# 2024 DRAFT BUDGET OVERVIEW

# PIECEMEAL APPROACHES & REGRESSIVE TAX STRUCTURES INSTEAD OF REAL REFORM


NOVEMBER 2023

KULLUNAIRADA

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The 2024 budget was sent to Parliament on September 28, two weeks after its adoption on September 12 by the Council of Ministers. Changes were made in the meantime without formal approval from the executive. These changes notably include provisions from the 2023 draft budget law that the Finance and Budget Committee refused to review. Therefore, the draft law sent to Parliament does not comply with constitutional requirements (Article 65) since the final version was not approved by two-thirds of the CoM[1].

**The submission of the draft before the beginning of October implies that the budget may be adopted by decree if Parliament fails to examine it within the specified time frame** (article 86 of the constitution). In fact, the interim government intends to proceed as such, given that revenue provisions are crucial for financing expenditures, estimated at 3.3 billion dollars at the rate of LBP 89,000 per dollar.

The budget omits the settlement law for the 2022 fiscal year, as required by Article 87 of the constitution. Beyond the obligation reiterated by the Constitutional Council, the importance of the settlement law lies in the necessity for MPs to be able to refer to the actual execution of the budget in order to control its implementation and accurately evaluate the projections included in the 2024 budget law. Of course, Lebanon will end the current year, 2023, without any budget at all.

The 2024 draft budget includes a serious new violation: granting the executive branch the power to modify taxes by decree. Article 83 and various provisions of the draft law authorize the Minister of Finance to modify tax brackets, deductions, and rates based on inflation, which contradicts Articles 81 and 82 of the constitution that reserve this authority for Parliament.

**In substance, the budget proposes no reforms to address key issues that limit fiscal space, including the urgency to restructure debt, restructure the public sector, reform state owned enterprises, and reconfigure the taxation system. It instead exclusively resorts to piece-meal quick fixes to increase revenues, while perpetuating an extremely regressive fiscal policy.** While the recalibration of taxes is essential, the proposed additional fiscal burden imposed on taxpayers, void of tax reforms, is neither fair nor well-calculated: it disproportionately impacts low and middle-income groups and strangles an already struggling formal economy while no effort is exerted to combat evasion and informality. In addition, the purely accounting approach related to the treasury's need to dollarize its revenues has far-reaching consequences impacting monetary sovereignty. Finally, the disconnect between fiscal and monetary policies results in a budget that mixes different currencies and exchange rates, despite repeated calls and commitments to unify exchange rates. This is chiefly linked to the reluctance to reflect losses as a result of a devaluation on banks' balance sheets, and proceed with a bank restructuring process, which remains a priority four years into the crisis.

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**Note: This document was prepared before the Gaza war and its extension into Lebanon. The impact of the war will inevitably impact fiscal projections.**

[1] This violation could lead to a legal challenge before the Constitutional Council and/or hinder the adoption of the budget by decree.

# 1. LIMITED FUNDING

**The budget aims to be almost balanced.** Deficit has been reduced by nearly 60% compared to version initially adopted by the CoM. The projected deficit is LBP 17,189 billion, approximately USD 193 million[2], and represents ~6% of expenditures, as opposed to the initial version's 14%. This contraction is explained by a slight decrease (-1.8%) in planned expenditures, which now stand at LBP 295,113 billion (approximately USD 3.32 billion) instead of LBP 300,519 billion, and an increase of 7.8% in revenues, reaching LBP 277,924 billion (USD 3.12 billion) instead of LBP 258,785 billion. That being said, the current budget is still a significant increase from the 2022 budget which stood at USD 1.8 billion.

**The deficit is estimated at 1% of GDP, although the proposal does not provide any macroeconomic indicators.** It can be indirectly deduced, notably from comments provided to the IMF in June during the Article IV mission, that the authorities estimate the GDP for 2023 at USD 20 billion. Thus, the budget deficit would be 1% of GDP, down from 2.3% of GDP in its initial version. The MoF has declared to the press that it shall be providing projections by November. However growing informality and potential economic deterioration might affect effective revenue collection adding uncertainty to fiscal funding.

**Fiscal projections do not account for quasi-fiscal operations conducted by the Central Bank until now, which the new interim governor has announced to suspend.** In a June 2023 report, the IMF estimated that while the declared 2022 budget deficit was at 5% of GDP (based on the Ministry of Finance's accounts) it actually stood to 8.5% of GDP when considering quasi-budgetary operations by BDL. Estimates for 2023 are not yet available. However, upon taking office in early August, the interim governor of the Central Bank announced that BDL would no longer finance the budget deficit through monetary creation, as foreign exchange reserves had been depleting at an unsustainable rate of USD 800 million per month. This position theoretically eliminates any possibility of financing public expenditures in 2024 beyond tax collection, as borrowing is impossible since the April 2020 sovereign default in the absence of any public debt restructuring process.

**The current budget draft is a pure accounting exercise based on adjusting expenditures to actual monthly revenue collection levels. May 2023 onwards figures were used to estimate and annual USD 3.12 billion[3].** The main political decision in 2023 was to adjust taxation to the depreciation of the Lebanese pound and inflation to offset the sharp drop in state revenues that occurred the previous year. According to the IMF, fiscal revenues are estimated to have collapsed to 6% of GDP in 2022 (compared to 10% of GDP in 2021 and over 20% before the crisis). The new valuation, effective in May, is bearing fruit, with actual collected revenues totaling around USD 260 million per month, or USD 3.12 billion in annual terms.

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[2] At the exchange rate of LBP 89,000 to the dollar

[3] Projections are based on actual revenues collected since May 2023. A corrected projection integrating the impact of the current war should be expected from the government.

**Based on projected revenues, public expenditure is set at USD 3.3 billion, roughly 20% of the 2019 level (USD 17 billion), significantly reducing fiscal space.** This collapse is even more pronounced than that of the economy, which contracted by 40% between 2019 and 2022. The role of the state is thus greatly diminished at a time of unprecedented crisis when targeted public investment (in infrastructure, social protection, and a reformed administration) is the only way to stimulate essential private sector investment and foster growth.

# 2. ABSENCE OF A REFORMIST VISION

**The budget is very opaque regarding expenditure allocation.** A recurring problem is that budgetary expenditures do not account for all of the state's commitments, including arrears. The exact breakdown of different categories of expenditures is not very clear, as the budget nomenclature does not adhere to modern standards that facilitate understanding. There is also considerable confusion about the accounting of external grants and certain transfers. Some salaries are directly funded by international donors, especially those of the military and part of the education personnel for whom foreign exchange funds are transferred directly by the Central Bank. Likewise, most donor financing is not reported in the budget nor the EDL fuel purchases financing scheme are transparent.

**In addition, there is the oversized allocation to the "budget reserve," a credit item whose allocation is left to the discretion of the executive.** This reserve is endowed with LBP 78,302, roughly USD 880 million, more than a quarter of the entire 2024 budget. In principle, this reserve is intended to finance unexpected or exceptional expenses. However, its disproportionate size in relation to the budget is a sign of an inability to plan public spending, which is the function of the budget. This also contradicts the principle that it is the Parliament's responsibility to authorize public spending in advance, in a detailed manner, and not just post-facto, assuming that the Parliament exercises its oversight. Finally, this opacity opens the door to all sorts of abuses.

**The allocation of public expenditures reflects a complete lack of vision regarding the role of the state, an absence of a strategy to restore debt sustainability, and a lack of fiscal space to finance social protection and investment expenditures.** The bulk of the expenditures are current expenditures (93.3% of the total, of which 5% goes to debt service), with investment expenditures reduced to 6.7%. Current expenditures are mainly allocated to personnel cost (USD 1.7 billion) and purchase of goods and services (USD 522 million).

| | LBP Billion | USD Billion, (rate 89.000) | % of total | Var/initial draft in % |
|---|---|---|---|---|
| Current primary expenditures | 260538 | 2.9 | 88.3 | -3.6 |
| Debt service | 14648 | 0.2 | 5.0 | 0.0 |
| Capital expenditures | 19,877 | 0.2 | 6.7 | 28.0 |
| Total expenditures | 295,113 | 3.3 | 100 | -1.8 |

**The budget includes no projections regarding public debt or any strategy to put public finances on a sustainable path.** There is no mention of public debt in the 2024 budget bill, as if it doesn't exist, even though there remains a line item for debt service of LBP 14,698 billion (approximately USD 165 million, 5% of expenditures). According to IMF estimates, public debt represented 282% of GDP in 2022. The foreign exchange debt has increased from USD 33 billion in 2019 to USD 41 billion as of January 2023, including USD 14 billion in arrears related to unpaid Eurobond principals, coupons, and accrued interests, according to the latest figures published by the Ministry of Finance[4].

**There is no mention from the government, the Ministry of Finance, or in the draft budget about the accounting exercise conducted by former governor Riad Salame, which resulted in an additional debt of USD 48 billion on the Treasury.** In the first quarter of 2023, the former governor decided to account for all the dollar sales operations undergone to the benefit of the Treasury since 2007 as USD 16.5 billion of debt owed by the Lebanese state to the Central Bank. Later in June 2023, the value of the "revaluation" item in BDL assets rose from zero to over USD 42.25 billion. These "assets" represent the BDL losses that the former governor decided to compensate by converting into debt owed by the state in favor of the Central Bank.

## A PURELY ACCOUNTING APPROACH TO PUBLIC WAGES

**Salaries and allowances for public sector employees account for half of the budgetary expenditures.** They have undergone two revisions to adjust for inflation, following an accounting exercise void of any strategy based on these employees' rights, roles and responsibilities, or a broader reform aimed at ensuring continuity of essential public services.

**According to estimates, there is a total of 330,000 employees on the public sector payroll;** this includes 120,000 retirees and 210,000 active employees.

**In total, public sector employees receive the equivalent of seven times their base salary in nominal value.** An additional salary was granted under the 2022 budget (Article 111 of the law dated 11/15/2022), followed by four more in April 2023, based on a decision by the Council of Ministers, which also increased the transportation allowance to LBP 450,000, contingent on 14 days of attendance. However, the real value in dollars remains much lower. For example, someone who was receiving LBP 1.5 million was earning the equivalent of USD 1,000. Today, their base salary is increased to LBP 10.5 million, which is worth USD 118. However, these increases are presented as temporary because they do not actually become part of the salary and do not confer any rights, especially for end-of-service benefits.

**Furthermore, salaries are paid in dollars by the Central Bank as part of a short-term monetary policy aimed at controlling the Lebanese pound exchange rate.** The sustainability of this policy is far from guaranteed. Until the departure of Riad Salameh, the payment was made through the Sayrafa platform, which has been abandoned by his successor Wassim

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[4] http://www.finance.gov.lb/en-us/Finance/PublicDebt/PDTS/Documents/General%20Debt%20Overview%20Updated%20as%2031%20January%202023.pdf

Mansouri. Mansouri now claims that the allocation of dollars to public employees, is entirely financed through the market conversion of taxes collected by the Treasury.

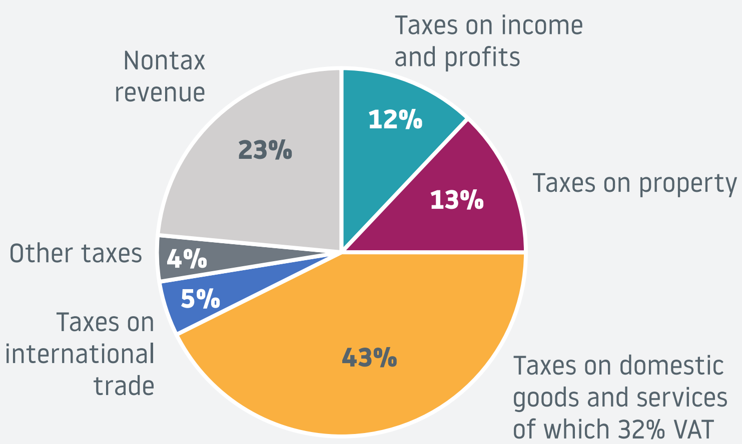
**In any case, the handling of this major expenditure item reflects the lack of consideration for the necessary civil service reform, not in a purely accounting and monetary context, but within the framework of an essential state reform.** This requires an in-depth debate on the functions of the state – security, education, health, justice – in the interest of society as a whole, rather than an approach based on the capture of public resources for clientelistic purposes. It also involves finding sustainable sources of financing as part of a comprehensive budget overhaul, as well as the creation of specific training funds and the reform of the pension system.

# 3. ULTRA-REGRESSIVE FISCAL POLICY

**The draft budget perpetuates an ultra-regressive taxation system, while the dominant cash economy threatens the effectiveness of revenue collection.** There can be no viable economic policy without an increase in taxes. However, tax collection relies on establishing trust between taxpayers, economic agents, and the state – an institutional fiction meant to embody the social contract – mandated to serve the interests of households and businesses.

**The burden of contribution continues to disproportionately fall on the same categories of taxpayers – the poorest and the most law-abiding – while the wealthiest and those operating in the informal sector are spared.** The majority of budget revenue comes from consumption taxes, customs duties, and VAT, mostly collected at the point of entry for goods (50% of the total), as well as fees collected for various formalities or service provisions for which users are captive. For example, administrative fees alone account for 4% of the projected total revenue, compared to 12% for all income taxes combined. Telecom revenues, another indirect tax disguised as public operator tariffs, now represent nearly 9% of expected revenues due to price adjustments.

**DIRECT TAXES CONTRIBUTE TO ONLY A QUARTER OF BUDGET REVENUES**



# 4. KEY ARTICLES THAT RAISE RED FLAGS

**We have raised the following red flags with relevant policy makers; while many have been either cancelled or amended by the Budget and Finance Parliamentary Committee, others have yet to be discussed.**

## ARTICLE 20 – "FAST-TRACKING" PUBLIC SERVICES

Introducing a fee for quick and urgent services in public administrations called "Paid Urgent Services"; paid by those wishing to expedite their transactions or those with urgent matters. The main risk is to legalize bribery and corruption under the guise of "quick service". Instead of reforming public administration under a framework of principles, this new measure undermines institutions, hampers oversight bodies, and prevents accountability. It also breaks the principle of fair treatment between citizens: those who cannot afford to pay fast-track services could be denied access to public services.

**This article was cancelled by the Budget and Finance Parliamentary Committee.**

## ARTICLE 21 - LEGITIMIZING HAIRCUTS

Taxpayers are allowed to settle their taxes for previous periods in foreign currency – namely "lollars" based on 50% of the exchange rate of the US dollar on the BDL platform (previously 40%). This article legalizes the concept of "old accounts"; de facto legitimizing haircuts on deposits in the absence of any bank restructuring framework. This is to the benefit of banks who are reducing their liabilities.

**This article was cancelled by the Budget and Finance Parliamentary Committee.**

## ARTICLE 22 - DOLLARIZATION OF TAXES

Several exceptions are included to the principle of paying taxes in Lebanese pounds. This decision is driven by the Treasury's need of dollars to finance its FX expenditures in an increasingly dollarized economy. However, a full-fledged dollarization of taxes will decrease demand for LBP on the market, mainly driven by the need to pay taxes or EDL fees in local currency, thereby leading to further depreciation, particularly in the absence of a comprehensive new monetary policy.

**This article is pending review by the Budget and Finance Parliamentary Committee.**

## ARTICLE 25 - ARBITRARY CALCULATION OF INCOME TAX ON DOLLARIZED WAGES

Salaries and wages in USD are converted into Lebanese pounds at a discounted rate in accordance with the provisions of Article 35 of Law No. 10 dated 15/11/2022. The tax is then applied according to a revised scale that results in an increase in the tax burden on employees in the formal private sector. The calculated tax is then converted into foreign currency based on the BDL Platform rate. On the one hand this is an arbitrary calculation that does not reflect the real exchange rate. On the other hand, the main issue is the discrepancy between those who earn wages in liras and those who are paid in dollars, in addition to an excessive burden on low and middle-income wage-earners. Taxation policies and exchange rates should be unified.

**This article is pending review by the Budget and Finance Parliamentary Committee.**

## ARTICLE 58 - INCOME TAX ON CAPITAL GAINS ABROAD

An article, reformist in principle, was initially introduced by Minister of Finance Youssef Khalil in the 2023 budget. It was later amended by the government that attempted to introduce a tax amnesty that would have benefitted individuals with fortunes held abroad who have been evading taxes for decades while residing in Lebanon. The revised article was then withdrawn under pressure from civil society – including Kulluna Irada – and the 2024 article reverts back to the initial version, which in itself presents solid starting point. Concrete steps at the Ministry of Finance still need to be taken to ensure the effective implementation of this article, namely the adoption of procedures allowing information exchange with foreign tax administrations.

**This article has been reviewed by the Budget and Finance Parliamentary Committee.**

## ARTICLES 64,65, 69 – POORLY DESIGNED TAX BRACKET RE-EVALUATION

The reevaluation of tax brackets to adjust for inflation results in an increase in the tax burden on certain income groups, which may risk promoting tax evasion (check comment on article 25).
For example, the income tax on salaries, wages, and retirement pensions is as follows:
A 2% tax on net income that does not exceed LBP 70 million (USD 786), up to 25% on the net income subject to tax exceeding LBP 2.44 (USD 27,415).
This means that the tax threshold was lowered to less than USD 790, while it was at USD 4,000 in the 2019 budget. Additionally, the tax rate for the highest bracket (25%) now applies to income equivalent to approximately USD 27,415, whereas it used to apply to income equivalent to USD 150,000.

**These articles, particularly tax brackets, are being reviewed by the Budget and Finance Parliamentary Committee.**

## ARTICLE 111 – LOWERING THE VAT THRESHOLD TO ONE-THIRD OF ITS PREVIOUS LEVEL

The new threshold for VAT liability is set at LBP 2 billion, which corresponds to a monthly turnover of just over USD 2,000. Prior to the crisis it was set at LBP 100 million which was equivalent to USD 5,555 monthly. Lowering it may lead to significant practical problems with the tax administration leading to more tax evasion and nurturing the cash economy. Alternatively, an effective implementation of the law might affect the competitiveness of small and medium-sized enterprises.

**This article had not been examined yet by the Budget and Finance Parliamentary Committee by November 12.**

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