chemical	88	12%	88	10%
Textiles and textile articles	42	6%	77	9%
Other exports	310	43%	369	42%
Total	**714**	**100%**	**889**	**100%**

Source: MOF, DGC

New Customs Law
Summary Information

The Council of Minister's enacted a **new customs law** (WTO compatible), which simplifies and expedites customs procedures, adopts international standards, applies modern and fair dispute settlement procedures, allows for the electronic declaration of goods, and fosters the development of industrial zones and free zones. The new customs law introduced significant modifications to the old 1954 law. The new law went into effect on April 23, 2001 and is designed to bring the Port of Beirut in line with international standards and allow the rapid and more transparent clearance of goods.

Its **main features** are the following: (a) simplifying and expediting customs procedures, (b) adopting international standards for declaration of the value and country of origin of the imported goods, (c) allowing the usage of modern Information Technology practices, (d) eliminating complicated transitory clauses for computation of duties upon tariff change, (e) applying a modern and fair dispute settlement procedure between the Customs Authority and the trader (disputes will be settled in a commercial court by a designated judge instead of an Internal Customs Court), (f) allowing for the electronic declaration of goods, re-organizing the Customs Clearance Profession and allowing for specialized companies to operate in this domain with a strict control over clearance operations, (g) modernizing legal texts which govern the responsibilities of shippers, ship captains and ship owners in accordance with international laws and practices in order to relieve the parties above from penalties, where infractions were committed without their knowledge or consent, (h) fostering the development of industrial zones and free zones and simplifying their regulations in order to activate their economic role, and (i) eliminating unnecessary and costly Consular fees previously required by importers in the country of origin.

Section 6: Developments on the VAT front

Following its approval by the Council of Ministers on June 7, 2001, the VAT law was ratified by Parliament on December 5, 2001 and was implemented on February 1, 2002.

General characteristics of the VAT:

The VAT is levied at a **single rate of 10 percent** on all goods and services, both imported and domestically produced.

Exempted goods include (a) livestock, poultries and agricultural products sold in their raw state, agricultural equipment, pesticides, (b) bread, flour, meat, fish, milk and yogurt and their derivatives, (c) rice, sugar, salt, and macaroni & all different kinds of pasta, (d) books, magazines, newspaper, (e) medicines and drugs, medical equipment, pharmaceutical products, (f) gas for household consumption, (g) seeds, fertilizers, and animal feed, (h) baby food, (i) vegetable oil, (j) ink and paper for printing, (k) stamps, (l) precious and semi precious stones, gold and silver and other precious metals, (m) and currency.

Exempted services include (a) medical services, (b) educational services, (c) public transportation of individuals, (d) banking and financial services, (e) insurance, (f) activities of non-profit organizations regarding activities performed for non-profit purposes, (g) supply of gold to the Central Bank, (h) betting, lotteries and other forms of gambling, (i) sale of built properties, (j) residential rents of built properties, (k) farmers' activities concerning the supply of their agricultural production.

Thirty-five **decrees** pertaining to the implementation modalities of the VAT have already been finalized, twenty-eight of which have already been approved by the Council of Ministers and issued.

Registration started immediately after the ratification of the law. As of February 14, 2002, the total number of registered entities were **7,322.** Out of this number, **mandatory** registrations amounted to **6,425 companies** (businesses with a total turnover above LBP 500 million are required to register). The number of **optional registrations**, therefore, equaled **897 companies** (optional registration threshold covers businesses with a turnover between 150 and LBP 500 million).

Declaration: At the end of each tax period (which is one quarter instead of one month at the early stages of implementation), each taxable person shall submit a declaration within a maximum of 20 days from the end of the tax period.

Public awareness and communication: Prior to the launch of the VAT, ninety seminars and meetings had already been held in different Lebanese regions, and were targeted at various audiences and all economic sectors. An advertising campaign was also launched to educate the general public on the new tax and an Information Center was set up to answer inquiries about the VAT law, registration procedures etc. Moreover, a VAT website is already operational (www.finance.gov.lb).

The VAT **replaced** the 5 percent tax previously imposed on hotels and restaurants, as well as the taxes previously imposed on non-alcoholic beverages and cement.

The **VAT unit** consists of a staff of **164,** around 144 of whom are auditors and 20 are consultants.

Section 7: Developments on the tax regularization front

The tax regularization law was ratified by Parliament on December 5, 2001 following its approval by the Cabinet on June 21, 2001. The tax regularization is valid for the operations of industrial, commercial, and non-commercial entities for the period 1992-1999 (inclusive) for all income tax files that have not yet been audited by the fiscal authorities. It also pertains to the income tax files for the years 1992-1994 that have already been audited but the amounts of which have not yet been settled. The exempted entities from the regularization law are (i) holding and offshore companies and (ii) taxpayers enjoying permanent or temporary tax exemption. Taxpayers can choose, within a period of three months from the date of implementing the law either to abide to the dispositions of the tax regularization law, or to the dispositions of the regular tax payment.

This law will allow the Revenue Directorate to further monitor current tax compliance and new tax avoidance and evasion. The implementation of the tax regularization law is expected to yield LL 100 billion, in accordance with the 2002 Budget law.

The ratification of the tax regularization law also triggered the operation of another law, the "professional tax", which had already been ratified as part of 2000 Budget law pending the approval of the tax regularization law by Parliament.

PROFESSIONAL TAX
Summary Information

The adoption of a professional tax on corporations, individual companies, and professionals will yield LL 40 billion. This tax will be levied according to the following schedule:

- Annual tax of LL 2 million on Lebanese joint stock companies
- Annual tax of LL 750,000 on limited liability companies and other corporations
- Annual tax of LL 550,000 on individual companies taxable according to real profits
- Annual tax of LL 250,000 on taxpayers according to lump-sum profits
- Annual tax of LL 50,000 on taxpayers taxable according to estimated profits

The professional tax is applicable regardless of the year-end results of concerned companies.

Section 8: Developments on the privatization front

With a privatization law that is already ratified by Parliament (in May 2000) and a Privatization Council that has held regular meetings since June 2001, the government is working on the various sectors to be privatized.

Telecommunication Sector: On June 14, 2001, the cabinet approved a new telecom bill which liberalizes the sector, organizes the competitive structure of its market, and permits its privatization. This new telecom draft law is currently in its final discussion stage in Parliament, where it was approved by the Parliamentary Committee for telecom on October 1st, 2001. It is now being discussed by the Administration and Justice Committee, which constitutes the last step prior to its discussion and ratification in the General Assembly.

On the legal front as well, the six-month continuation of services' period originally awarded to the two cellular companies following the early termination of their ten-year contracts was extended by an additional three months. An arrangement was reached between the government and the two operators to freeze both domestic and international legal actions during this period of time. Indeed, the two current operators will continue their operations in their present form and under the conditions of their existing contracts until the end of March 2002. In the meantime, the two mobile operators will cooperate with HSBC's investment banking arm and with the audit firm, KPMG, both companies mandated by the Ministry of Telecom in November to perform the valuation of the companies and of the indemnities linked to the early termination of their contracts and to prepare for the privatization process.

Electricity: The electricity sector in Lebanon witnessed various developments during the period October – December 2001. Following the government's mandate to BNP Paribas in March 2001 to act as a financial advisor to identify a strategic partner and to design a business plan for the company, the government, in September, appointed the legal firm, Dewey Ballantine, to provide advice on the power regulation law (forwarded to Parliament in November) and on the privatization of EDL. In addition, an international audit firm (Deloitte) was also appointed to perform the due diligence on EDL. A new Director General and Chairman of the Board was appointed by the Council of Ministers in December. A comprehensive business plan is currently being prepared. The Parliamentary Committee on Public Works and Energy in the meantime has been deliberating the new electricity draft law, which sets out the procedures that must be followed to restructure the electricity sector and to eventually privatize it. According to the draft law, the production and distribution phases are to be privatized, whereas transmission operations are to be kept under government supervision.

Water sector: A new water sector law had been ratified by Parliament in May 2000 and was later amended in December 2001 in order to incorporate the waste-water sector. The water law calls for reforming the sector by regrouping the management and responsibilities of potable water and waste water from the existing twenty-two to four or five water regional offices (Beirut, Mount Lebanon, North, Bekaa, and South).

As a first step towards privatizing the water sector, the Government is in the final stages of negotiating a mandate with investment bank "Société Générale" for advisory services for the privatization of the water and waste water sectors in Lebanon. The mandate incorporates the responsibility for preparing the sector for its privatization, including its audit and legal groundwork. On the other hand, a management contract to finance infrastructure work in the Tripoli water office (which is to become the

North Water Authority in accordance with the new water and waste water law) was awarded to a private company under a € 20 million project financed by the "Agence Francaise de Developpement (AFD)".

Section 9: Developments on the trade liberalization front

On the trade liberalization front, the **Association Agreement between the European Union (EU) and Lebanon was initialed on January 10, 2002,** following six years of negotiations.

The agreement calls for the intensification of the political dialogue between the EU and Lebanon, cooperation on social affairs, migration, cultural, scientific, and technical affairs as well as on respect for human rights and democracy.

Moreover, it advocates economic cooperation in a wide range of sectors, including the harmonization of trade regulations, and adoption of international technical standards in view of improving Lebanon's access to the EU and world markets for manufactured and agricultural products.

In addition, it includes provisions relating to intellectual property, services, public procurement, competition rules and monopolies.

The agreement's most important objective is the **gradual liberalization of trade** between Lebanon and the EU in order to create a Euro-Med Free Trade Area by 2010.

In order to expedite the liberalization of trade, Lebanon and the EU will sign an **"interim agreement"**, a move that will permit the association agreement's trade concessions to enter into force prior to the parliamentary ratification of the agreement on both sides, which could take up to three years. The "interim agreement" is expected to take effect in the Spring of 2002.

The **dismantlement of custom duties** on **imports** from the EU will start five years after the enforcement date of the agreement and will be gradually reduced (starting from year five, duties and charges will be annually decreased by 12 percent) to zero twelve years after the entry into force of the agreement.

Lebanon's **exports** of industrial products to the EU will continue to be allowed entry to the EU free of customs duties (with the exception of a list of sensitive agricultural and agro-industrial exports).

As to liberalization of services, Lebanon will provide a schedule of specific commitments on services, in accordance with GATS, as soon as it is finalized. The Agreement provides for discussions one year after entry into force of the Agreement.

Section 10: Other structural and sector measures

In order to reactivate economic activity, the government implemented a number of real sector measures, the most important of which are summarized below:

National Social Security Fund: On March 15, 2001, the Cabinet approved a reduction of firms' contributions to the Fund from 38.5% of an employee's wage to 23.5%. The decrease in employees' participation fees constituted an attempt to stimulate private investment and generate new jobs. This measure was also meant to reduce evasion by employers that are not settling payments, and encourage those that are not registered to join the fund. The reductions consisted of:

- a cut in the employers' contributions in the maternity and sickness fund from 15 percent to 9 percent,
- a cut in the employers' contributions to the family allowance fund from 15 percent to 6 percent,
- a cut in the employees' contribution fees from 3% to 2% in the maternity and sickness fund

These measures were accompanied by an increase in NSSF coverage to include dental care, in addition to the already existing services of family allowances, end-of-service payments, maternity and sickness.

On the legal front, a draft law modernizing and regulating the NSSF was reviewed by the Ministry of Labor. The law is divided into two main pillars, namely administrative reform and end of service indemnity reform, which can be both summarized as follows:

<u>Administrative reform front</u>: It is mainly suggested to limit the managerial authority of the directors and replace the technical committee with an appraisal council. More specifically, the new draft law proposes to decrease the number of board members and to clearly specify their responsibilities, to appoint a government representative on behalf of the custodian Ministry, and to subject the fund's financial decisions to the Minister of Finance's supervision, to appoint an "Appraisal Council" whose job is to ensure the legality of NSSF's actions and suggest modernization of the fund, to define the director general's duties and to clearly make a distinction between the responsibilities of the director general and those of the board members.

<u>End of service indemnity front</u>: It is mainly proposed to replace the current end-of-service indemnities by a monthly pension, in a public insurance scheme that would also incorporate elements of compensation for disability or death. Any employee would be eligible to draw a pension from the age of 64, the official retirement age, as well as a lump-sum amounting to 25 percent of the total pension amount allowed. The 25 percent government contribution would be cancelled. More specifically, the new draft law recommends to adopt the concept of personal savings and to set up a unified account for all the insured employees covering the risks of death and aging, to provide a retirement salary amounting to 75%-82% of the retiree's last salary, to define the disability concept and the related benefits.

<u>Extension of government subsidized loans to productive sectors</u>:

The government has developed a program to help finance small and medium size loans in the sectors of agriculture, tourism, industry, and technology. The Government subsidizes the interest rate on such loans by bearing between 5 and 7 percent of the cost of borrowing. As a result of this measure, over the year, government subsidized loans extended by commercial banks have increased by 656 percent, from LL 68 billion in 2000 to LL 514 billion in 2001. The largest share of loans (61 percent) went to industry, followed by tourism (34 percent).

Table 14. Subsidized Loans to Productive Sectors

Sectors	Number of loans provided in 2000 (LL bn)	Number of loans provided in 2001 (LL bn)
Industry	45	314
Agriculture	1	19
Tourism	22	175
Specialized technologies	0	6
Total	**68**	**514**

Source: Central Bank of Lebanon
These subsidized loans are distributed to the five Mohafazat.

By the same token, the government extended support to the same types of industries through the Guarantee Scheme for Loans offered by "Kafalat". The Kafalat program was established in August 1999 in a joint venture between 50 commercial banks, the government, and the National Institute for Deposits Guarantees. In its newly revised scheme in 2001, Kafalat now enables banks to lend up to LBP 300 million, up from LBP 100 million in the original system. Loans should have a maximum maturity of 5 years. Kafalat underwrites 75 percent of the loan in case of default and charges a guarantee fee of 3 percent.

Up till 2001, the program issued guarantees for 715 loans compared with 131 loans up till January 2001. Most of the loans were extended to agriculture (45 percent) and industry (39 percent) and they are distributed as follows:

Table 15. Kafalat Loans to Productive Sectors

Sector	Number of loans up till January 2001*	Number of loans up till December 2001
Industry	58	278
Agriculture	60	323
Tourism	6	54
Handicrafts	2	14
Specialized technologies	5	46
Total	**131**	**715**

**Statistics are not available for end of 2000*
Source: KAFALAT
These Kafalat loans are distributed to the five Mohafazat.

Extension of government support for investment promotion:

In order to boost the Lebanese agricultural sector and help overcome the financial difficulties that farmers are currently facing by supporting and promoting Lebanese exports to traditional and new markets, the government granted IDAL (the Investment Development Authority of Lebanon) an amount of LL 50 billion (as part of 2001 Budget Law) and mandated the Authority with devising a program and a mechanism for the support of Lebanese fresh produce exports "Export Plus".

Table 16: Export Plus: Beneficiaries and exports by product

	Bekaa	North	Rest of Lebanon	**TOTAL**
Number of beneficiaries	123	37	63	**223**
Vegetable exports (tons)	64,150	9,150	700	**74,000**
Fruit exports (tons)	30,000	32,000	16,000	**78,000**

Source: Investment Development Authority of Lebanon (IDAL)

Four months following the launch of the "Export Plus" on August 14, 2001, the volume of agricultural exports through the program amounted to 152,000 tons. When around 12,000 tons of agricultural exports outside of "Export Plus" are added to this number, the increase over the comparable period in 2000 amounts to 59 percent. Fruit and vegetable exports during the period August 15-December 15, 2001 increased by approximately 28 percent and 76 percent respectively over the comparable period of 2000. More than 80 percent of agricultural produce managed through "Export Plus" are exported to the Gulf countries, 10% to Jordan and the remaining to other countries.

NEW INVESTMENT LAW

Summary Information

On August 16, 2001, a new law encouraging investment in Lebanon was ratified by Parliament. The law mainly comprises:

- Distributing IDAL's functions into four directorates: finance and administration, research and planning, information and marketing, and a one-stop-shop directorate
- Bestowing IDAL the authority to (a) replace all public administrations and institutions in awarding licenses to new investments and to (b) market Lebanese products abroad especially agricultural and agro-industrial products
- Dividing Lebanon into three main regions A, B, and C where investors in region A benefit from an amnesty of two years on income tax and tax on dividends provided they list at least 40% of their company's shares on the Beirut Stock Exchange. Investors in region B (mainly projects of a tourist nature) will benefit from the same advantages as region A and will also obtain a decline of 50% for five years on their income and dividend taxes. Investors in region C (mainly projects in the technology sector) will profit from the same advantages as region A and will be entitled to an exemption on paying income and dividend taxes for a period of ten years.
- Granting investors of all three regions (A, B, and C) the permission to receive work permits issued by IDAL provided that at least two Lebanese workers are employed for each foreign worker.

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