



November 14, 2006

IMPACT OF THE JULY OFFENSIVE ON THE PUBLIC FINANCES IN 2006 UPDATED FIGURES- EXPLANATORY NOTE

The Ministry of Finance has revised the end-year fiscal projections it had issued in August 2006, in the immediate aftermath of the July 2006 Israeli War on Lebanon.

Table 1. Comparison of 2006 end-year projections

<i>LL billion</i>	Total 2006 (expected as of November 2006)	Total 2006 (expected as of August 2006)
Revenues	7,828	6,714
-grants	809	
-revenues excl grants	7,020	
Expenditures	12,598	12,521
-Debt service	4,635	4,636
-Primary exp	7,963	7,885
of which/disbursement from grants	809	
Deficit	(4,770)	(5,808)
Primary balance	(-135)	(1,171)

Source: Ministry of Finance estimates

Notes: The Ministry of Finance revised the year end 2006 estimates based on the most recent available data and updated war damage assessment figures.

When the previous estimates were published in August 2006, only the first half of the year fiscal performance figures were available, the blockade was ongoing and there was still no clear view on damage assessment.

Total deficit and primary balance

The total deficit is expected to be lower than originally planned due to better revenues than expected back in August. The primary balance is also anticipated to reach a deficit of LL 135 billion whereas it was then thought to deteriorate to a deficit of LL 1,171 billion. Debt service was kept unchanged at LL 4,635 billion.

Revenues

On the revenue side the difference between the new projection of **LL 7,828 billion¹** (based on January September revenue performance) and the **LL 6,714 billion**

¹ Revenues are accounted to be LL7,097 billion in the 2006 draft budget because they only include the LL78billion grant received to the Treasury accounts. The other \$500MN Saudi grant was deposited in a special account at the BDL.

projected revenues at the outset of the war in the document entitled "Fiscal Impact of the July 2006 War" arises mainly from:

- ▶ The early figure does not account for LL 809 billion **grants** received; LL 78 billion of which are direct transfer to the Treasury account 36 and are recorded as part of Treasury revenues.
- ▶ **VAT** estimate for year-end turned out to be higher than anticipated immediately after the July 2006 war. While VAT revenues for QIII internal operations were projected at LL 80 billion, MOF received LL 104 billion and the declared amount is LL 131 billion². Even for the second quarter, with which filing and payment date coincided with the beginning of the July war, and despite the installment scheme granted over four months (November and December 2006; February and March 2007), MOF nearly received 68 percent of the declared amount³.
- ▶ **Higher projected revenues from car gasoline** due to the decrease in international oil prices. Back in August 2006, the Treasury had not collected excises from car gasoline for 3 months in a row. With the surprisingly lower than previously forecasted effective prices of car gasoline at imports, come September, the Treasury resumed its collection of excises. Today it is levying approximately LL 6,000 per 20 liters.
- ▶ **Revenues from the Telecom Surplus** are projected to be higher because the initial forecast took assumptions of higher figures for damages and losses as a result of the war, as provided by the Ministry of Telecommunication.
- ▶ **Port revenues** are expected to generate LL 50 billion to the Treasury. During the period of preparation of the document entitled "Fiscal Impact of the July 2006 War", the blockade was still ongoing and given damages to the Port of Beirut, the expectation was that the Treasury will not receive anything from that source.

Table 2. Immediate Post-War (August 2006) and Recent (November 2006) year end Revenue Projections

<i>(LL billion)</i>	2005	Expected 2006 August Projections	Expected 2006 Nov Projections	% change 2006
Tax Revenues	4,864	4,596	4,677	1.76%
Taxes on Income Profits & Capital gains	1,047	1,120	1,110	-0.89%
Taxes on Property	414	637	556	-12.72%
Domestic Taxes on Goods & services	1,896	1,761	1,818	3.24%
<i>Value Added Tax (VAT)</i>	1,693	1,565	1,625	3.83%
Taxes on International Trade	1,268	828	933	12.68%
<i>Excise</i>	787	448	533	18.97%
<i>Customs</i>	481	380	400	5.26%
Other Tax Revenues (fiscal stamps)	241	250	260	4.00%
Non Tax Revenues	2,116	1,695	1,980	16.81%

² In 2005 QIII, MOF received LL 144 billion and in 2004 QIII, MOF received LL 138 billion.

³ QII 2006 = LL142billion; QII 2005 = LL 113 billion; and QII 2004 = LL120 billion

Entrepreneurial & Property Income*	1,662	1,238	1,446	16.80%
Administrative Fees & Charges	365	367	443	20.71%
Treasury Revenues*	421	423	362	-14.42%
Grants			809	
Total Revenues	7,401	6,714	7,828	16.59%

*Treasury Revenues figure for 2006 (based on September figures) are net of the LL 78 billion grants received directly to the Treasury Account 36. The total amount of grants is consolidated with the LL 809 billion.

Source: Ministry of Finance estimates

Expenditures

The difference (LL 78 billion lower) between the new projection for primary spending of LL **7,963** billion estimated in November 2006 (based on preliminary data till September 2006), and the LL **7,885** billion expected primary spending as reported in the document titled "Fiscal Impact of the July 2006 War" is mainly due to:

- ▶ The early figure accounted for LL 500 billion for war-related spending, while the recently updated figure is in the order of LL 732 billion. However, this increase was partially offset by a slight reduction in non-war related capital spending, which, until October 2006, did not resume its pre-war average level. As a result, capital expenditures are expected to increase by LL99 billion.
- ▶ Higher transfers than originally expected were reported to the Higher Relief Council, compared to what was expected immediately after the end of the war; at the time, it was estimated that this transfer will not exceed LL 50 billion. However, the entire LL78 billion received as grants to the Treasury were transferred to the HRC, on top of the treasury advances that were provided to the HRC earlier.

Against this increase, some other items reported a drop relative to the early estimation, as suggested by the trends reported so far, for instance:

- ▶ Higher spending was expected for hospitals in August projections, as a result of the mass war injuries received by these hospitals. As such, expenditures were assumed to rise by LL 30 billion compared to 2005. However realized figures until October 2006 suggest that spending on hospitals will exceed 2005 figures only by only 10 billion, noting that the latter figure is the estimated cost for covering war-related injuries.
- ▶ The remaining regular spending witnessed a slowdown, with a higher magnitude than what was accounted for in the early estimate reported in the document entitled "Fiscal Impact of the July 2006 War".
- ▶ The EDL transfer has been reduced by LL 31 billion. This is the net effect of two variables: The payment by EdL of 71 billion LL of fuel oil and gas oil purchases through a revolving loan (ULOC loan) and its own account, and the increase of fuel oil and gas oil purchase accruals for December by LL 50 billion.

Table 3. Immediate Post-War (August 2006) and Recent (November 2006) year end Expenditure Projections

	2005	Expected 2006 August Projections	Expected 2006 Nov projections	% change 2006
Current expenditures, of which	7,925	9,010	8,952	58-
Personnel Cost	3,193	3,322	3,311	11-
Debt service ^{1/}	3,534	4,636	4,635	1-
Consumption goods	213	173	154	19-
External services	82	90	81	9-
Other transfers	569	468	458	10-
<i>of which NSSF</i>	290	150	170	20
Other current expenditures	258	252	237	15-
<i>of which hospitals</i>	192	230	203	27-
Capital expenditures^{2/}	534	1,122	1,242	120
<i>War-related spending</i>		500	732	232
Other treasury expenditures, of which	1,701	2,359	2,372	13-
<i>Electricite du Liban^{3/}</i>	833	1,433	1,402	31-
<i>Municipalities</i>	384	354	398	44
<i>Higher Relief Council (war-related)</i>		50	99	49
Unclassified expenditures	44	30	32	+2
Total expenditures	10,203	12,521	12,598	+77

Source: Ministry of Finance estimates

Notes:

1/ includes the principal payment of c-loans

2/ excluding foreign financed capital expenditures

3/ Transfers to EDL includes debt service payments related to EDL