Is Lebanon's Debt Sustainable?
A Closer Look at Lebanon's Debt Dynamics

By Samer Y. Saab

Johns Hopkins University

School of Advanced International Studies

Currency Crises in Emerging Economies
Prof. Cem Karacadag

Fall 2005

Table of Contents

I. BACKGROUND, MOTIVATION AND METHODOLOGY

A. Background

1. Lebanon has one of the highest public debt stocks (relative to GDP) in the world, currently at over 185 percent of 2003 GDP. Economic policy continues to be dominated by chronic imbalances in government finances which have seen the budget deficit average over 17 percent of GDP over the past five years.

2. For a better appreciation of the current policy issues, the origins and evolution of current fiscal problems need to be ascertained: as shown below, fiscal disarray resulting from 16 years of brutal civil war and delays in implementing post-war fiscal adjustments partly explain the current situation. Furthermore, an unstable and corrupt political environment and social reluctance to proposed fiscal adjustments, as well as other structural and technical factors unique to Lebanon greatly contributed to fiscal disarray.

The War Legacy[1] *(1975-1991)*

3. The effects of war on public finances can be grouped under four major themes (see Table 1 in Appendix):

- A general breakdown in government authority, with direct consequences on revenue collection. Revenue went from over 15 percent of GDP before 1975 to well below 8 percent on average for the period 1975-1989. In 1988 for example, revenue reached an all-time low of 1.8 percent of GDP. The loss of control over the airports and seaports meant lost customs revenue for the government, which was (and still is, although at a diminishing rate) the most important tax revenue.
- The stagnant and irregular economic activity, as well as a general environment of mistrust and social chaos further exacerbated revenue collection.
- Periods of high inflation led to an erosion of real revenue.
- Government expenditure, as a percentage of GDP, rose to over 20 percent on account that the authorities had attempted to maintain a minimum level of social and public services through subsidies to basic staples and services, and on account of high military expenditures and increased interest payments.

[1] Helbling (1999)

As a result, the newly formed government at the end of 1990 inherited a sizeable amount of budget debt, valued net at around 87 percent of GDP.

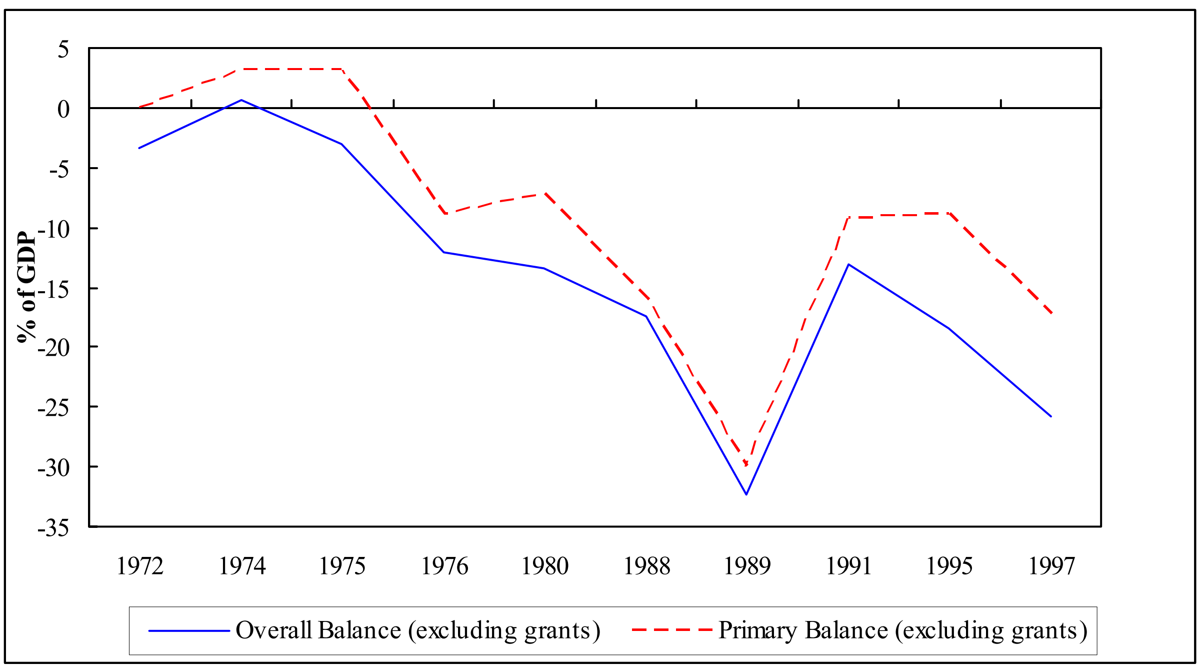
Postwar Stabilization (1991-1992)

4. The fiscal situation in 1991 and 1992 improved considerably for several reasons: revenue recovered as the government of national unity regained control over revenue sources (particularly with respect to customs and non-tax revenues), growth picked up rapidly as a result of economic activity normalization, and expenditures declined due to the elimination of military expenditures and an institution of a hiring freeze. Finally overall fiscal deficit as a percentage of GDP dropped to 13 percent in 1991 and 11 percent in 1992.

Postwar Reconstruction (1993-2001)

5. More generally, the 90's were characterized with large deviations of the actual budget deficits and the actual debt path from targets that had been registered from 1994 onward, leading most to believe that more fiscal adjustments were needed. Previous fiscal adjustments were mainly underpinned by expenditure restraint and increased revenue resulting from economic growth and better tax administration, but were not sufficient.

Figure 1. Lebanon: Primary and Overall Budget Balance,1972-1997



6. Reflecting considerable political and macroeconomic uncertainties immediately after the war, Lebanon initially had only very limited access to either international capital markets

or foreign official financing and had to resort to domestic capital markets to finance its budget deficit. Short-term treasury bills denominated in Lebanese pounds with maturities from 3 to 12 months were the only available instrument initially, with an average maturity of 9-10 months. At the end of 1997, about 7 percent of the outstanding treasury bills were held by nonresident investors.

Paris II and Beyond (2002-Present)

7. The positive outcome of the Paris II donor conference (November 24, 2002) has given Lebanon a "breathing space" in which to address the stock and flow fiscal difficulties that are at the heart of the economic vulnerabilities facing the country. Cash commitments from the conference amounted to $2.9 billion (approximately 10 percent of total government debt back in 2002). Another $1.3 billion was committed for project financing. These long term concessionary loans (about 15 years) have a grace period of 5 years and carry an average annual interest rates of around 3-6 percent range.

8. This presented the government with the opportunity to retire some of the higher yield Lebanese pounds T-bills, and also some dollar-denominated Eurobonds as this may reduce the market's probability of a devaluation or even default.

9. Owing to a sizeable reduction of interest charges and a projected increase in the primary balance, the overall government balance could decline from 14.6 percent of GDP in 2003 to about 8 percent of GDP in 2004, according to recent IMF trends and projections[2]. This should in principle bring back the overall debt-to-GDP ratio back to 2002 levels at 178 percent of GDP. The immediate impacts of Paris II also included a decline in the interest bill (by 5.5 percentage points of GDP in 2004) due to refinancing at lower global interest rates.

B. Motivation and Methodology

10. Recent data suggests that there are tentative signs of a certain reversal in direction of the overall debt-to-GDP ratio in Lebanon. The most recent IMF projections[3] notes that lower financing costs and higher revenue and spending restraint have improved debt dynamics. However, in the absence of additional fiscal adjustment, and in an environment of rising interest rates, debt dynamics would again become unstable in the medium-to-long term.

11. Progress with many of the fiscal measures the government agreed to undertake in the context of Paris II has been poor, partly as a result of political bickering and the easing of the immediate pressure on the budget, sapping the reform programme of its urgency. Recent political developments (the *de facto* sacking of Prime Minister Hariri after a bitter power struggle with President Lahoud and the passing of a critical resolution at the UN Security

[2] IMF (September 2004)

[3] IMF (August 2004)

Council condemning the handling of the issue) only add to the uncertainty that the reform train will pick up steam anytime soon[4].

12. IMF previous medium-term projections[5] of debt-to-GDP ratios for Lebanon in the Article IV context have been systematically over-optimistic and off-target. Projections done in 1994, 1996, 1997, 1999, and 2001 projected a conversion point in the debt-to-GDP curve within 2 to 3 years of the projection date. None of these conversion points materialized. **The aim of this paper is to offer an alternative medium-term projection of the debt ratio**, while trying to refine the judgment on variables and assumptions that enter into the projection. More specifically, more emphasis will be given to political and social factors that often through Lebanon's history hindered or dwarfed any reform momentum. Consistent with a Debt Sustainability Analysis framework, a set of assumptions on public debt, primary balance, revenue and expenditure structure and trend, gross financing, and interest rate and growth dynamics will be formulated. The analysis will be complemented with a look at a reduced set of vulnerability indicators for public sector debt sustainability.

[4] Economist Intelligence Unit (November 2004)

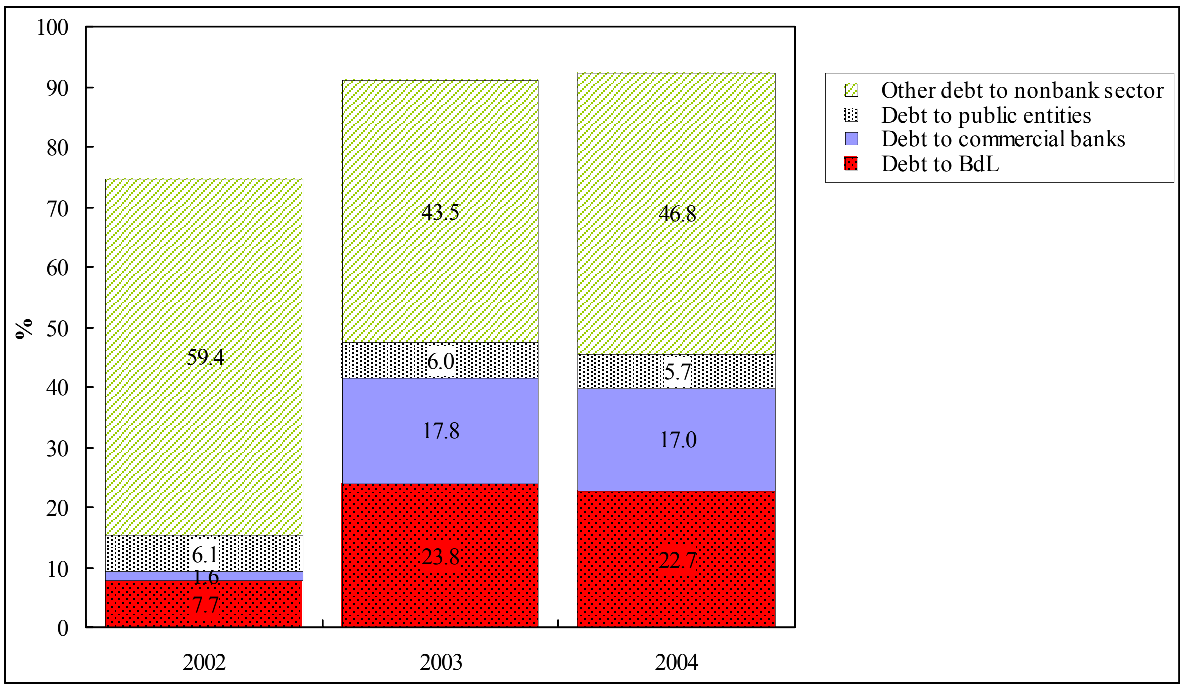
[5] IMF (May 2002)

II. Anatomy of Lebanon's Public Debt

A. Description

13. Lebanon's gross debt stands today at close to 35 billion U.S. dollars, or 178 percent of preliminary 2004 GDP, according to the latest figures from the IMF Art IV mission (See Table 2 in Appendix). It is down from 185 percent of GDP in 2003, although the 2004 figures are only preliminary. It is 55 percent domestic currency dominated, and is mostly short term financed by , first, the non-bank sector (including individuals) at 47 percent share, second, by the BdL at 23 percent share, and third, by the commercial banks at 17 percent share.

Figure 2. Lebanon: Composition of Debt, 2002-2004



14. A closer look at the fiscal environment in Lebanon reveals the following main points about the composition of government revenues and expenditures (See Tables 3 and 4):

- **A growing reliance on direct taxes**: the recent successful introduction of a new VAT tax on goods has seen a gradual shift towards reliance on direct taxes and less reliance on indirect taxes like customs duties, which used to constitute the bulk of government receipts in previous years, especially during the war. This in term gives the government more fiscal flexibility in terms of direct control over tax receipts, with an general increase in tax elasticity.

- **A momentarily shrinking interest bill**: interest payments to GDP has been declining since 2003 after the government successfully refinanced with lower rates part of its outstanding Eurobonds through a swap in August 2004 (and also directly related to the after-effects of Paris II in 2002). The interest bill fell from 18.2 percent of GDP in 2003 to a preliminary 12.7 percent of GDP in 2004. This again provides more fiscal flexibility for the short term, although it is not clear if this trend will continue in the longer term as world rates rise and refinancing occurs at higher costs (see Section III for a more detailed analysis of assumptions for a medium-term debt sustainability analysis).

- **A high level of nondiscretionary spending**: A principal source of vulnerability is a high proportion of nondiscretionary spending to total spending, which limits a government's flexibility to adjust spending levels downward when it is necessary to do so. Current primary expenditures stand at 16.8 percent of GDP, or 85 percent of primary expenditures, including a sizeable 1.7 percent of GDP in forms of transfers to EdL (Electricite du Liban, the state power company) and NSSF (the social security fund).

15. In terms of trends in fiscal balances, we notice a positive trend movement for the primary balance-to-GDP ratio, which stands currently at 4.2 percent of GDP, up from 2.9 percent of GDP in 2002, and up from -17.2 percent of GDP in 1997. The question remains whether the recent primary surplus registered is debt-stabilizing if maintained in the future. However, overall debt balance have remained in chronic deficit, albeit in an improving trend consistent with the improvement in primary deficit trends (overall debt balance stands at -8.2 percent of GDP, down from -15.1 percent of GDP in 2002).

16. Overall, budgetary performance in 2004 has been much stronger than expected, due largely to solid revenue growth. VAT receipts have been particularly buoyant, but revenue performance has been strong across the board. Non-interest budgetary expenditure has been contained effectively.

B. Sources of Fiscal Vulnerability

17. Fiscal risk analysis is an attempt to gauge the sensitivity of fiscal outcomes to variations in key underlying assumptions and other factors[6]. It is also conceivable that a situation where government debt may not continue to be promptly or fully serviced, despite the Lebanese government's best intentions (and their unblemished payment record), as the result of a form of self-fulfilling expectations. This is related to the *"second generation type"* model of speculative attack, where it is the speculative pressure itself that pushes the government to default. The following however is an identification of the major short term and longer term more likely sources of fiscal vulnerability for Lebanon.

[6] Hemming and Petrie (2000)

The Political Environment

18. The stability, predictability, and transparency of a country's political institutions are important considerations in analyzing the parameters of economic policymaking, including how quickly fiscal policy errors are identified and corrected. National security is a concern when military threats place significant burdens on fiscal policy, reduce the flow of potential investment and puts the balance of payments under stress[7].

19. Political risk is of special importance to Lebanon due to its rich history of political unrest, civil and regional wars, geostrategic position, and paralyzed internal political structure. Quantifying political instability is tricky, and is not the object of this paper. However, it is useful to identify four variables[8] that help quantify political instability in Lebanon specifically. They are:

- Political polarization, or the effective number of parties. Bussiere and Mulder (1999) argue that needed reforms are delayed because parties cannot agree on the cost of the reform, and not on the necessity of reform.

- Political cohesion of the government, where government effectiveness is hampered by having to cooperate with coalition partners.

- Electoral indecision, also known as the volatility index, and is defined as uncertainty about the political process (usually elections or approving the budget) and its outcomes. Agents cannot make predictions about fundamentals like inflation targets, commitment to the exchange regime, and the budget deficit if the result of the political process in question is a major unknown.

- Election dates, as periods of elections appear to carry increased amounts of vulnerability or uncertainty.

This said, simply assuming that governments will always take the right measures to reduce economic vulnerabilities misses an important point: governments are sometimes unable to implement reforms because they face political constraints.

20. In Lebanon's case, these constraints are often more binding than they seem and are always present in the background: Lebanon's complex social and ethnic structure, a structure based more on sectarianism and clan mentality and allegiance than nationalism, is well mirrored in parliament and high levels of government. Every political decision has to be carefully considered so as to satisfy a complex set of constraints. Later in Section III, it will be emphasized that no major fiscal reforms can effectively be undertaken before the planned

---

[7] Standards and Poors (April 2002)

[8] Bussiere and Mulder (April 1999)

2005 general elections: The recent *de facto* sacking of Prime Minister Hariri (widely viewed as pro-markets and pro-reforms) and his team of ministers (including the minister of Finance) cast shadows of doubt on whether the new government headed by Mr. Karameh (an old-guard political and social consensus figure) can effectively undertake any significant changes, including most importantly the Paris II privatization commitments.

The Initial Fiscal Position

21. The initial fiscal position and the short-term forecast is sensitive to changes in macroeconomic variables like GDP growth, unemployment, inflation, interest rates, external trade, capital flows, the exchange rate, and other variables affecting revenue, expenditure, and financing. Lebanon's initial fiscal position (today) is plagued by vulnerabilities as described in Section II.A, including a growing reliance on direct taxes, a high level of nondiscretionary spending, a large albeit shrinking interest bill, and generally little fiscal flexibility. For assumptions on key macroeconomic variables in the medium term, see Table 5. Specifically, there is evidence suspicion that in periods of higher interest rates, and in the absence of further fiscal adjustments, the current trend of debt dynamics may well be unsustainable.

Contingent Liabilities

22. Experience in recent crises suggests that contingent liabilities are often an important source of increases in public indebtness[9]. Explicit liabilities include state guarantee for non-sovereign borrowing, trade and exchange rate guarantees, and State insurance schemes, while implicit guarantees include financial system bailouts, and clean up of liabilities of entities being privatized, to name a few.

23. Relevant contingent liabilities for Lebanon include transfers to EdL and NSSF, an implicit commitment to the fixed exchange rate, and liability cleanup of SOEs proposed for privatization. Also, even though the financial system in Lebanon is reasonably sound, liquid and capitalized, one cannot exclude the possibility of a financial system bailout in case a banking crisis ensues.

Structural Weaknesses

24. The institutional capacity for fiscal management is a major determinant of fiscal vulnerability in Lebanon: most notably among the institutional aspects are the government roles and responsibilities (public sector size), the public availability of information, the budget process, and the integrity of fiscal information. The IMF consistently qualifies the national accounts data system of Lebanon as being "inadequate in depth and coverage and unsuitable for any policy analysis framework".

[9] In Indonesia, for example, public debt rose by more than 50 percent of GDP in the aftermath of the crisis, much of which reflected issuance of new debt to finance the recapitalization of banks by the central bank.

25. Finally, a government that has a general reputation for being ineffective, opaque, and corrupt will usually be vulnerable. Lebanon has shown over the years, with varying degrees, symptoms of nontransparency and corruption.

III. Assumptions and Medium-term Projection

A. Key Macroeconomic Assumptions

Growth

26. The economy is estimated to grow at 4 percent in 2005 and 2006[10] in real terms, and around 3.5 percent from 2007 to 2009. Growth will mainly driven by external demand for Lebanese services (tourism), and internal buoyancy in the construction sector. Furthermore, government difficulty in curbing non-debt spending is also fuelling growth, keeping government consumption (Cg) high.

Inflation

27. The expected pickup in demand is likely to cause a similar moderate rise in inflationary pressure over the forecast period. Furthermore, sustained pressure is expected from the fact that the U.S. dollar, and hence the Lebanese pound, remains weak against the Euro, adding to final prices of certain imported goods and services. The economy is operating well within its capacity however.

Exchange and Interest Rates

28. For most countries, there is little reason to presume that a move to a more flexible exchange rate regime would consistently lower real interest rates: real rates might be lower in some periods than they would be if they were tied to rates in an anchor country, and higher in others. This flexibility is valuable because, under a flexible regime the authorities can presumably choose to vary the real rate to suit the situation of the domestic economy. (Nominal rates might even be higher if inflation credibility is lower under a flexible regime.) However, for Lebanon, real rates might be secularly lower under a flexible exchange rate regime: a flexible regime may increase the chance of sustained or very high inflation, of which Lebanon has had experience, but by the same token it reduces the chances of a default, which might be even more harmful to real output and loan quality. Hence, on balance risk premia might be lowered.

29. It is unlikely however, for mostly political and credibility reasons, that the government will abandon the peg to the dollar in the forecast period.

[10] Economist Intelligence Unit (November 2004)

B. Baseline Scenario

30. For the baseline scenario (Table 3), the general assumption is that the government will not undertake any major structural fiscal (or other) reform in the near future. On the revenue side, government plans of increasing the VAT rate, possibly introducing a tax on income, and improving tax collection in general will not materialize during the forecast period. On the expenditure side, expenditure discipline is expected to loosen up starting 2005 through increased capital expenditure outlays earmarked for long overdue reconstruction and infrastructure upgrading. Furthermore, plans to privatize EdL will fall flat and transfers to offset EdL losses will continue and pickup pace moderately. Transfers to the NSSF will also pickup pace in 2005 and continue. Most other items will grow with inflation.

C. Adjustment Scenario

31. For the adjustment scenario (Table 4), the main assumption is that the government will have to undertake a comprehensive program of fiscal restructuring aimed at improving expenditure discipline and increasing revenue in the long-term. On the revenue side, the VAT rate will increase by 30 percent relative to the present rate (VAT rate moves from 10 to 13 percent), EdL will be privatized in 2007 and "other nontax revenue" will adjust accordingly from 2008 onwards. The idea of income tax introduction will remain however just an idea as it is socially and politically very unpopular. On the expenditure side, capital spending will be capped, transfers to EdL will phase out starting 2007, and a restructuring program for the NSSF to protect the government from contingent liabilities will temporarily increase transfers in 2005 and 2006, but will phase out these transfers starting 2007. For both scenarios, wages and salaries will only grow with inflation.

D. Projection Results

Figure 3. Projection Results: Primary Balance (percent of GDP)

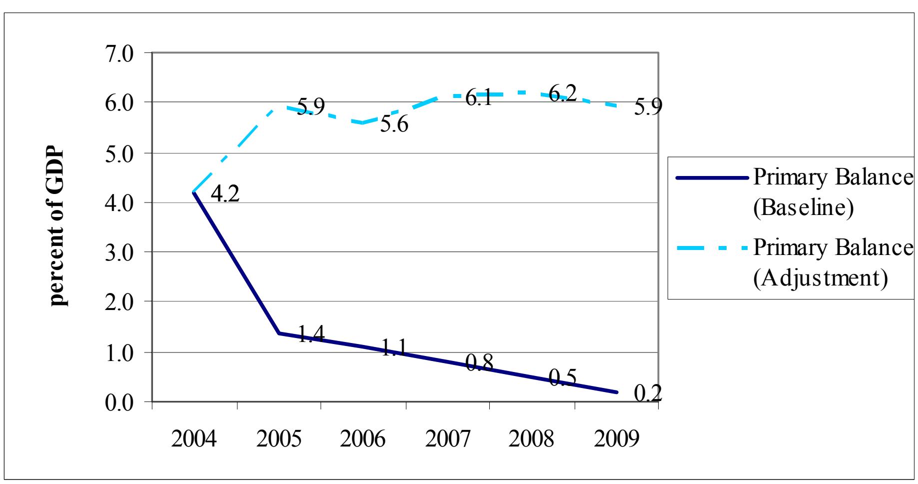


Figure 4. Projection Results: Overall Balance (percent of GDP)

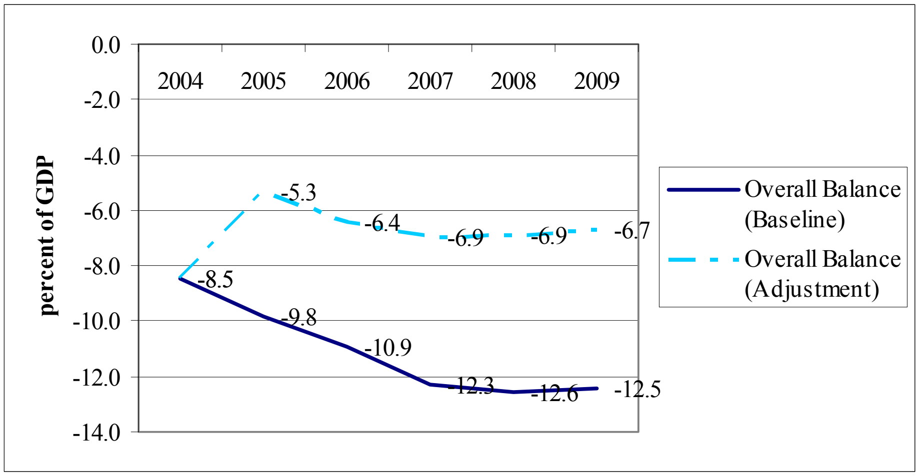
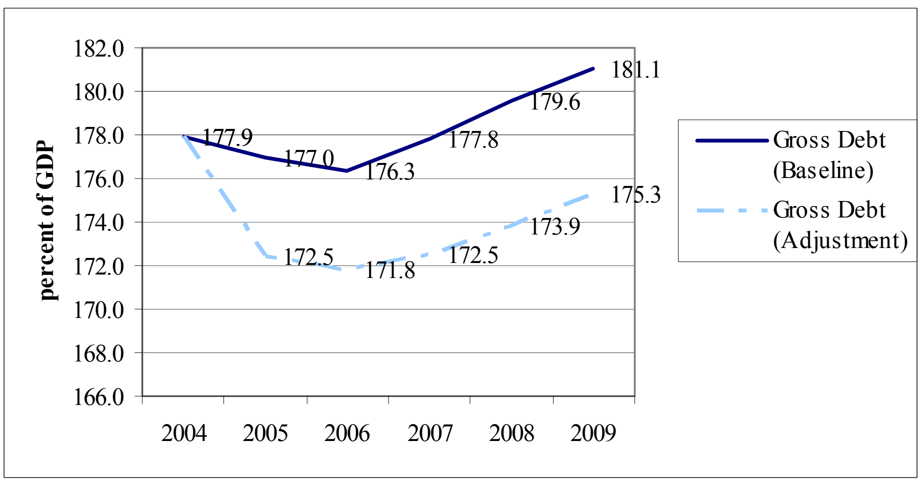


Figure 5. Projection Results: Gross Debt Stock (percent of GDP)



IV. Conclusion

32. The authorities have been adamant, at Paris II and other occasions, that they view any eventual breach of contract (default) as disastrous, and would rather follow any other strategy. The only debt instruments, the conditions on which the authorities will never have to breach, are those denominated in Lebanese pounds, because the authorities can always create Lebanese pound liquidity. Put another way, the authorities seem to truly prefer hyperinflation to default. This said, the results of the projection suggests that, for both scenarios really, the debt dynamics will return to a seemingly unsustainable path starting 2007, after a brief period of stabilization (Figures 3, 4, and 5 above). **The Baseline Scenario would require a 2.5 percent of GDP debt-stabilizing primary surplus, and the**

Adjustment Scenario requires an even bigger debt-stabilizing primary surplus (around 6.2 percent of GDP) over the forecast period.

33. However, given that the threat of an involuntary government debt restructuring and an ensuing banking crisis has certainly not completely disappeared—there is still a lot of uncertainty surrounding the outcome of the government's additional fiscal efforts and the size of the proposed privatization receipts—the authorities should also use this time to develop further contingency plans to mitigate the impact of a possible involuntary government debt restructuring, in particular on the banking system.

34. The positive outcome of the Paris II conference (November 24, 2002) has given the Lebanese authorities some "breathing space" in which to address the stock and flow fiscal difficulties that are at the heart of the country's economic vulnerabilities. This author believes that Paris II was indeed a missed opportunity, and that the urgency that preceded Paris II is emerging again today: Lebanon seems to have gone full circle since 2001.

Table 1. Government Operations pre-1998

	Selected Prewar Years		Selected War Years					Postwar Years		
	1972	1974	1975	1976	1980	1988	1989	1991	1995	1997
	(in percent of GDP)									
Revenue	12.1	15.6	10.7	3.7	13.7	1.8	6.8	15.9	16.8	16.4
Tax Revenue	8.0	11.5	7.5	2.0	9.5	0.6	1.4	5.4	11.1	12.6
Indirect Taxes	5.6	8.9	6.4	1.9	7.0	0.1	0.3	3.2	9.5	10.7
of which custom duties	2.4	2.6	1.1	0.2	2.4	0.5	1.1	2.4	7.3	7.5
Direct taxes	2.4	2.6	1.1	0.2	2.4	0.5	1.1	2.2	1.6	2.0
Nontax revenue	4.1	4.1	3.1	1.7	4.3	1.2	5.5	10.5	5.7	3.8
Expenditure	15.4	15.0	13.6	15.7	27.1	19.2	39.1	28.9	35.2	42.2
Current expenditure	12.1	12.4	7.6	12.6	20.9	17.8	36.7	25.1	25.7	33.6
Wages and Salaries	...	...	...	...	8.5	4.5	7.2	9.0	10.4	10.8
Other current	...	...	...	...	10.8	4.5	10.9	10.3	3.8	7.4
Interest payments	...	...	...	...	1.5	5.9	11.3	5.0	10.4	14.8
Domestic	...	...	...	...	1.5	5.8	11.2	4.9	9.7	14.1
Foreign	...	...	...	...	0.1	0.1	0.1	0.0	0.7	0.7
EdL fuel subsidy	...	...	...	...	...	2.9	7.4	0.8	1.2	0.7
Capital expenditure	3.3	2.6	6.1	3.1	6.3	1.4	2.4	3.9	9.4	8.6
Overall Balance (excluding grants)	-3.3	0.6	-3.0	-12.0	-13.4	-17.4	-32.3	-13.1	-18.4	-25.8
Primary Balance (excluding grants)	0.0	3.2	3.1	-8.9	-7.2	-16.0	-29.9	-9.2	-8.9	-17.2

Sources: Ministry of Finance, Banque du Liban, Council for Development and Reconstruction

Table 2. Anatomy of Public Debt

	2002	2003	2004
	(in millions of U.S. dollars)		
Gross debt	30,727	33,382	34,718
Domestic currency	16,784	17,807	18,879
Foreign Currency	13,943	15,575	15,839
Debt to BdL	2,351	7,938	7,874
Domestic Currency	479	5,929	5,896
Foreign Currency	1,872	2,009	1,978
Debt to commercial banks	18,256	14,526	16,265
Domestic Currency	11,417	8,161	8,708
Foreign Currency	6,839	6,365	7,557
Debt to public entities	2,137	1,701	1,660
Other debt to nonbank sector	7,983	9,217	8,919
Domestic Currency	2,751	2,016	2,615
Foreign Currency	5,232	7,201	6,304
	(in percent of GDP)		
Gross debt	177.7	185.0	177.9
Domestic currency	97.1	98.7	96.8
Foreign Currency	80.6	86.3	81.2
	0.0	0.0	0.0
Debt to BdL	13.6	44.0	40.4
Domestic Currency	2.8	32.9	30.2
Foreign Currency	10.8	11.1	10.1
Debt to commercial banks	105.6	80.5	83.4
Domestic Currency	66.0	45.2	44.6
Foreign Currency	39.6	35.3	38.7
Debt to public entities	12.4	9.4	8.5
Other debt to nonbank sector	46.2	51.1	45.7
Domestic Currency	15.9	11.2	13.4
Foreign Currency	30.3	39.9	32.3

Table 3. Fiscal Operations Projection: Baseline Scenario

	Actual		Prel.	Baseline Scenario				
	2002	2003	2004	2005	2006	2007	2008	2009
	(in billion of Lebanese pounds)							
Primary Balance	763	974	1,228	432	371	283	185	75
Revenue	5,828	6,596	7,151	7,437	7,660	7,890	8,127	8,370
Tax Revenue	3,996	4,526	4,938	5,136	5,290	5,448	5,612	5,780
Taxes on income and profit	727	783	912	948	977	1,006	1,036	1,068
Taxes on property	300	321	382	397	409	421	434	447
Taxes on domestic goods and services	1,162	1,560	1,839	1,913	1,970	2,029	2,090	2,153
of which: VAT revenue	1,013	1,386	1,640	1,706	1,757	1,809	1,864	1,920
Taxes on international trade	1,618	1,645	1,533	1,594	1,642	1,691	1,742	1,794
Tariffs	595	475	516	537	553	569	586	604
Excises	1,023	1,170	1,017	1,058	1,089	1,122	1,156	1,190
Other taxes	189	217	272	283	291	300	309	318
Nontax revenue	1,832	2,070	2,213	2,302	2,371	2,442	2,515	2,590
Enterpreneurial and property income	933	1,252	1,374	1,429	1,472	1,516	1,561	1,608
Profit transfer from BdL	20	0	0	0	0	0	0	0
Other	913	1,252	1,374	1,429	1,472	1,516	1,561	1,608
Admin fees and charges	373	383	377	392	404	416	428	441
Other nontax revenue	98	81	83	86	89	92	94	97
fines and forfeits	22	6	6	6	6	7	7	7
other	76	75	77	80	82	85	88	90
Other treasury revenue	428	354	379	394	406	418	431	444
Primary expenditure	5,065	5,622	5,923	7,005	7,289	7,607	7,942	8,295
Current primary expenditure	4,485	4,708	4,947	5,155	5,309	5,469	5,633	5,802
Wages, salaries and pensions	3,008	3,078	3,186	3,262	3,360	3,461	3,565	3,672
Wages and salaries	2,151	2,234	2,300	2,355	2,426	2,499	2,574	2,651
Pension benefits	857	844	886	907	934	963	991	1,021
Transfers to EdL	60	174	206	300	309	318	328	338
Other current	1,417	1,456	1,555	1,592	1,640	1,689	1,740	1,792
of which transfers to NSSF	227	271	300	550	567	583	601	619
Capital expenditure	580	914	976	1,850	1,980	2,138	2,309	2,494
Domestically financed	392	713	775	1,480	1,524	1,570	1,617	1,666
Foreign financed	188	201	201	370	396	428	462	499
Interest bill	4,712	4,942	3,743	3,510	4,020	4,665	4,963	5,112
Overall balance	-3,949	-3,968	-2,515	-3,078	-3,649	-4,382	-4,778	-5,037
GDP nominal	26,076	27,199	29,416	31,299	33,490	35,666	37,985	40,454

Table 4. Fiscal Operations Projection: Adjustment Scenario

	Actual		Prel.	Adjustment Scenario				
	2002	2003	2004	2005	2006	2007	2008	2009
				(in billion of Lebanese pounds)				
Primary Balance	763	974	1,228	1,853	1,869	2,189	2,353	2,404
Revenue	5,828	6,596	7,151	8,008	8,248	8,496	8,906	9,216
Tax Revenue	3,996	4,526	4,938	5,706	5,878	6,054	6,235	6,423
Taxes on income and profit	727	783	912	948	977	1,006	1,036	1,068
Taxes on property	300	321	382	397	409	421	434	447
Taxes on domestic goods and services	1,162	1,560	1,839	2,483	2,558	2,635	2,714	2,795
of which: VAT revenue	1,013	1,386	1,640	2,217	2,284	2,352	2,423	2,496
Taxes on international trade	1,618	1,645	1,533	1,594	1,642	1,691	1,742	1,794
Tariffs	595	475	516	537	553	569	586	604
Excises	1,023	1,170	1,017	1,058	1,089	1,122	1,156	1,190
Other taxes	189	217	272	283	291	300	309	318
Nontax revenue	1,832	2,070	2,213	2,302	2,371	2,442	2,671	2,793
Enterpreneurial and property income	933	1,252	1,374	1,429	1,472	1,516	1,561	1,608
Profit transfer from BdL	20	0	0	0	0	0	0	0
Other	913	1,252	1,374	1,429	1,472	1,516	1,561	1,608
Admin fees and charges	373	383	377	392	404	416	428	441
Other nontax revenue	98	81	83	86	89	92	250	300
fines and forfeits	22	6	6	6	6	7	7	7
other	76	75	77	80	82	85	88	90
Other treasury revenue	428	354	379	394	406	418	431	444
Primary expenditure	5,065	5,622	5,923	6,155	6,379	6,306	6,553	6,812
Current primary expenditure	4,485	4,708	4,947	5,155	5,309	5,150	5,305	5,464
Wages, salaries and pensions	3,008	3,078	3,186	3,262	3,360	3,461	3,565	3,672
Wages and salaries	2,151	2,234	2,300	2,355	2,426	2,499	2,574	2,651
Pension benefits	857	844	886	907	934	963	991	1,021
Transfers to EdL	60	174	206	300	309	0	0	0
Other current	1,417	1,456	1,555	1,592	1,640	1,689	1,740	1,792
of which transfers to NSSF	227	271	300	550	750	50	50	50
Capital expenditure	580	914	976	1000	1,070	1,156	1,248	1,348
Domestically financed	392	713	775	770	824	890	961	1,038
Foreign financed	188	201	201	230	246	266	287	310
Interest bill	4,712	4,942	3,743	3,510	4,020	4,665	4,963	5,112
Overall balance	-3,949	-3,968	-2,515	-1,657	-2,151	-2,476	-2,610	-2,708
GDP nominal	26,076	27,199	29,416	31,299	33,490	35,666	37,985	40,454

Table 5. Key Macroeconomic Assumptions

	Actual						Av.	St.dev.	Baseline and Adjustment Scenarios				
	1999	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009
Real GDP growth (in percent)	1.2	-0.4	-0.6	2.0	2.0	5.0	1.5	2.0	4.0	4.0	3.5	3.5	3.5
Average nominal interest rate on public debt (in percent)	13.0	12.4	11.3	11.0	10.7	7.4	11.0	2.0	8.0	9.0	10.0	11.0	11.0
Average real interest rate (nominal minus deflator, in percent)	13.0	13.0	9.1	9.3	8.4	4.4	9.5	3.2	5.6	6.0	7.0	8.0	8.0
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	0.0	-0.5	2.3	1.8	2.3	3.0	1.5	1.4	2.4	3.0	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	5.0	28.1	-25.6	-2.8	8.5	0.8	2.3	17.4	0.5	4.0	5.0	5.0	5.0

Table 6. Medium-term Projection Summary Results

	Baseline Scenario					
	2004	2005	2006	2007	2008	2009
Real GDP growth (in percent)	5.0	4.0	4.0	3.5	3.5	3.5
Inflation rate (GDP deflator, in percent)	3.0	2.4	3.0	3.0	3.0	3.0
Primary balance (million LP)	1,228	432	371	283	185	75
Primary balance (percent of GDP)	4.2	1.4	1.1	0.8	0.5	0.2
Overall balance (million LP)	-2,515	-3,078	-3,649	-4,382	-4,778	-5,037
Overall balance (percent of GDP)	-8.5	-9.8	-10.9	-12.3	-12.6	-12.5
Gross debt (million LP)	52,320	55,398	59,047	63,428	68,206	73,243
Gross debt (percent of GDP)	177.9	177.0	176.3	177.8	179.6	181.1

	Adjustment Scenario					
	2004	2005	2006	2007	2008	2009
Real GDP growth (in percent)	5.0	4.0	4.0	3.5	3.5	3.5
Inflation rate (GDP deflator, in percent)	3.0	2.4	3.0	3.0	3.0	3.0
Primary balance (million LP)	1,228	1,853	1,869	2,189	2,353	2,404
Primary balance (percent of GDP)	4.2	5.9	5.6	6.1	6.2	5.9
Overall balance (million LP)	-2,515	-1,657	-2,151	-2,476	-2,610	-2,708
Overall balance (percent of GDP)	-8.5	-5.3	-6.4	-6.9	-6.9	-6.7
Gross debt (million LP)	52,320	53,977	57,549	61,522	66,038	70,914
Gross debt (percent of GDP)	177.9	172.5	171.8	172.5	173.9	175.3

References

Bussiere, Mathieu and Christian Mulder, April 1999, "Political Instability and Economic Vulnerability", *IMF Working Paper WP/99/46.*

Chalk, Nigel and Richard Hemming, April 2000, "Assessing Fiscal Sustainability in Theory and Practice", *IMF Working Paper WP/00/81.*

Economist Intelligence Unit, November 2004, "Lebanon Country Report".

Eken, Sena and Thomas Helbling, 1999, "Back to the Future- Postwar Reconstruction and Stabilization in Lebanon", *IMF Occasional Paper 176.*

Hemming, Richard and Murray Petrie, March 2000, " A Framework for Assessing Fiscal Vulnerability", *IMF Working Paper WP/00/52.*

IMF, May 2002, "Assessing Vulnerability", IMF Working Paper.

IMF, August 2004, "Lebanon- Draft Staff Report", Article IV Staff Reports.

Standards and Poors, April 2002, "Sovereign Credit Ratings: A Primer".