

## **PART IV**

# **SUPPORT TO THE FIVE-YEAR FISCAL ADJUSTMENT PROGRAM**

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The government has embarked on a five-year fiscal adjustment program that aims to reduce the fiscal deficit, decrease the debt burden and introduce a tax reform project. The five-year program sets a fiscal deficit target to 4.5% of GDP by 2003, stabilization of debt levels at 96% of GDP by 2003. This will allow for a decrease of real interest rates, which in turn will release substantial resources in our financial system to private sector financing.

To that aim, the government planned a number of reforms and policy measures. In this context, the UNDP project is heavily involved in helping the Ministry of Finance developing and implementing the reforms discussed in this section.

<b>Fiscal Reform</b>	Fiscal reform through a Wide-scale modernisation of the tax system that comprises the introduction of the VAT, the implementation of a general income tax and the reform of tax administration.
<b>Privatization Programme</b>	Privatization program and the increase in private sector participation in infrastructure development.
<b>Public Debt Management</b>	Improvement of the public debt management system, by developing a debt management strategy, modernizing the debt market and creating institutional mechanism for a modern debt management system.
<b>Expenditure Rationalization</b>	Rationalization expenditures management that entails fixing the ceiling on the level of expenditures and the reduction of current expenditures.

## IV.1. TAX REFORM AND MODERNIZATION

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### 1. Introduction of a VAT in 2001

It is currently under preparation at the MOF. The introduction of the VAT will result in the sharpest increase in overall tax revenues (by 2.9% of GDP) in 2001. A VAT unit was created at the Revenue Department and has been in operation since July 1999. The objective of establishing the unit is to follow up on the stages relating to the introduction of the VAT in January 2001.

The UNDP project has been involved in the preparations for the VAT in various respects, mainly:

- Participated in the formulation of the strategy for the implementation of the VAT.
- The project worked directly with the European Union on the preparations for a technical assistance project for the VAT. This effort incorporated the preparation of the project document, the formulation of the terms of reference and the creation of the VAT unit, which encompassed the recruiting of expert and technical assistants for the VAT project.
- The UNDP project also provided technical assistance and consulting support until early 2000 for the various stages of the VAT implementation process to guarantee that project components move according to plan. Currently, the unit indirectly participates in the supervision through being part of the VAT committee and providing various support and assistance to the VAT team.
- Some of this support lies on the legal front, which embraces both the preparation of the proposed law and the VAT technical document.
- On the economic front, the project helped the administration to prepare the theoretical and empirical studies discussing the impact of the VAT on the different sectors, the accounting procedures and standards for structuring tax collection and the threshold that will best fit the Lebanese economy.
- Within the scope of the VAT, the unit has also participated in discussions on tariff reform with the IMF and the EU.
- The project also helped by coordinating with international experts and organizing meetings with local representatives from the private sector.

The VAT project's five phases are the following: the preparatory phase, legislative phase, pre-administration phase, installation of the administrative unit, and finally the implementation phase.

## **2. Income and property tax reforms**

These reforms have started in the context of Budget 1999. Their main purpose is to increase equity and fairness in income distribution. In this context, the project is conducting the necessary studies along with international assistance in order to reform:

- The income tax system by installing the Global Income Tax. This reform is intended to replace the current existing system of schedular income taxes.
- The project is also assisting the MOF in the reform of the tax administration through the support provided to the Domestic Taxation Reform Project (DTR), which has been in operation at the Revenue Department since July 1996. The objective of the project is to re-haul the tax administration. Assistance is provided by REFM to insure that project components are moving in a timely fashion and through its contribution to the continuous training of existing staff. The DTR Project components consist of: Reengineering the various tax programs, updating systems and procedures, writing procedural guides, software development, and setting-up special audit units.

## IV.2. PRIVATIZATION

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According to the 5-year fiscal adjustment plan, privatization will be used to retire public debt and decrease expenditures. Needless to say, privatization's relative impact on the progress of the fiscal adjustment is very important. In this context, the project provides support to the MOF on the various issues related to the privatization process. Specifically, the unit advises the MOF on the following:

- Privatization regulatory framework: The unit has participated in the drafting of the framework law on privatization, which was approved by the Council of Ministers in May 1999 and ratified by Parliament in May 2000.
- Water and telecommunications laws: The unit has reviewed the water law, prior to its ratification in Parliament in May 2000, and the telecommunications draft law.
- Privatization master plan: The unit has participated in the inter-ministerial committee in developing a master plan for privatization.
- Privatization of MEA: The unit has supported the Ministry in the Government's negotiation with the International Finance Corporation. In particular, the unit has helped formulate and sign an advisory agreement to assess the alternative paths available for a successful divestment of Middle East Airlines.
- Information dissemination: The unit provides regular update to investment banks and consulting firms that are interested in the latest developments on privatization in Lebanon.

### IV.3. DEBT MANAGEMENT

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The reform of the debt management system has been integrated in the five-year fiscal adjustment program as one of its main pillars. Its objective consists of reducing the debt burden through actively managing government debt. In this context, the UNDP project has helped the Ministry of Finance in developing and implementing the reform of the existing debt management system towards a more efficient structure designed to control the debt dynamic and therefore help reduce the budget deficit.

The project contributed to this effort through the following:

1. Developing a vision for a debt management reform through setting the objective and strategy of the reform and introducing the required adjustment to the existing institutional framework for debt management (creating a debt management unit composed of a back office, middle office, and cash management unit).
2. Managing the foreign borrowing strategy on the international capital markets through ensuring better use of official loans, extending the maturity profile of the debt, and diversifying the investor base and currencies.
3. Participating in designing of the reform of the local debt market through streamlining the issuing strategy and creating benchmarks, developing the secondary market, improving and modernizing the market infrastructure, and adjusting the regulatory framework.
4. Coordinating between the various technical assistance missions for debt management (World Bank, IMF, and French Government) and negotiating a loan with the Arab Monetary Fund.
5. Following-up on debt service payments: The UNDP project is helping the MOF in the follow-up on the debt service payments for loans administered by the Ministry of Finance, especially Eurobond payments.

6. Reporting of external debt: The project is involved in the reporting and analysis of the external debt figures that are generated by the UNCTAD debt management system, DMFAS. In addition, the project is also coordinating between the Council for Development and Reconstruction, Banque du Liban, and the Ministry of Finance regarding the maintenance, control, data entry and backup of the DMFAS system. Moreover, the project has been coordinating with the technical team of the Central Bank the installation of the network version of DMFAS 5.2 at the Ministry of Finance. The support also entailed training of Debt Department staff on the new DMFAS with the coordination of the Central Bank. The UNDP team is now working in conjunction with the IT department at the MOF and the BDL, to ensure the installation of the latest version of DMFAS. DMFAS 5.2. is designed to meet the reporting needs and solve some inconveniencies prevailing in the existing system.

#### IV.4. EXPENDITURE RATIONALIZATION

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This is to be achieved by curbing current expenditures and interest payments. The UNDP project is involved in various activities related to expenditure management, among which are:

- Establishing key adjustment factors on the expenditure side and helping the MOF to reduce debt-servicing costs. This is achieved through the issuance of external debt and the privatization program that will also have an impact on current expenditures.
- The project is also involved in analyzing and monitoring expenditures. It informs and advises the minister on the measures needed to achieve the goals of the five-year fiscal adjustment program.
- Participated in preparing a matrix for expenditure management and rationalization with World Bank experts, which was part of the preparatory work for the fiscal reform loan.
- Working through the 20-20 initiative project to rationalize expenditures on the social sector.
- Participated in various other issues related to budget execution and preparation in order to improve the control of expenditures.

To achieve long-term fiscal sustainability and reposition the government in the economy, the following points are set as priorities:

- Put a ceiling on overall public expenditure
- Reduce share of current expenditures
- Rationalize investment spending
- Focus on social and regional development programs
- Improve the administrative efficiency in managing expenditure