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CONFIDENTIAL
EDS2001-0337

July 2, 2001
03:20:58 PM

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Date of Meeting: July 3, 2001

Egypt: Country Assistance Strategy

I wish to commend the authors of this comprehensive and candid CAS document and for the well-articulated strategy for the Bank Group assistance to Egypt. The preparation of the document before you involved an intense process of discussions and consultations with my Egyptian authorities. An inter-Ministerial Task Force, headed by the Minister of Planning and International Cooperation, was established last November specifically to ensure full involvement of the government in CAS preparation process. Feedback was also received from the private sector, think-tanks, development partners and other segments of civil society. Not surprisingly, therefore, the strategy responds well to Egypt's objectives and priorities.

As the document and government data show, Egypt has achieved robust economic growth and macroeconomic stability in response to concerted efforts on both stabilization and reform areas. Real growth rates have been improving steadily, averaging 5.5 percent in the second half of the 1990s and reaching 6.4 percent last year. Key macroeconomic indicators show substantial stability: Inflation was brought down from around 20 percent in the 1980s to 2.3 percent in 2000/01, interest rates kept at stable levels and more flexible exchange rate system put in place, external balance is being restored despite the pressures in the past few years with net international reserves currently at over $14 billion. Also significant is that the debt burden was cut sharply since the first half of the 1990s, bringing external debt to GDP ratio from 130 percent to 30 percent, and cutting debt service ratio to exports from over 17 percent to 8.7 percent.

The economy made a good recovery following the recent slowdown that reflected tighter monetary conditions in response to less favorable but transient conditions caused by a partial outflow of portfolio investments following the Asian crisis, the decline in tourism and the fall of international oil prices. Starting in mid-1999, continued oil price recovery, a rebound in tourism and the announcement of new exchange rate regulations have stabilized the external position. The current account deficit has narrowed and is expected to be in balance at mid-2001, and the trade deficit is also expected to further narrow. The improvement in the first half of 2000/01 was due to an increase in oil exports, decline of imports as well as a 20 percent rise in non-oil exports.

Needless to say, however, the challenges remain daunting in a country with a large population, limited resources and 550,000 new entrants to the job market every year. This is a well-recognized fact at all levels of the country's society and the authorities response will

continue to focus on structural reforms and maintaining macroeconomic stability and pursuing a strategy that seeks to achieve a higher private sector led rate of growth as an indispensable prerequisite for poverty reduction. This builds on the country's assets of social stability, large domestic market with rising purchasing power, relatively cheap and fairly educated labor force, deep-rooted cultural heritage and, in the field of natural endowments, substantial natural gas reserves.

The focal objective of development plans has been to achieve a high growth rate, 7-7.5 percent in the current plan, an objective which requires exceptional efforts on many fronts. The CAS described a number of areas where more action is needed to tackle the impediments to sustainable growth, including issues on openness, governance, financial sector as well as environmental and gender issues. My authorities fully recognize the importance of continuing to address these issues and in fact are working in collaboration with the Bank, the IMF and other partners on many aspects. In this direction a joint task force with the Bank had reached conclusions on the negative price incentive facing exporters. On tax policy and administration I wish to convey that the second and third phases of the Value Added Tax are scheduled to be implemented following parliamentary approval last month, that an overall income tax reform package will be presented for approval in September and the pension funds system will be reviewed. Trade liberalization will expand further with arrangements with the US, EU, and African countries and work to ensure that the custom and tariff systems will be consistent with GATT will proceed with technical help from USAID.

With regard to the financial sector, the government continues to increase the pace of structural reform. Enhancing the regulatory framework of the financial sector in general and improving the efficiency of the banking system in particular are high priority objectives. Various measures were adopted and more are planned to enhance the supervision of banks and encourage lending to the private sector. The government has recently confirmed to the IMF the intention to participate in the Financial Sector Assessment Program (FSAP). The financial sector is also credited for being free of cross-border financial abuse, and the government is drafting a law to this effect to be submitted to the forthcoming session of Parliament. Various measures were also put in place to improve fiscal management, including establishing a high-level committee to provide oversight over all government investments expenditures, implementation of performance-based budgeting to measure effectiveness of public expenditures and designing a program for the corporatization of economic authorities on both financial and managerial levels.

Social and human development has been given priority and substantial progress has been achieved, though, as expected, numerous issues remain. On education, significant attention and resources have been directed to this sector with good results on enrollment of both boys and girls, but much work still needs to be done to improve quality and relevance. On health, Egypt has achieved significant improvement in the health status of the population, as acknowledged in the document, and an ambitious Health Sector Reform Program has been implemented since 1998, though implementation has not been easy. Egypt has also put in place one of the largest and most successful social funds and has an elaborate social protection programs though, like many other countries, still faces the challenge of targeting. Child protection has been identified as an emerging area of concern and has been given particular attention, including by top political

leadership. In the related sector of agriculture and rural development, substantial success has been achieved in liberalization and elimination of land use controls contributing to improving productivity, increasing growth rate and narrowing the food gap. Many tasks still remain to improve the sector's contribution to alleviating rural poverty and the authorities have adopted a rural development strategy that seeks to address such issues as further improving productivity, increasing agricultural exports and dealing with the chronic problem of water scarcity.

Considerable progress has been achieved in promoting private sector activity and the government is continuing to pursue several initiatives to generate private investment, including foreign direct investment, through the creation of investor-friendly environment. Substantial investments were channeled to upgrade the physical infrastructure and a large privatization program was conducted resulting in the privatization of 130 enterprises values at $3.8 billion. The government also intends to divest most of the remaining enterprises in the coming 2-3 years. As a result the role of the private sector continued to expand and the share of the public sector in the economy declined in the past decade from 38 percent to less than 27 percent. In looking ahead, one of the most promising new sector opportunities is the fast-growing information and communication technology sector which is receiving top priority and where a special ministry has been established to help improving the environment for the expansion and deepening of the IT activities which their promising impact on improving efficiency economy-wide, and contributing to exports.

Several laws have been passed in 2000/01 to facilitate foreign direct investment, including a Financial Leasing Law, the IPR law and a landmark Mortgage Law designed to activate the real-estate market and contribute to private economic activity. A new capital market legislation is also in the process of being drafted to provide additional protection to investors. In response to these policies there are clear signs that investors perceptions, both domestic and foreign, are quite encouraging. Global rating agencies have rated Egypt as low investment risk opportunity and the long-term credit rating was also rated as investment grade. From 1997 to 1999 seven companies successfully issued GDRs and a current five-year sovereign bond offering, originally expected to total at least $500 million, has in fact attracted orders of $2 billion at the end of June. In issuing this offering the authorities have mainly intended to gauge market reaction which, as it turned, far exceeded expectations.

Turning to Bank Group strategy, I wish to convey my authorities endorsement of this strategy which has been thoroughly discussed in the past several months. They welcome the recognition of the need for an appropriate mix of lending and non-lending services that the authorities have been calling for in the past few years. They also endorse the more active IFC strategy to enhance private sector development and hope that this will build on the momentum achieved last year. The lending scenarios are appropriate, and the authorities consider that the high case could certainly be envisaged and share the view that the triggers should not be applied mechanistically. I also wish to make two points:

One, is on the impression conveyed in the language of the document that the policy dialogue has been weak. My authorities do not share this perception and, from their perspective,

the policy dialogue has been most useful and greatly valued. In fact the box on age 20 of the document clearly says that the policy dialogue with Bank Group has been greatly appreciated and the section on the Management Unit points to the closer and improved dialogue that decentralization has achieved. The perception of weak policy dialogue seems to have been generated largely by the issue of access to poverty incidence data and the need for work on assessment of the financial sector. As I mentioned above, my authorities have already indicated participation in the FSAP project, and I also wish to convey that they will also undertake with the Bank a poverty assessment.

Second, is the whole issue of Egypt's attitude towards borrowing which the document sees as excessively conservative borrowing strategy. The background for this stand is fairly clear and stems from the heavy debt burden that the country has suffered for many years until just over a decade ago when this was alleviated with most exceptional donor efforts. The country does not wish to go back to the old days and should certainly not be induced to do so. As in many middle-income countries, the development paradigm has changed and the Bank Group is expected to be creative in responding to the new needs. The argument that the current borrowing stance may not help provide the necessary funding that will secure the needed 7 percent growth rate and the consequent implication for employment has certainly been considered by the authorities. Their judgment is that the prospects for domestic and foreign investment can provide the needed funding, and that efforts will continue to create the conducive environment. In looking at the table on page 18, the high case scenario does stipulate a fairly high growth rate and policies will be directed to achieve this with continued cooperation with partners and without undue reliance on non-concessional resources. Furthermore, the authorities have now set the guideline that the annual volume of borrowing should not exceed the debt service, which is now about $1.5 billion. This should provide more flexibility for borrowing policies.