

## Action Fiche for Lebanon

### 1. IDENTIFICATION

Title/Number	Facility in support of SMEs energy efficiency investments		
Total cost	EU Contribution : €15,000,000		
Aid method / Method of implementation	Project approach - direct centralised management		
DAC-code	24030	Sector	Financial

### 2. RATIONALE

#### 2.1. Sector context

The Lebanese Economy is today improving after a period of political uncertainty (2006-2008) affecting the productive sectors in particular. To encourage the recovery of the sector the Government has been undertaking a series of specific measures and incentives at the tax, regulatory, financing and promotional levels.

More than three years after the 34-days 2006 conflict with Israel, its effects have been absorbed by the Lebanese economy. During 2008 and the first half of 2009, the Lebanese economy demonstrated a good resilience to regional and international tension and is expected to reach a strong GDP growth of 7% in 2009. The current global economic slowdown has moderately affected Lebanon due to the strong regulation of the Lebanese Central Bank -Banque du Liban- which aims at limiting their exposure to structured and high leverage financial products.

Lebanon still remains closely dependent on the situation of its economic partners and still needs to strengthen its domestic economic players, especially private sector. Therefore, even though the macro-economic indicators and the situation appear very promising, it is essential that the private sector benefits from a proper environment to fully deploy its potential to contribute to the long term and sustainable stabilization of the country. Lebanon is a small enterprise based economy. Enterprises employing five or less people constitute more than the ¾ of the total and enterprises with less than 50 employees generate most of employment, roughly 50% of the total. Therefore, a well functioning of the SMEs sector is crucial to livelihoods, employment and growth in Lebanon.

Private sector in Lebanon benefits from a rather liberalised economy that provides good opportunities, the good quality of the human resource and a vibrant banking sector but suffers from a poor enabling environment for its further development. The Lebanese financial sector is considered as one of the strongest assets of the national economy. It is characterised by the very high capitalization and level of deposits to GDP and high quality and modern international financial services. Nevertheless, the intermediation capacity of the financial sector on the domestic market, particularly lending to the private sector, remains limited, representing broadly 20% of assets. Indeed, the Lebanese commercial banks possess mainly short term deposit and, based

on that, they are reluctant to enter the risk of maturity transformation and provide long term loans to the SMEs. Therefore, SMEs continue to face difficulties in accessing credit, while they largely contribute to economic growth and job creation.

Moreover, Lebanese enterprises suffer from policy, legal and regulatory constraints and inadequate infrastructures, especially in the area of energy supply. High energy costs, caused by the combined use of public electricity supply and privately owned generators, are considered as one of the biggest threats for the Lebanese SMEs, notably for the manufacturing SMEs. The electric energy demand in Lebanon is estimated to grow at an average of 3–5% per year for the coming 10 years. Such an increase in energy demand is problematic for Lebanon, since its economy is almost totally dependent on imported fuel, which contributes 97% of the overall energy requirements. Energy savings measures have thus become indispensable, not only from an economic point of view, but also from an environmental point of view, given Lebanon's high exposure to the consequences of climate change.

The Lebanese authorities become more and more aware of the necessity to address environmental challenges and to mitigate consequences of climate change, as well as to develop energy efficiency measures and the use of alternative sources of energy. In that context, Banque du Liban launched circular N°197 to encourage investments in projects related to "environment" through exemptions to commercial banks of their minimum reserves at the Central Bank if an equivalent of these reserves was provided as loans to clients for such purposes. At this stage, this scheme remains unknown by potential beneficiaries, it is not really used by the banks and it is considered as not attractive enough for the private sector.

Investments in energy savings and renewable energy technologies often represent for Lebanese SMEs a huge cost with long payback periods. Lebanon has a huge potential to increase energy efficiency but there is a lack of access to appropriate financing mechanisms. Thus, the development of specialised energy efficiency financing windows in appropriate financial institutions is required, as well as the development of skills for energy efficiency project appraisal and the design of specialised financial products.

## **2.2. Lessons learnt**

Since 2003, the European Union (EU) has supported the development and reinforcement of the Lebanese private sector. In particular, with two programmes: 'Strengthening Quality Management, Capabilities and Infrastructure in Lebanon' (€15 M) and the 'Lebanon Integrated Small and Medium Enterprises Support Programme' (€17 M). The EU achievements so far in the areas of legislation, access to finance (through the Kafalat, the Lebanese guarantee Fund), assistance to enterprises, (business development centres, Euro-Lebanese Centre for Industrial Modernisation), as well as quality management, are considered encouraging.

The evaluations and the conclusions of the Results-Oriented Monitoring (ROM) recommend consolidating this type of initiatives in order to ensure their sustainability and maximize their impact. The main lessons learnt from the phasing out programmes are the following: (i) it is more efficient to concentrate on a limited number of actions, which can make a real difference for the private sector (ii) to

enhance sustainability, it is important to encourage arrangements put in place by public and institutional stakeholders.

In the field of energy and environment, the EU has also provided technical assistance in the framework of programmes such as the Euro Lebanese Centre for Industrial Modernisation (ELCIM), which aimed at identifying technical possibilities to reduce energy consumption by implementing new technologies. The impact was limited due to the absence of joint incentives from the existing different financial priorities in the Lebanese government .

A successful attempt to supply SMEs with a technical tool to address energy issues is in place till 2004 with the Lebanese Cleaner Production Centre (LCPC). It is helping and convincing the Lebanese SMEs to apply cleaner production to their production process. A financial tool is still lacking to facilitate SMEs going from energy saving awareness to energy saving implementation; moreover the industry sector is the one mostly benefiting from this tool.

Kafalat being aware of the SMEs energy issues has just started a new guarantee initiative for SMEs from all sectors, but it still has to be complemented by an adequate financing scheme.

### **2.3. Complementary actions**

This programme is conceived in complementarity with the EU and other donors' new initiatives supporting both private sector development and energy efficiency and saving measures.

The "Lebanon Integrated Small and Medium Enterprises Support Programme" (2006) will have continuity through the programme on "Reinforcement of the Private Sector Competitiveness in Lebanon" funded by the EU in 2008. The objective of this programme is to improve the competitiveness of the Lebanese private sector by contributing to the enhancement of the business enabling environment, by strengthening services to enterprises with a focus on innovation and by strengthening quality management system at national level.

In the field of environment, a specific structure has been set up by UNDP through its Environment and Energy (E&E) Programme, which provides institutional strengthening and policy support for a more effective environmental and energy management, notably through mainstreaming of environment and energy savings into national agendas. In that context, UNDP has set up a *Lebanese Center for Energy Conservation* (LCEC), which should in the long term become a Lebanese independent institution to manage energy savings initiatives for the private sector. This structure should provide audits and advice in the specific field of energy consumption but its human capacity remains limited to face the demand. It has mainly worked on public utilities, important private businesses and specialized engineering companies dealing with energy conservation and renewable energy solutions. The issue of a specific financing mechanism is currently being addressed to complement the current technical structure.

## **2.4. Donor coordination**

There is currently no donor coordination mechanism led by the government. The Ministry of Finance has become responsible for donors' coordination and for monitoring donors' pledges as well as the effective disbursements of the €7 billion committed in Paris III Donors Conference under the form of budget aid, project aid, and loans. An Inter-Ministerial Committee on Economic Affairs has been constituted to coordinate these issues between the Ministries of Economy and Trade, Finances, Central Bank and OMSAR (Office of the Minister of State for Administrative Reform), but it has not met during the last year.

The EU is therefore the only donor with an overall approach addressing the challenges of the private sector in view of increasing its competitiveness and the environment preservation. Given its important support in the field of private sector development, the EU Delegation to Lebanon coordinates a working group on Private Sector Development (PSD) to exchange information and experiences in related programmes. Among the main participants at this group are the International Finance Corporation (IFC), the World Bank, United Nations Development Programme (UNDP), United Nations Industrial Development Organisation (UNIDO), USAID, l'Agence Francaise de Developpement (AFD) and several EU member States and third countries. Also, the EU is maintaining a regular dialogue with the main private sector representatives, in particular, the Federation of the Four Chambers of Commerce, Industry and Agriculture in Lebanon, the Association of Lebanese Industrialists and various sector unions. In the field of energy/environment, German GTZ is also an important player. The UNDP is involved in several projects related to end-use energy efficiency, renewable energy, but most of them concern the public sector (buildings, facilities).

Thus, the approach of this project is fully in line with the Paris Declaration on Aid Effectiveness and the European Consensus on development, notably in strengthening national development strategies and associated operational frameworks. Further, the project is focused on improving coordination and complementarities with other donors, in building on existing structures and systems and strengthening policy coherence. Broad consultations with stakeholders will be undertaken and cooperation between the civil society and the private sector will be enhanced.

## **3. DESCRIPTION**

### **3.1. Objectives**

The overall objective is to create incentives for SMEs to invest in energy efficiency/savings as well as in renewable energy technologies by providing investment facilities through a Facility.

The specific objectives are:

- (1) To reduce the vulnerability of SMEs due to the high energy costs and increase their competitiveness and

- (2) To support the strategic development of products and services in the renewable energy and energy efficiency sector with the aim of creating a local market on sustainable energy.

### **3.2. Expected results and main activities**

#### ***Expected results:***

The main expected results are the reduction of the energy costs for SMEs in Lebanon, the development of alternative sources of energy, the awareness of private sector operators about the energy challenges on efficiency and the potential of using renewable energy.

#### ***Main activities and programme structure***

##### **Component 1**

The Facility is to support to the scheme -foreseen in the Circular n°197- launched by Banque du Liban in favour of environment. The scheme aims at encouraging environmental investments by SMEs with no restriction on the loan amount.

Whereas the sectors targeted by the Banque du Liban scheme are rather wide (anything that could have an environmental dimension, private and public applicant, various sectors), the Facility will provide an extra incentive for SMEs for investments in energy efficiency and renewable energy.

This Facility will contribute to make this scheme more attractive through:

- an extension of the loan duration by 3 years;
- an extension of the grace period by one year.

##### **Component 2**

In parallel, the Facility will use Kafalat as a vehicle to complement the scheme to target very small companies in a more vulnerable situation. Kafalat, being the only institutional guarantee organization in Lebanon and supervised by the Banque du Liban, is anchored in the SME sector and strongly linked with the banking sector in Lebanon.

The project will assist Kafalat in its newly developed guarantee scheme “Kafalat Energy” addressed to environmental projects. Whereas the existing guarantee schemes of Kafalat (Kafalat Classic and Kafalat Plus –both co-financed by the EU-) are open for the agriculture, industry, tourism and high-tec sectors) the first phase will be focused on manufacturing SMEs.

##### **Component 3**

The Facility will be granted on the basis of the economic and environmental impact assessment of the investment to be done by the eligible companies. Therefore, a pool of technical experts will be set up in the domain of energy efficiency and renewable energy; they will be able to analyse technically and financially the proposed energy

saving investments for the benefit of the Lebanese commercial banks, which currently have no capacity to examine such type of requests.

The work of the experts will encourage the banks, in the medium term, to develop and promote this Facility and, in the long term, to continue developing their activities in the newly created niche.

### **3.3. Risks and assumptions**

Political instability is a recurrent standard risk in Lebanon for the effective implementation of any project. However, this risk is now mitigated by the fact that the main project partner, Banque du Liban, is likely to be less affected than line ministries by any governmental crisis and potential changes of government in Lebanon.

A general risk is that the target group of SMEs either is not duly informed on the opportunities offered by this Facility or it could show poor interest in this scheme, although this seems very unlikely given that SMEs usually complain about the lack of incentives to invest on energy saving technologies. In this regard, a specific budget item of this project will be allocated to communication addressed to the potential beneficiaries of this scheme.

This project is based on the assumption that the attribution criteria for grants are clearly defined (impact of the investment made by the SMEs on energy consumption/savings) and the potential adverse effects are mitigated. These criteria will be defined thanks to the support of the envisaged pool of experts in efficiency and renewable energy field.

### **3.4. Crosscutting Issues**

All loans supported by the Facility will be screened against a set of defined environmental criteria aiming at promoting the use of renewable energy or energy efficiency/saving measures.

During all phases of the project, particular attention will be paid to the principle of good governance and rule of law among the institutional and private stakeholders. In particular, improved and more transparent management, decision-making procedures and rules will be tackled.

### **3.5. Stakeholders**

The main stakeholders are the Lebanese SMEs which will benefit from the Facility and will undertake investments on energy savings measures at a reduced cost. Commercial banks will benefit from the project as they will be able to grant more loans, to potentially attract new clients and to develop their presence on a new market niche in expansion.

Banque du Liban will be a key stakeholder in the implementation of the Facility: it will benefit from an important technical support to make its new circular more attractive to private sector.

Similarly, Kafalat, the Lebanese credit guarantee agency, will be the secondary implementing body. It is a joint stock company supervised by the Banque du Liban through the National Institute for the Guarantee of Deposits. Kafalat is playing a unique role as facilitator of lending to SMEs in several sectors by providing credit risk guarantees and has a de facto monopoly in this field. It will develop a new competence to better serve very small companies that it usually targets.

The Council for Reconstruction and Development (CDR) as National Coordinator is also a key stakeholder.

#### **4. IMPLEMENTATION ISSUES**

##### **4.1. Method of implementation**

The method of implementation of this project will be through the centralised management modality.

A Financing Agreement is already signed with the beneficiary, the government of the Republic of Lebanon through the Council for Reconstruction and Development (CDR), for the 2007 project "Enterprise Support Facility with the EIB". In view of the context described in point 1, the Action Fiche in the decision C(2007) 1185 of 20<sup>th</sup> March 2007 needs to be consequently re-oriented and adapted. Thus, the original Financing Agreement will be subject to an addendum adapting the necessary contents and integrating new Technical and Administrative Provisions (TAPs) consistent with this Action Fiche.

A grant contract is already signed between the European Commission and Banque du Liban, and it will be subject to an addendum to integrate the provisions of the above-mentioned modified decision.

A Technical Assistance component is foreseen in the budget to accompany the implementation of this action.

##### **4.2. Procurement and grant award procedures**

###### **(1) Contracts**

All contracts implementing the action must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the Commission for the implementation of external operations, in force at the time of the launch of the procedure in question.

Participation in the award of contracts for the present action shall be open to all natural and legal persons covered by ENPI Regulation. Further extensions of this participation to other natural or legal persons by the concerned authorising officer shall be subject to the conditions provided for in article 21(7) of ENPI Regulation.

###### **(2) Specific rules for grants**

The essential selection and award criteria for the award of grants are laid down in the Practical Guide to contract procedures for EU external actions. They are established

in accordance with the principles set out in Title VI 'Grants' of the Financial Regulation applicable to the general budget. When derogations to these principles are applied, they shall be justified, in particular in the following cases:

- Financing in full (derogation to the principle of co-financing): the maximum possible rate of co-financing for grants is 100%. Full financing may only be applied in the cases provided for in Article 253 of the Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of the Financial Regulation applicable to the general budget of the European Communities.
- Derogation to the principle of non-retroactivity: a grant may be awarded for an action which has already begun only if the applicant can demonstrate the need to start the action before the grant is awarded, in accordance with Article 112 of the Financial Regulation applicable to the general budget.

#### **4.3. Budget and calendar**

The budget of the Enterprise Support Facility is 100% financed by the European Union. The total financial contribution of the EU to the projects amounts to € 15 millions. The indicative budget breakdown is as follows:

Support to Banque du Liban – Financial scheme in favour of energy savings investments	€11 900 000
Support to Kafalat on guarantee mechanisms	€2 300 000
Technical assistance, provision of expertise on energy efficiency and renewable energy	€400 000
Audit and evaluation	€300.000
Visibility	€100.000
Total	€15 000 000

The implementation of the programme will last 48 months from the date of the signature of the addendum to the Financing Agreement.

#### **4.4. Performance monitoring**

Banque du Liban and other bodies in charge of implementation will be responsible for providing regular reports on the utilisation of the project funds and the energy saving loans (number of loans, amount of funded investment, beneficiaries). The reporting modalities and schedule will be set up in the addendum to the Financing Agreement.

Specific monitoring will be undertaken as deemed necessary to ensure coherence and complementarily with other donor actions and in coordination with the Lebanese government.

#### **4.5. Evaluation and audit**

Evaluations by external consultants and external audits will be performed in accordance with the EC procedures. Financial audits will be undertaken.

#### **4.6. Communication and visibility**

The EU Delegation to Lebanon and the Banque du Liban will develop together a visibility plan, with a double objective: to publicise information regarding the scheme put in place by Banque du Liban and the type of investments that could be eligible for a subsidy. Further, visibility to the EU funding will be assured.

Visibility activities will include standard supports, such as brochures/flyers, as well as media (press and TV). In addition, information conferences could be organised in cooperation with the Chambers of Commerce of Beirut, Zahle, Saida and Tripoli and the participation of Banque du Liban and Kafalat to present the modalities of this facility to the local companies.