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The World Bank

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Report No. 54690-LB

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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INTERNATIONAL FINANCE CORPORATION

COUNTRY PARTNERSHIP STRATEGY
FOR
LEBANESE REPUBLIC
FOR THE PERIOD FY11-FY14

July 28, 2010

MNC02 Country Management Unit
Middle East and North Africa Region

CURRENCY AND EQUIVALENTS

Fiscal Year
January 1 to December 31

Unit of Currency = Lebanese Pound (LBP)
1US$ = 1500 LBP (As of July, 2010)

ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activities
AFD	Agence Française de Développement
AWI	Arab World Initiative
ALMPs	Active Labor Market Policies and Programs
BDC	Business Development Centers
BdL	Banque du Liban (Central Bank of Lebanon)
CAD	Current Account Deficit
CAS	Country Assistance Strategy
CAS	Central Administrations for Statistics
CDR	Council for Development and Reconstruction
CGAC	Country Governance and Anti-Corruption (CGAC)
CHUD	Cultural Heritage and Urban Development Project
COA	Court of Accounts
CPI	Consumer Price Index
CPPR	Country Portfolio Performance Review
CPS	Country Partnership Strategy
DPL	Development Policy Loan
EC	European Commission
EdL	Electricité du Liban (Lebanon Electric)
EOSI	End-of-Service Indemnity
EPCA	Emergency Post-Conflict Assistance
ESIA	Economic and Social Impact Assessment
ESP	Economic Social Development Program
ESW	Economic Sector Work
FDI	Foreign Direct Investment
FMIP	First Municipal Infrastructure Project
FY	Fiscal Year
GDP	Gross Domestic Product
GIT	Global Income Tax
GNP	Gross National Product
GoL	Government of Lebanon
HCP	Higher Council for Privatization
IBRD	Int'l Bank for Reconstruction & Development
ICA	Investment Climate Assessment
ICT	Information and Communication Technology
IDA	International Development Association
IDF	Institutional Development Fund
IFC	International Finance Corporation
IMC-SP	Inter-Ministerial Committee for Social Policy
IMF	International Monetary Fund
IOF	Institute of Finance
ISN	Interim Strategy Note
LBP	Lebanese Pound
LNG	Liquefied Natural Gas
MDGs	Millennium Development Goals
MDTF	Multi Donor Trust Fund
MEHE	Ministry of Education & Higher Education
MENA	Middle East and North Africa
METAC	IMF-Middle East Technical Assistance Center
MIC	Middle Income Countries
MIGA	Multilateral Investment Guarantee Agency
MOET	Ministry of Economy and Trade
MOEW	Ministry of Energy and Water
MOF	Ministry of Finance
MOIM	Ministry of Interior and Municipalities
MOL	Ministry of Labor
MOSA	Ministry of Social Affairs
MTEF	Medium-Term Expenditure Framework
NGOs	Non-Governmental Organizations
NPTP	National Poverty Targeting Program
NSSF	National Social Security Fund
PEP-MENA	Private Enterprise Partnership for the Middle East & North Africa
PER	Public Expenditure Review
PFM	Public Financial Management
PM	Prime Minister
PPP	Public-Private Partnership
ROSC	Report on Observance of Standards & Codes
RWA	Regional Water Authorities
SIL	Specific Investment Loan
SMEs	Small and Medium Enterprises
SMP	Statistical Master Plan
TA	Technical Assistance
TBs	Treasury Bills
TF	Trust Fund
TFL	Lebanon Trust Fund
UBE	Universal Basic Education
UNDP	United Nations Development Program
UNRWA	United Nations Relief and Work Agency
VAT	Value Added-Tax
WBG	World Bank Group
WBI	World Bank Institute

ACKNOWLEDGEMENTS

A long standing and sustained collaboration between the World Bank Group and the Government of Lebanon shaped all stages of development of this Country Partnership Strategy (CPS). The CPS benefited from extensive and thoughtful discussions with government representatives and was also enriched by views from other partners in Lebanon – development partners, civil society organizations, parliamentarians, political and civil leaders, academics and representatives of the private sector – all of whom we warmly thank.

This Country Partnership Strategy was prepared under the guidance of Hedi Larbi, Country Director, by a team led by Demba Ba, Country Manager for the World Bank in Lebanon and Thomas Jacobs, Sr. Country Officer for the IFC. The CPS Core Team included: Sebnem Akkaya, Lead Economist; Husam Beides, Sr. Energy Specialist; Mohammed Benouahi, Lead Water and Sanitation Specialist; Mouna Couzi, Operations Analyst; Mona El-Chami, Sr. Financial Management Specialist; Abdelmoula Ghzala, Lead Infrastructure Specialist; Pilar Maisterra, Country Program Coordinator; Robert Maurer, Lead Urban Sector Specialist; Alaa Sarhan, Sr. Environmental Economist; Rapti Goonesekere, Sr. Economist; and Haneen Sayed, Lead Operations Officer.

The preparation of this CPS involved contributors from many units of the World Bank Group (WBG) particularly members of the Lebanon Country Team, whose country experiences and knowledge have also been extremely valuable in shaping the WBG partnership strategy. Although it is impossible to name them all, they are all to be thanked and congratulated for their excellent collaboration and teamwork. The following members made especially important contributions: Randa Akeel, Gender Specialist; Nada Abou-Risk, Program Assistant; Aseel Barghuthi, Junior Professional Associate; Chadi Bou Habib, Economist; Zeina El Khalil, Public Information Associate; Lina Fares, Procurement Specialist; Parameswaran Iyer, Sr. Water and Sanitation Specialist; Claire Kfouri, Water and Sanitation Specialist; Wael Mansour, Economist; Sabah Moussa, Sr. Executive Assistant; Hoveida Nobakht; Principle Operations Officer; Frank Sader; Colin Scott, Lead Specialist; Simon Stolp, Sr. Energy Specialist, Andrew Stone, Lead Private Sector Development Specialist; Janette Uhlmann, Country Officer; Sophie Warlop, Operations Analyst; and Mona Ziade, Communications Officer.

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Executive Summary

1. ***Lebanon's economy has repeatedly proved its resilience to external shocks and its ability to rebound quickly from crisis if political stability exists.*** But the need now is to put the economy on a path to high, sustainable, and broad-based growth. Sustained high growth is vital for Lebanon to improve its fiscal position and continue to move forward to achieve fiscal space and debt sustainability, create jobs for the fast-growing educated labor force and support social inclusion. Unique features of Lebanon's confession-based political system and challenging geopolitical environment have made it difficult for consecutive governments to implement needed reforms, despite a shared understanding of which reforms are critical for growth.

2. ***Lebanon's key near-term policy challenge is to maintain a prudent approach to economic management***. The financial sector has prospered thus far despite the global financial turmoil. But with high twin deficits and public debt, Lebanon remains vulnerable to external shocks and has limited fiscal space. Given the substantial exposure of commercial banks to the public debt, careful fiscal and debt management to maintain the confidence of domestic and foreign depositors and investors remains critical. Continued prudent monetary policies are also critical, for managing risks and buffering Lebanon from the effects of the global crisis.

3. ***Over the medium-term, achieving high growth and employment creation requires addressing the deeper structural economic determinants of growth and fiscal adjustment.*** The resources currently invested in the government debt are unlikely to be made available for productive investments while monetary policy continues to directly influence medium- to long-term interest rates. And the financial sector still lacks strong incentives to intermediate a large share of its liabilities towards productive investments.

4. ***The Policy Statement of the national unity government (in office since November 2009) and the 2010 Budget Law reflect a strong will to put Lebanon back on a steady and sustainable political and economic growth path.*** The Statement and the Budget Law identify electricity, water, telecoms, urban transport, local development, environment, public education, and social protection as priority focus areas in which reform and investment actions will produce tangible results that will revive the country's middle class, promote equity and fairness, widen access to better quality and more affordable health care and education and; provide adequate social safety nets for the most vulnerable. Success with these initial actions will create favorable social and political space that the Government could use to tackle the deeper and more difficult reforms that are needed to sustain development in these sectors and achieve broad-based growth.

5. ***The World Bank Group's (WBG) support to Lebanon over the past decade has focused mainly on post-war reconstruction and on macro and fiscal recovery.*** The partnership has been frequently jolted by political and security crises but it has been flexible and resilient, allowing frank dialogue. The current IBRD portfolio consists of eight active projects for a total net commitment of US$269.8 million, of which US$138.4 million has been disbursed to-date. It has supported the reconstruction of critical infrastructure. Project implementation is generally

satisfactory and the disbursement ratio over the last three years has been above the three-year average (FY08-FY10) for MENA and for the IBRD portfolio as a whole. IFC has played a key complementary role and its committed portfolio has risen from US$38 million at the end of FY05 to US$203 million as of June 2010. The donor community views the World Bank Group as leading the engagement of Lebanon's development partners to coordinate activities.

6. ***Going forward, an effective country partnership strategy must be shaped by political reality, able to respond flexibly to support reform when it does take place, and focused on economic and fiscal management as well as social stability.*** Under the CPS for FY11-14, the scope and degree of the World Bank Group's support will be determined by the Government's willingness and ability to undertake reforms in areas that are seen to contribute to growth, fiscal stability, and social cohesion.

7. ***The main objective of the CPS is to support the Government in putting the economy on a path to sustained, high, and broad-based economic growth.*** The Bank Group will continue to support the Government with investment lending and analytical and advisory services, through the existing loan portfolio, and through a new indicative lending envelope ranging between US$375 and US$550 million assuming reasonable pacing and distribution over the four-year CPS period. This lending and technical assistance will be complemented by IFC investments and advisory services.

8. ***In consideration of the country context and drawing from the lessons learned over the ISN period, the CPS adopts a two-tiered approach:*** (i) maintain a Core Program of engagement which consists of selected investments in basic services, as well as technical assistance and analytical work that will serve to inform and build momentum around key reforms; and (ii) stand ready to engage more deeply in additional areas that have been selected because of their critical role in supporting Lebanon's economic growth, fiscal and social stability, as well in reinforcing economic and trade relations with the Gulf and the Mashreq. The CPS envisages to engage in the areas of fiscal stability and public financial management, competitive business environment, economic infrastructure, human capital development and social protection.

9. ***The core CPS program will be assessed annually to determine the results achieved, and the Bank Group will stand ready to engage more deeply in areas where there is traction for reform***. The criteria for moving to deeper engagement in a given area are: (i) there is sufficient agreement within Government and among affected stakeholders on a well articulated policy reform agenda; and (ii) the reform will have a positive impact on one or more of the following: economic growth, fiscal space, and social inclusion. The Bank would be ready to provide budget support through a general or sector-specific development policy loan if Lebanon implements a sound macroeconomic framework and introduces a robust reform program that has a positive impact on the fiscal situation.

10. ***There is a risk that narrow sectarian interests will continue to overshadow national-level interests and obstruct the implementation of the government's newly adopted economic reform program***. This risk could be compounded if macroeconomic stresses develop as a result of external shocks. Maintaining the World Bank Group's analytical and advisory activities to build capacity for reforms and to stimulate and inform the debate around policy options should help build consensus around the reform program. Combined with continued strong engagement by the Bank in the development and implementation of a social protection strategy, these activities could provide an instrument to mitigate the risk.

COUNTRY PARTNERSHIP STRATEGY FOR FY11-FY14
LEBANESE REPUBLIC

I. COUNTRY CONTEXT

1. ***Lebanon is a small, high-middle-income country of 4.2 million people with a large diaspora of several millions, an area of 10,452 km^2, and an average GDP per capita of around US$7,000 in 2008***. More than 85 percent of the population lives in cities, and about half lives in the capital, Beirut. Youth below age 14 represent 25.8 percent of the population, while the active youth (age 18-35) account for 31.8 percent of the population. The country has long been known not only for its political instability but also for its talent in banking, education, and engineering and for its open economy and liberal press. Though it has no natural resources it is one of the few countries in the region with ample water resources and plentiful rainfall. Its service-based economy is driven by a dynamic private sector and is highly dependent on the Arab Gulf economies with significant linkages with the neighboring Mashreq economies in trade, labor, finance and real-estate. These strong linkages highlight the potential benefits that Lebanon could obtain from increased regional cooperation as promoted by the Arab World Initiative (AWI).

2. ***The economy has many times proven its resilience to external shocks and its ability to quickly rebound from crisis if political stability exists.*** Yet it is necessary during this Country Partnership Strategy (CPS) period to put the domestic economy on a path to high, sustainable and broad-based growth that will create the necessary employment opportunities to meet the needs of a fast growing educated labor force, and most importantly to achieve fiscal space and debt sustainability. Unique features of the country's confession-based political system and challenging geopolitical environment have made it difficult for consecutive governments to implement reforms, despite a shared understanding of which reforms are critical for economic growth.

A. Political Context

3. ***Lebanon is a sectarian-based consensual democracy in which political authority is shared among confessional groups***, with power divided largely between representatives of the Christian and Muslim communities. The Taef Accord, which ended the Civil War in 1990, established a system whereby the President, the Prime Minister, and the Speaker of the Parliament share power.

4. ***The consensual nature of the country's governance system render policy decision-making lengthy and can create deadlock*** that has, in the past, derailed government's drive for reform. Lebanon also has a unique position in the region, and its domestic politics are complicated by relations with external actors.

5. ***The country's complex political economy affects the quality of its public institutions of policy making as well as its public institutions of services delivery***, resulting in often low quality services being provided by the public sector. As a consequence, citizens turn to, sometimes, more costly alternative sources of service.

6. ***Lack of capacity has emerged as another obstacle to reform in most sectors.*** In general, the service delivery sectors are severely short in resources, especially skilled staff. The performance of

ministries and their capacity to deliver public services are therefore affected by the current staffing policy.

7. ***During the implementation period of the World Bank's Interim Strategy Note (ISN)—July 2007-June 2009—Lebanon's political situation was very uncertain. The hostilities in July, 2006 had caused serious human and physical losses and significant damage to the economy,*** jeopardizing national stability and ushering in a period of uncertainty. The International Community responded rapidly, pledging US$7.6 billion in aid at the Paris III Donor Conference in January, 2007. But not long after this Conference, and the adoption of the ISN to support implementation of the Government's Paris III reform program, the consensus for reform evaporated and Lebanon experienced major political conflict. Political stalemate resulted in the closure of Parliament, the withdrawal of the opposition from the Government, and an increase in political violence. The resulting instability and insecurity affected activities throughout the economy well into 2008.

8. ***With the Doha Accords of May 2008, the settlement of Lebanon's political crisis and the ensuing improvement in security resolved much of the uncertainty.*** The formation of a transitional coalition government ushered in a period of hope for a quick return of security and political stability that paved the way to legislative elections on June 7, 2009. The polls resulted in a victory for the March 14 political coalition, which led to the appointment of parliamentary majority leader Saad Hariri as Prime Minister. Prime Minister Hariri formed a "National Unity" Government in November 2009, following protracted negotiations with the opposition over the distribution of key ministerial posts.

9. ***Election debates of the economic platforms of the major political blocs revealed a consensus that prudent fiscal policy, responsible debt management, and improved service delivery to the people are*** critical for an inclusive and stable Lebanon. But while all political groups in Lebanon agree on the importance and objectives of reforms, they differ on how to reform, particularly with respect to the role that private sector should play in service sectors such as telecommunications and utilities.

10. ***Because of the complexity of the political landscape in Lebanon and the inherent difficulty of achieving consensus on reform and its implementation, an effective assistance strategy must be shaped by political reality and able to respond flexibly*** to support reform when it does take place. First-best solutions are not often feasible, given the political equilibrium, but any support strategy should work towards economic and fiscal management as well as social stability. In the coming period, the scope and degree of the World Bank Group's (WBG's) financial support will be determined by the Government's willingness and ability to undertake reforms in areas that are seen to be contributing to growth, fiscal stability, and social cohesion.

B. Social Context and Progress towards Millennium Development Goals

11. ***Regional disparities in living conditions are significant in Lebanon.*** Poverty is concentrated in the suburbs of large cities and in remote rural areas especially in the northern region of Akkar, which has been lagging behind the rest of the country; in this region, 80 percent of the population is rural and as many as 63 percent of the families are deprived and face serious poverty. Overall, nearly 28 percent of the Lebanese population (1 million) are considered to be poor, living on

US$4/day (Lebanon's "upper poverty line"), and 8 percent (300,000 Lebanese) are considered extremely poor, living on US$2.4/day (the "lower poverty line").[1]

12. ***Uneven living standards across Lebanon's regions reflect the absence of a regionally balanced development strategy, coupled with differences in educational attainment and human capital.*** Development efforts since the end of the Civil War have focused on post-conflict urban reconstruction, while the northern region, mostly rural, houses 46 percent of the country's extremely poor. In addition, influences from external forces promote suspicions among the population, and increase tensions in a country where the central government and state institutions are fragile and inefficient, and most citizens turn instead to their religious, tribal, or ethnic identities. Among Lebanon's most vulnerable and excluded groups are the Palestinian refugees, some 373,000, spread across 12 camps and other poor urban areas.

13. ***Compared with most other middle-income countries, Lebanon achieves relatively good health and education outcomes.*** At around 72 years, life expectancy in Lebanon is comparable with that in other middle-income countries. Infant and child mortality rates and the maternal mortality rate are below the regional averages for the Middle East and North Africa. Lebanon invests heavily in education, committing 13 percent of GDP for this purpose; 60 percent of this investment comes from private funds. Secondary school enrollment rates are 13 points above the regional average. However, weak institutional capacity and inefficiencies limit Lebanon's prospects of developing higher quality education and health services.

14. ***Though Lebanon invests heavily in human capital, it sees its best-trained people migrate abroad or face low rates of return domestically.*** The unemployment rate is estimated at more than 7.9 percent in 2008. Nearly half the unemployed (48.4 percent) are young people aged 15-24. Youth unemployment in Lebanon is estimated to be as high as the average for the Arab region (roughly 26 percent), the highest in the world.

15. ***Young women have been affected worse than young men.*** Unemployment is higher among women than men, at 9.6 percent compared to 7.7 percent (2004[). 2] Though women are as educated as men—the ratios of girls to boys in primary, secondary, and tertiary education are 0.97, 1.10, and 1.16, respectively—and the fertility rate is relatively low—at 2.2 births per woman[3]—women's labor force participation is low, at 37 percent, compared to the 55 percent average in other upper-middle-income countries.[4] On average, Lebanon's female workers are more educated than male workers, yet they experience wage discrimination, particularly at advanced employment levels, and face more challenging working conditions than their male counterparts.[5]

16. ***In tracking the world's progress towards achieving Millennium Development Goals (MDGs), the United Nations Development Program (UNDP) has suggested that Lebanon will achieve most of the MDGs by 2015, except for three:*** (i) halving extreme poverty; (ii) reducing child mortality; and (iii) reversing environmental degradation. For all the MDGs however, there remain important regional disparities in access, quality, and efficiency.

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[1] According to the 2004-2005 Living Conditions and Household Budget Survey. See "Poverty, Growth and Inequality in Lebanon," UNDP, 2007, and "Poverty, Growth and Income Distribution in Lebanon"; UNDP, August 2008.
[2] UNDP and the Lebanese Ministry of Social Affairs, The National Survey of Household Living Conditions (2004).
[3] Data are for 2006; World Bank Central Database (August 2008).
[4] World Bank Central Database (August 2008).
[5] "Gender-Based Differences among Entrepreneurs and Workers in Lebanon," The World Bank, December 2009.

C. Economic Context

17. ***The Lebanese economy is a service-oriented economy that has a long-standing and proactive trade tradition.*** Services and trade sectors account for 60 percent of GDP and 73 percent of jobs; both sectors have a significant potential for growth. Led by tourism and financial services—which are seen as the backbone of the Lebanese economy—the services sector alone account for about 35 percent of GDP. Lebanon receives massive financial transfers and capital inflows from abroad—net foreign inflows of services, capital, income and remittances reached 60 percent of GDP in 2009. Among the underlying reasons is the comparative advantage of the Lebanese banking sector which is governed by bank secrecy and exhibited strong resilience to adverse external shocks as well as internal political instability.

18. ***Lebanon's growth and job creation performance has been below potential in the face of its huge financial resources and overall improvement of key macroeconomic indicators over the last decade***. Most of these financial resources are consumed or unproductively invested, hence, preventing the extension and modernization of productive capacities, and in turn, economic growth and job creation. There has been moderate increase in investment which has been essentially directed to the real estate sector, which has accounted for close to 70 percent of total investments since 1997. Most of the remaining investments go to metallic industries that provide the construction sector with intermediary goods. In turn, these sectors rely mostly on non-Lebanese labor. Hence, concentration of investments in these sectors has little impact on the employment of Lebanese nationals while channeling productive resources into activities where productivity gains are potentially scarcer. Macroeconomic imbalances and related perceived risks (resulting in relatively high interest rates), as well as many barriers reducing competitiveness and investment opportunities are among the key factors that discourage longer-term productive investments in the economy.

19. ***Lebanon is recognized for its human capital and the entrepreneurship skills of its citizens; however it has traditionally faced significant migration and brain drain.*** With 54 percent gross enrollment rate in tertiary education, Lebanon exceeds by far the 26 and 23 percent rate registered respectively for the Middle East and North Africa (MENA) region and for Middle-Income Countries (MIC).[6] However, human capital seems to be undervalued in the domestic labor market. Gross private returns to education are low compared to international standards—an estimated 9 percent for Lebanon against 21 percent worldwide. This reflects low levels of productive investments in sectors that demand skilled labor. Along with political instability, low returns for education is a major factor behind the Lebanese brain drain. Migration is traditionally a large phenomenon with the Lebanese Diaspora, considered to be one of the largest in the world in terms of proportion to resident population. The Lebanese Diaspora has traditionally strong linkages to their home country: Lebanon was the 7th largest country in the world in terms of the ratio of incoming remittances to GDP in 2008 with 25 percent, making remittances inflows larger than Foreign Direct Investments (FDIs). Remittances remained strong in 2009 at 20 percent of GDP.

20. ***The hostilities in the summer of 2006 resulted in serious human and physical losses and caused a significant damage to the Lebanese economy.*** Though estimates vary, it is likely that total direct damages were around US$2.8 billion, with a further US$700-800 million in indirect

[6] World Bank's World Development Indicators, 2009.

damage.[7] Economic performance and employment has been severely affected with a significant loss of output from the hostilities in 2006.

21. ***These events, however, have amplified the urgency of reform and donor response. In the months following the hostilities and while addressing the urgent reconstruction and recovery needs, the Government worked to adapt its medium-term economic program to the new circumstances and presented it at the Paris III Donor Conference in January, 2007.*** The program made an effort to balance fiscal measures needed for stabilization with structural measures needed for higher growth. Donors responded favorably and generously to the program, pledging a total of US$7.6 billion assistance, of which 76 percent were signed into agreements and about 52 percent disbursed by the end of May, 2010.

22. ***The reform efforts suffered a significant setback with a prolonged political impasse through May 2008, but reconstruction and recovery progressed speedily.*** While the strong recovery helped in containing the fiscal and public debt position, Lebanon's fiscal deficit before grants remains high (9.7 and 8.5 percent of GDP in 2008 and 2009, respectively) and continues to feed a very high public debt (148.0 percent of GDP in 2009). The majority of Lebanon's public debt (US$50.7 billion at end-2009) is held by private creditors, particularly by domestic commercial banks holding 57 percent of public debt. The public debt is predominantly short-term (about 46 percent is scheduled to mature by the end of 2011, and 21 percent by the end of 2010). It is very probable that high interest rates linked to the public debt overhang do not encourage long term productive investments. Unless Government financing needs strongly decline, investors would continue to prefer to invest in highly remunerative short-maturity bonds. Significant levels of new growth and fiscal effort are, in turn, required to stabilize Lebanon's presently unfavorable debt dynamics.

II. RECENT ECONOMIC DEVELOPMENTS, AND MACROECONOMIC OUTLOOK

A. Recent Macroeconomic, Fiscal, and Financial Sector Developments

23. ***Despite the protracted political and security crisis and the adverse external economic environment in the aftermath of the 2006 hostilities, the economy recovered at a much faster pace than originally envisaged.*** Real growth rebounded to 7.5 percent in 2007 and 9.3 percent in 2008. Preliminary figures for 2009 show a real growth rate of 9.0 percent and estimation for 2010 is 8.0 percent. Although there was in 2009 some slowdown in foreign trade-in-goods and overall transactions[8] in the economy, reflecting the adverse impact of the global economic downturn, this impact remained much more measured than originally envisaged, leading the Central Bank (Banque du Liban- BdL) to revise the real GDP growth projections for 2009 up from 3 percent expected early in the year. While the growth performance in 2007 is explained by a low base in 2006 (when real growth was 0.6 percent), the growth thereafter was supported by sustained strong regional demand for Lebanon's services and large inflows of transfers and capital (services exports increased by about 38 percent in 2009 over and above the 44 percent increase registered in 2008, and net inflows of services, income, transfers, and capital reached over 60 percent of GDP in 2009).

[7] Over 1,000 people were killed, 5,000 were injured and close to one million (a quarter of the population) were internally displaced. Additionally, brain drain accelerated as up to 200,000 people left the country.
[8] Source BdL – Compensated Checks.

24. ***Inflation decelerated in 2009, following the drop in international prices, which has brought import costs down***. Imported inflation in Lebanon has a strong impact on the Consumer Price Index (CPI) since imports of goods amount to about 40 percent of domestic absorption. The deceleration of prices was particularly prominent between April and October when the CPI increased by only 2.1 percent on average (y-o-y)—the overall increase in the CPI remained low at 2.8 percent in 2009 compared to the 10.7 percent average increase in 2008[9]. It should be noted that the CPI index does not directly reflect trends in real estate prices, which, following a substantial increase in 2008 (about 50 percent on average), remained high in 2009, reflecting strong capital inflows, and persistent demand and supply in the sector.

25. ***The decline in international prices of commodities is having a positive impact on Lebanon's foreign accounts.*** The trade-in-goods deficit increased by only 0.8 percent in 2009 (y-o-y) compared to 41 percent a year earlier, reflecting mainly the deceleration in imports. Exports of services continued to improve in 2009 with tourism arrivals to Lebanon increasing by a substantial 39 percent during this period. As a result, the current account deficit is estimated to have declined to 15.5 percent in 2009 (from a high of 18.5 percent in 2008) and continues to be easily financed by external inflows. Net foreign inflows of services, transfers, income and capital reached US$20.7 billion in 2009, up from US$16.1 billion registered in 2008. Similarly, change in net foreign assets reached US$7.9 billion, up from US$3.5 billion a year earlier. The continued inflow of capital has helped to bolster the value of the Lebanese Pound (LBP) which is pegged to the US dollar.

26. ***Lebanon's financial market developments have been favorable despite the global financial turmoil. Deposits and reserves have risen sharply since 2008.*** The money supply increased by US$13.4 billion (39 percent of GDP) in 2009, out of which about 55 percent has been registered in the second half of the year. Lending to the private sector remained strong, increasing by 15 percent in 2009. This reflects the sharp increase in resources of commercial banks, as well as the increase in incentives from BdL to promote lending in local currency. The incentive measures included expansion in the sector coverage of the subsidy on interest rates,[10] and exemptions on compulsory reserves for loans denominated in local currency (LBP), excluding consumer loans and real estate lending. Gross foreign currency reserves hit a new high of US$25.7 billion in December, 2009 (equivalent to about 19 months of imports of goods), up from US$17.1 billion in December, 2008. The dynamic of reserves reflect both higher capital inflows and a shift by depositors out of dollars into the local currency because of the interest rates advantage.[11] Reflecting these developments, the dollarization of deposits declined to 64.5 percent by December 2009 from 69.6 percent at end-2008 (77 percent at end-2007).

[9] Source: Consultation and Research Institute (CRI).

[10] Since 2000, the BdL and the Government initiated schemes to promote lending to private sector investment operations. These initiatives include subsidizing interest payments of the borrowers, extending special guarantees to the borrowers, and granting exemptions on compulsory reserves of creditors. Initially focusing on projects in agriculture and industry, these schemes were gradually expanded to include other sectors, such as ICT, environment/energy efficient projects, tourism and housing. Although the special schemes exist also for loans denominated in foreign currencies, they are essentially directed toward lending in LBP. All currencies taken together, these schemes are particularly developed in agriculture (84 percent of total lending – mostly in LBP), tourism (70 percent), housing (59 percent – all in LBP), and industry (42 percent). Without these schemes, some sectors, especially agriculture, would have been crowded out from the credit market. Also, with the sharp rise in real-estate prices, these schemes are allowing access to housing by the resident middle-class.

[11] With the sharp decline in the Libor, the spread between deposits in LBP and deposits in foreign currencies widened by increasing from 271 basis points (bpt) in December 2007 to 389 bpt in December 2008 and remaining high thereafter at 370 bpt.

27. ***Strong growth and higher revenue collection checked the increase of fiscal deficit and public debt ratio, but fiscal deficit remains high.*** Despite increased expenditures (as a result of higher transfers to the Electricité du Liban (EdL), and wage and some non-wage benefits in the public sector introduced in 2008 in response to a sharp increase in inflation), strong domestic revenue collection helped contain the fiscal deficit (excluding grants) at around 9-10 percent of GDP over the last two years. This brought faster improvement in the primary fiscal balance than had been expected. These improvements partially checked the growth in debt which is estimated to have declined to 148.0 percent in 2009 (see Table 1 below). However, high growth is the single most important driver of the fast improvement in the debt ratio since 2007. Interest payments remained high at around 11 percent of GDP during this period (about 46 percent of revenues), continuing to feed the high public debt. The composition of debt changed between end-2008 and December 2009, with an increase in the share of debt denominated in LBP to 58 percent of total debt. The average interest rate on foreign currency debt slightly increased to 7.35 percent in December 2009, up from 7.24 percent at end-2008 which reflects the exchange before maturity of US$1.9 billion worth of debt against new issuances of Eurobonds at higher interest rates[12] in early 2009. However, issuances of Eurobonds since December, 2009 are on rather favorable terms. In March 2010, Lebanon issued US$1.2 billion worth of Eurobonds with a 10-year-maturity and a coupon rate of 6.375 percent.[13]

Table 1: Drivers of Change in Public Debt Ratio: 2007-2013

In Percent of GDP	2007-Act.	2008-Act.	2009-Prel.	2010-Est.	2011-Proj.	2012-Proj.	2013-Proj.
Debt	167.8	157.1	148.0	139.0	133.6	129.2	124.3
Change in Debt	-12.1	-10.7	-9.1	-9.0	-5.4	-4.3	-5.0
Contribution of:							
Primary Balance Including Grants	-2.4	-2.2	-3.0	-1.7	-1.1	-1.6	-2.0
Interest Payments	12.4	11.0	11.1	10.2	9.8	9.1	8.5
Public Sector Deposits	0.2	8.4	4.2	0.0	0.0	0.0	0.0
Nominal GDP Growth Effect	-18.7	-27.4	-20.9	-17.5	-14.1	-11.8	-11.4
Other Items	-3.6	-0.6	-0.5	0.0	0.0	0.0	0.0
Memo Item: Grants	*-1.4*	*-0.9*	*-0.4*	*-0.4*	*-0.2*	*-0.3*	*-0.3*

Source: Official Data and World Bank Staff Calculation

Notes1: (-) sign indicates contribution to reduction in debt and (+) to increase in debt

Note2: BdL erased about US$2.0 billion of government debt in 2007 through re-evaluation of its stock of gold.

B. Medium-Term Macroeconomic Prospects

28. ***The key near-term policy challenge for Lebanon is maintaining a prudent approach to economic management.*** Lebanon's financial sector has so far prospered despite the global financial turmoil. However, with high twin deficits and public debt, Lebanon remains highly vulnerable to confidence and external shocks and has limited fiscal space. Therefore, careful fiscal management to maintain confidence of all (domestic and foreign) depositors and investors remains critical for Lebanon's economic prospects, given the substantial exposure of commercial banks to

[12] The exchange was done in three issuances: two in US$ and one in Euro. One issuance in US$ is maturing in 2012 and has an interest rate of 7.5 percent. The other issuance in US$ is maturing in 2017 and has an interest rate of 9 percent. The issuance in Euro is also maturing in 2017 with an interest rate of 7.75 percent.

[13] The Eurobond issue was managed by three Lebanese banks and subscribed essentially by domestic investors, including banks. The proceeds of the operation were utilized for the redemption of the US$1.065 billion Eurobonds with a rate of 7.125 percent due in March, 2010.

the public debt. A stable political and security environment and continued prudent monetary policies are also critical to managing risks – including security risks, both internal and those stemming from regional tensions - and buffering Lebanon from the effects of the global crisis.

29. ***Over the medium-term, however, sustaining high growth rates will call for implementation of key structural reforms.*** While fiscal adjustment is a necessary condition to improve Lebanon's long-term growth potential, it is not a sufficient one. Resources that are currently invested with the government could be prevented from financing productive investments while monetary policy continues to directly influence medium- to long-term interest rates, and the financial sector's incentives to intermediate a large share of its liabilities towards productive investments remain weak. Unless Government financing needs strongly decline, investors will prefer to invest in highly remunerative short-maturity bonds whose remuneration in US dollars is guaranteed by the monetary policy in place since the mid-90s. Improving the performance of the country in terms of growth and employment creation, however, requires addressing deeper structural economic causes that will help create new growth and facilitate fiscal adjustment.

30. ***Bank staff projections for the medium-term (2011-2013) take into account the importance of the external economic environment, political stability and evolving medium-term economic program expressed in the Government's Policy Statement.*** The base-case scenario assumes a political environment that is conducive to decision-making, as well as the absence of major military action related to regional tensions, and takes account of: (i) an expected gradual increase in oil prices (and hence of regional oil wealth) and their impact on foreign inflows and growth; (ii) a projected gradual recovery in growth—in the region and world-wide—and its impact on demand for Lebanon's exports of goods and services; (iii) government's plan to increase public investments in key service sectors (in particular, electricity, telecom, water and roads maintenance) over the medium-term, financed essentially through a decline in primary surplus while new tax measures (including long overdue increased taxation in the real estate sector and slightly higher taxes on interest income), would start gradually bringing additional revenues over the longer run; and (iv) government's program to stimulate private investment and growth, including through improved service delivery, and enhanced public-private-partnership (PPP).

31. ***The above assumptions combined with the current present favorable economic dynamics and constructive political environment project an average 6 percent growth over the medium-term.*** Available early indicators for the first half of 2010 point to continued good economic performance over the near-term. Over the medium-term, the Government's evolving economic program suggests initiation of structural reforms (particularly energy, water, telecom and private sector development) that would improve the business/investment environment, competition, the entry and operation of Small- and Medium-Enterprises (SMEs), and service delivery, which collectively would upgrade, to some degree, the long-term growth potential of the Lebanese economy. Many of these reforms (particularly energy and telecom sector reforms) are considered urgent by private sector representatives and will raise business confidence considerably. In the medium-term, it is also expected that the flow of income transfers, remittances, Foreign Direct Investment (FDI), and portfolio investments into Lebanon will remain favorable (albeit at rates closer to historical averages) due to the gradual rise in oil prices, as well as the positive response of domestic private investment to the Banque du Liban incentives summarized above (given higher reserves and lower inflation) and overall improved business confidence in Lebanon's economic prospects. These factors would collectively help stimulate growth and reduce interest rate spreads, thereby helping offset the negative short-term impact of gradual fiscal consolidation on aggregate demand. Based on these factors, we expect real GDP growth to converge to a higher trend growth

of about 6 percent on average in the medium-term along with an improvement in the public debt ratio (see Table 1).

Table 2: Lebanon's Medium-Term Macro Outlook

	2007-Act.	2008-Act.	2009-Prel.	2010-Est.	2011-Proj.	2012-Proj.	2013-Proj.
Growth & Prices							
GDP growth-real	7.6%	9.3%	9.0%	8.0%	7.0%	6.0%	6.0%
CPI	-3.5%	10.4%	2.8%	4.9%	3.6%	3.1%	3.1%
Public Finance							
Public Debt	*167.7%*	*157.1%*	*148.0%*	*139.0%*	*133.6%*	*129.2%*	*124.3%*
Fiscal Balance Including Grants	*-9.3%*	*-8.8%*	*-8.1%*	*-8.5%*	*-8.7%*	*-7.5%*	*-6.5%*
Primary Balance Inclduing Grants	*3.1%*	*2.2%*	*3.0%*	*1.7%*	*1.1%*	*1.6%*	*2.0%*
Total Expenditures	*33.9%*	*33.1%*	*32.9%*	*32.9%*	*32.8%*	*31.6%*	*30.6%*
Interest Payments	12.4%	11.0%	11.1%	10.2%	9.8%	9.1%	8.5%
Transfers & Subsidies	5.0%	5.5%	4.7%	5.3%	5.2%	4.8%	4.4%
Other Current Primary Expenditures	13.8%	14.7%	15.5%	14.7%	14.5%	14.5%	14.4%
Public Investment	2.7%	1.8%	1.6%	2.6%	3.2%	3.3%	3.3%
Total Revenues	*24.6%*	*24.2%*	*24.8%*	*24.4%*	*24.1%*	*24.1%*	*24.1%*
Foreign Grants	1.4%	0.9%	0.4%	0.4%	0.2%	0.3%	0.3%
Domestic Revenues	*23.2%*	*23.4%*	*24.4%*	*23.9%*	*23.9%*	*23.9%*	*23.9%*
Direct Taxes	6.0%	6.3%	6.1%	6.1%	6.1%	6.1%	6.1%
Indirect Taxes	11.6%	12.4%	13.4%	13.4%	13.4%	13.4%	13.4%
Non Tax Revenues	5.5%	4.7%	4.9%	4.5%	4.5%	4.5%	4.5%
External Sector							
Exports of GNFS	23.0%	24.6%	22.3%	21.7%	21.2%	20.9%	20.7%
Imports of GNFS	48.2%	53.7%	47.0%	46.2%	45.2%	44.7%	43.9%
Current Account Deficit	*-11.2%*	*-18.5%*	*-15.5%*	*-15.4%*	*-15.2%*	*-15.1%*	*-14.8%*
FDI	8.8%	9.1%	10.8%	10.1%	9.6%	9.1%	8.5%
Reserves	39.0%	57.0%	74.3%	65.6%	58.9%	53.7%	49.0%
Memo Items							
Average Cost of the debt	7.7%	7.8%	8.2%	7.8%	7.8%	7.5%	7.2%
Primary Balance of Stabilisation		-16.4%	-9.8%	-7.3%	-4.3%	-2.7%	-3.0%
Nominal GDP - US$ million	25,047	29,933	34,528	39,155	43,572	47,802	52,444
Debt Service to Domestic Revenues	53.7%	47.0%	45.5%	42.6%	41.0%	38.1%	35.6%

World Bank Staff Calculations.

32. ***The twin deficits are expected to slowly improve during the projection period. The current account deficit in 2009 was lower at 15.5 percent of GDP (compared to over 18.5 percent of GDP in 2008), and it is projected to continue to slightly improve through 2013.*** Reflecting the Government approved plan for improving the performance of the electricity sector, transfers and subsidies would decline moderately starting in 2011. In parallel, public investment will be higher to address, in particular, supply deficiencies in the electricity and water sectors, and to upgrade telecom services and roads. The Government also maintains emphasis on improving the effectiveness of expenditure management as a whole. Tax revenues are expected to remain robust with the impact of the rise in direct taxes gradually materializing in the longer run. Non-tax revenues – essentially transfers from the Telecom sector – are expected to remain constant in percent to GDP. Accordingly, 2010 budget expenditures are estimated to remain high at 32.9 percent of GDP, and the primary surplus before grants is projected to be squeezed down to around 1 percent of GDP in 2011 before starting to recover in 2012. The ratio of revenues to GDP is projected to remain stable and the debt to GDP ratio is expected to continue to gradually improve in 2010-2013.

33. ***On the financing side, Lebanon has recently resumed borrowing in foreign currencies. The abundance of liquidity in domestic currency, particularly since the onset of the global financial crisis, has led the Government to opt for increasing net financing from domestic sources in domestic currency.*** Indeed, the share of Lebanese Commercial Banks in the debt portfolio increased to 56.7 percent in December, 2009 from 54 percent in December, 2008, and the share of the Central Bank increased to 13.4 percent from 11.9 percent. The financing from these two sources was mainly in domestic currencies. In 2010, the Government has so far continued financing the deficit by issuing LBP-denominated Treasury Bills (TBs) and resumed the issuance of Foreign Currency-denominated debt. The new Eurobonds issuances are re-equilibrating the composition of debt towards the legal ceiling of 50 percent of foreign currency-denominated debt, taking advantage of the low interest rates in the international market. In addition, low cost, concessional foreign debt financing also remains available subject to accelerated structural reforms, with a large portion of Paris III pledges remaining undisbursed (52 percent including funds tied to structural reforms).

34. ***The costs of divergence from a solid reform route are high.*** The medium-term reform scenario suggests that even with fiscal adjustment (with 1.6 percentage points of GDP lower fiscal deficits between 2009 and 2013) and a fairly positive growth response in the medium-term, debt will remain high (124 percent of GDP in 2013), largely because of the continued high cost of servicing the large debt stock (see Table 2 above). In the event of a weak policy response and a deteriorating internal and/or external political environment, and/or unfavorable external shocks, Lebanon's growth potential would remain repressed (on average at around its historical trend rate of 3.5 percent for the period 1993-2006) due to a lack of profitable business opportunities, weak external competitiveness and low levels of business confidence in economic prospects. Primary public spending in terms of GDP would also remain at its historical average, and interest payments in terms of GDP would remain high. In such a low growth scenario, the fiscal deficit would remain unsustainably high (at double digit levels in terms of GDP), and the debt-to-GDP ratio would grow back to the high level experienced just a few years ago. This would inevitably further expose the country to a risk of financial disruption, should investors, holding the vast majority of Lebanon's debt, lose confidence in the country's debt servicing capacity.

III. LEBANON'S PRIORITIES AND AGENDA FOR DEVELOPMENT

35. ***At the Paris III Conference in January 2007, Lebanon presented its "Reconstruction, Recovery, and Reform" Program for 2007 to 2011.*** This medium-term structural reform program consisted of six main pillars: (i) economic revival; (ii) social sector reform; (iii) macro-fiscal reform; (iv) privatization; (v) recovery and reconstruction; and (vi) budget support. Thirty-eight donors and institutions pledged about US$7.6 billion in support of the program (equivalent to one third of Lebanon's GDP). About 52 percent of this amount had been disbursed by end-May 2010.

36. ***Though reconstruction and recovery progressed speedily, the apparent consensus on the reform agenda quickly dissolved and little, if any, progress was made on reforms.*** A political crisis emerged, lasting for about 18 months and leading to the formation in September, 2008 of a transitional government until the parliamentary elections in June, 2009.

37. ***The new Government, in office since November 2009, established its program "Progress and Development" (ESP) as a cornerstone for its policy statement to Parliament.*** The ESP

embodies the economic and social development platform of the national unity Government and reflects a strong will to put Lebanon back on a steady and sustainable political and economic growth path. The ESP seeks to: (i) revive the country's middle class through job creation and better distribution of wealth, for example: by broadening ownership of real estate and improving access to economic infrastructure; (ii) improve the quality of Lebanese life through better safeguarding the environment, widening access to better quality and more affordable health care and education, and providing adequate social safety nets for the most vulnerable; and (iii) promote equity and fairness through broadly-based growth, narrower regional disparities, reduced gender disparities, reliance on the rule of law, and good governance to restore the credibility of state institutions.

38. ***To achieve these objectives, the ESP calls for leveraging the framework that Paris III provides to implement a national program, including a set of well-targeted structural reforms and investments for enabling growth:*** (i) sound fiscal management that provides a sustainable macroeconomic framework while offering fiscal space to offer adequate social and infrastructure services and social safety nets for the most vulnerable people; (ii) a modernized, effective, and strong public administration; (iii) adequate physical infrastructure, especially for utilities and transport; (iv) an appropriate regulation and risk-sharing framework for effective private participation in the economy, particularly in telecoms services; and (v) adequate social protection services and an education system whose planning and production are matched to the demand for skills in the domestic and global labor market. The ESP also recognizes the need to pay special attention to the challenges posed by environmental degradation and gender imbalances and to leverage existing economic and sector work in these two areas to fast-track reforms.

39. ***The Government has identified electricity, water, telecoms, urban transport, local development, environment, public education and social protection as priority focus areas*** in which immediate reform and investment actions will produce tangible results toward meeting the pressing needs of the population. Success with these initial actions would create favorable social and political space that the Government could use to tackle the deeper and more difficult reforms that are essential for putting these sectors on a sustainable development path and the economy on a sustainable broad-based growth.

- ***Electric power:*** The Cabinet has adopted in June, 2010, a Policy Note and an Action Plan to reform the power sector in order to provide continuous and cost-effective electric power to all citizens and productive sectors. The Plan seeks to increase in the short-term generation capacity by at least 600 MW, as well as implement energy-efficiency and savings programs, thus preparing the ground for deeper reforms of tariff and sector management and governance. The Plan also aims to implement strict bill collection measures through the private sector and will encourage energy conservation, the use of clean technologies, and renewable energy resources such as solar power.

- ***Water supply:*** The Government is seeking to improve access to water and the continuity of water supply to fulfill the increasing demand, by improving water distribution and conservation and completing the water infrastructure of the Greater Beirut Regional Water Authorities. It also seeks to rationalize water consumption and to promote the preservation of water resources. With regard to wastewater, the Government aims to stop the contamination of groundwater, improve the operation of existing treatment sites, and accelerate the construction of new sites to protect the natural resources.

- ***Telecommunications*****:** The Government seeks to modernize the infrastructure and regulatory framework so the sector can provide modern and cost-effective Information and Communication Technology (ICT) services with the aim of stimulating private sector led economic growth. It plans to expand the penetration rate and to tackle gaps in the quality and range of service through the extension of broadband services and private sector participation in the provision of telecommunication services and related business.

- ***Urban transport:*** The Government seeks to improve public transport to facilitate the movement of citizens and to reduce transport costs and delays. It will launch a national plan for public transport services and establish traffic control centers, install more traffic signals, and firm up the punitive measures for traffic violations.

- ***Local development:*** In response to sustained urbanization the Government recently adopted the National Land Use Master Plan which provides the framework for a more balanced territorial development promoting social cohesion while building on the fast growing tourism sector potential and using the exceptionally rich historical and cultural heritage assets of the country for economic development.

- ***Environment:*** The Government envisages actions to encourage the use of clean energy and renewable energy, along with adopting sustainable management policies for solid waste, wastewater, water, and reforestation programs.

- ***Education:*** The Government objectives are to improve the quality of public education by expanding access to early childhood education, reducing dropout and repetition rates, enhancing the qualifications and performance of the teaching workforce, adopting school-based planning, development and improvement, establishing a National Qualifications Framework which will link the various education levels to the labor market, and introducing quality assurance at the higher education level.

- ***Social protection:*** The Government intends to accelerate the implementation of reforms that were started under Paris III, the most critical of which are: the introduction of the new pension law, which replaces the ill-functioning End-of Service Indemnity (EOSI) system with a defined-contribution, fully-funded pension system; improving the financial sustainability of the National Social Security Fund (NSSF), as well as, the quality and efficiency of its services and operations; and the expansion and rationalization of health insurance within a unified framework.

- ***Labor Markets:*** In the area of employment and labor market policies, the Government defined an ambitious program which includes developing a framework for effective Active Labor Market Policies and Programs (ALMPs), particularly for youth and gender inclusion; modernizing labor market policies including related regulations; developing income protection mechanisms for workers (such as unemployment insurance); and strengthening the Ministry of Labor's capacity to lead the reform process and its implementation. In the area of social safety nets, the Government intends to implement a nation-wide program of targeted social assistance through the National Poverty Targeting Program (NPTP).

IV. THE WORLD BANK GROUP PARTNERSHIP STRATEGY

A. Nature of the Partnership

40. ***The World Bank Group and Lebanon have built a strong partnership*** that has enabled frank and substantive discussion about the country's development challenges, as well as, about the political economy and its impact on the Government's ability to implement reforms. Over the past decade the framework for the Bank Group's support has focused primarily on post-war reconstruction and on macro and fiscal recovery. The partnership has been frequently jolted by political and security crises linked to the unique features of Lebanon's political system and geographic location.

41. ***The experience over the past five years highlights the Bank Group's ability to be flexible and to respond to unanticipated changes in the country's circumstances and needs.*** Following the 2006 hostilities, the Bank acted quickly to help assess the extent of the damage and the scope of Lebanon's reconstruction needs and to assist in the reconstruction of basic municipal and urban infrastructure. It also played an important role in supporting the fiscal and structural reforms of the Government's Paris III agenda, including through emergency support to the budget. The ISN set out a 15-month transitional framework of technical and financial assistance to support the Government's efforts to create reform momentum, paving the way for broadening and deepening these reforms as the political environment stabilized. Through these actions, the Bank also helped lay the foundation for an effective and more inclusive social safety net, better public financial management, and increased private sector development.

42. **Similarly, IFC was quick to engage with the Bank in supporting the recovery of the private sector**. During this period, IFC opened a Country Office in Beirut (co-located with the Bank) and significantly scaled-up its activities in Lebanon. IFC exceeded its Paris III/Reconstruction pledge of US$250-275 million, having committed almost US$770 million since the end of the 2006 conflict and through June 30, 2010. During this period, IFC's investment and Advisory Services emphasized: (i) increasing access to financial services for SMEs and trade finance activities; (ii) easing administrative constraints; (iii) promoting improved corporate governance; and (iv) improving competitiveness and facilitating greater private investments. Coordination between the Bank and IFC has continued to strengthen, leading to this first joint CPS for Lebanon.

43. ***Because of the continuous frank dialogue that the Bank has enjoyed with Lebanon over the last decade,*** as well as its track record in responding effectively to Lebanon's requests for assistance, the WBG is now well placed to engage the GoL in a partnership that seeks to achieve sustainable, broad-based, high economic growth, which is central to moving the Lebanese economy from the current high-risk equilibrium to a more sustainable fiscal and debt equilibrium. This CPS also recognizes that the Lebanese economy is among the most linked with the Mashreq and GCC economies; and hence the Bank Group will support the GoL in adopting a proactive regional integration approach to addressing some of its key development challenges in areas such as: electricity, trade, labor, and finance, while remaining cognizant of the challenges posed by the geo-political environment in the region, especially with regard to security.

44. ***Recognizing that women's economic activity can play an important role in Lebanon's productivity and economic growth***, and given the multidimensional factors that affect the choices that they make, the WBG will pursue a gender-integrated approach, including monitoring of key

gender indicators in selected areas of WBG intervention (human capital development and social protection; business environment and SMEs; and infrastructure).

B. Implementation of the ISN and Lessons Learned

45. ***The ISN was prepared in the aftermath of the summer 2006 hostilities and the ensuing political impasse which had rendered some of the CAS (approved in December, 2005) assumptions and projections untenable.*** The ISN was designed to support the Government's medium-term structural reform program - Paris III - discussed at the International Donor Conference in January, 2007. However, implementing this ambitious program required broad political support and consensus on key reforms, which proved to be short-lived as a political crisis emerged, lasting about 18 months and leading to the formation of a care-taker government until the parliamentary elections of June, 2009. As such, while the ISN priorities were fully aligned with Lebanon's own priorities, the design of the strategy was generally appropriate to the challenging country circumstances, and the quality of the portfolio has shown considerable improvement over the period, implementation of the reform program itself has been slow**.**

46. ***The portfolio currently consists of eight active Bank projects for a total net commitment of US$269.8 million, of which US$138.4 million has been disbursed to-date.*** These projects have been financed by a mix of IBRD (US$209.7 million) and the Lebanon Trust Fund (US$60 million). The latter was created with a transfer from IBRD net income in September 2006, following the summer 2006 hostilities. In addition, Lebanon has been able to access a variety of existing Bank-administered trust funds, including Institutional Development fund grants, Development Grant Facility grants, Cities Alliance grants, Persistent Organic Pollutants and grants from the State and Peace-Building Fund.[14] The current portfolio includes seven of these grants, totaling US$3.4 million. The portfolio has supported the post-war reconstruction of critical infrastructure (especially in the areas of water supply and sanitation, urban transportation, and urban development) and the strengthening of capacity in public institutions in need of reform (in electricity, social protection, and fiscal management). It is worth noting that trust funds have played a central role in the World Bank's support to Lebanon and have been instrumental in the preparation of structural reforms under the ISN and Paris III. This support was also bundled with IFC investments to facilitate bank lending to SMEs affected by the conflict through advisory support and risk guarantees. Trust funds have also been used to support the reconstruction of the Nahr El-Bared camp and its adjacent communities. In addition to the US$2 million grant from the Development Grant Facility, which is financing small-scale infrastructure projects and services for the communities surrounding Nahr El-Bared, the Bank has set-up a Multi-Donor Trust Fund (MDTF) which channels donor contributions to the United Nations Relief and Works Agency (UNRWA) for the reconstruction packages for the old camp and has been fully disbursed.

47. ***Project implementation is generally satisfactory.*** With an average disbursement ratio of 27percent over the last three years (FY08-FY10), Lebanon's portfolio has performed better in this regard than MENA (21percent disbursement ratio) and the IBRD portfolio as a whole (25percent disbursement ratio). While all projects are expected to achieve their development objectives, the sustainability of the outcomes will continue to depend on the implementation of sector reforms and sufficient expenditure on maintenance.

[14] For a complete list of Trust Funds, see Annex 2.

48. ***The Bank has also produced and disseminated a number of pieces of analytical work and just-in-time policy notes that have shaped policy debates*** and provided policy advice and analytical underpinning for reform, namely in electric power, water, education, agriculture, broadband deployment strategy, pensions, labor markets, investment climate, gender, and environmental management (see Annex B4 for the complete list).

49. ***IFC's program in Lebanon has grown significantly over recent years,*** with the committed portfolio increasing from only US$38 million at the end of FY05 to US$203 million through June 2010. IFC has played a key complementary role to IBRD in Lebanon, having committed almost US$770 million since August 2006, as part of the WBG response to Paris III. More than US$580 million of this was provided in trade finance through guarantees provided to Lebanese banks under IFC's Global Trade Finance Program. IFC commitments, via a variety of equity, debt, and guarantee instruments, included more than US$150 million for local banks to lend to smaller businesses. This was facilitated by a US$15 million grant from IBRD that, in part, was used to support risk participation agreements by IFC to encourage bank lending to the SME sector. In 2010, IFC invested US$100 million in equity in Byblos Bank to help in its local and regional expansion. Building on its achievements during the ISN period and in line with the renewed commitment to the Arab World Initiative, IFC aims to support the regional expansion of Lebanese real sector firms, while continuing to support increased access to finance for small- and medium-enterprises. A focus on equity transactions, the energy sector, and the environment are expected to be core to IFC's program during the period of the CPS.

50. ***Reflecting back on the ISN implementation period, a number of key lessons can be*** drawn around the need for realism and flexibility in the Bank Group's support to Lebanon. Specifically: (i) the complexity of the political environment for decision making in Lebanon should not be underestimated; (ii) it is helpful to establish a flexible framework of activities that can be scaled up or down according to progress made on the reform program; (iii) it is important to set realistic objectives; and (iv) simple project design and the use of adaptable instruments are necessary to be able to respond flexibly to challenges and changing priorities.

C. Consultation Process

51. ***Together with the IFC, the Bank embarked on broad consultations at the start of the CPS process***, seeking to achieve a wide consensus from Lebanon's highly politicized and diverse stakeholders. The consultations involved: (i) rival political groups, including parliamentarians; (ii) public institutions; (iii) the donor community; (iv) the private sector; and (v) NGOs, academicians, and representatives of the civil society at large. These consultations helped to consolidate the focus and scope of the CPS draft. They also reinforced the Bank Group's growing image in Lebanon as a "Knowledge Bank," judging from the participants' feedback, and garnered wide support for the institution's Access to Information Policy.

52. ***Political parties and public officials show a reasonable level of agreement on the reform priorities outlined in the GoL's priority Action Plan***, but they differ over the implementation options. Their differences are clearly shaped by political interests.

53. ***Lebanon's private sector sees the need to improve the business environment to encourage investment and job creation and curb brain drain.*** Some key complaints of the private sector include the country's inadequate infrastructure and the weak enforcement of laws, especially

commercial laws, which undermines investor confidence. More support for SMEs is needed as a way to reduce the migration of skills.

54. ***The civil society organizations display a clear lack of confidence in the state and its institutions under the existing consensual power-sharing formula***. They voiced strong support for a Bank role in facilitating agreement on some of the less controversial reforms, such as in the electricity and water sectors, and cautioned against an ambitious strategy that would be undermined by the prevailing political economy.

55. ***The donor community views the Bank as leading the engagement of Lebanon's development partners to coordinate activities.*** The political economy issues and the historical context of the policy reform challenges should be further discussed within the donor community given Lebanon's unique political equilibrium.

D. Strategic Objectives of the CPS

56. ***The main objective of the CPS is to support the GoL in putting the Lebanese economy on a path to sustained, high and broad-based economic growth*** which is critical for Lebanon to continue to improve its fiscal and debt sustainability; create employment; provide adequate infrastructure and social services and support social inclusion.

57. ***Achieving growth and employment creation requires addressing deeper, structural, economic determinants of growth and fiscal adjustment.*** To this effect, the shared strategy between the Government of Lebanon and the World Bank Group consists of focusing CPS support on a set of well-targeted and reinforced structural reforms and investments, which will create the following enablers of high economic growth:

i. Economic management that furthers fiscal and macroeconomic stability;
ii. An improved business environment with appropriate regulation and risk sharing frameworks for effective and increased private investments in the real economy;
iii. Adequate provision of cost-effective infrastructure services, especially in: electricity, water and transport, with adequate regard to local development, environment, and competitiveness of factor costs; and
iv. A public education system for which production and quality meet domestic and global labor market demand, as well as, an expanded and effective social protection system for the population at large, including robust labor market policies and programs targeting vulnerable youth and women.

58. ***Recognizing the dependence of the Lebanese economy on the region's economies and the potential benefit of deeper economic integration,*** the CPS will include support to promote economic integration through a number of potential regional projects, including: cross-border trade facilitation and infrastructure to reduce trade transaction costs and increase competitiveness; energy interconnection and a regulatory framework for a regional energy market; and the harmonization of business regulations in the region to promote private sector investment, capital flows and regional competitiveness.

59. ***Furthermore, both the GoL and the WBG acknowledge that the frail application of principles of good governance remains one of the key challenges that restrain the potential for growth in the public and private sectors.*** Lebanon has credible and well established institutions on

the demand side of good governance (a free press, a strong civil society, parliament, academic think tanks, etc.). The country, on the other hand, suffers a shortage of public institutions capable of formulating good public policy and of producing and delivering public goods. This has led to lack of transparency and accountability in the public sector as well as difficulty in enforcing laws, regulations and judicial decisions. As a result, public sector institutions are avoided by much of the population when possible, and parallel mechanisms have emerged to fill the gap in service delivery; the public no longer expects quality services from public institutions and has ceased to hold the government accountable for the failure to deliver. The CPS supports the GoL's strategy for improved governance throughout the four areas of engagement, specifically, public finance management reform, business environment reform, corporate governance reform of EdL and Caisse Nationale de Sécurité Sociale (CNSS). Should the Government initiate a more comprehensive program, beyond what it is already undertaking under the sector reform programs, the WBG will provide the knowledge and financial services it needs to implement a comprehensive good governance program.

Box 1: Governance, Anti-Corruption and Service Delivery Challenges within Lebanon's Complex Political Economy

Lebanon is faced with substantial governance challenges and a complex political economy which not only affects the quality of governance but can also limit the impact of development assistance. The Bank undertook a Country Governance and Anti-Corruption analysis (CGAC), a Social Impact Analysis of the Electricity and Water sectors, and a review of Lebanon's political economy to identify governance-related risks on a sectoral level as well as entry points to mitigate these risks.

Towards this end, governance stocktaking notes were prepared in three sectoral areas: electricity, water, and social protection. The studies provided evidence that the political interests and the socioeconomic interests of dominant political and economic groups often converge and influence public decision-making, resulting in low-quality services being provided by the public sector. Power generation, water and social protection have been particularly vulnerable to this dynamic.

The Social Impact Analysis of the Electricity and Water sector provided evidence on how different households, specifically the poor, were severely affected by governance weaknesses. It demonstrated that the malfunctioning of these sectors contributed to poverty because the financial burden of expensive and ineffective water and electricity services, coupled by insufficient supply, has been carried by the consumers.

The political economy analysis suggested on a general level that reform practices that might seem ideal from a technical point of view may not be feasible in Lebanon's historical and institutional setting and therefore require flexible adjustments of the reforms. Moreover, reform will be difficult unless it is balanced among all stakeholders and supported through broadly based communication and participation across sectarian lines.

The preparation of the CPS has been informed by the existing analysis and applies flexibility to customize the Bank Group's engagement strategy to the political realities of Lebanon. The strategy focuses support on areas where the policy and institutional environment are conducive to effective engagement and development results and stands ready to respond to opportunities in areas where development initiative is either politically not feasible or technically not ready. In addition, the CPS promotes stronger accountability and enhanced transparency by emphasizing reliance on domestic accountability mechanisms such as: 1) strengthening of internal audit and controls within line ministries; 2) promoting the inclusion of social accountability and complaints-handling measures within projects; and 3) sharpening the terms of reference of external audits to be more focused on detecting fraud and corruption. Also related to the governance agenda are the efforts to improve accountability and transparency in the private sector (private sector accounting and auditing standards and professional accreditation).

Sources: Lebanon Country Governance and Anti-Corruption (CGAC) Process, November 2008; Understanding Resilience: the Skills Needed and the Costs Incurred, Political Economy of the Lebanese System 1985-2006; June 2009; Lebanon-Social Impact Analysis, Electricity and Water Sector, March 2009.

E. CPS Principles of Engagement (Two-Tiered Approach)

60. ***Because of Lebanon's complex political economy, it is difficult to foresee where reforms are most likely to take place.*** However, it is possible, through well selected World Bank Group ESW, TA, and Advisory Services, targeted investments and close policy dialogue, to develop solutions that will help move the reform agenda forward. In consideration of the country context and drawing from the lessons learned over the ISN period, it is proposed to adopt a two-tiered approach: (i) maintain a Core Program of engagement which consists of selected investments in basic services, as well as technical assistance and analytical work that will serve to inform and build momentum around key reforms; and (ii) stand ready to engage more deeply in additional

areas where there is traction for reform. Selectivity has been applied in determining the areas of intervention of the CPS, that is, where the reform is anticipated to strengthen growth potential, increase fiscal stability and enhance social equity. Progress on implementation of the Core Program will be assessed on a frequent basis (annually) to determine the results achieved, and the GoL and Bank Group will jointly agree on areas for possible scale-up of WBG engagement. These consultations will provide the framework and the basis for moving from Tier I to Tier II.

Tier I- Core Program

61. ***Under the Core Program, the Bank Group will continue to support the Government through the existing portfolio,*** which includes Specific Investment Loans (SILs) and Trust Funds (TFs) in energy, water, transport, municipal and urban development, social protection, and fiscal management, as well as IFC's investment and Advisory Services (see Annex 2: World Bank Portfolio Performance). Going forward, new activities will be added to the Core Program on a selective basis with a view to strengthening the momentum for key reforms that are needed for growth, fiscal stability and social inclusion. These new activities can take the form of selected knowledge services (ESW, just-in-time technical assistance and IFC Advisory Services) or targeted investment support in critical areas identified as binding constraints to growth.

62. ***In addition, because fiscal and debt sustainability is central to sustained high growth,*** the Core Program will focus on providing technical assistance in public finance management and fiscal consolidation as well as in statistical capacity building. The Core Program will also include technical assistance to enhance employment and labor market policies with particular focus on policies that aim to improve women's access to job opportunities. Advisory Services and investments will be provided in support of regional integration and business environment in partnership with IFC. IFC will pursue private sector investments and Advisory Services with a focus on priority areas such as sustainable energy, development of SMEs, and private provision of health, education and infrastructure services.

Criteria for Moving to Tier II

63. ***The criteria for moving from the Core Program to the second tier in a given area are***: (i) there is sufficient agreement within the Government and among affected stakeholders on a well-articulated policy reform agenda; and (ii) the reform has a positive impact on one or more of the following areas: economic growth, fiscal space, and social inclusion. The second tier could bring to bear policy-based lending by the Bank, provided that there exists a sound macroeconomic framework and a robust reform program that has a positive impact on the fiscal situation.

64. ***During the life of the CPS, the WBG and the GoL will evaluate progress made by the GoL in the implementation of its reform agenda and determine the area(s) in which results have been achieved and where there is enough traction to deepen engagement.*** It is understood that the assistance strategy could move into the second tier in one or more sectors while remaining in the Core Program in other areas. The areas of engagement in the Core Program are presented below along with current and planned WBG instruments of support and anticipated program outcomes, as agreed with the GoL, and shown in the Results Matrix in Annex 1.

F. Areas of Engagement

65. Building on the Bank's experience and dialogue with the Government during the last three years, the following areas have been selected because of their critical role in supporting Lebanon's economic growth, fiscal and social stability, as well reinforcing economic and trade relations with the Gulf and the Mashreq.

Fiscal Stability and Public Financial Management

66. ***Lebanon's fiscal and public debt positions create major risks to macro-fiscal sustainability and to prospects for high growth.*** Debt and, hence, the debt service burden are high, depleting the fiscal space that is needed for public investments in lagging economic infrastructure and social services. To achieve enough fiscal adjustment to generate a sizable primary surplus with a beneficial impact on efficiency and growth will require a combination of the following:

- ***Improving the management of the electric power sector*** to reduce costs, improve revenue collection, promote energy efficiency, and thus reduce subsidies (about US$1.2 billion), while increasing supply and strengthening the performance of existing systems through adequate investment;

- ***Reforming the public sector pension system*** to restore its financial viability and raise the productivity of the public labor force without increasing real government spending (such reforms would also improve equity over the medium run);

- ***Increasing the equity and efficiency of the tax system***, for example by improving taxation of real-estate property and capital gains on real estate transactions and considering measures that make for better burden sharing across socioeconomic groups; and

- ***Dynamic debt management***, through additional measures such as selective asset swaps when possible, and foreign assistance—linked to a program of structural and fiscal reforms—to smooth the burden of fiscal adjustment.

67. ***In addition, clear linkages need to be made between public resource management and the Government's macroeconomic objectives***, and better alignment is needed between expenditure and planning. The annual budgeting process is marred by variability and uncertainty, and both transparency and monitoring functions are in need of strengthening.

68. ***The steps that have been taken by the GoL over the past two years could be expanded into a sustained program of fiscal consolidation and debt management.*** Bearing in mind the country's complex political economy, some of the above reform options could be designed and implemented rapidly under the Core Program, whereas other reforms will require Lebanon to make fundamental choices regarding the future role and responsibilities of the State, and thus, may require a longer timeframe for maturation, decision, and implementation. Any of the reforms outlined above in the areas of expenditure management and/or revenue enhancement will improve efficiency in the use of public resources and create fiscal space. As such, they are expected to increase productive public investment and the availability of public services, leading to growth and better social outcomes.

69. ***In the area of public financial management, the GoL has made significant progress in implementing reforms.*** Nevertheless, there remain three areas where progress has been slow and where better efficiency and accountability are needed to ensure effective fiduciary risk mitigation, not only for Bank-financed investments, but also for the GoL's own resources. Addressing these issues would pave the way for using country systems to support Bank-financed operations. Priority areas include: (i) consolidating the budget by establishing a unified budget framework that accounts for public sector financial activities, including foreign-financed projects and Council for Development and Reconstruction (CDR) projects and presents consolidated audited financial statements; (ii) strengthening internal controls by amending the Public Accounting Law and establishing an internal audit function at the Ministry of Finance; (iii) strengthening external audit by reforming the Court of Accounts (COA) to address the issues of independence and the amendment of the mandate to cover exclusively the external audit function; and (iv) revising the current public procurement laws and setting in motion a number of activities that will facilitate effective implementation of the law (e.g. updating standard bidding documents, training staff, and establishing a dispute resolution mechanism).

70. ***Capacity building and implementation support for public finance management and fiscal consolidation is a key element of the Core Program.*** The main goals of this engagement are to improve budget preparation and the comprehensiveness of the budget, with an emphasis on integrating the current and capital budget; placing the annual budget in a multi-year perspective; strengthening budget execution with a focus on the treasury management function; and strengthening debt management; along with the creation of a specialized Debt Management Department in the Ministry of Finance. The Bank is providing technical assistance—funded through a grant under the Lebanon Trust Fund—to facilitate this work (Fiscal Management Reform Implementation Support Project). The implementation of this project, which is being closely coordinated with related support from the IMF Middle East Technical Assistance Center (METAC) and forthcoming European Commission (EC) assistance, is expected to gain pace and bring results over the next two years. In the 2010 budget circular, the Government has laid the ground and provided a three years medium-term framework for the preparation of the 2010 to 2012 budgets.

71. ***Statistical capacity building to enhance the quality of policy and decision making is another key element of the Core Program.*** A Statistical Master Plan has been recently prepared by GoL with technical support from the World Bank. The Plan provides for setting up the regulatory and institutional framework as well as building the national capacity for production, analysis, and dissemination of economic and social data. Its implementation is critical to creating a system that can produce the timely and relevant data needed by both policy makers and civil society. The Bank will continue to support these efforts in coordination with other development partners using trust fund resources.

72. ***The GoL recognizes that the importance of gender statistics is an important factor in highlighting and mainstreaming gender issues in its economic planning, policy-making and development.*** Therefore, the GoL's Statistical Capacity Building Program includes a gender statistics component with gender-specific activities. These include: (i) a comprehensive review of recent and accessible research that sheds light on gender equality and gender equity issues in Lebanon; (ii) mainstreaming gender coverage in the questionnaires and surveys to be carried out by the Central Administrations for Statistics (CAS); and (iii) ensuring that the CAS mandate includes the provision of gender relevant statistics and harmonization and coordination of gender statistical work in Lebanon. The World Bank, in coordination with other development partners (UNDP, EC, USAID, and Agence Française de Developpement (AFD) will provide coordinated financial support and technical assistance to the CAS in implementing these activities.

Competitive Business Environment

73. ***The ability of Lebanon's private sector to generate growth and employment is severely constrained by the high costs of doing business and by the inequitable and unpredictable application of policy***. Key binding constraints to private-sector led economic growth arise from: (i) uncompetitive infrastructure pricing and unreliability, such as in telecommunications and electricity; (ii) high cost of doing business due to outdated commercial laws, vague and non-transparent regulations, discretionary bureaucratic interpretation, and weak contract enforcement; (iii) insufficient domestic and regional trade facilitation; (iv) rigid labor and social security regulations restricting flexibility in the domestic and regional labor market; and (v) the absence of a regulatory framework for Public-Private Partnerships (PPPs). While Lebanon has a sophisticated financial system, further improvements in the financial sector could increase Lebanon's competitive edge. For instance, access to credit remains limited and costly, and the right to use moveable property for collateral is not well established. Corruption is another hindrance to developing a more vibrant private sector in Lebanon. In addition, reliable and transparent corporate financial reporting is needed to build investor confidence and support a strong business climate, with consequent positive impacts on competitiveness and economic growth. Small- and Medium-Enterprise (SME) are playing an increasing role in catalyzing economic growth, as important sources of job creation, and the ability of an SME to produce high-quality, transparent and comparable financial statements is often a determining factor for access to credit. All of the above-mentioned issues create a perception of high-risk for new business entrants, discourage new investments, and hamper competitiveness. These difficulties and many others are reflected in Lebanon's rank of 108th out of 183 economies in the "Ease of Doing Business Index" for 2010.

74. ***In the capital market, Lebanon has thus far fallen short of improving regulations and pursuing structural policies that optimize the impact of foreign inflows on the productive capacity of the domestic economy.*** Capital inflows are invested in a narrow scope of sectors, including the banking and real estate sectors. In addition, as is the case in most small open economies, the large capital inflows are causing a contraction of sectors producing traded goods and causing a corresponding increase in relative prices. In advancing its financial market, Lebanon can build the capacity of the Beirut Stock Exchange and promote investment banking; this can increase opportunities for investors and provide new sources of funding for entrepreneurs and the business community at large.

75. ***Furthermore, findings from a 2008 World Bank Report on gender highlights that gender inequities exist in the private sector in Lebanon.***[15] While on average, female workers are more educated than male workers, females experience wage discrimination, and SMEs owned by women find it harder to access finance and face greater challenges circumventing the many regulatory processes than do their male counterparts. As a result, female entrepreneurship is relatively low in Lebanon. As part of its program for improving the business environment, which calls for increasing the number of financial tools available to SMEs and bringing business support services up to international best practices, the GoL intends to pursue targeted initiatives to level the playing field for women-owned/operated SMEs. These gender-targeted initiatives will be supported by World Bank Group activities which will explore: (i) a financial guarantee/risk sharing product to support women-owned SMEs; (ii) a gender-integrated approach within an assessment of SME access to finance in the governorates surrounding the Beirut area; (iii) a gender-disaggregated list of baseline indicators for the monitoring of performance and graduation of women-versus male-

[15] Gender-Based Differences among Entrepreneurs and Workers in Lebanon, The World Bank, 2008.

owned SMEs from Business Development Centers (BDCs); and (iv) the development of gender-relevant training and business support initiatives within the broader SME business support program. IFC Advisory Services aims to provide support to financial institutions to help them target women-owned businesses specifically.

76. ***To help the GoL tackle the challenges in the business environment, the World Bank Group will support the GoL to:*** (i) improve government regulations and policy to facilitate private sector dynamism, in particular for SMEs; (ii) develop and implement a new competition law and build the capacity of a dedicated authority to phase out exclusive agency agreements and enforce regulations that foster competition and create a level playing field for private sector; (ii) remove the impediments to independent power producers and public-private partnerships by modifying certain provisions of the Code of Commerce; (iii) facilitate lending through collateral that would strengthen SMEs' access to finance; and (iv) promote the modernization of the accounting and reporting architecture through capacity building workshops and training of SMEs on international reporting standards. This agenda has been prepared with the support of the Bank Group's policy dialogue and analytic work and is also linked to enabling private investment and to other priority sectors such as power and telecommunications, water, and public financial management. On financial development, the WBG will help the GoL articulate clear policy objectives and strategy during the CPS period with Analytical and Advisory Activities (AAA), such as selected Reports on Observance of Standards and Codes (ROSCs), including a bank governance assessment, and an FSAP Update, when the government is ready for such diagnostic work. The Bank will also partner with the Lebanese Accounting Association to strengthen the professional accountancy body and to support accountancy reforms.

77. ***Given the potential of the telecommunications sector in stimulating private sector investment and contributing to growth, the CPS will support the GoL's objective to structure the telecommunications sector in a way that introduces competition, improves capacity and quality of services, reduces cost to consumers while maintaining the flow of critically needed revenue into the national budget.*** The GoL is developing a new reform strategy for the sector consisting of: (i) defining and establishing a strategic and policy framework for the restructuring and development of the sector that maximizes its contribution to economic growth and generates sufficient fiscal revenues for the treasury; (ii) aligning the existing institutions and operators to the framework by restructuring them to operate on a commercial basis; and (iii) gradually bringing in market forces through private participation in investments and in provision of all telecom services to drive down the cost of services in line with global trends. This new strategy, once finalized, will require an agreement within government on the path and the pace of implementation. Under the Core Program of the CPS, the World Bank Group will continue providing advice to finalize the development of the telecommunication sector strategy. An Institutional Development Fund Grant will be mobilized to finance capacity building to the Telecommunications Regulatory Authority. In addition, IFC Advisory and Investment products could be leveraged to the extent the private sector becomes part of the GoL's strategy for telecom reform.

Economic Infrastructure

78. ***Access to reliable and cost-effective infrastructure services remains a major constraint on growth and social development in Lebanon***. The unreliability of infrastructure services, combined with differences in availability across the country, hinders competitiveness of Lebanese industry, constrains economic growth and increases regional disparities.

79. ***Lebanon also stands to gain from the regional integration of its infrastructure networks, namely the transportation network and, the electricity network.*** The integration of the transportation network would promote an efficient transfer of merchandise and persons and would be a critical element in facilitating regional trade, especially with the growing markets of Syria and Iraq. In the electricity and gas sectors, by connecting to the regional network, Lebanon would be able to overcome shortage problems caused by an inefficient and ineffective electricity sector once increased supply becomes available.

- ***Electricity Sector***

80. ***Economic growth and fiscal stability in Lebanon are unattainable without major reform and investment in the electric power sector.*** Currently the sector cannot supply the electricity needed by households and businesses. Massive subsidies are required (amounting to 4 percent of GDP in 2009) to cover insufficient revenues, because overall the performance of the sector is very poor: tariffs are set far too low for cost recovery, governance of the sector is inadequate, and Electricité du Liban (EdL) performs poorly, both operationally and financially, with high technical and financial losses. Investments in new generation capacity have lagged far behind growing electricity demand. Reducing the fiscal burden of the sector on public finances, mobilizing resources to meet energy investment needs, and restructuring EdL into a commercially viable utility will be among the most important policy and structural reform challenges the Government will have to undertake. Also, of importance in the GoL's strategy in addressing the above challenges is the role of energy conservation and of securing supplies of alternatives to expensive fuel oil. Specific recommendations for reforming the power sector have been extensively discussed at various levels of government, but in the past, lack of political decision and consensus over sequencing of priorities has meant that little implementation has taken place.

81. ***The Bank Group aims to support the GoL's action plan for development of the electricity sector.*** The GoL, building on previous studies, has adopted in June 2010, an electricity sector policy note, including a reform action plan aimed at improving the performance of the sector and laying the foundation for a financially self-sustained sector in the medium- to long-term: This plan includes a set of well articulated short, medium and long-term measures aimed at: (i) improving sector governance by effectively corporatizing EdL's management of the sector according to commercial principles and building its managerial capacity to improve the technical and financial performance of the sector; (ii) reducing the fiscal burden by revising the electricity tariff structure and setting rates that will over time put the sector on a sustainable path; (iii) increasing the supply of electricity-- additional 600 MW in the short-term and 900 MW in the medium-term; (iv) reducing the cost of generation through investments in low fuel cost generation, rehabilitation of transmission and distribution networks and contracting distribution, billing and collection to private sector; (v) promoting renewables and increasing demand efficiency and energy savings; and (vi) promoting all forms of Public-Private Partnerships to facilitate the modernization of the sector.

82. ***Under the Core Program, the Bank Group will support the GoL's efforts to increase efficiency and better manage the sector while helping to leverage other donors' investments in generation and transmission capacity***. Through ongoing technical assistance and policy dialogue, the Bank will help advance reforms in the management of the sector while preparing an investment loan to rehabilitate the transmission and distribution systems to ensure that investment in additional generation capacity is well used. The Bank will also help the GoL mobilize concessional financing from donors that have already committed and/or expressed interest in the sector. The Bank is working with the GoL to help it finalize its strategic development plan for the electricity sector along with a time-bound implementation plan in order to expedite endorsement by the GoL cabinet.

Finally, the Bank plans to provide technical assistance and financing support for implementation of sustainable energy efficiency and demand-side management programs as well as alternative energy such as Liquefied Natural Gas (LNG) and renewables. In parallel, IFC will explore investment and advisory opportunities to facilitate greater lending by financial institutions (especially banks) to enable them to finance the investments of their clients in sustainable energy, including energy efficient systems and renewable energy. IFC Advisory Services and investment would complement the Bank's activities, in line with the GoL's emerging strategy related to the role of the private sector, especially in the area of PPPs.

83. ***Support to regional energy integration will be provided to help Lebanon strengthen the interconnection of its power grid with the Mashreq countries,*** benefit from a regional gas supply (either through pipeline or Liquefied Natural Gas (LNG) when deemed feasible, and participate in the development of a regional energy market in the medium- to long-term. The WBG will use the framework of the AWI to mobilize additional resources for investment and to roll-out complementary instruments such as MIGA guarantees and IFC Advisory Services and investments, including the use of PPP schemes.

❖ ***Water Sector***

84. ***Despite Lebanon's relatively ample water resources, its water supply and sanitation sector has not kept pace with demand and lags far behind the standards associated with the country's level of economic development.*** The annual cost of inadequate public water supply is estimated at US$470 million (2 percent of GDP in 2008), of which household spending on private water supply is estimated at US$308 million. Despite relatively high connection rates, the continuity of water supply is low and reaches as little as three hours a day in the Beirut-Mount Lebanon region which houses about 40 percent of the Lebanese population. It is estimated that the seasonal imbalance of water resources will lead to chronic water shortages by as early as 2020 if no measures are taken to improve efficiency and to increase storage capacity. Wastewater collection coverage averages 58 percent and wastewater treatment facilities are few and small. Discharge of wastewater has polluted water resources and the use of raw wastewater is increasingly leading to soil pollution and health hazards. Environmental degradation caused by the discharge of untreated wastewater costs Lebanon about one percent of GDP a year.

85. ***Several government actions are needed to address the irregularity of water supply and the environmental threat posed by untreated waste.*** First, investments are needed to reconstruct, rehabilitate, and expand water supply and wastewater networks, treatment plants, storage, and transfer facilities. To this end, an integrated water sector policy and strategy will help identify and prioritize programs and activities in the sector. Second, Lebanon's Regional Water Authorities (RWAs) need technical, financial, and managerial autonomy so they can improve operations and maintenance, raise cost-recovery levels, and build internal capacity. Third, efforts need to be made to enable the expansion of private sector participation in the sector.

86. ***Wastewater collection and treatment services need to be extended, and discharges need to be subject to tighter control.*** Wastewater services, which fall legally under the jurisdiction of the RWSs, are de facto provided and financed by the Ministry of Water and Energy, Municipalities, NGOs, donors, and small private sector operators. Regional Water Authorities have yet to take full responsibility for wastewater collection and treatment, and the unfinished reform agenda has contributed to institutional uncertainty and fragmentation of functions. The discharge of wastewater and the use of raw wastewater need to be more strongly monitored and controlled by the government.

87. ***The Bank will support the Government in water supply along a number of lines.*** In the Core Program, through financing of the Greater Beirut Water Supply Project, the Bank plans to target the provision of additional potable water to Greater Beirut. This Project aims to provide clean water to around 1.5 million people in the Greater Beirut Region. Under this operation, the GoL expects to complete the restructuring of the sector, build the management capacity of the Ministry, and help the RWAs develop and implement a new tariff structure and farm out billing and collection. The Bank will also support the preparation of an Integrated Water Sector Policy and Strategy to prioritize and sequence the needed investments in the sector for consideration and decisions by the GoL.

- ***Transport***

88. ***Transport has become a major constraint on economic and social activities in Greater Beirut.*** Institutional capacity to oversee urban transport services is nominal, and regulations to ensure minimum levels of quality and safety are rarely enforced. With almost no formal public urban transport system, the more than 2 million Beirut residents rely on cars to meet their transport needs. Estimates indicate that public transport carries about 30 percent of daily passenger movements/trips throughout Lebanon. Services are provided by the informal sector, mainly by shared taxis, which are privately owned and operated, primarily by single-vehicle owners providing both intra- and inter-city transport. Private sector operators provide dependable bus and taxi services. Major investments since 2006 have improved the urban transport infrastructure. The key challenges the GoL will face in improving urban mobility will be enforcing traffic rules and regulations, promoting private sector investments in urban transport services, planning for and adequately managing road assets, and mobilizing enough funding to carry out regular road maintenance and properly address road safety issues.

89. ***Under the Core Program, the Bank will continue through the existing Urban Transport Development Project (UTDP) to provide the GoL financial and AAA support*** to establish a basic institutional framework and to complete the critical investments needed to maximize efficiency of existing urban transport infrastructure in the City of Beirut and the Greater Beirut area. Moreover, the Bank will support the government with technical assistance to address the remaining challenges under the UTDP Project, namely: securing the effective performance of the installed traffic management system, implementation of the Traffic Police Action Plan and, completion of the preparatory studies for an integrated public transport system. The Core Program will also lay the foundation for potential World Bank financial support for an integrated Public Transport System in Beirut (Trans-Beirut). This will include completion of the restructuring of the existing Public Transport Authority, addressing the legacy of existing service taxi enfranchisement, and identification of a mechanism for the financial sustainability of a public transport system. IFC will also explore opportunities to support private sector investment in this sector.

90. ***With regard to trade,*** excess costs, time-intensive port clearances and land border crossings reduce Lebanon's competitiveness. The average cost to bring a container from Beirut port to the city is more than US$600 and there is an average of a week before imported goods are available for use. Asycuda World (AW), a web-based system for submitting and assessing customs declarations is being introduced to address part of this issue. Major benefits will only be gained through the coordinated implementation of AW by the Mashreq Countries and by better coordination of Lebanon's own import inspections procedures. Lebanon's principal foreign trade is in services and, until recently, there has been little interest in facilitating export trade in goods. This approach has

shifted in light of the new initiative to position Tripoli as a regional trade hub. More than 70 percent of Lebanon's international trade passes through the port of Beirut and is linked to three trade corridors: two East-West to Iraq and one North-South from the EU to the Gulf. Lebanon's connection to these corridors is part of the GoL's regional integration and economic growth strategy. In this regard, the Core Program could include a regional project to facilitate cross border trade for Mashreq countries; this effort would lead to improved transport infrastructure more efficient and fluid logistics chains within the sub-region, including border crossings and missing infrastructure links in the case of Lebanon. IFC will explore opportunities to expand its successful Global Trade Finance Program which provides guarantees to selected Lebanese banks involved in trade and related activities for SMEs.

❖ ***Environment and Waste Management***

91. ***Lebanon needs to reverse the degradation trend of its natural resources to preserve and capitalize on the benefits of the country's environmental domain.*** There is strong competition for land in Lebanon, and the absence of a more efficient land use planning system has resulted in increased pollution and environmental degradation, which threatens the resource-based sources of economic growth, such as agriculture and tourism. Lebanon made significant strides in its efforts to address environmental degradation, but is still facing major issues including: (a) air pollution in Lebanon's urban centers; (b) water quality degradation and a gradual move towards a water balance deficit by 2020; (c) insufficient wastewater network; (d) poor municipal solid waste management; (e) limited land and biodiversity resources; and (f) high urban pressure on the coast line. For example, municipal solid waste is a persistent issue, given that Lebanon generates a total of 1.4 million tons/year of which 800,000 tons/year are collected from Greater Beirut and Mount Lebanon and transferred to the Naameh Sanitary Landfill, which was established in 1998 to take 3 million tons for the following ten years. At present, the quantity of waste has reached more than 8 million tons. In the cities, there is only one controlled waste dump in Tripoli and one sanitary landfill to serve the Municipalities of Zahle, which was financed by the World Bank. All the other cities dispose their waste in open dumps, river basins and valleys.

92. ***Under the Core Program, technical assistance will be provided to support the preparation of the Government's action plan for the establishment of an integrated and affordable municipal solid waste management system throughout the country.*** More specifically, the Bank through AAA will support: (i) enhancing institutional and legal framework for the solid waste sector; (ii) improving financial performance of the sector (on both cost and revenue sides), including cost effectiveness of private and public services and cost recovery system; and (iii) enhancing social and environmental performance of the sector. The Bank will also support Lebanon in accessing the carbon market and in promoting Clean Development Mechanism operation in solid waste sector, and hence generating additional revenues for the sector while contributing to climate change mitigation. Using trust funds and building on the 2010-CEA, the Bank will support the GoL in improving environmental governance, more specifically with regard to the predictability of the regulatory and institutional framework, the improvement of the enforcement of environmental regulations, the harmonization of the environmental assessment system, and the disclosure of environmental information which are all important constraints to private sector investment. In parallel, IFC will explore advisory opportunities to promote cleaner production processes and technologies.

❖ ***Local Economic Development***

93. ***The GoL's objectives aim at clarifying the responsibility of local governments,*** enhancing the status of the elected authorities, streamlining the functioning of the municipal council, and modernizing the administrative and financial procedures. To this effect, the GoL is preparing a new Decentralization Law. In addition, several major reforms are also under consideration to improve and consolidate the municipalities' finances: (i) local tax system reform to give more weight to the property tax which takes into account the real contributive capability of a particular area; (ii) pioneering modern municipal management systems to gradually strengthen the decentralization process (i.e., budget process, accounting system, computerization, etc.); and (iii) the revision of the Independent Municipal Fund management practices to improve the predictability of the transfers and facilitate the financing of local investments. In terms of financing options for municipalities, IFC could leverage its global experience with sub-national finance to support improved and extended public services at the local level on the basis of non sovereign, commercial financing with a view to expanding financing options for municipalities and eligible state-owned enterprises.

94. ***The GoL considers tourism development not only as a key economic priority*** (earning 20 percent of the country's GDP prior to the civil war as indicated by the Ministry of Tourism), but also as an essential vehicle to promote local development, in close collaboration with the local government and the private sector. By leveraging its full potential, tourism can serve as a catalyst for reviving regional economies, creating local job opportunities, favoring backward-forward linkages to local communities, generating income alternatives, and raising municipal revenues. This is especially useful to dispel the evident regional disparities between the northern and southern parts of the country and the area around the coasts and Beirut.

95. ***Under the Core Program, the Bank will provide TA to help the GoL develop the municipal sector and promote local development.*** **This TA will cover the following areas:** (i) institutional level: the effective application of new management guidelines, after the adoption of the new Decentralization Law; (ii) spatial management: better coherence of city projects with the national land use planning strategy, and the development of a long-term integrated regional development program; (iii) management capacity: awareness building among the elected representatives with regard to land-related issues, the modernization of the territorial civil service, the dynamic management and training of human resources, the introduction of modern management tools, and the more systematic involvement of civil society in development plans; (iv) financial-level: the increased mobilization of local resources, the identification of new revenue streams, and the use of loans as part of the overall financing of urban needs; and (v) community-driven development: investments that will create jobs, income opportunities, leverage local assets thereby increasing economic empowerment in communities and reducing regional disparities.

96. ***Building on the achievements of the Cultural Heritage and Urban Development Project (CHUD), as well as the First Municipal Infrastructure Project (FMIP), under the Core Program*** the Bank plans to provide a Sector Investment Loan (SIL) for local community development, which would bring together the main policies and reforms to address the key institutional and financial challenges described above and help reduce regional disparities. It would also be an important instrument to better equip cities to participate actively in delivering on the country's broad-based economic growth strategy, while also mobilizing the additional financing to increase the much needed urban infrastructure and improve cities' competitiveness. Promoting the country's unique cultural and historical assets through a well-managed local development program is also key.

Human Capital Development and Social Protection

- ***Education***

97. ***The quality of education outcomes in Lebanon is inconsistent with the level of investment, as the internal efficiency of public education is low.*** Lebanon has a pupil/teacher ratio of 17:1 at the primary level and 8:1 at the secondary level; dropout and repetition rates have been persistently high; and the number of investment years required to produce a 9th grade completer is very high. Also, the distribution of physical facilities has been highly politicized, resulting in over-capacity in some areas and under-capacity in others. The oversupply and misallocation of teaching and administrative staff is acute, causing salaries and wages to constitute 87 percent of the Ministry of Education and Higher Education's total spending.

98. However, despite the oversupply of teachers, the teaching force is under qualified with only 4 percent of public school teachers holding a specialized degree and more than half possessing less than a university level education. There is little or no in-service training offered to new teachers, and the quality standards for hiring new teachers is weak.

99. While gross enrollment rates at the primary level are above the regional average (at 72percent), the share of these students enrolled in public Kindergartens represents only 20percent of total enrollment. The public Kindergartens are not distributed according to local needs, nor do the teachers have the necessary qualifications. In addition, infrastructure and equipment is sub-standard in many of the Kindergartens located in disadvantaged areas.

100. Finally, financing of the education sector is highly fragmented and inefficient, and leads to inequities. Government budget statistics do not allow resource allocation to be analyzed by level of education, region, learning outcomes, or socioeconomic groups of beneficiaries. In higher education, quality standards, quality assessment mechanisms, and accreditation processes are virtually absent. In coming years, the GoL needs to embark on a second phase of education sector reforms to address these key challenges.

101. As part of the Core Program, the Bank plans to provide support to the GoL's education quality enhancement program in the form of a Sector Investment Loan which would: (i) increase the enrollment rate of children 3 to 5 years of age in public schools, improving their school readiness and equal opportunity at the start of general education; (ii) enhance the quality of teaching and learning; and (iii) lay the groundwork for improving the interface between the general education, technical/vocational education, and higher education streams, and for better aligning the education system with the requirements of the labor market. IFC will explore possibilities of developing student lending programs delivered through the banking sector, targeting low- and middle-income students, drawing on the experiences of its student loan programs in other countries in the MENA region.

102. ***The GoL also intends to lay the groundwork for medium-term reforms in higher education.*** Based on the prevailing political economy, the GoL is also giving priority to addressing the challenges facing higher education particularly the lack of quality assurance and accreditation mechanisms. The Bank will support the GoL in this choice and in building a partnership through either technical assistance or a subsequent investment loan targeted to reforms in the higher education sector.

❖ *Pensions, Health Insurance, Social Safety Nets and Labor Markets*

103. ***Lebanon's social protection system consists of a fragmented and low-coverage social security (pension) system, multiple health insurance schemes, limited and badly-targeted social safety net programs, and distorted labor markets.*** The pension system has low coverage and high fiscal costs and entails very different treatment for workers in the public sector, the military, and the private sector. The pension schemes for the civil service and military, run by the Ministry of Finance, cover just 6 percent of the labor force and cost 2.7 percent of GDP a year (of which 2.2 percent account for military pensions); the current implicit pension debt represents between 50-60 percent of GDP. By contrast, the End-of-Service-Indemnity (EOSI) scheme for private sector workers, run by the National Social Security Fund (NSSF), covers 30 percent of the labor force and has annual expenditures of 0.8 percent of GDP. The EOSI runs a surplus and has reserves of about 12.6 percent of GDP. Even so, as an end-of-service-indemnity scheme, it does not provide its beneficiaries adequate protection in old age. While in the private sector the implicit rates of return on contributions and targeted replacement rates are low and inadequate, in the public sector they are significant and unaffordable, resulting in inequitable treatment of workers across plans and insufficient income protection during old age.

104. ***With regard to the gender dimension, the government recognizes that the high incidence of migration among men has consequently created a higher incidence of female-headed households*** thereby increasing the proportion of women among the most vulnerable in the population. In view of this, the government intends to ensure that its national targeting system incorporates a gender dimension in better targeting government subsidies to vulnerable women. The Bank will continue to provide technical assistance under the Emergency Social Protection Implementation Support Project II (ESPISP II) and a new TA for the roll-out of the new targeting system.

105. ***Much technical and financial assistance has been deployed over the past three years to address the key challenges facing NSSF***: its inadequate governance, weak administrative systems, and design problems with the three programs that it manages—end-of-service indemnity, health insurance (maternity and sickness fund), and family allowances.

106. ***Lebanon needs a comprehensive framework for health insurance and social protection***. Despite a large number of public insurers and private insurance companies, less than 50 percent of the population enjoys formal health insurance coverage. Out-of-pocket household spending, as a result, accounts for more than 60 percent of total health expenditures. Such health financing arrangements give households inadequate financial protection from the costs of ill-health. Seven public institutions offer health insurance programs, implicitly or explicitly.[16] There is little coordination between their policies, and in the case of the Ministry of Health and the NSSF the mandates regarding population coverage and the use of public subsidies have not been clearly defined.

107. ***The problem of employment creation in Lebanon is acute and is related to the nature and level of growth, the investment climate, labor market policies, skills creation, and social protection policies.*** During the last decade there has been virtually no net employment creation, with those jobs that have been created being mostly in the informal sector and lacking social security coverage. The unemployment rate has increased (7.8 percent in 2004 to 8.9 percent in

[16] The National Social Security Fund (NSSF), the Ministry of Public Health, the Fund for Civil Servants, the Fund for the Military, the Fund for Teachers, and two funds for Security Forces.

2007) and is more prevalent among females. Youth unemployment is at a regional high (26 percent). Labor mobility between civil service and private sectors, and also within the private sector is discouraged by inadequate portability of social security benefits. Active labor market policies and programs are inadequate to address issues of unemployability, job search or entrepreneurship. Over the next 10 years, the Lebanese economy would need to create more than 5 times the number of jobs it is currently creating in order to absorb the new labor market entrants.

108. ***In doing so, special attention will be given to the gender dimension in light of the fact that women's employment stands at 37 percent.*** To provide women with greater access to quality employment, Lebanon could benefit from a review of the labor code in terms of addressing areas that may constitute discouraging factors to women's employment. In the context of the World Bank MILES (Macroeconomics, Investment Climate, Labor Market Institutions, Education and Social Protection) framework, an employee-employer survey will be supplemented with a module on gender to collect and analyze data on challenges of informality and job security for women in Lebanon, for which a gender report will be produced as an input to the government framework. Moreover, the Bank will provide technical assistance support and capacity-building to review and amend the labor code with special attention to gender inclusion.[17] IFC will explore opportunities to promote greater access to finance opportunities for women-owned businesses through the financial sector, in close cooperation with the Bank.

109. ***Formal social safety net programs are weak, fragmented, and inadequate to play an effective role in time of economic need.*** The few programs that exist (housing, education, and heating-fuel subsidies) are not well targeted, so their poverty impact is questionable. The Ministry of Social Affairs (MOSA) is the main public provider of social safety net programs with an annual budget of only US$60 million, of which 70 percent is distributed to NGOs and welfare associations. Though many community and local development programs exist, and are primarily supported by donors, there is little harmonization or coordination among them. With one million Lebanese living on no more than US$4/day, and 300,000 living on US$2.4/day or less[18], and with the evidence of widening regional disparities, the GoL needs to consider a larger and more effective role for social safety nets.

110. ***In social insurance and labor markets, the Ministry of Labor (MOL) has defined a program of reform, the key elements of which include:*** (i) introducing and implementing the new pension system for private workers; (ii) developing effective active labor market policies and program (ALMPs) which include redefining the role and structure of the National Employment Office; (iii) modernizing labor market policies including related regulations; (iv) furthering reforms in the National Social Security Fund (NSSF); (v) developing income protection mechanisms for workers; and (vi) strengthening the MOL's capacity to lead the reform process and its implementation. The GoL intends to proceed with the full roll out and implementation of the National Poverty Targeting Program (NPTP) and will develop and adopt a health insurance framework to provide organizing principles for any plans to expand and rationalize health insurance coverage. Each area of the above program will pay particular attention to the gender

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[17] The Lebanese labor law has undergone a number of revisions since it was issued in 1946, a period during which Lebanon also signed various international and regional labor agreements. In this context, and in order to better adapt to international and regional changes in labor legislation, the Minister of Labor signed a proposed revision of the labor law in early 2010. The proposal was forwarded to the Cabinet in May 2010, and is expected to be approved by the end of 2010. With respect to the gender related aspects of the law, the revisions propose a longer maternity leave (10 weeks), establish a one hour daily break for breast-feeding women, and apply exceptions on certain types of firm from regulations against women working night shifts and mandating certain types of firms to establish individual or collective child-care facilities.

[18] Source: "Poverty, Growth and Income Distribution in Lebanon"; UNDP, August 2008.

characteristics of the Lebanese domestic labor market, for the purpose of enhancing gender inclusion and social protection.

111. ***Under the Tier I Program, the Bank will continue providing implementation support through the existing portfolio***, namely ESPISP II and the multi-sector analytical program of MILES. In addition, if requested, the Bank could provide a technical assistance loan to further support the implementation of the above government program.

G. Potential Lending Envelope

112. ***During the CPS period (FY11-14), the indicative lending envelope will range between US$375 and US$550 million*** assuming reasonable pacing and distribution over the four-year CPS period. The actual lending envelope will depend on a number of factors, some that are country-specific and others that are related to IBRD's overall financial capacity. The size and timing of actual commitments will depend in particular on the mix of Investment Loans and Development Policy Loans. The higher end of the range assumes that the program is primarily concentrated on investment lending and that it is somewhat evenly distributed throughout the CPS period. Under the Core Program, in addition to the ongoing portfolio, only investment lending and AAA is envisioned. The Tier II Program assumes implementation of reforms in one or more of the priority sectors along with a sound macro-economic framework, which will set the stage for budget support through a general or sector-specific development policy loan.

V. RISKS AND RISK MITIGATION

113. ***Among the main risks in Lebanon is stop and go reform implementation.*** The Government's reform program emphasizes growth and fiscal deficit reduction to reduce the public debt. While initiating the necessary structural, sectoral and social reforms is in most cases at the Government's discretion, advancing their implementation requires legislative approval and greater consensus building within the Lebanese public. The past policy track record does not provide much comfort in this area: the prolonged period of weak and slow reform implementation and lack of fiscal adjustment is largely responsible for the high fiscal and current account imbalances and volatile growth performance, despite the fact that the issues and remedies were well identified. There is therefore a significant risk that narrow sectarian interests will continue to overshadow national-level interests and obstruct again the implementation of the newly adopted economic reform program. This risk could be compounded should macro-economic stresses develop, as a result of external shocks (resulting from volatility in oil prices, surge in commodity prices, as well as insufficient growth in the main partner regions). Maintaining the Bank's effort to build future capacity for reforms through analytical and advisory activities could help enhance consensus around the reform program, which combined with continued strong engagement by the Bank in the development and implementation of a social protection strategy, could provide a mitigation instrument.

114. ***There are important external financial risks inherent in Lebanon's dependence on foreign capital inflows.*** Financial management has been helped by large inflows of foreign capital from the Lebanese diaspora and from Arab investors that have fed the capacity of the economy and the banking sector to absorb large sovereign debt. For the scheme to continue, confidence of both domestic and foreign depositors and investors is key. Past episodes have shown that confidence is

highly sensitive to political developments.[19] In addition, a change in international financial prospects resulting in increased international interest rates would reduce the spread between interest rates in Lebanon and the rest of the world. This would reduce capital inflow to Lebanon, the alternative being a rise in domestic interest rates with detrimental consequences on Banks' profits and on the budget balance. By maintaining fiscal discipline, the Government would be able to mitigate this risk by compensating for the decline in the spread through a reduction in sovereign risk.

115. ***Systemic corruption and governance-related risks are high.*** Lebanon's public sector has become a major source of political rents, aided by the weak rule of law and lack of law enforcement, especially when offenders are politically protected. The political will to address these obstacles remains constrained by sectarian interests. The CPS addresses governance problems through promoting stronger accountability. Since this generally requires parallel bottom-up and top-down approaches and coordination among various stakeholders, discussion about "feasible" and "good enough" governance reforms to meet key development objectives is to be continued. During the implementation of the CPS, the Bank will seek to deepen dialogue around feasible governance arrangements that are compatible with Lebanon's political economy. The Country Management Unit has commissioned a country governance and anti-corruption analysis to identify governance-related risks, as well as entry points to mitigate these risks against the background of Lebanon's complex political environment. Increasingly, it has been recognized that reform practices that might seem ideal technically may not be feasible in Lebanon's historical and institutional setting.

116. ***Building capacity in the public sector remains important to address governance challenges.*** Civil service reform per se is unlikely to be feasible. However, combined with building awareness to prepare the ground for reforms, a targeted engagement in building capacity within sectors and involving civil society in monitoring performance has potential for success.

117. ***Addressing governance challenges will require broadly-based communication and participation across sectarian lines.*** One key measure is to enhance transparency through broader public dialogue including with the media and stakeholders. This approach is likely to help build awareness about the negative socioeconomic impact of current conditions. Analysis of stakeholders' positions has shown that reform will be difficult unless it is balanced among all communities. Awareness of these issues allows a search for creative solutions to problems that are often not technical in nature. The Bank through active engagement with the media, academia, and local opinion leaders, will continue to support an informed debate around development issues and the trade-offs that are involved in policy choices.

118. ***The fragile political environment in Lebanon and the tense regional security environment could also pose important risks.*** Internally, the inter- and intra-sectarian divisions could restart, easily provoking an escalation of tensions. Social unrest, security shocks and political missteps may draw the country into political crisis and policy paralysis, and could badly hit investors and depositors' confidence. Lebanon is also exposed to a number of regional political and security risks, such as the Arab-Israeli conflict and wider regional tensions.

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[19] For example, in Spring 2002 when regional and local developments necessitated massive bilateral donor support at the Paris II Conference; in 2005 in the aftermath of the assassination of former PM Hariri; and in 2006 during and after the July hostilities and ahead of the Paris III Conference. In each of these episodes, quick and substantial balance-of-payments and/or budget support from friendly governments, combined with the dexterity of the Lebanese monetary authorities and the high cohesion of the banking community, eventually succeeded in reassuring investors.

ANNEX 1: RESULTS MATRIX

Country Development Goals	Issues and Obstacles	Outcomes to Which the CPS Expects to Contribute	Milestones and Progress Indicators	Bank Group Interventions and Partners
STRATEGIC GOAL 1: Growth & Fiscal Sustainability				
1.1 Fiscal Space				
Debt and debt-servicing burden is reduced	Fiscal and public debt positions create major risks to macro-fiscal sustainability and prospects for high growth.	Create enabling conditions for management of fiscal balance by: • Improving macroeconomic programming and policy analysis to guide revenue and expenditure choices and to facilitate integration of planning and budgeting functions; • Publishing and implementing a medium-term debt management strategy; • Establishing formal coordination mechanisms between MoF and BdL to improve debt management.	Macro-Fiscal analysis and modeling function further developed, fully operational and periodically updated A High Level Committee (HLC) has been established. MoU between MoF and BdL has been agreed on and the HLC has had its first meeting.	EFMIS, Developing Capacity Building Tools for Sustainable Governance (IDF Grant), Policy Notes, and Technical Assistance UNDP, EU, France
1.2 Public Financial Management				
Improve efficiency and quality of Public Expenditure	Absence of a clear macro-framework, budget, MTEF, and alignment between expenditure and planning Absence of a planning tool for effective resource management	Budget preparation process is better aligned with government policies and provides stronger basis for expenditure control and strategic resource allocation by: • Introducing a multi-year budget planning process (MTEF) (baseline: incremental annual budget planning) • Regularizing preparation of the public investment program and	The conceptual framework and implementation plan for the introduction of the MTEF has been developed by the MoF. Guidelines and basic procedures for public investment programming of a periodicity equal to that of the	EFMIS, Policy Notes UNDP, IMF/METAC, EU, France

		synchronizing it with that of the budget cycle	aggregate MTEF are defined. Basic procedures for estimation of recurrent costs are developed.	
1.3 Statistical Capacity Building				
Increased evidence-based policy making	Lack of resources and autonomy of the Central Administration for Statistics (CAS) results in a weak and fragmented statistical system.	Enhanced capacity of Central Administration of Statistics (CAS) and clarification of roles and responsibilities to carry out and analyze key surveys. Indicator: Household survey and poverty work totally carried out by CAS according to international standards.	Government endorses the Statistical Master Plan (SMP). Review of the statistical legal framework completed. Series of training programs for survey, data analysis and poverty assessment completed. On-the job support provided to at least 4 senior technical staff of CAS.	Statistical Capacity Building TA UNDP, ILO, EU
STRATEGIC GOAL 2: Competitive Business Environment				
2.1 Business Environment				
Streamline and simplify legal and regulatory framework for businesses	Outdated commercial regulations and discretionary bureaucratic application of rules, particularly for SMEs.	Improvement in some key aspect of the legal and regulatory framework to facilitate company creation, operation, access to credit and/or exit (administrative procedures, commercial and company law, commercial and/or collateral registries, etc.) Enhanced capacity of public administration to implement business environment reform.	Establishment of inter-ministerial commission and its secretariat for monitoring reform process. Adoption of Action Plan with World Bank Technical Assistance prioritized list of reform projects.	IFC Advisory Services for Secured Lending, Alternative Dispute Mechanisms and PPPs

2.2 Access to Finance for SMEs and Women Entrepreneurs				
Increase number of financial tools/schemes available to SMEs and women-owned SMEs and streamline business support services across Lebanon.	Outreach of finance and financial guarantees to SMEs (particularly outside Beirut) falls below potential and demand. Business Support Centers (BDCs) do not provide consistent level of support to SMEs across Lebanon (in addressing business regulatory constraints).	Development of financial tools for SMEs and women-owned SMEs. Improved delivery of services by BDCs (such as gender-targeted workshops) in supporting capacity of SMEs, particularly in business management and processing/navigation of regulatory processes.	A comprehensive assessment and an M&E framework for financing outreach and tools to SMEs is completed, identifying underserved areas. One workshop to increase outreach by financial institutions to women-owned SMEs A review of BDCs is completed including an M&E framework to monitor graduating enterprises and women entrepreneurs.	WB Technical Assistance IFC Advisory Services
2.3 Trade & Regional Integration				
Minimize trade related restrictions	Trade finance for private sector firms is limited due to counter-party and country risks.	Access by private sector to trade financing improved. <u>Indicator:</u> At least a 10% increase in trade finance volume provided by banks to the private sector.	Number of banks participating in Global Trade Finance Program increases from 3 in 2010 to 6 in 2013.	IFC Investment IFC Advisory Services
2.4 Telecommunications				
Introduce competition, improve capacity and quality of services, and reduce cost to consumers.	Limited availability of ICT services; low quality of fixed line services; mobile penetration below potential. High prices of telecommunications services.	Development of a strategy for reform of the telecommunications sector with complementary tools to manage the fiscal transition, with a view to establishing a long term sustainable fiscal base for the sector. Enhanced capacity of the Telecommunications Regulatory Authority (TRA).	Assessment of different policy options to reform the telecoms sector, with an eye to managing the resulting fiscal transition, and establishing a sustainable fiscal base for the sector.	TA for telecommunications strategy. IDF Grant to support implementation of telecommunications strategy.

Strategic Goal 3: Economic Infrastructure (Electricity, Water, Transport, Environment & Waste Management, Local Development)				
3.1 Electricity				
Increase supply of reliable electricity and reduce drain on government budget	Poor operational and financial performance of EdL. Unreliable and costly electricity services due to insufficient generation capacity. Large subsidies to sector from national budget due to insufficient revenues from tariff.	Improved operational performance of EdL. Indicator: Network losses reduced from a baseline of 37% in 2010.	Preparation and approval of a plan for EdL performance improvement Improved demand management and distribution network performance through implementation of demand management and loss reduction programs	WB Technical Assistance WB Investment Loan/GEF/WB Technical Assistance
3.2 Water				
Increase reliability of water supply, develop comprehensive water resources management plan.	Fragmentation and weak technical, financial and managerial capacity of Regional Water Authorities (RWAs). Inadequate water and wastewater planning supply, storage, treatment, and distribution capacity. Outdated and inadequate water resource management strategy and planning.	Access to and reliability of potable water is increased in the Greater Beirut Region. Beirut Mount Lebanon Water Authority (BMLWA) and Bekaa Regional Water Authority (BRWA) have a strengthened management capacity Indicators: Additional 250,000 m^3/d of potable water is provided to the Greater Beirut Region by end-2014; Supply hours during lean season increased three-fold by end-2014. The GoL has a national water resource management strategy and plan. Indicator: A NWRMS has been adopted by government.	**Beka'a Regional Water Authority** Full-time managing director for Bekaa Regional Water Authority appointed by August 2011. Business plan developed by December 2011. Wastewater management plan developed for Bekaa Valley by May 2011. **Beirut Mount Lebanon Water Authority** Acceptable commercial billing and accounting standards implemented by December	World Bank assisted ongoing investment: Baalbeck Water and Wastewater Project World Bank assisted ongoing investment (grant): West Bekaa Emergency Water Supply Project Greater Beirut Water Supply ($200 million loan) investment project- with $140 million counterpart financing from the Beirut Mount Lebanon Water Authority

			2012. Water resource management study completed by December 2011.	
3.3 Transport				
Improve efficiency of existing urban transport infrastructure in the Greater Beirut Area	Severe traffic congestion as a result of limited road network capacity. Lack of parking management and shortage of parking spaces. Limited capacity and poor quality of public transport system services.	Efficiency of existing urban transport infrastructure and traffic management in the city of Beirut and Greater Beirut Area is improved. <u>Indicators:</u> • Travel time on selected main urban roads reduced by 25% (baseline 2010). • Increased regulation of on-street parking in selected zones. • Formulation of an integrated urban transport strategy for the Greater Beirut Area.	Traffic Management Organization (TMO) with Intelligent Transport System (ITS) capabilities is established. Installation of about 580 pay-and-display multi-space parking meters; TA and training to build capacity for parking management. Transport feasibility studies completed	Ongoing Urban Transport Development Project TA to MoTPW Agence Française de Dévelopment (AFD)
3.4 Environment & Waste Management				
Municipal Solid Waste Management	Weak legal and institutional framework including lack of defined roles and responsibilities, poor strategic planning and very modest managerial and technical capacities.	Sector strategic objectives and priority needs well defined together with an effective national planning framework and implementation arrangements are in place.	National MSW Plan with quantitative targets in terms of service delivery and quality prepared and initiated by 2012.	Ongoing World Bank CEA with municipal solid waste as one on the main covered topics.
3.5 Local Development				
Promote balanced and sustainable territorial	Outdated municipal finance framework.	Improved transparency and predictability of inter-governmental fiscal transfers	Use of the standard accounting and financial management practices is systematized in	Implementation of the ongoing FMIP project (Grant financing), Municipal Finance

development	Weak management capacity of municipal sector at central government level. Large and growing disparity in living standards across regions	<u>Indicator:</u> Intergovernmental transfers are settled on a quarterly basis to all municipalities. Transparency is increased in the municipal sector due to the implementation of a modern M&E system. A Regional Development Master Plan is adopted. Historic and cultural assets are adequately preserved and managed with a view to create tourism revenue opportunities for local communities**.**	municipalities. Functional Municipal Observatory is established to collect data on local tax revenues and transfers from central government. Establishment of Regional Development Board. Increased rehabilitation activities in historic urban cores in compliance with approved regulations recognizing the centrality of their cultural heritage to their economic and social development.	TA. Ongoing CHUD Investment Project, Additional Financing, AAA, CEA Partners: AfD, EU, UNDP, Italy, Germany, US, Kuwait Fund.
STRATEGIC GOAL 4: Human Capital Development and Social Protection				
4.1 Education				
Improve quality teaching and learning in general public education	Children entering primary public schools are not ready cognitively and non-cognitively due to low pre-school enrollment and low quality pre-school education.	Improved school readiness among first graders in disadvantaged communities <u>Indicators:</u> • Number of 3-5 year olds enrolled in public preschools in rural and suburban areas has increased by 10% between 2010 and 2013. • 20% improvement in scores of participating schools in ECERS	110 renovated preschool facilities in public schools in disadvantaged areas by end-2013.	Education Reform for Quality Schools Project (ERQSP) SIL ($35 m under preparation) EU, USAID, AFD

	Qualification of teachers is low and there are no incentives to participate in professional development. Management of the public education system is centralized with limited school level empowerment.	(Early Childhood Environment Rating Scale). Public School teachers have upgraded skills and performance levels to meet national objectives. <u>Indicator</u>: 40% of teachers have received certification under the new Teacher Career and Professional Development Framework. Public Schools are empowered to plan and manage their improvement and development. <u>Indicator</u>: At least 30% of schools with active School Councils by end-2013.	Training of at least 1000 KG teachers in public schools in new ECE curriculum by end-2013. Adoption by Parliament of System of Professional Standards for Teachers. 20% of schools with school improvement plans approved and under implementation.	Education Reform for Quality Schools Project (ERQSP) SIL ($35 m under preparation) EU, USAID, AFD
4.2 Social Protection and Social Safety Nets				
Adequate social protection for the elderly, sick, and unemployed.	The National Social Security Fund (NSSF) is in financial deficit, and the quality and efficiency of its services and operations are low.	Improved administration, delivery and financial sustainability and targeting of social services through implementation of new systems and adoption of new policies in the NSSF, MoL, MoPH, MoSA, PCM, and MEHE. <u>Indicators:</u> • Reduction in annual deficits of the Maternity and Sickness Fund and the Family Allowance Fund. • An in-patient electronic claiming system (NAPS) • is operating in all hospitals nationwide.	NSSF Board approves plan for equilibration of Maternity and Sickness Fund. Government annually reduces its arrears with NSSF.	Emergency Social Protection Implementation Support Project II (ESPISP II) – under implementation

	Labor market policies and programs not functioning effectively	Facilitate employment through effective active labor market policies and programs, such as development of more efficient employment services (public or private). Indicator: Necessary systems and regulation needed for the effective operation of employment offices in the private sector in place.	Framework for active labor market policies and programs adopted by Ministry of Labor	MILES (AAA) Employment and Labor Markets Technical Assistance (SIL)
Improve living standards of the poorest and most vulnerable parts of the Lebanese population.	Impact of formal social safety net programs on poverty is minimal. Untargeted, weak, fragmented, social safety net programs.	The National Poverty Targeting Program (NPTP) for social safety nets is implemented, operational and in full use, based on a targeting mechanism that uses transparent and scientific criteria that assess households' eligibility.	Establishment of a database on poor and vulnerable populations using proxy-means testing targeting mechanism. Nation-wide public relations campaign on the NPTP implemented.	Emergency Social Protection Implementation Support Project II (ESPISP II) CIDA Italian Cooperation

ANNEX 2: WORLD BANK PORTFOLIO PERFORMANCE

1. There are eight active projects for a total net commitment of US$269.8 million (including IBRD and Lebanon Trust Fund resources) of which US$138.4 million has been disbursed to-date (July 5, 2010). Project implementation is generally satisfactory, and all projects are expected to achieve their development objectives. However, four projects are currently at risk in the portfolio, mainly due to slow disbursement and effectiveness delays. The Bank is planning to engage in yearly participatory Country Portfolio Performance Reviews with the Government to review portfolio implementation and ensure effective and satisfactory completion of projects. The disbursement ratio over the last three years has been above the three-year average (FY08-FY10) for MENA and for the IBRD portfolio as a whole; however, in FY10 it was 14.9 percent which was below the MNA and Bank average of 19.2 percent and 26.4 percent respectively.

2. In September 2006, the World Bank's Board of Governors approved a grant of US$70 million for a Lebanon Trust Fund (TFL) to support the Government's reconstruction efforts following the July/August 2006 hostilities. The resources came in the form of a grant from the Bank's surplus. The TFL financing is assisting in municipal and water infrastructure rehabilitation, supporting reform implementation in the energy and social sectors, and improving the allocation and use of public financial resources. US$15 million was allocated to IFC to scale up its Risk Sharing Facility to Lebanese banks by providing a first loss grant (US$14 million) and technical assistance (US$1 million) to expand the coverage of Kafalat (the Lebanese SME guarantee agency) and to support other organizations that finance SMEs.

3. The Bank's portfolio was restructured in FY05 to strengthen project implementation. Portfolio performance improved considerably thereafter. However, the two month implementation interruption caused by the 2006 hostilities resulted in a delay of five to six months for all the projects in the portfolio. Once project implementation resumed, close supervision by the project teams (Government and Bank) resulted in improved performance and reduced delays. Following the hostilities, the Bank adopted country financing parameters for Lebanon which provided a new framework for cost sharing arrangements and greatly improved the speed of implementation at a time of crisis. To ease the financial burden on the Government, all Loan Agreements were amended in August 2006 to allow for 100 percent financing and to eliminate counterpart contributions for a period of one year, until August 2007. PIUs quickly focused on remobilizing contractors to re-start the interrupted works. Unallocated project funds were redirected towards emerging priority needs to relieve hardship in local communities. To date, the Bank may still finance up to 100 percent of the project costs based on merit and justification, applying the parameters with due diligence on a project by project basis. This has increased the flexibility of use for Bank loan proceeds, reduced the transaction costs to the country and the Bank, and is expected to enable easier harmonization of donor procedures around country systems.

4. The portfolio financial management (FM) performance is overall satisfactory**.** This was confirmed during the 2009 portfolio review and it will be updated for the coming participatory Country Portfolio Performance Review. The strengths of the portfolio FM performance include: adequate staffing, reliable and timely reporting, smooth funds flow, adequate controls, and clean audit reports. However, the portfolio has an unsatisfactory audit timeliness rate due to: (i) delay in receiving projects' audit reports, audited financial

statements, and management letters; and (ii) to lack of assets management systems. In terms of the audit issue, it is being addressed by early selection of auditors with whom the Bank is conducting frequent informative and planning meetings to ensure delivery of timely acceptable reports. As to the assets system, the projects are being required to maintain an updated list of assets that is validated through having beneficiaries confirm existence and functionality status and through performing physical inspection. During the CPS period, these areas will continue to be monitored closely to ensure proper compliance.

5. Every project is born with two exogenous "flags," signaling risks associated with the macro-economic environment and poor outcome track record of completed projects.[20] While the number of project-specific risk flags initially increased in the wake of the hostilities, the average number of flags per project is now below that of June 2006.

6. Nonetheless, a number of systemic obstacles to implementation, applicable to all projects in the portfolio, remain. The public procurement system still relies on a law from the 1960s and is in urgent need of reform[21]. While efforts have been taken by the Council for Development and Reconstruction (CDR)—the main implementation agency for Bank funded operations—to streamline the process, the tendering process still takes up to four months. Concerns regarding the sustainability of institutional development components also remain, due to the difficulties in attracting quality civil servants and consultants to the public sector, associated with the GoL's freeze on new hiring. These issues and others will be addressed in the context of the GoL's reform program.

7. Experience has shown that capacity building components tend to be ignored until late in project life. This results in the need to extend projects to complete these components satisfactorily. This tendency will be addressed early on in future operations by the project teams.

8. In addition to the investment portfolio, Lebanon has been able to access a variety of existing Bank-administered trust funds, including Institutional Development Fund grants, Development grant Facility grants, Cities Alliance grants, Persistent Organic Pollutants Trust Fund grants and grants from the State and Peace-Building Fund.[22] The current portfolio includes seven of these grants, totaling US$3.4 million. The portfolio has supported the post-war reconstruction of critical infrastructure (especially in the areas of water supply and sanitation, urban transportation, and urban development) and the strengthening of capacity in public institutions in need of reform (in electricity, social protection, and fiscal management). It is worth noting that trust funds have played a central role in the World Bank's support to Lebanon and have been instrumental in the preparation of structural reforms under the ISN and Paris III. This support was also bundled with IFC investments to facilitate bank lending to SMEs affected by the conflict through Advisory support and risk guarantees. Trust funds have also been used to support the reconstruction of the Nahr El-Bared camp and its adjacent communities. In addition to the US$2 million grant from the Development Grant Facility which is financing small-scale infrastructure projects and services for the communities surrounding Nahr El-Bared, the Bank has set up a Multi-Donor Trust Fund (MDTF) which

[20] The flags are Country Environment and Country Record. The first is based on a composite indicator of a country's weak macro management. The second is based on an independent evaluation of samples of completed project (selected by the Independent Evaluations Group), where net commitments associated with unsatisfactory projects represent more than 40 percent of commitments for completed projects over the previous five years.
[21] A new public procurement draft law is awaiting the approval of the Council of Ministers.
[22] For a complete list of Trust Funds, see Table next page.

channels donor contributions to the United Nations Relief and Works Agency (UNRWA) for the reconstruction of the camp.[23] To-date, the MDTF has financed rubble removal and reconstruction packages for the old camp and has been fully disbursed.

9. Active Trust Funds Table

Fund	TF Name	TF Prog. Src	Closing Date	Percent Disbursed	Grant Amt (USD)
TF091513	Nahr El-Bared Emergency Recovery Project	DGF	12/31/2010	46.89	2,025,000
TF056820	IDF-Lebanon: Supporting the Judiciary System in the Enforcement of Environmental Legislation	IDF	7/5/2010	80.28	327,000
TF090548	IDF Grant for Developing Capacity Building Tools for Sustainable Governance	IDF	8/14/2010	75.76	338,000
TF093850	Emergency Fiscal Management Reform Implementation Support Project (EFMIS-TA)	LTF	9/30/2011	10.24	4,000,000
TF058084	Emergency Power Sector Reform Capacity Reinforcement Project	LTF	12/31/2010	65.83	5,000,000
TF092582	Second Emergency Social Protection Implementation Support Project - ESPISP II	LTF	3/31/2012	8.32	6,000,000
TF058085	West Beka'a Emergency Water Supply Project	LTF	11/20/2011	16.62	15,000,000
TF057505	First Municipal Infrastructure Project (FMIP) – Additional Financing	LTF	6/30/2011	53.68	30,000,000
TF092011	Cities Alliance - Al Fayhaa Sustainable Development Strategy	CITIES	7/31/2010	72.42	345,190
TF093689	Conflict-Affected Areas of North Lebanon: Nahr El-Bared Camp (UNRWA)	MNA-FS	12/31/2013	100	7,975,000
TF096155	Nahr El-Bared (Secretariat Costs)	MNA-FS	2/28/2014	5	490,075
TF091523	POPs Canadian TF: Inventory & Removal of POPs Materials Project Supervision	POPS	12/31/2010	95.34	24,875
TF091522	POPs Canadian TF: 2 Inventory & Removal of POPs Materials	POPS	12/31/2010	4.5	248,748
TF095205	Recovery and Reconstruction of the Nahr El-Bared Palestinian Refugee Camp and Conflict Affected areas of North Lebanon	SPBF	12/31/2010	100	90,000
TF092049	MENA Region-Specific Guidelines for Integrated Prevention and Care for Key Vulnerable Groups	GAIDS	04/30/2010	76	83,511
TOTAL					**71,947,399**

10. The Bank has also produced and disseminated a number of Economic and Sector Work pieces and just-in-time policy notes aimed at shaping policy debates and providing analytical underpinnings for reform, namely in pensions, labor markets, investment climate, gender and environmental degradation. The Bank is providing technical assistance to support the

[23] To-date Spain, Norway and Finland have contributed a total of US$9.78 million to the MDTF.

implementation of electricity sector reforms by evaluating fuel options (LNG, CNG and coal), and is providing advice to the Telecommunication Regulatory Authority. Other noteworthy analytical work includes the Social Impact Analysis for Electricity and Water Sectors, the Public Expenditure Reviews for the Energy and Water Sectors, and the Policy Note for Regional Development of the North. The Bank is also providing capacity building activities to: (i) the Central Administration for Statistics to complement the ongoing advisory assistance to implement the Statistical Master Plan and reform the legal framework of the statistical system; (ii) the National Social Security Fund to assist its management to undertake the needed reforms and train the NSSF staff in all basic skills for a modern social security institution; and (iii) local development in five of the biggest growth centers (Cities of Tripoli, Jounieh, Saida, Sour and Ba'albeck) to further stimulate their economic development potential and drive regional economic growth.

ANNEX 3

ACTIVITIES OF DEVELOPMENT PARTNERS (Ongoing/Future)																							
Areas of Engagement	**EC**	**AFD**	**KFW**	**French Govt.**	**Italy**	**EIB**	**Japan (JBIC)**	**USAID**	**KFAED**	**AFESD**	**SFD**	**KSA**	**OFID**	**ADFD**	**IDB**	**China**	**FAO**	**OHCHR**	**UNFPA**	**UNESCO**	**ILO**	**UNICEF**	**UNRWA**
Fiscal Adjustment, Economic and Public FM (€/$ M)																							
➢ Public Administration										$31							$0.15		$2				
➢ Data Collection/Statistics																			$0.80	$0.40		$1.80	
➢ Growth (job creation, local dev., private sector)	€ 56																				$8.40		
➢ Support to Reforms	€ 52																						
Economic Infrastructure (€/$ M)																							
➢ Energy										$152													
➢ Water Supply & Sanitation	€ 5	€ 40	€ 22	€ 20	€ 124.80	€ 200	$40	$45.50	$112.50	$194	$11			$27	$134.50		$0.27					$1.30	
➢ Telecommunications																							
➢ Infrastructure/Transport	€ 30 (+ € 10 for studies)				€ 7.90	€ 60			$73	$209	$74	$135	$25	$10	$201								
➢ Environment					€ 2.30												$2.60			$0.10			
➢ Agriculture/Farming					€ 4.50			$7.50									$2.89						
➢ Nahr el Bared	€ 27.80				€ 5			$6															$130.8 (Reconst. & Relief Recov.)
➢ Other	Demining € 11							$3													Conflict Prevention $0.9		Imp. Refugee Living Cond. CII $7.2 Protection $0.5
Business Environment (€/$ M)																							
➢ Investment Climate																							
➢ Support to SMEs	€ 15				€ 2	€ 100		$1.60		$87													
➢ Governance	€ 4							$17.70															
➢ Other	Justice /Law € 30							$33.90								TCP $5.6							
Local Development (€/$ M)																							
➢ Cultural Heritage & Urban Development		€ 9			€ 12.20			$5.75												$0.77			
➢ Municipal Infrastructure								$28.75															
➢ Tourism																							
Developing Human Capital (€/$ M)																							
➢ Health	€ 4				€ 6.70										$89.80		$0.21		$4.90				Reg. $14.3 Projects $0.6
➢ Education	€ 44							$20.00	$53.50	$25	$18.50				$66					$0.78		$0.88	Reg. $36.3 Projects $4.2
➢ Community Dev./Job Creation					€ 6.70			$14															
➢ Support to Civil Society/NGOs	€ 3							$26.35															
➢ Youth	€ 0.40																		$0.04	$0.20			
➢ Other								$0.99										Human Rights	Gender $3	Gender $0.65 Soc. Supp.	Child Labor $0.8 and Gender	Child Protection	Relief & Social Services $4.5 Supp. & Operational

* Total funding from USAID amounts to US$213.6 m covering education, training, health, governance, support to SMEs and micro-enterprises, support to Parliament/Judiciary, social development, Small Grant Program, water/wastewater, infrastructure and agriculture.

**UNRWA's human development and humanitarian services encompass primary and vocational education, primary health care, social safety-net, community support, infrastructure and camp improvement. UNRWA is the implementing agency for approx. US$190m provided by various donors.

ANNEX 3: Development Partners Table (Continued)

Abbreviations:

ADFD = Abu Dhabi Fund for Development
AFD = Agence Française de Développement
AFESD = Arab Fund for Economic and Social Development
EC = European Commission
EIB = European Investment Bank
FAO = Food and Agriculture Organization
IDB = Islamic Development Fund
JBIC = Japan Bank for International Cooperation
KFAED = Kuwait Fund for Arab Economic Development
KFW = Kreditanstalt für Wiederaufbau
OFID = OPIC Fund for International Development
OHCHR = Office of the High Commissioner for Human Rights
SFD = Saudi Fund for Development
UNESCO = United Nations Educational, Scientific and Cultural Organization
UNFPA = United Nations Population Fund
UNICEF = United Nations Children's Fund
UNRWA = United Nations Relief and Works Agency
USAID = United States Agency for International Development

ANNEX 4: PROGRESS UNDER THE ISN (FY2008-2009) AND LESSONS LEARNED

Date of CAS: **July 9, 2007**

Progress Report: None required
Period covered by ISN: July 1, 2007 – October 30, 2008

Introduction

1. This document evaluates the achievement of the objectives of the FY08-09 Interim Strategy Note (ISN) dated July 9, 2007 (Report 39779-LB). The document assesses the effectiveness of the ISN in aligning its objectives with Lebanon's strategic goals, keeping in mind the country's circumstances; and highlights the lessons learned over the period to inform the new Country Partnership Strategy.

Context of the ISN

2. The ISN was prepared in the aftermath of the summer 2006 hostilities and the ensuing political impasse which had rendered some of the CAS (approved in December 2005) assumptions and projections untenable. The move to an ISN reflects the recognition that greater focus and flexibility are required. The period covered by the ISN was only 15 months in appreciation of the uncertain economic and political situation in Lebanon and taking into account the elections that were scheduled for the Fall of 2007, after which the Bank had planned to initiate a new CAS by October 2008.

3. The ISN was designed to support the Government's medium-term structural reform program – Paris III – discussed at the International Donor Conference in January 2007. Paris III focused on structural reforms, including fiscal adjustment to reverse Lebanon's unfavorable debt dynamics, reforms to enhance growth by strengthening the business environment and competitiveness and social sector reforms. The ISN set out a transitional framework of technical and financial assistance to contribute to the Government's efforts to establish reform momentum.

4. Implementing this ambitious Paris III program required broad political support and consensus on key reforms, such as energy sector reforms which were critical for improved fiscal/debt sustainability and growth prospects, and social sector reform to benefit the poor and vulnerable and contribute to fiscal improvement in the medium term. However, the broad political support expected at the time of the ISN preparation was short-lived and a political crisis emerged which lasted about 18 months and lead to the formation of a care-taker government until the parliamentary elections of June 2009.

Overview of ISN Relevance

5. **The ISN program priorities were fully aligned with Lebanon's own priorities and development objectives.** The ISN focused on providing assistance to the GoL to advance the implementation of key reforms spelled out in Paris III and pave the way for their broadening and deepening as the political environment would stabilize. The ISN correctly recognized that Lebanon was facing a period of high uncertainty. The ISN, therefore, proposed a short-term transitional support to the GoL and the areas of focus, particularly under pillar 1, were selected because they could have the highest impact on medium-term public expenditure and social reform and were deemed to enjoy broad political support.

6. The ISN was, in substance, highly relevant and rightly aligned with the GoL strategy and was structured around three pillars that should have been mutually reinforcing, and focused on: (1) governance, economic management and growth support; (2) human capital development and poverty reduction; and (3) resource and environmental management. The ISN was not results-based and there were no specific targets outside the project results framework. Thus, it is difficult to judge progress in meeting ISN objectives in many areas.

7. The suggested lending and non-lending assistance was relevant and consistent with the strategy. The major focus of the lending program was two consecutive Development Policy Operations to support the implementation of the Government's reform program (Paris III) and projects financed by the Lebanon Trust Fund. The planned AAA was expected to inform the budget planning exercise and the refinement of medium-term sector reform actions and address public management and poverty assessment.

8. The ISN focused on a set of early actions and outcomes needed to kick start and achieve the Paris III program objectives over time, and was prepared on the basis of the apparent consensus of all parties on the critical reforms needed to improve the fiscal/debt sustainability and growth prospects in the medium to long term. The strategy clearly recognized that the period covered was uncertain, but nevertheless proved to be ambitious and complex. The political situation in Lebanon continued to be tense as of 2007 and the apparent consensus on the reform agenda quickly dissolved. Some of the major risks identified in the ISN materialized and the government program the ISN was designed to support proved to be too ambitious.

Identified Risks

9. The ISN identified four key risks, all of which were considered to be high. First, the political and security risks. The ISN noted that in the short run the fragile political environment in Lebanon and the tense regional security environment posed the most important risks. Second, the ISN identified public debt and financial crisis risks. The main risk of macroeconomic and financial instability lies in the size of the fiscal imbalance and the spiraling public debt dynamic. The ISN also identifies external financial risks given Lebanon's dependence on foreign capital inflows from the Lebanese diaspora and Arab investors. Third is the risk of stalled reform program. The ISN cites the risk of narrow sectarian interests overshadowing the national-level interests, which could be compounded as macro-economic stresses develop, given Lebanon's poor past policy reform track record. Fourth was portfolio risks that are rooted in the macro-economy, institutional processes and capacity constraints. To partially mitigate the risks, the ISN focused WBG's financial assistance on fiscally and socially rewarding elements of the reform program; emphasized timely implementation of the macroeconomic stabilization measures and intensified efforts to build the capacity for reforms.

Overview of ISN Implementation

10. The implementation of the ISN objectives was supported by an IBRD lending envelope of US$170 million for two DPLs in support of Paris III. The first DPL was approved in August 2007. However, the Government failed to demonstrate significant progress in implementing Paris III, and the DPL's performance triggers, particularly on a program for electricity sector restructuring. The second DPL was, therefore, never completed. Instead of a second DPL, the Board approved additional financing for the Urban Transport project for US$69.7 million. The ISN had envisaged two additional projects financed by the Lebanon Trust Fund and both were approved in FY09 for a total commitment of US$10 million focusing on providing additional technical assistance on social protection reform and fiscal management.

11. Out of the 12 projects active during the ISN period up to June 2009 (6 IBRD loans, 6 grants from the Lebanon Trust Fund, of which one was WBG executed, and one DPL), 2 IBRD projects (Community Development Project and First Municipal Infrastructure Project) closed as well as the WBG-executed project from the TFL. The Community Development Project was rated “moderately satisfactory” on overall outcome of the project and on WBG performance, due to the difficult political environment and institutional framework that was present during project implementation. The First Municipal Infrastructure Project closed achieving all of its development objectives and was rated “satisfactory” on outcomes, WBG and Borrower performance.

12. The general quality of the projects that remained open during the ISN period was good, however some projects continued to suffer from procurement, disbursement and effectiveness delays. One IDF grant closed (National HIV/AIDS Monitoring and Evaluation) and one PCF Grant (Establishment of Mechanisms for National Reconstruction) closed during the period under consideration, yielding satisfactory results. There were no apparent safeguard issues in the portfolio under the ISN period. In order to ease the financial burden on the Government, all Loan Agreements were amended in August 2006 to allow for 100 percent financing and eliminate counterpart contributions for a period of one year, until August 2007. The new WBG policy (OP/BP6.0) simplified procedures and reduced the transaction costs imposed on the Government of Lebanon. To date, the WBG may still finance up to 100 percent of the project costs based on merit and justification, applying the parameters with due diligence on a project by project basis. This has increased the flexibility of use for WBG loan proceeds, reduced the transaction costs to the country and the WBG, and is expected to enable easier harmonization of donor procedures around country systems. The policy rests on three guiding principles: (i) expenditures financed from the WBG loan proceeds are productive; (ii) the impact of operations financed under such loans on the borrowing country’s fiscal sustainability is acceptable; and (iii) oversight arrangements on the use of WBG funds are acceptable.

13. The five proposed diagnostic activities were completed, but only one was delivered on time and four were delivered with slight delay. The energy and water Poverty and Social Impact Analysis was deemed more appropriate than the traditional Poverty Assessment planned in the ISN to analyze the distributional impacts of the proposed structural reforms (that would affect access to, quality and cost of service) and mitigation measures. This diagnostic work together with the three Public Expenditure Reviews provided the GoL with meaningful information and analysis to implement reforms. One of the five activities should have been labeled as technical assistance as it was designed to provide technical assistance to the GoL in addressing some the findings and recommendations of the Economic and Social Impact Assessment undertaken following the summer-2006 hostilities.

14. The ISN had planned for non-lending technical assistance to complement WBG support to Paris III and focused on two critical areas: building the capacity of the Central Administration for Statistics on poverty analysis and social statistics, which is ongoing; and TA on financial sector assessment and public debt management

15. While the ISN had not proposed any specific intervention to assist with the recovery and reconstruction of the Nahr El-Bared Camp and the conflict affected areas in the North of Lebanon, at the request of the Government, the WBG prepared an in-depth analysis of the impact and a reconstruction strategy, financed by post conflict grants, to underpin the activities to be supported by a small multi-donor trust fund managed by the WBG. The US$10 million multi-donor trust fund was set up in 2008 to pass donor contributions for the reconstruction and recovery of Nahr El-Bared and Beddawi camps to the United Nations Relief and Works Agency for Palestine Refugees in the Near East. To-date, the removal of rubble in the first reconstruction areas has been completed but work temporarily halted awaiting resolution of questions on how to deal with antiquities discovered at the site.

16. An ISN with a limited (15 month) duration was deemed appropriate for guiding WBG Group strategy. However, the program envisaged for such a short period of time was too heavy to ensure successful timely completion. The political impasse discussed above extended the period of the ISN period to cover the full fiscal year 2009. This allowed for the completion of all the activities envisaged.

Overview of Achievement by Pillar

Pillar 1 - Governance, Economic Management and Growth Support. To achieve this pillar's objective, the ISN planned for two consecutive Development Policy Loans (DPL); projects financed by the Lebanon Trust Fund focusing on building the capacity to prepare and implement reforms in the electricity and social sectors; the public expenditure reviews in three sectors; assistance in advancing public financial management reforms; and a poverty assessment.

17. The **DPLs** were the centerpieces of the ISN. The first DPL, the Reform Implementation DPL I (RIDPL), was prepared on the basis of the apparent consensus of all parties on the reforms needed to reduce the budgetary burden of the power sector, modernize the business environment and telecommunications sector, and reform social protection. The program was designed to respond to significant structural issues in the Lebanese economy which have a significant impact on the budget deficit, a significant cause of macroeconomic imbalance and instability.

18. The focus of the program was justified since covering its deficit absorbs 20 percent of the Government revenues. The design of the program focused on short-term actions having a clear impact on advancing sector governance reforms and financial viability, and on actions aimed at enticing the private sector to provide management skills and financing to the power sector. These priorities were suitably selected to achieve the maximum impact in the short term and to prepare for further improvements in the medium term as the sector reform program was implemented.

19. The project closed with an unsatisfactory rating with four of the five indicators not achieved and the fifth one only partially achieved. The main factors which affected the implementation of the reform program supported by the RIDPL were the political events in Lebanon following the approval of the RIDPL. This further complicated the intertwinement of sector reforms with the realities of Lebanon's political economy. Lebanon's political economy allocating considerable amount of subsidies and redistribution of public sector services as well as the lack of agreement on the objectives of sector reform have impeded progress on implementing reform measures, especially in the electricity sector. The main reasons for the failure to implement reform are not technical, since the sectors have benefited from a wealth of engineering and technical assessment reports providing recommendations for sector improvement and an agenda for sector reform. The situation in Lebanon continued however to be tense with demonstrations by the opposition paralyzing parts of Beirut for months, sporadic political violence and assassinations, the postponement of Presidential elections, the suspension of parliamentary sessions, and a long process leading to formation of an interim government with its main mandate to prepare new parliamentary elections. This volatility in the political conditions in Lebanon paralyzed government decisions necessary to advance reforms supported by the RIDPL.

20. The WBG had recognized the fragile political environment during the preparation of the RIDPL and the ambitious reforms included in Paris III program, but took a calculated risk and decided to support continued involvement in Lebanon as it felt that the WBG needed to stay firmly engaged with the process initiated at the Paris III Conference. The WBG decided to take a calculated risk and proceed with the RIDPL, believing that there was a window of opportunity which, in the end, did not materialize. However, it the potentially negative impact of the fragile political

environment on implementation of the reforms included in the RIDPL. The lesson learned is that it may be more effective to have a series of DPLs (or a multiple tranche DPL) that set less ambitious incremental targets. Without a strong consensus on those specifics amongst the key political actors, forward movement proves elusive.

21. While progress in implementing structural reforms has been slow due to the reasons mentioned above, the technical work progressed well, largely supported by **WBG advisory and technical assistance work and the TA projects financed by the Lebanon Trust Fund**. Three PERs were completed for the energy, water, and agriculture sectors together with the poverty and social impact analysis, providing the Government with solid studies on which to build and implement the reforms, if the political will were to materialize.

- In the *telecommunications sector,* some encouraging steps have been taken, but the privatization of the sector has been postponed. Political difficulties and increasing budget deficit have led to the postponement of the auction of the two mobile companies from 2007 to 2008. However, the Ministry of Telecom has taken several measures aiming to reduce the cost of telecommunications and to enhance the client base of the sector. These measures include: (a) reducing the subscription fee to the cell-phone lines; (b) reducing the fee for a prepaid card; (c) awarding the management contracts for the two cellular phones networks to two private companies for one year renewable; (d) increasing investments in the infrastructure of the sector in order to raise the capacity of the network; and (e) launching auctions on 32 distinguished cell-phone numbers which brought US$2.5 million to the Government.

- With WBG support, technical work for *social sectors* is also progressing, especially at the Ministry of Social Affairs where the Government is focusing on: (a) elimination of duplication in service delivery and program implementation among core ministries; (b) reform and restructuring of the Ministry of Social Affairs by identifying weaknesses in its mandate, structure and programs; and (c) establishment of a targeting mechanism (see more details on the achievements under Pillar 2). The Government had launched an initiative to strengthen the governance and administration. The first Phase of the Administrative and IT Master Plan was completed and all branches of the NSSF started the automated work. (I would suggest that we use the achievement und

- The Ministry of Finance has drafted laws to reform tax procedures and the GIT legislation, while taking steps to improve its budget formulation and debt management. The key measures taken and implemented by the MoF include: (a) the construction of a comprehensive database, enabling timely issuance of tax schedules and reducing tax arrears; (b) the creation of a Cash Management Unit; and (c) the implementation of debt management Law. However, the increase in VAT and some other tax policy measures expected to be adopted under the Paris III program to enhance the budgetary revenues have been postponed.

- In the *electricity sector*, some initial measures have been taken in the power sector where work is progressing on the corporatization plan for EdL, although with serious delays.

Pillar 2: Developing Human Capital and Mitigating the Poverty Effects of Transition

22. To achieve this pillar's objective, the ISN planned for the second DPL to focus largely on the implementation of the Government's comprehensive Social Action Plan developed as part of its medium-term reform program. Technical assistance was programmed funded by the Lebanon Trust Fund to complement the DPL and accompany the reform in its implementation phase. The ISN

planned to continue WBG support in the education support with the ongoing IBRD project and support the reform in education finance, reorganize the management of the public education system and develop a nationally agreed upon education sector strategy to achieve better outcomes.

23. As mentioned above, the lack of progress on the reforms supported by the first DPL prevented the finalization and approval of the second DPL which was expected to focus on three social clusters. However, two technical assistance projects financed by the Lebanon Trust Fund and AAA have supported the following achievements:

- Approval by Cabinet of a Policy Statement adopting the principle of (proxy-means testing) targeting for its social assistance/safety net programs.
- Successful implementation of the pilot of the new targeting mechanism and commenced preparation of the national roll-out.
- Cabinet approval of a US$20 million conditional cash transfer program to keep poor students from dropping out due to financial difficulties (targeting public schools).
- Joint Parliamentary Committee approval of new draft law converting current end-of-service-indemnity scheme for private workers into a fully-funded defined contribution pension system.
- Completed development of the hospital electronics claims processing system in the NSSF and piloted in two hospitals which will greatly improve efficiency of the system once rolled out.
- Developed reform options to reestablish financial sustainability of the health insurance branch in the NSSF, which was sent to the Board for approval.
- Establishment of an Inter-ministerial Committee for Social Policy to coordinate social policy.

24. In *education*, the ongoing project places a primary focus on building the institutional capacity, knowledge base, analytical tools, and readiness to implement education sector reform, as opposed to engaging in the reform process itself. The following was achieved under the project:

- Development of a National Education Sector Strategy following a wide process of consultation. The strategy is being utilized as the basic document guiding the strategic directions of the next five year. An Education Sector Development Prospectus and Matrix was subsequently developed with medium term priorities activities, outputs, and output indicators associated with these priorities.
- Formulating a Medium Term Expenditure Framework and a Program Based Budget for the period 2009-2011, as a shadow budget, based on the comprehensive financing study and the National Strategy completed under the project.
- Approximately 450 school principals have undergone a professional development program to improve leadership, motivational, and management skills, and formulated school development plans.
- Completed the automation of the General Science stream of the official examination, and administered it in June 2009.

25. In *health*, the WBG provided technical assistance to the Government to develop instruments for and undertake integrated bio-behavioral surveys of high risk groups. The IDF Grant enhanced national capacity to ensure effective tracking of the HIV prevalence among the high risk groups and prevent the spread of HIV. The WBG initiated a study to assess health equity using an available

household survey dataset. The study indicated a higher incidence of catastrophic health payments among households in the lower income quintiles and in the poorer regions of the country.

26. In *social development*, the WBG supported poor and disadvantaged communities, and specific vulnerable groups through the implementation of the Community Development Project (closed in 2008); and promoted a fruitful cooperation between civil society organizations, NGOs, CDR, sector ministries and municipalities to restore a feeling of trust in the Government and its ability to spend the money well. Under the project, 326 sub-projects were completed.

- 113 subprojects targeted farmers and helped increase the productivity of their agricultural land, crops and livestock through vocational training on issues pertaining to better land and crop management.
- Under the Youth Thematic Program, youth groups received training in life skills activities, followed by youth counseling sessions and referral systems. The project also offered training that targeted children enrolled and dropped out from school to increase their academic skills and encourage them to remain in school.
- Under the Disability Thematic Program, a disability prevalence study was completed to raise awareness of disability programs in schools. Teachers in 10 schools received training on inclusive education techniques.
- Women-specific courses were completed, aimed at empowering women legally and socially through education by increasing their knowledge and awareness, acquiring an income-generating skill, or developing their artistic skills.
- The capacity of NGOs/CSOs was improved with the upgrade of their proposal writing, financial management and procurement skills.
- In 2007, a decree was signed by the Prime Minister creating the Inter-ministerial Committee for Social Policy which is important to ensure that the innovative approaches to gender, youth, and disability are included in the Social Strategy.

Pillar 3: Resource and Environmental Management

27. To improve the management of water resources, the WBG proposed to undertake analytical and advisory services to help the Government implement actions specified in the Government's strategy.

28. The World WBG has played an active role in the development and implementation of the Government's strategy for an improved water sector. The results of the 2004 Sector Policy Note and 2006 Economic and Social Impact Assessment (ESIA) have largely driven the Government's agenda moving forward. The WBG provided in-depth analysis to support the GoL's reform in the sector with a public expenditure review which complemented the poverty and social impact analysis. The findings of the reports are that Lebanon's overarching challenge will be to establish trust with consumers while simultaneously improving performance. Major investments in each sector targeting infrastructure, management and human resources will need to take place while increasing revenue from consumers who have little faith in the system and want to see concrete results or credible action. In substance, the PER proposed a policy matrix recommending:

- Improving continuity of supply to achieve 24/7 across the country, while in parallel, increasing volumes of wastewater collected and treated;
- Improving efficiency in the water sector can generate sufficient resources to close the investment gap in WSS. This is particularly important, considering Lebanon's limited fiscal space.

- Improving sector efficiency through investment prioritization; implementation of Law 221; utility management; and information management.

29. The WBG recommendations have not been implemented to-date because of the political situation described above. A PER discussion was held on October 2, 2009 with relevant stakeholders (Government donors and civil society). The Government has requested additional support as it moves forward with the implementation of the medium term framework.

30. The WBG is also providing financial support to the ongoing Ba'albeck Water and Wastewater Project designed to connect people to water supply and wastewater services, installing meters, improving sanitation conditions, strengthening the capacity of the newly created Beka'a Regional Water Authority, and have the private sector operate and maintain the infrastructure facilities in the Ba'albeck area. The project has been instrumental in improving the coverage of potable water and providing better access to water supply and sanitary services. Through this project, the World WBG is working with the Government in furthering the reform agenda, focusing on the introduction of an adequate tariff scheme and the involvement of the private sector in the operations and maintenance (O&M) of networks and facilities. To-date, the infrastructure components have been completed, and on the institutional aspect, most of the by-laws (of the water sector law) were issued, but the whole reform agenda needs to be launched within the framework of the recently agreed action plans and reform strategies.

31. The ongoing Beka'a Emergency Water Supply Project is designed to alleviate the precarious conditions of the long-neglected water supply systems in West Beka'a, which were been further aggravated by the 2006 war. To-date, 95percent of the project is committed and implementation has just started. The WBG is working with the Kuwaiti Fund for Arab Economic Development (KFAED) in cofinancing this project, with KFAED contributing US$37 million to complete the program's financing plan.

32. Under Pillar 3, the WBG had also planned to stay engaged in the environment sector in the areas of environmental degradation and technical support to the Ministries of Environment and justice to improve the enforcement of environmental regulation. To-date, drafts of the chapters of the reference book on Noise, Solid waste, Soil, Agriculture, Transportation, Air pollution, Biodiversity and Tourism sectors are finalized and the analysis of environmental law courses offered at international universities and international judicial institutes completed. A major achievement lies in the Judicial Training Institute's decision to introduce a course on environmental law expected to be launched in 2010.

33. An agriculture sector public expenditure review note was finalized in June and suggests that Lebanon may want to pursue a two phase agriculture sector strategy that first focuses on fresh fruit and vegetables and agro-processing for domestic and Gulf country markets, eventually followed by entry into European markets. In order to implement such a strategy, the Ministry of Agriculture needs to align its functions around services it will provide, the most important of which are related to various dimensions of food quality and safety. In order to finance this, the GoL may consider reforming agriculture subsidy programs and reallocating the savings to raise capital spending. This would be facilitated by investing in critical areas including logistics, food quality and safety and research and development. In the longer-term it requires institutional reform that involves consolidating Lebanon's fragmented agriculture expenditures under a single institution that supports a single strategy. The report was sent to GOL in June 2009 for their review and comments. A workshop to discuss the findings of the PER is planned for November 2009 with relevant stakeholders.

Portfolio Assessment

34. Implementation of ongoing projects and proactive supervision has contributed to achievement of project objectives in most instances. The portfolio of projects under implementation during the ISN period showed considerable improvements following the July/August 2006 hostilities, as a result of a concerted effort by project management units, supported by WBG staff. Indeed, the Government's increased attention to sector priorities and the delivery of results to the population gave WBG staff the opportunity to discuss with counterparts ways to reassess the various components of their projects and address problematic areas with renewed determination. As a result, the portfolio became in better health than it was before the hostilities, and portfolio implementation progress was rated Satisfactory. Today, Project implementation is generally satisfactory and all projects are expected to achieve their development objectives. A portfolio review was completed with the Minister of Finance on April 21, 2009, to assess project implementation bottlenecks. The WBG is also planning to engage in a participatory Country Portfolio Performance Review with the new government to review portfolio implementation and ensure effective and satisfactory completion of projects. The average disbursement ratio for Lebanon in FY08 stood at 29.7 percent, well above the FY08 MNA and WBG averages of 21.6 percent and 21.3 percent respectively. The disbursement ratio for Lebanon in FY09 stood at 36.1 percent, well above the MNA and the Bank averages of 20.7 percent and 25.8 percent respectively.

Validity of the Choice of Instruments

35. The ISN rightly selected DPLs as the best financial instrument to support the Government's program. In fact, the political stalemate would have made it impossible for any investment lending operation to become effective because Parliamentary approval is required for investment lending. The ISN envisaged two policy-based lending operations to advance reforms that were likely to have an impact on macroeconomic and fiscal balances over time. The DPLs were sequenced to limit exposure in case of deterioration in the political, economic or security situation. Lack of progress on the reforms supported by the first DPL prevented the finalization of the second one. Therefore, of the US$175 million envisaged for development policy lending, only US$100 million was approved. Instead of a DPL, additional financing for the ongoing Urban Transport Project was approved for US$69.7 million.

36. The ISN also envisaged two TA projects to be financed by the remaining funds of Lebanon Trust Fund. The investment income earned on the trust fund allowed the WBG to grant a second capacity building project to support the implementation of social protection reform, which was particularly important to keep the momentum in light of the absence of the second DPL.

37. The delivery of first DPL operation has been timely, and in line with the ISN, but the technical assistance operations were delivered with delays pointing out to the over-optimism of the ISN program.

Table 1: Planned and Actual Lending (FY08-09)

	Project ID	Proposed FY	Approval FY	Proposed Amount US$M	Approved Amount US$M
IBRD					
Reform Implementation DPL I	P094288	2008	2008	100	100
Reform Implementation DPL II	P105823	2008	Dropped	75	-
Urban Transport Project Supplemental	P034038	Unplanned	2009	-	69.7
Lebanon Trust Fund					
Social Protection Reform Implementation Support	P106489	2008	2008	1	1
Social Protection Reform Implementation Support II	P 111849	-	2009	-	6
Emergency Fiscal Management Reform	P 111602	2008	2009	4	4
Other Grants					
Inventory of POPs material	P108112	2008	2008	-	0.22
Small Grants Program to NGOs					
Carbon Finance		2008	Dropped	-	-

38. The ISN focused the Bank's **advisory and technical assistance** on building the capacity for reforms, engaging with the Government on the development and implementation of reforms, and assisting the implementation of the reform program. During the ISN period, the WBG delivered several important advisory reports, including a poverty and social impact analysis, and three Public Expenditure Reviews (in energy, water and agriculture). Most major reports have been publicly disclosed and disseminated in broad consultations with the Government, Parliament, Private Sector and Civil Society at large. Lebanon's relatively free and cosmopolitan media also helped in the dissemination of these reports in wide coverage, prompting public debate across the political and social spectrum. The sequencing of analytical and technical assistance services enabled the WBG to provide strategic and well-targeted assistance. The series of studies completed in FY08 and FY09 have provided support to the Government in identifying options for reforms and building its capacity to develop and implement the reform.

39. The WBG also prepared a gender assessment exploring the working environment for females and the conditions as well as, barriers that women entrepreneurs face in the business and investment environment. Wide dissemination of the report has taken place with representatives from the Government, civil society and academia. The report has been publicly disclosed upon the Government's agreement.

Table 2: Planned and Actual Analytical and Advisory Work (FY08-09)

	Product ID	Proposed FY	Delivery Status
Diagnostics			
Electricity Sector PER	P105314	2007-08	Actual FY08
Water Sector PER	P110556	2007-08	Actual FY09
Agriculture Sector PER (TA)	P098755	2008	Actual FY09
Economic and Social Impact Assessment Follow-up TA		2008	Ongoing
Poverty & Social Impact Analysis	P089777	2008	Actual FY09
Technical Assistance			
TA on Financial Sector Assessment/Public Debt Management		Ongoing	Ongoing
Capacity Building on Poverty Analysis and Social Statistics with the Central Administration of Statistics	P113206	Ongoing	Ongoing
Broadband Strategy and Capacity Building	P116146	-	FY09

Management of the Risks

40. The identification of risks unfortunately proved to be prophetic, with internal political instability leading to the Government's inability to implement the Paris III reforms. The second risk only partly materialized and Lebanon's financial sector prospered in 2009 despite the global financial turmoil, with strong capital flows and domestic private investment. However, Lebanon's continued high debt calls for a prudent approach to near-term economic management and Lebanon has limited fiscal space. In the face of the political impasse on the reform program, the Bank focused, as identified in the ISN as mitigation measures, on building the capacity for reform and ensuring that the projects in the portfolio achieve their development objectives.

Main Lessons for CPS Design and Implementation

41. The ISN was designed and implemented in a challenging country context. In this context, the design of the CPS was generally appropriate. It set up a flexible, demand-driven arrangement around the Government's Program. The following important lessons can be drawn:

- **The complexity of the political environment for decision making in Lebanon should not be underestimated.** In Lebanon, the confessional system of governance and the resulting diffusion of political authority make such reforms subject to collective action, and such collective action is, for the same reasons, far from guaranteed.
- **Establish a flexible framework of activities that can be scaled up or down according to progress made on the reform program** and be realistic about the program that can be implemented during the allocated time period.
  - Focus lending in sectors where consensus on reform has developed and provide non-lending analytical and advisory work to sectors where broad-based consensus remains to be consolidated.
  - Establish a strategic and cohesive program of Bank activities that is not wholly dependent upon one counterpart or one instrument.
  - Maintain a core set of Economic and Sector work (ESW) and diagnostic products as a basis for scaling up or developing new activities.
  - Be prepared to scale down or disengage if the momentum for reform has disappeared and switch to a technical assistance/knowledge-based partnership.

- **Set realistic objectives, and avoid objectives that are unrealistic in the country context even if they are ideologically noble or current.** Expectations of impact of Bank support should be commensurate with the limited amount of assistance provided. Significant time is required for reaching a consensus on sensitive reforms after decades of mismanagement and internal conflicts, and the weak capacity in government administration.
- **Designing simpler projects and using adaptable instruments are even more important in today's context to flexibly respond to challenges and changing priorities.** The Government's implementation capacities still face the challenge of simplifying its procedures to expedite project implementation.

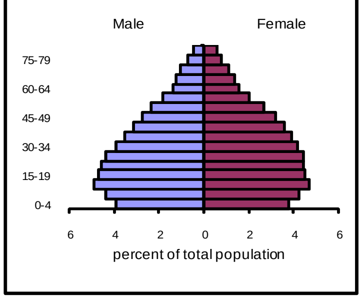
Lebanon at a glance

7/13/10

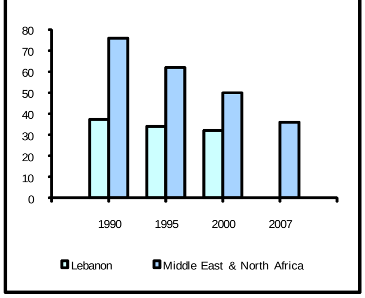
Key Development Indicators

	Lebanon	M. East & North Africa	Upper middle income
(2009)			
Population, mid-year (millions)	4.2	325	949
Surface area (thousand sq. km)	*10*	8,778	47,176
Population growth (%)	0.7	1.8	0.9
Urban population (% of total population)	89	57	75
GNI (Atlas method, US$ billions)	34.0	1,053	7,454
GNI per capita (Atlas method, US$)	8,060	3,237	7,852
GNI per capita (PPP, international $)	*11,750*	*7,350*	12,214
GDP growth (%)	9.0	5.5	4.2
GDP per capita growth (%)	8.2	3.7	3.3
(most recent estimate, 2003–2009)			
Poverty headcount ratio at $1.25 a day (PPP, %)	..	4	..
Poverty headcount ratio at $2.00 a day (PPP, %)	..	17	..
Life expectancy at birth (years)	..	71	71
Infant mortality (per 1,000 live births)	..	29	19
Child malnutrition (% of children under 5)	..	12	4
Adult literacy, male (% of ages 15 and older)	93	82	95
Adult literacy, female (% of ages 15 and older)	86	65	92
Gross primary enrollment, male (% of age group)	105	107	112
Gross primary enrollment, female (% of age group)	99	104	109
Access to an improved water source (% of population)	..	88	94
Access to improved sanitation facilities (% of population)	..	74	82

Age distribution, 2008



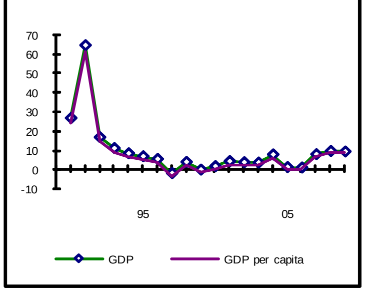
Under-5 mortality rate (per 1,000)



Net Aid Flows

	1980	1990	2000	2009 [a]
(US$ millions)				
Net ODA and official aid	237	252	199	1,076
Top 3 donors (in 2008):				
France	16	26	31	306
United States	3	12	32	210
European Commission	5	29	36	122
Aid (% of GNI)	..	*2.6*	1.1	3.5
Aid per capita (US$)	91	80	53	257

Growth of GDP and GDP per capita (%)



Long-Term Economic Trends

	1980	1990	2000	2009
Consumer prices (annual % change)	..	-99.7	-0.8	2.8
GDP implicit deflator (annual % change)	..	*97.4*	-2.1	5.8
Exchange rate (annual average, local per US$)	..	695.1	1,507.5	1,507.5
Terms of trade index (2000 = 100)	..	*92*	100	101

	1980	1990	2000	2009	1980–90	1990–2000	2000–09
					(average annual growth %)		
Population, mid-year (millions)	2.6	3.2	3.8	4.2	1.9	1.8	1.2
GDP (US$ millions)	..	*4,690*	17,260	34,528	..	7.5	4.6
		(% of GDP)					
Agriculture	..	*7.3*	7.1	5.3	..	*4.9*	1.4
Industry	..	*25.5*	22.8	16.5	..	*3.1*	4.4
Manufacturing	..	*14.4*	13.0	8.8	..	*4.3*	2.2
Services	..	*67.2*	70.1	78.2	..	*4.3*	4.3
Household final consumption expenditure	..	124.5	84.1	79.0	..	6.6	5.8
General gov't final consumption expenditure	..	14.0	17.3	15.5	..	13.2	-12.9
Gross capital formation	..	29.3	20.4	30.2	..	8.5	6.6
Exports of goods and services	..	12.5	14.2	22.3	..	24.1	10.2
Imports of goods and services	..	79.9	35.9	47.0	..	11.8	6.3
Gross savings	..	-10.5	-1.2	93.7			

Note: Figures in italics are for years other than those specified. 2009 data are preliminary. Group data are through 2008. .. indicates data are not available.
a. Aid data are for 2008.

Development Economics, Development Data Group (DECDG).

Balance of Payments and Trade

	2000	2009
(US$ millions)		
Total merchandise exports (fob)	1,050	4,410
Total merchandise imports (cif)	5,988	15,116
Net trade in goods and services	-3,738	-8,545
Current account balance	-3,718	-5,363
as a % of GDP	-21.5	-15.5
Workers' remittances and compensation of employees (receipts)	1,582	*7,180*
Reserves, including gold	8,273	35,722

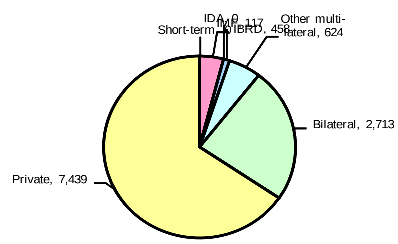
Central Government Finance

	2000	2009
(% of GDP)		
Current revenue (including grants)	18.6	24.8
Tax revenue	14.6	19.5
Current expenditure	38.9	31.3
Overall surplus/deficit	-23.4	-8.1
Highest marginal tax rate (%)		
Individual	..	..
Corporate	..	..

External Debt and Resource Flows

	2000	2009
(US$ millions)		
Total debt outstanding and disbursed	3,968	33,935
Total debt service	680	830
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	23.0	98.3
Total debt service (% of exports)	24.5	6.5
Foreign direct investment (net inflows)	..	..
Portfolio equity (net inflows)	..	..

Composition of total external debt, 2008

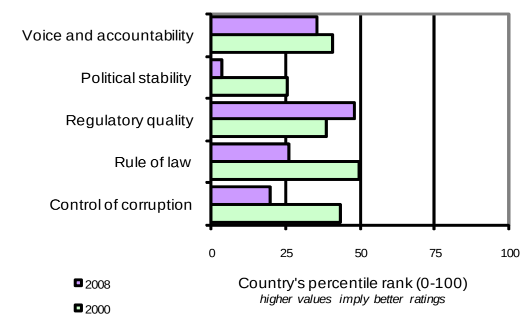


US$ millions

Private Sector Development

	2000	2009
Time required to start a business (days)	–	9
Cost to start a business (% of GNI per capita)	–	78.2
Time required to register property (days)	–	25
Ranked as a major constraint to business	**2000**	**2008**
(% of managers surveyed who agreed)		
Access to/cost of financing	..	*16.5*
Electricity	..	*12.5*
Stock market capitalization (% of GDP)	9.2	32.2
Bank capital to asset ratio (%)	6.4	7.8

Governance indicators, 2000 and 2008



Source: Kaufmann-Kraay-Mastruzzi, World Bank

Technology and Infrastructure

	2000	2008
Paved roads (% of total)	*84.9*	..
Fixed line and mobile phone subscribers (per 100 people)	35	52
High technology exports (% of manufactured exports)	2.3	*0.3*

Environment

	2000	2008
Agricultural land (% of land area)	58	*67*
Forest area (% of land area)	..	..
Nationally protected areas (% of land area)	..	..
Freshwater resources per capita (cu. meters)	*1,231*	1,145
Freshwater withdrawal (billion cubic meters)	1.4	*1.3*
CO2 emissions per capita (mt)	4.1	*3.7*
GDP per unit of energy use (2005 PPP $ per kg of oil equivalent)	6.6	*10.5*
Energy use per capita (kg of oil equivalent)	1,307	*959*

World Bank Group portfolio

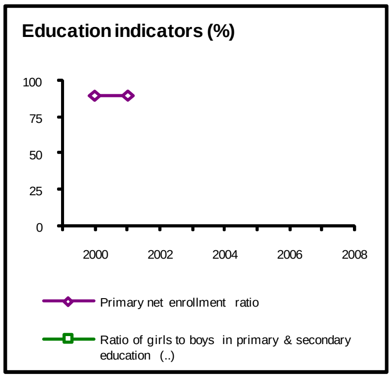
	2000	2008
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	311	458
Disbursements	42	40
Principal repayments	17	116
Interest payments	14	20
IDA		
Total debt outstanding and disbursed	–	0
Disbursements	0	0
Total debt service	–	0
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	218	99
of which IFC own account	127	99
Disbursements for IFC own account	20	35
Portfolio sales, prepayments and repayments for IFC own account	25	4
MIGA		
Gross exposure	–	–
New guarantees	–	–

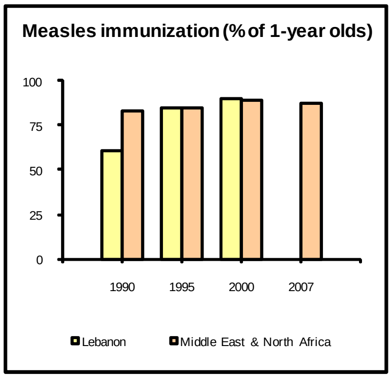
Note: Figures in italics are for years other than those specified. 2008 data are preliminary. 7/13/10
.. indicates data are not available. – indicates observation is not applicable.

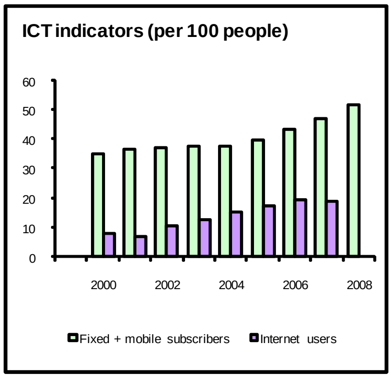
Development Economics, Development Data Group (DECDG).

With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Lebanon			
Goal 1: halve the rates for extreme poverty and malnutrition	**1990**	**1995**	**2000**	**2008**
Poverty headcount ratio at $1.25 a day (PPP, % of population)	..	..	..	..
Poverty headcount ratio at national poverty line (% of population)	..	..	..	..
Share of income or consumption to the poorest qunitile (%)	..	..	..	..
Prevalence of malnutrition (% of children under 5)	..	*3.0*	..	..
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	..	*76*	90	..
Primary completion rate (% of relevant age group)	..	..	..	87
Secondary school enrollment (gross, %)	62	66	..	82
Youth literacy rate (% of people ages 15-24)	..	..	..	..
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	..	..	..	..
Women employed in the nonagricultural sector (% of nonagricultural employment)	..	..	..	..
Proportion of seats held by women in national parliament (%)	..	..	..	..
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	37	34	32	..
Infant mortality rate (per 1,000 live births)	32	30	28	..
Measles immunization (proportion of one-year olds immunized, %)	61	85	90	..
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	150	..
Births attended by skilled health staff (% of total)	..	*89*	..	..
Contraceptive prevalence (% of women ages 15-49)	..	..	..	..
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	0.1	0.1	0.1	*0.1*
Incidence of tuberculosis (per 100,000 people)	..	..	..	..
Tuberculosis cases detected under DOTS (%)	..	..	..	..
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	..	..	100	..
Access to improved sanitation facilities (% of population)	..	..	..	..
Forest area (% of total land area)	..	..	..	..
Nationally protected areas (% of total land area)	..	..	..	..
CO2 emissions (metric tons per capita)	3.1	3.9	4.1	*3.7*
GDP per unit of energy use (constant 2005 PPP $ per kg of oil equivalent)	7.5	7.0	6.6	*10.5*
Goal 8: develop a global partnership for development				
Telephone mainlines (per 100 people)	13.3	12.9	15.3	17.9
Mobile phone subscribers (per 100 people)	0.0	3.4	19.7	34.0
Internet users (per 100 people)	0.0	0.1	8.0	22.5
Personal computers (per 100 people)	..	1.4	4.6	*10.2*







Note: Figures in italics are for years other than those specified. .. indicates data are not available. 7/13/10

Development Economics, Development Data Group (DECDG).

Annex B2
Selected Indicators* of Bank Portfolio Performance and Management
(As of July 5, 2010)

Indicator	**2007**	**2008**	**2009**	**2010**
Portfolio Assessment				
Number of Projects Under Implementation [a]	9	9	10	8
Average Implementation Period (years) [b]	4.0	4.3	4.0	4.6
Percent of Problem Projects by Number [a, c]	11.1	11.1	10.0	25.0
Percent of Problem Projects by Amount [a, c]	13.0	13.8	1.6	4.1
Percent of Projects at Risk by Number [a, d]	44.4	44.4	50.0	50.0
Percent of Projects at Risk by Amount [a, d]	19.0	20.1	22.0	31.9
Disbursement Ratio (%) [e]	24.9	29.7	36.1	14.9
Portfolio Management				
CPPR during the year (yes/no)	Yes	No	Yes	No
Supervision Resources (total US$)	454	859	804	980
Average Supervision (US$/project)	50	78	73	109

Memorandum Item	**Since FY 80**	**Last Five FYs**
Proj Eval by OED by Number	17	3
Proj Eval by OED by Amt (US$ millions)	733.6	190.5
% of OED Projects Rated U or HU by Number	47.1	66.7
% of OED Projects Rated U or HU by Amt	31.5	63.0

a. As shown in the Annual Report on Portfolio Performance (except for current FY).
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

* All indicators are for projects active in the Portfolio with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

ANNEX B3

IBRD Program Summary

(As of July 5, 2010)

Tentative IBRD Base-Case Lending Program a

Fiscal year	*Project ID*	*US$(M)*	*Strategic Rewards (H/M/L) b*	*Implementation Risks (H/M/L) b*
2011	Greater Beirut Water Supply	200.0	H	M
2011	Education Reform for Quality Schools	35.0	H	M
2011	Cultural Heritage and Urban Development – Additional Financing	20.0	H	L
2012	Energy Sector Investment Project	20.0 [c]	H	M
TOTAL		**275.0**		

a. This table presents the proposed program for FY11-FY12

b. For each project, the strategic rewards and implementation risks are expected to be High (H), Moderate (M), or Low (L)

c. The actual amount will depend on the Government's needs once the sector investment program has been adopted.

ANNEX B3

IFC Investment Operations Program

(as of June 30, 2010)

	2007	2008	2009	2010*
Commitments (US$m)				
Gross	165.7	225.6	184.5	192.0
Net**	165.7	225.6	184.5	192.0
Net Commitments by Sector (%)				
CGF	87.9	93.4	100	100
CGM	12.1	6.6	0	0
Total	100	100	100	100
Net Commitments by Investment Instrument (%)				
Equity	3.9	0	0	52.0
Guarantee	42.6	86.7	100	48.0
Loan	53.4	6.6	0	0
Quasi equity***	0	6.6	0	0
Total	100	100	100	100

* As of June 30, 2010
** IFC's Own Account only
*** Quasi Equity includes both loan and equity types

ANNEX B4
Summary of Non-Lending Services
(As of July 5, 2010)

Product	*Completion FY*	*Cost (US$000)*	*Audience a/*	*Objective b/*
Recent Completions				
Electricity Sector Expenditure Review	2008	70.2	Government/Bank	Knowledge generation/Problem-solving
Capital Market Supervision	2008	0.0	Government/Bank	Knowledge generation/Problem-solving
Poverty Assessment: Poverty and Social Impact Analysis	2009	281.3	Government/Bank	Knowledge generation/Problem-solving
Improve HIV/AIDS Programming in Lebanon	2009	13.0	Government/Bank	Knowledge generation/Problem-solving
Public Expenditure Review for Water	2009	222.2	Government/Bank	Knowledge generation/Problem-solving
Gender Assessment	2009	208.6	Government/Bank	Knowledge generation/Problem-solving
Capacity Building to Central Administration for Statistics (Programmatic TA) – Part I	2009	99.8	Government/Bank	Knowledge generation/Problem-solving
LPDC Nahr El Barid Reconstruction and Recovery	2009	80.4	Government/Bank	Knowledge generation/Problem-solving
CDM TA for Lebanon	2009	20.8	Government/Bank	Knowledge generation/Problem-solving
Broadband Strategy and Capacity Building	2009	47.6	Government/Bank	Knowledge generation/Problem-solving
Agriculture TA	2009	76.6	Government/Bank	Knowledge generation/Problem-solving
Capacity Building to Central Administration for Statistics – Part II	2010	87.01	Government/Bank	Knowledge generation/Problem-solving
Underway				
Private Sector Development TA	2010	120.8	Government/Bank	Knowledge generation/Problem-solving
Support to Implementation of Electricity Sector	2010	267.7	Government/Bank	Knowledge generation/Problem-solving
Labor Markets and Migration	2011	219.9	Government/Bank	Knowledge generation/Problem-solving
Country Environmental Analysis	2011	220.2	Government/Bank	Knowledge generation/Problem-solving
Broadband Policy for ICT-Enabled Economic Growth	2011	156.7	Government/Bank	Knowledge generation/Problem-solving
Challenges of Informality for Women	2011	18.0	Government/Bank	Knowledge generation/Problem-solving
Tourism and Growth Potential Study	2011	53.9	Government/Bank	Knowledge generation/Problem-solving
Planned				
Water Sector Strategy	2011	0.0	Government/Bank	Knowledge generation/Problem-solving
Capacity Building to Central Administration for Statistics – Part III	2011	0.0	Government/Bank	Knowledge generation/Problem-solving

a. Government, donor, Bank, public dissemination.
b. Knowledge generation, public debate, problem-solving.

ANNEX B5

Lebanon Social Indicators

	Latest single year			Same region/income group	
	1980-85	1990-95	2003-09	M. East & North Africa	Upper-middle-income
POPULATION					
Total population, mid-year *(millions)*	2.9	3.5	4.2	325.2	949.3
Growth rate *(% annual average for period)*	1.7	1.9	1.1	1.8	0.8
Urban population *(% of population)*	79.4	85.0	88.9	57.3	74.8
Total fertility rate *(births per woman)*	3.6	2.7	..	2.7	2.0
POVERTY					
(% of population)					
National headcount index	..	..	..	..	..
Urban headcount index	..	..	..	..	..
Rural headcount index	..	..	..	..	..
INCOME					
GNI per capita *(US$)*	..	3,200	8,060	3,237	7,852
Consumer price index *(2000=100)*	168	85	112	124	121
Food price index *(2000=100)*	..	..	-365	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	..	..	..
Lowest quintile *(% of income or consumption)*	..	..	..	..	..
Highest quintile *(% of income or consumption*	..	..	..	..	..
SOCIAL INDICATORS					
Public expenditure					
Health *(% of GDP)*	..	..	..	2.8	3.5
Education *(% of GNI)*	..	2.6	..	5.2	4.6
Net primary school enrollment rate					
(% of age group)					
Total	..	..	..	91	94
Male	..	..	..	94	94
Female	..	..	..	89	93
Access to an improved water source					
(% of population)					
Total	..	..	..	88	94
Urban	..	..	..	95	98
Rural	..	..	..	81	82
Immunization rate					
(% of children ages 12-23 months)					
Measles	23	85	..	86	93
DPT	17	93	..	89	92
Child malnutrition *(% under 5 years)*	..	..	..	12	4
Life expectancy at birth					
(years)					
Total	66	69	..	71	71
Male	64	68	..	69	68
Female	68	71	..	73	75
Mortality					
Infant *(per 1,000 live births)*	38	30	..	29	19
Under 5 *(per 1,000)*	44	34	..	34	23
Adult (15-59)					
Male *(per 1,000 population)*	241	210	..	158	211
Female *(per 1,000 population)*	181	150	..	106	127
Maternal *(per 100,000 live births)*	..	..	..	200	110
Births attended by skilled health staff *(%)*	..	..	..	80	95

CAS Annex B5. This table was produced from the CMU LDB system. 07/13/10

Note: 0 or 0.0 means zero or less than half the unit shown. Net enrollment rate: break in series between 1997 and 1998 due to change from ISCED76 to ISCED97. Immunization: refers to children ages 12-23 months who received vaccinations before one year of age or at any time before the survey.

ANNEX B6

Lebanon - Key Economic Indicators

Indicator	2005	2006	2007	2008	2009	2010	2011	2012	2013
	Actual			Estimate			Projected		
National accounts (as % of GDP)									
Gross domestic product[a]	100	100	100	100	100	100	100	100	100
Agriculture	6	7	7	7	5	5	5	5	5
Industry	21	20	22	21	17	16	15	14	14
Services	73	73	71	72	78	78	80	81	81
Total Consumption	99	98	97	99	95	94	94	94	93
Gross domestic fixed investment	22	23	27	30	30	30	30	30	30
Government investment	3	3	3	2	2	3	3	3	3
Private investment	20	20	24	27	29	28	27	27	27
Exports (GNFS)[b]	21	21	23	25	22	22	21	21	21
Imports (GNFS)	43	42	48	54	47	46	45	45	44
Gross domestic savings	1	2	3	1	5	6	6	6	7
Gross national savings[c]	5	12	17	11	15	15	15	15	15
Memorandum items									
Gross domestic product	21839	22437	25057	29933	34528	39155	43572	47802	52444
(US$ million at current prices)									
GNI per capita (US$, Atlas method)	5660	5670	6200	6980	8020	9090	10110	11070	12060
Real annual growth rates (%, calculated from 02 prices)									
Gross domestic product at market pric	0.9	0.7	7.6	9.3	9.0	8.0	7.0	6.0	6.0
Gross Domestic Income	-0.3	0.7	7.2	8.8	10.3	7.9	6.9	5.9	5.9
Real annual per capita growth rates (%, calculated from 02 prices)									
Gross domestic product at market pric	-0.5	-0.4	6.7	8.5	8.2	7.2	6.2	5.3	5.3
Total consumption	-3.1	-1.6	9.9	8.7	5.3	7.5	6.5	5.5	5.0
Private consumption	0.0	3.2	15.1	8.8	4.8	7.8	6.5	5.6	5.0
Balance of Payments (US$ millions)									
Exports (GNFS)[b]	4675	4769	5767	7350	7688	8484	9227	9996	10869
Merchandise FOB	2629	2686	3527	4403	4410	4766	5097	5430	5822
Imports (GNFS)[b]	9312	9456	12075	16089	16234	18095	19713	21374	23008
Merchandise FOB	8625	8880	11197	15018	15116	16864	18386	19960	21501
Resource balance	-4637	-4687	-6308	-8739	-8545	-9611	-10485	-11378	-12139
Net current transfers	1063	1969	2769	2360	2332	2731	3020	3330	3546
Current account balance	-3761	-2535	-2798	-5941	-5363	-6034	-6637	-7225	-7757
Net private foreign direct investment	1908	1800	1883	2620	3678	3916	4139	4268	4414
Long-term loans (net)	2529	6130	5310	5635	-120	-10	317	398	-122
Official	-55	-100	1672	543	-60	-78	-145	-157	-171
Private	2584	6231	3638	5091	-59	68	462	555	49
Other capital (net, incl. errors & ommissions)	40	-2635	-2338	1149	9608	2724	2923	3402	4416
Change in reserves[d]	-716	-2760	-2056	-3462	-7804	-597	-743	-843	-951
Memorandum items									
Resource balance (% of GDP)	-21.2	-20.9	-25.2	-29.2	-24.7	-24.5	-24.1	-23.8	-23.1
Real annual growth rates (YR02 prices)									
Merchandise exports (FOB)	8.5	-2.6	23.7	11.4	-6.5	5.8	6.0	6.3	6.6
Primary	8.1	-7.3	26.7	20.6	-11.9	10.0	10.0	10.0	10.0
Manufactures	8.8	0.3	22.0	5.9	-2.9	3.3	3.5	3.7	4.2
Merchandise imports (CIF)	-1.8	-4.1	16.7	19.8	5.8	8.5	7.8	8.0	7.0

(Continued)

ANNEX B6

Lebanon - Key Economic Indicators (Continued)

Indicator	Actual 2005	Actual 2006	Actual 2007	Estimate 2008	Estimate 2009	Estimate 2010	Projected 2011	Projected 2012
Public finance (as % of GDP at market prices)[e]								
Current revenues	22.5	24.6	24.6	24.2	24.8	24.4	24.1	24.1
Current expenditures	29.4	32.8	31.2	31.2	31.3	30.3	29.5	28.4
Current account surplus (+) or deficit (	-6.9	-8.2	-6.6	-7.0	-6.5	-5.9	-5.4	-4.3
Capital expenditure	2.1	2.8	2.7	1.8	1.6	2.6	3.2	3.3
Foreign financing	0.1	4.3	5.5	-1.0	0.1	0.0	0.7	0.8
Monetary indicators								
M2/GDP	269.5	279.0	277.1	267.8	285.7	285.7	294.1	303.0
Growth of M2 (%)	3.5	6.4	10.9	15.5	23.1	13.4	14.6	13.0
Private sector credit growth / total credit growth (%)	16.0	22.6	62.4	72.1	74.3	74.0	78.7	81.8
Price indices(YR02 =100)								
Merchandise export price index	100.0	104.9	111.4	124.8	133.8	136.6	137.8	138.1
Merchandise import price index	100.0	104.9	113.1	128.9	114.0	117.3	118.6	119.2
Merchandise terms of trade index	100.0	100.0	98.5	96.9	117.3	116.5	116.2	115.8
Real exchange rate (US$/LCU)[f]	273.4	267.4	278.1	286.4	326.1	325.6	332.5	339.9
Real interest rates								
Consumer price index (% change)	-2.2	-3.6	-3.5	10.4	2.8	4.9	3.6	3.1
GDP deflator (% change)	-0.7	2.1	3.8	9.3	5.8	5.0	4.0	3.5

a. GDP at factor cost
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.
d. Includes use of IMF resources.
e. Consolidated central government.
f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

ANNEX B7

Lebanon - Key Exposure Indicators

Indicator	Actual				Estimated		Projected		
	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total debt outstanding and disbursed (TDO) (US$m)[a]	9592	10359	11460	11351	33935	29724	33093	37153	41367
Net disbursements (US$m)[a]	297	767	1179	-76	-120	-10	317	398	-122
Total debt service (TDS) (US$m)[a]	1791	1635	1345	1465	830	816	1326	2229	2389
Debt and debt service indicators (%)									
TDO/XGS[b]	129.9	114.5	99.3	92.5	264.7	210.6	209.4	217.2	223.8
TDO/GDP	43.9	46.2	45.7	37.9	98.3	75.9	76.0	77.7	78.9
TDS/XGS	24.3	18.1	11.7	11.9	6.5	5.8	8.4	13.0	12.9
Concessional/TDO	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IBRD exposure indicators (%)									
IBRD DS/public DS	3.7	8.0	6.6	10.0	7.1	8.7	5.0	3.5	2.6
Preferred creditor DS/public DS (%)[c]	7.8	11.1	16.2	15.6	18.9	20.4	11.8	6.7	5.1
IBRD DS/XGS	0.7	1.2	0.6	1.1	0.4	0.5	0.4	0.4	0.3
IBRD TDO (US$m)[d]	446	403	529	458	434	394	474	422	369
Of which present value of guarantees (US$m)									
Share of IBRD portfolio (%)	0	0	0	0	0	0	0	0	0
IDA TDO (US$m)[d]	0	0	0	0	0	0	0	0	0
IFC (US$m)									
Loans	8.0	10.6	159.2	210.6	184.5	92.0	100.0	115.0	115.0
Equity and quasi-equity /c	0.0	0.0	6.5	15.0	0.0	100.0	0.0	10.0	10.0
MIGA									
MIGA guarantees (US$m)									

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

ANNEX B8 – LEBANON
Operations Portfolio (IBRD/IDA and Grants)
(As of July 5, 2010)

Closed Projects 20	
IBRD/IDA	
Total Disbursed (Active)	113.44
of which has been repaid	24.07
Total Disbursed (Closed)	332.2
of which has been repaid	430.65
Total Disbursed (Active + Closed)	445.64
of which has been repaid	454.72
Total Undisbursed (Active)	95.79
Total Undisbursed (Closed)	2.01
Total Undisbursed (Active + Closed)	97.80

Active Projects		Last PSR Supervision Rating			Original Amount in US$ Millions					Difference Between Expected and Actual Disbursements [a/]	
Project ID	Project Name	DO	IP	Fiscal Year	IBRD	IDA	Grants	Cancel.	Undisb.	Orig.	Frm Rev'd
P074042	LB - Ba'albeck Water and Watewater	MS	MS	2002	43.53				14.34	14.34	14.34
P103885	LB - Beka'a Emergency Water Supply	MS	S	2007			15.00		12.45	12.45	-0.05
P050529	LB - Cultural Heritage and Urban Development	S	MS	2003	31.50				11.47	11.47	
P111849	LB - ESPISP 2	MU	MU	2009			6.00		5.20	1.55	
P111602	LB - Emergency Fiscal Management Reform	S	S	2009			4.00		3.50	0.67	
P104774	LB - Emergency Power Reform Capacity Reinf.	MU	MS	2007			5.00		1.58	1.58	
P103875	LB - Municipal Infrastructure	S	S	2007			30.01	0.01	12.83	12.74	0.43
P034038	LB - Urban Transport Development Project	S	S	2002	134.7				70.0	0.28	26.51
Overall Result					209.73		60.01	0.01	131.35	55.08	41.22

[a/] intended disbursements to date minus actual disbursements to date as projected at appraisal.

ANNEX B8
IFC Committed and Disbursed Outstanding Investment Portfolio
(As of June 30, 2010)

		Committed					Disbursed Outstanding				
FY Approval	Company	Loan	Equity	**Quasi Equity	*GT/RM	Partici pant	Loan	Equity	**Quasi Equity	*GT/RM	Partici pant
2007	Admic	0	4.60	0	0	0	0	4.60	0	0	0
2010	BLC Bank	0	0	0	0.13	0	0	0	0	0.13	0
2007	Blom	21	0	0	0	0	21	0	0	0	0
2010	Bank Beirut II	0	0	0	32.28	0	0	0	0	32.28	0
2010	Banque Libano Fransabank	0	0	0	10.57	0	0	0	0	10.57	0
2008	Butec holdings	0	0	15	0	0	0	0	15	0	0
2010	Byblos bank	0	85.71	0	0	0	0	85.71	0	0	0
2007	Cl sal	9.2	0	0	7.5	0	9.2	0	0	3.19	0
2010	Fransabank	6.46	0	0	7.68	0	6.46	0	0	3.39	0
2005	SIS Adma	2.83	0	0	0	0	2.83	0	0	0	0
Total Portfolio:		**39.49**	**90.31**	**15**	**58.16**	**0**	**39.49**	**90.31**	**15.0**	**49.56**	**0**

* Denotes Guarantee and Risk Management Products.
** Quasi Equity includes both loan and equity types.


IBRD 33433
35°30'E
36°00'E
36°30'E
35°30'N
34°00'N
34°30'N
33°00' N
LEBANON
Mediterranean Sea
To Al Hamidiyah
To Tall Kalakh
To Hims
Kabir
Qoubauyat
Halba
Funaydiq
Abou Moussa
Tripoli
Zhgarta
NORTH LEBANON
Hermel
To Al Qusayr
Qaa
Chekka
Sib'il
Ihdin
Amioun
Bcharri
Jaoz
Orontes
Douma
Qurnat as Sawda' (3,088 m)
Aynata
Al Labwah
Lebanon Mtns.
Anti-Lebanon Mtns.
Bekaa Valley
To An Nabk
Al Aqurah
Jbeil
Ibrahim
Afqa
Baalbeck
Jounie
MOUNT LEBANON
BEIRUT
Antilyas
BEKAA
Rayak
Hammana
Baabda
Zahleh
To Az Zabadani
Litani
Damour
Beit ed Dine
Jieh
To Ad Dimas
Joub Jannine
Awwali
Saida
Qaraaoun
Jezzine
El Zahrani
Rachaiya
Hasbani
0 10 20 30 Kilometers
0 10 20 Miles
Nabatiyeh
Marjayoun
NABATIYEH
Tyre
SOUTH LEBANON
To Baniyas
To Qiryat Shemona
Hula
Tibnine
Naqoura
Bent Jbail
Rmaich
To Gadot
To Nahariyya
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LEBANON
SELECTED CITIES AND TOWNS
GOVERNORATE (MOHAFAZAT) CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
GOVERNORATE (MOHAFAZAT) BOUNDARIES
INTERNATIONAL BOUNDARIES
NOVEMBER 2004