A Framework for Reducing the Lebanese Budget Deficit

The Report's Authors

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Preface - Kamal Shehadi

This is the second report prepared by the Lebanese Center for Policy Studies (LCPS). It updates last year's report entitled "Budgetary Politics in Lebanon" which reviewed the budgetary proposals for fiscal 1997.

Similarly, the present report will review the proposals for the 1998 budget. As in the previous report, the authors will discuss the most important issues surrounding Lebanon's fiscal situation. The first section of the report was released in October in order to contribute to the ongoing discussion regarding the fiscal deficit and ways and means to reduce it. It was followed, after the formulation of the budget proposals for 1998, by a section that reviews those proposals.

Despite serious intentions to contain the fiscal deficit in 1997, the indications are that the results for the year will be disappointing. Not only the fiscal deficit appears likely to exceed the budgeted target considerably; but the debt situation seems to be approaching the red line of 100 percent of the GDP. Important statements have been made in the press, both by the Governor of BDL and by a senior official of the World Bank that the debt to GDP ratio should not exceed the 100 percent mark. Also it may be recalled that the meeting on economic issues that was convened by the Prime Minister in July 1997 resulted in recommendations to reduce the fiscal deficit and to strictly contain expenditures. More recently the possibility of adopting a number of important revenue measures has been under consideration.

The first section of the report represents an attempt to tie together the suggestions and initiatives currently under discussion in the context of an illustrative scenario to eliminate the fiscal deficit over the four years 1998-2001. This scenario does not represent a blueprint for a deficit reduction policy. It is designed to highlight the issues and to stimulate further discussion. While there could be several permutations of deficit reduction effort, all are likely to contain certain key elements: new revenue measures, strict restraints on spending, lowering interest rates, efficient debt management, and protection of important macro-economic gains such as price stability and the balance of payments position. All these issues are explored in the LCPS report.

The report starts by estimating, in a very preliminary way, the expected fiscal results for 1997. It would appear that total budgetary expenditures are likely to reach LL8 trillion while revenues are estimated at LL4 trillion. The deficit is equivalent to 18 percent of the GDP, or 50 percent of expenditures - another measure that is commonly used. The budget had forecast a deficit of ten percent of the GDP or 37 percent of expenditures. Interest payments are the largest single component of expenditures and the one principally responsible for overspending relative to the budgetary estimates.

Deficits of this magnitude cannot continue to be incurred. If they did, they would eventually pose a serious risk to financial stability. Therefore, measures and policies need to be adopted to contain the fiscal deficit in the first instance, and to eliminate it eventually. This is a very difficult task in itself, let alone to attempt it while at the same time increasing social spending.

The only way to successfully reconcile the multiple, and to some degree conflicting, objectives is to adopt a comprehensive strategy to be followed over a number of years. Unfortunately, the present approach in the country is short-term and fragmented. For example, while the budget for 1998 was under preparation, revenue and expenditure initiatives under the so-called "$1 billion project" - that include new taxes and fees - were put forward. It was not clear how those two key segments of the state's fiscal policy related to each other. It would be prudent to include the annual spending from the $1 billion project within a consolidated state budget.

On September 24, 1997 the Council of Ministers failed to approve the so- called "$1 billion project" now reduced to $800 million, because of opposition to increases in gasoline fees. The scenario described below was adjusted in light of the fiscal plan for 1998. Initially, it was enough to note that as long as the ceiling on spending and the size of the deficit did not change, the rejection or approval of the expenditures and the borrowings components of the project, could be ignored under the assumptions of the illustrative scenario (of course the components would change). The story is different as far as the revenue measures. New sources of revenues need to be found if the objectives of the scenario are to be met. Indeed all this strongly underlines the word illustrative that has been used often in this exercise.

The report presents a framework for eliminating the budget deficit over the four years 1998-2001. The illustrative scenario used is intended to highlight the issues and the measures that may be employed in a deficit reduction strategy. In simple terms, the illustrative scenario suggests eliminating a fiscal deficit equivalent to 18 percent of the GDP by increasing taxation by the equivalent of four percent of the GDP and by exercising spending restraints over four years - through an absolute freeze on spending. This would have the effect of reducing expenditures in real terms to achieve effective spending reductions equivalent to 14 percent of the GDP. To be realistic, the freeze on total expenditure is suggested at LL7.8 trillion, much higher figure than the LL6.5 trillion budgeted in 1996 and 1997. Under the overall spending ceiling, substitution would be possible to reflect changing priorities. Equally important, as interest rates are lowered and the interest component of spending is reduced, the margin for non-interest spending is expanded. The government would have more room to spend on social and infrastructure projects.

The mechanics of fiscal adjustment discussed in the report are, unavoidably, technical, interrelated and complex. By far, the most important element is to achieve a reversal in interest payments on the public debt and the mechanisms that would be employed in this endeavor would impact on the banking sector, the balance of payments and could influence the level of economic activity in the country. Public debt management is a new field in Lebanon. Before the war, the country had no debt to speak of. Even in 1993, the net debt load was equivalent to less than 40 percent of the GDP. Four years later it is approaching the 90 percent level.

The second section of the LCPS report examines the 1998 budget proposals and suggests that the revenue, expenditure and deficit targets are tight but achievable. Successful implementation would require careful monitoring right from the beginning of the year and willingness to adopt corrective measures if the desired outcome appeared to be in danger of being derailed. While the projected reduction in the fiscal deficit in 1998 is substantial, the impact on the country's overall debt situation would just about arrest the deterioration. Therefore considerable effort will be required for many years to come if a significant reduction in debt burden is to be secured.

It is common-place in Lebanon these days to be faced by the question: What are the alternatives? The illustrative scenarios presented in the report do not pretend to supply the alternative but they do suggest a structure for an alternative. They also show that there are no easy alternatives.

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Part I- A Framework for a Budget Deficit Reduction Effort

Introduction

It is now generally recognized in Lebanon that continuing to incur very large fiscal deficits is unsustainable. Between 1994 and 1997 treasury revenues have been equivalent to 15-18 percent of the Gross Domestic Product (GDP). In the same four years, total government budgetary expenditures have been about one-third of the GDP (in 1995) and are estimated to have approximated 36 percent of the GDP in 1997. The resulting deficits, equivalent to some 16-19 percent of the GDP, were financed by borrowing, predominantly in the local currency, at high interest rates. With interest rates in Lebanon several percentage points above international rates, and with a stable (if not modestly appreciating) exchange rate of the Lebanese pound to the US dollar, capital inflows have been attracted to Beirut. This resulted in substantial balance of payments surpluses despite the fact that the current account of the balance of payments recorded a considerable deficit. The significant appreciation of the Lebanese currency and the substantial growth in imports helped to moderate price increases in Lebanon.

Eventually, however, the cost of servicing this borrowing, on expensive terms, became too steep. It is estimated that paying the interest on the domestic debt in 1997 consumed almost all the revenues collected. The reverse fact is also true, namely that the primary balance in the budget is in much better shape when interest payments are excluded. A crucial element in the necessary fiscal adjustment is tackling the heavy burden of repaying debt.

Measures to reduce the deficit, however, are not simply technical steps designed to achieve certain numerical objectives, but also reflect a political will to carry them out. There is also the social dimension to the extent that reducing the deficit requires additional taxation and careful thought concerning areas of expenditure.

While this is inevitable in any budgetary formula, the selection process becomes more crucial when the deficit needs to be reduced drastically. The government needs to be seen as fair in apportioning the burdens and sacrifices. Clearly, however, it is beyond the scope of this report to consider the political and social dimensions of reducing the deficit. Rather the report will concentrate largely on the fiscal issues and, where relevant, will consider briefly the interaction between budgetary issues and other macro-economic variables; particularly in the external sector. Perhaps the underlying issues in this difficult situation could be best explored in the context of a framework for reducing the budget deficit.

This report does not pretend to be a blueprint for a deficit reduction policy. Rather it is intended to highlight the issues and outline the instruments involved. The answers to the issues that will be raised are, in the final analysis, judgmental. Lebanese society, as a whole, is required to arrive at a reasonable consensus on certain fundamental questions as a basis for creating an effective fiscal adjustment policy. Broadly these questions are: What level of expenditures can the country afford? What pattern and level of taxation is fair and appropriate in Lebanon? What size of public sector is proper for Lebanon? What are the trade-offs between holding assets and incurring debt?

It is hoped that this report will make a contribution to the ongoing discussion on Lebanon's present fiscal situation.

The Framework

Described below is a simple framework for a deficit reduction effort. It is not offered as a blueprint solution for Lebanon's fiscal troubles. Rather it is intended to highlight the issues, mechanisms and kinds of measures that would need to be employed in constructing a viable deficit reduction effort in Lebanon.

The objective in this illustrative exercise is to eliminate the budget deficit denominated in Lebanese pounds over the four fiscal years 1998-2001 and to limit the deficit financed by external borrowing (i.e. financing tied to specific projects) to a maximum of the equivalent of three percent of the GDP. The assumptions underlying this scenario are:

a) annual GDP growth of 12 percent in nominal terms in 1998-2001

b) revenue growth in line with the nominal expansion of the GDP

c) discretionary additional revenue measures equivalent to four percent of the GDP implemented in 1998

d) a freeze in nominal terms on total expenditures in Lebanese pounds at approximately LL7.8 trillion annually in the 1998-2001 period. This would be some LL200 billion below the estimated 1997 level.

The base year for this illustrative example is 1997 for which whole year results are estimated on the basis of data for nine months (See Table 1). Broadly, total expenditures are estimated to attain about LL8 trillion and revenues approximately LL4 trillion. With these preliminary estimates, the deficit would be equivalent to nearly 18 percent of the GDP (See Table 2). This deficit does not include foreign financed CDR (Council for Development and Reconstruction) expenditures. If these were to be included the overall deficit would probably exceed the equivalent of 20 percent of the GDP. On the basis of preliminary estimates for 1997, a 1998 hypothetical budget outline is constructed incorporating the known fiscal initiatives that are currently under discussion. Specifically, it is assumed that:

1. Revenues measures equivalent to about four percent of the GDP consisting mainly of LL5,000 increase in the price of 20 liters of gasoline, and a five percent sales tax, or its equivalent, in custom duties, are taken at the beginning of 1998, at the latest. Theoretically, these measures could be implemented over the two years 1998-1999 or even over four years. They could also be replaced by a combination of other measures. However, the effect of the measure can be diluted if spread over time.

2. Total expenditures would be limited to LL7.8 trillion, that is LL200 billion less than the estimated total actual expenditures for 1997. This assumption is based on the recommendation adopted at the July conference on the economy. A much more ambitious target would be to accomplish the reduction from the 1997 budget allocations. Such an objective, however, would appear to be unrealistic. If taken at face value, it would obscure the need for revenue measures. On the other hand, if it is to be implemented effectively, it would require very steep cuts in spending, much more than appears to be under current discussion. There is a widespread view that a significant amount of government spending is squandered. Without taking a position on this matter, practical considerations dictate that a fiscal policy cannot be established on the assumption that waste would be reduced if not eliminated. The first step should be to achieve the savings, by reducing waste, and once this becomes a fact to adjust fiscal policy accordingly.

3. Social and capital expenditures to be financed from the proposed package of approximately $1 billion of borrowed cash would be spread over a number of years and would be included under the LL7.8 trillion limit for total expenditures. Under present procedures this proposed borrowing, and the expenditures it would finance, can be presented and approved by Parliament under legislation separate from the budget. But from an analytical point of view (for the purpose of this exercise) these expenditures are considered as being covered by the overall ceiling on government spending, and the drawings on the loan as part of the of the budget deficit.

With these assumptions, revenues and expenditures are calculated almost to balance at the equivalent of 22 percent of the GDP in 2001; somewhat higher than the historical levels experienced in Lebanon in the pre-war years (under 20 percent of the GDP). On the basis of these assumptions more than three-quarters of the adjustment effort would fall on measures to reduce spending, and the balance accounted for by new methods of obtaining revenue.

Obviously, the proportions of the mix could be varied. It is believed, however, that in Lebanon's present circumstances reducing spending would appear to be more feasible technically, and politically as well. Technically, because curtailing expenditure could ensure that spending limits are not exceeded, while revenue generation is less predictable. Politically, expenditure restraint, more than revenue augmentation, could be perceived as a passive instrument. Finally, within the spending limit, the authorities could exercise some flexibility in rearranging, admittedly to a limited degree, the pattern of expenditures. In fact, when considerable savings in interest payments is achieved, the room for non-interest expenditures would increase.

Revenue Measures

Treasury revenues would be expected to rise in line with the anticipated growth in the GDP. Some measures might be needed to ensure that this happens. If this was the only thing to occur, the ratio of revenues to GDP would remain at approximately the 18 percent level, and the deficit, in the context of the scenario, would not be eliminated. Hence the need for additional revenue measures estimated at the equivalent of four percent of the GDP.

To ensure revenue growth is balanced with the expansion in the economy, the efficiency of the tax system would have to be strengthened in order to reflect economic trends. Tax laws would need to be enforced and collection procedures improved. Duties, fees and utilities charges should be collected. Without strict enforcement, revenue collections would lag and public utilities would experience financial difficulties, translating into an additional burden on the Treasury. Wheat and petroleum prices would need to reflect international prices, and in the case of the latter commodity to secure significant income for the budget.

In addition to ensuring that receipts keep pace with growth in the economy (i.e. to grow at 12 percent annually), new revenue measures are needed to raise the revenue-to-GDP ratio. While direct taxation could be revised, the larger part of the new revenues would likely need to be raised from indirect taxes - specifically a sales tax or a value-added tax (possibly starting with the former and developing it into the latter). Most of Lebanon's neighbors in the eastern Mediterranean region have a sales tax.

The scenario assumes that such a measure would be in place in 1998 and enhanced in later years. Moreover, when and if Lebanon starts implementing an association agreement with the European Union, a further strengthening of the indirect tax already in place would need to be undertaken in order to recoup revenue losses resulting from the tariff duty reductions which is required in the partnership agreement with the EU.

This scenario does not assume any receipts accruing to the Treasury arising from sales of assets to be used for financing general expenditures. In Lebanon's present circumstances, serious consideration should be given to applying the proceeds of sales of assets (including proceeds from privatization) only for the purpose of repaying part of the debt. This is important both psychologically and in terms of perception. Using these proceeds to finance the fiscal gap could be perceived as a temporary measure. But when such receipts are applied to permanently reduce the debt, then the budget secures a lasting benefit. Of course, all this assumes the existence of a program to reduce the deficit which is being implemented effectively.

Expenditure planning and control

Total expenditures in the budget in Lebanese pounds are estimated at about LL8 trillion in 1997. The objective for the four years 1998-2001 could be to place an absolute limit on these expenditures at LL7.8 trillion annually. This ceiling would be comprehensive and include all disbursements from the specialized funds (i.e. CDR, Council for the Development of the South, and The Fund for the Displaced People) and from cash borrowing abroad. The only expenditures that would not fall under the ceiling would be project expenditures financed by external loans secured on appropriate terms. These externally financed outlays would be subject to a separate ceiling not to exceed the equivalent of three percent of the GDP. Strict implementation of the ceiling on aggregate expenditures, assuming nominal annual GDP growth of 12 percent, could be expected to reduce effective government spending by the equivalent of 14 percent of the GDP to roughly 22 percent of the GDP in 2001.

While spending priorities are continuously being followed by the authorities, under a strict spending ceiling this task becomes even more important. In the context of Lebanon's fiscal arrangement, meaningful priorities of expenditure would make better sense if all government outlays (excluding project expenditures financed entirely by external loans) were examined simultaneously and relative to each other, regardless as to whether the legal formalities require it or not. In the budget itself, expenditure flexibility is virtually non- existent because budgetary outlays are dominated by given items such as wages and interest on the debt. These expenditures are obligated by law or are contractual and cannot be tampered with. Presently expenditures with a greater degree of flexibility, that is of discretion and choice, are operated essentially outside the budget.

Streamlining the budgetary process on the spending side would be enhanced by the integration of the special funds, i.e. CDR, Council for the Development of the South, and The Fund for the Displaced People, into the budget proper. The present arrangement, which compartmentalizes government expenditures into several budgets, renders it unclear as to what is causing the deficit. The perception that certain outlays are financed while others are not disappears when all spending is gathered into one account and compared with total receipts. The excess of the former over the latter is the cause of the deficit, and not any particular expenditure. Moreover, under the existing arrangements, Parliamentary review and approval of the budget is constrained and resembles more a formal procedure than a substantive shaping of fiscal policy. This is because what is formally presented to Parliament is a budget that does not include some significant discretionary expenditures. Thus on the spending side Parliament can do very little. Could it recommend not to pay salaries, wages, rents, and the interest on the debt? In fact, more likely than not Parliament ends up recommending adding allocations for some departments.

The expenditures outside the budget are approved under special legislation separate from the budget, as for example when Parliament endorses an external loan arrangement for a specific project, or an external cash borrowing. Once these arrangements are approved, then implementation becomes a matter for government decisions. These procedures have significant drawbacks. First when a loan agreement is presented to Parliament it stands on its own; it is not presented and discussed in the context of a comprehensive fiscal position nor an integrated development strategy. A more rigorous procedure would be for parliament to conduct reviews following the initial approval to contract a loan and its terms. The reviews would center on the appropriateness of plans to draw on the loan to finance expenditures in a fiscal year. The implementation of the second step could be in the context of the annual budget discussion in Parliament. Thus Parliamentary discussion would be more comprehensive than under present practice as it would provide an opportunity to review all expenditure proposals for the fiscal year and their sources of financing.

A start could be made by the government voluntarily mapping out to Parliament and to the public at large a fully comprehensive fiscal plan. Further down the road, consideration might be given to streamlining the budgetary process through legal requirements that the budget should encompass all government expenditures, revenues, and borrowing, and mandating full and prompt auditing of all government accounts.

Debt management

Interest payments on the public debt have risen sharply in recent years and in 1997 are estimated to account for nearly half of budgetary expenditures. Consequently, a crucial element in attempting to achieve viable spending policies under a ceiling would be to reduce the burden of interest payments. Every Lebanese pound not lost in repaying the interest is a freed resource available to finance other outlays. Reversing the trend in interest payments is vital for a successful reduction of the deficit; without it the budget is in danger of being overwhelmed by the swelling tide in interest payments.

There are four ways to achieve this objective, and all four instruments could be used simultaneously. First, of course, is to reduce the fiscal deficit itself, and therefore the financing needs of the budget. Second is to reduce interest rates. Third is to reduce the stock of debt, and fourth is to rearrange the debt structure away from high interest instruments and towards relatively lower interest-bearing instruments.

The impact of a contracting budget deficit on interest payments is obvious and direct. A lower deficit would reduce the financing needs of the budget and could be expected to lower the interest rates at which the financing is obtained. It would also reduce the increase of the debt and it could also help in securing lower interest rates on the refinancing of maturing debt instruments.

In addition to reducing the deficit in 1998, the authorities have an unusual opportunity, through liquidity management, to effect a significant lowering of the interest rates structure. In the recent past, a significant accumulation of public sector deposits has occurred. These had increased from LL1.4 trillion at the end of 1993, to LL2.7 trillion at the end of 1995, and to LL4.6 trillion at the end of June 1997 (See Table 3). At this level, these assets are probably more than double the amount needed in a liquid account for normal transactional purposes. In these circumstances, the authorities could allow a withdrawal of deposits of LL1 trillion in each of 1998 and 1999 to finance a major portion of the projected budget deficit. The impact on new financing requirements for the budget would be very substantial, which could translate into a very significant reduction in interest rates (See Table 4). Again, a lower interest rates structure would open up opportunities for refinancing maturing debt to reduce further the burden of interest payments. Lowering interest rates could also be helpful in encouraging domestic economic activity.

The refinancing referred to above calls for replacing a portion of the existing Lebanese pound debt by new debt instruments, also denominated in Lebanese pounds, carrying lower interest rates and hopefully longer maturities as well. Refinancing through conversions into foreign debt instruments to take advantage of interest rates differential might not be prudent. The interest rates differential, and therefore the savings, would diminish as Lebanese demand for foreign borrowing rises in order to effect the refinancing. It would also mean burdening the Lebanese economy with the exchange risk which is presently carried by the holders of pound-denominated debt instruments. Finally, the servicing of a growing foreign debt would constitute an additional burden on the balance of payments.

The use of Lebanon's assets to reduce the stock of debt merits careful consideration. A cost benefit analysis could be undertaken to determine the balance of advantages between asset holding and debt reduction. In this assessment no category of assets should be excluded, including public corporations which might be privatized, as well as gold holdings. At the same time, the assessment would examine how many assets could be used and in what mix and proportions. In all cases, any use of assets must be surrounded by ironclad safeguards designed to ensure that the proceeds are used only in the context of a permanent reduction in the stock of debt. Given the seriousness of the subject, consideration could be given to enacting legislation that would spell under what circumstances the assets could be used and with what safeguards.

To what extent should the debt be reduced? Clearly, one immediate objective is to strengthen the budget by freeing it from the burden of excessive debt service payments. Beyond that task, the question that needs to be asked is what level of debt would be appropriate for Lebanon. There are no established guidelines for debt levels; much depends on the circumstances and the objectives of the country concerned. For a small country like Lebanon, endeavoring to recapture its position as a significant financial center, the example of the competition such as Luxembourg and Switzerland (less than 25 percent of the GDP) might be contemplated as a long term goal. Broadly, a conservative debt load would range up to 30 percent of the GDP. The Maastricht criteria of up to 60 percent of the GDP, which are intended to ensure relatively strong currencies that could be kept together in line in the prospective European Monetary Union, is approximately halfway between the conservative position and the zone of risk at over 100 percent of the GDP. These categorizations present a rough guideline. No one should imagine that at 99 percent of the GDP there is no danger, and that at 101 percent of the GDP a crisis would erupt. Jordan presents an example of a country in the region that allowed its debt-to-GDP ratio to rise significantly above the 100 percent mark in the 1980s. Beginning late in that decade, and for almost ten years, it implemented several adjustment programs, negotiated debt reschedulements and sought debt relief before recovering to below the 100 percent mark.

Based on the estimated preliminary fiscal results for 1997, Lebanon's net total debt to GDP is indicated at the equivalent of 90 percent (See Table 2), the gross debt ratio is calculated to reach a higher level. The difference between the two ratios is accounted for by the considerable accumulation of public sector deposits. Given the existence of these liquid assets, which could be used to reduce quickly the stock of gross borrowing, it would be reasonable, under these special circumstances, to give more weight to the net debt concept.

At the same time, it should be noted that the budget faces a debt service bill that is a function of the gross debt position. Moreover, normally, and unless there are overriding circumstances, liquid balances are maintained at a level corresponding to the flow of transactions. When these two considerations apply, the gross debt/GDP ratio is used. If the budget demand for borrowing is reduced by LL2 trillion in 1998-1999, as suggested above by utilising the accumulated deposits, the calculated result would be to diminish the difference between the two ratios; these are estimated to be 71 percent and 76 percent for net debt and gross debt respectively in 2001.

The debt ratios discussed above are applied to the total debt comprising the portion denominated in domestic currency with the part that is in foreign exchange. In several important ways there is no difference between the two segments since under Lebanon's free exchange system all Lebanese-denominated assets could immediately translate into demand for foreign assets. While it is true that a country could run out of foreign exchange and in that case default on its foreign debt service payments, it could always print its own currency and need not therefore technically default on servicing its debt denominated in the domestic currency. This of course leads to rapid inflation as witnessed during the early 1990s in Lebanon. That would defeat the policy aimed at price and exchange rate stability. In a downward spiral a segment of society - and it is usually the most vulnerable segment - would be forced to bear the loss.

The impact on the external sector

Reducing domestic interest rates aggressively (i.e. by some 3-5 percentage points) in order to contain the fiscal deficit could, as a side effect, result in unsettling the balance of payments position, involving some reserve losses. This could come about because the strength in Lebanon's balance of payments situation in recent years has been dependent to some degree upon attracting funds through the mechanism of high interest rates.

A closer look at Lebanon's balance of payments developments in recent year reveals a remarkable evolution (See Table 5). Between 1992 and 1996 imports doubled, they rose from $3.8 billion to $7.6 billion reflecting the requirements for reconstruction. Over the same period exports rose by some 70 percent. Preliminary data for the first half of 1997 indicate a likely leveling off in both imports and exports at the 1996 level, or possibly somewhat lower, particularly for exports. This would be in line with a slower pace of economic activity in 1997 and government measures taken in the middle of the year intended to restrain import growth, particularly certain categories of cars and some agricultural products. The trade of deficits which more than doubled between 1992 and 1996 (from $3.2 billion to $6.5 billion) might ease to about $6 billion in 1997. The current account balance is influenced by significant inward private transfers. Nevertheless, the current account deficit in 1996-1997 appears to have been running in the range of $5 - 6 billion annually. It is noteworthy that all these numbers are very large in proportional terms; that is if they are related to a GDP estimated at about $13 billion in 1996.

Details of capital account transactions are difficult to obtain particularly for the most recent period. However, the overall balance in the external accounts is known as it can be obtained from the foreign exchange movements of the banking system, as published by BDL. These reflect an approximate balance in 1992, large surpluses in 1993 and 1994, and 1996 (after a modest surplus in 1995). In the first half of 1997 the surplus position continued. When the large current account deficits are matched against the overall surpluses, the implied balancing factor, essentially net capital inflows, is very large; it has been of the order of $5 billion annually in 1993-1995 and over $6 billion in 1996. Clearly the capital inflows have more than financed the current account deficits and contributed to the reserves building up.

The gross foreign exchange reserves have increased from $1.5 billion at the end of 1992 to $6.5 billion at the end of May 1997. The question that could be asked is whether there was a need to increase reserves to such an extent. This increase has not been cost-free to the government. Every $100 million in reserves that was accumulated because of high interest rates on government treasury bills costs the state budget about $10 million annually. This represents the difference in interest rates paid on government securities and the interest rates paid to BDL on its foreign exchange deposits. (For the purpose of this example the spread has been assumed at ten percentage points).

A principal purpose of the reserves is to give confidence and help support the stability of the exchange rate. The difficult question is how much reserves are needed to achieve this objective. There is no straightforward answer to this question. A high reserves level might not be enough if the fiscal deficit is excessive, while a moderate level of reserves could be sufficient if the fiscal deficit is eliminated. Confidence in the currency is not dependent solely on the level of reserves, particularly when a significant portion is attracted by high interest rates. Confidence is also generated by strong policies designed to eliminate the fiscal deficit and by the performance of the economy as a whole.

Exchange rate stability is very important, but is there room for some exchange rate flexibility to facilitate the competitiveness of the economy? In this regard, the question could be raised whether the recent government measures to increase customs duties on certain categories of car imports, and to ban imports of some agricultural products, do not point to an exchange rate level at which imports are relatively cheap and also at which the domestic productive sector perceives a competitive disadvantage. To answer this question satisfactorily requires a careful analysis of not only movements in nominal exchange rates but also changes in relative inflation rates and in sectoral productivity.

Obviously, all this is beyond the scope of the present report.

It would be paradoxical to suggest that an effort to strengthen the fiscal position in Lebanon could lead initially to pressures on the balance of payments because normally a strengthened fiscal stance tends to help improve the balance of payments position and vice versa. Lebanon, however, now finds itself in this predicament because while the growing fiscal deficits contributed to the weakening of the current account of the balance of payments, the high interest rates contributed to attracting net capital inflows sufficient to create an overall surplus in the external account. If fiscal deficit reductions now assume an important priority, then the policy makers will need to consider how to reduce interest rates, and therefore the burden on the budget, while protecting the balance of payments position, a potentially delicate operation in its initial phases. But over the medium term, as fiscal consolidation is seen to be taking hold, the normal pattern of a strong fiscal position underpinning the external sector could be expected to emerge. Much will depend upon the strength and credibility of the total program designed to reduce the fiscal deficit.

The size of public sector issue

The public sector in Lebanon is large, encompassing a wide variety of activities. Government expenditures, including investments financed by foreign loans, probably approach 40 percent of the GDP. These include significant amounts mandated by the conditions prevailing in the aftermath of the war - such as repairing the damaged infrastructure, compensation for war damage, compensation for displaced people, support for the residents of south Lebanon while the security emergency continues, and the rebuilding of the armed forces. Also, in the post-war period, with a significant shift in the distribution of income, coupled with the impact of the inflation/depreciation setback of the early 1990s, the demand for social services financed by the government has increased, and calls for increased salaries have persisted. In addition, the state owns the public utilities - water, electricity, communications, ports, airports, railways (and now the national airline), as well as real estate. The public sector as a whole might well approach 50 percent of the GDP. In addition, the banking sector in Lebanon has become highly dependent on the government in that its profitability is closely linked to holding the lucrative government treasury bills. All the components of this intricately related structure will be affected, and therefore will have to be adjusted, when a strong deficit reduction effort is implemented. It would not be an exaggeration to say the discipline that will be imposed by a deficit reduction effort will touch on wide-ranging social and political issues. What should be the salary of a high school teacher? Who should operate the public utilities? What level of payments should there be for social services?

It is beyond the scope of this report to attempt to find the correct response to these and other questions; indeed the task would require a number of teams to tackle these issues. Having said that, it might be useful, however, to mention three broad principles as a starting point for public discussion.

First, the smaller the government sector is, the better. This would be in line with Lebanon's traditional policy of relying on private initiatives to drive the economy; it is also the general trend in the world today. On the expenditure side, total government outlays, including investment financed by foreign loans, in the neighborhood of 25 percent of the GDP would appear to be feasible provided that sufficient priority is given to ensure an adequate and fair level of social services. Within the total of government spending, the portion that is clearly related to the consequences of the war, in particular the transfer payments for compensation, should be identified and phased out as soon as possible. On the revenue side, there should be room to raise domestic receipts to at least 22 percent of the GDP level, both through more efficient implementation of existing taxes and fees and by introducing new ones. Even at that level, the Lebanese tax burden would be lighter than in non-oil producing countries of the region.

Second, with a lower interest rates structure, the banking system should reorient its activities away from investments in government treasury bills and toward its traditional role of financing the private sector.

Third, serious and careful consideration needs to be given to privatizing some public entities. The issues here are complex and an adequate regulatory framework to protect the public interest should be developed. At the same time, the utilities that may be privatized, as well as existing private enterprises, should be allowed to operate efficiently - that is not to be burdened by restrictive regulations - and to compete regionally and beyond. All this would be consistent with Lebanon's traditional open and liberal economic philosophy.

Technical remarks

This report explores an illustrative path for a deficit reduction effort. Needless to say, there are many other possible permutations for such an effort, each carrying within it implied consequences. For example, if it is considered that budgetary expenditures could not be reduced to less than 30 percent of the GDP, the implicit consequence would be either to increase the bid to generate new revenues very substantially or risk a continuing deficit. Another objective might be that reducing the deficit should not in any way endanger the external sector. Here, the approach would require a very severe deficit reduction program implemented over a short period of time, and to accept the possible consequences for employment and social stability.

There are also timing issues. Why spread the effort over four years? Why not ten years? Would it be credible? A longer period would encompass more than one administration.

Would successive administrations be committed to the same program? On the other hand, some may prefer not to spread the adjustment pain, but rather to effect a shock treatment all up front. Would social and political conditions tolerate such an approach? Then there are considerations tied to the political agenda, such as Presidential or Parliamentary elections. Finally there are the aspects of the unknown, surprises such as a severe aggression from abroad, that could disrupt the most carefully laid plans.

A third category of questions would revolve around the validity of the assumptions underlying a particular scenario. Could not the economy grow much faster in real terms? Would not a regional peace treaty transform the situation? In this area, it is important not to allow oneself to wishfully assume the problem away, nor to sink into paralyzing pessimism. The illustrative scenario discussed in the report while not pessimistic is very demanding, and nevertheless could use a margin of safety.

Part II- Analysis of the 1998 Budget Proposals

Background

The struggle to contain the budget deficit in Lebanon is an endeavor that has been on-going for a number of years. Very large deficits were unavoidably incurred during the war years, but in 1993 when the govern managed to regain significant control over revenue sources, the deficit-to-GDP ratio fell to less than nine per cent. (The deficit discussed in this study refers to the deficit incurred in Lebanese pounds in the State Budget; it does not include the deficit incurred by the Council for Development and Reconstruction (CDR) and financed by foreign loans. If this component of public spending is consolidated within the State Budget, the overall budget deficit would be a few percentage points higher.)

Another factor that helped to hold the deficit down in 1993 was the lag that is usually experienced between initiating spending plans and implementing them. This lag was overcome in 1994 when total expenditures in the budget rose by 72 per cent while revenues increased by 20 per cent. The consequence was that the deficit exceeded the equivalent of 19 per cent of the GDP in 1994. In the circumstances efforts were made in 1995 to reduce the deficit through enhancing revenue generation while the expansion in spending was held down. The result was that the deficit contracted by nearly four percentage points to the equivalent of 15.6 per cent of the GDP.

The 1996 budget foresaw further progress in deficit reduction and it projected a deficit equivalent to 12 per cent of the GDP. This result was to be attained by a 33 per cent growth in revenues while the increase in spending was to be held at ten per cent. In the event, revenue collections were LL492bn less than projected in the budget, while expenditures exceeded the budgeted allocations by LL767bn. The consequence was that the overall budget deficit, rather than being reduced significantly, rose by 2.5 percentage points, to the equivalent of 18 per cent of the GDP.

A summary of Government Finances, 1996-1998 is shown in Table 6.

Developments in 1997

In the 1997 budget another attempt was made to cut back the budget deficit, this time drastically by almost eight percentage points. The strategy rested on a decision to freeze total spending in 1997 at the level of the approved budget allocations for 1996 and not to allow any additional expenditures unmatched by new revenue resources. This meant holding aggregate spending in 1997 significantly below the actual level expected for 1996. At the time of the formulation of the budget, total outlays in 1997 were already forecast to attain LL7200bn, and in fact turned out to be only marginally higher than that estimate. Therefore, to achieve the 1997 spending reduction target of 12 per cent relative to the expected actual spending in 1996, great efforts in exercising expenditure controls were required. The revenue forecast in the 1997 budget was founded on realistic estimates.

Preliminary actual data for the January-September 1997 period indicate total expenditures in the budget at LL5,883bn (92 per cent of allocations for the year as a whole). Clearly the intention to exercise strict restraint on spending had not been effective. For the year as a whole aggregate spending is projected at close to LL8000bn - as an order of magnitude - but it could be some LL100-200bn less than this forecast. In any case spending in excess of the budgeted allocations seems to amount to about LL1,500bn of which additional interest payments borne by the budget are estimated at LL500bn. The cost of higher salaries for teachers and uncovered Treasury advances apparently also contributed to excess spending.

With regard to revenue collections, in the first nine months of the year receipts totaled LL2,719bn (66 per cent of the budget forecast). For the year as a whole revenue generation is projected - also as an order of magnitude - at around LL4,000bn. As was noted above about expenditures, receipts in the year as a whole could also be some LL100-200bn less than presently estimated. Considering a slower rate of economic expansion in 1997 than was anticipated a year ago (that is, at the time the budget forecast was prepared) and also in view of the punitive raises in import duties on certain categories of cars, which are believed to have adversely affected collections, the revenue estimate at LL4,000bn or marginally less tends to substantiate the view that the revenue forecast in the budget was generally realistic.

With the broad magnitudes for revenues and expenditures mentioned above, the overall deficit in the budget is forecast at LL4,000bn, equivalent to almost 18 per cent of the GDP (with CDR expenditures included, the ratio would likely exceed 20 per cent of the GDP). If these estimates materialise the net debt-to-GDP ratio would be at the 90 per cent level and the gross debt ratio would exceed the 100 per cent level. A substantial use of government deposits in the second half of 1997 would draw the two ratios closer together and enable the gross debt ratio to remain below the 100 per cent mark. That would constitute an effective use of assets to reduce the stock of debt.

In addition a new debt component has recently emerged in public discussions. These are the reported delayed payments of about $125m to hospitals and an uncovered deficit in the Fund for the Development of the South of $50m. These are commonly referred to as domestic arrears. They are debts owed to the private sector which had extended this lending involuntarily. Technically, it may be difficult to allocate these expenditures to the years in which they were incurred. A practical arrangement could be to recognize these arrears - and any others that may exist - as part of the stock of debt as it stands now. When such arrears are repaid in the future from borrowed resources, the implications would be substituting one form of debt for another.

The Pre-Budget Discussions

By mid-1997 the unsatisfactory fiscal situation had become increasingly evident and subject to widespread public discussion. The Prime Minister called for a conference in July 1997 at which the problem of the fiscal deficit and the mounting debt were major topics. In these meetings there was a broad consensus that continuing large fiscal deficits could not be tolerated and that ambitious measures would have to be implemented if the overall debt situation was to be contained within manageable proportions. With that objective in mind it was strongly recommended that total spending in 1998 be reduced by LL200bn relative to their 1997 level. It was also urged that the quality of spending be scrutinised carefully in order to eliminate waste. The conference also called for redoubling efforts to enforce tax laws and to collect fees and utility charges comprehensively. It was also suggested that the authorities should look into the feasibility of new revenue measures.

In September 1997 the government considered, but did not approve, a package of taxes, spending and borrowing measures - the so-called $1bn project, later reduced to $800m. The relationship between the proposed package and the then forthcoming budget proposals for fiscal 1998 was not spelled out. In the first section of this report, it was assumed that the whole package would be part of the budget.

The revenue component of the package was ambitious in scope and very important in content. The two most important elements in the proposed revenues consisted of LL5,000 fee per 20 liters of gasoline and the introduction of a sales tax. These, with other measures, were estimated to generate new resources for the budget equivalent to about four per cent of the GDP. Apart from the resource mobilization aspect, which is very important in itself, these measures would have strengthened greatly the component of tax spending within the context of the Lebanese tax system. Lebanon still laca modern sales tax to use as an instrument in fiscal management, including replacing receipts from import duties which might need to be reduced in the context of a trade association agreement with the European Union. As for the gasoline tax, it is needed not only to generate quick and considerable revenues but also to encourage conservation in fuel use, and to support policies designed to tackle the problems of traffic congestion and environmental pollution. Retail gasoline prices in Lebanon are about half those charged in Greece.

The spending components of the package were listed as follows: $200m for the Fund for Displaced People, $125m to pay overdues to hospitals, $50m to cover the deficit in the Fund for the Development of the South, and the balance of $425m to finance social projects in remote regions of the country. The financing was to be generated by dollar long-term borrowing abroad.

The 1998 Budget Proposals

In early October 1997 the government submitted to Parliament the proposals for the 1998 budget. Revenues were estimated at LL4,956bn, and expenditures at LL7,925bn, resulting in an estimated deficit of LL2,969bn. The details for the revenue and expenditure proposals are as follows.

1. Revenues

The revenue forecast in the 1998 budget proposals suggests a rate of expansion about twice the projected rate of growth in nominal GDP (12 per cent under the assumptions of this study). To achieve the ambitious result the proposals specify in detail a large number of tax and fee adjustments including the introduction of substantive new revenue measures. Wide-ranging increases in fees are enumerated in Table 9 of the attachment to the draft budget law. The 12 pages of this attachment comprise increases in the following categories of fees:

1. Car licenses (with considerable differentiation based on horsepower)

2. Driving license fees

3. Passport fees

4. Work license fees for non-Lebanese

5. Real estate fees for a wide variety of transactions

6. A fee on cement

7. University registration and degree fees

All these fees are specific (so many Lebanese pounds per transaction) and the most important are the fees on cars, real estate transactions, and on cement. With respect to cars, compliance has been a problem in the past, therefore collecting effectively significantly higher fees could be problematic and will require very determined efforts.

Assuming strict implementation of the proposed increases in all categories of fees, a significant expansion in revenue generation could be expected. The budget proposals also suggest tapping new sources of revenue, as shown in Table 7.

A breakdown of Revenues is shown in Table 8.

Around LL387bn in receipts arise from new taxes and fees, constituting 7.8 per cent of revenues. Tax revenues are estimated at LL3.63trn, an increase of 15 per cent over the budgeted figure for 1997 (see Table 3). Non tax revenues are forecast to reach LL1.33 trn in 1998, reflecting a 46.5 per cent rise compared to the 1997 budget.

A more detailed analysis of tax revenue reveals the following:

* Revenue from income and profit taxes is estimated at LL440bn, representing 12 per cent of total tax revenue.

* Revenue from sales tax on goods and merchandise is a new source of revenue estimated at LL240bn, representing 6.6 per cent of total tax revenue.

* Revenue from property taxes is estimated at LL470bn, representing 13 per cent of total tax revenue.

* Revenue from indirect taxes on commodities is estimated at LL286bn, or eight per cent of total tax revenue.

* The major source of revenue stems from taxes imposed on international trade, estimated at LL1.95trn and constituting 53.8 per cent of tax revenues or 39.3 per cent of total revenues.

* Taxes from other sources stand at LL230bn, which represents 6.3 per cent of total tax revenue.

* Revenues from public boards, governmental institutions, and government property drastically increased from LL374bn to LL704bn.

* Revenues from administrative fees drastically increased from LL230bn to LL428bn, of which traffic law infringement fines increased from LL115bn to LL275bn.

* No revenues from the sale of public assets and settling of loans are expected, compared to LL40bn in 1997 budget.

2. Expenditures

On the expenditure side, budget expenditures are expected at LL7,375bn. However, after adding both of the amounts expected to be spent from amounts carried over from 1997 and the amounts expected to be allotted to municipalities, total gross expenditures estimate amounts to LL7,925bn. In the draft budget, current expenditures are estimated at LL6,588bn and investment expenditures LL703bn, representing 89 per cent and 11 per cent of proposed expenditure respectively. The breakdown of the anticipated spending allotted to municipalities and the amounts expected to be spent from amounts carried over from 1997 not available.

The proposed public spending for 1998 is shown in Table 9. A breakdown of Expenditures is shown in Table 10.

The main components of expenditure by type were sub-divided as follows:

* Expenditures on wages, salaries and indemnities are estimated at LL2,492bn, representing 37.8 per cent of current expenditures, or 31.4 per cent of total expenditures.
* Debt service constitutes LL3,200bn, or 40.4 per cent of budget expenditures, of which 91 per

cent are domestic interest payment.
* Expenditure on goods and services totaled LL234bn, subdivided into LL136bn for goods and LL98bn for services. This represented three per cent of expenditures.
* Investments expenditure in Lebanese pounds totaled LL703bn of which LL386bn was allocated to infrastructure and other projects; LL66bn went to equipment and supplies; LL74bn to maintenance; and LL34bn to miscellaneous expenditures and 143bn in support of CDR.

A more detailed analysis of the breakdown of expenditures by ministries reveals that:

* Spending by the Ministry of Defense increased by three per cent, from LL738bn to LL760bn, accounting for 18 per cent of total expenditures.

* Spending by the Council of Minister rose by 16 per cent, from LL408.7bn to LL475bn, accounting for 11.4 per cent of total expenditures.

* Spending by the Ministry of Education increased by 21 per cent, from LL388bn to LL470bn, accounting for 11 per cent of total expenditures.

* Spending by the Ministry of Health increased by 69 per cent, from LL160bn to LL270bn, representing 6.5 per cent of total expenditures.

3. Overall position

There are several favourable features in the 1998 budget proposals and a few weak spots. The revenue estimate appears to be achievable, assuming a recovery in the economy, particularly in the real estate sector, and the spending forecast seems to be realistic enough to be adhered to.

The projected 25 per cent rise in revenues is expected to be underpinned by the enhancement of many revenue items and the introduction of new measures including the nucleus of a potential broad-based sales tax. It is assumed that all these measures would be in effect as of the beginning of 1998. In the aggregate they appear to be sufficient to promote revenue growth in line with the projected nominal expansion of the GDP (12 per cent), and to generate incremental receipts equivalent to about two per cent of the GDP. A main weakness in the revenue package lies in a partial dependence on raising fees, some of which are specific (i.e. specified as a fixed amount per transaction). Such fees grow with the volume of transactions and therefore tend to lag behind nominal GDP growth. These fees would need to be adjusted periodically.

On the expenditure side total spending is projected at LL7,925bn consisting of LL7375bn in the 1998 draft budget, LL350bn in unused allocations from previous years re-authorized for spending in 1998, and LL200bn authorized for outlays by the municipalities. Excluding the municipalities, the proposals appear to fulfill the recommendation of lowering the government's own expenditures by LL200bn. Including the municipalities, aggregate expenditure is essentially frozen at the estimated 1997 level. Considering that total outlays are estimated to have increased by over one third in 1996-1997, a cap on expenditures in 1998 would appear to be feasible. It would nevertheless require strict monitoring in order to assure continuing compliance. The weakness in the expenditure estimates might be in the projection for interest payments, which are capped at the expected 1997 level. To realize this estimate would require a significant decline in interest rates.

The projected overall fiscal deficit of LL3trn is about LL1trn less than the deficit estimated for 1997. In terms of ratios to GDP, the deficit is forecast to fall by six percentage points to just under the equivalent of 12 per cent of the GDP. That would represent the best fiscal performance since 1993. Impressive as this achievement would be if realized, the impact on the debt burden would be merely to stabilize the situation at an uncomfortably high level. While the gross debt ratio would decline significantly, it would be expected to remain around the 100 per cent mark; the net debt position would be expected to grow marginally to 92 per cent of the GDP. Clearly, there is no room for slippage in implementing the budget and reinforcement might well become necessary during the course of the fiscal year.

A Revised Framework for a Deficit Reduction Effort

Table 11 showing a summary of government finances provides two sets of projections for the years 1998-2001. The original projections (which were published earlier) have been revised to reflect the 1998 budget proposals. Below are listed the assumptions for the original and the revised projections.

	Original	**Revised**
Objective	Fiscal balance in 2001	Same
GDP growth	12% in nominal terms	Same
Expenditures	Capped at LL 7.8 trillion annually	Capped at LL 8 trillion annually
Revenues	Grow in line with nominal GDP plus 4% of GDP additional revenue effort in 1998.	Grow in line with nominal GDP plus 2% in 1998 and 1% additional in each of 1999, 2000, and 2001

In the first part of the LCPS report, which was published in October, it was stressed that these scenarios were merely intended as examples to clarify issues and possibilities. With this objective in mind it might be useful to compare the aggregated numbers over the four years in the two scenarios:

(In LL trillion)

	Original	**Revised**	**Difference** *(Revised minus Original)*
Revenue	+26.30	+25.63	-0.67
Expenditure	-31.20	-31.94	-0.74
Deficit	-4.90	-6.31	-1.41

Broadly, the revised scenario provides over the four years for some LL740bn in additional expenditures and generates some LL670bn less in revenues. The latter occurs despite the fact that the revenue effort in the revised scenario totals to the equivalent of five per cent of the GDP, but is spread over the four years; while the original scenario assumes four per cent of the GDP all built into the first year. The cumulative difference in the deficit of LL1.41trn gets reflected in the debt burden position in the year 2001. While the original scenario aimed for the 70-75 per cent of GDP range, the revised one projects the 75-80 per cent range.

The measures and policies required to underpin a deficit reduction effort, whether as outlined above in the original or the revised scenarios, are essentially the same. The options and possibilities were described in the first section of the report which was published earlier. It is clear that in Lebanon's circumstances the effort will have to be comprehensive, utilising a wide range of instruments, and cast in the context of the medium-term programme that is pursued with determination. Scenarios can be invented, developed, scrutinised, and adjusted. Their intent is to explore, enlighten, and stimulate discussion. But in the end the only scenario that really counts is the one articulated and implemented by the authorities.

A revised Summary of Government Finances for the years 1993- 2001 is shown in Table 11.

Table 1
(in LL Billions)

		Revenues			Expenditures			Deficit		
		Actual	*Budget*	*Actual/ Budget*	*Actual*	*Budget*	*Actual/ Budget*	*Actual*	*Budget*	*Actual/ Budget*
1997	**Jan-Sep**	**2,719**	4,100	**66%**	**5,883**	6,400	**92%**	**3,164**	2,300	**138%**
1996		3,534	4,025	**88%**	7,288	6,458	**113%**	3,754	2,433	**154%**
1995		3,033	3,150	**96%**	5,856	5,630	**104%**	2,823	2,480	**114%**
1994		2,241	2,246	**100%**	5,204	4,106	**127%**	2,963	1,860	**159%**
1993		1,855	1,701	**109%**	3,017	3,400	**89%**	1,162	1,699	**68%**

Source: Ministry of Finance

Table 2
Summary of Government Finances
(in Trillions of LL)

	Actuals				*Estimated*	*Projected*			
	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
GDP	13.12	15.34	18.06	20.41	22.45	25.14	28.16	31.54	35.33
Revenues	1.86	2.24	3.03	3.53	4.0	5.5	6.2	6.9	7.7
Expenditures	3.02	5.20	5.86	7.29	8.0	7.8	7.8	7.8	7.8
Deficit	1.16	2.96	2.82	3.75	4.0	2.3	1.6	0.9	0.1
Revenue/GDP	14.1%	14.6%	16.8%	17.3%	17.8%	21.9%	22.0%	21.9%	21.8%
Expend/GDP	23.0%	33.9%	32.4%	35.7%	35.6%	31.0%	27.7%	24.7%	22.1%
Deficit / GDP	8.9%	19.3%	15.6%	18.4%	17.8%	9.1%	5.7%	2.9%	0.3%
Gross Debt	6.38	10.59	14.08	20.11	24.11	25.41	26.01	26.91	27.01
Net Debt	4.99	7.95	11.38	16.24	*20.24*	*22.54*	*24.14*	*25.04*	*25.14*
Gross Debt/GDP	48.6%	69.0%	78.0%	98.5%	107.4%	101.1%	92.4%	85.3%	76.4%
Net Debt/GDP	38.1%	51.8%	63.0%	79.6%	90.2%	89.7%	85.7%	79.4%	71.2%

For GDP (1997-2001) -LCPS estimates. Assumed nominal growth rate of 10% in 1997, and 12% annually for 1998-2001.
For Fiscal data- Ministry of Finance 1993-1996. 1997-2001 LCPS estimates. 1997 based on 8 months actuals. 1998-2001 based on assumptions in text.
For Debt data- 1993-1996: BDL. For 1997-2001 reflects the cumulative deficits over 1996 base. It does not include deficit incurred in foreign currencies. In 1998-1999, financing the deficit includes LL 1 trillion drawdown in each year from public sector deposits.
Source: Ministry of Finance, BDL, and LCPS estimates.

Table 3
PUBLIC DEBT
(in trillions of LL)

	1992	1993	1994	1995	1996	June 1997
I- Gross Public Debt	**5.18**	**6.38**	**10.59**	**14.08**	**20.11**	**23.31**
A- Internal Public Debt	**4.45**	**5.82**	**9.32**	**12.00**	**17.23**	**20.02**
Central bank loans	*0.42*	*0.47*	*0.08*	*0.10*	*0.10*	*0.11*
TB	0.12	0.41	0.00	0.00	0.00	0.00
Loans	0.30	0.06	0.08	0.10	0.10	1.13
Commercial bank loans	*3.23*	*4.25*	*7.35*	*8.55*	*12.66*	*13.61*
TB	3.22	4.24	7.34	8.49	12.56	13.51
Loans to public institutions	0.02	0.00	0.04	0.06	0.11	0.10
Others	*0.80*	*1.10*	*1.90*	*3.35*	*4.47*	*6.30*
private sector	0.70	0.92	1.43	2.74	3.28	4.71
public institutions	0.09	0.18	0.45	0.58	0.86	1.06
financial institutions	0.00	0.01	0.02	0.03	0.32	0.52
B- External Debt	**$ 400 m**	**$ 327 m**	**$ 771.8 m**	**$ 1,304.6 m**	**$ 1,856 m**	**$ 2,139.5 m**
or		**LL 0.56 tr.**	**LL 1.27 tr.**	**LL 2.08 tr.**	**LL 2.88 tr.**	**LL 3.29 tr.**
developmental & governmental institutions		0.36	0.45		1.10	1.12
others		0.20	0.82		1.78	1.92
II- Public Sector Deposits	**0.83**	**1.39**	**2.64**	**2.70**	**3.87**	**4.58**
III- Net Public Sector Debt	**4.35**	**4.99**	**7.95**	**11.38**	**16.24**	**18.73**

For GDP (1997-2001) -LCPS estimates. Assumed nominal growth rate of ten percent in 1997, and 12 percent annually for 1998-2001.
For Fiscal data- Ministry of Finance 1993-1996. 1997-2001 LCPS estimates. 1997 based on eight months actuals. 1998-2001 based on assumptions in text.
For Debt data- 1993-1996: BDL. For 1997-2001 reflects the cumulative deficits over 1996 base. It does not include deficit incurred in foreign currencies. In 1998-1999, financing the deficit includes LL1 trillion withdrawal in each year from public sector deposits.
Source: BDL

Table 4
Interest Rates
(Per cent at end of period)

	1992	1993	1994	1995	1996	June 97
3-m TB	13	17.22	13.49	16.01	14.29	13.4
6-m TB	15	19.65	14.83	17.21	16.15	14.21
1-year TB	20.99	21.07	14.73	18.26	17.02	15.2
2-year TB	26	23.99	15.84	23.39	20.54	16.73

Source: BDL

Table 5
Summary of Balance of Payments
(in millions of $)

	1992	1993	1994	1995	1996	June 1997
Exports	601	686	743	985	1018	369
Imports	-3786	-4908	-5541	-6755	-7559	-3551
Trade Balance	-3185	-4222	-4798	-5770	-6541	-3182
Net Services	-29	-149	10	36	50 [1]	25 [1]
Private Transfers	416	565	685	836	1000 [1]	500 [1]
Current account balance	-2798	-3806	-4103	-4898	-5491	-2657
Net capital movements [2]	2851	4975	5234	5154	6277	3329
Overall balance	53	1169	1131	256	786	672

1- Estimated by LCPS
2- Including errors and omissions. Calculated as residual.
***Source**: BDL*

Table6
Summary of Government Finances) *in billions of LL(*

	1996		1997			1998
	Budget	**Actual**	**Budget**	**9 months**	**Actual (1) Expected**	**Budget**
Revenues	4,025	3,533	4,100	2,719	4,000	4,956
Expenditures	6,458	7,225	6,400	5,883	8,000	7,925
of which interest payments	*(2250)*	*(2508)*	*(2700)*	*(2418)*	*(3200)*	*(3200)*
Deficit	2,433	3,692	2,300	3,164	4,000	2,969
in percent						
Deficit / GDP (1)	11.9	18.1	10.2	14.1	17.8	11.8

(1) LCPS estimates for GDP and the expected actuals for 1997.
Source: Ministry of Finance

Table 7
New Sources of Revenues

in billions of LL	**1998**
Sales tax on good and merchandise	240
Sales tax on tourist institutions	10
Ownership deed renewal tax	30
Market fees	11
Lebanese University registration fees	6
Airport fees	4
Fees on cab license plates	17
Work permit fees	16
Fees on other permit	3
Revenues from settlement of public beach properties	50

Source: Proposed Budget 1998

Table 8
Breakdown of Revenues

in billions of LL	**Budget 1997**	**Proposed Budget 1998**
Tax revenues	**3,152**	**3,626**
Tax on Income, Profits, and Capital	375	690
Income tax	375	440
Sales tax	0	250
Sales tax on goods and merchandise	*0*	*240*
Sales tax on tourist institutions	*0*	*10*
Tax on property	405	470
Tax on constructed property	80	50
Tax on inheritance	50	40
Non-recurrent tax on property	275	380
Real estate taxes	*275*	*350*
Ownership deed renewal tax	*0*	*30*
Internal fees on goods & services	292	286
Internal fees on goods	35	62
Monopoly boards' profits	30	70
Tax on services	17	14
Other taxes on goods and services	210	140
Car registration	*50*	*80*
Tax paid by companies with concessions	*120*	*10*
Departure tax	*40*	*50*
Fees on trade and international exchange	1,800	1,950
Import fees	1,800	1,950
Other tax revenues	280	230
Revenues from revenue stamp	*250*	*210*
Taxes not classified in other accounts	*30*	*20*
Revenues from sources other than tax	**908**	**1,330**
Revenues from public boards, government institutions, and government property	374	704
Revenues from non-financial public boards and government institutions	243	607
Revenues from the Casino du Liban	*15*	*32*
Revenues from grottos, historical and touristic sites	*3*	*5*
Revenues from surplus of the national lottery boards' budget	*25*	*20*
Revenues from surplus of the communications ministry' budget	*200*	*550*

Revenues from government financial institutions	100	80
Revenues from the Central Bank (profit and difference in value of gold and foreign currency reserves)	100	80
Revenues from government property	11	15
Revenues from the Beirut International Airport	*10*	*10*
Revenues from other government property	*1*	*5*
Other revenues from public institutions	20	2
Interest on capital	*20*	*2*
Fees and revenues from administrative and sales sources	**349**	**502**
Administrative fees	230	428
Fees collected by public notaries offices	*20*	*20*
Consular fees	*50*	*30*
Fees collected by the surete generale	*25*	*75*
Traffic law infringement fines	*115*	*275*
Fees collected by judicial departments and courts	*20*	*17*
Market fees	*0*	*11*
Administrative returns	18	25
Lebanese University registration fees	*0*	*6*
Examination fees	*12*	*6*
Airport fees	*0*	*4*
Revenues from seaport managements	*6*	*9*
Sales	1	19
Proceeds from sale of official gazette and justice ministry bulletin	1	2
Fees on cab license plates	0	17
Fees on permits	0	20
Work permits fees	0	16
Fees on other permits	0	3
Administrative fees and returns from other services	100	10
Revenues from fines and confiscation procedures	20	11
Miscellaneous non-tax revenues	165	113
Retirement payments deductions	50	30
Post offices revenues	10	10
Exceptional non-tax revenues	105	73
Revenues from settlements of building violations	100	20
Repossessions	5	3
Revenues from settlements of public beach properties	0	50
Revenues from sales of public assets and settling of loans	40	0
Total Revenues	**4,100**	**4,956**
Source: Ministry of Finance		

Table 9
Proposed public spending for 1998

(in billion of LL)	**Before**	**After the Adjustment**
Current Expenditure	**6,268**	**6,588**
Gross total of wages, salaries and social service payments	2,491	2,492
Debt servicing	3,200	0
Fund for the displaced	10	--
Council of the South	64	--
Social welfare institutions	91	--
Educational center	25	235
Administrative expenses (consumer products and services)	231	--
Hospitalization expenses	225	--
Servicing financial debts and subsidizing the grain and sugar cane office (not including tobacco subsidy)	39	--
Power subsidy	100	--
Public housing institution	50	--
Other current expenditure items	67	--
Investment expenditure	**648**	**703**
Installations under construction	351	386
Equipment	66	--
Maintenance	54	74
Payments earmarked for investment (representing the government's share in the cost of public projects mainly financed by foreign loans)	143	--
Other expenditure items earmarked for investment	34	--
Budget reserves that can be used for various expenditure items	84	--
Budget expenditures	**7,325**	**7,375**
Total amounts expected to be spent from amounts carried over from the 1997	350	--
Total amounts expected to be allotted to municipalities	200	--
Total gross expenditure estimate	**7,875**	**7,925**

Source: Ministry of Finance

Table 10
Breakdown of Expenditures

(Billions of LL)	**Budget 1997**	**Budget 1998**	**Percentage Change 97-98**
Presidency of the Republic	2.732	2.727	-0.18%
Parliament	39.166	35.559	-9.21%
Council of Ministers	408.758	475.274	16.27%
Ministry of Justice	31.317	34.573	10.40%
Ministry of Foreign Affairs	79.427	86.297	8.65%
Ministry of Interior	349.206	350.740	0.44%
Ministry of Finance	43.972	42.727	-2.83%
Ministry of National Defense	738.132	759.799	2.94%
Ministry of National Education	387.884	469.809	21.12%
Ministry of Public Health	159.646	270.155	69.22%
Ministry of Labor	3.795	4.486	18.20%
Ministry of Information	22.197	24.093	8.54%
Ministry of Public Work	145.659	125.073	-14.13%
Ministry of Agriculture	47.450	44.070	-7.12%
Ministry of Economy and Trade	4.649	4.791	3.07%
Ministry of Post and Communication	15.858	13.908	-12.30%
Constitutional Council	1.208	1.592	31.76%
Ministry of Water Resources	143.358	89.569	-37.52%
Ministry of Tourism	13.084	9.634	-26.37%
Ministry of Fuel	0.691	0.668	-3.44%
Ministry of Housing and Cooperatives	3.741	54.101	1346.37%
Ministry of Displaced	7.278	9.190	26.27%
Ministry of Rural and Municipal Affairs	0.550	0.977	77.63%
Ministry of Technical and Vocational Education	39.904	32.684	-18.09%
Ministry of Social Affairs	94.513	94.486	-0.03%
Ministry of Emigrant	6.744	5.986	-11.23%
Ministry of Transportation	90.633	106.323	17.31%
Ministry of Culture and Higher Education	153.848	187.242	21.71%
Ministry of Environment	5.540	5.451	-1.62%
Ministry of Industry	1.386	3.326	139.97%
Debt to be Paid	2,700.00	3,200.00	18.52%
Budgetary Reserves	690.675	829.690	20.13%
Total Expenditures	**6,433.0**	**7,925.0**	**23.2%**

Note: Total expenditures in 1998 include re-authorized allocations from the previous years and allocations for municipalities. Comparable figures are not included in the 1997 budget figures. This factor accounts for a significant portion of the projected expenditure increase. **Source: Ministry of Finance.**