



## Public Finance Prospects 2005 Ministry of Finance Yearly Report

- ☒ **General Fiscal Developments:** The total fiscal balance improved by 7.5 percent in 2005, an overall improvement resulting mainly from a cut-down in expenditures which offset the decline in total receipts. In terms of GDP, the total deficit attained one of its lowest post-war levels, at 8.4 percent of GDP in 2005, compared to 9.2 percent of GDP in 2004. Meanwhile, the primary surplus declined by 26 percent, amounting to LL 737 billion or 2.2 percent of GDP for 2005, compared to LL 996 billion or 3 percent of GDP for 2004. As for total primary spending, it witnessed a rise of LL 150 billion between 2004 and 2005, driven primarily by the increased transfers to EDL and NSSF. It should be noted that the fiscal situation showed signs of recovery after July 2005<sup>1</sup>. (section 1).
- ☒ **Revenues and Expenditures:** The LL 228 billion improvement in the total deficit between 2004 and 2005 resulted primarily from a reduction in expenditures, which went down from 32.12 percent of GDP in 2004 to 30.78 percent of GDP in 2005. This is mainly due to the 12.1 percent drop in debt service payments - still a direct effect of the Paris II event. Meanwhile, total revenues declined from 22.9 percent of GDP in 2004 to 22.3 percent of GDP in 2005, chiefly resulting from a decrease in overall tax revenues which overtook, in magnitude, an increase in non-tax revenues. (sections 2 and 3).
- ☒ **Public Debt Developments:** In 2005, net debt increased to 158.8 percent of GDP from 151.5 percent of GDP by end-2004. The gross stock of debt, which cumulated at LL 58,048 billion, also increased from 164.7 percent of GDP in 2004 to 175.1 percent of GDP in 2005. (section 4).
- ☒ **External Trade:** The deficit in the trade balance reached USD 7,460 million in 2005, narrowing by 2 percent compared to the year 2004. This improvement results from a USD 133 million (or 8 percent) rise in exports, and a USD 57 million (or 1 percent) decrease in imports. (section 5).
- ☒ **VAT Developments:** The year 2005 witnessed: (a) a 3 percent decrease in the amount of VAT declared by businesses, with retail trade and business services being the highest contributors. (b) A 2 percent drop in the amount of VAT declared at customs from the import of merchandise, due to slight decreases in the import of several product categories. (section 6).

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<sup>1</sup> Please refer to Box 1 for more details

## Section I: Fiscal Overview 2005

Table 1. Summary of Fiscal Performance

(LL billion)	2004	2005	2004	2005	Change	
	December	December	Jan-Dec	Jan-Dec	2004-2005	% Change
Budget Revenues	721	568	7,075	6,984	-91	-1.3%
Budget Expenditures <i>of which:</i>	638	649	8,306	7,802	-504	-6.1%
<i>Debt Service</i>	389	395	4,021	3,534	-487	-12.1%
<b>Budget Deficit/Surplus</b>	<b>83</b>	<b>-81</b>	<b>-1231</b>	<b>-818</b>	<b>413</b>	<b>-33.5%</b>
in % of Budget Expenditures	13.0%	-12.5%	-14.8%	-10.5%		
<b>Budget Primary Deficit/Surplus</b>	<b>472</b>	<b>314</b>	<b>2,791</b>	<b>2,716</b>	<b>-75</b>	<b>-2.7%</b>
in % of Budget Expenditures	74.1%	48.3%	33.6%	34.8%		
Treasury Receipts	31	37	439	421	-18	-4.1%
Treasury Payments	385	363	2,235	2,401	166	7.4%
Total Budget and Treasury Receipts	752	605	7,515	7,405	-109	-1.5%
Total Budget and Treasury Payments	1,023	1013	10,541	10,203	-337	-3.2%
<b>Total Cash Deficit/Surplus</b>	<b>-271</b>	<b>-408</b>	<b>-3,026</b>	<b>-2,798</b>	<b>228</b>	<b>-7.5%</b>
in % of Total Expenditures	-26.5%	-40.2%	-28.7%	-27.4%		
<b>Primary Deficit/Surplus</b>	<b>118</b>	<b>-13</b>	<b>996</b>	<b>737</b>	<b>-259</b>	<b>-26.0%</b>
in % of Total Expenditures	11.5%	-1.2%	9.4%	7.2%		

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

At the end of 2005, the **total deficit** (budget and treasury) improved by 7.5 percent, from a deficit of LL 3,026 billion in 2004 to LL 2,798 billion in 2005. In terms of GDP, it was equivalent to 8.4 percent of GDP<sup>2</sup>, dropping from 2004's level of 9.2 percent of GDP and reaching one of its lowest post-war levels. This improvement was mainly accomplished due to the continued positive effect of the Paris II conference on the debt service bill.

In terms of GDP, while revenues decreased from 22.9 percent of GDP in 2004 to 22.3 percent in 2005, expenditures dropped from 32.1 percent of GDP in 2004 to 30.7 percent in 2005. The year 2005 ended with a **primary surplus** of LL 737 billion, or 2.2 percent of GDP, dropping from last year's primary surplus of LL 996 billion or 3 percent of GDP.

The **budget deficit** ameliorated by almost 34 percent compared to 2004. In terms of GDP, it improved from 3.8 percent of GDP in 2004 to 2.5 percent of GDP in 2005. Behind this progress are improvements in budget expenditures, as **budget revenues** actually decreased by 1.3 percent in 2005, from a level of LL 7,075 billion in 2004 to LL 6,984 billion in 2005. In fact, the overall amelioration in the budget deficit is due to a cut-down in **budget expenditures**, which dropped by 6 percent, from LL 8,306 billion in 2004 to LL 7,802 billion, chiefly as a result of the 12 percent decline in debt service.

<sup>2</sup> As per latest GDP and growth estimates (MOF, BDL, IMF), GDP for 2004 equals LL 32,815 billion and GDP for 2005 equals LL 33,243 billion.

### Box 1. Fiscal Performance Improvement after July 2005

The tragic events of February 14, 2005 subjected Lebanon to a shock that few countries can withstand. The assassination of the Late Prime Minister Hariri and his companions, and the events that followed, proved to be a difficult test for the Lebanese economy.

However, after a hard beginning to the year, and due to better management, the fiscal situation started showing signs of reversal after the month of July.

While primary expenditures had increased by 6.9 percent in Jan-July 05 compared to Jan-July 04, they dropped by 3.9 percent in Aug-Dec 05 compared to Aug-Dec 04.

Furthermore, while revenues had declined by 3.8 percent in the first 7 months of 2005 against the same period of 2004, they improved by almost 2 percent in the last 5 months of 2005 against the same period of 2004. Most importantly, while the primary surplus had declined by 63 percent in Jan-Jul 2005 (versus the same period of 2004), it improved by 52 percent during the last 5 months of the year. As a result, the total deficit also improved after July 2005, witnessing an improvement of almost 12 percent over Aug-Dec 2005 compared to Aug-Dec 2004, whereas it had ameliorated by only 3.5 percent in Jan-Jul 2005 against the same period of 2004.

#### Comparison of Fiscal Performance Jan-July vs. Aug-Dec (2004-2005)

(LL billion)	2004	2005	%	2004	2005	%
	Jan-July	Jan-July	Change	Aug-Dec	Aug-Dec	Change
Budget Revenue	4,170	4,019	-3.6%	2,905	2,965	2.1%
Budget Expenditures	4,628	4,306	-7.0%	3,678	3,496	-4.9%
<b>Budget Deficit/Surplus</b>	<b>-458</b>	<b>-287</b>	<b>-37.4%</b>	<b>-773</b>	<b>-531</b>	<b>-31.2%</b>
<b>Budget Primary Deficit/Surplus</b>	<b>1,773</b>	<b>1,466</b>	<b>-17.3%</b>	<b>1,018</b>	<b>1,250</b>	<b>22.8%</b>
Treasury Receipts	251	234	-6.8%	188	188	-0.4%
Treasury Payments	1,349	1,449	7.5%	886	952	7.4%
Total Budget and Treasury Receipts	4,421	4,253	-3.8%	3,094	3,153	1.9%
Total Budget and Treasury Payments	5,977	5,755	-3.7%	4,564	4,448	-2.5%
<b>Total Cash Deficit/Surplus</b>	<b>-1,556</b>	<b>-1,502</b>	<b>-3.5%</b>	<b>-1,470</b>	<b>-1,295</b>	<b>-11.9%</b>
Primary Expenditures	3,746	4,002	6.9%	2,774	2,667	-3.9%
<b>Primary Deficit/Surplus</b>	<b>675</b>	<b>251</b>	<b>-62.9%</b>	<b>320</b>	<b>486</b>	<b>51.8%</b>

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

## Section II: Revenue Outcome

**Table 2. Total Revenue**

(LL billion)	2004 December	2005 December	2004 Jan-Dec	2005 Jan-Dec	% Change
<b>Budget Revenues, of which:</b>	<b>721</b>	<b>568</b>	<b>7,075</b>	<b>6,984</b>	<b>-1.29%</b>
<i>Tax Revenues</i>	466	378	5,169	4,867	-5.84%
<i>Non-Tax Revenues</i>	255	190	1,907	2,117	11.06%
<b>Treasury Receipts</b>	<b>31</b>	<b>37</b>	<b>439</b>	<b>421</b>	<b>-4.13%</b>
<b>Total Revenues</b>	<b>752</b>	<b>605</b>	<b>7,515</b>	<b>7,405</b>	<b>-1.45%</b>

Source: MOF, DGF

In 2005, **total revenues** witnessed a drop of over 1 percent compared to 2004, equaling LL 7,405 billion in 2005, compared to LL 7,515 billion in 2004. In terms of GDP, total revenues decreased from almost 22.9 percent of GDP in 2004 to 22.3 percent of GDP in 2005. The decline in total revenue collection results from drops in both Budget Revenues and Treasury Receipts in 2005 compared to 2004.

**Budget revenues** went down by 1.3 percent in 2005, from 21.6 percent of GDP in 2004 to 21 percent of GDP in 2005. The overall drop in budget revenues is mainly due to the near 6 percent decline in tax revenues in 2005, which overtook the 11 percent increase in non-tax revenues.

**Tax revenues** (as part of budget revenues) amounted to LL 4,867 billion in the year 2005, which is equal to 14.6 percent of GDP compared to 15.8 percent of GDP in 2004. The near 6 percent overall drop in tax revenues in 2005 resulted to a large extent from a drop in revenues from international trade taxes and to a lesser extent from decreases in revenues from domestic taxes on goods and services and fiscal stamp fees.

**Tax on income, profits and capital gains** generated LL 1,047 billion or 3.2 percent of GDP for 2005, compared to LL 908 billion or 2.8 percent of GDP in 2004. This over 15 percent amelioration is namely due to improvements in the performance of the income tax on salaries and wages, the income tax on capital gains and dividends, and tax on interest income. In particular, the following developments occurred:

(a) Collection of the **income tax on profits** in 2005 went down by 2 percent, amounting to LL 409 billion by December 2005, compared to LL 418 billion by December 2004. This drop was reflected in the amount of income tax on profits collected from the large taxpayers. In fact, the collection of the tax on profits of the largest taxpayers went down by over 10 percent, from LL 205 billion in 2004, to LL 184 billion in 2005. The 10 largest taxpayers paid over 27 percent less tax on profit in 2005, paying LL 74 billion compared to LL 101 billion in 2004<sup>3</sup>.

(b) With revenues amounting to LL 95 billion in 2005, **income taxes on capital gains and dividends** witnessed a near 20 percent increase compared to the LL 79 billion collected in 2004, (the 2005 level of collection is in line with the average yearly collection in 2001 and 2002, compared to a depressed level of collection in 2003-2004). In fact, 23 percent (or LL 22 billion) of this LL 95 billion was declared by the 10 largest taxpayers; they declared 28 percent more of this tax in 2005 compared to the previous year.

<sup>3</sup> For more information on large taxpayers, please refer to Box 2

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(c) The **5% tax on interest income** collected LL 337 billion by December 2005, witnessing 47 percent higher revenues than the LL 229 billion collected in 2004. Of that total amount, LL 207 billion are tax proceeds collected from commercial banks (mainly on deposits), and the remaining amount (LL 130 billion) represent tax proceeds collected from the BDL. Whereas the average monthly collection of this tax from commercial banks was relatively steady at approximately LL 17 billion per month, the inflows from BDL witnessed major fluctuations, namely during the four months of March, April, September, and October, whereby the Treasury received bulk payments of LL 40 billion, LL 12 billion, LL 20 billion and LL 18 billion respectively compared to an average monthly collection of LL 5 billion. These bulk amounts may be due to the fact that interest is paid on CDs on a semi-annual basis. Furthermore, the difference in the amounts paid during these months is due to maturing CDs.

(d) The **income tax on wages and salaries** for the year 2005 collected LL 186 billion, up 16 percent from the LL 160 billion collected in 2004. The ongoing increases in receipts from the income tax on salaries and wages can largely be explained by the modernization of procedures and the completion of the employees database (mainly private sector employees,) following the launch of the DASS reform in 2003. In fact the registration of all private sector employees was nearly completed in May 2005; the registration process is still being carried on a continuous basis. As of December 2005, there were 18,066 employers and 319,146 employees registered in the database making it the most up-to-date among all governmental agencies' databases. As such, we have witnessed a steady increase in the average quarterly declaration proceeds from an average of LL 30 billion in 2003, to an average of LL 33 billion in 2004, to an average of LL 41 billion in 2005. In fact, over the last 3 years (2003-2005), the reform of the withheld tax on wages and salaries has improved collection by 36 percent.

**Table 3. Tax Revenue**

(LL billion)	2004	2005	2004	2005	%
	December	December	Jan-Dec	Jan-Dec	Change
<b>Tax Revenues:</b>	<b>466</b>	<b>378</b>	<b>5,169</b>	<b>4,867</b>	<b>-5.84%</b>
<b>Taxes on Income, Profits, &amp; Capital Gains,</b>	<b>52</b>	<b>45</b>	<b>908</b>	<b>1,047</b>	<b>15.35%</b>
<i>of which:</i>					
<i>Income Tax on Profits</i>	23	13	418	409	-2.03%
<i>Income Tax on Wages and Salaries</i>	4	4	160	186	16.10%
<i>Income Tax on Capital Gains &amp; Dividends</i>	2	3	79	95	19.69%
<i>Tax on Interest Income (5%)</i>	19	22	229	337	47.31%
<i>Penalties on Income Tax</i>	3	2	19	17	-8.44%
<b>Taxes on Property, of which:</b>	<b>59</b>	<b>71</b>	<b>405</b>	<b>414</b>	<b>2.38%</b>
<i>Built Property Tax</i>	13	9	106	90	-14.88%
<i>Real Estate Registration Fees</i>	42	60	261	291	11.46%
<b>Domestic Taxes on Goods &amp; Services, of</b>	<b>185</b>	<b>134</b>	<b>1,971</b>	<b>1,896</b>	<b>-3.80%</b>
<i>which:</i>					
<i>Value Added Tax</i>	165	114	1,763	1,693	-3.96%
<i>Other Taxes on Goods and Services, of</i>					
<i>which:</i>	20	20	194	192	-1.04%
<i>Private Car Registration Fees</i>	11	11	109	108	-1.64%
<i>Passenger Departure Tax</i>	9	9	82	83	0.87%
<b>Taxes on International Trade, of which:</b>	<b>149</b>	<b>107</b>	<b>1,617</b>	<b>1,268</b>	<b>-21.59%</b>
<i>Customs</i>	51	42	530	481	-9.19%
<i>Excises, of which:</i>	98	65	1,087	787	-27.63%
<i>Petroleum Tax</i>	52	22	644	362	-43.85%
<i>Tobacco Tax</i>	15	17	197	189	-3.77%
<i>Tax on Cars</i>	31	26	241	231	-4.21%
<b>Other Tax Revenues (namely fiscal stamp fees)</b>	<b>20</b>	<b>21</b>	<b>268</b>	<b>241</b>	<b>-10.08%</b>

Source: MOF, DGF

Proceeds from the **Taxes on Property** witnessed an overall increase of over 2 percent, at LL 414 billion in 2005, compared to LL 405 billion in 2004, mainly due to higher property registration receipts, as proceeds from the built property tax actually decreased this year:

- (a) **Built Property Tax**, the recurrent component of the tax, generated LL 90 billion in 2005, almost 15 percent lower than the LL 106 billion collected over January-December 2004. This downward trend is mainly due to the amendment of the property tax structure, as per Budget Law 2004<sup>4</sup>. In the year 2005, the assessment schedules for the years 2002 and 2003 were issued for 9 cadastral areas in Beirut, and the assessment schedules for the remaining 3 cadastral areas of Beirut are expected to be issued in 2006.

<sup>4</sup> Article 30, Paragraphs 54 and 56 of Budget Law 2004, amended and simplified the structure of the tax by imposing one structure of progressive rates (instead of the past two prevailing structures, a proportional rate and progressive rates). It modified the tax base from the aggregated value of a property owner's overall real estate assets as was the case before, to the value of each real estate separately.

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(b) **Real Estate Registration Fees**, the non-recurrent taxes on property, collected LL 291 billion in 2005 compared to LL 261 billion for 2004, representing over 11 percent higher receipts. This may hint at a higher real estate activity lately<sup>5</sup>. In fact, the number of total real estate properties sales transactions went up by almost 3 percent, reaching 55,099 transactions in 2005 compared to 53,535 transactions in 2004. In parallel, the price value of the total sales transactions also increased by 16 percent, from LL 4,345 billion in 2004, to LL 5,036 billion in 2005.

Of the total real estate sales transactions of 2005, 1,770 of them were undertaken by foreigners, representing a large increase from the 31 transactions in 2004. By the same token, fees paid by these foreigners on the sales transactions also increased by 16 percent, from LL 44 billion in 2004, to LL 52 billion in 2005.

Total receipts from **domestic taxes on goods and services** (exclusive of excises) equaled LL 1,896 billion by December 2005, around 4 percent below the collection level in January-December 2004. This is mainly due to near 4 percent lower revenues from the VAT and around 2 percent lower receipts from car registration fees.

The year 2005 collected LL 1,693 billion from the **Value-Added Tax**, almost 4 percent below the LL 1,763 billion collected during the year 2004. However, it should be taken into account that on a cash-basis, LL 1,673 billion was effectively collected in 2004<sup>6</sup>, thus VAT collection in 2005 actually increased by 1.2 percent compared to 2004.

It is worth noting here that despite lower economic growth in 2005 (1 percent real growth) compared to the growth rate achieved in 2004 (6 percent real growth rate), the VAT generated, on a cash basis, higher proceeds in 2005. This may be explained by the lowering of the mandatory registration threshold to LL 150 million in the beginning of this year, as per Article 20 of Budget Law 2004, which increased the number of individuals who are subject to the VAT. In fact, the average number of declarations received per quarter in 2005 equaled 17,444 declarations, compared to an average of 15,715 declarations in 2004, representing an increase of 11 percent.

Internally, and on a cash basis, VAT collection amounted to LL 516 billion, remaining relatively stable and generating 0.27 percent higher receipts during the year 2005 compared to the year 2004<sup>7</sup>.

As for VAT collected at import, it equaled LL 1,177 billion in 2005, compared to LL 1,248 billion in 2004, thus dropping by nearly 6 percent. However, taking into account the re-classified amount of LL 90 billion, the year 2005 witnessed an effective increase of 1.5 percent compared to the year 2004.

**Other taxes on goods and services** (namely include car registration fees and the passenger departure tax) collected a total of LL 192 billion for 2005, 1 percent less than the amount collected in 2004. This overall decrease resulted mainly from the 1.6 percent decrease in receipts from car registration fees which outweighed the near 1 percent rise in receipts from the departure tax:

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<sup>5</sup> However, this result may not necessarily be a reliable indicator of real estate market activity specifically during the year 2005 since new property owners are not obliged to register their property immediately after the purchase.

<sup>6</sup> Around LL 90 billion of the VAT amount recorded for 2004 represents VAT on fuel imports for EDL, collected effectively in 2002 and 2003, as guarantees and recorded then as Treasury revenues. This amount was reclassified under VAT revenues in June and December 2004. Therefore, on a cash basis, the Treasury collected effectively LL 1,673 billion of VAT in 2004. Hence, the LL 1,693 billion of VAT collected in 2005 should actually compare to LL 1,673 billion in 2004, representing an actual 1.2 percent increase.

<sup>7</sup> Further note that VAT refunds amounted to LL 132 billion in 2005, compared to LL 75 billion in 2004, representing an increase of 76 percent.

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(1) Private car registration fees<sup>8</sup> collected LL 108 billion during 2005, 1.6 percent lower than the collection level in 2004. This result is consistent with the 4 percent decline in the import of Transport Equipment (please refer to the trade section) and with the similar decline in excises levied on car imports (please refer to the following section), suggesting an overall depressed car market activity compared to the activity level in 2004.

(2) The passenger departure tax collected LL 83 billion in 2005, almost stable compared to 2004, attesting to the fact that passenger flow to Lebanon was affected by the events that occurred in 2005, as the trend had been increasing at an important level during previous years, especially in 2004. In 2005, 1,139,524 tourists visited Lebanon, compared to 1,278,469 tourists in 2004, representing a decrease of almost 11 percent.

**Taxes on international trade** (custom duties and excises) collected LL 1,268 billion by December 2005, down nearly 22 percent from LL 1,617 billion by December 2004. Behind this drop in revenues stand an approximate 28 percent decline in the collection of excise revenues and a 9 percent decline in customs receipts.

**Excises**<sup>9</sup> generated LL 787 billion in the year 2005, nearly 28 percent lower than the LL 1,087 billion collected during 2004. This is mainly due to a near 44 percent decline in car gasoline excise revenues resulting from the capping of the price of fuel at pump stations as of May 2004, in response to increasing fuel prices. It is worth noting that the Treasury lost LL 450 billion in forgone revenues in 2005 from the capping of the price of car gasoline at a fixed level. The year 2005 further witnessed a drop in the revenue collected from the excises on tobacco (by almost 4 percent) and on cars (by 4 percent).

**Car Gasoline:** In 2005, Lebanon imported the same quantity of car gasoline as in 2004, which is equivalent to 1.666 billion liters; however this was at a value of LL 1,051 billion compared to LL 770 billion for the same quantity in 2004, i.e., the effective price at imports rose from LL 462/liter in 2004 to LL 631/liter in 2005 equivalent to a 36.6 percent rise in value. The effective excise rate for the whole year is calculated at LL 217/liter, compared to LL 386/liter for 2004, and LL 489/liter for 2003.

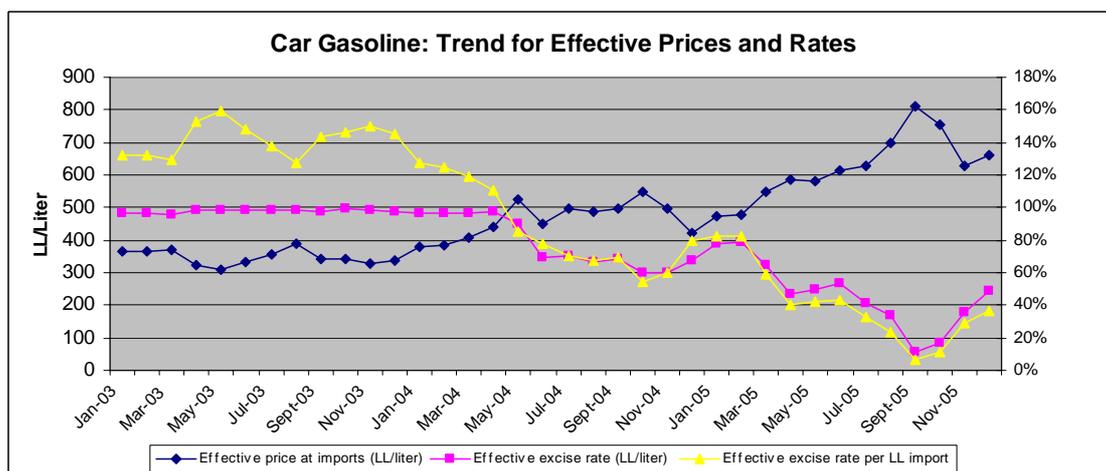
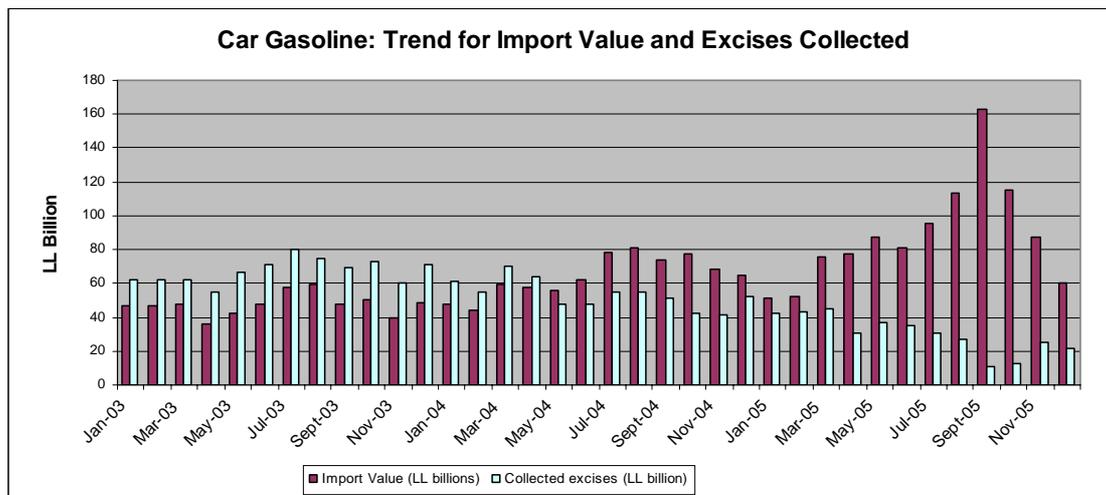
In fact, since the capping of the fuel price at pump stations at LL 23,000 or US\$15.25 per 20 liter (following the Council of Ministers' decision on May 20th 2004) in response to increasing international oil prices, excises collected have largely decreased relative to the import value. In April 2004, prior to the capping of the car fuel price, excises worth LL 64 billion were collected on LL 58 billion of car gasoline imported. In December 2005, only LL 22 billion of excises were collected on LL 60 billion of car gasoline imported.

Furthermore and as previously mentioned, the effective price at import has gradually increased in the last two years, while the effective excise rate has decreased. In fact, in April 2004, the effective price at import was LL 443/liter and the effective excise rate was LL 489/liter (or 110.3percent per LL of import). In December 2005, the effective price at import had gone up to LL659/liter while the effective excise rate dropped to LL 242/liter (or 36.7percent per LL of import).

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<sup>8</sup> One time fee paid upon the purchase of a car.

<sup>9</sup> Excises are collected at imports on car gasoline,, tobacco and cars mainly, and on alcoholic beverages.



**Tobacco:** Receipts from excises on tobacco imports for the year 2005 totaled LL 190 billion dropping by 4 percent compared to the year 2004. In fact, this went in line with the near 7 percent decline in the value of tobacco imports between 2004 and 2005 (LL 185 billion worth of tobacco products were imported in 2005 compared to LL 198 billion in 2004). Behind this decline in imports stands a 21 percent decrease in tons of imports.

**Cars:** With LL 231 billion of excises collected, the year 2005 witnessed a drop of 4 percent in receipts from excises on cars, compared to the year 2004. This decline in excise collection is explained by a decrease of almost 7 percent in the import of cars which totaled LL 847 billion for 2005 compared to LL 909 billion for 2004. In fact, the number of cars imported in 2005 dropped by almost 9 percent, whereas the average price per car imported in 2005 was 2 percent higher than that of 2004.

**Customs revenues** amounted to LL 481 billion by December 2005, 9 percent lower than the LL 530 billion collected in 2004. The overall effective tariff rate in 2005 went down to 3.4 percent compared to 3.7 percent in 2004. On the other hand, imports remained relatively stable, decreasing by a mere 1 percent in 2005 as compared to 2004 (please refer to the trade section).

Possible explanations for the drop in customs revenues are:

- (a) A decrease in non-oil imports that are subject to customs duties in 2005 relative to 2004. In fact, non-oil imports subject to customs duties (such as machinery and mechanical appliances, chemical products and transport equipment) totaled LL 7,114 billion in 2005 declining by 4 percent relative to 2004. The import of machinery and mechanical appliances declined by 4 percent, the import of chemical products dropped by 1 percent, and the import of transport equipment declined by 4 percent.
- (b) An increase in imported goods which are exempt from customs duties under trade agreement, such as the Greater Arab Free Trade Agreement (GAFTA) which came into effect in January 2005

**Other tax revenues (mainly fiscal stamps)** reached LL 241 billion in the year 2005, registering a 10 percent decrease from the level of collection in the previous year, suggesting there was an overall slow down of transactions taking place in the economy in 2005.

**Table 4. Non-Tax Revenue**

(LL billion)	2004	2005	2004	2005	% Change
	December	December	Jan-Dec	Jan-Dec	
<b>Non-Tax Revenues</b>	<b>255</b>	<b>190</b>	<b>1,907</b>	<b>2,117</b>	<b>11.06%</b>
<b>Income from Public Institutions and Government Properties, of which:</b>	<b>206</b>	<b>135</b>	<b>1,448</b>	<b>1,663</b>	<b>14.85%</b>
Income from Non-Financial Public Enterprises, of which:	202	131	1,391	1,614	15.99%
<i>Revenues from Casino Du Liban</i>	9	5	42	51	20.71%
<i>Revenues from Port of Beirut</i>	0	0	0	58	100.00%
<i>Budget Surplus of National Lottery</i>	3	10	37	47	28.77%
<i>Transfer from the Telecom Surplus</i>	190	116	1,310	1,456	11.12%
Property Income (namely rent of Rafik Hariri International Airport)	3	4	48	44	-9.48%
Other Income from Public Institutions (interests)	1	1	8	6	-32.95%
<b>Administrative Fees &amp; Charges, of which:</b>	<b>42</b>	<b>46</b>	<b>365</b>	<b>365</b>	<b>-0.16%</b>
Administrative Fees, of which:	32	36	284	290	2.08%
<i>Notary Fees</i>	2	2	17	17	0.69%
<i>Passport Fees/ Public Security</i>	8	8	90	88	-1.53%
<i>Vehicle Control Fees</i>	17	19	129	129	0.41%
<i>Judicial Fees</i>	2	2	20	20	-0.73%
<i>Driving License Fees</i>	1	2	15	16	6.43%
Administrative Charges	4	5	28	25	-9.72%
Sales (Official Gazette and License Number)	1	1	4	3	-24.56%
Permit Fees (mostly work permit fees)	4	4	41	39	-4.92%
Other Administrative Fees & Charges	1	1	8	8	-9.08%
<b>Penalties &amp; Confiscations</b>	<b>0</b>	<b>1</b>	<b>5</b>	<b>4</b>	<b>-14.75%</b>

Source: MOF, DGF

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**Non-tax revenues** generated LL 2,117 billion in 2005, increasing by 11 percent compared to 2004. Their share of GDP also improved, equaling 6.4 percent of GDP in 2005 compared to 5.8 percent of GDP in 2004. This improvement is mainly attributed to an increase of nearly 15 percent in revenues from public institutions and government properties. The remaining components under the non-tax revenue category either remained stable or decreased slightly compared to last year: revenues from administrative fees and charges were stable, revenues from penalties and confiscation decreased by LL 1 billion and other non-tax revenues went down by LL 3 billion.

**Income from public institutions and government property** reached LL 1,663 billion in 2005, compared to LL 1,448 billion for 2004, representing an almost 15 percent increase in receipts. This increase is due to improvements in revenue collection from several components under this category, the main of which being transfers from the **telecom budget surplus**. In effect, Revenues from the telecom budget surplus for 2005 amounted to LL 1,456 billion, compared to LL 1,310 billion in 2004, representing an 11 percent increase in revenues.

Furthermore, revenues from the **Casino du Liban** increased by nearly 21 percent as compared to the year 2004, reaching LL 51 billion at the end of 2005,.

As for revenues from **Port of Beirut**, they equaled LL 58 billion (LL 33 billion of which were collected in March 2005 and LL 25 billion in October 2005). Please note that no revenues were recorded for 2004.

Also, revenues from budget surplus of the **National Lottery** amounted to LL 47 billion in 2005, representing an increase of almost 29 percent compared to the previous year.

**Administrative fees and charges** collected LL 365 billion in total for 2005, remaining relatively unchanged from the collection level of 2004.

With LL 290 billion collected, **Administrative Fees** (namely judiciary fees, public security fees, road usage fees and driving license fees) registered an overall 2 percent increase between 2004 and 2005, owing mainly to LL 7 billion of additional penalties on fees paid in 2005.

As for **Administrative Charges** (which include public exam fees, registration fees in public schools and the Lebanese University, and fees from port authorities), they generated LL 25 billion in 2005, compared to LL 28 billion in 2004, witnessing a 10 percent decrease in collection.

**Permit fees** also witnessed a decline in 2005, collecting LL 39 billion over the year, compared to LL 41 billion in 2004, representing a 5 percent decline.

**Treasury revenues** for the year 2005 amounted to LL 421 billion, compared to LL 439 billion in 2004, witnessing a drop of 4 percent. Of that total amount, LL 187 billion represents Municipalities' share of revenues of government taxes and fees (namely from custom duties, and property taxes), which were 72 percent higher than their revenues for 2004.

## Box 2 Performance of the Large Taxpayers' Office in 2005

In its bid to institute tax reforms and modernize the Revenue Administration, the Ministry of Finance launched the Large Taxpayer Office (LTO) in May 2005, with the goal of creating a functional structure to revenue administration over the medium-term. The LTO currently administers income tax chapters I (tax on profit income) and chapter II (tax on salaries and wages income) and chapter III (tax on income from movable assets) for taxpayers whose annual turnover exceeds LL10 billion, as well as all insurance companies and financial institutions (including banks).

### **Number of Large Taxpayers**

The number of taxpayers registered at the LTO as at 31/12/2005 was 619 entities, distributed as follows:

- Banks and Financial Institutions: 66
- Insurance companies: 30
- Joint-Stock Companies and Limited Liability Companies: 523

### **Amounts Declared\***

The tax amounts declared by the large taxpayers were as follows:

Amounts Declared by Large Taxpayers			
<i>LL billion</i>	2004	2005	%Change
Income Tax	205	184	-10.30%
Tax on Salaries and Wages	62	67	8.57%
Tax on Capital Gains (10%)	53	72	35.92%
Tax on Interest (5%)*	235	343	46.28%

*\*In accordance with article 51 of Law No 497/2003*

Amounts Declared by 10 Largest Taxpayers			
<i>LL billion</i>	2004	2005	%Change
Income Tax	101	74	-27.30%
Tax on Salaries and Wages	18	16	-8.36%
Tax on Capital Gains	17	22	28.15%

The amount of income tax declared by the largest taxpayers decreased by 10 percent compared to 2004. This drop is even more apparent when the amounts declared by the 10 largest taxpayers are examined; the largest 10 taxpayers declared 27 percent less income tax this year. As expected, the deterioration is reflective of the overall decrease in the collection of income tax on profits witnessed this year.

Declaration amounts by large taxpayers regarding the tax on salaries and wages, the tax on capital gain and the 5 percent tax on interest increased in 2005 compared to 2004 (except for the amounts declared of the tax on salaries and wages of the 10 largest taxpayers which actually went down). These results are also reflective of the performance of these 3 taxes for all taxpayers in 2005.

*\* Please note that the amounts in this box may differ from those mentioned in the revenue section (tax revenues in table 3) since they are based on the amounts declared, while the figures in the revenue section are based on actual payment made.*

## Section III: Expenditure Outcome

Table 5. Expenditures by Transaction Classification

(LL billion)	2004	2005	2004	2005	
	December	December	Jan-Dec	Jan-Dec	% Change
<b>Total Expenditures</b>	<b>1,023</b>	<b>1,013</b>	<b>10,541</b>	<b>10,203</b>	<b>-3.20%</b>
<b>Budget Expenditures</b>	<b>638</b>	<b>649</b>	<b>8,306</b>	<b>7,802</b>	<b>-6.06%</b>
Expenditures Excluding Debt Service	248	254	4,284	4,268	-0.38%
Debt Service, of which:	389	395	4,021	3,534	-12.11%
<i>Domestic Debt</i>	152	190	2,246	1,533	-31.76%
<i>Foreign Debt, of which:</i>	237	205	1,776	2,002	12.74%
<i>Eurobond Coupon Interest*</i>	186	153	1,501	1,709	13.86%
<i>Concessional Loans Principal Payments</i>	36	38	161	178	10.56%
<i>Concessional Loans Interest Payments</i>	15	14	113	114	0.88%
<b>Treasury Expenditures , of which:</b>	<b>385</b>	<b>363</b>	<b>2,235</b>	<b>2,401</b>	<b>7.45%</b>
<i>Municipalities</i>	8	49	461	384	-16.60%
<i>Previous Years' Appropriations</i>	173	178	619	675	9.05%
<b>Non-Interest Expenditures (Total Expenditures minus Debt Service)</b>	<b>634</b>	<b>618</b>	<b>6,519</b>	<b>6,669</b>	<b>2.30%</b>

Source: MOF, DGF

\* Includes general expenses related to Eurobond transactions

**Total Expenditures (budget and treasury)** for the year 2005 reached LL 10,203 billion, down by 3.2 percent from 2004. In terms of GDP, total expenditures represented 30.78 percent of GDP in 2005, down from 32.12 percent of GDP in 2004.

**Budget expenditures** equaled LL 7,802 billion by the end of 2005, compared to LL 8,306 billion in 2004, representing a drop of 6 percent. Of total budget spending, LL 4,268 billion were classified as **non interest expenditures**, compared to LL 4,285 billion of primary spending during 2004.

Meanwhile, **Treasury Expenditures** for the year 2005 increased by over 7.4 percent, from LL 2,235 billion in 2004 to LL 2,401 billion in 2005. However, this increase in Treasury spending was offset by the decrease in Budget spending, resulting in the overall improvement in total expenditures.

**Total Primary Expenditures (Non-Interest Expenditures)** represented 20.12 percent of GDP in 2005, up from 19.87 percent of GDP in 2004. In fact, these expenditures amounted to LL 6,669 billion in the year 2005 compared to LL 6,519 billion in 2004. The LL 150 billion increase in primary expenditures mainly results from (a) the LL 201 billion higher transfer to NSSF (LL 290 billion at end-2005) and (b) LL 397 billion higher direct and indirect spending on EDL. The bulk of increase of the latter - amounting to LL 341 billion- resulted from the increase in direct transfers through treasury advances to cover the EDL deficit that reached LL 833 billion in 2005. Indirect transfers increased as well by LL 56 billion, as a result of payment of electricity bills through both budget transfers (Materials and Supply) and treasury advances (water authorities).

Looking at expenditures from an economic perspective, the year 2005 witnessed a drop in both current and capital expenditures, and a rise in treasury spending.

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**Current expenditures** for the year 2005 amounted to LL 7,925 billion, compared to 8,051 billion in 2004, representing a drop of 1.6 percent, which was mainly due to a decline in debt service by LL 487 billion.

Primary current expenditures amounted to LL 4,391 billion in 2005, up by almost 9 percent from the 4,030 billion registered in 2004. The LL 361 billion increase mainly resulted from a rise in various transfers (which included transfers to NSSF), as well as increased spending on materials and supplies and personnel cost.

Further details on current expenditures are highlighted in what follows (*also please refer to table 6*):

**Personnel cost** in 2005 amounted to LL 3,193 billion, LL 99 billion higher than the level of 2004. This rise is mainly attributed to (a) An increase of LL 54 billion (almost 7 percent) in spending on end-of-service compensation between 2004 and 2005; and (b) An increase of LL 57 billion in the salaries and wages (For more information on salaries and wages please refer to box 3).

**Interest payments** registered the lowest level since 1998, totaling LL 3,534 billion in 2005, 12 percent lower than the LL 4,021 billion paid during 2004, mainly due to a near 32 percent decline in the servicing of the domestic debt. The decline in the debt service bill was due to the persistent positive impact of Paris II transactions and the overall decline in the interest rate level that took place at that time. As for foreign currency debt service, it witnessed an increase of almost 13 percent, amounting to LL 2,002 billion in 2005, compared to 1,776 billion in 2004. The increase in the foreign currency interest bill is due to the rise in the amount of foreign currency debt held in 2005. Foreign currency debt amounted to LL 27,690 billion at the end of December 2004, up from LL 23,442 in December 2003, an 18 percent increase. (*For more details, please refer to the Debt Section*).

**Materials and supplies** reached LL 213 billion by December 2005, increasing by LL 97 billion from their level at the end of 2004. This increase is mainly due to the near LL 93 billion payment of public administrations' electricity bills to EDL, in accordance with Law # 672 enacted on February 17<sup>th</sup>, 2005 which opened an additional allocation in 2004 Budget Law, under the Ministry of Finance's budget to reimburse accrued electricity bills on behalf of public administrations.

**External services** (rent, postal services, insurance, advertisement and public relations) amounted to LL 82 billion, down 27 percent from their end-2004 level.

**Various transfers** reached LL 569 billion in 2005, up from LL 360 billion with the main driver of this increase is the transfer to NSSF amounting LL 290 billion in 2005, against 89 billion in 2004. (the transfer in 2005 was based on Law 671 issued in February 5, 2005 stipulating the opening of LL 240 billion additional Budget allocation in the 2004 Budget. This allocation is earmarked to reimburse government contribution to the National Social Security Fund on account of 2003 and 2004).

When excluding the transfers made to the NSSF, expenditures under this article remained relatively constant, rising by LL 8 billion between 2004 and 2005.

In addition to the transfers to NSSF, the various transfers included subsidies paid to the annex budget of the General Directorate of Grains and Sugar Beet in the amount of LL 15 billion.

**Table 6. Expenditures by Economic Classification**

(LL billion)

	Jan-Dec 04	Jan-Dec 05	Change in percent
<b>1. Current expenditures</b>	<b>8,051</b>	<b>7,925</b>	<b>-1.57%</b>
1.a Personnel cost, of which	3,094	3,193	3.20%
<i>Article 13: Salaries and wages</i>	2,072	2,129	2.76%
<i>Retirement and end of service compensations</i>	810	864	6.67%
1.b Debt service payments	4,021	3,534	-12.11%
1.c Materials and supplies	116	213	83.43%
1.d External services	113	82	-27.25%
1.e Various transfers	360	569	58.27%
<i>o/w NSSF</i>	89	290	225.84%
1.f Other current	275	258	-6.03%
<i>Hospitals</i>	236	192	-18.73%
<i>Others</i>	38	66	71.88%
1.g Reserves	72	75	3.93%
<i>Interest subsidy</i>	72	75	3.93%
<b>2. Capital expenditures</b>	<b>817</b>	<b>534</b>	<b>-34.64%</b>
2.a Acquisitions of land, buildings, for the construction of roads, ports, airports, and water networks	12	15	25.39%
2.b Equipment	49	25	-48.58%
2.c Construction in Progress	646	413	-36.07%
2.d Maintenance	60	46	-24.40%
2.e Other Expenditures Related to Fixed Capital Assets	49	35	-29.24%
<b>3. Other treasury expenditures, of which</b>	<b>1,477</b>	<b>1,701</b>	<b>15.13%</b>
Municipalities	461	384	-16.60%
EDL*	492	833	69.37%
Treasury advances for water authorities	85	48	-43.51%
Treasury advances for diesel oil subsidy	8	14	82.70%
Treasury advances for Telecom companies (payment of the retained guarantee amount)		15	
<b>4. Unclassified expenditures</b>	<b>69</b>	<b>5</b>	<b>-93.10%</b>
<b>5. Customs cashiers</b>	<b>126</b>	<b>39</b>	<b>-69.37%</b>
<b>6. Total expenditures (excluding CDR foreign financed)</b>	<b>10,541</b>	<b>10,203</b>	<b>-3.20%</b>

Source : statement of account 36, cashier spending, Public Debt Department figures , Fiscal performance gross adjustment figures

\* Excludes Treasury advances to water authorities for their accrued electricity bills (LL 48 billion) and Budget transfers (LL 93 billion) under the line item "Materials and Supplies" for the settlement of public administrations' accrued electricity bill.

### Box 3. Overview of Salaries and Wages in 2005

In 2005, salaries and wages increased by over 2 percent compared to the year 2004, representing 22 percent of total expenditures and one third of total primary expenditures.

Salaries and wages cover the salaries and wages of all employees (such as full-time and part-time employees, consultants, advisors, workers earning a lump-sum-amount...), compensations (such as family, overtime, transportation...), allowances (such as sickness and maternity, marriage, birth, death, hospitalization, schools, social spending, treatment in medical centers...), bonuses, contributions to pension funds (such as those of COOP employees, members and employees of parliament, judges and judges of the religious courts, contributions to the Lebanese University...)

Salaries and wages can be broken down into three major components:

- 1) The salaries of military personnel (include armed forces within the government such as the Lebanese Army, the Internal Security Forces, the General Security Forces, and the State Security Forces) made up almost half of the total wage and salary bill for 2005, and increased by over 3 percent compared to 2004. The main reason for the increase is the rise in spending on sickness for military personnel (it increased by 10 percent in 2005 compared to 2004).
- 2) The salaries of education personnel (including salaries of teachers, contributions to salaries/wages of Lebanese University...) for the year 2005 constituted around one third of the total wage and salary bill. The amount paid for education personnel was 8 percent higher in 2004, mainly due to the hiring of new teachers during the end of 2004 (Decree No13542 Dated October 14, 2004).
- 3) The salaries of civil personnel constituted 24 percent of the total wage and salary bill for 2005, and were 6 percent lower than the amount paid in 2004. The main reason for the decrease is that transfers to the employees' COOP were around 18 percent lower in 2005 than in 2004.

#### Breakdown of Salaries and Wages

<i>LL billion</i>	2004	2005	Percentage change
<b>Military Personnel</b>	<b>986</b>	<b>1,020</b>	<b>3.49%</b>
Army	668	686	2.75%
Internal Security forces	241	255	5.74%
General Security forces	57	59	2.97%
State Security forces	20	21	2.65%
<b>Education Personnel</b>	<b>653</b>	<b>705</b>	<b>7.97%</b>
<b>Civil Personnel</b>	<b>582</b>	<b>549</b>	<b>-5.63%</b>
<b>Grand-Total</b>	<b>2,221</b>	<b>2,275</b>	<b>2.42%</b>

*\* The grand total differs from the total for the item "Article 13: Salaries and Wages" in table 6 because the amounts listed in this box for Education personnel include contributions to the salaries of Lebanese University staff.*

*Source: MOF, DGF*

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**Other current expenditures** for 2005 amounted to LL 258 billion, 6 percent lower than in 2004. This overall decrease resulted mainly from a drop of LL 44 billion of transfers to hospitals, and a simultaneous increase of LL 32 billion in transfers to the Ministry of Education, in settlement of arbitration decisions related to contractual teachers wages and salaries.

**Interest subsidies** for loans to the productive sectors (agriculture, industry, tourism, technology and crafts) increased by LL 3 billion or by 4 percent from their level in 2004, reaching LL 75 billion in 2005.

**Capital expenditures** for the year 2005 amounted to LL 534 billion, decreasing by LL 283 billion (almost 35 percent) compared to 2004. This large decline is mainly attributed to:

- Lower transfers to the *Displaced Fund* which amounted to LL 20 billion in 2005 compared to LL 158 billion in 2004 (i.e., decline by LL 138 billion)
- Lower transfers to the *Council of the South* which reached an amount of LL 66 billion in 2005 compared to LL 116 billion in 2004 (i.e., decline by LL 50 billion).
- Lower transfers to the Ministry of Public Works and Transport, which amounted to LL 39 billion in 2005 compared to LL 70 billion in 2004 (i.e., decline by LL 31 billion).
- Lower transfers to the *CDR* which totaled LL 235 billion in 2005 compared to LL 247 billion in 2004 (i.e., decline by LL 12 billion).

**Other treasury expenditures** increased by 15 percent during 2005 compared to 2004. The main items classified as part of "the other treasury expenditures" are Municipalities and EDL.

(a) In 2005, spending on **municipalities** was almost 17 percent lower than in 2004, LL 384 billion in 2005 against LL 461 billion in 2004.

(b) Transfers to **EDL** from the treasury were higher than last year, amounting to LL 833 billion in 2005 compared to LL 492 billion in 2004, i.e., with an increase of almost 69 percent. (*please refer to table 7*)

In addition to treasury direct transfers, EDL received further indirect transfers that raised the expenditures of EDL in 2005 to LL 974 billion, as compared to 577 in 2004, i.e. increasing by 69 percent. These transfers included:

- Treasury advances to water authorities for their accrued electricity bills, amounting to LL 48 billion.
- Budget transfers under the line item "Materials and Supplies", amounting to LL 93 billion.

It is worth noting that the increase in transfers to EDL has slowed down since September 2005, as EDL started withdrawing from the Algerian and Kuwaiti Fund agreement for the supply of fuel oil. However, repayments on these two agreements will start in June 2006.

In 2005, EDL's deficit amounted to LL 1,212 billion (excluding the company's delayed payments to suppliers and others), of which LL 974 billion was paid from Treasury accounts. The rest (LL 238 billion) was spent through the agreements signed with Algeria and Kuwait.

**Table 7. Transfers to EDL**

(LL billion)	2004	2005	
	Jan-Dec	Jan-Dec	% Change
<b>EDL of which:</b>	<b>577</b>	<b>974</b>	<b>68.80%</b>
<b>Debt Service of which:</b>	<b>341</b>	<b>245</b>	<b>-28.15%</b>
C-Loans and Eurobonds, of which:	205	196	-4.20%
Principal Payment	143	143	0.00%
Interest Payment	61	53	-13.68%
Loans for Fuel Oil Payment	33	49	46.27%
BDL Guaranteed Loan Payment	103	0	-100.00%
<b>Treasury Advance for Fuel Purchase</b>	<b>150</b>	<b>130</b>	<b>-13.33%</b>
<b>Treasury Advance for EDL' s Losses*</b>	<b>-</b>	<b>458</b>	<b>100.00%</b>
<b>Material and supplies (electricity bills)</b>	<b>-</b>	<b>93</b>	<b>100.00%</b>
<b>Treasury advance to water authorities</b>	<b>85</b>	<b>48</b>	<b>-43.53%</b>
<b>Expropriations</b>	<b>2</b>	<b>-</b>	<b>-100.00%</b>

Source: MOF, DGF

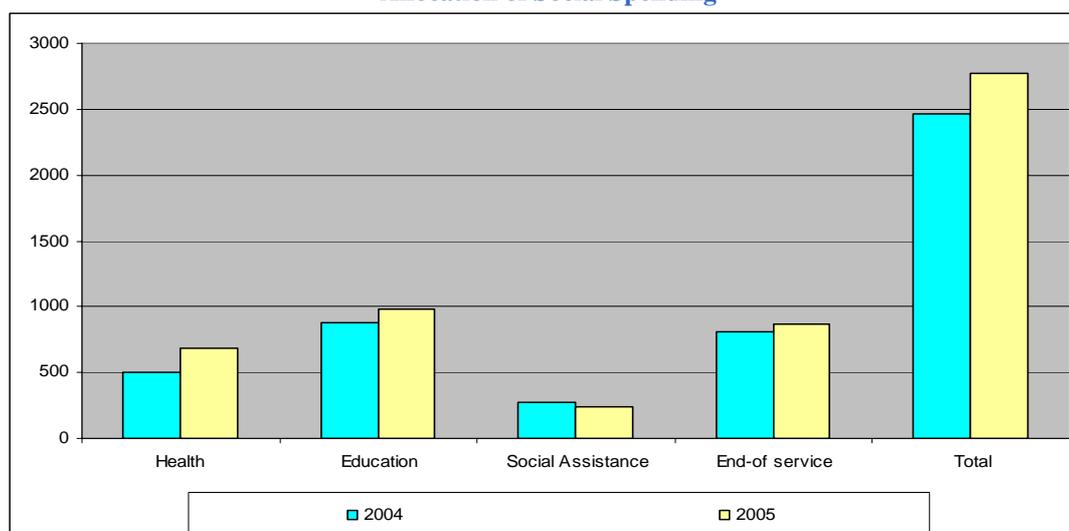
\* Decree No. 14561 dated June 10,2005 - Decree No. 14917 dated July 5,2005 - Decree No.15542 dated October 5,2005

### Details of Social Expenditures

While overall expenditures witnessed a decrease of 3 percent in 2005 compared to 2004, social spending actually increased by 13 percent this year. This spending includes the two fundamental social services of (a) education health, (b) pension and end-of-service indemnity, as well as other areas of interventions classified as social assistance.

Of the total LL 2,788 billion of social spending in 2005, education accounted for the largest bulk, at 35 percent of total spending, covering mainly the Ministry of Education and Higher Education, in addition to educational allowances paid to security forces. Spending on Pension and end-of-service ranked second, representing 31 percent of total social expenditures. As for spending on health, it accounted for 25 percent of total social spending whereas it had accounted for 20 percent of total social spending in 2004. The increase was driven by the increase in the NSSF allocation, which amounted to 290 billion by the end of 2005.

**Allocation of Social Spending**



Source: MOF, DGF

**Table 8. Social Spending for 2004-2005**

<i>(LL billion)</i>	Jan-Dec 2004	Jan-Dec 2005	Magnitude of change	Percentage change
<b>Health</b>				
Hospitalization in the private sector	236	192	-44	-19%
Purchase of Medication	48	55	7	14%
Hospitalization of public sector employees in private sector	62	85	23	37%
Maternity and sickness allowance	25	17	-8	-32%
NSSF	89	290	201	226%
Other	41	49	9	22%
<b>Sub-Total</b>	<b>501</b>	<b>688</b>	<b>187</b>	<b>37%</b>
<b>Education</b>				
Ministry of Education and Higher Education <i>of which</i>	773	882	109	14%
<i>Wages and Salaries of the General Directorate of Education</i>	481	534	53	11%
<i>Wages and Salaries of the General Directorate of Higher Learning</i>	1	0	0	-26%
<i>Wages and Salaries of the General Directorate of Technical Education</i>	58	61	3	5%
<i>Contributions in the salaries of the Lebanese University</i>	149	146	-3	-2%
<i>Contributions to non profitable organizations (private schools)</i>	22	29	7	32%
<i>Construction under execution (construction and restoration of schools)</i>	21	40	18	85%
Education allowance in private sector	103	101	-2	-2%
<b>Sub-Total</b>	<b>877</b>	<b>983</b>	<b>107</b>	<b>12%</b>
<b>Other Social Spending</b>				
Marriage allowance	2	2	0	-21%
Birth allowance	2	2	0	-14%
Death allowance	2	2	0	1%
Other social spending allowance	6	4	-2	-27%
Contribution to mutual funds	23	21	-2	-8%
Ministry of Social Affairs, <i>of which</i>	73	69	-5	-7%
<i>Transfers to non profit organizations</i>	71	67	-4	-6%
Ministry of Displaced	5	3	-2	-34%
Transfers to employees' cooperative	165	135	-30	-18%
Treasury advances for diesel oil subsidy	8	14	6	83%
<b>Sub-Total</b>	<b>286</b>	<b>252</b>	<b>-34</b>	<b>-12%</b>
<b>End of service &amp; Pensions</b>	<b>810</b>	<b>864</b>	<b>54</b>	<b>7%</b>
<b>Grand-Total</b>	<b>2,474</b>	<b>2,788</b>	<b>314</b>	<b>13%</b>

Source: MOF, DGF

## Section IV: Public Debt Developments

Table 9. Public Debt Outstanding by Holder as of End-December 2005

LL Billion	Dec-02	Dec-03	Dec-04	Dec-05	Change Year-to-date	% change Year-to-date
Assumes full LL replacement						
<b>Gross Public debt</b>	<b>47,276</b>	<b>50,285</b>	<b>54,061</b>	<b>58,048</b>	3,987	7.4%
<b>Domestic debt</b>	<b>25,302</b>	<b>26,843</b>	<b>26,371</b>	<b>29,140</b>	2,769	10.5%
a. Central Bank (including REPOs and Loans to EdL to finance fuel purchases)*	723	8,938	10,652	11,686	1,034	9.7%
b. Commercial Banks	17,211	12,303	12,220	14,128	1,909	15.6%
c. Other Domestic Debt (T-bills)	7,368	5,603	3,500	3,325	-175	-5.0%
<i>o/w Public entities</i>	3,221	2,564	2,187	2,446	259	11.8%
d. Accrued interest included in domestic debt	832	566	356	517		
<b>Foreign debt</b>	<b>21,974</b>	<b>23,442</b>	<b>27,690</b>	<b>28,909</b>	1,219	4.4%
Ratio to total debt	46.5%	46.6%	51.2%	49.8%		
a. Bilateral, Multilateral and Foreign Private sector loans	2,752	2,934	2,983	2,855	-128	-4.3%
b. Paris II related debt (Eurobonds and Loans)	1,432	3,731	3,814	3,681	-134	-3.5%
c. BDL Eurobond (Paris II)	2,819	2,819	2,819	2,819		
d. Market Eurobonds	14,569	13,631	17,686	18,729	1,043	5.9%
e. Expropriation bonds				419		
f. Accrued Interest on foreign currency debt	402	327	388	406	18	4.7%
<b>Public sector deposits</b>	<b>2,964</b>	<b>3,019</b>	<b>4,360</b>	<b>5,418</b>	1,059	24.3%
<b>Net debt</b>	<b>44,312</b>	<b>47,266</b>	<b>49,702</b>	<b>52,630</b>	2,929	5.9%
<b>Gross market debt**</b>	<b>36,765</b>	<b>29,638</b>	<b>31,861</b>	<b>34,759</b>	2,898	9.1%
<b>% of total debt</b>	<b>78%</b>	<b>59%</b>	<b>59%</b>	<b>60%</b>		

Source: Ministry of Finance, Banque du Liban

Notes:

\* The BDL has extended loans to EDL for the equivalent amount of US\$ 300 million to purchase fuel oil. These loans are listed as public debt as they are government guaranteed

\*\* Gross market debt equals gross debt less the portfolios of the BDL, NSSF, bilateral and multilateral loans, and Paris II related debt.

**Gross public debt** amounted to LL 58,048 billion (USD 38.5 billion) as of 31<sup>st</sup> December 2005, which is equivalent to 174.6 percent of GDP<sup>10</sup>. Despite an overall deficit of 2,798 billion LL, decreasing by 7.5 percent compared to 2004, gross public debt (net of accrued interest) increased by LL 3,807 billion or 7.4 percent over the December 2004 level. This increase reflects the pre-funding policy of the Ministry of Finance during the second half of the year to benefit from the high liquidity of the domestic banking sector and the renewed interest following the tragic political events in February 2005.

<sup>10</sup> GDP estimated figure for 2005:LL 33,243 billion

**Net public debt amounted** to LL 52,630 billion (USD 35 billion) registering an increase of LL 2,929 billion or 5.9 percent since end-December 2004.

**Domestic currency debt** as of end-December 2005 amounted to LL 29,140 billion, registering an increase of LL 2,769 billion (or approximately 10.5 percent) over the end-2004 level. This was mainly due to an increase in the Lebanese Pound Treasury bill portfolios of commercial banks. Also, the portfolio of the Central Banks in Lebanese Pound Treasury bills increased over the end-2004 level. Central Bank financing was dominant throughout the period from mid-February through end-May 2005 given that market demand was subdued against the political developments that followed the tragic assassination of PM Hariri in February. However, domestic debt held by BDL decreased from a peak of LL 15,236 billion in March 2005 to LL 11,686 billion in December 2005 (a decrease of LL 3,550 billion or 23 percent), owing to the resumption of interest by commercial banks in Lebanese Pound denominated treasury bills. Commercial banks' appetite for Lebanese Pound denominated Treasury bills resumed in April 05 and domestic debt held by commercial banks increased from a trough of LL 7,387 billion in March 2005 to 14,128 billion in December 2005 (a 91 percent increase).

**Weighted average cost of debt** as at end December 2005, increased from a level of 6.56% as at end December 2004 to 7.61%. The weighted average cost of outstanding domestic debt increased from a level of 6.04% in December 2004 to 7.99% in end-December 2005. As for the weighted average cost of foreign debt, it registered 7.23% in December 2005, up from 7.05% a year earlier.

**Table 10. Evolution of Weighted Average Cost of outstanding Public Debt**

Date	Total Debt	Domestic Debt	Foreign Debt
Nov-02	11.97%	13.82%	9.21%
Dec-03	8.34%	9.18%	7.39%
Dec-04	6.56%	6.04%	7.05%
Dec-05	7.61%	7.99%	7.23%

**Primary market interest rates** currently range between 5.22 percent for the 3-month t-bills to 9.34 percent for the 36-month t-bills. As compared to 2004, all market interest rates increased marginally, except for the interest on the 3-month t-bill, as is apparent in the table below.

**Table 11. Evolution of Primary Market Treasury Bills Yields**

Maturity	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005
3-month	5.48 percent	5.22 percent	5.22 percent
6-month	6.53 percent	6.31 percent	7.24 percent
12-month	6.87 percent	6.69 percent	7.75 percent
24-month	7.99 percent	7.74 percent	8.50 percent
36-month	8.68 percent	8.68 percent	9.34 percent

*Source: Ministry of Finance*

**Average time to maturity** of domestic debt as of 31<sup>st</sup> December 2005, equaled 1.6 years and the average maturity of issued instruments was 31 month. As for foreign debt, and as of 31<sup>st</sup> December 2005, the average time to maturities of Eurobonds and Concessional Loans was 4.9 years and the average maturity of issued Eurobonds instruments was 8.33 years.

**Table 12. Net Issuance of Eurobonds in 2005**

<i>US\$ million</i>	
<b>Eurobonds Issued</b>	<b>2,500</b>
<b>Eurobonds Redeemed</b>	<b>1,700</b>
<b>Net Issuance</b>	<b>800</b>

*Source: Ministry of Finance*

**Foreign currency debt** by end-December 2005 amounted to LL 28,909 billion (equivalent to US\$ 19 billion), increasing by LL 1,219 billion (or 4.4 percent) since the beginning of the year. Part of this increase reflects the issuance of USD 278 million (equivalent to LL 419 billion) for the settlement of expropriations pursuant to Law No.450 dated July, 29, 2002 and according to Council of Ministers resolution No.24 dated August, 18, 2005. In addition, during 2005, the Ministry of Finance issued an aggregate amount of Eurobonds equivalent to US\$ 2.5 billion. Eurobonds US\$ 1.75 billion were raised during the first half of the year and a US\$ 750 million in October of 2005. During the year 2005, the total amount of Eurobonds redeemed amounted to US\$ 1.70 billion. Therefore, the net issuance of Eurobonds in the year 2005 amounted to US\$ 800 million.

**Table 13. Terms and Conditions of Eurobonds issued in 2005**

<b>Feb-05</b>					
	1,000,000,000	USD	6.500%	02/25/05	02/25/07
<b>May-05</b>					
	250,000,000	USD	7.000%	05/11/05	05/11/08
<b>Jun-05</b>					
	250,000,000	USD	7.375%	06/20/05	06/20/08
	250,000,000	USD	8.625%	06/20/05	06/20/13
<b>Oct-06</b>					
	750,000,000	USD	8.500%	10/18/05	1/19/2016

*Source: Ministry of Finance*

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**Table 14. Performance of Lebanese Eurobond Secondary Market**

(Prices and yields as of the closing of 03-Feb-2006).

<b>Republic of Lebanon Eurobonds</b>	<b>Mid- Price</b>	<b>Mid-Yield</b>
<i>Euro</i>		
<b>LEB 8.875 06</b>	103.458	3.40%
<b>LEB 7.250 09</b>	105.875	5.24%
<i>US Dollars</i>		
<b>LEB 9.875 06</b>	100.945	5.20%
<b>LEB 10.5 MAY 06</b>	101.270	5.25%
<b>LEB 10.5 AUG 06</b>	102.322	5.56%
<b>LEB 8.625 07</b>	104.125	5.92%
<b>LEB 7.375 08</b>	102.625	6.16%
<b>LEB 10.125 08</b>	109.000	6.18%
<b>LEB 10.250 09</b>	112.375	6.40%
<b>LEB FRN 09</b>	105.375	6.57%
<b>LEB 7.000 09</b>	102.000	6.40%
<b>LEB 7.125 10</b>	102.375	6.46%
<b>LEB 7.875 11</b>	105.375	6.65%
<b>LEB 7.750 12</b>	104.875	6.82%
<b>LEB 8.625 13</b>	109.375	6.98%
<b>LEB 8.500 16</b>	108.375	7.30%
<b>LIBAN 10 15</b>	118.375	7.23%
<b>LEB 11.625 16</b>	128.625	7.57%

Source: CSFB

For information on Eurobonds Outstanding and Eurobond issues visit the Ministry's website  
[www.finance.gov.lb](http://www.finance.gov.lb)

**Table 15. Public Debt Outstanding by Instrument as of End-December 2005**

LL Billion	2002	2003	2004	2005	Change	% Change
	Dec	Dec	Dec	Dec	Year-to-date	Year-to-date
<b>Total Debt</b>	<b>47,276</b>	<b>50,285</b>	<b>54,061</b>	<b>58,048</b>	<b>3,987</b>	<b>7.4%</b>
<b>Domestic Debt</b>	<b>25,302</b>	<b>26,843</b>	<b>26,371</b>	<b>29,140</b>	<b>2,769</b>	<b>10.5%</b>
<b>1. Long Term Bonds, of which:</b>	<b>22,268</b>	<b>24,691</b>	<b>20,766</b>	<b>23,384</b>	<b>2,618</b>	<b>12.6%</b>
a- 60 Months Bonds	0	650	650	1,772	1,122	172.6%
b- 54 Months Bonds	0	616	616	616		
c- 48 Months Bonds	0	0	0	633	633	633..%
d- 36 Months Bonds	339	884	8,943	14,521	5,578	62.4%
e- 30 Months Bonds	0	3,033	3,033	3,033		
f- 24 Months Bonds	21,214	18,986	7,281	2,385	-4,896	-67.2%
g- Coupon Interest	715	522	243	425	182	74.9%
<b>2. Short Term Bills, of which: 1/</b>	<b>2,866</b>	<b>1,799</b>	<b>5,102</b>	<b>5,247</b>	<b>145</b>	<b>2.8%</b>
a- 12 Months Bills	1,522	796	2,887	3,023	136	4.7%
b- 6 Months Bills	1,028	424	2,103	2,068	-35	-1.7%
c- 3 Months Bills	317	579	112	156	44	39.3%
<b>3. Other Domestic Debt 2/</b>	<b>169</b>	<b>353</b>	<b>504</b>	<b>509</b>	<b>5</b>	<b>1.0%</b>
<b>Foreign Debt</b>	<b>21,974</b>	<b>23,442</b>	<b>27,690</b>	<b>28,909</b>	<b>1,219</b>	<b>4.4%</b>
<b>1. Eurobonds, of which:</b>	<b>19,222</b>	<b>19,566</b>	<b>23,682</b>	<b>25,161</b>	<b>1,479</b>	<b>6.2%</b>
<i>Paris II related Eurobonds</i>	1,432	2,789	2,789	2,789	0	0.0%
<b>2. Loans, of which:</b>	<b>2,752</b>	<b>3,876</b>	<b>4,008</b>	<b>3,747</b>	<b>-261</b>	<b>-6.5%</b>
a- Paris II Concessional Loan	0	942	1,026	892	-134	-13.1%
b- Bilateral and Multilateral Loans	2,316	2,595	2,728	2,658	-70	-2.6%
c- Foreign Private Sector Loans	436	338	255	197	-58	-22.7%

Source: MOF, Banque du Liban

1/ Includes Accrued Interest on Short-Term Bills

2/ Mainly composed of loans extended to EDL to finance fuel purchases

Table 15 above demonstrates the **evolution of public debt by instrument**. On the domestic debt front, the demand for both long-term and short-term bonds increased as compared to December 2004. However, subscriptions in long-term bonds were much higher than short term bonds. On the long-term bonds, the increase mostly occurred in the 60-month and 36-month categories, while the 24-month bonds witnessed a large decline. This drop was due to the maturity of the zero interest treasury bills (issued in the context of Paris II)<sup>11</sup> in the amount of LL 4,404 billion in the first half of 2005. Approximately, LL 2,460 billion of these zero interest Treasury bills were rolled over into new 6 and 12-month treasury bills. The rates for these T-Bills ranged between 3.090-3.750 percent for the 6-month maturity, and 3.265-4.125 percent for the 12-month maturity. The remaining zero-interest T-Bills were renewed at market rates, most notably in the 36-month category, which by end-December 2005 represented about 50 percent of total domestic debt outstanding.

<sup>11</sup> Please refer to the Special Report entitled 'One-Year Progress After Paris II' on the Ministry's website [www.finance.gov.lb](http://www.finance.gov.lb)

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Moreover, since April 2005, commercial banks have over-subscribed in the 36-month Treasury Bills and substituted their shorter term Treasury Bills by this category. This shows the commercial banks' strong appetite for longer term Lebanese Pound denominated Treasury Bills.

**Domestic debt subscription** over the period July-December 2005, have been affected in most instruments – with the exception of the 12-month maturity. Most investors showed **a special interest in the 36 month category** which can be explained by the yield it is currently offering at 9.34 percent. The 6 month category is also attracting considerable interest amongst the shorter term instruments being offered. Over the July-December 2005 period 51 percent and 30 percent of all subscriptions were made in the 36 month and 6 month categories, respectively.

Over the same period, the least attractive maturities are the 12-month (showing the only deficit in subscriptions), the 3-month category (slight surplus), and the 24 months (relatively small surplus). Only 9 percent, 7 percent and 3 percent of all subscriptions were made in the 12 month, 24 month and 3 month categories.

Over the period July-December 2005, the total surplus in subscriptions amounted to LL2,690billion, with a deficit of LL107 billion in short term maturities and a surplus of LL 2,798 billion in relatively longer dated instruments. This implies an average surplus in monthly subscriptions of LL450billion.

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#### Box 4. The Lebanese Republic Issued Longest Eurobond to Date in October 2005

##### *Transaction Summary*

On October 6, 2005, the Republic of Lebanon launched and priced a Eurobond transaction in the international capital markets. Settlement and closing took place on Tuesday October 18, 2005. The transaction was managed by Citigroup, Bank Audi and BankMed.

The Eurobond deal was denominated in US Dollars and raised a total of US\$750 million of fixed rate notes for the Republic at a coupon of 8.5% due 19 January 2016.

The transaction was transaction 3.7 times oversubscribed, and attracted record high demand from international accounts with 42% of bonds allocated to offshore investors.

##### **Summary of Terms and Conditions**

<b>Issuer:</b>	Republic of Lebanon
<b>Rating:</b>	B3/B-/B-
<b>Bookrunners:</b>	Bank Audi, s.a.l. Audi Saradar Group, Banque de la Méditerranée s.a.l., and Citigroup
<b>Series number</b>	Series 40
<b>Issue amount:</b>	US\$ 750,000,000
<b>Issue date:</b>	October 18, 2005
<b>Maturity date:</b>	January 19, 2016
<b>Coupon rate:</b>	8.5 percent per annum payable semi-annually in arrear
<b>Interest Payment Dates:</b>	On January 19 and July 19 in each year, starting January 19, 2006 (1st coupon date) and July 19, 2006 (2nd coupon date)
<b>Re-offer Price:</b>	99.182%
<b>Re-offer yield</b>	8 <sup>5/8</sup> percent
<b>Issue Type:</b>	Fixed Rate Note, launched off the Global MTN program
<b>Governing Law:</b>	New York Law
<b>Listing:</b>	Luxembourg and Beirut

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## Section V: Evolution of External Trade

**Table 16.** External Trade

(USD Million)	2004	2005	2004	2005	Change	% Change
	December	December	Jan-Dec	Jan-Dec		
Exports	176	217	1,747	1,880	133	8%
Imports, of which:	860	872	9,397	9,340	-57	-1%
Mineral Products	298	237	2,068	2,226	158	8%
<b>Trade Balance</b>	<b>-684</b>	<b>-655</b>	<b>-7650</b>	<b>-7460</b>	<b>190</b>	<b>-2%</b>

Source: MOF, Directorate General of Customs (DGC)

**Balance of trade:** In 2005, the trade deficit narrowed by 2 percent. This took place due to the 12 percent increase in exports and the 1 percent decrease in imports. The rise in exports is due in large part to the continuous surge in exports to Arab countries, the European Union, and China.

By the end of 2005, **imports** amounted to USD 9,340 million, compared to USD 9,397 million one year earlier. From a product perspective, the decrease in imports reflects (1) a USD 48 million decrease in the value of the imports of machinery and mechanical appliances, (2) a USD 34 million decrease in the imports of transport equipment, and (3) a USD 8 million decrease in the imports of products of the chemicals. Excluding the imports of mineral products (as their import witnessed a nominal increase), the value of imports in 2005 is found to have actually decreased by 3 percent compared to 2004.

From a regional perspective, the decrease in the value of imports reflects (1) a USD 40 million decrease in imports from the European Union (2) a USD 22 million drop in imports from Arab Countries, (3) a USD 5 million decrease in imports from the United States. At the same time, there was a USD 26 million increase in imports from Switzerland and USD 16 million additional imports from China.

By the end of 2005, **exports** reached USD 1,880 million, increasing by USD 133 million with respect to 2004. From a product perspective, the increase in exports is mainly owed to (1) a USD 48 million augmentation in the exports of base metals and articles of base metals (2) a USD 43 million upsurge in the exports of prepared foodstuff and (3) a USD 40 million increase in the export of machinery and mechanical appliances. This increase countered the USD 63 million decrease in the exports of pearls, precious or semi precious stones. From a regional perspective, the augmentation in the value of exports reflects a USD 81 million increase in exports to Arab Countries, a USD 22 million increase in exports to the European Union, and a USD 14 million rise in exports to China. These increases offset the USD 62 million drop in exports to Switzerland.

**Table 17. Imports Distribution by Product**

(USD million)	2004		2005		2004		2005	
	December	December	Jan-Dec	% Share	Jan-Dec	% Share	Change	% Change
Mineral Products	175	237	2,068	22%	2,226	24%	158	8%
Machinery and Mechanical Appliances	110	99	1,109	12%	1,061	11%	-48	-4%
Transport Equipment	94	83	843	9%	809	9%	-34	-4%
Products of the Chemical	85	75	828	9%	820	9%	-8	-1%
Base Metals and Articles of Base Metals	50	63	596	6%	651	7%	55	9%
Other Goods	346	314	3,952	42%	3,773	40%	-179	-5%
<b>Total</b>	<b>860</b>	<b>872</b>	<b>9,397</b>	<b>100%</b>	<b>9,340</b>	<b>100%</b>	<b>-57</b>	<b>-1%</b>

Source: MOF, DGC

- **Import Distribution by Product:**

Imports of **mineral products** increased by 8 percent and cumulated at USD 2,226 million as opposed to USD 2,068 million a year earlier. The increase in the import value of mineral products mainly resulted from:

1)- A USD 187 million increase in the imports of **car gasoline** which reached USD 697 million by the end of December 2005. This increase resulted from the 37 percent increase in the average price, at imports, of car gasoline from LL 462 per liter in January-December 2004 to LL 631 per liter in January-December 2005. Quantities imported remained stable at around 1.666 billion liters and hence the increase in the value of car gasoline imports was nominal. Car gasoline in 2005 was mainly imported from France, Italy, and Romania.

2)- A USD 27 million increase in the imports of **other fuel oils** (fuel oil is imported for the consumption of EDL plants in Zouk, Jiyeh, Tyre, and Baalbeck) which amounted to USD 452 million in 2005 compared to USD 425 million in 2004. This increase resulted from:

a)- USD 149 million was due to the 52 percent increase in the price of fuel oil at imports which increased from LL 288 per liter in 2004 to LL 437 per liter in 2005. 72 percent of other fuel oils were imported from the Russian Federation.

Since quantities imported decreased by 30% or 665 billion liters, the increase in the value of fuel oil imports was nominal.

3)- A USD 73 million or 8 percent decrease in the imports of **gas oils** (gas oil or diesel oil, or what is commonly known as "Mazout", is mainly imported for use at EDL's plants in Zahrani and Deir Ammar) which reached USD 818 million in 2005 compared to USD 891 million in 2004.

Quantities of gas oils imported reached 1.977 billion liters by the end of December 2005 compared to 3.120 billion liters in January-December 2004. The average price of gas oils imported increased from LL 431 per liter in January-December 2004 to LL 624 per liter January-December 2005.

Gas oils in 2004 were imported mainly from Italy, Saudi Arabia, Kuwait and the Russian Federation.

**Table 18. Mineral Products Import Breakdown**

	Jan-Dec 2004	Jan-Dec 2005	Change	% Change
<b>Import Value Details (in USD Million):</b>				
- Car Gasoline	510	697	187	37%
- Gas Oil	891	818	-73	-8%
- Fuel Oil	425	452	27	6%
<b>Imports Quantity Details (in Million Liters):</b>				
- Car Gasoline	1,665	1,666	1	0%
- Gas Oil	3,120	1,977	-1,143	-37%
- Fuel Oil	2,226	1,561	-665	-30%
<b>Imports Price Details (in LL per Liter):</b>				
- Car Gasoline	462	631	169	37%
- Gas Oil	431	624	193	45%
- Fuel Oil	288	437	149	52%

Source: MOF, DGC,

The 4 percent decrease in **machinery and mechanical appliances** imports, which registered USD 1,061 million by the end of December 2005 in contrast with USD 1,109 million in 2004, is the consequence of (1) a USD 27 million decrease in the imports of **reactors, boilers, machinery and mechanical appliances** (or what can be described as electrical material for industrial use) which cumulated at USD 595 million in 2005 (they were mainly imported from China, Germany, Italy, and the United States) and (2) a USD 21 million augmentation in the imports of **electrical machinery and equipment and parts thereof** (or what can be described as electrical appliances for household use) which totaled USD 466 million during 2005. They were mainly imported from China, United Kingdom, France and Germany.

**Transport Equipment** imports were worth USD 809 million in 2005 as opposed to USD 843 million one year earlier, witnessing a 4 percent decrease compared to 2004. This drop was fueled by the decrease in the imports of **vehicles** which declined by USD 50 million during 2005, cumulating at USD 779 million. The decrease in the value of vehicles imported can be attributed to the drop in the value of cars imported by USD 41 million, reaching USD 562 million by the end of 2005. This was mainly due to the lower quantity of cars imported which registered 41,986 units in 2005 decreasing by 8.7 percent from 45,969 units in 2004. Vehicles were mainly imported from Germany, Japan, the United-States, and France.

Imports of **products of the chemical** registered USD 820 million 2005 compared to USD 828 million in 2004 or a 1 percent decrease. This decline can be attributed to (1) a USD 5 million decrease in the imports of **pharmaceutical products** (imported mainly from France, Germany, Switzerland and the United Kingdom)

**Base metals and articles of base metals** imports cumulated at USD 651 million by the end of 2005 compared to USD 596 million by the end of 2004, increasing by 9 percent. This increase was due to (1) a USD 31 million increase in **iron and steel**, which totaled USD 328 million in 2005 (mainly imported from Ukraine, Egypt, and Syria) and (2) a USD 14 million increase in **aluminum and articles thereof**, which totaled USD 95 million (mainly imported from the United Arab Emirates, Italy, France, and Greece) .

**Table 19. Exports Distribution by Product**

(USD million)	2004		2005		2004		2005		% Change
	December	December	Jan-Dec	% Share	Jan-Dec	% Share	Change		
Pearls, Precious or Semi-Precious Stones	23	61	287	16%	224	12%	-63	-22%	
Machinery and Mechanical Appliances	25	27	274	16%	314	17%	40	15%	
Base Metals and Articles of Base Metals	25	25	228	13%	276	15%	48	21%	
Products of the Chemical	22	22	149	9%	163	9%	14	9%	
Prepared Foodstuffs	13	17	148	8%	191	10%	43	29%	
Other Exports	68	66	661	38%	712	38%	51	8%	
<b>Total</b>	<b>176</b>	<b>217</b>	<b>1,747</b>	<b>100%</b>	<b>1,880</b>	<b>100%</b>	<b>133</b>	<b>8%</b>	

Source: MOF, DGC

- Export Distribution by Product:**

Exports of **pearls, precious or semi-precious stones** decreased by 22 percent and totaled USD 224 million during 2005 as opposed to USD 287 million in 2004. About USD 120 million of pearls, precious and semi precious stones were exported to Switzerland. Other major destinations include the United Arab Emirates, and Libya.

**Machinery and mechanical appliances** exports increased by 15 percent, cumulating at USD 341 million during 2005 in contrast to USD 274 million a year earlier. This increase resulted from (1) a USD 23 million rise in the exports of **reactors, boilers, machinery and mechanical appliances** which amounted to USD 120 million by the end of 2005 and (2) a USD 17 million increase in the exports of **electrical machinery and equipment and parts thereof** which became worth USD 194 million during 2004. They were principally exported to Iraq, Kuwait, United Arab Emirates, and Nigeria.

Exports of **base metals and articles of base metals** increased by 21%, reaching USD 276 million compared to USD 228 million during 2004. This is mainly due to a USD 6 million increase in **iron and steel** exports, which amounted to USD 109 million, of which USD 78 million exported to Turkey, a USD 8 million increase in **articles of iron and steel** exports, which amounted to USD 43 million (mainly exported to United Arab Emirates, Jordan, and Kuwait) and a USD 24 million increase in **copper and articles thereof** exports, which reached USD 44 million in 2005. About USD 22 million of **copper and articles thereof** were exported to China. Other major destinations include Sri Lanka and Southern Korea.

**Products of the chemical** exports progressed by 9 percent totaling USD 163 million in 2005 compared to USD 149 million in 2004. The increase was the outcome of (1) a USD 11 million upsurge in the exports of **inorganic chemicals**, which registered USD 50 million in 2005 (mainly exported to turkey, India and Spain) and (2) a USD 2 million increase in the exports of **pharmaceutical products**, which reached USD 9 million in 2005 (mainly exported to Iraq, United Arab Emirates, and Sudan).

**Table 20. Regional Distribution of Imports**

(USD million)	2004	2005	2004		2005		Change	% Change
	December	December	Jan-Dec	% Share	Jan-Dec	% Share		
European Union*	309	333	3,637	39%	3,597	39%	-40	-1.1%
Arab Countries	151	176	1,344	14%	1,322	14%	-22	-1.7%
China	63	68	718	8%	734	8%	16	2.3%
United States	47	45	553	6%	548	6%	-5	-1.0%
Switzerland	20	15	396	4%	422	5%	26	6.6%
Other	270	235	2,749	29%	2,717	29%	-32	-1.2%
<b>Total</b>	<b>860</b>	<b>872</b>	<b>9,397</b>	<b>100%</b>	<b>9,340</b>	<b>100%</b>	<b>-57</b>	<b>-0.6%</b>

\*The European Union included until end-April 2004, the following countries: Austria, Belgium, Denmark, Finland, France, Germany and Greece, Ireland, Italy, Luxemburg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.. New countries may have joined the EU, but to facilitate comparisons with 2004 and preserve the cohesion with the trade figures published in 2005, the old nomenclature was preserved.

#### Regional Distribution of Imports:

In 2005, imports from the **European Union** decreased slightly by 1 percent compared to 2004, reaching USD 3,597 million this year compared to USD 3,637 million in 2004. This small decrease was mainly due to the following:

- (a) A USD 63 million or 16 percent drop in imports from the **United Kingdom**, which reached USD 323 million in 2005, compared to USD 386 million in 2004. In 2005, Lebanon mainly imported the following products from the United Kingdom: machinery and mechanical appliances for a total amount of USD 89 million, pharmaceutical products for a total value of USD 43 million, reactors and boilers and machinery and mechanical appliances for an amount of USD 36 million, and vehicles in the amount of USD 30 million.
- (b) A USD 72 million or 10 percent decrease in imports from **Germany**, which amounted to USD 657 million by end-2005, compared to USD 729 million by end-2004. Lebanon's main imports from Germany in 2005 were: vehicles for a total amount of USD 283 million, reactors and boilers and machinery and mechanical appliances for an amount of USD 75 million, and pharmaceutical products for an amount of USD 62 million.

Further drops in imports between 2004 and 2005 were witnessed for other European countries such as the **Netherlands** (USD 19 million) and **Spain** (USD 22 million).

Although imports in general witnessed a slight decrease, imports from certain European countries actually increased in 2005. For example:

- (a) Imports from **France** increased by USD 57 million (or 8 percent), reaching USD 788 million in 2005 compared to USD 731 million in 2004.
- (b) Imports from **Italy** rose by USD 46 million (5 percent), amounting to USD 976 million in 2005, compared to USD 930 million in 2004.

Imports from **Arab countries** also went down by almost 2 percent, decreasing from USD 1,344 million in 2004 to USD 1,322 million in 2005. The main imports from Arab countries for 2005

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were (1) mineral fuels and oils which were worth USD 443 million, (2) iron and steel whose imports attained USD 126 million, and (3) aluminum and articles thereof in the amount of USD 62 million.

Imports from **China** registered an increase of over 2 percent, rising from USD 718 million in 2004 to USD 734 million in 2005. The main imports from China were reactors and boilers (USD 121 million), electrical machinery and mechanical appliances (USD 96 million), and articles of apparels and clothing accessories (USD 43 million).

Imports from the **United States** dropped slightly by 1 percent, from USD 553 million in 2004 to USD 548 million in 2005. In 2005, Lebanon's main imports from the United States consisted of USD 85 million of vehicles, USD 79 million of tobacco and manufactured tobacco substitutes, USD 65 million of mineral fuels and mineral oils, and USD 51 million of boilers and reactors.

As for imports from **Switzerland**, they increased by almost 7 percent, reaching USD 422 million in 2005, compared to USD 396 million in 2004. The main imports from Switzerland for 2005 were pearls, precious and semi precious stones for a total import value of USD 315 million and pharmaceuticals worth USD 49 million.

- **Regional Distribution of Exports:**

Exports to **Arab countries** increased by 9 percent, amounting to USD 1,006 million in 2005, compared to USD 925 million in 2004.

Lebanon's main Arab trading partners in 2005 were Syria (USD 187 million), Iraq (USD 178 million), United Arab Emirates (USD 155 million), and Saudi Arabia (USD 140 million). The main trading partners for 2004 had been Iraq (USD 255 million), Syria (USD 145 million), the United Arab Emirates (USD 135 million), and Saudi Arabia (USD 113 million).

The overall increase in exports to Arab countries occurred despite the USD 77 million (or 30 percent) drop in exports to **Iraq**, which reached USD 178 million by end-2005 compared to USD 255 million by end-2004. This decline affected several export categories, especially those Lebanese products that have usually enjoyed high demand in the Iraqi market, such as:

- (a) Electrical machinery and equipment which witnessed an export decrease of USD 37 million (40 percent) compared to 2004
- (b) Salt, sulphur, earths and stone, and plastering material, the export of which went down by USD 16 million (or 24 percent) compared to the previous year
- (c) Furniture; bedding, mattresses, mattress supports witnessed a drop in exports in the amount of USD 8 million (or 85 percent) compared to last year.
- (d) Cement, the export of which dropped by USD 7 million (or 85 percent) compared to 2004.
- (e) Reactors, boilers, machinery and mechanical appliances which underwent a decrease in exports of 4 million (21 percent) relative to the year 2004.

The main exports to Iraq in 2005 were (1) Electrical machinery and equipment (USD 55 million) (2) Salt, sulphur, earths and stone, and plastering material (USD 49 million) (3) Reactors, boilers, machinery and mechanical appliances (USD 14 million), (4) Wood and articles of wood; wood charcoal (USD 9 million), and (5) Vehicles (USD 7 million). Upon comparing with the main exports to Iraq in 2004, the top three exports are found to be the same. However, the fourth and fifth exports in 2004 were respectively furniture (bedding, mattresses, mattress supports) and cement, which witnessed a large increase in exports this year, as mentioned previously.

The overall improvement in Lebanese exports to Arab countries mainly resulted from export increases to several Arab countries:

- (a) Exports to **Syria** increased by USD 42 million (or 29 percent), reaching USD 187 million by end-2005, compared to USD 145 million a year earlier. Lebanon's main exports to Syria were salt, sulphur, earths and stone, plastering material (USD 57 million), paper, paperboard and articles of paper pulp, of paper or of paperboard (USD 15 million), and electrical machinery and equipment and parts (USD 10 million).
- (b) Exports to the **United Arab Emirates** increased by USD 20 million (or 20 percent), equaling USD 155 million in 2005, compared to USD 135 million a year earlier. The main exports to the UAE consisted of pearls, precious and semi precious stones (USD 48 million), electrical machinery and equipment and parts (USD 21 million), and articles of apparel and clothing accessories (USD 8 million).
- (c) Exports to **Saudi Arabia** witnessed a rise of USD 27 million (or 24 percent), amounting to USD 140 million in 2005, compared to USD 113 million a year earlier. Lebanon's main exports to Saudi Arabia were reactors, boilers, machinery and mechanical appliances (USD 17 million), paper, paperboard and articles of paper pulp, of paper or of paperboard (USD 12 million), and articles of apparel and clothing accessories (USD 11 million)

Lebanese exports also increased to other Arab countries, such as **Egypt** (increase of USD 15 million or 38 percent), **Kuwait** (rise of USD 14 million or 21 percent), and **Jordan** (increase of USD 12 million or 19 percent)

**Table 21. Regional Distribution of Exports**

(USD million)	2004		2005		2004		2005		%
	December	December	Jan-Dec	% Share	Jan-Dec	% Share	Change	Change	
Arab Countries	91	90	925	53%	1,006	54%	81	9%	
Switzerland	15	52	187	11%	125	7%	-62	-33%	
European Union	14	14	156	9%	178	9%	22	14%	
United States	4	4	49	3%	58	3%	9	18%	
China	1	1	12	1%	26	1%	14	117%	
Other	51	55	417	24%	486	26%	69	17%	
<b>Total</b>	<b>176</b>	<b>217</b>	<b>1747</b>	<b>100%</b>	<b>1,880</b>	<b>100%</b>	<b>133</b>	<b>8%</b>	

Source: MOF, DGC

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Exports to **Switzerland** receded by 33 percent, amounting to USD 125 million by the end of December 2005 compared to USD 187 million a year earlier. Lebanon's main exports to Switzerland for 2005 consisted mainly of USD 120 million worth of pearls, precious and semi precious stones.

Lebanese exports to the **European Union** increased from USD 156 million to USD 178 million. Lebanon's main exports to the European Union for 2005 consisted mainly of USD 18 million worth of tobacco and manufactured tobacco substitutes, USD 16 million worth of aluminum and articles thereof, and USD 14 million worth of reactors, boilers, machinery and mechanical appliances.

Exports to the **United States** increased by 18 percent, reaching USD 58 million in 2005 compared to USD 49 million in 2004. Lebanese exports consisted mainly of furniture, bedding and mattresses for USD 12 million, pearls, precious and semi precious stones for USD 10 million and preparation of vegetables, fruits and nuts for USD 6 million.

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## Section VII: Value Added Tax Developments

Please note that most of the VAT figures mentioned in this section are extracted from declarations/claims processed. As such, these figures depend on the number of processed declarations at a given date (in this case the figures are as of February 2006) and may be subject to change in the future as more declarations/claims are processed. Hence, this is to be taken into account when comparing with the results of 2004, as the VAT outcome mentioned in this section for 2005 may not be the final one.

The following section examines the **VAT amounts declared internally, broken-down by economic activity**<sup>12</sup>. In fact, Table 18 compiles the 10 largest VAT contributing economic activities in 2004 and 2005. It provides an insight into the Lebanese economy in terms of the most active economic sectors. The amount of VAT declared in 2005 totaled LL 572 billion, compared to LL 587 billion for 2004<sup>13</sup>, representing a 2.6 percent decrease.<sup>14</sup>

Historically, **Retail Trade** always ranked first in the top ten list of the highest VAT-generating economic activities. Retail trade collected approximately the same amount of VAT in 2005 as in 2004 (around LL 124 billion), and accounted for 22 percent of the total VAT declared in 2005 (in 2004 it made up 21 percent of total VAT collection).

**Business activities** (namely advertising, architectural, and engineering works, and legal consultancy) also maintained their rank of last year at second place with approximately LL 64 billion, collecting almost 8 percent higher VAT in 2005 compared to 2004, and making up 11 percent of total declared VAT in 2005, compared to 10 percent in 2004.

The year 2005 seems to have witnessed an expansion of the **construction activity** in the country, as the amount of VAT it generated increased by approximately 3 percent between 2004 and 2005, constituting 10 percent of total internal VAT, compared to 9 percent in 2004, and rising to the third rank in 2005 from the fifth rank in 2004.

With LL 50 billion of VAT declared in 2005, **Wholesale trade** registered about 10 percent lower collection compared to the amount registered for 2004. However, its share of total VAT remained constant at 9 percent of total VAT declared in both 2004 and 2005.

In 2005, the amount of VAT declared by the **hotels and restaurants** business, which totaled approximately LL 45 billion, dropped by 22 percent compared to 2004. This is reflective of the economic slowdown resulting from the tragic events which occurred throughout the year. This deterioration was also mirrored in the activity's contribution to total internal VAT, (which dropped from 10 percent in 2004 to 8 percent in 2005), and its fall from the third ranking in 2004 to the fifth ranking in 2005. In fact, these results are consistent with the 11 percent drop in the number of tourist arrivals to the country in 2005 when compared to 2004 (please refer to the following section on tourist refund).

VAT generated by the internal **sale of cars**, which also includes the maintenance and repair of cars and fuel sales at pump stations, rose by over 2 percent, contributing 5 percent of total VAT declared in 2005 which is the same as 2004, and further preserving its sixth position in the ranking of the ten largest VAT generating activities

With LL 22 billion, and despite a 9 percent reduction in the total amount of VAT declared in 2005, **manufacturing of food products** (namely non alcoholic beverages sweet confectionaries and bakeries) maintained its 4 percent contribution to total VAT declared as in 2004, and went up to 7<sup>th</sup> rank in 2005 from 8<sup>th</sup> place in the ranking of the ten largest VAT generating activities

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<sup>12</sup> Taxpayers' economic activities are classified along the Ministry's Business Activity Code which adopts the ISIC nomenclature.

<sup>13</sup> The amount of VAT declared for 2004 may differ from previously published figures, due to auditing and adjustment.

<sup>14</sup> Please note that the amounts of VAT declared (extracted from declaration forms) differ from VAT amounts actually collected on a cash-basis (Fiscal Performance figures). As such, and as mentioned in the Revenues Section, internal VAT cash collected increased by 0.27 percent in 2005 compared to 2004.

Partly exempt<sup>15</sup>, **real estate** transactions recorded the same level of declared VAT in 2005 as in 2004, i.e. LL 20 billion, and also maintained the same level of VAT contribution as in 2004, at 3 percent of total declared VAT.

With LL 17 billion of declared VAT in 2005 the **Post and telecommunication sector**<sup>16</sup> witnessed a drop of 29 percent in 2005 compared to 2004. This drop was reflected in the sector's VAT contribution, which went down from 4% of total VAT declared in 2004, to 3% in 2005, i.e. from the seventh most VAT generating activity in 2004, to the ninth this year.

In parallel to the suggested expansion of the construction sector as indicated by the VAT declaration data, the year 2005 also witnessed an 11 percent rise in VAT declared by the **manufacturing of non-metallic mineral products** industry, (glass, ceramic, cement, concrete and plaster which are inputs to construction). With LL 13 billion of VAT declared in 2005, this industry's share of total declared VAT remained constant at 2 percent.

**Table 22. VAT Revenues from Internal Operations (10 Largest Contributing Activities)**

(LL millions)

Economic Activity (ISIC Nomenclature)		2004	% Share	Prev. Rank	2005	% Share	% Change
<b>Rank</b>	<b>VAT from internal activity</b>	<b>587,175</b>	<b>100%</b>		<b>571,962</b>	<b>100%</b>	<b>-2.6%</b>
1	Retail Trade ( <i>except for motor vehicles</i> )	124,097	21%	1	124,702	22%	0.5%
2	Business Activities ( <i>namely advertising, architectural &amp; engineering activities, legal consultancy</i> )	59,052	10%	2	63,558	11%	7.6%
3	Construction ( <i>including airport &amp; road paving</i> )	53,158	9%	5	54,596	10%	2.7%
4	Wholesale Trade ( <i>except for motor vehicles</i> )	55,701	9%	4	50,314	9%	-9.7%
5	Hotels and Restaurants	57,458	10%	3	44,674	8%	-22.2%
6	Sales, maintenance, & repair of motor vehicles and sales of fuel at pump stations	28,065	5%	6	28,708	5%	2.3%
7	Manufacturing of food products ( <i>namely non alcoholic beverages &amp; sweet confectionaries, also including pastry shops &amp; bakeries</i> )	24,092	4%	8	21,984	4%	-8.7%
8	Real estate and Leasing Activities	20,047	3%	9	19,949	3%	-0.5%
9	Post and Telecommunications	24,484	4%	7	17,440	3%	-28.8%
10	Manufacture of non-metallic mineral products ( <i>glass, ceramic, concrete, cement and plaster</i> )	11,738	2%	10	13,018	2%	10.9%
Other		129,285	22%		133,018	23%	2.9%

Source: MOF, VAT Directorate, VAT Declaration Forms

(Please note that VAT figures in this table represent declared amounts whereas VAT figures in the Revenue section are cash collected amounts. Note that VAT declaration amounts may vary depending on the number of processed declarations at a given date.

<sup>15</sup> The sale of real estate is VAT exempt. Only commercial rent is subject to 10 percent VAT.

<sup>16</sup> Please note that the VAT charged on the mobile and fixed line telecommunication, and which used to be levied under the Municipal tax prior to VAT implementation, is not accounted for in these figures as it is directly transferred to Municipalities by the telecommunication providers, and is not collected by the Treasury. This is to say that the contribution of the telecommunication sector to VAT is supposed to be much higher than the figures in Table 18.

**Table 23. VAT Revenue Collected At Customs ( Five Largest Contributing Items )**

( LL billion)	2004		2005		% Change
	Jan-Dec	% Share	Jan-Dec	% Share	
<b>VAT customs collection* , of which</b>	<b>1,204</b>	<b>100%</b>	<b>1,181</b>	<b>100%</b>	<b>-2%</b>
Mineral products	362	30%	358	30%	-1%
Machinery and mechanical appliances	166	14%	158	13%	-5%
Transports equipment	154	13%	145	12%	-6%
Base metals & art of base metal	93	8%	101	9%	9%
Prepared foodstuffs	93	8%	93	8%	0%
Others	336	28%	326	28%	-3%

Source: Directorate General of customs (DGC), Import Declarations

\* Please note that VAT collected at Customs in this table may differ from the amount previously mentioned in the Revenue Section as this data is captured from the Customs Administration Declaration forms whereas VAT in the fiscal performance is on a cash basis amount.

The VAT collected at imports amounted to LL 1,181 billion in 2005, representing a 2 percent drop compared to the LL 1,204 billion collected in 2004, more or less reflecting the relative stability of imports between 2004 and 2005 (imports decreased by 1 percent).

In fact the distribution of the VAT collected at imports in terms of product categories (please refer to Table 19) mirrors the composition of imports, whereby the highest contributing products to import VAT are themselves the top five most imported product categories<sup>17</sup>, (please refer to the trade section).

As usual, **mineral products**, ranked first in the imported products category, raising the highest share of VAT at customs, bringing in LL 358 billion worth of VAT during 2005. Compared with 2004, the result is relatively unchanged (1 percent decrease). Mineral products' share of total VAT also remained unchanged at 30 percent of total VAT collected at customs.

In terms of VAT collection at import and with LL 158 billion, **machineries and mechanical appliances** came in second, contributing to 13 percent of total VAT collected at customs. However, the amount of VAT collected in 2005 is 5 percent below the level collected in 2004, mirroring the 4 percent drop in the import of these products.

**Transport equipment** ranks third in the Five Largest Import VAT Contributing list (12 percent contribution). With LL 145 billion of VAT collected, this product category witnessed a 6 percent drop in revenues compared to the amount generated in 2004, reflecting the 4 percent decrease in imports.

Contrary to the previous product categories, and with LL 101 billion of VAT collected, **base metals and articles of base metals** generated 9 percent higher VAT at customs in 2005 compared to 2004, and contributed with 9 percent of total VAT collection at import. This improvement reflects the similar increase in the import of this product category.

As for **prepared foodstuff**, the fifth largest VAT contributing product category, it generated the same amount of VAT at customs in 2005 compared with 2004 (LL 93 billion), and maintained the same 8 percent contribution to total VAT at import.

(For further details on trade performance, please refer to Section V).

<sup>17</sup> Except for chemical products which are the fourth most imported product category, but which do generate little VAT because a large share of chemical products are VAT exempt (namely medicine, some pharmaceutical products, fertilizers, etc...)

**Table 24. Statistics from VAT Declaration Forms***(Amounts in LL billion – except for first item)*

	2003	2004	2005	03-04 % Change	04-05 % Change
Number of Declarations Received	42,916	62,860	69,777	46.47%	11.00%
Amount of VAT Declared	477	527	516	10.38%	-1.99%
Total Amount of VAT Claimed for Refund	79	181	176	129.81%	-2.91%
<i>Diplomats &amp; Int. organization</i>	3	5	5	42.88%	6.41%
<i>Exempted sectors**</i>	15	24	34	57.07%	41.55%
<i>Exporters***</i>	41	71	83	75.02%	16.12%
<i>Semi Annual and Annual Refund claims****</i>	19	81	54	324.87%	-33.36%
VAT Tourist Refund	6	11	11	74.40%	6.00%

Source: MOF, VAT Directorate, VAT Declaration Forms as of February 28<sup>th</sup>, 2006

VAT revenue figures in this table are based on quarterly VAT declaration forms, whereas the VAT revenue figures in the Fiscal Performance represent cash collections. Note that VAT revenues in this Table may also differ from the VAT figures in Table 18 depending on the number of processed declarations at a given date.

\*\*Under Article 59 of VAT Law and its amendment in 2004, exempted sectors are granted 100% refund.

\*\*\* Exports are zero-rated

\*\*\*\* By virtue of VAT Law and its amendment in 2004, VAT creditors/carry forwarders can refund their VAT twice each year.

**VAT Declarations:** Since the VAT's introduction in February 2002, the total number of declarations received per year has been steadily rising; it rose from 33,881 declarations in 2002, to 42,916 declarations in 2003, to 62,860 declarations in 2004, and finally to 69,777 declarations in 2005. The average number of declarations received per quarter has also increased, from an average of 10,729 declarations in 2003, to 15,715 declarations in 2004, to 17,444 declarations in 2005. These increases result mainly from the successive lowering of the mandatory registration threshold from an initial annual turnover threshold of LL 500 million in 2002, to LL 300 million in 2003, to LL 225 million in 2004 and to LL 150 billion in 2005<sup>18</sup>.

As for the total aggregate amount of VAT filed and declared by businesses, it increased from LL 477 billion in 2003, to LL 527 billion in 2004 but decreased to LL 516 billion in 2005, representing a drop of 2 percent compared to 2004<sup>19</sup>.

As for the average amount of VAT declared per declaration, it gradually decreased from an average of LL 11 million in 2003, to LL 8 million in 2004, to LL 7.4 million in 2005. This decrease was in line with the lowering of the mandatory registration threshold for annual turnover. Hence, as smaller taxpayers are being registered for the VAT, the average amount of VAT declared per declaration is decreasing.

In 2005, **VAT tourist refund**, which is an indicator of tourist activity, totaled LL 11 billion increased slightly compared to last year, rising by 6 percent compared to 2004 (LL 11.172 billion in 2005 compared to LL 10.54 billion in 2004), whereas it had increased by over 74 percent in 2004 compared to 2003.

Whereas the number of incoming tourists had been on an increasingly rising trend since 1997, it was halted especially in the beginning of 2005, due to the tragic events of February 14 and all that followed. In fact, the number of tourists had been continuously climbing since the year

<sup>18</sup> Please note that Article 20 of Budget Law 2004 lowered the mandatory registration threshold to LL 150 million of annual turnover, to be effective as of the first January 2005. Further note that Budget Law 2004 has cancelled the voluntary registration threshold, granting businesses and individuals the right to register in the VAT regardless of the level of their annual turnover.

<sup>19</sup> It should be noted that on a cash basis, internal VAT actually increased slightly in 2005 compared to 2004. Please refer to the Revenue Section

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1997, reaching 1,278,469 incoming tourists by end-2004<sup>20</sup>, then dropped by almost 11 percent in 2005, reaching 1,139,524 incoming tourists by year-end.

**Total VAT Claimed for Refund (excluding tourist refund<sup>21</sup>):** The total amount of VAT claimed for refund totaled LL 176 billion, registering an overall 3 percent drop in 2005. This was in line with an overall drop in the number of refund claims received in 2005. In fact, 3,666 refund claims were received in 2005, compared to 3,859 refund claims in 2004.

Refunds claimed by **Diplomats and International Organizations** totaled LL 5 billion in 2005, compared to LL 4.7 billion in 2004, increasing by around 6 percent.

Refund amounts claimed by **exempt sectors**<sup>22</sup> rose by almost 42 percent, from LL 24 billion in 2004 to LL 34 billion in 2005. On the other hand, the number of refund claims presented by refund sectors decreased by 8 percent in 2005 compared to 2004, which would indicate an increase in the average amount of refund amount per claim. In fact, the average amount of refund per claim for exempt sectors went up from an average of LL 17 million per refund claim in 2004 to LL 26 million per refund claim in 2005. The increase in refund amounts claimed in 2005 compared to 2004 is mainly due to the continuous effect of the modification of the rate of refunds for exempt sectors (according to article 59 of the VAT law) from 50 percent on all operating expenses to 100 percent as per Article 25 of Budget Law 2004<sup>23</sup>. The amendment went into effect in April 2004, and since then, more people have become aware of it; thus the increase in refund amounts claimed continued well into the year 2005.

On the exports side, VAT refund claims for **exporters**<sup>24</sup> totaled LL 83 billion, rising by 16 percent in 2005 compared to 2004, reflecting the 8 percent export boosts in 2005. In 2005, there were 10 percent less refund claims presented by exporters, indicating a rise in the average amount of refund requested per claim. In fact, the average amount per claim presented by exporters rose from an average of around LL 38 million per claim in 2004 to LL 49 million per claim in 2005.

As for **refund claims from VAT creditors/carry forwarders**, they registered a 33 percent drop in 2005, from LL 81 billion worth of refund claims in 2004, to LL 54 billion in 2005<sup>25</sup>. As for the number of claims presented in 2005, that number went up by 33 percent, indicating a decrease in the average amount of refund claimed; the average amount of refund per claim went down from LL 249 million per claim in 2004 to LL 124 million per claim in 2005.

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<sup>20</sup> Over the (1951-2005) period, the year 2004 witnessed the second highest number of incoming tourists recorded in Lebanon, the highest being during the year 1974 which registered a record high of 1,423,920 incoming tourists.

<sup>21</sup> Please note that tourist refund operations are effected by an international company "Global Refund"; and not by the Treasury, and hence tourist refund figures are accounted for separately.

<sup>22</sup> Article 59 of VAT Law 379 granted exempt activities, namely exempt industries such as agro food, pharmaceutical, agricultural chemicals, printing and publishing, etc...,and exempt services such as education and medical services, etc...,the right to refund the VAT incurred, in order not to add burden on their operating costs.

<sup>23</sup> Please note that the rate of refund of VAT incurred on capital investment was initially set at 100 percent as per Article 59 of VAT Law 379.

<sup>24</sup> As is consistent with a destination based VAT, the Lebanese VAT Law zero-rate Exports.

<sup>25</sup> Please note that the LL81 billion in VAT creditors/carry forwarders' refund claims in 2004 was y high due to Article 22 of Budget Law 2004 which granted VAT creditors refund twice per year instead of only once as had previously been the case.