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Thematic Reports

WHEAT AND BREAD SUBSIDIES

2007 – 2011

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Executive Summary

The Government of Lebanon subsidizes both the production of domestic wheat and the consumption of Arabic bread. These two intertwined policies are implemented through the Directorate General of Cereals and Beetroot (DGCB), which is established under the Ministry of Economy and Trade and has received the legal mandate to do so since 1959.

When subsidizing domestic wheat, the DGCB purchases it from Lebanese farmers at guaranteed prices and sells it at international market prices making a loss that is covered by the subsidies allocated in the National Budget for this purpose. Farmers can claim subsidies up to a certain ceiling in tons per donum of cultivated land only in order to prevent abuses.

When subsidizing bread, the DGCB imports wheat at international prices and sells it to the mills at subsidized prices making a loss that is covered from budget transfers. Fluctuations in the price of wheat between the purchasing date and the selling date may, however, allow the DGCB sometimes to make small profits as well.

In practice, however, these subsidies have important implications on the cash management of the Treasury and represent a non negligible burden for the public finances. They have cost LL129 billion to the Treasury between 2007 and 2011 on a net basis and, therefore, the rationale for their existence should be addressed within the scope of a broader framework reviewing all the subsidies provided by the State to the agricultural sector as well as its overall social policy. It should be noted that most of the LL129 billion spent was allocated for bread subsidy, comparatively; the wheat subsidy for farmers had a relatively low cost.

I. Introduction

I.1 Background.

Although Lebanon does not have an officially adopted national subsidy policy, the Lebanese government provides agricultural subsidies to farmers in the form of high producer¹ prices. These subsidies benefit tobacco and wheat producers. Consumption subsidies which benefit the whole population are also available through reduced excise rates on car gasoline or lower prices on electricity, diesel oil and Arabic bread.

The Office of Cereals and Beetroot which was later renamed the Directorate General of Cereals and Beetroot (DGCB) as its activities expanded² was established by Legislative Decree 143 dated June 12, 1959 to encourage the production of cereals and beetroot and to ensure that the quantities produced are sold at subsidized prices. In addition to the development of the agricultural sector, one of its key prerogatives is to preserve the stability of the wheat supply. It is, therefore, allowed to import wheat and sell it at subsidized prices, following the approval of the Council of Ministers (COM).

The DGCB is currently funded through the sale of its stored stock of cereals, budget allocations and treasury advances³. However, the law also stipulates that the DGCB could collect revenues (1) from the imposition of protectionist duties on wheat flour, cereals, raw sugar and refined sugar, (2) by charging service fees, (3) from receiving aid and grants with COM approval and, (4) miscellaneous revenues⁴. Until, 1995 and the publication of the unified customs law, which unified all tariffs under customs, the DGCB used to collect duties on sugar and any product including sugar such as ketchup.

Within its mandate to support the development of the agricultural sector, the DGCB:

- ✓ Provides subsidies for the domestic production of wheat by purchasing the local production from farmers at above market prices and selling it at market prices to flour mills (there are thirteen mills⁵ of which one located in the South is by date of publication inactive) or traders and,

1 The producer's price according to the OECD definition is *"the amount receivable by the producer from the purchaser for a unit of a good or service produced as output minus any VAT, or similar deductible tax, invoiced to the purchaser; it excludes any transport charges invoiced separately by the producer."*

² As per Decree 2896 dated December 12th, 1959 amended by Decree 2896 dated December 28th, 1973..

³ The provision of Treasury advances to the DGCB outside the budgetary framework to engage in operations of wheat purchases to ensure market provision and the subsidy of domestic production is regulated by Legislative Decree 4797 dated June 22nd, 1966.

⁴ Article 11 of Legislative Decree 143 dated June 12, 1959 as amended by Law 20 dated February 25, 1967.

⁵ Source: <http://www.economy.gov.lb/index.php/subCatInfo/1/127>.

- ✓ Can pay upon decision of the Council of Ministers compensation to domestic farmers per donum⁶ of land cultivated.

In a context of volatile commodity prices and based on COM decisions, since 2007 the DGCB has also intervened to subsidize the price of wheat that goes into the production of bread in order to keep the bread price stable. The DGCB did so in 2007 by providing a direct subsidy to the mills, which is an exceptional measure that is taken when the government has to face a sudden crisis in international prices. If there is sufficient time, the DGCB prefers to import wheat through tendering on the international market, procuring at international market prices and selling to the mills at subsidized prices.

I.2 Objective.

This report aims to shed light on the subsidies paid by the Treasury to both wheat farmers and Arabic bread consumers through the payments made to the DGCB. The focus is mainly on the mechanisms of the subsidies and the associated financial flows. The relationships and issues addressed in connection with sector policy (agriculture/wheat) and economic/social policy and national subsidy policy are not addressed here – findings from the analysis could feed into some pertinent recommendations.

I.3 Structure of the Report.

It is important to clarify that this is a public finance report and, therefore, the structure of the report is organized around the type of payments made to the Directorate General of Cereals and Beetroot and their associated reimbursements during 2007-2011 with a brief outlook for possible payments in 2012. In other words, we are interested in wheat and bread subsidy policies to the extent that they imply the transfer of a contribution from the National Budget or the provision of advances from the Treasury which have been or will have to be reimbursed. Part I presents the legal mandate the DGCB and its scope of intervention. In Part II, we discuss treasury advances made to the DGCB for accepting the delivery of the 2007-2011 wheat harvests from Lebanese farmers at subsidized prices. In Part III, we discuss the treasury advances made to the DGCB to import wheat in order to sell to flour producing mills at subsidized prices in 2007-2008 and 2010-2011⁷. Part IV reviews a transfer made from the budget to the DGCB without any explicit allocation of purpose.

⁶ One donum is equivalent to one thousand meters squared of land.

⁷ In 2009, international wheat prices were considered to be “low” enough by the agents in the Lebanese market and therefore the Government did not provide any subsidy. For more information on prices in 2009, please refer to Chart 1. “*Evolution of international FOB Gulf of Mexico wheat prices January 2007-May 2012*” on page 9.

Part V addresses eventual payments that could be expected in 2012. Finally, some conclusions and recommendations are presented in Part VI.

II. Subsidy Payments to Wheat Farmers in 2007-2011

II.1 Historical Background

According to the time series published by the Ministry of Economy and Trade, a total of 554,252 tons of domestically produced wheat were subsidized between 1993 and 2005 or an average of 46,635 tons per year (for more information, see Table 1 in the Annex). The DGCB purchased wheat from farmers at guaranteed prices and sold it to local millers at lower prices. The subsidy was based on the amount of wheat produced that met certain quality criteria. The magnitude of the subsidy per farmer was capped in relation to the size of cultivated area in order to limit subsidies on smuggled wheat from neighbouring countries⁸. Caps were based on in depth expert studies and varied according to regions.

In 2005, the COM decided to phase-out the subsidy provided to wheat (and beetroot) farmers over a period of three years starting 2006. The subsidy was to be reduced by a third each year, and concurrently, the Ministry of Economy and Trade was requested to suggest a mechanism allowing the direct provision of the subsidy to farmers⁹. However, the execution of the decision was suspended for wheat as wheat farmers found themselves unable to sell the 2006 harvest, amounting to 65,389 tons of wheat due to low international prices. The whole harvest had therefore to be subsidized. It was purchased at LL375,000 per ton and sold for LL225,000 per ton for a total cost of LL9.8 billion. The total number of farmers benefitting was 1,302 farmers.

II.2 The 2007 and 2008 Wheat Seasons

In 2007, the international price started to increase and part of the production was sold in domestic and external markets; and, only 8,345 tons of wheat had to be purchased. It was purchased at LL375,000 per ton and sold for an average of LL507,984 for a total profit of LL1.1 billion. The harvest of 2008 required no subsidy as international market prices were high enough, and farmers were able to sell the whole production for that year (a production estimated at 50,000 tons). Therefore, no subsidy payments had to be made by the treasury to the DGCB in 2007 and in 2008. The number of benefitting farmers decreased to 1,069 farmers.

⁸ Subsidy Reform Options, International Monetary Fund, November 2007.

⁹ As per Council of Ministers Decision (COM) 42 dated October 13th, 2005.

II.3 The 2009 Wheat Season

In 2009, the phase-out policy was formally reversed¹⁰ by the COM, which allowed, on exceptional basis for the 2009 wheat season, the purchase of the total production at a subsidized price of LL 475,000 per ton compared to the international market price of LL250,000 per ton. Subsidy was to be provided to farmers based on the surface area cultivated rather than the quantity of wheat produced, i.e. according to the region where they operate wheat farmers were allowed to claim a certain quantity of wheat per donum of land. For example, in Zahle and Western Beqa'a, farmers could claim up to 0.5 ton of wheat per donum, whereas in North Lebanon, farmers could claim up to 0.4 ton per donum. Otherwise, the mechanism might have been open to distortion. Some farmers might have been able to sell to the government at the subsidized price imported wheat under the pretext to have produced it locally but had actually purchased at market price.

This decision was followed by the provision of a treasury advance¹¹ of LL10 billion to the DGCB in order to contribute to the implementation of the subsidy decision for up to 75,000 tons of wheat expected to be produced. However, because of unfavourable conditions, the season only produced 36,688 tons (134,430 donums), which were purchased by the DGCB at LL 475,000 per ton or a total of LL17.4 billion benefitting 688 farmers. The quantity was later resold in the market for a total of LL9.8 billion or LL268,462 per ton.

The actual subsidy amounted to LL7.6 billion or LL208,000 per ton. In 2010, the DGCB reimbursed the Treasury the amount of LL9.8 billion, which it collected from the sale of the wheat¹². The remaining LL0.2 billion of the treasury advance that was not reimbursed represented expenditures associated with the subsidy transactions incurred by the DGCB.

II.4 The 2010 Wheat Season

In 2010, the climate fluctuations (high temperature in the day and extreme cold at night) and the floods and inundations that affected Lebanese farmers, especially in the Beqaa region, led to damages affecting up to 60 percent of the production in some cases. Consequently, the COM allowed the Ministry of Economy and Trade to purchase the 2010 wheat production at a price to be set by the Council of Ministers¹³.

¹⁰ Following the adoption of the COM Decision 102 dated March 26th, 2009.

¹¹ As per Decree 2018 dated May 22nd, 2009.

¹² Reimbursements were made in two payments: LL9.5 billion in July 2010 and LL0.283 billion in October 2010 (Letter of Directorate General of Cereals and Beetroot Number 1596/9 dated October 6th, 2010).

¹³ As per COM decision 50 dated April 27th, 2010.

To prevent abuse of the subsidy, the CoM decided on a hybrid structure, whereby LL375,000 would be paid to farmers per ton of wheat delivered and an extra compensation of LL100,000 per donum of cropped land¹⁴.

It was estimated that the 2010 season would reach 60,000 tons of wheat from a cropped area of 175,000 donums. Therefore, LL40.75 billion would be needed (of which LL0.75 billion for expenses) for the subsidy program, of which LL13 billion were to be covered by the DGCB and LL27.75 billion¹⁵ were to be provided by treasury advance¹⁶. The actual quantity of wheat delivered by farmers to the DGCB was below expectations at 10,890 tons and LL15 billion were withdrawn by the DGCB from the treasury advance to cover for the purchase of wheat and the compensation per donum. The DGCB ended up buying 10,875 tons at a price of LL3.9 billion. The local wheat purchased was sold to the mills at a subsidized price of LL448,000 per ton: 5,849 tons were sold to the mills in March 2011 and another 5,041 tons were sold in April 2011 for LL448,000 per ton in the first 15 days of April and LL404,500 per ton for the second half of the month. In other words, 9900.5 tons were sold at LL448,000 per ton and LL1017.6 at a price of LL404,000 for a total amount of LL4.85 billion. The subsidy (excluding indemnities) turned ,therefore, into a net profit of LL0.9 billion.

If we add the LL 13 billion paid as indemnities for the 129,563.49 donums we reach a total cost of LL12.1 billion

In June 2011, a LL7 billion reimbursement was made to the Treasury and in October 2011 LL0.2 billion was reimbursed. The total cost to the Treasury of the 2010 season subsidy was LL7.8 billion. The policy benefitted a total of 898 farmers.

In summary, the net cost of wheat subsidy on the Treasury has not exceeded 0.01 per cent of GDP as we can see in the table below following i)- the high prices witnessed in 2007 and 2008, which allowed the farmers to sell their produce at market prices, and ii) the bad climatic conditions which severely damaged the harvests in 2009 and 2010. It should be noted that season 2009 was a particular case because part of its cost was funded indirectly through a budget transfer of LL7.5 billion. For more information, please refer to table 6 and its explanatory text on page 19 for more information.

¹⁴ As per COM decision 43 dated July 21st, 2010.

¹⁵ As per COM decision 18 dated September 21st, 2010.

¹⁶ As per Decree 5167 dated October 6th, 2010.

Table 1. A Summary of Wheat Subsidy Cost per Season

| (in LL Billion) | Season 2007 | Season 2008 | Season 2009 | Season 2010 |
|---|-------------|-------------|-------------|-------------|
| Net Cost of the Subsidy to the Treasury 1/ | 0 | 0 | 0.2 | 7.8 |
| Net Cost (in percent of GDP) | 0.00% | 0.00% | 0.00% | 0.01% |
| Net Cost (in percent of primary expenditures) | 0.00% | 0.00% | 0.00% | 0.07% |

Source: DGF, MOF

1/Excluding any budgetary transfers.

III. Subsidy Payments to Cap the Price of Bread 2007-2011

III.1. Historical Background

On December 8th, 1997, the price of bread was set at LL1,500 for 1.5Kg by the Minister of Economy and Trade. This was slightly reduced at LL1,500 per 1.4Kg in February 2nd, 2005, following negotiations between the Minister of Economy and Trade and the syndicates representing the bakeries. On May 17th 2006, the price was set at LL1,500 for 1.3Kg by the Ministry, and by end of 2006, an amicable agreement between the government and the syndicates pushed further down to LL1,500 for 1.170 Kg. A couple of months later, on June 6th 2007, a new Ministerial decision slightly reduced it to LL1,500 for 1.12 Kg.¹⁷

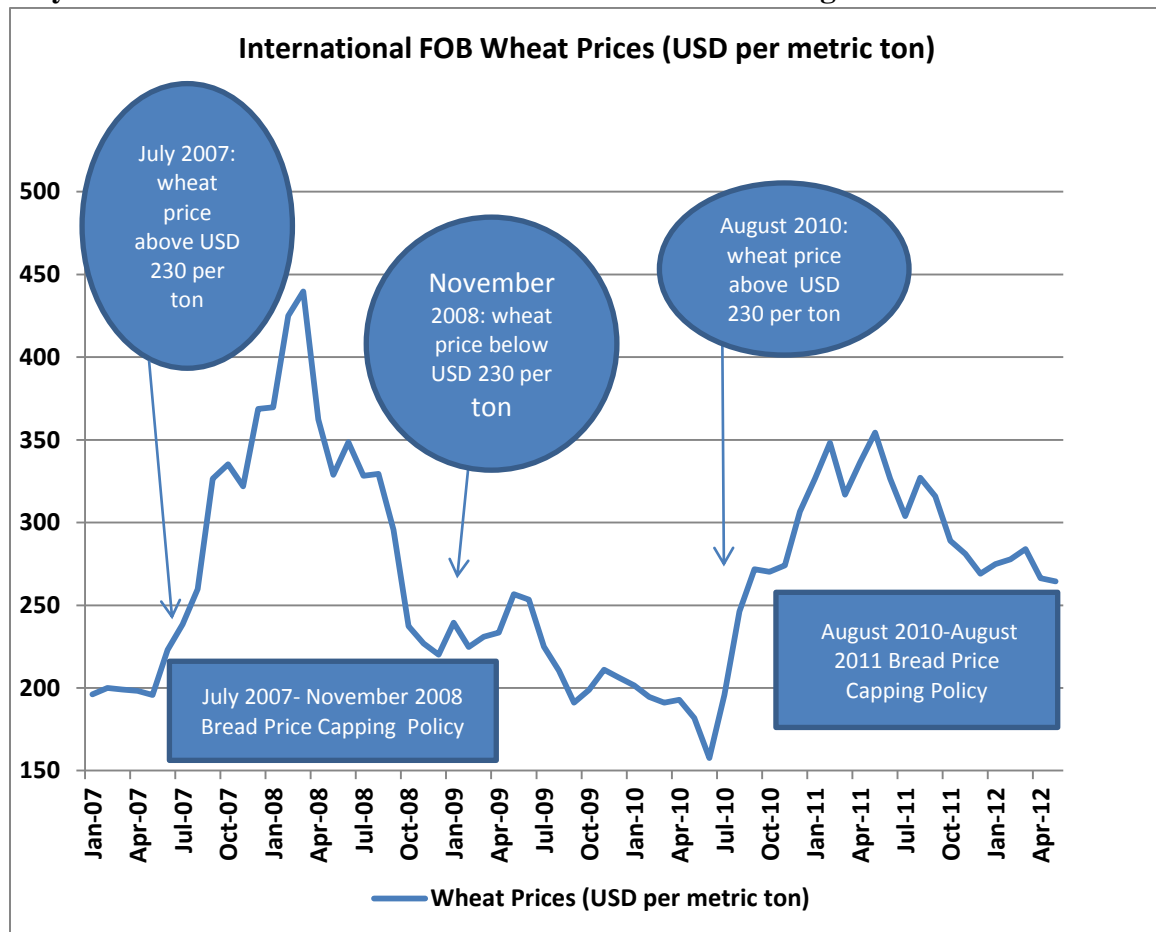
III.2. Bread Price Capping Policy 2007-2008

In a context of increasing prices of wheat and diesel oil in international markets and in order to stabilize the price of bread at LL1,500 per pack (1 pack = 1.12 kg), the Government decided in July 2007 to subsidize wheat. For the price of a pack of bread to remain at LL1,500, the price of flour should not exceed LL480,000 per ton, which required at the time a wheat CIF Beirut price of USD210 per ton¹⁸. However, the price of wheat (CIF Beirut) had reached USD310 per ton in July 2007 and was obviously putting pressure on the price of flour.

¹⁷<http://www.economy.gov.lb/index.php/subCatInfo/1/127>

¹⁸ Following COM Decision 68 dated July 28th, 2007.

Chart 1. Evolution of international FOB Gulf of Mexico wheat prices January 2007-May 2012 vs. Lebanese Government Bread Subsidies Timing



Source: IMF WEO time series,

As illustrated in the graph above whenever since 2007 the wheat price FOB Gulf of Mexico exceeded USD230 per ton (which roughly translates into a CIF Beirut price threshold of USD 300 per ton), pressure started to build on the COM to subsidize the price of wheat for Arabic bread.

The consumer subsidy scheme for bread was based on two components:

- The first component was executed as a temporary solution, until the Ministry of Economy and Trade was able to import wheat. It was based on the provision of treasury advances to the DGCB in order to directly subsidize the price of wheat for the mills until the end of the year 2007. The government first set the subsidy at USD 50 per ton of wheat between August and October 2007 and then increased it to USD 75 per ton of wheat for the November-December 2007 period after CIF price of wheat reached USD 365 per ton at the end of October 2008¹⁹.

¹⁹ As per COM Decision 50 dated November 10th, 2007.

This component was executed through:

- Provision of a treasury advance of LL12.0 billion to cover the cost of subsidizing imported wheat for milling and bread making at USD 50 per ton²⁰,
- Provision of a treasury advance of LL2.3 billion to cover the additional cost of subsidizing imported wheat for milling and bread making²¹,

Under this component, a total of LL 14.3 billion was paid as treasury advance to the DGCB to cover the cost of directly subsidizing the price of wheat for the mills until the end of the year 2007. Of the advance, LL0.7 billion were repaid to the Treasury. Thus, the real cost of the subsidy under this component was LL13.5 billion. Information on the quantity of wheat subsidized under the direct subsidy is not available.

- The second component was based on the provision of treasury advances to the DGCB to purchase imported wheat for milling and Arabic bread making. The imported wheat was to be sold to the mills at a subsidized price. The revenues from the wheat sales plus the unutilized credit from the treasury advances were to be reimbursed to the Treasury after deduction of the operational costs incurred by the DGCB in the subsidy process.

This component was executed through the provision of:

- A treasury advance of LL25.0 billion to purchase a first quantity of 50,000 tons of wheat with a margin of 5 percent²²,
- A treasury advance of LL33.2 billion to purchase a second quantity of 50,000 tons of wheat with a margin of 5 percent²³,
- A treasury advance of LL3.0 billion to cover the price differentials of the purchase of the second quantity of 50,000 tons of wheat²⁴,
- A treasury advance of LL34.0 billion to purchase 50,000 tons of wheat with a margin of 15 percent²⁵, and,
- A treasury advance of LL80.0 billion to purchase 100,000 tons of wheat with a margin of 5 percent²⁶.

²⁰ As per Decree 649 dated August 22nd, 2007.

²¹ As per Decree 926 dated February 7th, 2008.

²² As per Decree 589 dated July 31st, 2007.

²³ As per Decree 749 dated January 3rd, 2008.

²⁴ As per Decree 893 dated February 7th, 2008.

²⁵ As per Decree 832 dated January 18th, 2008.

²⁶ As per Decree 1136 dated March 7th, 2008.

A total of LL 160.8 billion were paid as treasury advances to the DGCB to purchase wheat under this component of the policy. A total of 241,745.95 tons of wheat were imported by the DGCB for LL156.6 billion or an average price of LL647,641 per ton.

The wheat was sold by the DGCB to the mills for a total amount of LL76.9 billion or an average price of LL318,052 per ton. The DGCB repaid to the Treasury a total of LL81.0 billion, of which LL 4.2 billion were the unused portion of the treasury advances provided and LL76.7 billion were collected from the sale of wheat to the mills²⁷. The real cost of the subsidy under this component, therefore, amounted to LL 79.9 billion, which represented an average cost of LL330,334 per ton of wheat.

In conclusion, between August 2007 and September 2008, a total of LL175.1 billion was paid by the Treasury to the DGCB as treasury advances for wheat subsidy and a total of LL81.7 billion was repaid to the Treasury. The difference between what was paid and what was reimbursed in cash was regularized for accounting purposes through ex-post budget allocations²⁸.

The wheat subsidy policy ended on 15 November 2008²⁹.

III.3. Bread Price Capping Policy 2010- 2011

Phase 1. August 2010-March 2011

The floods in Western Europe and the fires and dry climate in the Russian Federation in 2010 led to a decrease in the supply of wheat and an increase in the international price of wheat, to USD 330 per ton (CIF Beirut) in the summer of 2010. Consequently, upward pressure started to raise the price of flour sold by mills to bakeries, which was LL480,000 per ton³⁰ on the basis of wheat (CIF Beirut) at USD 230-240. In order to prevent the pass-through of this increase in the international price to the price of bread (LBP 1,500 per 1.12 Kg.), the DGCB:

²⁷ LL0.2 billion were netted out to cover the expenditures incurred in the importation, storage and selling process.

²⁸ An amount of LL45 billion was included in the 2009 Budget Proposal and LL59 billion in the 2010 Budget Proposal. A first regularization was done in November 2009 for LL45 billion and a second one in January 2011 for LL18 billion.

²⁹ As per COM Decision 71 dated November 8th, 2008.

³⁰ This threshold was officially set as per COM Decision Number 68 dated July 28th, 2007.

- Was authorized to “borrow” wheat from the stocks of the mills for a period of one month³¹ starting August 23, 2010. Effectively, the DGCB requested the mills to sell the ‘borrowed’ wheat to bakeries at the subsidized price of LL 392,000, on the agreement that the wheat ‘borrowed’ would be returned to the mills upon arrival of the wheat imported by the DGCB.³²
- Obtained a treasury advance of LL 60 billion³³ to cover the purchase of 100,000 tons of imported wheat (+-5 percent): (i) to return the quantities borrowed from the flour mills, and (ii) to sell the remaining wheat imported to the flour mills at the CIF Beirut import price i.e. its international price and not a subsidized price set by the Council of Ministers. This indicates that the Government was planning to discontinue the subsidy as soon as possible. By the end of September, in a context of persistent high prices and with no mandate to sell the imported wheat at subsidized prices the Ministry of Economy and Trade reduced the size of the bread pack sold at LL1,500 from 1.12 Kg to 1 Kg³⁴.

Out of the LL 60 billion provided in treasury advances, LL27 billion were paid in 2010 for a total purchase order of 50,000 tons of wheat (+-5 percent). The actual amount imported between August 2010 and December 2010 stood at 51,250 tons for LL 27.3 billion (LL 0.5 billion was to cover the expenses associated with import) or a price of LL 533,617 per ton. Of the total amount imported, 20,864 tons were returned to the mills by the Directorate General of Cereals and Beetroot and the balance was kept as reserve for intervention in case of necessity.,

However, continued increases in the international price of wheat led the Ministry of Economy and Trade to issue decisions to sell the imported wheat at a subsidized price starting February 1, 2011. These decisions were based on exceptional approvals from the Executive Authority, represented by the Presidency of the Republic and the Presidency of the Council of the Ministers, and were to be regularized by the Council of Ministers after the formation of a new Government³⁵.

This led the Ministry of Economy and Trade to make an extra payment of LL 28 billion in QI 2011 for the importation of an additional 48,533 tons of wheat in January-April 2011. Thus,

³¹ It ended on October 18th, 2010.

³² As per COM Decision number 102 dated August 18th, 2010 and COM Decision Number 28 dated September 29th, 2010.

³³ COM Decision number 102 dated August 18th, 2010. Treasury advance was provided as per Decree number 4947 dated September 4th, 2010.

³⁴ Starting September 17th, 2011 and onwards.

³⁵ As per Minister of Economy and Trade Decisions Number 3/H.CH dated February 11th, 2011, Number 5/H.CH dated February 28th 2011, Number 15/H.CH dated April 4th, 2011 . These were finally regularized following the issuance of COM Decision Number 25, dated August 11th, 2011.

the total allocations opened by the DGCB from the treasury advances issued in 2010 amounted to LL 55.4 billion, of which LL54.3 were actually paid to the wheat suppliers. The total quantity imported reached 99,783 tons at an average price of LL 554,168 per ton³⁶.

The wheat imported was resold as follows:

Table 2. Subsidy Price for the sale of Wheat Imported under Decree 4947/2010

| Month | Quantities (in tons) | Gross Revenues from Sales (in LL) | Effective Monthly Average Selling Price (LL per Ton) |
|---------------------|----------------------|-----------------------------------|--|
| Nov-10 | 5,970 | 2,339,287,000 | 391,821 |
| Dec-10 | 11,967 | 4,688,521,000 | 391,801 |
| Jan-11 | 1,931 | 756,606,000 | 391,821 |
| Jan-11 | 1,000 | 588,000,000 | 588,000 |
| Feb-11 | 13,736 | 6,252,412,000 | 455,194 |
| Mar-11 | 19,060 | 8,538,880,000 | 448,000 |
| Apr-11 ¹ | 8,669 | 3,883,712,000 | 448,000 |
| Apr-11 ² | 1,656 | 712,069,000 | 429,993 |
| May-11 | 25,545 | 10,586,410,000 | 414,422 |
| Jun-11 ³ | 9,915 | 4,141,120,000 | 417,662 |
| Total | 99,449 | 42,487,017,000 | 427,226 |

Source: Ministry of Finance Calculations Based on the Supporting Documents Presented by the Directorate General; of Cereals and Beetroot to the Treasury Directorate (Letter 919/9 dated May 5th, 2011.

1/Between April 1st, 2011 and April 15th, 2011

2/Between April 16th, 2011 and April 30th, 2011

3/Between June 1st, 2011 and June 13th, 2011.

In total 99,449 tons were sold for a total gross amount of LL42.4 billion or on average LL427,226 per ton. To obtain the amount to be reimbursed to the Treasury, the refunds made to the mills from the total gross amount have to be netted out. This happened in two steps:

- The revenues from the 53,664 tons of wheat sold between November 2010 and March 2011 amounted to a total of LL23 billion³⁷ net or LL431,651 per ton, which were paid back to the Treasury in May 2011.

³⁶ Letter of the Directorate General of Wheat and Beetroot to the Ministry of Finance Number 919/9 dated May 5th, 2011

³⁷ The gross amount is LL23,163,706,000, of which LL154,808,000 were deducted as refunds to the mills leaving LL23,008,898,000 net. The refund was paid because certain mills being in urgent need of wheat in early February 2011 had purchased it at the price of LL467,500 per ton as per MOET Decision Number 2/H.CH. dated February 2nd, 2011. The price of wheat having been later reduced retroactively to LL448,000

- The remaining 45,785 tons were sold for 19.2 billion³⁸ net or LL422,045 per ton. To this amount was added the LL1.15 billion unused credit line provided by the treasury advance and was deducted the LL.026 billion administrative costs of the subsidy policy, leading to a second reimbursement of LL20.1 billion in September 2011.

The actual cost of the first phase of the subsidy policy under Decree 4947/2010 turned out to be as follows:

Purchase amount + Administrative Expenditures- Net Revenues from Sales =

LL54.3 Billion+ LL0.265 billion-LL42.2billion=LL12.4 billion.

Phase 2. April 2011-December 2011

In April 2011, in a context of continuous high international wheat and diesel oil prices, the DGCB addressed a letter to the Presidency of Council of Ministers requesting a LL70 billion treasury advance to import 100,000 tons (+-5 percent) and to sell it at a subsidized price to mills. Given the emergency of the situation (cereals stock were only sufficient to cover consumption needs till May 2011³⁹), and in the absence of the Council of Ministers (to decide on the extension of the bread price capping policy)⁴⁰, the Presidency of the Council of Ministers issued an exceptional approval⁴¹ providing the DGCB a treasury advance of LL35 billion to import 50,000 tons of wheat (+-5 percent). The treasury advance is to be regularized from the 2012 Budget.

In May 2011, a first payment of LL16 billion was transferred, of which LL15.9 billion were used to import around 26,250 tons of wheat at the price of LBP610,000 per ton⁴², and a second one of LL13.4 billion was made in June to import another 26,250 tons at the price of

starting February 1st, 2011 as per Decision 3/H.CH . It was therefore, decided to pay back the difference to these mills.

³⁸ The gross amount is LL19,323,311,000, of which LL139,743,750 were deducted as refunds to the mills leaving LL19,183,567,250 net. The refund was paid because certain mills purchased their whole April wheat consumption beginning April The price of wheat having been later reduced to LL404,500 starting April 16th, 2011. It was therefore, decided to pay back the difference to these mills.

³⁹ The actual need for the month of May 2011 was estimated at 23,388 tons while the available stock in the country did not exceed 20,014 tons.

⁴⁰ The Government had been in a situation of caretaking since January 13th, 2011.

⁴¹ As per the Presidency of the Council of Minister's Letter 97/A dated April 12th, 2011. This exceptional authorization was later formalized by Decree 6056 dated August 6th, 2011 when the new government was formed based on Decree 5818 dated June 13th, 2011 .

⁴² As per COM Decision 25 dated August 11th, 2011.

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LBP510,000 per ton⁴³. The two operations amounted to a total transfer of LL29.4 billion, of which LL29.3 billion were used for 52,500 tons of wheat or LL560,089 per ton.

Table 3. Subsidy Price of Wheat Imported under Decree 6056/2011

| Month | Quantities (in tons) | Revenues from Sales | |
|---------------------|----------------------|-----------------------|------------------------------|
| | | (in LL) | Effective Price (LL per Ton) |
| Jun-11 ¹ | 8,620 | 3,486,752,000 | 404,500 |
| Jul-11 | 22,969 | 9,296,765,000 | 404,760 |
| Aug-11 ² | 6,081 | 2,459,765,000 | 404,500 |
| Sep-11 | 3,425 | 1,428,914,000 | 417,201 |
| Oct-11 | 3,714 | 1,488,750,000 | 400,848 |
| Nov-11 | 7,038 | 2,784,080,000 | 395,584 |
| Dec-11 | 850 | 333,121,000 | 392,001 |
| Total | 52,696 | 21,278,147,000 | 403,789 |

Source: Ministry of Finance Calculations Based on the Supporting Documents Presented by the Directorate General; of Cereals and Beetroot to the Treasury Directorate (letter 2470/9 dated December 16th 2011).

1/Between June 14th, 2011 and June 30th, 2011.

2/Starting August 1st, 2011, wheat was sold at international prices again.

In total 52,696 tons were sold for a total gross amount of LL21.2 billion or LL403,789 per ton. To obtain the amount to be reimbursed to the Treasury, the refunds made to the mills from the total gross amount have first to be netted out⁴⁴. To the net revenues (LL21.26 billion), the unused credit line (LL0.11 billion) was added and administrative costs (LL0.14 billion) were deducted. The resulting total amount of LL21.23 billion was transferred to the Treasury in December 2011.

The actual cost of the subsidy policy under Decree 5056/2011 was as follows:

Purchase amount + Administrative Expenditures- Net Revenues from Sales =

LL29.2 Billion+ LL0.143 billion-LL21.26billion=LL8.2 billion.

This means that the total costs of bread subsidy in 2010-2011 was LL20.6 billion or LL135,000 per ton.

The bread subsidy policy ended on 1 August 2011⁴⁵.

⁴³ As per COM Decision 25 dated August 11th, 2011.

⁴⁴ The refund to mills was LL10,325,280.

⁴⁵ As per COM Decision 25 dated August 11th, 2011.

Table 4. A Summary of Bread Subsidy Cost per Season

| (in LL Billion) | Season 2007- 2008 | Season 2010-2011 |
|---|-------------------|------------------|
| Net Cost of the Subsidy to the Treasury | 93 | 21 |
| Net Cost (in percent of GDP) | 0.21% | 0.04% |
| Net Cost (in percent of primary expenditures) | 0.91% | 0.19% |

Source: DGF, MOF

The net cost of bread subsidy to the Treasury is summarized in the table above. It cost LL 93 billion or 0.21 percent of GDP in 2007-2008 versus LL21 billion or 0.04 percent in 2010-2011. This decrease is explained by (i) the decline in the quantity of wheat subsidized from 241,745.95 in 2007-2008 to 152,145 tons in 2010-2011, a 89,600.95 or 37 percent decrease and (ii) the decrease in the prices of wheat between July 2007-November 2008 and August 2010-August 2011 by USD 17 dollar per ton from USD 325 per ton to USD 308 dollar per ton.

IV. Other Payments to the Directorate General of Cereals and Beetroot

In addition to the LL 42 billion paid in treasury advances to the DGCB in 2010 as part of the bread price capping and support to wheat farmers policies, the Ministry of Finance also made a transfer to the DGCB of LL 7.5 billion from the 2009 national budget allocation as a general contribution to its annexed budget⁴⁶ to cover its deficit. No such transfers were made in 2007-09 and in 2011.

V. Payment Prospects for 2012

The Council of Ministers decided⁴⁷ in August 2011 to buy, through the DGCB, the wheat and the barley harvested in the 2011 season at a maximum price of LL550,000 per ton of wheat and LL525,000 per ton of barley. The wheat and barley harvests were expected to reach 70,000 tons and 5,000 tons, respectively. Total cost was estimated at LL43.5 billion, of which LL14.5 billion was to be paid through treasury advance, LL19.25 billion through budget transfers, and the remaining from cash available in the accounts of the DGCB at the Central Bank (around LL10 billion). However, the 2011 wheat harvest did not exceed 18,478 tons and 4,2 tons⁴⁸ of barley, which was purchased for LL10.2 billion. Therefore, a treasury advance was not needed and there was no impact on the cash flow of the Ministry

⁴⁶ Ministry of Economy and Trade Ministerial Decision 157/1 dated July 16th, 2009.

⁴⁷ As per COM Decision Number 24 dated August 11th, 2011.

⁴⁸ A surprisingly low figure that was confirmed with the Directorate General of Cereals and Beetroot.

of Finance. The 2011 wheat harvest has not yet been sold by the DGCB and information on prices are not available yet. A total of 940 farmers benefitted from the wheat subsidy policy of 2011.

The Council of Ministers also decided⁴⁹ in March 2012, following an increase in the price of wheat to subsidize the price of bread by (i) selling the local wheat purchased from Lebanese farmers at LL550,000 per ton at the price of LL400,000 per ton – an estimated total cost of LL3 billion, (ii) import 50,000 tons of wheat at LL495,000 per ton and sell it later for LL375,000 per ton. The upfront cash needed for the second operation amounts to LL27 billion, which was approved by the Council of Ministers through a LL27 billion treasury advance⁵⁰. A first payment of LL11.8 billion was made in June 2012 and a second one in July 2012 for LL11.2 billion to import a total of +/- 50,000 tons of wheat. In the same period, the mills claimed that the cost of flour production was increasing as a result of (i) diesel oil prices increase in international markets, (ii) the issuance of the decree increasing the minimum wage in the private sector, as well as (iii) the additional costs due to the rationing of electricity and the need of mills to rely on expensive electricity generating sets. Following negotiations with the mills, the Ministry of Economy and Trade reduced the size of bread to 900 grams per LL1,500⁵¹ starting May 1st, 2012.

VI. Conclusions and Recommendations

Conclusions.

1. Fluctuations of the international wheat price have had important cash flow consequences for the Treasury. When the price is on the downside, the Government subsidizes local production to support wheat farmers and, when it is on the upside, pressures from mills and bakeries mount to subsidize the price of wheat in order to keep the price of bread stable. This policy leads to upfront payments of significant unexpected amounts by the Ministry of Finance through the provision of treasury advances for which financing has to be found.
2. The impact of the subsidy policy on the Treasury should take into account not only the amounts disbursed by treasury advances and the budget allocations, but also the amounts reimbursed by the DGCB following the sale of wheat at subsidized prices.
3. The cash flow between the DGCB and the Treasury was mostly negative since 2007, as shown in the Table 5 below. Depending on the years, the size of the deficit was larger or smaller according to the magnitude of the payments and reimbursements made; in 2011, even a surplus was recorded.

⁴⁹ As per COM Decision Number 54 dated March 7th, 2012.

⁵⁰ As per Decree 8011 dated April 23rd, 2012.

⁵¹ As per Ministerial Decision 56/1/A.T. dated April 25th, 2012.

Table 5. Payments to and Reimbursements from the Directorate General of Cereals and Beetroot

| (LL Billion) | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|------------|------------|-----------|------------|-------------|
| Payments to the Directorate General of Cereals and Beetroot of which: | 32 | 142 | 10 | 50 | 58 |
| <i>Treasury Advances for Local Wheat Production Subsidy</i> | 0 | 0 | 10 | 15 | 0 |
| <i>Treasury Advances for Importation of Wheat and Bread Price Subsidy</i> | 32 | 142 | 0 | 27 | 58 |
| <i>Contribution from the National Budget to the Annexed Budget</i> | 0 | 0 | 0 | 8 | 0 |
| Reimbursements from the Directorate General of Cereals and Beetroot, of which: | 0 | 73 | 9 | 10 | 71.5 |
| <i>Local Wheat Production Subsidy</i> | 0 | 0 | 0 | 10 | 7.2 |
| <i>Importation of Wheat and Bread Price Subsidy</i> | 0 | 73 | 9 | 0 | 64.3 |
| Balance with DGCB | -32 | -69 | -2 | -40 | 13.5 |

Source: DGF, MOF

- The cash flow impact shown above is different from the actual seasonal cost of the policies, which we is summarized in Table 6 below. The bread subsidy policy of 2007-2008 cost the Treasury LL93 billion in terms of net transfers to consumers of Arabic bread. The subsidy policy cost for 2010-2011 did not exceed LL21 billion because 1) international FOB prices peaked at USD350 per ton compared to USD 450 per ton in 2007-2008, and 2) international FOB prices remained above USD200 per ton for a much longer period (approximately 16 months in 2007-2008 versus approximately 12 months in 2010-2011).

Table 6. Actual Cost of Subsidy Policies per Subsidy Period for the Treasury

| (in LL Billion) | 2007-2008 | 2009-2010 | 2010-2011 |
|--|-----------|------------|------------|
| Actual Cost of Bread Subsidy: (1)-(2) | 93 | 0 | 21 |
| (1) Bread Subsidy Policy- Disbursements | 175 | 0 | 85 |
| (2) Bread Subsidy Policy-Reimbursements | 82 | 0 | 64 |
| Actual Cost of Wheat Farmers Subsidy: (1)+(2)-(3) | 0 | 7.5 | 7.8 |
| (1) Wheat Subsidy for Farmers- Disbursements | 0 | 10 | 15 |
| (2) Budgeted Transfer to the DGCB | 0 | 7.5 | 0 |
| (3) Wheat Subsidy for Farmers- Reimbursements | 0 | 10 | 7.2 |

Source: MOF, DGF

5. The subsidy of local wheat production for the 2009 season did not put any burden on the Treasury as the LL10 billion treasury advance was fully reimbursed. However, the DGCB did incur a net cost of LL7.6 billion, which it paid from its own account surpluses. One could, therefore, interpret the LL7.5 billion budget transfer to the DGCB in 2010 as an indirect subsidy of the 2009 local wheat production. This is in line with the cost in the 2010 season (LL7.8 billion).
6. In total all these policies cost the Treasury not less than LL129 billion in the 2007-2011 period. About ninety percent of this cost was for the bread subsidy. The experiences of the past years support the case for macro-fiscal scenarios that assume the continuation of both the bread and the wheat subsidy in the coming years

Recommendations.

- 1- International wheat prices should be closely monitored by the Ministry of Finance (MOF) and the Ministry of Economy and Trade (MOET), for early price warnings as necessary, and to allow for better short-term cash management and improved medium-term fiscal projections.
- 2- Agricultural subsidies, particularly with respect to wheat and bread, should also be monitored. This is important in view of increased demands i) to reintroduce the beetroot subsidy, and ii) to subsidize feed-grain and milk production.
- 3- Past governments have not been successful in ending subsidies or in rationalizing them, as these have usually been reintroduced as soon as price swings re-emerged. A coherent policy that is devised by Government (represented by the Ministry of Agriculture, MOF and MOET) and the private sector is needed since the trend is that demand for cereals will most likely outpace supply, with a resulting upward trend in prices.
- 4- The following issues need to be addressed by Government:
 - a) In the context of the policy to support poor households, who are the main beneficiaries of the bread subsidy, is there an alternative to this expensive subsidy that would better target the poor?

- b) Has the wheat subsidy achieved its objective of enhancing domestic production of cereals, and crop rotation? Alternatively, has the subsidy rather acted as a disguised cash transfer to people assumed to be poor?
- c) Is a wheat subsidy annual cost of LL 9 to 10 million per farmer considered to be high? Or should the subsidy be viewed as an element of a rural policy that makes it an acceptable cost to pay as incentive to farmers to stay on the land?

ANNEX.

Table 1. Locally Produced Wheat Purchased by the DGCB 1993-2011

| (In tons) | Local Wheat Purchased by DGCB | Donums Cultivated | Number of Farmers | Subsidized Purchase Price (LBP) | Selling Price (LBP) | International Price (USD) |
|-----------|-------------------------------|-------------------|-------------------|---------------------------------|---------------------|---------------------------|
| 1993 | 16,368 | | | | | |
| 1994 | 21,049 | | | | | |
| 1995 | 16,182 | | | | | |
| 1996 | 17,515 | | | | | |
| 1997 | 24,380 | | | 400,000 | | 184 |
| 1998 | 29,142 | | | 400,000 | | 140 |
| 1999 | 38,193 | | | 400,000 | | 150 |
| 2000 | 67,323 | | 1,035 | 400,000 | 448,000 | 140 |
| 2001 | 70,417 | | 1,418 | 400,000 | 448,000 | 140 |
| 2002(1) | 66,375 | 154,792 | 1,270 | 375,000 | 375,000 | 130 |
| 2003 | 53,669 | 161,080 | 1,207 | 375,000 | 250,000 | 150 |
| 2004 | 60,728 | 190,692 | 1,248 | 375,000 | 250,000 | 150 |
| 2005 | 72,911 | 158,953 | 1,276 | 375,000 | 225,000 | 150 |
| 2006 | 65,389 | 185,622 | 1,302 | 375,000 | 225,000 | 150 |
| 2007 | 8,345 | 162,735 | 1,069 | 375,000 | 507,984 | 200 |
| 2008 (2) | NA | NA | NA | NA | NA | 350 |
| 2009 | 36,688 | 130,595 | 688 | 475,000 | 268,462 | 200 |
| 2010 (3) | 10,890 | 150,433 | 898 | 375,000 | 448,500 | 170-350 |
| 2011 (4) | 18,478 | 139,966 | 940 | 550,000 | NA | 260-400 |

Source: 1995-2011, Ministry of Economy and Trade, Directorate General of Cereals and Beetroot 1993-1994, Ministry of Economy and Trade as published in the IMF Technical Assistance Report "Subsidy Reform Options", November 2007, Unpublished

(1) It should be noted that for 2002 part of the harvest was sold for LL300,000 per ton.

(2) No subsidy in 2008 and therefore the only figure available is an estimate of 50,000 tons produced domestically and sold in Lebanese and foreign markets.

(3) In addition to LL375,000 per ton, the DGCB paid LL100,000 per donum compensation to farmers in 2010. Moreover, part of the harvest was sold for LL404,500 per ton.

(4) Barley was purchased at LL525,000 per ton.

Table 2. Importation of Wheat 1993-2011

| | Imports of Wheat (Value in LBP) | Imports of Wheat (in Tons) | Beirut CIF Price of Wheat (in LBP per Ton) |
|------|---------------------------------------|-------------------------------|---|
| 1993 | NA | NA | NA |
| 1994 | NA | NA | NA |
| 1995 | NA | NA | NA |
| 1996 | 122,141,669,000 | 442,807 | 275,835 |
| 1997 | 82,095,162,690 | 282,443 | 290,661 |
| 1998 | 75,264,435,575 | 324,149 | 232,191 |
| 1999 | 60,304,179,176 | 289,882 | 208,030 |
| 2000 | 68,512,993,177 | 339,380 | 201,877 |
| 2001 | 60,600,764,000 | 278,785 | 217,375 |
| 2002 | 51,224,363,872 | 263,240 | 194,592 |
| 2003 | 65,480,824,121 | 302,651 | 216,358 |
| 2004 | 130,040,701,597 | 478,361 | 271,846 |
| 2005 | 95,036,333,148 | 402,406 | 236,170 |
| 2006 | 89,457,559,260 | 321,451 | 278,293 |
| 2007 | 170,067,669,160 | 405,140 | 419,775 |
| 2008 | 242,093,680,562 | 418,036 | 579,122 |
| 2009 | 164,132,802,456 | 537,577 | 305,320 |
| 2010 | 194,823,265,959 | 506,112 | 384,941 |
| 2011 | 216,947,220,501 | 446,118 | 486,300 |

Source: Ministry of Finance (MOF,) Directorate General of Customs (DGC)

Table 3. Cost Structure of Wheat, 2005

| | LL per Donum Unless Specified Otherwise | Percent |
|--------------------------------|--|----------------|
| Seeds | 7,500 | 4% |
| Tilling and Plantation | 7,000 | 4% |
| Fertilizers | 18,000 | 11% |
| Irrigation | 15,000 | 9% |
| Medicaments | 2,500 | 1% |
| Harvest | 20,000 | 12% |
| Bags | 12,000 | 7% |
| Transportation | 10,000 | 6% |
| Rent | 75,000 | 45% |
| Total Gross Cost | 167,000 | 100% |
| Exc. Revenues from Chaff Sales | 60,000 | |
| Net Cost | 107,000 | |
| Net Cost (LL Per Ton) | 214,000 | |

Source: Ministry of Economy and Trade, Directorate General of Cereals and Beetroot