

ACTION FICHE N° 3

1. IDENTIFICATION

Title	Support for Economic Recovery II: SME Facility in support of an EIB Global Loan		
Total cost	€15 million to support a €100 million EIB loan		
Aid method / Management mode	Project approach – <i>centralised</i> Management		
DAC-code	24030	Sector	Financial Sector

2. RATIONALE

2.1. Sector context

As a result of the hostilities last summer Lebanon has suffered a substantial setback on the economic front. Real GDP, which was expected to grow by around 6 % in 2006, will most likely turn into contraction of up to -5%. The cost in terms of economic activity and growth is likely to extend well beyond 2006.

Although there was significant physical damage the major impact on the private sector and SMEs has been indirect and a result of the economic disruption. The major impacts are lower sales due to the loss of customers, lower investor and consumer confidence, transport disruptions and lost access to markets, lost suppliers and key staff. Indirect losses are difficult to estimate although survey evidence from October 2006 suggests that over 90% of firms suffered sales losses while at the same time their expenses (excluding payroll) remained the same or increased during the war.

The tourism sector is most affected both through a lost tourist season and longer-term through the effect on Lebanon's image. Occupancy rates were at 90% before the war and recent data suggests that even for the Eid holiday occupancy rates could have reached 40% from a maximum of 30% in October. Linked to this is the impact on the agricultural sector and food producers who were geared up to supply the high season demand which evaporated and who were left with large stocks. Manufacturing virtually shut down during the hostilities with the sector beginning to see a revival in October. Key personnel have also left and it is unclear whether they will return.

Survey estimates suggest the vast majority of businesses are operating at a level of sales below pre-war levels and that, on average, businesses are producing at around 60% of their pre-conflict levels. While some may recover quickly it is clear that for a significant number it will take much longer and many are in the process of deciding whether to rebuild their operations confidence. Others are deciding whether to relocate elsewhere in the region.

In terms of sales, most firms expect to have recovered to pre-war levels within 1-2 years, however, while nearly three-quarters of firms were planning to make new investments for the vast majority of firms these have been cancelled or postponed.

The performance of the private sector is evident in the performance of the banks loan portfolios. While there has been an immediate impact banks are concerned about the longer-term effects of the economic slowdown. The Lebanese financial sector is considered 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. Despite this successful development, its intermediation capacity on the domestic market, particularly lending to the private sector, remains limited, representing broadly 20% of assets.

2.2. Lessons learnt

This programme builds upon actions already being implemented by the EC in support of the development of the private sector. It will also benefit from the experience of the EIB through its previous 21 operations signed with Lebanon over the last 13 years. The EC is working closely with the EIB and the Central Bank of Lebanon (BdL) to prepare this project. The experience of the EIB in managing EC interest rate subsidies and that of the BdL in managing the scheme of the Lebanese government is incorporated in the project.

2.3. Complementary actions

The EC has various initiatives supporting enterprises through technical assistance. The EIB has an ongoing line of credit in support of enterprises. The EC support to the Kafalat credit guarantee scheme is complementary this action. Following the hostilities, and in view of a request from the Lebanese government, several donors are planning to provide support to enterprises through various lines of credit and guarantee schemes through the Central Bank (BdL) and directly with the private sector. These initiatives by IFC, AFD, OPIC, Arab Fund for Economic and Social Development, are currently under preparation. This includes the EIB Global Loan €100 million, which will be supported through this project. The Lebanese government also has an interest rate subsidy scheme for enterprises.

2.4. Donor coordination

Meetings have been held with the other donors planning similar initiatives mentioned above, and with the BdL to ensure that any community action is complementary and coherent with existing and future actions of other donors. Coordination will continue with the BdL, the EIB and other donors during the detailed preparation phase.

3. DESCRIPTION

3.1. Objectives

The overall objective is to help ensure that enterprises affected by the war can rapidly gain access to credit.

3.2. Expected results and main activities

This €15 million enterprise action will support an EIB €100 million global loan to encourage the recovery of the private sector after the war. It will complement other government initiatives for the private sector including tax and export promotion initiatives. The funds will be channelled through the Central Bank and will be linked to individual EIB loan requests. The majority of the funds will be used to provide front-loaded interest rate subsidies on EIB loans. Funds will also be used to finance training courses for bankers in the areas of credit risk assessment and enterprise finance.

3.3. Stakeholders

The main stakeholders are the enterprises who will benefit from an EIB loan and the commercial banking sector that will also provide loan finance. The BdL, as implementing partner for the EIB and EC, is also a key stakeholder in the project. The Council for Reconstruction and Development (CDR) as National Coordinator is also a key stakeholder.

3.4. Risks and assumptions

Political instability is a risk to the effective implementation of the project although this is mitigated by the fact that the project partner is the Central Bank which is likely to be less affected than line ministries. The BdL has extensive experience in managing EIB loans and the Lebanese government's interest rate subsidy scheme.

3.5. Crosscutting Issues

All EIB loans are screened against environmental criteria. Technical assistance support to the commercial banking sector and to the BdL will improve governance.

4. IMPLEMENTATION ISSUES

4.1. Implementation method

Centralised management.

This support to enterprises in Lebanon will be closely coordinated and linked with an EIB loan. A Financing Agreement will be signed with the government of Lebanon, the Council for Reconstruction and Development (CDR). A grant contract will be signed by the Commission with the Central Bank of Lebanon (BdL) who will be responsible for implementation of the project. The Central Bank of Lebanon manages all EIB loans to the government, as well as interest rate subsidy schemes of the government and other donors. This, together with the current crisis situation declared in Lebanon justifies the direct award of the grant contract to Central Bank of Lebanon given that the bank manages EIB loans.

4.2. Procurement and grant award procedures

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.

All programme estimates must respect the procedures and standard documents laid down by the Commission, in force at the time of the adoption of the programme estimates in question.

4.3. Budget and calendar

The budget of the Enterprise Support Facility is 100% financed by the Commission and it is exclusively applicable to EIB loans. EIB loans can finance up to 50% of each project. The remaining 50% of the project will be financed by local commercial banks and enterprises' own resources which can also benefit from a subsidy from the government or other donors. This Facility includes (on an indicative basis):

- direct EIB loan support activities worth EUR 14,680,000;
- technical assistance contracts (including monitoring) worth EUR 200,000;
- visibility activities worth EUR 20,000
- audit, evaluation and monitoring worth EUR 100,000;

A Financing Agreement will be signed with the CDR . The implementation of the project will last 48 months (4 years) from the date of signature of the Financing Agreement.

4.4. Performance monitoring

Performance monitoring will be coordinated with the EIB. The BdL will be responsible for providing regular reports on the utilisation of the project funds and EIB loans. Specific monitoring will be undertaken as necessary to ensure coherence and complementarity with other donor actions and in coordination with the Lebanese government.

4.5. Evaluation and audit

Mid-term and final evaluations by external consultants and external audits will be performed in accordance with the EC procedures. Financial and systems audits will be undertaken before

4.6. Communication and visibility

Visibility activities will be coordinated with those of the EIB. The European Commission will ensure that adequate communication and visibility is given to the EC funding by the BdL and CdR (press conferences, brochures/flyers, media reports, etc.).