

**PROJECT INFORMATION DOCUMENT (PID)
IDENTIFICATION/CONCEPT STAGE**

Report No.: PIDC36781

Project Name	Leveraging Innovation in Financial Service Provision to Manage Crisis in Lebanon
Region	MIDDLE EAST AND NORTH AFRICA
Country	Lebanon
Sector(s)	Payments, settlements, and remittance systems (30%), Microfinance (40%), Other social services (30%)
Theme(s)	Micro, Small and Medium Enterprise support (40%), Social Safety Nets/Social Assistance & Social Care Services (30%), e-Services (30%)
Lending Instrument	Lending Instrument
Project ID	P157983
Borrower Name	Ministry of Economy and Trade
Implementing Agency	Mercy Corps
Environment Category	C - Not Required
Date PID Prepared	09-Nov-2015
Estimated Date of Approval	22-Feb-2016
Initiation Note Review Decision	The review did authorize the preparation to continue

I. Introduction and Context

Country Context

Note - graphs and tables cannot be uploaded into the portal. A word document version of the initiation note will be uploaded in the portal and will include the appropriate graphs and tables.

1. Lebanon - a small open economy of high middle income status with a population of 4.5 million people in 2013 – is acutely fragile due to a history of civil war, external conflict, and several waves of Palestinian, and most recently, Syrian refugees. GDP per capita in 2013 was approximately USD 17, 390 in PPP terms and USD 9,905 in current dollars. Services and trade are the most important sectors in the economy with tourism and financial services bring key economic drivers. GDP has grown an estimated 4.4 percent on average from 1993 to 2014. However, growth has been volatile and uneven due to frequent political and economic shocks. Policymaking is complicated by a confessional system of governance that serves promotes the preservation of confessional peace at the expense of effective service provision.

2. Poverty reduction and employment generation are two critical ongoing development challenges in Lebanon. Based on available (but unsatisfactory) data, poverty incidence has been elevated and broadly unchanged for the past 25 years. Since the end of the civil war, extreme poverty has hovered between 7.5 to 10 percent and have been highly concentrated in the north and south of the country and in dense pockets of certain urban areas. Prior to the Syrian crisis around 11

percent of the labor force was unemployed. Unemployment was particularly acute amongst women (22%) and youth (34%). Labor force participation is low, with less than half of the working age population participating in the labor market. Between 2004-2009, the main contributors to net job creation were trade (61 percent) and low productivity sectors (33 percent), followed by construction (10 percent). Higher productivity services such as information and communications technologies have registered very little growth (only 5 percent of total net job creation).

3. Lebanon's economy has been adversely affected by the ongoing conflict in neighboring Syria and closely-linked regional instability. UNCHR estimates there are approximately 1.2 million refugees (approximately 1 out of every 5 residents) in Lebanon as of July 2015. An economic and social impact assessment (ESIA) completed by the World Bank in 2014 found that the conflict may (1) cut real GDP growth by 2.9 percentage points each year, entailing large losses in terms of wages, profits, taxes, or private consumption and investment; (2) push approximately 170,000 Lebanese into poverty (over and above the 1 million currently living below the poverty line) and double the unemployment rate to above 20 percent, most of them unskilled youth; and (3) depress government revenue collection by USD1.5 billion while simultaneously increasing government expenditure by USD1.1 billion due to the surge in demand for public services, bringing the total fiscal impact to USD2.6 billion. In 2013 the debt to GDP ratio increased since the first time since 2006 and currently stands at 134%, one of the highest in the world. With the added fiscal impact from the Syrian crisis, the debt ratio is projected to continue to increase over the medium term.

4. Though Lebanon is an upper middle income country, weak and deteriorating public institutions mean the State is unable to deliver satisfactory quality public services. More affluent citizens compensate through purchasing private goods (e.g. private schools, electricity generators), the poor and middle class are often unable to access basic services, which reinforces inequality and lack of economic opportunity. Furthermore, weak basic infrastructure contributes to poor quality of growth and stagnant poverty levels. The Syrian crisis and large influx of refugees have placed significant stress on public services. The World Bank ESIA estimates the cost for the central government to meet additional demands for health, education and social safety nets for 2012-2014 is USD 308- 340 million. This figure is outside of what is being provided by the international community through humanitarian assistance.

Sectoral and Institutional Context

5. The Lebanese financial system is large and is a critical part of the overall service sector. The overall asset base of the banking sector hovers at around 350% of GDP. Total assets of operating banks grew by 6.6% in 2014, moving from USD 164.8 billion in 2013 to USD 176 billion. Wealth is heavily invested in bank deposits in banking sector that has an estimated 64% dollarization level. Deposits of commercial banks accounted for 289.4% of GDP in 2014, or the equivalent of USD 144.4 billion, increasing by 6.0% from 2013 levels. The banking sector has shown resilience to external shocks, including considerable losses incurred by Syrian affiliates. This is in part due to the very stable non-resident deposits in US Dollars which are attracted by the elevated spread relative to international markets. The IMF has estimated that some 40% of bank deposits belong to non-residents. Moreover the banking system holds just over 50% of all government paper which amounts to approximately 35% of total commercial banking sector assets that are exposed to both sovereign and foreign exchange risk.

6. Access to finance in Lebanon is relatively high when compared to regional peers, however,

well below the average level for low middle income levels. At the household level, 47% of Lebanese adults have an account at a formal financial institution, well above the MENA regional average (14%) and in line with adults in the rest of the developing world (46%). Those with accounts also seem to view them as less useful for their needs – only 18% of account holders in Lebanon saved formally, as compared to 24% amongst middle income economies. Women and poorer segments face higher levels of financial exclusion in Lebanon, with 33 and 27 percent formal account ownership respectively. Only 1% of Lebanese use a mobile phone to pay bills or send/receive money.

7. There are approximately 65 commercial banks operating in Lebanon. Private credit as a percentage of GDP stands at 94%, well above the income group median (49.1%), while below. Lending, however, is overwhelmingly relationship based and hampered by high collateral requirements. The share of SME loans as a percentage of total banks' loans is (based on latest available data) around 16 percent in Lebanon, the highest share in MENA after Morocco at 34 percent and Yemen at 20 percent (See Figure 3; World Bank and Union of Arab Banks, 2010). Lebanese firms depend significantly on the banking sector for their financing, as 53 percent of all firms, 50 percent of small firms and 63 percent of medium-sized firms report having contracted a bank loan. Overall, domestic commercial bank finance account for 24 percent of firms' working capital finance and 39 percent of their investment finance. Smaller firms have a reduced reliance on banks to finance business needs and generally finance through internal sources (see figure 9).

8. The somewhat favorable credit environment for SMEs are due in part to various incentive and support programs to SME lending provided by the GOL and BdL since 2000, for example subsidizing interest payments of SME borrowers, extending special guarantees to SMEs through Kafalat, and granting exemptions on compulsory reserves of creditors. It is estimated that through circular 331, the Lebanese Central Bank (BDL) has made available over \$400 million of equity capital through commercial banks. It is unclear how much of this business would appeal to the commercial banks in the absence of these incentive programs.

9. Non-bank financial institutions (NBFIs) including leasing, factoring, microfinance and capital market solutions could play larger role in inclusive finance in Lebanon, however, are hampered by deficiencies related to financial infrastructure (collateral registries, settlement and custody systems, and credit information) and regulatory constraints. Lebanese capital markets are relatively small given the financial market is dominated by the banking sector. The Beirut Stock Exchange (BSE) has only 11 listed entities with a total equity market capitalization of US\$ 10 billion or 24% of GDP, smaller than its peer countries (both in the region and among countries with similar income level); and trading is very thin among these stocks. Lebanon has a sizeable government bond outstanding, but the secondary market is not very active. Meanwhile, the non-government debt market is very small and fully dominated by banks.

10. The formal Lebanese microcredit sector has been growing strongly over the last years and around 20 players now offer a variety of financial services to low-income clients. Microcredit providers are regulated based on their registration type: non-bank financial institutions (NBFIs) and comptoirs, formal money lenders, fall under the Central Bank's supervision, while around a dozen NGOs and one cooperative respectively report to the Ministry of the Interior and the Ministry of Agriculture. They operate in one of the most active financial services market in the region, alongside 53 other NBFIs, 78 commercial banks, and an unknown number of comptoirs. While the aggregated microcredit portfolio (US\$ 120 M) remains very small as compared to the banking

sector's assets (less than 0.1%), it currently impacts up to 15% of the Lebanese households, more particularly the most vulnerable families. Faith-based organizations excluded, the MFIs cumulative outreach was slightly above 100,000 borrowers as of December 2014, in a country of 4.2 million nationals. Al Majmoua, NGO and the largest player, counted for 48% of the outreach on its own. Together with the 3 largest NBFIs, Vitas (main shareholder: Global Communities), Emkan (main shareholder: BankMed), and Ibdaa (main shareholder: AGFUND), they represent over 80% of the sector, both in terms of portfolio and clients.

11. Social protection and poverty are critical development challenges for Lebanon, and have become more pressing issues since the beginning of the Syrian conflict. Since the end of the civil war, extreme poverty has hovered at between 7.5 to 10 percent, while 28 percent of the population was poor using the upper poverty line. Over half of Lebanese citizens claim they lack funds necessary after paying for basic needs and necessities and 63 percent report not being able to afford basic necessities at some point. The supply of low-skilled workers has growth significantly due to the Syrian crisis, thus adversely affecting incomes and opportunity for low-income and poor Lebanese. Jobs are often informal in nature and have been taken by non-Lebanese. Lebanon's national social safety net program, the National Poverty Targeting Program (NPTP), was launched in 2011. While initial progress has been made the program remains nascent. Coverage remains low – in 2013 the program reached only 27 percent of the extreme poor and 7 percent of the poor. The GOL's objective is to expand the program to reach all the individuals below the extreme poverty line by 2024. This is estimated at 7.19 percent of the population.

Relationship to CAS/CPS/CPF

Relationship to the SCD

12. This program contributes directly to the key findings in the Lebanon Systematic Country Diagnostic (SCD) which posits that Lebanon's failure to generate inclusive growth and jobs are due in part to regional conflict and violence. The SCD underscores that security shocks have historically rendered growth volatile, with Syria being a recent demonstration of such fragility and exacerbating access to and quality of health, education, and social services. The SCD suggest the promotion of greater self-reliance and economic autonomy among vulnerable host communities and refugee populations through targeted livelihoods assistance and policies for their medium-term inclusion in the national economy. The proposed operation will utilize access to financial services and innovation in payment systems to promote economic resilience amongst vulnerable communities and refugees in Lebanon, with a particular focus on women.

Relationship to the World Bank Groups Twin Goals:

13. Financial inclusion - access and usage of quality financial services, including credit, savings, payments and insurance - is an enabler and a catalyst for achieving the Bank Group's goals of ending extreme poverty by 2030 and boosting shared prosperity for the bottom 40 percent of the population in all developing countries. The proposed project is also directly in line with the World Bank's global initiative to provide universal financial access by 2020. At the microeconomic level, access and use of appropriate financial services improves household welfare through increased incomes, lower vulnerability, and an increase in productive investment. Financial inclusion can also spurs household enterprise activity, offering greater opportunity and choice to low-income families. Financial inclusion can also help address joblessness because it helps grow enterprises, many of

whom are stifled by lack of access to credit and savings services that would enable them to invest in fixed capital, expand, and employ more people. Recent evidence (Han, Rui, and Melecky, 2013) demonstrates that broader access to and use of bank deposits can significantly mitigate bank deposit withdrawals or growth slowdowns in times of financial stress. This research suggests there are synergies between financial development (financial inclusion, innovation, competition, etc.) and stability (microprudential, macroprudential, business conduct supervision, etc.).

14. Financial inclusion is particularly critical for communities in fragile and conflict-affected states. According to analysis of finindex data completed in 2013, just 15 percent of adults have an account at a formal financial institution while 26 percent report having saved in the past year. Adults in these economies are significantly more likely than those in the rest of the developing world to report borrowing for health or emergency purposes. Weak institutions in the formal financial sector—public and private—are a common feature in fragile and conflict-affected states. The resulting lack of economic stability and opportunity for individuals is both a driver and a consequence of insecurity. An inability to smooth consumption and make investments through formal savings and credit systems often exacerbates conflicts. It is during this period of instability where having a safe place to save or a reliable method for receiving remittances or transferring cash is most critical. Connected, often weak financial infrastructure and institutions exacerbates slow pace after recovery as savings have been wiped out and entrepreneurs lack capital to start new businesses.

Relationship to World Bank Strategies:

15. The program contributes directly to the second pillar of MENA region's new regional strategy (focusing on renewing the social contract and regaining trust, resilience, reconstruction/recovery, and regional integration). The strategy calls for promoting resilience of communities to conflict and shocks, including providing development assistance to refugees and the communities hosting them. The strategy stresses the importance of working around conflict and instability in particular areas, as well as using targeted advisory and analytical work to marshal global knowledge and crowd-in resources via partnerships. The program also contributes to the WBG's agenda on Fragility, Conflict, and Violence (FCV) by producing high-level analytical work gathering international best practices, and developing a policy framework on financial inclusion during times of crisis to apply to countries across the MENA region. The electronic cash transfer program pilot will seek to apply international best practices and create a demonstration effect which can catalyze further investment in such a program.

Relationship to Other World Bank Projects:

16. This project builds and innovates on ongoing investment lending and technical assistance work in both the financial sector (mainly microfinance and financial inclusion of households) and with regards to livelihood development and the development of effective social safety nets. The project extends technical assistance and cooperation with microfinance institutions (MFIs) in Lebanon, an activity initiated under the Lebanon Micro, Small and Medium-Size Enterprise Facility (P148583). The program supports broader financial inclusion goals of key Lebanese policymakers, including the Central Bank and the Ministry of Finance. The project also directly complements and extends work under the Social Promotion and Protection Project (P124761). The project expands on World Bank support to the National Poverty Targeting Program (NPTP) by linking beneficiaries with access to financial services, thereby promoting sustainability and efficiency of the existing cash transfer program.

Collaboration with Development Partners

17. The project will be executed in direct partnership with the Consultative Group to Assist the Poor (CGAP), an independent policy and research center housed at the World Bank in charge of advancing the global financial inclusion agenda through research, learning, and guiding regulation for governments, service providers, donors, and investors. Meetings have been held or are being organized with all major international organizations involved in electronic cash transfers to vulnerable populations in Lebanon (UNHCR, IRC, etc.) as well as with microfinance institutions (MFIs). Similar meetings are being organized with development stakeholders in Jordan (when feasible). Technical cooperation is essential to build on existing programs and to address gaps (geographic/technical/technological) in cash transfer programs and to ensure the project effectively applies financial innovation to promote economic resiliency amongst intended beneficiaries. The team is in daily discussion with CMU staff to facilitate government cooperation. The World Bank team is engaging in regular consultation meetings, an appraisal mission in December will follow up with all stakeholders.

18. The project will be prepared in synergy with key bilateral donors in Lebanon, including the Department for International Development (DFID), USAID, and the Department of Foreign Affairs, Trade, and Development Canada (DFATD). Global thought leaders on electronic transfers as an entry point for financial inclusion, including the Gates Foundation and the United Nations Capital Development Fund (UNCDF).

II. Project Development Objective(s)

Proposed Development Objective(s)

19. The project development objective (PDO) is to enhance the economic resilience of vulnerable populations and refugees in Lebanon through piloting innovative approaches to financial inclusion. The PDO will be met through threetransmission channels. First, the project will produce rigorous analytical work documenting global best practices in innovative mechanisms to deliver financial services during crisis. Second, the project will apply innovation at the programmatic level through piloting the provision of microfinance services to recipients of agency-executed cash transfers. Third, through regional learning, the project will develop a policy framework for delivering financial service provision to other conflict-affect countries in the MENA region.

Key Results

20. Progress towards achieving the project's objectives will be measured through a series of quantitative and qualitative indicators at the PDO and at the intermediate level. Key results and indicators at the PDO level, are: (i) improved ability of Lebanese stakeholders to apply international best practices to leverage financial inclusion through electronic cash transfer systems; ii) reduction in vulnerability and an improvement in household welfare of beneficiaries; and iii) improved policy environment for financial inclusion through the development of policy guidelines for authorities across the region, and iv) improved financial inclusion amongst targeted beneficiaries.

21. Key results and indicators at the intermediate level are: i) number of direct project beneficiaries participating in the digitized cash transfer program, with a particular focus on women; ii) number of cash transfer beneficiaries from extremely poor households; iii) number of transaction accounts and other financial services provided and used by project beneficiaries; iv) analytical output on promoting economic resilience through access to financial services; v) number of workshops and learning events completed; and vi) establishing a policy framework for engagement moving forward.

III. Preliminary Description

Concept Description

A. Description (Concept)

22. Component 1: Strengthening the analytical base on promoting economic resilience of refugees and vulnerable host communities through access to financial services. The objective of this component is to enhance knowledge of Lebanese policymakers on innovative approaches to promoting economic resilience of vulnerable Lebanese and refugees through financial inclusion, drawing on international best practice in both microfinance, livelihood development, and crisis management. The analytical work will also assess the legal/regulatory framework and institutional setup in Lebanon and propose interventions to be piloted. Particular attention will be placed on innovative linkages between cash transfers and financial services – for example digital transfers to transaction accounts, remote agent network development, or linkages to microinsurance and savings products. (\$250,000)

23. The analytical work will coordinate closely with key international actors working on promoting financial inclusion using cash transfers as an entry point, particularly in fragile and post-conflict contexts. This includes the United National Capital Development Fund (UNCDF), United Nations High Commission for Refugees (UNHCR), the GSMA, DFID, and the Gates Foundation, in close coordination with Lebanese authorities. The analytical work will commence directly after grant effectiveness and will inform the programmatic pilot under component 2 of the program. The document will seek to have impact both on the global levels, highlighting international best practices for promoting financial inclusion during emergency/crisis context, and locally through analyzing the institutional and regulatory options for Lebanon. Depending on implementation, the team may produce two outputs. The first focused on bringing international best practices to managing crisis in Lebanon and the second an internal document providing policy suggestions for Lebanese authorities.

24. Component 2: Programmatic Pilot of an electronic cash transfer program where transfers are digitized and connected to microfinance institutions (MFIs). The objective of this component is to promote economic resilience and livelihood development over a medium-term time horizon through targeted income support linked to access and usage of transaction accounts. The pilot would in first

instance target low-income vulnerable Lebanese communities who have been affected by the economic instability caused by the ongoing Syrian crisis. Particular attention will be placed on female-headed households. The income support program would also benefit refugees. (\$1,800,000)

25. The pilot will catalyze innovation through two transmission channels. First, the pilot will seek to employ international best practices with regards to targeting and payment systems. This involves digitizing transfer payments through mobile or card-based technology. Secondly, the pilot will link cash transfers to microfinance institutions (MFIs) who can then offer beneficiaries financial services (transaction accounts) and non-financial services (financial education training). This pilot would be informed by the analytical work and draw on international best practice and current institutional/regulatory realities in Lebanon.

26. The program will include a rigorous evaluation comparing outcomes of beneficiary groups with respect to household welfare, vulnerability to economic shocks, access and usage of financial services, and relative poverty levels. This evaluation will capture the primary economic effects of the income support program as well as additionalities with respect to access and usage of financial services through participating microfinance institutions.

27. Component 3: Regional knowledge sharing and policy framework development. The objective of this component is to improve policies to promote economic resilience during periods of crisis through regional knowledge sharing and policy development. Funding would finance a series of workshops on the role of financial inclusion in times of crisis in the MENA region, as well as technical assistance in developing a policy framework on using innovative financial inclusion pathways to manage crisis and conflict for the MENA region as a whole. (\$250,000)

IV. Safeguard Policies that Might Apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		x	
Natural Habitats OP/BP 4.04		x	
Forests OP/BP 4.36		x	
Pest Management OP 4.09		x	
Physical Cultural Resources OP/BP 4.11		x	
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12		x	
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

V. Financing (in USD Million)

Total Project Cost:	2.3	Total Bank Financing:	0
Financing Gap:	0		
Financing Source			Amount
State and Peace Building Fund			2.3

VI. Contact point

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