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MEMORANDUM OF THE PRESIDENT

OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

AND THE

INTERNATIONAL FINANCE CORPORATION

TO THE

EXECUTIVE DIRECTORS

ON A

COUNTRY ASSISTANCE STRATEGY

FOR

THE ARAB REPUBLIC OF EGYPT

June 5, 2001

CURRENCY EQUIVALENTS

Currency unit: Egyptian Pound (LE) as of May 9, 2001

US$1 = LE 3.87

FISCAL YEAR

July 1 – June 30

ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Assistance
BOT	Build, Operate, Transfer
CAS	Country Assistance Strategy
CBE	Central Bank of Egypt
CEDAW	Committee for the Elimination of all Discrimination Against Women
CG	Consultative Group
COMESA	Common Market for Eastern and Southern Africa
CPPR	Country Portfolio Performance Review
DFID	Department for International Development
ECD	Early Childhood Development
EHDR	Egypt Human Development Report
ESW	Economic and Sector Work
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FSAP	Financial Sector Assessment Program
FY	Fiscal Year
GDP	Gross Domestic Product
GDLN	Global Distance Learning Network
GDI	Gross Domestic Investment
GEF	Global Environment Facility
GOE	Government of Egypt
HSRP	Health Sector Reform Program
IBRD	International Bank for Reconstruction and Development
ICT	Information & Communications Technology
IDA	International Development Association
IFC	International Finance Corporation
IFPRI	International Food Policy Research Institute
ILO	International Labor Organization
IMF	International Monetary Fund
MDF	Mediterranean Development Forum
MIGA	Multilateral Investment Guarantee Agency
NBI	Nile Basin Initiative
NCCM	National Council for Childhood and Motherhood
NGO	Non-governmental Organization
OED	Operations Evaluation Department
PBDAC	Principal Bank for the Development of Agricultural Credit
SFD	Social Fund for Development
SME	Small- and Medium-size Enterprises
UNDP	United Nations Development Program
USAID	United States Agency for International Development
WBI	World Bank Institute
WFP	World Food Program

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EGYPT COUNTRY ASSISTANCE STRATEGY

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EXECUTIVE SUMMARY

i. During the second half of the 1990s, **Egypt's growth performance strengthened in *quantitative* terms, but it showed some *qualitative* weaknesses.** Following the stabilization efforts of the early 1990s, macroeconomic policy provided a stable environment for private sector activity, with particular success in reducing inflation. Stabilization was accompanied by the implementation of a series of structural reforms in the areas of capital markets, tariff reduction, reforms of the insurance industry, privatization of more than half of the designated public enterprises with assets worth almost US$4 billion, and improvement in the targeting of the social safety net. This resulted in higher GDP growth, but the impact in terms of poverty reduction remains to be assessed. In addition a number of concerns have emerged as to the sustainability of this economic performance. First, there is the short-term concern regarding the macroeconomic framework. Despite the roughly 12 percent depreciation of the currency since January 2000, the effective exchange rate remains appreciated. There has also been a reversal of the fiscal stance since 1999. Resulting balance of payments pressures have led to significant loss of reserves. Second, with the exception of manufacturing, the fastest growing sectors have been generally non-tradable, focused on domestic demand. Perhaps most significantly for the medium term, growth sectors in Egypt have not been technology-intensive, nor associated with large improvements in productivity. In particular, the construction boom that occurred during 1995-99 was a significant component of the increased investment and growth effort. The issue is to what extent the draft Mortgage Law -- expected to improve housing affordability through longer amortization periods -- can resuscitate this sector, which has witnessed a major slowdown in 2000-2001. Third, despite a recent rebound, merchandise exports practically stagnated during the 1990s, a period during which world merchandise trade expanded by an average of 5.6 percent per annum.

ii. **Egypt possesses many advantages that can allow it to achieve a growth rate high enough to result in a sustainable reduction in poverty.** It has a relatively large domestic market with rising purchasing power. It has a relatively cheap labor force and incomparable cultural and touristic attractions. It has proven natural gas reserves of over 40 trillion cubic feet, compared to its current annual domestic consumption of only 17 billion cubic feet. It boasts social stability with exceptionally crime-free urban centers.

iii. **For Egypt to exploit these comparative advantages and to tackle the problem of increasing unemployment, it would have to pursue policies that engender a strong and sustained growth.** This will depend essentially on two factors. First, the country will need to address more aggressively its unfinished agenda of structural reforms. This will entail reactivating the recently sluggish privatization program; further reducing tariffs and other trade barriers; implementing tax reforms; undertaking changes in the legal system to make investment easier and commercial disputes quicker to settle; and developing a financial system that is prudentially sound, provides medium- and long-term resources at lower cost, and responds more rapidly to the needs of small businesses. The second factor is the level of investment and borrowing needed to achieve the current Five-Year Plan's growth objective of 7.0-7.5 percent. Even if the Government succeeds in doubling foreign direct investment during the decade from its present level of US$1.5 billion per annum, it is almost certain that the anticipated higher growth rate will not materialize without increased foreign capital flows, including from less concessional sources. While Egypt's reduction of its external debt from 130 percent of GDP in 1989 to 30 percent of GDP in 2000 is commendable, the continuation of this excessively conservative external borrowing strategy will restrict GDP growth to around 5 percent, not sufficient to absorb the 550,000 new job entrants into the labor

market and to make inroads into the current backlog of unemployment. Avoiding external public borrowing for projects with high social rates of return carries a real—and probably sizeable—penalty in the form of foregone productive investment.

iv. **In important respects, the Bank's role in Egypt is similar to that in most lower middle-income countries.** The Bank is by no means the major partner in the country. USAID and the EU have larger assistance programs. Moreover, given the country's cautious external borrowing strategy and Egypt's graduation from IDA about two years ago, the Bank cannot anchor its role in its financial contribution. On the other hand, despite some progress in negotiations with foreign financial institutions to float a Eurobond, Egypt does not yet have sustained access to private international markets. Taken together, these factors have several implications for the Bank's involvement in Egypt:

- The Bank's lending role in Egypt is limited to a modest level. This is the Government's prerogative, and determines the nature of the Bank's overall involvement in the country. However, the downside is that, should the Government decide to have the Bank play a larger lending role commensurate with Egypt's size and importance, we will not be able to respond quickly, simply because the Bank lacks the solid analytical base that is a prerequisite for a rapid response. This weak policy dialogue is particularly apparent in two critical areas: (a) analysis of the nature and incidence of poverty in Egypt, which prevents the Bank from developing a truly effective poverty alleviation strategy; and (b) an assessment of the financial sector, which would help the Government better understand, and respond to, the weaknesses of the financial system and its vulnerability to economic shocks.
- Within this constrained relationship, *selectivity* in Bank's involvement becomes critical. In particular, the Bank's focus will be in areas where (a) Government commitment to projects is unequivocally strong; (b) the Bank has a long and positive experience (water sector and irrigation; human development); (c) it can bring knowledge management and experience of other countries to guide Egypt's policy reforms (mortgage market development; information and communications infrastructure; poverty and gender analysis; and community-based development); and (d) it can serve as a *catalyst* for mobilizing financing packages 2-3 times that of Bank loans for well-designed and high priority projects. Given the important programs of other development partners, the Bank will have minimal direct involvement in energy, industrial restructuring, and environment.
- In view of the Government's requirement that all new operations should have a grant element of at least 40 percent, it will be critically important to ensure even closer cooperation with development partners that have softer lending terms than those of the Bank.
- Over time, and as the size of the Bank's portfolio decreases, a greater share of administrative budget resources will be allocated to knowledge-based, non-lending activities which are high priority for the Government or which are necessary for due diligence.

v. **The role of IFC has increased considerably over the past three years and is expected to expand further.** IFC's committed portfolio is now US$328 million. This makes it IFC's largest portfolio by far in the Middle East and North Africa.

vi. **The over-arching objective of the Bank Group's country strategy in Egypt is to reduce poverty and unemployment.** Working closely with the authorities and other development partners, the Bank Group will focus on three types of interventions: (a) *interventions that support higher and*

sustained growth (supporting macroeconomic stability; phased restructuring of the bank and corporate sectors; and improved infrastructure for greater competitiveness). Given the important and active involvement of USAID and the EU in this broad area, the Bank's lending, at least under the base case scenario, will be limited; (b) *targeted interventions for poverty reduction* (basic education and health; social protection and safety net; and rural poverty); and (c) *interventions with indirect poverty reduction impact.* These include interventions that may have major indirect benefits for the poor in terms of promoting broad-based growth, development of poor areas, initiating dialogue on governance and community development issues, and building effective institutions.

vii. **The *"base case"*--considered to be the most likely scenario—presumes a continuation of the current pace of growth (5.0-5.5 percent per annum) and policy implementation.** The scenario is characterized by no significant shocks or reversals of policy reforms, but also no major structural reform breakthroughs. The base case strategy will be implemented through the following instruments.

- The Bank's portfolio is expected to shrink to about 14 operations by FY04, compared to 19 at present. Four considerations will dominate the Bank's portfolio management: (a) closer management of closing dates to ensure speedier delivery of project benefits; (b) greater effort on the part of the Government and the Bank to reduce effectiveness delays; (c) a special effort to reduce the use of project management units (PMUs) to ensure sustainability of project outcomes; and (d) while early indications of parallel financing with development partners for the Bank's proposed new operations are positive, discussions will be initiated with the Government to move away from the project-by-project requirement of meeting the 40 percent grant element toward a more macro or sectoral approach to debt concessionality.
- The Bank's Analytical and Advisory Activities (AAA) program will focus on: (a) studies and activities that provide the intellectual underpinning for operations and technical advice in human development, rural development and water management; (b) core diagnostic work on poverty, public expenditure review, financial sector assessment, and gender analysis and mainstreaming. The recently completed Social and Structural Review provides a solid base for deepening policy dialogue between the authorities and the key development partners. WBI is expected to play an important role in disseminating world-wide best practice and bringing focus on high priority development issues. Over time, the share of analytical and capacity building work in the program is expected to increase. Most critically needed AAA will be funded out of the Bank's administrative budget. However, arrangements will be explored with other donors and possibly the Government to share costs for additional on-demand AAA or capacity building services. A review of the effectiveness of the Bank's AAA will be undertaken toward the end of the CAS period to guide our future analytical and capacity building work in Egypt.
- New lending of 2-3 projects a year amounting to a total of US$450-500 million during the period FY02-04.
- Selective expansion of IFC and MIGA activities. IFC's priorities, closely coordinated with those of the Bank, will focus on developing private-financed infrastructure; providing support to the services sector, including tourism; supporting internationally competitive and export-oriented ventures; supporting the privatization effort through both advisory services and providing financing to privatized ventures; providing support to small and medium enterprises; developing financial markets; and possibly participating in building pipelines to export Egypt's large natural gas reserves to Eastern Mediterranean countries.

- The use of Bank guarantees, alongside MIGA and IFC investments, will be explored to attract private capital into areas where performance risk remains a major bottleneck.

viii. **In terms of alternative scenarios, a *"high case"* assistance scenario would apply if there is a major deepening of the structural reforms or in the case of a severe deterioration in the external environment which may lead the Bank to step up its assistance in support of a credible program.** Under this scenario, the Bank could increase total lending over the three years to around US$1.5 billion of which about a half could be in the form of quick-disbursing loans. As indicated earlier, the rapidity of the Bank's response will be determined to a large extent by the existence of a sustained dialogue between the Government and the Bank on the key structural issues. Alternatively, if the implementation of policy reforms and Bank portfolio deteriorate considerably (deepening controls, halting structural reforms, and deteriorating Bank portfolio), a ***"low case"* lending scenario** would be envisaged, under which Bank lending for the whole period would be limited to about US$100 million for one or two projects in the social sectors. Triggers for the scenarios are outlined in the main text.

ix. **There are risks attached to the proposed country strategy.** These are summarized in Section VI of the CAS, and relate to external exogenous shocks, the risk of fiscal unsustainability, and delays in the implementation of macroeconomic and structural reforms. However Egypt is unlikely to face a major risk of balance of payments crisis in the short run, thanks to the adequate international reserves (US$14 billion, about eight months of imports), and cautious attitude to new borrowing, which has resulted in low debt service ratio and a relatively small short-term debt (at 6.5 percent of total debt). Egypt has continued to maintain a very good track record in servicing its debt to the Bank Group. Bank exposure is moderate, and expected to remain so under the base case lending proposal. IBRD's share of Egypt's overall external debt service would be a comfortable 6-7 percent, as compared with the guideline of 20 percent.

x. **The following issues are suggested for Board consideration:**

- Is the proposed Bank Group program sufficiently selective, taking into account the role of other development partners?
- Does the proposed mix of lending and non-lending services reflect the changing relationship between Egypt and the Bank Group?
- Are lessons learned from the implementation of the previous CAS sufficiently taken into account in the design of the present assistance program?
- Is there sufficient flexibility in the proposed lending program to respond to downside risks?

I. RECENT DEVELOPMENTS AND POLICY OPTIONS

A. Political Context

1. Following President Mubarak's re-election for a fourth six-year term in 1999, a new government was formed in October 1999, with an ambitious reform agenda. This was followed by Parliamentary elections during October/November 2000. While the ruling National Democratic Party (NDP) retained its parliamentary dominance, its majority was reduced from 94 percent of parliamentary seats in 1995 to 85 percent. The number of opposition deputies in parliament increased from 13 to 54, and many prominent NDP legislators lost their seats.

2. While voter apathy is still quite high (turnout in the election ranged from 14 percent to 40 percent across the country), the election process has been widely perceived as a step in the right direction. In particular, for the first time the legislative elections were supervised by the judiciary.

3. With parliamentary elections completed, the pace of policy reforms will be determined to a large extent by the Government's commitment to reforms and its ability to pass through Parliament several pieces of important legislation (e.g., Mortgage Law, Anti-Trust Law, Financial Leasing Law, Intellectual Property Rights Law, Labor Law, NGO Law).

4. Egypt is an important player in the Middle East peace process and recent developments in the area have been detrimental to prospects for political stability and economic development in the whole region.

B. Recent Economic Developments

5. Egypt's economic growth performance during the second half of the 1990s has been robust. The stabilization efforts of the early 1990s resulted in lower growth (averaging 3.8 percent during 1990-95). However, they set the stage for sustained GDP increase during the past five years (averaging about 5.5 percent during 1996-2000)[1]. Macroeconomic policy provided a stable environment for private sector activity by maintaining external and internal balances stable for most of the period (see Table 1), with particular success in reducing inflation.

6. During the last two to three years, however, concerns have emerged about the sustainability of this economic performance, in particular with regard to the external accounts. These concerns are focused on two key areas:

- First, there is an issue regarding the structural and productivity underpinnings of growth. Egypt remains an inward looking economy, with a lukewarm performance of non-oil manufacturing exports both in terms of growth and composition, as well as not being a major recipient of foreign direct investment (FDI). Other growth sectors, in particular services and construction, while creating new employment, are also not contributing to improving productivity and the economy's competitiveness.
- Second, there is a shorter-term concern regarding the macroeconomic framework. Despite the roughly 12 percent depreciation of the currency since January 2000, the real effective exchange rate remains appreciated, while productivity has not strengthened as much as hoped for. Balance of payments (BOP) pressures began in 1997, which led to a significant loss of reserves and to the

[1] This average could be lower once the final GDP data for 2000 are revised downward to about 5.0 percent, as has been indicated by government sources. It is also important to note that the growth rate of non-oil GDP has been more variable. In 1999/00, non-oil GDP is estimated to have grown at 4.3 percent, down from 8.1 percent in 1998/99.

abandonment of the fixed nominal dollar peg during 1999-2000. The Government has taken action but continued pressure on reserves suggests that investors continue to have concerns.

TABLE 1: EGYPT'S KEY ECONOMIC INDICATORS
(percentages unless otherwise stated)

	1990-1995 (Annual Average)	1996	1997	1998	1999	2000*
GDP, market prices, real growth rate	3.8	5.0	5.5	5.6	6.0	6.4
GDP per capita, real growth rate	1.6	3.1	3.6	3.8	4.3	4.7
Gross Domestic Investment, ratio to GDP	19.7	16.6	17.7	20.5	22.8	24.2
Gross Domestic Savings, ratio to GDP	13.6	10.8	13.0	14.0	14.4	19
Exports of GNFS, real growth rate	5.7	1.6	2.4	-7.7	9.2	7.0
Imports of GNFS, real growth rate	2.6	1.6	1.9	1.1	12.8	9.4
Merchandise Terms of Trade Index (1992=100)	98.5	95.8	114.4	97.4	96.8	107.3
Current Account Balance, ratio to GDP	3.5	-0.3	0.2	-3.0	-1.9	-1.2
Overall Fiscal Balance, ratio to GDP	-7.1	-1.3	-0.9	-1.0	-4.2	-3.6
Foreign Direct Investment (Billions of US$)	0.9	0.6	0.7	1.0	0.7	1.6
Total Government Debt, ratio to GDP	116.9	96.9	92.6	88.4	88.8	84.7
External Debt (DOD), ratio to GDP	69.6	46.8	40.1	36.7	33.7	30.0
Debt Service, Ratio to Exports of GNFS	17.4	13.2	9.7	8.5	9.5	8.7
Inflation Rate (CPI)	14.4	7.3	6.2	3.8	3.8	2.8
Gross Reserves (months of imports)	7.5	11.9	12.0	10.6	10.2	8.6
Reserves/M2	28.9	37.8	35.9	32.4	26.2	21.7

* Provisional. All figures are for fiscal years, i.e., 2000 means 1999/2000.
Source: World Bank Live Data Base (LDB). Data for 2000 are government estimates, and could be revised.

7. Investment, both public and private, has been one of the main driving forces behind the robust GDP growth in the post-stabilization period. Gross Domestic Investment (GDI) increased to 24.2 percent of GDP by 2000, up from 16.6 percent in 1996. This increased investment has been mainly driven by high domestic credit growth, high public investment expenditures and privatization. Annual credit growth, in particular credit to the private sector, has been very high during most of the post-stabilization period: indeed during 1994-99, nominal credit growth to the private sector was more than double the nominal GDP growth. Government capital expenditure also increased from 5.4 percent of GDP in 1998 to 8.2 percent and 6.8 percent in 1999 and 2000, respectively. Privatization, which was particularly intense during 1996-99—averaging some 24-29 transactions annually for an average value of 1 percent of GDP per annum—was likely another factor behind the increase in private investment. Foreign direct investment (FDI) has played a more modest role. During 1996-2000, it averaged some US$1 billion annually (roughly 1 percent and 5 percent of GDP and GDI, respectively). More than half of the FDI flow into Egypt during the past decade has been in three subsectors: chemicals, food and beverage, and engineering. If tourism were added to them, they would represent some 70 percent of the total.

8. An analysis of the sources of growth in Egypt during the past few years additionally suggests that, while the country's growth performance was strong in *quantitative* terms, it was less so in *qualitative* terms.

- First, except for manufacturing (which grew at almost 10 percent during 1998-2000) the fastest growing sectors have been primarily non-tradable, mainly focused on domestic demand. In particular, the services sector has been the largest contributor to GDP growth. While tourism explains part of the sector's expansion, much of this growth was linked to domestic demand. In addition, the construction boom that occurred during 1995-99 (with the sector recording double-digit growth rates during this period) was a significant component of the increased investment effort. The issue is to what extent the draft Mortgage Law -- expected to improve housing

affordability through longer amortization periods -- can resuscitate this sector, which has witnessed a major slowdown during 2000-2001.

- Second, merchandise exports practically stagnated during the 1990s, a period during which world merchandise trade expanded by 5.6 percent per annum on average. Between 1990 and 1998, Egypt's merchandise exports declined from 15 percent of GDP to merely 6.2 percent, and their share in total world merchandise exports declined from 0.15 percent in 1990 to 0.1 percent in 1998. The recent rebound in export growth most likely reflects the response to the depressed domestic market. Constant market share analysis reveals that Egypt failed to take advantage of buoyant world trade because it did not trade enough in products for which world consumption was growing fast (large and negative world consumption switching effect) and because it lost market shares in its traditional exports products (negative competitiveness effect).
- Third, and perhaps most significant for the medium-term, growth sectors in Egypt are not technology-intensive, except perhaps manufacturing, and they are not usually associated with large improvements in productivity. For example, while part of the boom in construction may reflect upgrading of key infrastructure, it also suggests that a significant share of investment constituted new buildings rather than re-tooling or investments in high-tech sectors. In this regard, FDI has not been a source of technology to upgrade Egypt's competitiveness and productivity. Given the large role of state banks in the financial system, financial intermediation may have suffered from interference and weakened the quality of the investment being financed. And as suggested by the negligible importance of net exports in aggregate demand and the rather disappointing composition of exports, even manufacturing growth seems to have been concentrated in satisfying local demand, and has been in relatively low technology sectors such as textiles. In short, growth in Egypt has been driven largely by factor accumulation rather than by total factor productivity gains.

C. More Recent Economic Challenges

9. Since early 1998, an important macroeconomic issue has been the pressure on the balance of payments (BOP). The current account swung significantly from a surplus in 1997 to a deficit equivalent to 3 percent of GDP in 1998, before gradually improving to a deficit of about 1 percent of GDP in 2000. In 2000 and the first quarter of 2001, the capital account also showed a significant deficit mainly because of net outflows from the domestic banking system. To ease the demand for foreign exchange, the authorities imposed import restrictions, and in 1999 the Central Bank of Egypt (CBE) started to draw down reserves to meet the growing demand for foreign exchange and to defend the exchange rate peg. In total, net international reserves declined from US$20 billion in 1998 to US$14.3 billion by December 2000 (equivalent to nine months of imports). The authorities relaxed the peg and allowed the nominal exchange rate to depreciate gradually, from US$/LE3.40 in January 2000 to US$/LE3.85 in January 2001[1]. In early 2001, the authorities put in place a new exchange rate system that, depending on how it is implemented, may allow for more flexibility in the nominal exchange rate.

10. The main exogenous factor behind the pressure on the BOP was the decline in tourism receipts following the attack in Luxor on tourists in late 1997. An additional important factor was the continued appreciation of the real exchange rate after 1997, mainly as a result of the sharp rise in the value of the US dollar to which the Egyptian pound was pegged. This trend in the pound must have contributed to the poor export performance as well as the reduced confidence in the sustainability of the peg, especially in conjunction with the relatively weak productivity performance.

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[1] The weighted average of market rates during the last three weeks of January 2001.

11. The impact of these unfavorable shocks was initially exacerbated by the macroeconomic policy mix of the authorities. Perhaps concerned with the decline in tourism in 1998, the authorities continued to implement expansionary fiscal and monetary policies during 1998-99, despite emerging symptoms of overheating, and only moved to tighten monetary policy during 2000. This policy reversal, in turn, led to a domestic liquidity squeeze, particularly in the private sector, which was exacerbated by the accumulation of payment arrears by the government. As a result, overnight inter-bank interest rates rose from 11.5 percent in October 1999 to 14.6 percent in February 2000. As fears and complaints about the impact of the lack of liquidity on domestic activity grew, the authorities once again eased monetary policy, as indicated by the decline in the inter-bank rate to below 11.5 percent during April-December 2000.

12. On the fiscal front, while the authorities were successful in containing the budget deficit during 1995-98, it increased significantly in 1999 and 2000 (4.2 percent of GDP in 1999 and 3.6 percent in 2000). The sudden reversal in the fiscal stance can be explained partly by improved reporting of fiscal data by consolidating into the budget the expenditures financed by the National Investment Bank (NIB). It also partly reflects the Government's decision to clear the arrears to the private sector to spur the slowing economy. However, there has also been an increase in public investment in mega projects. The Government has announced that it will tighten control on public investment spending, and is making a concerted effort to identify private investors in the Middle East for some of the larger projects. However, preliminary data on the 2000/2001 fiscal deficit suggest little success so far.

D. Poverty and Social Indicators

13. Poverty analysis in Egypt has been severely hampered by the absence of a rigorous and systematic assessment of poverty incidence and the Government's reluctance to allow access to primary data. However, based on investigations undertaken since 1995 (Box A), the incidence of poverty in mid-1990s was in the range of 22-48 percent of the total population with about 7-10 percent of the population ultra-poor[1]. Poverty is concentrated in the rural areas and urban-female headed households. It is the worst in rural Upper Egypt.

14. The extent to which the recent high growth performance in the second half of the 1990s translated into poverty reduction remains to be assessed. But continued sustainable high growth will be essential for achieving significant poverty reduction in Egypt. Given that poverty in Egypt is relatively shallow, policies that encourage labor-intensive growth are particularly important in bringing a relatively large number of households back above the poverty line.

15. Egypt has made important strides in improving several of its social indicators during the past decade. Between 1990 and 1998, life expectancy has increased from 63 years to 67 years; fertility rate has declined from 4.0 to 3.3; and infant mortality rate (per 1000 live births) has declined from 69 to 49. Population growth has slowed to slightly under 2 percent, compared to 2.5 percent two decades ago. However, some outcome indicators, such as literacy, infant mortality and maternal mortality do not reflect the high levels of inputs. For example, the net primary enrollment ratio is around 93 percent, yet illiteracy is still about 45 percent. Moreover, despite almost universal access to health care, which is higher than in most countries at similar income levels, infant mortality is higher than in comparator countries. Similarly, although the proportion of GDP spent on education and health is similar to or greater than in comparator countries, the efficiency of service delivery in these sectors clearly needs improvement. Finally wide disparities persist between Upper Egypt and Lower Egypt and between the rural and urban populations especially in terms of fertility rates and infant and child mortality rates.

[1] These figures are not endorsed by the Government, and a detailed household survey has just been completed.

16. In terms of achieving the International Development Goals (IDGs) by 2015, prospects are good for meeting these goals. The two main areas that will need special attention are (i) reducing by half the number of malnourished children between 1990 and 2015 (the number of underweight children under the age of five remains at almost 12 percent compared to 10.4 percent in 1990; and (ii) making progress toward gender equality and empowering women (at roughly 80 percent, the ratio of girls to boys in primary and secondary schools has not improved much during the past decade; and literacy rates among girls 15-24 years old, while improving, lag behind boys). The Bank's assistance strategy, with its focus on social development and elimination of gender disparities, takes account of these challenges (see section IV).

BOX A: INCIDENCE AND DYNAMICS OF POVERTY IN EGYPT

Poverty analysis in Egypt is handicapped by a lack of systematic assessment of poverty incidence and the Government reluctance to provide access to survey data. UNDP's Egypt Human Development Report (EHDR), IFPRI and some Egyptian institutions undertook poverty assessments in the 1990s. Their results varied considerably according to survey data used and estimation of different poverty lines. The Government has just completed a large household survey, from which data will become available in mid-2001. A thorough assessment of poverty in Egypt in the late 1990s cannot be undertaken before such survey data become available.

Incidence of Poverty: Recent estimates put the incidence of poverty in the mid-1990s in the range of 22%-48% of the total population, while the ultra-poor have been estimated at 7%-10% of total population. The range of the poverty incidence is wide because a large proportion of the Egyptian population lies near the estimated poverty lines and small changes in the estimation of poverty lines yield significant changes in the incidence of poverty.

Dynamics of Poverty: There are few comparable surveys to assess the evaluation over time of poverty in Egypt. The 1996 EHDR shows that the incidence of poverty (using upper poverty line estimates) increased from 30% in 1981/82 to 39% in 1990/91 and further to 48% in 1995/96.

Geographical Concentration of Poverty: Approximately two-thirds of the poor (and three-quarters of the ultra-poor) live in rural areas. EHDR's Headcount Index estimates the incidence of poverty in 1995/96 at 34% in urban Governorates while in rural Governorates it ranged between 48% in Lower Egypt and 60% in Upper Egypt. The depth of poverty is estimated to be markedly worse in rural Upper Egypt.

Characteristics of the Poor: Recent poverty assessments confirm that poor people tend to live in larger households and support more children per adult. The poor and non-poor tend to have similar rates of male labor force participation but females' participation rates are much lower for the poor. Poverty is highly concentrated in female-headed households (50% more poverty compared to male-headed households in urban areas and 29% more in rural areas according to IFPRI). IFPRI's survey also shows that, on average, the poor have 2.6 fewer years of schooling than the non-poor and their literacy rate is 27% lower than the non-poor.

EGYPTIAN PARTICIPATORY POVERTY ASSESSMENT (EPPA): An interesting exercise was undertaken in 1999 by the Egyptian Social Fund for Development (SFD) in collaboration with the UK Department for International Development (DFID) in nineteen communities across five Governorates. The EPPA aimed to find out from the poor themselves what they saw as key issues and constraints preventing them from playing their full role in economic, political and social life. Similar to the general findings in other countries of the Bank's *"Voices of the Poor"* study, the Egyptian analysis concluded that the poor do not see poverty simply in financial terms but associate it with social status, control over assets such as land, access to housing, health and education and with the ability to gain a secure livelihood. The poor also linked their poverty to issues of social recognition, status, dignity and autonomy. At the community level, poverty is seen by the poor to be associated with lack of access to resources (safe water, sanitation, transport, quality land and social services). There is a strong sense among the poor in Egypt that poverty is self-perpetuating. Levels of political and social exclusion affected the ability of individuals and communities to access assets and resources.

Sources: IFPRI (1998), SFD/DFID (1999) and Handoussa (2000), EHDR (1996)

II. EGYPT'S DEVELOPMENT AGENDA

17. The Government's twenty-year plan covers the period 1997-2017 within which it implements five-year plans. The current five-year plan covers the period 1996/97-2001/02. The Government's over-arching objective, as expressed in these plans, is to achieve a private sector-led growth rate of 7.0-7.5 percent that would create gainful employment opportunities and reduce the incidence of poverty. The agenda for achieving sustainable high growth and poverty reduction calls for significant deepening of structural reforms, as well as addressing specific cross-cutting issues of

increasing relevance to Egypt's economic and social development, such as external openness, governance, financial sector reform, environment, and gender. The authorities' strategic development agenda addresses also the following high priority areas: (i) accelerating social and human development; (ii) promoting rural development as an effective poverty alleviation mechanism and addressing critical water sector issues; and (iii) removing obstacles to private sector development. Egypt intends to continue its internal program of reform with particular emphasis on strengthening institutions. Fostering regional integration, particularly in the context of the Common Market for Eastern and Southern Africa (COMESA) and the Nile Basin Initiative (NBI) is also an important area, but this has not yet evolved as a strategic priority, although in the future it most likely will.

A. Achieving Sustainable High Growth and Reducing Poverty

18. Apart from its success in stabilizing the economy, Egypt has implemented a series of structural reforms during the past few years in the areas of capital markets, tariff reduction, reforms of the insurance industry (e.g., amendment of the Insurance Law to permit foreign investors to own shares in Egyptian insurance companies), privatization of more than half of the Law 203 public enterprises, joining of COMESA, initialing the EU Association Agreement[1], the recent introduction of a more flexible exchange rate mechanism, and the strengthening of the social safety net (improved targeting, reduced subsidies).

19. However, if the country is to achieve the desired 7 percent growth rate, it would need to continue upgrading its human capital, remove obstacles to private sector development, particularly with regard to small and medium scale enterprises, and address the critical policy issues of agricultural development and water resource management. In addition to these sectoral policy issues (discussed more fully below), Egypt will need to address a number of critical constraints on growth and poverty reduction which are broad and cross-cutting. The cross-cutting issues relate to increased openness, governance, the financial sector, environment and gender.

Increased Openness

20. In contrast with the strong growth in domestic demand during the 1990s, the performance of merchandise exports during the last decade has been generally weak. As noted above, merchandise exports as a share of GDP declined from 15 percent in 1990 to 6.2 percent in 1998, and Egypt has lost market share in world markets. A recent joint Government of Egypt/World Bank task force concluded that exporters face highly negative price incentives as well as cumbersome customs procedures and other administrative barriers.

21. Success in improving the performance of non-oil merchandise exports will be largely determined by removal of the anti-export bias in trade policy and a more flexible management of the exchange rate. With regard to trade policy, the key reform is to reduce the level and dispersion of import tariffs. The recent initialing of the EU agreement is a key step to integrate Egypt successfully into the world economy, providing a framework for reduced protection. In addition, the authorities would need to improve the responsiveness of the public administration in developing an export-friendly environment, strengthen infrastructure, streamline and modernize customs procedures, including updating and harmonizing product standards and quality control, and facilitating export finance.

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[1] Egypt initialed the Association Agreement with the EU in January 2001. It is part of the wider Euro-Med framework that also covers cooperation in cultural, human rights and other areas. On the trade side, the objective is to dismantle tariffs within a period of 17 years after ratification. The Agreement also provides European market access (quotas) to Egyptian agricultural commodities.

Governance Issues

22. Egypt's key economic governance issues relate to tax policy and administration; civil service reform; legal and judicial reform; greater involvement and participation of civil society in service delivery and decision-making; and corporate governance.

- Tax policy and administration: Surveys in many countries suggest that petty corruption and, more generally, ineffectiveness by tax officials increases business costs and distorts competition. In addition, tax incentives tend to offset each other out and have little incremental effect. A good business environment requires improvements in administration as well as in the tax code itself. With regard to the former, the joint Government/World Bank task force report recommended setting public performance standards that can be easily monitored through management information systems in all major functions of revenue collection[1]. A start could be made with the duty drawback and sales tax rebates for exports. With regard to the tax code, the task force suggested revision of the code and abolishing most tax incentives. Such a system would reduce distortions, limit discretion and facilitate tax administration.
- Improving the civil service: Egypt faces a major problem of a large, inefficient and underpaid civil service with weak professional incentives and performance. The civil service not only stands out for its enormous over-staffing (the government employs roughly one-quarter of the total labor force of about 22 million) and weak productivity, but also for its immense political influence in resisting efforts to reform it.[2] Interviews in Egypt suggest that dramatic reforms of the civil service, or of particular portions of it, are not considered politically feasible. Under these circumstances, the above-mentioned Government/World Bank task force report identified three types of short-term actions. These actions are similar to those already proposed above in the tax area and include: establishing and publicly monitoring performance standards; setting up institutional formal complaint mechanisms linked to internal management and disciplinary processes; and contracting out activities to private companies (for example, pre-shipment inspection of imports).
- Commercial legal system: While the courts in Egypt are well respected by the private sector and are trusted to uphold contracts and property rights, the system is seen as too slow and cumbersome in resolving commercial legal disputes. The "clearance rate" for commercial dispute resolution (percentage of filed cases actually resolved) was reported in the mid-1990s to be 36 percent (compared to 80-100 percent in most developed countries). Cases that were cleared averaged over six years to resolve. The main reasons for this poor performance appear to be the limited number of judges and their low remuneration, the extensive use of court experts (civil servants), the lengthy and inappropriate procedures (including the lack of effective case management), and poor court facilities.
- Greater participation of civil society: Experience from other countries confirms that promoting citizen consultation in strategy preparation for public service delivery, involving civil society in the monitoring of public sector performance, and decentralizing more decision-making to communities increases transparency and accountability. The Government has started to involve civil society--service users, think-tanks, private sector, women's groups, non-governmental organizations (NGOs) and other groups of citizens--in planning and decision-making. Recent examples are the participatory process of preparation of the next Five-Year Plan, the intense

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[1] The joint report "Egypt: Action Plan for improving the Business Environment, Civil Service and Business Linkages" was one of five reports prepared by joint Government-World Bank Task Forces during 1999-2000. The other four areas covered were: export promotion; social safety nets; employment and training; and private financing of infrastructure.

[2] For details on interactions between Egypt's civil service and business, see FIAS: "Egypt – Reform Investment Administration and Strengthen Investment Servicing," Washington D.C., April 1998.

consultations with civil society on the draft Mortgage Law and other pieces of legislation. The Government has also expressed interest in innovative uses of the internet and other forms of information and communications technology (ICT) to enhance the efficiency, transparency and accountability of government (e-Government). There is, however, a great deal more to be done in this whole area, especially in terms of effective decentralization of decision-making, and facilitating the role of the more than 14,000 NGOs in Egypt in providing social services and serving as part of the country's social safety net. In this context, it is important for the Government to ensure that the new draft NGO law is supportive of civil society.

- Corporate governance: Just as public governance issues discussed above are important for the public sector, so corporate governance is important in the private sector. With Egypt's increasing exposure to globalization and its need to tap domestic and international capital markets, corporate governance standards will need to improve to give investors the protection required to encourage them to provide capital. Increasingly, individual investors, funds, banks, and other financial institutions base their decisions not only on a company's outlook, but also on its reputation and its governance. Corporate governance comprises those aspects of the economic environment, laws, regulations, procedures and common practices that provide an incentive framework for companies to maximize long-term value of shareholders, while respecting the interests of stakeholders and society at large. Given the depth and size of the capital markets in Egypt, a corporate governance assessment would be a useful tool for the country.

Financial Sector Issues

23. Despite a steady reduction in the importance of the public sector in the financial system, its role remains dominant, especially through its ownership of large banking and insurance institutions. Though good progress has been made in revitalizing the capital markets in the last few years, banks still constitute the bulk of the financial system. The dominance of the publicly owned institutions in the Egyptian economy and their inability to match the performance of their international and private counterparts has limited the scope and depth of the financial markets and its development. The range of products available in the financial markets is insufficient to meet the needs of private sector, and access of small- and medium-size enterprises (SME's) to the financial products is constrained. International experience indicates that banking systems dominated by state banks can be reformed effectively through a well-designed and well-managed program of privatization that focuses on improving governance and introducing market discipline. The four state-owned banks in Egypt (National Bank of Egypt, Bank of Alexandria, Banque du Caire, and Bank Misr) account for more than half of all loans and advances outstanding. Any program for the development of the financial markets would need to address the effect of their public ownership on the development of the financial markets.

24. Access to financial sector data has been limited, making judgements on the health of the financial system difficult. However, based on data provided by the authorities, Egypt's prudential standards conform to the international standards. While capital adequacy requirements meet the minimums established by the Basle Committee, and regulations regarding loan classification and provisioning are in line with international standards, the disclosure practices need further improvement. Non-performing loans have risen slightly as share of total portfolios (according to Central Bank of Egypt data, from 9.6 percent at the end of 1999 to 10.5 percent at the end of 2000). International experience indicates that rapid credit growth of the type seen in Egypt during the past decade is likely to be associated with a decline in lending standards. Banks may, therefore, be vulnerable to a deceleration of economic activity. Under these circumstances, a further strengthening of regulation and supervision standards needs to be accorded priority. This should be done in parallel with the extensive training effort being undertaken by the Central Bank of Egypt to upgrade banking

skills across the board. The Government understands the importance of these issues and is considering participation in the Financial Sector Assessment Program (FSAP). This exercise would help the authorities to assess better the vulnerabilities and development needs of the country's financial system.

25. There are also issues related to the non-bank financial sector, such as implementing a well-designed mortgage law to facilitate better housing finance; developing the corporate bond markets; reforming the insurance sector; introducing new financial services; introducing new instruments (risk management instruments are particularly lacking); and assuring more market-based rural credit. However, in terms of strategic priority, the issue of the health of the banking system and modernization of the regulatory framework for the capital markets need more emphasis.

Environmental Issues

26. Egypt's high population density and concentration of industry along the Nile Valley and the Delta have led to an increased burden on the country's natural resource base and have adversely affected public health. The main environmental issues faced by the country are:

- Acute water scarcity and declining quality: Per capita water availability is expected to fall from the current level of about 950 cu.m per year to about 670 cu.m by the year 2017. Water quality in the Nile river and the canals deteriorates in a northward direction due to the disposal of municipal and industrial effluents, agricultural drainage as well as decreasing flow. Drainage canals are heavily polluted. While access to sanitation in urban areas is 20 percent of the total urban population of 45 million, the comparable figure for the rural population is only 5 percent. Public health is, therefore, seriously affected, with water-borne diseases a major cause of death, and a predominance of the shallow wells in the Nile acquifer being contaminated.
- Land degradation: Annual loss of agricultural land due to urban encroachment is estimated between 15,000 and 30,000 feddans (1 feddan = 0.42 hectares). The major causes of land degradation are poor irrigation drainage, soil salinization, inadequate crop rotation and selection, fragmented land tenure and soil erosion.
- Increasing pollution and untreated urban and hazardous waste disposal: The major sources of outdoor pollution are hazardous air emissions and water discharges from the heavy metallurgical industries, refineries, cement and power plants, as well as from a very aging transport sector. In addition, some 15 million tons of municipal solid waste are generated annually, of which about 2.5 million tons remain uncollected and no appropriate sanitary landfills exist for their disposal. Hazardous waste, agricultural and hospital waste are also mixed with municipal waste in open dumps where burning is the most common method of disposal. Air and water pollution are not surprisingly sources of respiratory and allergic ailments, especially among children.
- Poorly protected cultural and natural heritage: Air pollution, wastewater, uncontrolled urban encroachment and a large influx of tourists are the major causes of the poorly preserved cultural and historical monuments. The issue is not one of legislation; there are many sectoral laws regulating the environment in Egypt. The problem is the poor enforcement and compliance under those laws.

27. It will be extremely important to assess more systematically the economic damages from environmental degradation to raise public awareness. Egypt has witnessed a rapid surge of more than 200 NGOs in the field of environment, and these, together with an increasingly environment-conscious media, can be catalysts in orchestrating public debate on environment management.

Gender Issues

28. The Government has consistently expressed its commitment to integrating women fully in development. Gender is an important component in its current Five-Year Plan, and the Government has requested Bank support in mainstreaming gender in the next plan through a well-tailored gender assessment. It is a signatory to the Committee for the Elimination of all Discrimination Against Women (CEDAW), and its commitment to greater gender equality was well articulated at the UN's Beijing +5 meeting. Women are increasingly gaining equal access to legal protection under the law and improvements in access to education and health care over the past two decades have had a particularly positive impact on women. However, as the Government itself realizes, more needs to be done to bridge the gender gap, as summarized below.

- In the area of education and training, the Government is rightly focusing on (i) addressing issues that would increase girls' retention in schools; (ii) combating illiteracy, which affects 50 percent of all female adults, compared to 29 percent of all male adults; (iii) increasing women's training opportunities in science and math as well as technological and vocational training; and (iv) enhancing women's educational opportunities, particularly at the university level and in non-traditional fields. To overcome these challenges, more focus will be needed on the curricula side to ensure that text book content remains updated and does not include any gender-discriminatory material. Equally important is to focus on teacher caliber and teacher training needs.

- Official unemployment statistics indicate that female unemployment is twice or three times that of men, the highest rate being for young and educated women in rural areas. The ILO's latest World Employment Report indicates that women's participation in the labor force increased five times faster than men's during 1980-1996, and yet the participation rate in 1996 was 25 percent for women compared to 73 percent for men. Since agriculture employs some 40 percent of working women, gender considerations need to be borne in mind in any agricultural reforms. The same is true for public sector employment, where women constitute one-third of the employees. Facilitating women's access to micro credit, providing the relevant training, establishing vocational training centers that respond to women's needs, simplifying procedures for small projects and encouraging local banks and NGOs to combine micro credit with relevant training for women are some aspects of a viable strategy. Finally eradicating discriminatory hiring practices and other kinds of workplace discrimination, especially in the private sector, needs to be supported.

- In the area of health, despite progress in lowering population growth during the last two decades, more attention needs to be given to reproductive health services and the introduction of new methods of birth control. With regard to female genital mutilation (FGM), the Ministry of Health has issued a decree forbidding this practice in public and private centers and punishing the perpetrators. However, the practice continues and more is needed to educate and disseminate information as well as to improve the capacity of social and health workers and NGOs to address this issue. Early marriage is another area of concern. Despite the legal marriage age being 16, early marriage persists, adversely affecting women's health conditions. Legal measures to prevent this practice, which typically occurs because a good number of women are not registered at birth, must be implemented and supported by a national campaign to encourage and ensure registration of girls at birth.

- The Government is fully cognizant of the need to raise women's awareness of their legal and social rights as spelled out in the Constitution and in the conventions to which Egypt is a signatory. Apart from addressing the discriminatory hiring practices referred to earlier, the

Government has rightly identified as an important strategy tool to provide identity cards, which determine women's right to access services and to participate fully in the development process[1].

29. The Government expects the Bank and other development partners to play an important role in these areas through planned work on gender assessment and a public expenditure review, and, more generally, ensuring the mainstreaming of gender in all developmental activities.

B. Social and Human Development

Education Sector Issues

30. To remain competitive in the increasingly globalized economy, Egypt will require a sophisticated education system that can generate graduates with problem-solving and technological skills for the fast-changing, information-oriented environment. The attention and resources devoted to the sector by the Government have been significant, especially at the basic and secondary levels. The share of education in total expenditures increased from 12 percent in 1991 to about 20 percent at present. The share of pre-university expenditures in total education expenditures also increased from 72 percent in 1997/98 to 76 percent in 1998/99. However, these increased resources have not translated into producing quality students needed for the increasingly complex and demanding economy. Interventions at the higher education levels, including initiatives for improved science and technology programs, have yet to be launched, although a clear strategy is in place. And the Government has yet to start investing at the pre-basic level to establish a firmer foundation for human capital formation. The following are the key issues needing Government attention during the next few years.

- At the basic and secondary education levels, access has improved considerably: the net enrollment ratios for girls and boys at the basic level are 88 percent and 98 percent, respectively. The remaining challenge is to focus more on the quality of education, where only a small dent has been made in the retraining of some 700,000 teachers in technology and modern pedagogy. Similarly, professional development for about 80,000 school managers remains to be carried out to enable them to manage in a more decentralized system. Moreover, achievement testing and performance assessments need to be mainstreamed.

- The expansion of access at lower levels combined with a higher growth rate in the 18-24 years age cohort, has placed severe pressure on the higher education system. Per student expenditure at this level has declined by roughly 8 percent annually in real terms, leading inevitably to a drop in quality. Reforms are needed to facilitate greater involvement of the private sector, more use of information technology and greater cost-efficiency. While national consensus for the reform of higher education is strong, intensive technical assistance and financial support will be needed to undertake the reforms.

- International research confirms that relatively small investments in early childhood development (ECD) yield high returns in the long run for both individuals and society. ECD interventions, at both nursery school and kindergarten levels, have been shown to enhance nutritional and health status of children, improve their intelligence scores, increase school enrollment, and reduce repetition in, and dropout from, schools. Studies also show that, in general, the benefits of early interventions are especially high for disadvantaged children and their families. The Government will need to focus more on this area.

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[1] An Egyptian NGO won a Bank Development Marketplace grant to develop work in this area.

31. The authorities have been working closely with some 1200 stakeholders, including several donors, to develop a vision and an evolving strategy for all levels of education, drawing on international experience. This has resulted in the Government's 20-year framework for Education and Training, which is serving as the basis for cooperation with the key development partners in a coherent way.

Health Sector Issues

32. Over the last two decades, Egypt has achieved significant improvements in the health status of the population. Between 1980 and 1998, infant mortality rate declined from 120 per 1,000 live births to 49; and total fertility declined from 5.1 to 3.3. The country has invested extensively in health service infrastructure, and has provided good access to safewater, sanitation and basic public health programs.

33. Notwithstanding these achievements, wide *inequities* persist in the availability and quality of health care services and health outcomes: the infant child mortality rate is three times higher in the poorer rural governorates than in the urban ones. There are also significant *inefficiencies* in the system, exemplified by very low hospital occupancy rates (37 percent average occupancy rate in public hospitals), and by excessive prescription and use of drugs. There are 1.3 physicians per occupied hospital bed, one of the highest ratios in the world, while Egypt's medical schools are turning out more physicians than required, further exacerbating the existing surplus. At the same time, there is an uneven distribution of resources, with a surplus of physicians and hospital beds concentrated in urban areas and a dearth in the rural areas. Finally, while the incidence of HIV/AIDS in Egypt remains very low (at end 1999, the number of adults and children in Egypt with HIV/AIDS was estimated to be 8,100 cases, or just under 0.02 percent of the total population), there is need to maintain vigilance, especially among intravenous drug users[1]. There is also need for encouraging prevention and safe practices.

34. In 1997, total health spending in Egypt represented 3.8 percent of GDP (lower than the 5.3 percent average for lower income countries) of which 50 percent was out-of-pocket spending by households. As Egypt enters into the middle income transition, it faces a dual burden, requiring a response to (i) the disease burden of the poor (high infant and maternal mortality) and (ii) the emerging problems associated with health transition, namely an increase in risk factors such as obesity, smoking and hypertension leading to a rise in chronic disease and injuries from road accidents.

35. In 1998, the Government embarked upon an ambitious Health Sector Reform Program (HSRP), designed to be a blue-print for a comprehensive reform of Egypt's health sector over the next two decades. The HSRP represents a major shift away from more traditional health programs that focused on vertical programs for a defined disease or health problem. The reform begins to consolidate the fragmented health financing system within the framework of a national health insurance program, which will provide the basis for ensuring risk-pooling and equitable distributions of resources. It also aims to reduce duplication and wastage of resources among the many providers.

36. Embedded within the concept of *family* health, promoted under HSRP, is a call for greater participation of families and communities in health promotion and preventive care. Thus it represents increased importance given to integrating health care services with other social development programs. For example, the Bank-financed Population Project (FY96) fosters active collaboration between the Ministry of Health and the Social Fund for Development (SFD) to generate demand for

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[1] UNAIDS, 2000 Update.

family planning services in low demand areas through a variety of community development projects. This approach is particularly effective in reaching the most vulnerable and hard-to-reach population.

37. While the Government's strategy moves the sector in the right direction, the implementation of the strategy has proven to be challenging: despite the acceptance of the overall objectives and strategic framework for reform, the administration, in its day to day decision making process, continues to exhibit tendencies toward centralized control. This could undermine the intention of the reform strategy.

Social Protection Issues

38. Social insurance and unemployment schemes and labor market protection are only available to those employed in the formal sector. A better targeted social protection system is of paramount importance for the bottom two deciles of the population: the present social protection system, accounting for roughly 2 percent of GDP (food subsidies: 85 percent; Social Fund programs: 13 percent; and cash transfers and related programs: 2 percent) supports many non-poor. More generally, reforms need to be undertaken in key areas which have the potential to become drains on public resources (health insurance, food subsidies, social insurance/pensions, etc.). Moreover, institutional weaknesses are serious and impede the translation of policy into effective programs.

39. An emerging area of concern in Egypt is child protection as the country starts to exhibit symptoms of break-down of the traditional family networks and rise in urban slums. There has been a drop in school attendance for children belonging to the lowest quintiles of income. The establishment of the National Council for Childhood and Motherhood (NCCM), and the launch by President Mubarak of the second decade (2000-2010) for the protection and welfare of children has sharpened the focus on this area, making the approach more comprehensive and community-based.

C. Agriculture, Rural Development and Water

40. Egypt's agricultural sector pioneered the economic reform process that was then extended to the rest of the economy during the early 1990s. During the last two decades, substantial success was achieved in price liberalization of inputs and outputs, and the elimination of land-use controls for most crops. During the 1990s, the focus has been on increasing agricultural productivity of land and water through more efficient use of these limited resources. In response to these measures, the performance of the agricultural sector improved considerably: the average annual growth rate of agricultural production increased to 3.0 percent in the 1990s from 2.8 percent in the 1980s, and the food gap narrowed significantly.

41. Notwithstanding this progress, much more needs to be done to harness the full potential of the sector in increasing rural incomes and alleviating poverty. Greater openness in the markets of Egypt's significant trading partners would, of course, help. The following three issues appear most relevant for the coming years.

- According to a 1998 survey by the International Food Policy Research Institute (IFPRI), 63 percent of the poor and 74 percent of the ultrapoor in Egypt live in rural areas. Increasing the productivity of agriculture remains an important prerequisite for increasing the incomes of the rural poor in a sustainable manner. More effort needs to be made to develop new crop varieties and agricultural techniques to enhance small holder access to basic services, information, technology and extension. In addition, increased emphasis on non-agricultural sources of rural employment and income from rural handicrafts and industries will be needed for rural poverty alleviation. Improving the performance of financial services to the rural population remains an

important issue. Finally, in a country where 95 percent of the population lives on only 4 percent of the land, pressures are building on the government for horizontal expansion to new agricultural areas. Land reclamation efforts are underway in the Western Delta (through the Nasser Canal), the Eastern Delta and Sinai (Es Salam Canal) and more recently in the South of the New Valley area (Toshka) and East Al Aweinet on the border with Sudan. The costs and benefits of investments in the new lands will need to be carefully assessed.

- There is need for a more systematic approach to the development of agricultural exports. Revenues from agricultural exports during the 1990s have remained low and volatile (agricultural exports, excluding cotton, account for only 5 percent of total merchandise exports) owing to incomplete liberalization of prices and marketing mechanisms for some products. In sub-sectors such as cotton, this could threaten the existence of the whole sub-sector: on average, cotton exports in the 1990s reached only half of their 1980s volume. Other reasons, especially for the horticulture sub-sector (identified as the most promising sub-sector for exports) are shortages of adequate technical and managerial skills, lack of reliable supporting infrastructure (land, water and warehousing) and other services to allow private sector competitive involvement in the sector[1].

- Water scarcity will be a critical challenge for the future of Egypt. Per capita water availability in Egypt is about 950 cu.m. per year, lower than even the regional average of 1200 cu.m. per year. Compounding the problem of water quantity are issues related to the quality of water because of water-logging, salinity and degradation by pollution. Some water usage savings can be expected from the reuse of drainage water, rainwater harvesting and watershed management (mainly along the Mediterranean coast), limited desalination, reduction of Nile water flows to the sea and the continuation of irrigation and drainage improvement. The Nile Basin Initiative (NBI) should also help (see para. 74). However, increased investments will be needed for the operation and maintenance of the drainage and irrigation systems in the new and old lands, which will make the institution of a viable cost recovery program critical. Moreover, the increasing demand for limited water resources will put pressure on the Government to formulate policies and programs to improve water allocation among various water users. Since agriculture uses more than 80 percent of available water, a key option will be to reallocate water within agriculture, by moving gradually out of water-intensive crops such as rice and sugarcane. Finally, while substantial investments of over US$ 4 billion have gone to urban waste water management, rural sanitation and water pollution have remained relatively neglected.

42. The Government has adopted a rural development strategy that addresses many of the above issues. However, it is critically important that during the next few years the focus remain on water management issues, promotion of agricultural exports and a concerted effort to eradicate rural poverty.

D. Removing Obstacles To Private Sector Development

43. Despite considerable progress during the past decade, Egypt's private sector is saddled with a number of constraints that have thwarted opportunities for a much more vibrant private-sector-led growth (for a detailed discussion, see Annex 1). In addition to the trade and competition policy framework, and a financial sector that is dominated by the public sector and does not support small and medium enterprise (SME) development, the following are the main barriers to private sector development: unfavorable business environment; weak and inefficient infrastructure services; and a

[1] World Bank: "Toward Agricultural Competitiveness in the 21st Century: Egypt's Agricultural Export-Oriented Strategy," July 2000.

slowdown of the privatization process. In addition, the economy needs to take advantage of the information and communications technology (ICT) possibilities opened up by the "new economy".

Business Environment Related Issues

44. Private operators frequently identify the tax system and customs administration as a primary constraint. The system imposes uncertainty, delays and excess costs on Egyptian businesses, particularly on SMEs. The commercial legal system is also regarded as too slow, expensive and cumbersome in resolving commercial legal disputes. This limits the development of impersonal and complex contracting and raises the cost of business transactions. Labor regulations, while formally cumbersome, are not widely enforced. However they may deter large companies from investing and/or distort their investment decisions toward more capital-intensive, less employment-creating technologies.

45. The business environment is even less supportive of SMEs and micro enterprises.[1] There is little incentive for them to join the formal sector; formalization does not necessarily lead to a better access to land, capital and know-how. This implies a loss of growth potential in a potentially dynamic sector, loss of fiscal revenue for the government, and, when SMEs do choose to locate within the formal sector, unfair competition from larger firms.

Infrastructure Issues

46. In the past two decades Egypt has invested significantly in upgrading its physical infrastructure. Whereas twenty years ago businessmen would fly to Athens to make an international call and there was only one dual highway in the country, today telephones work well, roads are adequate, electric power is uninterrupted and water supply in urban areas is of generally good quality. Problems remain, of course. City transport, especially in Cairo, is congested and the railways and water services do not cover their costs. After a long investment boom, maintenance is an increasing concern. Moreover, the shift in budget expenditures to human resource development (especially education and health) have meant reduced resources available for infrastructure.

47. In order to cope with the need for continued infrastructure investment in a constrained budget environment, the Government is embarked on a massive effort to attract private capital to public infrastructure. Two power BOTs are under construction and two others are planned. Port handling has been concessioned out in one port and new airports and toll roads are being built on a BOT basis. Progress in mobilizing private funds is, however, slow in light of the fact that the concepts behind private investment in public entities is still relatively new to Egypt and problems of cost recovery and contractual agreements remain. Under the circumstances foreign investors approach such projects in Egypt cautiously. In addition, certain kinds of investment (for instance, rural water and sanitation and certain roadways) are not likely to attract private finance and the Government will need to step up investments in these particular areas. In parallel, funds for maintenance of existing investments are short.

48. There remains scope for further privatization in telephones, power and water services and a number of ventures are under negotiation. More aggressive marketing of such possibilities should be undertaken, however. In addition, Government needs to address difficult questions of cost recovery and adequate maintenance. Pricing of water is particularly sensitive in this regard. Finally, as

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[1] Egyptian enterprises employing less than 10 workers are estimated to contribute 80 percent of private sector value added and some 75 percent of employment.

greater private participation in infrastructure occurs questions of regulation and legal efficiency will become more important.

Privatization

49. After an impressive privatization drive during 1994/95-1999/00, when some 130 enterprises with assets worth about US$3.8 billion were privatized, there was a marked slow down in the process during most of 2000 in the run-up to the legislative elections in October/November 2000 and the volatile political situation in the Middle East. Other reasons for delay were related to valuation problems and a decision to undertake restructuring of a number of poorly performing companies prior to their privatization.

50. Despite progress made, the public sector still accounts for a remarkably high share of economic activity, at around 30 percent. Acceleration of the privatization process will be essential to revitalize the investment climate and to help sustain the momentum of growth. The Government has indicated its plans to divest most of the remaining enterprises during the next 2-3 years. The most imminent activities are the sale of 20 percent of Egypt Telecom, the privatization of the gas distribution network, and the sale of the public sector's share of joint venture insurance companies. Recent developments in the gas sector, where Egypt has a very significant resource, illustrate what is possible in terms of private sector involvement.[1] Since March 2000, major deals have been struck between the government and the private sector, with BP Amoco, Shell and British Gas.

Exploiting Information and Communications Technology (ICT) Possibilities

51. Egypt is one of the fastest growing information technology markets in the world, growing by some 35 percent annually. It is a major priority of the Government to capitalize on the country's relatively cheap pool of skilled labor. The recently established Ministry of Communications and Information Technology is in the process of setting up an enabling environment and developing programs in which ICT industries can continue to grow.

52. Government's initiatives are focusing on empowering the private sector and stimulating national demand for communication and information technology through education programs and public projects; establishing partnerships with global industry; and modernizing Egypt's telecommunications and postal infrastructure. In order to upgrade Egypt's infrastructure and develop the workforce, the Government has signed agreements with many global IT companies, notably IBM, Cisco Systems, Oracle, Network Solutions, and PSINET (adding to the cooperation agreement with Microsoft).

53. The number of internet users in Egypt continues to increase and is currently close to 500,000 subscribers, a market penetration of about 0.7 percent. The number of Internet Service Providers has grown to over 60, and the cost of internet access has fallen dramatically from an average of US$30 per month as a flat charge to less than $10 per month. Annual revenues from internet related services are estimated at about US$23 million. Additionally, market penetration for wireless and fixed line communication is growing and estimated to be currently around 3 percent and 10 percent, respectively.

54. While Egypt is a leader in the Arab World in terms of the "new economy", much remains to be done. Access to technology and internet in schools and universities at affordable prices needs to be

[1] Egypt has proven reserves of 43 trillion cubic feet and potential reserves of 120 trillion cubic feet. Current domestic consumption of only 17 billion cubic feet indicates the major potential for export.

assured. Telecommunications and in particular internet infrastructure needs greater attention. E-Commerce infrastructure, the heart of ICT, requires strengthening of the financial services sector and in particular greater use of credit cards.

55. There is also need for developing the regulatory environment for telecommunications and postal services, and for protecting intellectual property, financial regulation and the development of new cyber-laws. In addition, specific work is required to create awareness, promote Arabic content on web sites, encourage markets and develop and retain human resources. Without a focus in the last area, Egypt will continue to lose its best and brightest ICT professionals abroad.

III. EXTERNAL ENVIRONMENT AND MACROECONOMIC OPTIONS

A. External Environment

56. As indicated earlier, Egypt's economic growth during the 1990s has been largely driven by the domestic market. A decomposition of economic growth into its domestic and foreign components indicates that in the second half of the 1990s, some three-quarters of economic growth was a consequence of domestic demand. Nonetheless external factors do have important implications for the growth of the Egyptian economy in several ways.

- Egypt's terms of merchandise trade are expected to register a 4 percent increase in 2001, followed by a decline of about 3.4 percent per annum during 2002-2004. The merchandise export price index is expected to increase in 2001, in line with price increases for oil, manufactured exports and cotton, and to fall thereafter. The expected decline in terms of trade is also attributable to a modest projected increase in the price of imports.
- With the gradual decline of the oil sector in Egypt during the 1990s (the share of oil in GDP declined from a peak of 18 percent in the early 1980s to about 6 percent in the late 1990s) and the near balance between exports and imports of oil prices, the net impact of oil prices in the future will be insignificant.
- A slowdown in economic activity in Egypt's main trading partners (in the 1990s the shares of the EU countries, US and the Middle East were 48 percent, 13 percent and 12 percent, respectively) would affect demand for Egypt's major merchandise exports, particularly textiles and agricultural products, and tourism. With the projected improvements in the economies of the Gulf countries, worker remittances can be expected to remain high (US$3.7 billion in 2000). However a deterioration of the Middle East crisis could severely affect tourism and Suez Canal revenues.
- Given the country's manageable external debt (about 30 percent of GDP) and very small short-term debt, as well as expected declines in international interest rates, the cost of servicing external debt can be expected to decline.

57. In short, the external environment for Egypt presents a mixed picture, which could, however, be significantly negative in the case of further deterioration of the Middle East situation. The extent to which the country can exploit the positive external factors and prepare itself against the negative ones will be determined by the depth and pace of structural reforms.

B. Macroeconomic Constraints and Policy Options

58. The Government's key medium-term objective is to provide jobs for Egypt's growing population through labor intensive fast growth. Since the mid-1970s, labor has been mainly

absorbed by migration (about 2.7 million jobs), government (2.6 million) and the informal sector (3.7 million). Prospects for job creation in the first two areas seem dim, and most jobs would need to be created through the development of productive activities in the formal and informal private sectors. Indeed, to absorb new entrants (about 550 thousand per annum) and reduce unemployment (widely believed to be above the official estimate of 9 percent), the economy would need to expand annually at a minimum by 7 percent.

59. To achieve a growth target of at least 7 percent would entail changes in the medium-term macroeconomic framework generally followed by the authorities in the post-stabilization period. It would entail investment levels of about 5-6 percentage points of GDP above the 1999-2000 average level of about 24 percent (see Table 2). Since gross national savings, which averaged about 22.0 percent during 1999-2000, cannot be realistically expected to be above 25.0 percent during the decade, the country will require annual foreign inflows of around 5 percent of GDP to achieve the 7 percent growth rate. The Government expects that net private investment (FDI and portfolio investment) would double during the decade from its level of about US$1.5 billion in 2000. This will require a major improvement in the business environment. However, even if this level of private investment were attracted, Egypt would still need annually at least US$1 billion additional inflows, after taking into account medium and long term borrowing at the present levels.

60. The three prospective macroeconomic scenarios illustrate the implications for growth of a more intense structural reform program, as well as continued macro stability. The most likely scenario shows a gradual increase in the investment to GDP ratio, as in the recent past, without a major increase in domestic savings. The current account deficit increases over the 5-year projection period, but remains financeable, especially if Egypt attracts additional FDI. The scenario also presupposes a sustained improvement in export performance. While national savings as a ratio to GDP is not projected to increase significantly, the public sector is presumed to increase its savings efforts gradually over the period, as shown by the slow decline in the fiscal deficit, to the benefit of private consumption. The other two scenarios differ from the most likely scenario mainly with regard to the presumed savings and investment effort. In particular, non-government saving as a share of GDP is projected to increase modestly under the most likely and High Case scenarios, and to deteriorate by about three percentage points of GDP under the Low Case scenario.

TABLE 2: OUTLOOK FOR ECONOMIC INDICATORS UNDER THREE SCENARIOS

Indicator	Scenario	2000	2001	2002	2003	2004	2005
GDP growth rate (%)	Most-Likely	6.4	5.5	5.6	5.7	5.9	5.9
	Low Case	6.4	4.0	3.3	2.9	3.1	3.1
	High Case	6.4	6.0	6.9	7.2	7.5	7.8
Current Account/ GDP (%)	Most Likely	-1.2	-1.8	-2.1	-2.0	-2.0	-1.8
	Low Case	-1.2	-1.8	-2.8	-3.5	-4.1	-4.2
	High Case	-1.2	-1.7	-2.9	-3.5	-4.2	-4.8
Overall Fiscal Deficit/ GDP (%)	Most Likely	-3.6	-4.4	-4.3	-4.1	-4.0	-3.9
	Low Case	-3.6	-4.8	-4.6	-4.6	-4.5	-4.4
	High Case	-3.6	-3.6	-2.7	-2.2	-2.1	-2.0
Gross Domestic Investment/GDP (%)	Most Likely	24.2	25.0	25.1	25.4	25.8	26.0
	Low Case	24.2	23.9	23.6	23.5	23.2	22.9
	High Case	24.2	25.6	27.2	28.1	28.9	29.4
Export of Goods and NF Services, Real Growth Rate (%)	Most Likely	7.0	8.4	9.6	10.4	9.5	9.9
	Low Case	7.0	5.8	6.7	6.4	7.0	6.5
	High Case	7.0	10.9	11.4	11.7	12.0	12.3

61. Additionally, the most likely scenario (as well as the High Case) is based on three key strategic actions by the Government:

- *Ensuring macroeconomic stability.* Despite recent actions by the authorities, there is still considerable uncertainty whether these will suffice to reduce BOP pressures. Actions to reduce

the fiscal deficit do not seem to have had the expected results, and the 2001 outcome may represent a deterioration over the previous year. The recently introduced exchange rate system, basically an adjustable peg with a narrow band, is more flexible than the peg that was in place until 2000. The concern is whether in practice the new system will be managed in a flexible manner. Overall, the current combination of expansionary financial policies with a peg may lead to continued pressures on reserves.

- *Undertaking the necessary measures to increase productivity.* In addition to the maintenance of macroeconomic stability, this would entail second generation structural reforms, such as institutional strengthening, reduction of high effective protection, technological upgrading, promotion of FDI, considerable improvement in the services sector, including increased efficiency of service delivery, and enhancing technical skills of the labor force. Given the importance of banks in the financial system, actions to improve the efficiency of the intermediation are critical to improve growth performance.
- *Creating an export push.* More rapid economic growth cannot be achieved without a doubling of the growth rate of exports from the annual average of less than 4 percent during the last decade. Increase in non-oil merchandise exports will be largely determined by removal of the anti-export bias in trade policy, the responsiveness of the public administration in developing an export-friendly environment, better infrastructure, streamlined and modernized customs procedures, updating and harmonizing product standards and quality control and facilitating export finance.

62. Achieving a higher growth rate is also likely to imply, depending on the response of private capital flows, that the public sector will have to increase its foreign borrowing. Thanks to the highly favorable Paris Club debt and debt service reduction in 1991, workers remittances, Suez Canal payments, high aid flows, and appreciable economic growth, Egypt was able to reduce its external debt to GDP ratio from more than 130 percent in 1989 to about 30 percent in 2000. To maintain this favorable performance, the Government requires that total external debt should not increase in nominal terms (implying further reductions in the debt burden as a share of GDP and exports), and that all public foreign borrowing should be restricted to loans with a grant element of at least 40 percent. Given the increased external borrowing needs, the Government may have to begin to tap less concessional sources of financing and increase its nominal debt stock.

IV. BANK GROUP ASSISTANCE STRATEGY

A. Implementation of the Previous CAS: What Worked, What Did Not

63. The Board discussed the previous CAS for Egypt in May 1997. Overall, the Bank Group's lending and investment activity was in line with the CAS base case proposals. For the period FY98-00, the CAS foresaw 11 IDA/IBRD operations for a total of US$450-600 million. Actually 10 operations were approved by the Board for about US$580 million.[1] Similarly, IFC's investment flow – which depends on the investment climate, the availability of suitable transactions and partners, and the level of competition in funding from local banks – has increased steadily during this period. IFC's committed portfolio increased from about US$196 million at end FY97 to US$250 million at end of FY00. FY01 has witnessed a marked rise in the level of approvals and commitments. In the first 10 months, IFC approvals were US$177 million in loans, equity investments and guarantees in 8 different projects and a total of US$305 million for the account of participants to two power projects. IFC's committed portfolio at end-April 2001 stood at US$328 million. This is by far IFC's largest portfolio in the MENA Region.

[1] However, of these 10 operations, five were approved in one fiscal year –FY99—which was the last year of IDA-eligibility for Egypt.

64. In terms of specific aspects of the CAS, however, success in implementation has been mixed and sustainable institutional development has been less than expected. Box B provides an assessment of what worked well and what did not.

BOX B: IMPLEMENTATION OF PREVIOUS CAS: WHAT WORKED, WHAT DID NOT

What Worked Well	What Did Not Work So Well
• Despite some remaining problems, the overall quality of Bank/IDA portfolio has improved over the CAS period, in terms of number of problem projects, dropped projects, etc. (see paras. 78-83).	• Projects continue to encounter effectiveness delays. CAS had set a target of a maximum of nine months lapsed time between Board and effectiveness. In practice, delays have been longer (about a year).
• In two of the four areas of focus recommended by the CAS – human resource development and rural development – Bank intervention has been effective. "Bank support to irrigation and drainage has been relatively successful, with satisfactory outcomes and likely sustainability" (OED). The Bank's technical expertise and policy dialogue is greatly appreciated. Similarly in the education and health sectors, there has been a significant improvement in the quality of the policy dialogue, in close coordination with other development partners.	• In the other two areas of proposed focus of the CAS --- export push, and private sector development – the Bank's policy dialogue role was marginal, and planned projects (Export Development Project, planned for FY98; Private Sector Finance of Infrastructure, planned for FY00), did not materialize. More generally, the Bank's role in policy dialogue has been circumscribed. Moreover, the CAS had recommended the use of several partial risk guarantees, none of which materialized.
• IFC activities during the CAS period were broadly consistent with the strategy articulated, with investments in infrastructure, financial sector, oil and gas, tourism and industrial sectors.	• IFC needed to develop innovative ways to provide finance and skills to the SME sector. IFC set up a leasing company to finance SMEs, but more needs to be done.
• Bank's involvement, together with other development partners in the Social Fund for Development (one of the largest such funds in developing countries), has been instrumental in maintaining social stability during the reform process.	• Despite its overall achievement, the issue of sustainability of the Social Fund remains.
• Several knowledge-based activities (analytical work, workshops, etc.) were undertaken, which have been greatly appreciated by the Egyptian authorities. These sector activities focused on education, health, social safety nets, water sector, renewable energy and urban transport. Even more effective has been the preparation of the five Task Force Reports, carried out jointly by the Government and the Bank, aimed at providing the authorities with plans of action in: export promotion; improving business environment; training and skills development; social safety nets; and private provision of infrastructure.	• Because of lack of access to data, the Bank has not been able to undertake analytical work in two areas that the 1997 CAS correctly considered important: poverty assessment, and financial sector analysis. Under that CAS, two poverty related studies were planned Neither was undertaken. Even in the case of the five Task Force Reports, there has been little follow up on the policy dialogue with the Bank.

B. Lessons Learned and Benchmarks for Future Assessments

65. Based on the experience with the implementation of the previous CAS, and drawing on the conclusions of OED's Country Assistance Evaluation (see Box C) the following lessons can be drawn, which are being incorporated into the design of the new country strategy:

- IBRD lending to Egypt will be strongly demand-driven and will, therefore, inevitably fluctuate from year to year. The Bank Group should stand ready to respond with quick-disbursing lending in case of external or domestic shocks. However, for the Bank to respond rapidly there would need to be a deeper and more sustained policy dialogue based on solid analytical foundation.

- IBRD lending should be limited to areas where Government commitment to the projects is unequivocally strong and where the World Bank has had a positive experience. The Bank should be more realistic in the number of projects to be prepared. During FY98-00, 10 projects were presented to the Board. During FY02-04, no more than 6-7 projects should be planned under the base case scenario. Under this scenario, the size of the portfolio would decline from 19 projects at present to about 14 at the end of FY04.
- Given the Government's requirement that all new operations should have a grant element of at least 40 percent, it will be critically important to ensure that cofinancing (or parallel financing) from donors with softer lending terms than the Bank is in place before proceeding too far with preparation of projects. This indicates the need for even closer partnership with other donors. This should be accompanied by efforts to move away from a project-by-project fulfillment of the "40 percent rule" to a more macro or sectoral one.
- As the size of the portfolio decreases, a greater share of administrative budget resources should be allocated to knowledge-based non-lending activities for which the Government has expressed great interest, or which will be necessary for due diligence.
- Clear benchmarks should be established to enable future assessments of the Bank Group's involvement in Egypt.

BOX C: OED COUNTRY ASSISTANCE EVALUATION (CAE)

In January 2000, OED completed a Country Assistance Evaluation for Egypt, which was discussed by the Committee on Development Effectiveness. The report focused in particular on the period since 1990, although it included an overview of Bank assistance to Egypt since the 1950s. The following is a summary of the report's key findings and recommendations.

- Egypt has done a commendable job of significant structural reform, achieving macroeconomic stability and realizing strong growth, without major social unrest, in the past five years.
- Some social indicators, such as child malnutrition and life expectancy, have improved markedly. Others, including literacy, particularly among women, and infant mortality, although improved, have not achieved gains commensurate with good access to social services.
- The Bank's role in Egypt has been modest, although it was actively involved in the early 1990s in supporting structural adjustment and in helping Egypt with major debt rescheduling.
- An important gap in Bank assistance has been the absence of work on poverty alleviation.
- Because of the large amounts of concessional funding available to Egypt, the Bank should forge closer partnerships and cofinancing arrangements with other donors.
- The Bank should continue to lend in areas where the Government is interested, and where the Bank has had positive results, such as in irrigation and drainage.
- The next CAS should propose clear guidelines to link the administrative budget to the size and complexity of the portfolio, and the likely effective demand by the Egyptian Government for the Bank's lending and non-lending services.

66. Based on the above lessons, the following benchmarks will be used not only to guide the Bank's lending and non-lending involvement in Egypt but also to determine the allocation of country administrative budget for Egypt. Clearly judgement would need to be used in taking into account the overall observance of these benchmarks, rather than mechanistically requiring the fulfillment of each one of them.

- Success of the Bank Group in being able to complete substantive analytical work in the areas of poverty alleviation and financial sector.
- Sustained policy dialogue between the Government and the Bank.

- Fewer dropped projects and lower average cost of those dropped. Average cost to be aligned with Bank average during FY02-04.
- Delays in effectiveness reduced from an average of about a year now to about eight months.

C. Changing Relationship: Mix of Lending and Non-Lending Services

67. Owing to the availability of sizeable grant resources, the country's graduation from IDA, and its conservative borrowing strategy, new Bank lending to Egypt is expected to be modest in relation to the country's size and importance. IFC commitments should, however, expand, as should MIGA's. In addition, the Government places a very high value on Bank Group advice, global knowledge sharing, training, and its capacity to work in partnership with other development partners. Looking ahead, the share of non-lending services in the Bank's assistance to Egypt would increase over time. This is expected to happen as the size of the Bank's portfolio gradually shrinks from 19 projects at present to about 14 projects by the end of FY04. The objective should also be to move gradually toward cost sharing and eventually reimbursable services, in consultation with the Egyptian authorities. In the interim, the strategy would be to projectize technical assistance requests where feasible, and to seek collaborative arrangements with other development partners in which their resources would be used to leverage Bank knowledge and experience.

68. Notwithstanding the increasing importance of non-lending services, Bank lending in selected high priority areas will continue. The Government views Bank lending as important more than for its financial transfer aspect: it is valued for its *technical excellence* and for serving as a *catalyst* for mobilizing financing packages 2-3 times that of Bank loans for well-designed and high priority projects. Given the important involvement of USAID, EU and other development partners in Egypt, strict selectivity in Bank involvement will be observed. In particular, the Bank's focus will be in areas where (i) Government demand for and commitment to projects is unequivocally strong; (ii) the Bank has a long and positive experience (water sector and irrigation; human development); and (iii) it can bring knowledge management and experience of other countries to guide Egypt's policy formulation and implementation (information and communications infrastructure; mortgage market development; and community-based activities). Given the important involvement of other development partners, the Bank will have minimal involvement in energy, industrial restructuring, and environment.

D. Base Case Assistance Program

69. **The underlying assumption** for the base case is a continuation of the current pace of growth and policy implementation. The economy would grow around 5.5 - 5.9 percent annually, and is not subjected to any major external and domestic shocks. There is no substantial increase in private domestic or foreign investment. The government gradually improves its current fiscal and monetary stance and the current exchange rate policy. In short, the scenario is characterized by no significant shocks or reversals of policy reforms, but also by no major structural reform efforts.

70. **CAS instruments**. The Bank Group's proposed base case assistance strategy will be implemented through several instruments:

- Steadily improving the performance of the existing Bank portfolio of ongoing operations (see paras. 78-83), especially in terms of institutional development and sustainability.
- In terms of knowledge-based services, priority in AAA and capacity building work will be given to studies and activities that provide the intellectual underpinning for operations and technical advice in human development, rural development, water management and selected areas of infrastructure development. Priority will also be given to core diagnostic work on poverty,

public expenditure review and financial sector issues, as well as to gender analysis and mainstreaming, on the assumption that access to information is granted by the Government in these areas. The recently completed Social and Structural Review provides a solid basis for deepening policy dialogue between the authorities and the key development partners[1]. WBI is expected to play an important role in disseminating world-wide best practice and bringing focus on development issues identified as priority. Increasingly opportunities will be sought to partner with local think-tanks and other agencies in the conceptualization and dissemination of analytical work. A good recent example was the dissemination of the World Development Report 2000/2001 jointly with two local think-tanks. Most critically needed AAA will be funded out of the Bank's administrative budget. However, arrangements will be explored with other donors and possibly government to share costs for additional on-demand AAA or capacity building services. At the end of the CAS period a review of the effectiveness of the Bank's AAA will be undertaken to guide our future analytical and capacity building work in Egypt.

- 2-3 projects a year are included in the Bank's lending program in carefully selected areas where demand from Egypt is strong and where the Bank has a comparative advantage. This would amount to US$450-500 million in new lending during the period FY02-04. The lending program, as outlined below, is not yet programmatic, although the objective is to move gradually in that direction. Planned work on public expenditure review and continuing effort on improving financial management will help steer the process in that direction (see para 82 for fiduciary work related to Bank operations). In the interim, several ongoing and planned operations are of a sectoral and/or APL nature, especially in education, health and water sectors, involving a comprehensive sectoral approach, government ownership and close coordination with development partners.
- Selective expansion of IFC and MIGA activities (see para. 72).
- Exploring the use of IBRD guarantee instruments to attract foreign capital into areas where performance risk remains a major bottleneck.

71. **Focus of Bank Group Assistance**. The over-arching objective of the Bank Group's country assistance strategy in Egypt is to reduce poverty and unemployment. Working closely with other development partners, the Bank Group will focus on three types of interventions: (i) interventions that support higher and sustained growth; (ii) targeted interventions for poverty reduction; and (iii) interventions with major indirect poverty reduction impact. Table 3 summarizes the various Bank instruments to be employed under the base case assistance program.

72. **Interventions that support higher and sustained growth:** This entails providing support for macroeconomic stability, phased restructuring of the bank and corporate sectors, and improved infrastructure for greater competitiveness. It also involves the gradual integration of Egypt into global markets, particularly in the context of the recently initialed Association Agreement with the European Union (EU).

- Given the important and active involvement of USAID and the EU in this broad area, the Bank's lending will be limited to two projects where it has the knowledge base and comparative advantage: the Agricultural Exports Project and the Information Technology Infrastructure Project. In the case of the former project the objective is to support all aspects of promoting horticulture exports, especially in the context of the agreement with the EU. The project will draw on the findings of the recently completed report on agricultural exports. The Information Technology Infrastructure Project would support the authorities' efforts to develop the regulatory framework for the telecom sector and to modernize the strategy, structure, processes and systems

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[1] Egypt: *Social and Structural Review*, World Bank, June 2001.

of the Egyptian postal services in order to enhance its market orientation, internal efficiency and financial performance.

- On the analytical side, the Bank will work closely with the IMF and other development partners to undertake work on the Financial Sector Assessment Program (should the Government request it), capital market and mortgage market development, strengthening public debt management, improving the efficiency of public expenditures, and corporate governance, all consisting of high priority activities for more rapid and efficient growth. The Bank will also ensure an effective and continuous monitoring of the economic situation, and provide the authorities with guidance and advice through flagship economic reports such as the follow-up Social and Structural Review. WBI is expected to play a prominent role in disseminating information to the civil society[1].

TABLE 3: BASE CASE BANK ASSISTANCE PROGRAM, FY02-04

FY02	FY03	FY04
	ANALYTICAL WORK	
• Poverty Assessment • Early Childhood Development • Analysis of Social Health Insurance • Nile Basin Initiative • Corporate Governance Assessment • Gender Assessment • Economic Monitoring • CPAR Update	• Public Expenditure Review • Irrigation Improvement Sector Review • Drainage & Wastewater Reuse • Nile Basin Initiative • Financial Sector Assessment (FSAP) • Economic Monitoring • CFAA	• CAS • Social and Structural Review II • Nile Basin Initiative • Evaluation of Health Sector Reform • Economic Monitoring • Informal Policy Notes1/
	CAPACITY BUILDING (INCL. WBI)	
• Cairo Traffic Bureau • Environmental Training for Local Admin. • Primary Market for Government Securities • Integrating Global into Local Environment (TF) • Project Appraisal, Monitoring & Evaluation (IDF/WBI) • Health Sector Reform & Financing Workshop (WBI)	• Mortgage Market Development • Global Conference on Endemic Disease Control • Strengthening Public Debt Management • Governance Issues (WBI) • Public Expenditure Review Workshop (WBI) • Agricultural Trade & WTO (WBI)	• Wind Energy (GEF) • Solar/Thermal Energy (GEF) • Biodiversity (GEF) • Conference on Urban Management (WBI) • Conference on Water Issues (WBI) • Other demand-driven capacity building needs will be identified
	LENDING	
• Higher Education Project (US$50m) • Skills Development Project (US$50m) • Information Infrastructure: Telecom, Post, e-Commerce (US$10m)	• Natural Resource Management Project (US$50m) • Early Childhood Development (US$50m)	• Health Sector Reform II (US$100m) • Irrigation/Drainage Improvement (US$100m) • Agricultural Exports (US$40m) • Rural Water/Sanitation Project (US$50m)2

1/ Informal policy notes will be produced in various areas on client demand and identified need.
2/ This project is for FY04/05

- IFC's priorities, closely coordinated with the Bank's activities, will emphasize more rapid job creation through private sector use of natural resources for sustainable development. In particular, IFC will focus on (i) developing private sector financed infrastructure. Egypt has

[1] For more details on WBI involvement in Egypt, see Annex 2.

already made headway in attracting private investment in infrastructure projects, especially in the power sector (Sidi Krir, Suez and Port Said power generation plants). IFC has been involved in all three power projects awarded to the private sector. With the Bank providing policy advice and technical assistance, IFC will identify opportunities for investments in other infrastructure sectors; (ii) providing support to the services sector, including tourism. IFC has been financing tourism projects in Egypt with focus on integrated developments on the Red Sea coast. With the number of tourists expected to double during this decade, IFC will continue to seek selective investments in the sector; (iii) providing financing to internationally competitive and export-oriented ventures; and (iv) supporting the government's privatization effort through both advisory services to particular transactions and providing financing to privatized ventures. Other areas of future IFC involvement include supporting small and medium enterprises (SMEs), developing financial markets, and possible participation in building pipelines to export Egypt's large natural gas reserves to Eastern Mediterranean countries.

- The Bank guarantees could also help, alongside MIGA and IFC investments, in catalyzing private finance for infrastructure improvements. As in other countries, partial risk guarantees (PRGs) can be an element in attracting private financing for new investments on sustainable terms. Inclusion of a PRG in a project also has the effect of improving bid responses, increasing investment commitments, and stabilizing tariff requirements. Possible uses for guarantees include toll road projects, the Third Line of the Cairo Metro, and urban water and sanitation.

73. **Targeted interventions for poverty reduction.** Reflecting the over-arching objective of poverty reduction, most of the Bank's focus, planned lending operations, and IBRD administrative budget will be devoted to activities in this category. This is also the area where the Bank has a solid experience in Egypt and the analytical underpinnings for deepening our involvement.

- Work on basic education, social protection and social safety net will continue through the Bank's ongoing operations in education and the Social Fund for Development, in very close coordination with other development partners. Analytical work on early childhood development, followed by a well-designed project, is a new area of emphasis to improve the educational attainment of the Egyptian population, especially its disadvantaged segments.
- In the health sector, the Bank will build on its ongoing efforts at reforming the health sector, including a strengthened insurance system, continued improvement of management and decentralization, through both analytical and project involvement.
- Since poverty in Egypt continues to be mainly rural-based, the Bank will prepare a follow-up Natural Resource Management project that will increasingly encourage community-based development. A Rural Water/Sanitation project will address the critical needs of the unserved, mostly poor population.
- Water and sanitation is also an area of focus for the IFC. This will allow the Bank and IFC to jointly pursue a strategy of increased private sector participation in receptive urban governorates.
- On the analytical side, apart from the work aimed at supporting operations in health and early childhood development, the focus will be on (i) filling the major knowledge gap on the extent and nature of poverty in Egypt, through a comprehensive Poverty Assessment; (ii) ensuring greater equity and efficiency in the allocation of public resources to the social sectors, through a Public Expenditure Review (PER); and (iii) a Gender Assessment aimed at addressing the key gender-related issues, and, at the request of the authorities, developing mechanisms to mainstream gender in the country's next Five-Year Plan (2002/2003–2007/2008). WBI is expected to organize workshops/seminars on the experience of other comparator countries on health reform and financing, endemic diseases and PER.

74. **Interventions with major indirect poverty reduction impact**. Bank Group's assistance in this area supports interventions that may have major indirect benefits for the poor in terms of promoting broad-based growth, development of poor areas or building effective institutions.

- Three lending operations are planned: Higher Education, Skills Development and Irrigation/Drainage Improvement. The first two are aimed at making higher education more relevant to the needs of the economy and to establish a viable mechanism for training in entrepreneurial, technical and managerial skills. The Irrigation/Drainage project will build on the considerable work done so far in Egypt to improve the efficiency of irrigation and water use.
- In the area of analytical and capacity building work, several activities are planned. Sector work on irrigation improvement, and drainage and wastewater reuse would provide the analytical base for the Irrigation/Drainage Improvement Project.
- The Bank will continue to play a facilitating role in the Nile Basin Initiative (NBI). This initiative is led by ten riparian states of the Nile River Basin, and its goal is to develop the river in a cooperative and beneficial manner, overcoming decades of dispute[1].
- In the energy sector, GEF-financed activities are planned for wind, solar and thermal energy, as well as in biodiversity.
- In the environment area, many development partners (USAID, Germany, Italy and others) are already very active. Bank's technical assistance will, therefore, focus on areas such as integrating global into local environment, and environmental training for local administration.
- Finally, exploratory analytical work will be undertaken in the area of governance, focusing on linkages with economic efficiency, competitiveness, and service delivery to the poor. It would also include providing guidance and international experience on judicial and civil service reform as well as experience in community development activities. In the context of our ongoing projects (Matruh and Population) community participation in the design and implementation of projects has already begun. For example, the Matruh Natural Resource Project helped tribes improve the management of water resources. The follow-up Natural Resource Management Project will expand this process to other activities and areas.

E. Alternative Scenarios and Contingencies

75. The key assumptions underlying the **base case** and the corresponding Bank Group lending and non-lending activities are summarized in Section D above. A **high case lending scenario** could be envisaged under two possible eventualities: (i) a significant deepening of the structural reform (accelerated privatization; significant trade liberalization; credible policy measures to improve business environment; and effective export promotion policies); and improvement in the Bank's portfolio; or (ii) a major deterioration in the external environment during the course of implementation of a strong reform program (see Section V for possible risks), which may require the Bank to facilitate Egypt's access to IBRD resources in larger volumes. Under this scenario, the Bank could increase lending to around US$1.5 billion over the three years, of which about a half could be in the form of quick-disbursing loans. As indicated earlier, the rapidity of the Bank's response will be determined to a large extent by the existence of a sustained dialogue between the Government and the Bank on the key structural issues.

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[1] The ten riparian countries are: Burundi, Democratic Republic of Congo, Egypt, Eritrea, Ethiopia, Kenya, Rwanda, Sudan, Tanzania and Uganda. The first meeting of an International Consortium for Cooperation on the Nile (ICCON) is planned for June 26, 2001, to raise donor support and funding for the cooperative programs put forward by the NBI.

76. Alternatively, if the implementation of policy reforms and Bank portfolio deteriorate considerably (deepening controls, halting structural reforms, and deteriorating Bank portfolio), a **low case lending scenario** could be envisaged, under which Bank lending for the whole period would be limited to about US$100 million for one or two projects in the social sectors.

77. Based on the above, there are four main triggers that will determine the level of Bank lending in Egypt: macroeconomic framework; structural reforms; the quality of the overall policy dialogue; and portfolio management. Details are provided in Table 4.

TABLE 4: TRIGGERS AND MAIN ASSUMPTIONS FOR THE LENDING PROGRAM

BASE CASE ASSUMPTIONS	HIGH CASE TRIGGERS	LOW CASE TRIGGERS
• Gradual improvement in current monetary and exchange rate policies. Significant move towards fiscal sustainability. Fiscal deficit declines gradually from a level of 4.4% in 2001.	• Significant progress in achieving fiscal sustainability. Fiscal deficit of 3.6% achieved in 2001, and reduction in following years.	• Controls deepened, fiscal deficit unsustainably high.
• Elimination of tariff surcharge.	• Average unweighted tariff reduced to 22%.	• No progress in structural reforms, especially in trade liberalization.
• Progress toward reforms in the financial sector. FSAP completed.	• Acceleration of financial sector reform. FSAP completed. At least one of the 4 large public commercial banks privatized.	• No progress in financial sector reform.
• Improvement in the quality of policy dialogue. Full access to poverty data.	• Significant improvement in the quality of policy dialogue. Poverty Assessment completed as a joint product with the Government.	• No improvement in policy dialogue, and problems of access to data persist.
• Steady improvement in the Bank's portfolio. Problem projects in the 10%-35% range. Delays in effectiveness gradually reduced to about eight months.	• Significant improvement in the Bank's portfolio. Problem projects below 10%. Delays in effectiveness reduced to about six months.	• Significant deterioration in the Bank's portfolio. Problem projects over 35%. Effectiveness delays in excess of a year.

F. IBRD Portfolio Management and Performance

78. Historically, implementation of Bank projects has been good in Egypt (84 percent satisfactory compared to a Bank wide average of 74 percent). The current portfolio is of medium strength. At present the portfolio comprises 19 active operations of which 2 are at risk (about 10.5 percent). Sustainability and Institutional Development of Bank operations, as measured by OED have, however, been below Bank wide averages, reflecting the resistance of Egyptian institutions and procedures to change and the fact that the Bank is not a significant financial player in Egypt. Consistent with the overall good performance of projects in Egypt, there are some notable ones with strong results on the ground. Two such examples are Schistosomiasis Control Project, which has had a major impact on the incidence of bilharzia in Egypt, and the National Drainage Project, which has reduced the problem of a rising groundwater table, that leads to waterlogging and salinity.

79. Gross commitments from the Bank and IDA have swung widely over the years. For example, in FY99, the final year of IDA availability, US$550 million was committed, while during the two subsequent fiscal years only US$50 million was committed. This reflects Egypt's fluctuating financial needs, as well as availability of grant funds from other development partners. The average

size of the Bank's portfolio has been decreasing. The Egypt portfolio, nevertheless, remains large (18th largest in the Bank and second largest in MENA Region).

80. Three overarching issues have affected portfolio performance in Egypt: bureaucratic delays in loan and credit effectiveness; systemic problems in agriculture credit; and project-level requirement for minimum credit concessionality. Effectiveness delays reflect partly the Government's cautious approach to borrowing, although it is also the case that internal approval procedures are heavy. The Government and the Bank have agreed on the composition of the base case lending, and this should help reduce effectiveness delays. The Bank and Egypt are also exploring ways to streamline, if possible, the various steps of Ministerial and Parliamentary approval. Problems of agriculture credit are serious, affecting two operations with PBDAC, the Agriculture Bank, as well as the agriculture credit components of rural development projects. The Private Sector Agriculture Development Project, which recently became effective, has a strong institution building component which is designed to tackle the weaknesses of PBDAC. Finally, the current government requirement that each project should have a minimum grant element of 40 percent is complicating the preparation of IBRD projects. Debt concessionality needs to be monitored at the macro or sectoral level, rather than on a project-by-project basis.

81. Accuracy in supervision reporting is a central priority and ratings for Egypt are 100 percent realistic. The Country Team is committed to their remaining so. Proactivity has fluctuated in light of implementation difficulties with the Health Sector Reform Project, which is now satisfactory. At the end of this FY the proactivity index is forecast to be 100 percent.

82. In general, accounting standards and contracting and procurement arrangements are good. A Country Financial Accountability Assessment (CFAA) was completed in 1997, and a desk update is currently under review. The last Country Procurement Assessment Report (CPAR), which was done in 1994, was updated in 1998. A CPAR update and a full CFAA are planned for FY02 and FY03, respectively. Moreover, as part of the Government's effort to improve the efficiency and effectiveness of public investment and budgeting, Bank assistance has been requested for improved investment analysis, monitoring and evaluation (M & E) and results-based management. Egypt has been selected as the region's pilot for intensive M & E support. So far, WBI has delivered course material, an economy wide diagnostic of M & E capacity has been carried out, and an IDF grant planned to support the basic institutional development.

83. For the future, four considerations will dominate the Bank's portfolio management: (i) closer management of closing dates to ensure speedier delivery of project benefits; (ii) greater success on the part of the Government and the Bank to reduce effectiveness delays; (iii) a special effort to reduce the use of PMUs to ensure sustainability of project outcomes, and (iv) while early indications of parallel financing with development partners for the Bank's proposed new operations are positive, discussions will be initiated with the Government to move away from the project-by-project to a more macro or sectoral requirement of meeting the 40 percent grant element.

G. IFC Portfolio Management and Performance

84. IFC had a record year in FY01 with approval of eight projects for US$177 million for IFC's account and an additional US$305 million for participants. As a result, as of April 30, 2001, IFC had outstanding committed investments of US$328 million in Egypt in 19 companies, plus an additional US$305 for the account of participants.

85. IFC's investments are in the sectors of general manufacturing (steel, cement, paper), infrastructure, extraction of fuels, hotels, financial markets and chemicals (see Table 5). On a

volume basis, the highest level of IFC's investments has been in general manufacturing. The largest number of projects are in the financial sector where IFC has invested in the equity of companies engaged in commercial banking, leasing, life insurance, investment banking and in an offshore fund that invests in listed equities.

TABLE 5: SECTOR DISTRIBUTION OF IFC'S EGYPT PORTFOLIO
(Projected Shares by End FY-01)

Sector	Percentage of Committed Portfolio
Manufacturing	43%
Infrastructure	24%
Financial Services	14%
Mining/Extraction of Fuels	8%
Hotels & Tourism	7%
Chemicals & Petrochemicals	4%

86. As of April 30, 2001, 15.9 percent of IFC's disbursed loan portfolio in Egypt was in non-accrual status compared to 13.2 percent for IFC as a whole. All the non-accrual is on account of one investment, Misr Compressors.

87. IFC's activities in Egypt over the FY97-01 period have been consistent with the country strategy articulated in the previous CAS which indicated that IFC's investments would continue to focus on infrastructure, the financial sector, oil and gas, tourism, and key industrial activities.

88. In infrastructure, IFC approved and committed investments in FY01 of US$96 million for its own account and up to US$305 million under the "B" loan program in two investments to build and operate power plants at Port Said and Suez Gulf. In the financial sector, IFC focused on the creation of new specialized financial institutions and approved investments in a life insurance company, an investment bank, and a regional credit rating agency that launched a subsidiary in Egypt becoming the country's first rating company. IFC also helped mobilize capital for Egypt's burgeoning stock market by establishing an offshore closed-end fund investing in listed Egyptian equities. Total approvals in the financial sector in the period FY97-01 amount to US$44 million, all for IFC's own account.

89. In the industrial sector, IFC approved investments in nine companies producing steel, cement, carbon black, industrial gases, corrugated boxes and autoparts in the FY97-FY01 period totaling almost US$279 million of which US$199 million was for IFC's account and US$80 million under the "B" loan program. In tourism, US$26 million in loans and equity was approved mostly to expand an integrated tourist resort on the Red Sea coast.

90. IFC advisory activity since the last CAS included: conducting the financial and technical assessment of an integrated steel mill and arranging the financing for the company's investments to produce flat products; and providing advice on removing impediments to local bond market development, with financing from the Technical Assistance Trust Funds (TATF). In addition, the Foreign Investment Advisory Services (FIAS) was involved in several advisory assignments to: recommend reforms of investment procedures and institutions inhibiting FDI; and develop an FDI database and a general investment promotion strategy.

H. MIGA's Involvement in Egypt

91. Egypt has been a member of MIGA since 1988. As of December 31, 2000, MIGA has not yet provided any guarantees for investments into Egypt. However, it has covered three Egyptian overseas investments into sub-Saharan Africa for a total amount of US$14.7 million. In the second quarter of FY00, MIGA conducted a marketing trip to Egypt in recognition of the country's potential both as a host country for investments and as a source of foreign direct investments. The Agency received considerable interest from both Egyptian and foreign companies, the latter primarily for investments in the infrastructure sector. MIGA's per-project limit of up to US$200 million, its ability to syndicate additional insurance on the private market, as well as providing guarantees against Breach of Contract, which it provides on a case-by-case basis, position the Agency well to facilitate infrastructure projects and other types of investments. In the years to come, this is expected to translate into real applications and projects covered by MIGA for both inward and outward investments.

92. In FY00, MIGA's Investment Marketing Department assisted the Ministry of Public Enterprises in establishing a marketing presence on the Internet for the Egyptian privatization program through the Privatization Link. MIGA initially concluded a Memorandum of Understanding with the Ministry and has since provided technical assistance in mobilizing information on state-owned enterprises being divested, as well as the sales procedures and intermediaries being employed. Current efforts are underway to mobilize additional enterprise information from the Ministry of Economy and other ministries that are supervising the privatization of utilities, joint venture participation, and other state-owned assets.

I. Experience with the Decentralization of the Bank Group Country Management to the Field

93. The previous CAS was presented to the Board immediately prior to the decentralization of the Bank's Egypt Country Management Unit (CMU) to Cairo. Almost four years into the process of decentralization, many of the expected benefits from this move have been realized. Among these, the most noteworthy are: (a) closer dialogue with the clients on sectoral issues, especially with ministries and agencies such as education, health, rural development, water resources, and environment. This has undoubtedly increased the effectiveness of Bank interventions; (b) improved quality of portfolio management, with the CMU playing a critically important role in financial management, procurement, disbursement and other portfolio follow up; (c) significant improvement in the development and maintenance of partnerships with other donors (see paras. 97-100), private sector, academia, press and NGOs; and (d) a greatly enhanced comprehension of the political, social and economic realities of the country, which has made Bank interventions based more on realities on the ground.

94. Overall, there has been an improvement in country dialogue, although it needs to expand to certain important areas such as private sector development, financial sector reform and targeted poverty alleviation.[1] The expansion of the Bank's role in these areas would serve as triggers for the base and high cases in the present CAS.

95. Until about a year ago, the management structure of the CMU consisted of the Country Director in Cairo, a Deputy Resident Representative in Cairo, and a Country Coordinator at

[1] OED Country Assistance Evaluation of January 2000 notes: "The general dialogue with Government has markedly improved over the last several years, and this should be recognized as an important accomplishment, but it may have been at the cost of broadening that dialogue into other areas."

Headquarters. As of July 1, 2000, the position of Country Coordinator for Egypt was abolished, and as of January 1, 2001, as part of the overall reorganization in the MENA Region, a new CMU was established, still based in Cairo but also covering two additional active IDA countries – Yemen and Djibouti. Apart from improving client effectiveness for Yemen and Djibouti, this arrangement will also spread overhead costs in a much more affordable manner.

96. IFC also decentralized to the field, with the Regional Director now based in Cairo, and covering the entire MENA Region. In addition to the Regional Director, the IFC Cairo Office has six professional staff, including a lawyer.

V. COORDINATION WITH DEVELOPMENT PARTNERS

97. Owing to its size and geopolitical importance, Egypt receives relatively high levels of ODA, and Cairo houses representatives of almost all bilateral and multilateral development organizations (many of which operate on a regional basis). Effective partnership among and between donors and government is therefore vital. On a per capita basis net ODA flows to Egypt since 1990 have been among the highest in the world. FY91 (the time of the Gulf War) was an especially exceptional year in which Egypt received almost US$7.5 billion of ODA in one year. In the current FY the amount is lower (US$4.7 billion) but still significant.

98. The US and the EU are the predominant assistance providers to Egypt. Development assistance from the US has averaged about US$1 billion per year, but is now slowly diminishing (below US$800 million this year). EU assistance, aggregating that of the Community and the individual bilateral programs, also amounts to about US$1 billion per year. In addition, the regional development banks and Japan are all actively providing low cost resources. In this context, Egypt has maintained a strategy of maximizing grant funds and borrowing cautiously.

99. Donor coordination takes place at three levels for Egypt. The Consultative Group, chaired by the Bank, is held every three years (next scheduled for October 2001). In addition, a Donor Assistance Group (DAG), currently chaired by the Netherlands, meets monthly in Cairo. The DAG in turn has four sectoral subgroups, which meet as needed. Finally, under the leadership of the UN Resident Coordinator, there is a UN Heads of Agency Group which meets quarterly. The IMF representative and the Bank Country Director consult regularly in addition to the above. The Bank participates actively in the DAG and Heads of Agency Group and the subgroups of the DAG in human resource development and agriculture. All DAG meetings are periodically attended by representatives of government. These meetings are useful in articulating linkages between the extensive technical assistance and analytical work of bilateral donors with Bank Group work.

100. During the CAS preparation process, donor programs (lending, TA and analytic work) were reviewed to identify gaps and complementarities. Overall, the results show a high degree of complementarity and cooperation among donor programs, although there are some gaps as well. The Netherlands, Germany, Japan and the Bank are the major donors working on water management issues. The EU, USAID, the Bank and the rest of the UN family are working jointly to develop human capital. Italy, Germany and Canada have programs on small enterprise development, and the EU and USAID actively support privatization and industrial restructuring. The Arab Funds are playing an important role in infrastructure and land reclamation. Italy and the US are both working on cultural heritage issues. Gaps in the development effort are both analytical and operational. Analytically, knowledge about the incidence of poverty, public expenditures and financial system is very weak. Operationally, agriculture and rural development receive modest attention, as does water treatment and sanitation. Civil service reform is a high priority area which is not being tackled, and the various donor and government initiatives on women and children lack coherence. As part of the

preparation for the Consultative Group meeting, prioritization and allocation of responsibilities among the development partners will be firmed up, in close coordination with the Egyptian authorities.

BOX D. MAJOR DONORS IN EGYPT

The United States

The United States is the most significant contributor of development assistance to Egypt. Between 1975 and 2000 Egypt received about US$25 billion in ODA from the U.S. Current annual assistance is slightly below US$800 million and is diminishing at about US$40 million per year. U.S. Assistance is concentrated in four areas: 1) economic growth, which is essentially a cash transfer against policy reform, with an emphasis on privatization 2) human resource development which comprises projects in health, education and population; 3) science and technology which is a new initiative to strengthen Egypt's capacities in IT; and 4) environmental protection. USAID has existing programs in power, telecommunications, agriculture and water, all of which will be phased down. In addition to the above, USAID provides significant amounts of technical assistance, analytical support and training.

The European Union

The major EU instrument for assistance to Egypt is the MEDA grant program in support of the Euro-Med partnership. There are four large programs underway, valued at Euro 615 million: 1) education enhancement; 2) health sector reform; 3) the Social Fund for Development; and 4) industrial modernization. There are additional programs in private sector development, public enterprise reform and privatization, banking sector reform and family planning. The EU provides additional support to Egypt through some of its regional programs and through the EIB. With the recent initialing of an Egypt/EU Association Agreement there could be increases in the amount and scope of EU assistance.

Germany

Current annual commitments to Egypt amount to about US$70 million equivalent, comprising loans, grants and technical assistance. Grants and loans are focused on the environment (industrial pollution and wind energy), water supply and water management, urban development and the SFD. Technical assistance programs support vocational education (Kohl-Mubarak Initiative), agriculture and solid waste management. Current assistance levels by Germany are expected to remain stable over the foreseeable future. Future German development cooperation will be concentrated on three areas: water (water supply & sanitation, irrigation & drainage), social market economy (financial system, employment creation, small and medium enterprises, vocational training) and environment (renewable energy, solid waste management, industrial environmental protection, sustainable use of natural resources).

Japan

Japan provides grants and soft loans to Egypt. Cumulative grants amount to about US$1 billion and the current most significant one finances the first bridge spanning the Suez Canal. After a decade-long moratorium on lending, Japan reopened its soft loan window in 2000 and will focus on the environment, technology, human development and small and medium enterprises. On the technical assistance side, Japan supports transportation planning, improved management of the Suez Canal, water supply, environmental monitoring, water management in irrigation, pediatric emergency care and metal processing technology.

Arab Funds, IsDB, and AfDB

The Abu Dhabi Fund for Development, the Arab Fund for Economic and Social Development, the Kuwait Fund for Development, the Saudi Fund for Development and the Islamic Development Bank are all significant donors to Egypt. Total commitments from them since they began operations in Egypt cumulate to about US$2.8 billion, concentrated in industry, infrastructure, housing and the Social Fund. AfDB commitments to date are about US$1.3 billion and it has programmed a lending ceiling of about US$500 million per year for Egypt over the coming three years. The emphasis is on private sector development through credit programs and direct investments in human development.

Others

Although less important in terms of financial flows, other bilateral and multilateral agencies contribute significantly, especially in terms of technical assistance and training. Among the bilaterals, Canada, Denmark, Finland, Italy, the Netherlands, Spain, Sweden, Switzerland, and the UK are important. Among the multilaterals the main partners are IFAD, UNDP, UNICEF and World Food Program (WFP).

VI. BANK EXPOSURE AND RISKS

101. Egypt has continued to maintain a very good track record in servicing debt to the Bank Group. Bank exposure in Egypt is moderate. At end-2000, Egypt had IBRD debt outstanding and disbursed of about US$639 million, accounting for 2.2 percent of its external debt. If Egypt were to borrow from IBRD at the base case level of US$450-500 million during the period FY02-04, IBRD share in the total external debt is likely to remain around the same level. Within this framework, Egypt's debt service to IBRD as a share of its exports is expected to decrease to around 0.4 percent. At the average borrowing level of US$150 million a year, Egypt's debt service to IBRD as a share of its overall external debt service would be around 6-7 percent as compared with the guideline of 20 percent. Egypt's preferred creditor debt service relative to external debt service would decline from about 29 percent currently to around 27 percent by 2004, compared to the guideline of 35 percent.

102. Despite recently emerging economic difficulties, Egypt is unlikely to face a major risk of BOP crisis in the short-term. The country's reserves, despite their recent decline, remain adequate, at about US$14 billion, or more than eight months of imports. The authorities are expected to continue with their cautious attitude to new foreign borrowing, which has allowed the debt service to export ratio to decline to 8 percent. Short-term debt is also relatively small, at 6.5 percent of the total debt and 12 percent of reserves. The gradual depreciation of the pound since the summer of 2000 should also ensure reduced pressure on reserves and the balance of payments. However, the ability of the new exchange rate regime established by the Central Bank in January 2001 in dealing with any further pressure remains to be tested. And beyond exchange rate management, further trade liberalization would be required to improve the competitiveness of Egyptian exports and to reduce pressure on the current balance, as the short-term vulnerability of the balance of payments to domestic and external shocks remains high, as demonstrated in 1997-98.

103. In the medium-term, the implementation of the Bank Group's proposed assistance strategy faces two main risks: deterioration of the external environment and a slowdown in the pace of structural reforms.

104. At the international level, there is a risk that new disturbances in international markets may reduce private capital inflows that Egypt counts on to finance a sizeable portion of its investments. Egypt's foreign exchange earnings are also highly vulnerable to regional political developments and shocks. Workers' remittances, tourism, Suez Canal receipts, oil proceeds and foreign assistance are all susceptible to international developments, and particularly to the Middle East peace process. The untapped peace dividend in the region is huge, but the eruption of serious regional hostilities could lead to devastating effects on the Egyptian economy. While the gradual integration of the country's economy in the global economy should open up new opportunities and gradually reduce the overall volatility of foreign exchange receipts, it will also demand a much more proactive and vigilant management of the economy.

105. At the domestic level, Egypt faces the risk of fiscal unsustainability, notably if the expansionary financing of the mega projects were to continue with little improvement in tax revenues, or if the government were to assume some contingent liabilities (e.g., banking system, social security, guarantees to private sector). Under the most likely scenario, the fiscal deficit would remain in the range of 4.0-4.5 percent of GDP during 2001-2005. However, a liquidity crisis in some banks could represent a significant downside risk on public finance. In this latter regard, it is believed that the intermittent shortages in liquidity during the past two years, both in foreign and local currencies, have strained credit quality of the banks' portfolio, while the overall operating

environment of the banking sector has deteriorated in the context of lower GDP growth performance and declining real estate prices. Foreign currency borrowings by some large borrowers might also have been insufficiently hedged.[1] Although loan loss provisions have been built up and the Central Bank of Egypt maintains close monitoring, some public banks may remain significantly under-provisioned and under-capitalized.

106. The World Bank Group will work closely with the Egyptian authorities and other development partners to monitor the situation and help minimize these risks. Monitoring the macroeconomic situation is an important element in the Bank's policy dialogue. In the event of a major shock, the Bank would stand ready to support an agreed upon reform program through appropriate instruments.

James D. Wolfensohn
President

By:
Shengman Zhang

Peter L. Woicke

Washington, DC
June 5, 2001

[1] Further insight on the stability of the financial sector is critically needed. A Financial Sector Assessment Program (FSAP) report is under consideration by the Government for FY03.

World Bank Group Private Sector Strategy

Introduction

Private Sector Development (PSD) is critical for improving living standards and sustainable job creation as well as promoting Egypt's successful integration into the global economy. For the poor in particular, security, opportunity and empowerment will accrue primarily through job creation while access to infrastructure is becoming a critical need. The private sector can play a major role in not only providing this infrastructure but moving the economy to a more productive and globally competitive level. The World Bank Group (WBG)[1] will continue to support PSD as it remains a key element in the WBG's current CAS objectives.

Key Challenges

Egypt's key challenge is to sustain and accelerate growth in order to alleviate high unemployment and to pursue successful integration into the global economy. Overcoming both these challenges requires an expanded role for the private sector which is increasingly viewed as the motor of growth and raising competitiveness.

While private sector investment and growth have improved following the stabilization period, the pace of investment and productivity are significantly lower than what is needed to accommodate rapid labor force growth and demographic pressures. Continued and accelerated progress on improving private sector incentives through trade liberalization, privatization, public sector reform, and financial sector development are becoming critical. In today's global economy however, rapid technological change, shorter product cycles and developments in the IT sector have combined with privatization, trade and foreign investment liberalization to produce a very different business environment. The private sector will therefore need to adapt and respond to new ways of doing business–increased rates of innovation, new modes of competition, shorter process and product cycles–which are emerging from the global-wide diffusion of e-commerce and IT.

The Government of Egypt has embarked on a set of policies to accelerate "second generation" reforms to create a business environment conducive to private investment by enhancing public-private dialogue and cooperation, promoting a sound business environment and momentum on the privatization program, upgrading external competitiveness and technological capacity and boosting SME sector. These reforms are crucial for Egypt's ability to improve its economic growth performance and to compete successfully in the global market.

WBG Activity Since the Last CAS

The Bank Activity in PSD since the last CAS has been modest as Egypt has been able to maintain high reserves and therefore has not required Bank assistance. In the period under review, the Bank has carried out the following main activities in the PSD sector: (i) preparation of a financial

[1] WBG refers to IBRD, IFC and MIGA.

sector credit (PBDAC), (ii) participation in a joint World Bank/Government of Egypt business environment task force, and (iii) sector policy advice on Private Provision of Infrastructure.

IFC has had an active pipeline in Egypt, with equity and loan investments in manufacturing, financial and infrastructure sectors, including participation in the first private sector power generation projects.

MIGA has not provided any guarantees to Egypt. The principal reason has been the reluctance of the government to provide counter guarantees.

The Government is looking to (i) develop an effective partnership with the Bank that enables it to access the Bank's knowledge resources on PSD topics and (ii) if the need arises, access to financial resources.

Vision

There are five inter-linked themes to Egypt's vision for the private sector:

- Redefining how the public and private sector work together and reorienting the public sector - *Collaboration*

- Promoting an enabling environment for private sector development to eliminate constraints and meet international standards of service and cost – *A sound business environment.*

- Allowing the private sector to take complete control of all productive sectors in the economy over time – *Privatization.*

- Creating an environment that nurtures Small and Medium Enterprises (SME's) and allows them to fully develop their potential as well as to ensure access to markets, resources and infrastructure – *Nurturing.*

- Ensuring full participation in the global market and striking a balance between the "old" versus "new economy" – *Globalization.*

Overlaying these themes is the need to: (a) reform the *financial sector,* and (b) strengthen *infrastructure.*

Private Sector Development Priorities

Redefining the public and private sector so they can work together in a collaborative manner.

The agenda for private sector growth in Egypt has been clear for many years –discussion of ways to create an improved business environment that leads to better competitiveness, privatization, support for SME's, and financial sector strengthening have occurred many times. Why hasn't more progress been made in implementing this agenda? In large part the answer lies in the way the public

sector and private sector interact or do not interact. It is generally recognized there is substantial room for improvement in this relationship.

The lack of mutual understanding and trust between public and private sectors dates back to the state-building period and today reflects the fact that neither party has clearly articulated its roles and responsibilities in a modern economy.

Moving forward on this issue requires three main initiatives:

- Defining clear lines of trust and responsibility between the public and private sectors.
- A concerted effort to strengthen private sector's voice – through the creation of stronger business agencies, and a willingness on the Government side to consult.
- Civil service reform that discourages rent seeking, improves accountability and moves the civil service towards greater efficiency and effectiveness is clearly important.

The first and second initiatives are designed to promote a more collaborative overall partnership between the public and private sectors that will include: (i) finding a way for the public and private sector to work together on a case by case basis in resolving and streamlining the many business environment concerns; (ii) developing stronger business to business dialogue and linkages to supply industry and market specific information as well as provide a forum for lobbying on industry specific concerns; and (iii) bringing the informal sector into the fold, and at the same time giving it voice.

Civil service reform is central to every aspect of economic reform in Egypt and is extremely important to the successful implementation of the PSD agenda. Strengthening approaches to privatization, reducing red tape for the informal sector, reforming the financial sector, promoting the "new economy," and creating effective public private partnerships all require sustained civil service reform. However the reform process itself is dynamic and interactive--all of these policies will interact with and shape the reform process itself. New applications arising out of Information and Communications Technology (ICT) provide mechanisms to reduce and automate aspects of the civil service, privatization reduces its power and size and sends powerful signals. Thus a push-pull approach needs to be developed where one reform leads to another and then another.

Promoting an enabling environment for private sector development to eliminate constraints and meet international standards of service and cost.

To be the main engine of growth and employment generation in Egypt, the private sector requires: (a) a stable and liberal policy and incentive framework; (b) a business environment conducive to private sector activity where the rules of the game are transparent and clear, and transactions costs are minimized; (c) easy access to key financial, technical and information resources, and to markets; (d) low cost and high quality infrastructure services and (e) a first class labor resource.

- <u>Incentive Framework.</u> *The current policy environment inhibits competition* and distorts the incentives for firms to become more efficient and internationally competitive. Many sectors

continue to enjoy high rates of effective protection from imports, an issue of particular concern with respect to the EU Association Agreement, and has the effect of re-deploying resources toward protected sectors during the interim period. In spite of progress on privatization, continued state dominance in a number of sectors impedes private entry and access to resources. Finally, Egypt lacks a Competition Law and a regulatory agency to limit anti-competitive behavior in markets.

- Business Environment Related Issues. Private operators often indicate *the tax system and customs administration* as a primary constraint. The system operates in a way that imposes uncertainty, delays and excess costs on Egyptian businesses, particularly small and medium enterprises (SMEs). Officials continue to exercise considerable discretion in the application of tax and trade-related regulations, raising compliance costs and evasion[1]. There may be scope for streamlining tax incentives for new investments to make them more effective. *The commercial legal system* is also regarded as too slow, expensive and cumbersome in resolving commercial legal disputes and therefore is not heavily relied on by businesses. This limits the development of impersonal and complex contracting and raises the cost of business transactions[2]. *Secondary issues* that emerge from recent work, include (a) business and investment licensing; and (b) labor regulation.

- Access to Resources. *The financial system,* is characterized by a low level of competition, relatively high intermediation costs and a low level of innovation. This set-up has limited the access to credit for new firms and in particular emerging private SMEs. *Human resources* that have appropriate vocational and technical training are central to meeting the demands of the private sector and the new economy.

- Infrastructure. *Infrastructure services* impose excess costs on Egyptian firms both exporters and non-exporters, limiting their competitiveness and discouraging investment. Port services are slow and costly. Evidence also suggests that there are constraints in domestic transport (in part due to the limited road density), telecommunications and reliable electric power supply. Finally access to land or industrial sites also presents a constraint to private sector activity.[3] (A fuller discussion can be found below).

Privatization to ensure full participation by the private sector in all productive sectors in the economy.

Despite launching one of the most successful privatization programs around the world during the 1990s,[4] the overall contribution of the public sector to GDP has remained virtually unchanged in

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[1] It also appears that considerable administrative delays in releasing customs (duty drawback related) letters of guarantee is choking off the access to credit for exporting medium sized firms.

[2] A new Commercial Law has been under preparation for some time and is expected to be presented to Parliament in the coming months.

[3] A recent FIAS study has highlighted business incorporation procedures, access to land and constraints on site development as key constraints to FDI. Labor regulations, while formally cumbersome, are not widely enforced, but may deter large companies from investing or distort their investment decisions towards more capital-intensive, less employment-creating technologies. Also it increases reliance on short term, sometimes informal employment which in turn leads to insufficient investment in staff training.

[4] Measured in percentage of GDP privatized per annum.

the last decade. Most infrastructure activities and large financial institutions are controlled by Government, which also retains substantial holdings of public enterprises. This share of participation - at around 25% - is very high relative to other non-transitional economies and SOE's.

This high share of public activity has significant negative impacts:

- It crowds out the private sector and likely contributes to low productivity.
- It perpetuates an environment which is not conducive for private provision of infrastructure and the public sector has difficulty addressing the investment needs of the infrastructure and social sectors.
- Key providers of financial and infrastructure inputs to the private sector are neither efficient nor effective, which reduces the private sector's overall competitiveness .

To resolve these problems the following is required:

- Strengthening the management of the privatization program.
- Effective "commercial" corporatization of state-owned enterprises and economic activities that continue to be held at both the central government and municipal levels.
- Attention to investors' risk concerns through the development of financial instruments such as guarantees.
- Ensuring a level playing field as between foreigners and local investors on matters such as withholding taxes. This stands at 32% on interest payments to foreign lenders and is a major obstacle to foreign financing. [1]
- Developing a coordinated regulatory and policy regime that is consistent with the needs of a privately held infrastructure sector.
- Provision of substantial financial and other supportive resources to deal with restructuring and commercialization costs.

Creating an environment that nurtures SME's and Microenterprises and allows them to fully develop their potential.

SMEs and micro enterprises are a significant force in the Egyptian economy. Enterprises with less than 10 workers are estimated to contribute 80% of private sector value added and account for 75% of private sector employment.

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[1] In the Sidi Krir BOOT, investors were able to minimize the impact by taking advantage of the double taxation treaty with Switzerland.

SMEs receive little support from Government and are faced with a complicated and opaque tax and business regulatory regime. Moreover there is little incentive for them to join the formal sector; formalization does not necessarily lead to better access to land, capital and know-how and it is costly from the vantage point of tax reporting. This has the following unfortunate consequences:

- SMEs that are the future growth poles of the economy opt out of the formal sector, which means that growth and employment potential is lost.

- Rent seeking associated with allowing continued informality from within the administration is encouraged, which reinforces the problem.

- Those businesses that do chose to locate within the formal sector suffer from unfair competition – their competitors have a significantly lower cost structure.

Helping SMEs revolves around the following four areas:

- Providing access to finance, through the general strengthening of the financial sector mentioned above.

- Reducing and simplifying the bureaucratic red tape that overwhelms Egyptian businesses but particularly SMEs.

- Strengthening marketing channels, to ensure better information and support is available.

- Reforming the taxation system so that it is not unduly onerous, and is fair and simple to administer.

Micro enterprises would benefit from the encouragement of (i) micro financial institutions that are managed by private sector or non Governmental entities, and (ii) the availability of basic business know how (business administration and management, preparation of financial records, marketing).

Ensuring full participation in the global market, striking a balance between the old and "new economy".

To take advantage of globalization, Egypt needs to: (i) improve its export performance in non-oil sectors; and (ii) develop a strong "new economy" capability. A recent survey of private manufacturing firms suggests that the most binding constraints to firms include high tariff rates on imported inputs, lack of marketing and distributing companies, ineffective duty drawback regimes, cumbersome export procedures and absence of export credit and insurance services, particularly for SMEs. The severity of these constraints appears to be high in industries where Egypt appears to have a revealed comparative advantage: textiles and food products.

Competition in global markets is further hampered by a lack of managerial expertise with respect to exporting and high unit costs created by low capacity utilization. Egyptian firms also tend to lack internal facilities for international market promotion and appear to be caught in a cycle of

high domestic process for inputs, low domestic demand, low utilization of plant capacity and lack of incentives to expand output for world markets. Redundant labor was also reported to be a negative factor affecting competitiveness primarily from public sector firms. (Cassing et al 2000).

Export Processing Zones have not lived up to their potential in terms of generating foreign exchange earnings, employment and attracting FDI. Data on the performance of the EPZs is inadequate to monitor performance, objectives are unclear and there are few if any requirements regarding exports for firms registering in the zone.

Adopting a strategy to improve export competitiveness will require the following:

- A concentrated move towards a lower, more uniform tariff schedule.
- Overhaul of customs procedures to allow automatic clearance of products. Adoption of harmonized international standards and procedures to place producers on equal footing with international competitors. Streamline duty drawback and temporary admission procedures.
- Export finance focused particularly on SME sector.
- Better monitoring of EPZ sector, ensure that exporters have access to duty free inputs and benefit from infrastructure, tax, labor and environmental regulations in the zone. Enhanced role of private sector in management and operation of EPZs and overseas marketing of EPZs.

While Egypt is without a doubt the leader in the Arab world in the new economy (the main area being Information and Communications Technology (ICT)) and has demonstrated a comparative advantage in this sector, much remains to be done if Egypt is to expand these capacities. Globalization trends are facilitating new and innovative uses of ICT which further reinforces an accelerated pace of globalization. This implies that the costs of delayed upgrading technological capacity are rising, as demonstrated by the fact that in many developing countries, ICT-based approach is outperforming the traditional approach in accelerating economic and employment growth and contributing towards the quality of life.

Adopting a strategy in this area mutually reinforces many of the themes in generally strengthening the business environment.

- The heart of ICT is the e-Commerce infrastructure which requires strengthening the financial services sector and in particular promoting the widespread use of credit cards and automatic payment systems.
- Telecommunications and in particular internet infrastructure is also very important through links with overall infrastructure reform.
- Strengthening the general legal environment in terms of protecting intellectual property, financial regulation and the development of new cyber-laws.

In addition specific work is required to create awareness, promote Arabic content on websites, encourage market niches in this area and develop and retain human resources. Without a focus in this last area Egypt will continue to lose its brightest and best ICT professionals abroad.

Reforming the Financial Sector

From a strategic perspective, inefficiencies in the Egyptian financial sector system are the major issue, i.e. the total costs involved in the intermediation process. These costs are being incurred by the GOE (though perhaps not immediately realized) through the explicit and implicit subsidies (in terms of capital depreciation) and by the private sector (through the relatively high cost of funds - real interest rates to medium borrowers now probably approach 10% - and lack of access to credit).

Egyptian authorities feel that this problem can be resolved through a gradual program of institutional and policy reforms, with a particular focus on the state banks, while allowing greater freedom for the private sector to increase its share of the market. But, while some of these measures, in particular improved accounting and auditing standards and an enhanced supervisory regime, are essential and should be expedited, international experience, in widely different economic contexts, shows consistently that: a) sound financial systems cannot be built on or around dysfunctional banking systems; and b) banking systems dominated by state banks can only be reformed effectively through an aggressive program of privatization that is designed to change ownership, governance and introduce market discipline. Such a program has to be complemented with other measures to enhance regulation, supervision and competition and diversity in the system. Of course there are other issues, ranging from the need to build up the debt markets at one end and for better and more accessible housing finance and more market based rural credit at the other—to provide the diversity of products/institutions needed to support a more dynamic economy and ensure a stronger financial system. But in terms of strategic priorities the issue of the health of the banking system needs to be emphasized.

Strengthening the Infrastructure Sectors

The overriding infrastructure issue in Egypt is finding adequate levels of investment to both maintain existing assets and provide for new projects. Every infrastructure sub-sector is under-capitalized. Government revenues are not enough to support the level of investment required, and only the participation of the private sector can ensure adequate funds. BOTs have been attempted in energy, ports and roads, and some small concessions granted for water and wastewater services.

The main tool to involve the private sector and expand access to infrastructure is the promotion of entry and competition into the infrastructure sectors. This in turn would require adapting the regulatory framework to an environment with more numerous, and more diverse, players, and to the objective of expanding access. This might imply, for example, removing barriers to entry, adapting quality standards to willingness to pay, establishing targeted subsidy systems compatible with opening of sector to competition, and simplifying regulatory processes to enable small, less sophisticated operators, to participate.

Infrastructure issues to be addressed might include: the need for cross sectoral policies which encompass complementary or inter-related activities (e.g. gas and electricity); cross-sector

considerations on tariffs and subsidy mechanisms; and a consideration of whether regulatory institutions could/should be set up on a cross-sector basis.

World Bank Group Assistance Strategy

Overview

Egypt is fortunate in that it enjoys strong donor support from a wide variety of institutions including USAID, the EU, UNDP, AfDB, Kuwait Fund, KfW and the Islamic Development Bank. In broad terms the WBG strategy is to work in partnership with other donors to provide the following support:

The Bank will; (i) facilitate knowledge sharing on the implementation aspects of the agenda and (ii) provide financial resources to fund the significant implementation and restructuring costs arising from privatization and financial sector reform. The primary area where the Bank can help is facilitating the public/private partnership dialogue which is seen as the starting point for meaningful reform. In parallel, specific technical assistance can be provided in areas that will accelerate the forces for change, such as privatization, PPI and civil service reform.

To deliver on this agenda the Bank will work closely with the Government and other members of the donor community to develop innovative "low cost" financing packages and develop mechanisms for the provision of reimbursable technical assistance by the Bank.

IFC will focus on; (i) supporting PPI initiatives with either guarantee, capital or advisory services as the case may require, (ii) assisting the development of new financial sector institutions and instruments for the private sector, (iii) catalyzing new private sector investment in both the traditional (manufacturing, oil and gas and tourism), social sector and new economy sectors, (iv) supporting SME initiatives.

MIGA will remain available to provide guarantee instruments to facilitate new private sector investment, if required.

The Bank will work closely with the IFC and MIGA to develop projects incorporating public policy and institution building components that support direct lending to the private sector. Matrix A summarizes the complementarity of the Bank Group PSD assistance. Such projects could include privately supplied housing and infrastructure services and municipal finance.

Detailed Proposals

The following is a list of detailed proposals based on the five themes discussed above–namely collaboration, business environment, privatization, nurturing of SMEs and boosting globalization and integration of the new economy–all of which support the broader goals of improving growth performance, employment generation and competitiveness while enhancing Egypt's integration into the global economy.

Matrix A: Complementarity of the Bank Group PSD Assistance

	Bank	IFC
Financial sector The Bank Group would focus on enhancing legal and regulatory environment and strengthening the banking sector and the payments system, which would pave the way for increased IFC involvement.	- Non-lending services focused on capital market development and mortgage markets. - TA to strengthen the capacity of middle management in the Central Bank, and establish a primary market for Government securities. - Possible lending aimed at developing mortgage markets.	- TA/advice on and investment in innovative financial instruments or structures to build institutions in mortgage finance, underwriting and trading of bonds, and factoring. - Medium to long – term loans to banks and non-bank financial intermediaries. - Collaborate with the Bank on mortgage market development, by intervening in primary markets or becoming a shareholder of a secondary mortgage market institution.
SME development The Bank would focus on improving the business environment and collaborate with the IFC to reduce the constraints to SME development (finance, market access, etc.).	- Lending (under "high case scenario") to develop export finance mechanisms (e.g., pre-shipment export finance guarantees). - TA/ESW to help create a legal and regulatory framework conducive to SME development.	- Focused lending to facilitate access to finance (investments in credit lines, risk capital, guarantees, or non-bank financing instruments, such as leasing). - Extended African Project Development Facility to Egypt. - Selected direct investments in companies with clear development impact (e.g. IT).
Privatization	- TA to improve performance of public enterprises through the development of monitoring and management mechanisms, and corporatization. - Pilot turn-around fund to encourage privatization of selected public enterprises, if requested.	- Advisory services. - Selected transactions.
Infrastructure	- TA on policy and regulatory reforms in the power sector. - advise municipal authorities on PSP options in the water sector.	- IFC investments in IPPs in power. - Potential investments in diverse sectors such as water and wastewater, ports and airports.
Information and communication technology	- Lending and TA support in: (a) ICT Education; (b) capacity building of the Telecom Regulatory Authority; (c) preparation of a modern legal framework for e-commerce and e-government; (d) reform of postal services.	- Investments in educational facilities and/or technical institutions (in collaboration with the Bank) to promote computer literacy and ICT skills. - Investments in incubators and cyber parks.

In addition to providing a more detailed description of recommended actions, this section also highlights areas of potential comparative advantage for the Bank and IFC.

Detailed proposals under the main themes are set out below:

Collaboration: In recent years the Bank Group has supported a variety of approaches (consultative forums, regulatory complaint offices, and strengthening professional associations) designed to foster ongoing public-private dialogue on the objectives, scope and details of reforms. Such activities have included the creation of Private Sector Foundations in Senegal, Ghana and elsewhere, Competitiveness Review Commissions (Cote d'Ivoire and Cameroon) and simpler networking activities which have helped to harmonize the activities of diverse PSD groups and focus the agenda for public-private debate. To enhance the government –private sector dialogue the Bank Group can support a series of workshops and strengthening institutional and organizational capacity along these lines. A specific component of this work could be to develop conflict resolution mechanisms as well as to upgrade the capacity and support systems of local professional associations and chambers of commerce.

Business Environment: The business and regulatory environment plays a substantial role in determining the commercial orientation and cost structure of the private sector. WBG assistance in this area could include an omnibus ESW policy package addressing the legal-regulatory environment and administrative processes which impose barriers to entry, exit and domestic competition. This would include investment approval processes, competition policy to address nontradable sectors which will complement the trade facilitation component in addition to tax issues. An additional component of this package would be facilitating the private-public dialogue and collaboration.

Privatization: WBG assistance in this area could involve: (a) technical assistance to improve performance of public enterprises through the development of monitoring and management mechanisms, and corporatization; and (b) pilot turn-around funds to encourage privatization of selected public enterprises. In the longer term, depending on the speed of the privatization program, the Bank could provide financial resources to facilitate the program.[1] Privatization advisory services can be provided by the IFC, where the Government would prefer to give IFC a mandate for a particular transaction.

SME Development: In addition to the proposed assistance to create an incentive structure and business environment conducive to private sector (including SME) activity, the Bank Group can provide assistance in three dimensions of SME development: (a) facilitating access to resources, especially finance; (b) providing business development assistance; and (c) helping to build linkages between Egyptian and foreign SMEs. The nature of this assistance, in turn, varies for different categories of SMEs. Egyptian SMEs represent very heterogeneous sectors that consist of a large variety of enterprises in terms of the number of employees, amount of assets, technical competencies, "know-how", dynamism, etc., and range from informal to formal, self-employment to

[1] Turn-around funds catalyze operational and financial turnaround of target companies. The component would structure a package of managerial/technical resources and financing on terms which maximized the incentive of firm management to improve competitiveness and restore profitability, and solicit private sector participation in such a vehicle. The component would also serve to identify tax and regulatory obstacles to corporate restructuring.

enterprises hiring 200 or more workers, artisanal products to high technology products, or subsistence enterprises to those that are more competitive and dynamic.

Specific initiatives could include:

- Focused lending opportunities to facilitate access to finance (e.g., IFC investments in credit lines, risk capital, or non-bank financing instruments, such as leasing, as well as Bank assistance to develop modern export finance mechanisms, including guarantees etc.). The focus would be on sustainability. In addition, financial intermediaries will be targeted for assistance. Opportunities to issue credit lines for direct SME lending, especially in the leasing industry will be examined .

- Developing an ICT package for SMEs in different sectors (see section under ICT).

- As part of the WBG assistance, the business partnership group could help to spur the development of new partnership activities between selected European and Egyptian Chambers of Commerce that would: transfer expertise on best practices of Chamber services for SMEs, encourage linkages amongst European and Egyptian SMEs, and provide SME skills development in joint ventures and e-commerce.

Globalization: Under the CAS high case scenario, the Bank could consider a trade facilitation project which deals with tariff reforms, customs reforms and removing infrastructure and administrative constraints to exports. EPZ development and monitoring could also be included. In addition, the project could include schemes to facilitate access to foreign markets and buyers (e.g., matching grants financed by other donors, or e-commerce schemes managed and operated by professional associations) by Egyptian SME and new exporters.

- The Bank could also assist in the area of Information and Communication Technology. Specifically, a project will be prepared focusing on Information Infrastructure, which could include capacity building of the Telecom Regulatory Agency, preparation of a modern legal framework for e-commerce and e-government and reform of the postal services .

IFC plans to invest directly in internet or IT companies and in internet infrastructure enterprises. FIAS will continue to support efforts to improve the climate for foreign investors.

Financial Sector

The Bank would provide TA to promote the financial reform agenda. Specifically, this TA would focus on building the capacity of middle management in the Central Bank, and establishing a primary market for Government securities. The Bank would also collaborate with the IMF to enhance the legal and regulatory environment in the context of a financial sector assessment (FSAP).

A Mortgage Market capacity building activity could be prepared to provide various financial products that would help the Government in mobilizing at relatively low cost, the large amounts of private funding that will be needed. It may also be possible for the IFC to support a Bank operation by intervening in primary markets or by becoming a possible shareholder of a secondary mortgage market institution.

IFC would follow a three-pronged approach in the financial sector: creating or strengthening existing institutions, providing medium to long-term funding, and deepening the financial sector by developing the bond markets and introducing new financial instruments.

IFC's institution building role will build on the successful experience of setting up joint ventures between local financial institutions and international companies that are industry leaders, to promote the transfer of expertise and best practice. IFC expects to be active in setting up institutions to engage in activities that are as yet undeveloped, including mortgage finance, underwriting and trading of bonds, and factoring. Developing mortgage finance will first entail the growth of a primary market, where existing or new institutions provide mortgages. This is expected to happen with the passage of the mortgage law. A second stage will be the development of a secondary mortgage market, which will need the introduction of securitization and setting up secondary mortgage institutions.

IFC will continue to offer medium to long-term loans to the financial sector, to banks and to non-bank financial intermediaries. The maturities offered by IFC are longer than those available from other sources, and would enable financial institutions to better manage their balance sheets. Extending financing to intermediaries engaged in the SME sector, such as leasing companies, will be the focus of particular attention.

Developing the corporate bond market, and fixed income markets more generally, is an important component of general financial sector development. An active, well functioning primary market provides an important corporate finance tool that can reduce interest rate, foreign currency and refunding risk. Egypt has a somewhat active primary corporate bond market (although activity has dropped off sharply recently) with established procedures, but an illiquid secondary market. IFC has provided advisory services to the Capital Markets Authority on developing the corporate debt market, and will seek to complement that by setting up a new institution(s) or strengthening existing ones that underwrite and trade debt instruments. This activity would also support development of an active government securities market, which provides benchmark interest rates across the maturity spectrum, among other financial sector benefits.

Infrastructure

The Bank Group has and can continue to play a role in the infrastructure area, and increasingly in the private provision of infrastructure. Areas for Bank and IFC activity include power, water and wastewater, and ports and airports. Over the short term the role of the Bank in this sector would be to provide technical assistance on policy reforms and needed regulatory framework. IFC's involvement include both advisory activities and investment.

The water and sanitation sector has benefited from substantial donor funding over the past two decades. With donor funding expected to decline, policy advice will focus on attracting private sector participation in the provision of water and sanitation services. Low water tariffs are a major impediment to private sector participation. Reforms of the regulatory framework are expected to decentralize decision-making and grant more autonomy to municipal water and sanitation authorities in setting tariffs. The WBG can advise municipal authorities on PSP options and ways to implement transactions with private sector companies and IFC could provide direct financing to the projects. Cities such as Alexandria, with a strong commitment to private sector participation and where tariffs

are higher than other cities (they are still low by international comparison) are more likely to attract private sector investment in water/sanitation and can then serve as a model to be replicated in other cities.

In the renewable energy area work to develop self sustaining markets can also be pursued. IFC through PSAS can provide advisory services to facilitate private transactions.

In the power sector, reforms need to be aimed at attracting private sector participation and financing of the large amount of investment needed in generation, transmission and distribution to cater for load growth. IFC has been requested to provide financing for the first 3 IPP's in Egypt. While it is expected that there will continue to be demand for IFC financing in power generation, IFC's strategy will be to explore the scope for private participation in the distribution sub-sector and in developing alternative sources for generation such as wind power. In this sector, Egyptian authorities are dealing simultaneously with the cornerstone elements of sector reform, namely sector structure, ownership policy and regulation (including prices). Until recently, electricity supply was under monopoly control of the Egyptian Electricity Authority (EEA), but this has changed and the private sector is now authorized to build, own, operate and transfer (BOOT) power generation plants. In addition, the Government and Egyptian Electricity Holding Company are currently considering whether it is better to separate generation from distribution before proceeding with the privatization process.

While the technical performance of the generation, transmission and distribution systems is adequate, consumers receive a reliable service at a low price, and the power sector in Egypt has, over the last few years, experienced notable achievements, these arrangements have not been adequate to establish financial discipline and sound commercial practices in the power sector. The financial position of the sector is weak; there are subsidies in electricity tariffs and large arrears in the payment of electricity bills, mainly by several major customers in the public sector. As for pricing and regulation, electricity tariffs are set by Cabinet decree. There have been no changes in tariffs since 1994, which means that tariff rates have been decreasing in real terms.

IFC has been heavily involved in the power sector in Egypt in recent years. The work done on specific BOOT investments in power generation has provided an opportunity to address some of the issues facing the country in this sector. This involvement has allowed IFC, as a part of the Bank Group an initial entrée to the discussions with the Government of Egypt. The outcome of decisions made by the Government of Egypt will have a considerable impact on the future commercial performance of the sector, and its ability to attract the necessary investment for meeting future load growth.

IFC Activity since the last CAS

In the **manufacturing sector**, since the last CAS IFC approved 9 investments in companies producing steel, cement, carbon black, industrial gases, corrugated boxes and autoparts. In general however, demand for IFC financing in the manufacturing sector has been less than expected. This has largely been due to the availability of financing from other sources, including local and international banks, other multilateral agencies such as the European Investment Bank, the African Development Bank, the Islamic Development Bank and Arab funds and, to a limited extent, the domestic bond market. Another reason has been the fears of a possible devaluation of the Pound,

particularly since 1999, which have inhibited demand for US$ financing, including from IFC, particularly for projects which are not foreign exchange earners.

The last CAS identified IFC's strategy in the **financial sector** as a three-pronged approach of: creating or strengthening existing institutions, providing medium to long-term funding and providing technical assistance where appropriate expertise can be sourced. IFC made significant progress in all three areas. The aim of IFC's institution building efforts is to deepen the financial sector in Egypt, by introducing new activities and best practices and ultimately increasing the efficiency of the financial sector in providing services in support of private sector activity. Since the CAS, IFC has set up and invested in institutions in leasing, credit ratings, life insurance and investment banking. In all these cases, the companies are set up as joint ventures with international companies that are industry leaders to ensure that best international practice is followed. Orix Leasing Egypt has the Orix Corporation of Japan and Orix Leasing Pakistan as technical partners. The rating company, Nile Ratings, was set up with Fitch IBCA of the U.K. Commercial International Life Insurance Company is a joint venture between Egypt's leading private bank, CIB (which is also an IFC investment since 1992) and Legal & General, one of the leading U.K. insurance companies. The investment banking company, HC Securities, is in joint venture with Morgan Stanley Dean Witter.

IFC has also provided funding to the financial sector. A forfaiting credit line was recently approved to some Egyptian private banks to help them expand forfaiting services to their private clients. IFC has also extended a loan to a leasing company, ORIX Leasing Egypt which IFC helped establish in 1996, to enable it to expand the financing it provides to SME's. In FY01 IFC concluded a US$30 million loan to a leading investment bank to help it fund new lines of business and to expand into regional markets. IFC has also been offering long-term lines of credit to private Egyptian banks to enable them to provide term US$ funding to their private clients, but none have been concluded so far. In general , IFC lending to the financial sector, to banks and to non-bank financial intermediaries (NBFIs), has been in less demand than expected. Once Egypt was awarded investment grade rating from the major rating agencies in 1997, the availability of shorter term, but lower cost financing in US dollars from international banks to Egyptian banks improved and reduced the demand for IFC lending to the banking sector. NBFIs generally have a preference to borrow in local currency unless the foreign exchange risk can be hedged, and hedging instruments are limited in Egypt.

IFC has supported the growth of the Egyptian Stock Exchange. IFC included the Egyptian market in its widely followed IFC Indices in 1997, helping to increase international interest and the flow of capital to Egyptian equities. IFC also set up and invested in the first offshore country fund for Egypt (The Egypt Trust, capitalized at US$ 90 million) thus helping to mobilize international funds to invest in Egyptian listed equities.

IFC has also provided technical assistance to the Egyptian Capital Markets Authority (CMA) and Ministry of Economy to help develop the corporate debt market.

In **infrastructure**, the Government has opened up some areas to private sector investment. Power generation has been at the forefront and 3 contracts to develop and operate power stations have been awarded to private companies to date. The large financing requirements of these projects and the long tenors needed created a demand for IFC financing which was sought for all 3 projects.

IFC's Board approved financing to the first (Sidi Krir) in FY1999 and to the other 2 (Suez and Port Said) in FY2001. The loan to Sidi Krir has not been signed as the company has not yet chosen to convert the bridge loans it obtained from commercial banks to the longer term IFC loan. The loans to Suez and Port Said were signed in April 2001. IFC's loans are of the long tenors needed and, through the B loan program, IFC is able to mobilize large amounts of international bank financing to complement its own lending. For the Suez and Port Said projects, IFC will attempt to raise a total of about US$300 million from international banks to complement the US$90 million it will provide from its own resources.

World Bank Institute (WBI) in Egypt

As the focus of the Bank Group shifts increasingly toward knowledge-based activities, the role of WBI is expected to become correspondingly important in capacity building and knowledge management services. For greater impact and to assure selectivity, WBI will focus on a few strategic areas where the Bank Group is heavily involved. Table 3 summarizes some of WBI's activities under the base case scenario. In each case WBI is expected to ensure wide consultations and dissemination of experience of other countries in areas where AAA on Egypt is underway or completed.

Egyptian participants are expected to benefit from courses for the sub-region in Lebanon on: health sector reform and health financing; agricultural trade and WTO; and financial sector issues. Other WBI learning programs relate to governance issues, privatization strategy and infrastructure finance; and in the area of information and communication technology.

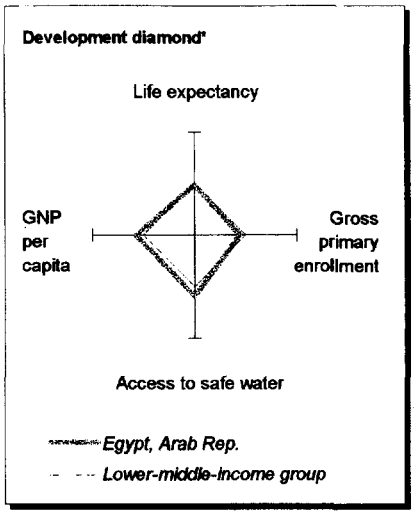
WBI's strategy is to work closely with, and strengthen, local partners for training and policy dialogue. Following the WDR workshop in Cairo (Feb 2001), a group of Egyptian civil society leaders will participate in country and regional development debates focused on poverty with videoconference support. Later, a similar group will provide critical input and draw substantial benefit from the next Mediterranean Development Forum (MDF) event scheduled for March 2002. The fourth MDF should be an effective instrument for policy dialogue in the region, with relevance and concrete follow-up for all countries concerned.

WBI will stay responsive to strong country demand in other specific areas, such as project appraisal, monitoring and evaluation, following up on the successful course offered in Cairo in March 2001. WBI will also explore the demand for learning on education (including ECD), reproductive health and population, as well as water and environment issues and urban management. It is also expected to support exploratory work and consultations on governance issues.

Egypt's global distance learning center will become operational in 2001 at the Regional Information and Technology Software Engineering Center (RITSEC). As part of the Global Distance Learning Network (GDLN), WBI, in collaboration with the Economic Research Forum (ERF) and RITSEC, will offer in 2002 a first distance learning course in Cairo for a regional audience on Macroeconomic Management for Financial Stability and Poverty Reduction.

Egypt, Arab Rep. at a glance

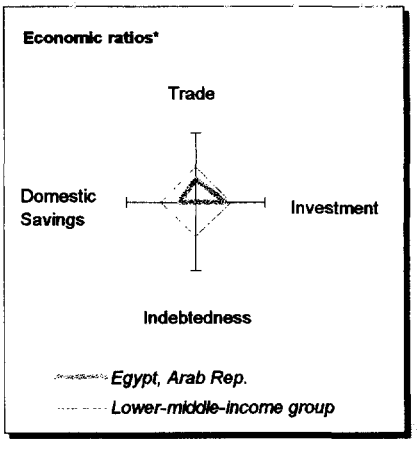
POVERTY and SOCIAL	Egypt	M. East & North Africa	Lower-middle-income
1999			
Population, mid-year *(millions)*	62.4	291	2,094
GNP per capita *(Atlas method, US$)*	1,380	2,060	1,200
GNP *(Atlas method, US$ billions)*	86.4	599	2,513
Average annual growth, 1993-99			
Population *(%)*	1.8	2.1	1.1
Labor force *(%)*	2.7	3.0	1.2
Most recent estimate (latest year available, 1993-99)			
Poverty *(% of population below national poverty line)*	23	..	..
Urban population *(% of total population)*	45	58	43
Life expectancy at birth *(years)*	67	68	69
Infant mortality *(per 1,000 live births)*	49	44	32
Child malnutrition *(% of children under 5)*	12	15	15
Access to improved water source *(% of population)*	95	89	80
Illiteracy *(% of population age 15+)*	45	36	16
Gross primary enrollment *(% of school-age population)*	101	95	114
Male	108	102	114
Female	94	88	116



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

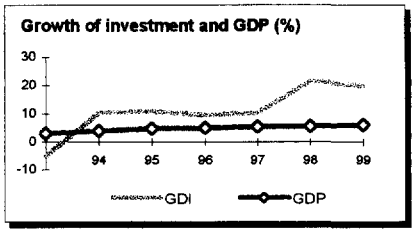
	1979	1989	1998	1999
GDP *(US$ billions)*	18.2	30.0	82.5	89.0
Gross domestic investment/GDP	32.8	31.8	20.5	22.8
Exports of goods and services/GDP	29.7	17.9	16.8	16.0
Gross domestic savings/GDP	14.2	17.3	14.0	14.4
Gross national savings/GDP	..	30.0	21.0	21.0
Current account balance/GDP	-10.6	-1.6	-3.0	-1.9
Interest payments/GDP	1.2	3.7	0.9	0.8
Total debt/GDP	82.1	151.9	36.7	33.7
Total debt service/exports	6.4	23.3	8.5	9.5
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..

	1979-89	1989-99	1998	1999	1999-03
(average annual growth)					
GDP	5.8	4.3	5.6	6.0	5.7
GNP per capita	4.5	2.6	3.9	3.9	4.1
Exports of goods and services	4.4	3.5	-7.7	9.2	12.4

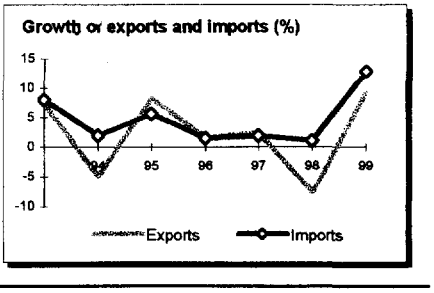


STRUCTURE of the ECONOMY

	1979	1989	1998	1999
(% of GDP)				
Agriculture	20.9	19.7	17.5	17.4
Industry	35.8	28.0	32.3	31.5
Manufacturing	13.6	18.1	18.6	19.5
Services	43.3	52.3	50.2	51.0
Private consumption	68.7	70.1	75.9	75.5
General government consumption	17.1	12.6	10.1	10.1
Imports of goods and services	48.3	32.4	23.3	24.4



	1979-89	1989-99	1998	1999
(average annual growth)				
Agriculture	2.8	3.0	3.7	3.7
Industry	5.6	4.0	7.1	3.7
Manufacturing	..	5.9	7.8	9.7
Services	7.5	4.6	5.4	8.3
Private consumption	3.5	4.2	4.3	3.6
General government consumption	4.8	1.8	4.5	3.9
Gross domestic investment	1.2	4.7	21.4	19.8
Imports of goods and services	-1.6	2.8	1.1	12.8
Gross national product	7.2	4.7	5.8	5.7



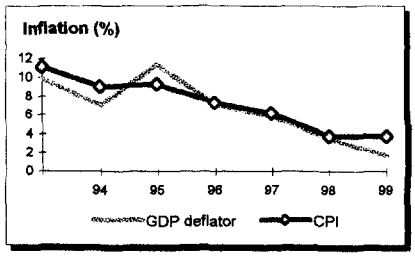
Note: 1999 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Egypt, Arab Rep.

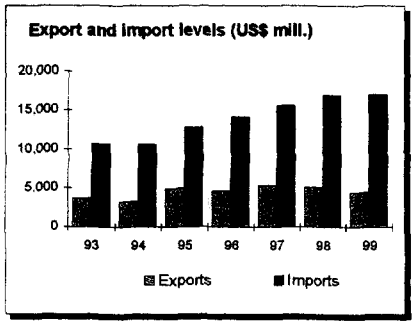
PRICES and GOVERNMENT FINANCE

	1979	1989	1998	1999
Domestic prices				
(% change)				
Consumer prices	..	16.7	3.8	3.8
Implicit GDP deflator	22.3	18.5	3.6	1.7
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	19.3	22.8	22.2
Current budget balance	..	-4.9	2.9	2.0
Overall surplus/deficit	..	-15.4	-1.0	-4.2



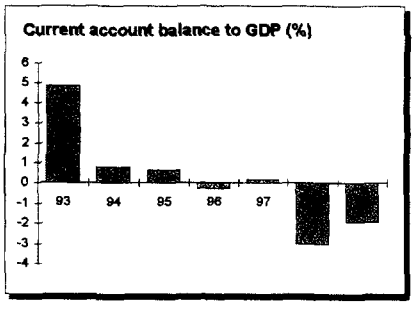
TRADE

	1979	1989	1998	1999
(US$ millions)				
Total exports (fob)	..	2,697	5,128	4,445
Cotton	..	1,066	1,728	1,000
Other agriculture	..	299	103	208
Manufactures	..	978	1,685	2,080
Total imports (cif)	..	10,361	16,899	16,969
Food	..	2,404	3,194	2,374
Fuel and energy	..	680	2,188	1,319
Capital goods	..	2,050	4,801	5,575
Export price index *(1995=100)*	..	91	98	94
Import price index *(1995=100)*	..	86	94	90
Terms of trade *(1995=100)*	..	107	105	104



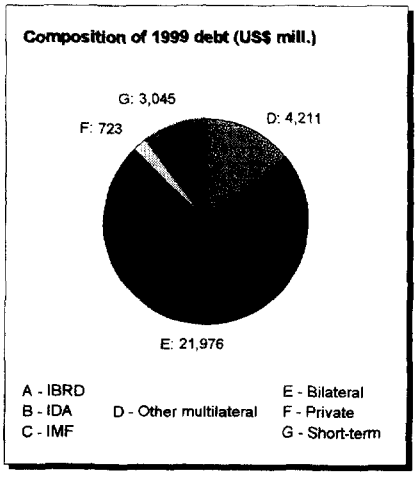
BALANCE of PAYMENTS

	1979	1989	1998	1999
(US$ millions)				
Exports of goods and services	5,401	8,216	13,503	13,537
Imports of goods and services	8,781	12,539	21,795	21,109
Resource balance	-3,380	-4,323	-8,292	-7,572
Net income	-1,069	-389	1,213	995
Net current transfers	2,534	4,243	4,600	4,869
Current account balance	-1,915	-469	-2,479	-1,709
Financing items (net)	1,747	35	2,344	-409
Changes in net reserves	168	433	135	2,117
Memo:				
Reserves including gold *(US$ millions)*	..	2,437	20,878	18,763
Conversion rate *(DEC, local/US$)*	0.7	2.6	3.4	3.4



EXTERNAL DEBT and RESOURCE FLOWS

	1979	1989	1998	1999
(US$ millions)				
Total debt outstanding and disbursed	14,906	45,611	30,313	29,955
IBRD	258	1,448	846	761
IDA	266	905	1242	1273
Total debt service	519	2,910	1,643	1,833
IBRD	22	250	236	221
IDA	2	12	25	28
Composition of net resource flows				
Official grants	258	455	..	..
Official creditors	1,148	397	0	-193
Private creditors	441	259	-105	-165
Foreign direct investment	1,216	1,250	..	..
Portfolio equity	0	0	..	..
World Bank program				
Commitments	298	241	142	550
Disbursements	172	118	217	199
Principal repayments	3	144	180	166
Net flows	169	-26	38	32
Interest payments	21	118	81	83
Net transfers	148	-144	-44	-50



CAS Annex B2 – Arab Republic of Egypt

Selected Indicators* of Bank Portfolio Performance and Management

As of Date: 05/30/2001

Indicator	1998	1999	2000	2001
Portfolio Assessment				
Number of Projects Under Implementation [a]	17	20	21	19
Average Implementation Period (years) [b]	4	3	4	4.7
Percent of Problem Projects by Number [a, c]	17.6	15	19	10.5
Percent of Problem Projects by Amount [a, c]	15.4	12.3	36.9	1.8
Percent of Projects at Risk by Number [a, d]	17.6	15	19	10.5
Percent of Projects at Risk by Amount [a, d]	15.4	12.3	36.9	1.8
Disbursement Ratio (%) [e]	36	14.4	8.1	5.6
Portfolio Management				
CPPR during the year (yes/no)	Yes (Nov 97)	No	No	No
Supervision Resources (total US$ thousand)	1,124.0	1,359.0	1,596.0	1,332.0
Average Supervision (US$ thousand/project)	62.5	59.1	76.0	66.6

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	73	7
Proj Eval by OED by Amt (US$ millions)	3474.7	435
% of OED Projects Rated U or HU by Number	24.3	29
% of OED Projects Rated U or HU by Amt [f]	14	2

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.

f. Figure is based on net disbursements of unsatisfactory projects after cancellations. If based on original commitments, figure for Last Five FYs would be 11%.

* 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.

Arab Republic of Egypt

Bank Group Program Summary

Proposed IBRD/IDA Base-Case Lending Program [a]

Fiscal year	*Project*	*US$(M)*	*Strategic Rewards (H/M/L)*	*Implementation Risks (H/M/L)*
2002	Higher Education Enhancement Prog.	50.0	H	M
	Skills Development	50.0	M	M
	Information Technology	10.0	H	L
	Result	**110.0**		
2003	Early Childhood Development	50.0	H	M
	Natural Resource Management	50.0	H	M
	Result	**100.0**		
2004	Health Sector Reform II	100.0	H	M
	Irrigation/Drainage Improvement	100.0	M	L
	Agriculture Exports	40.0	H	M
	Result	**240.0**		
	Overall Result	**450.0**		

a/ This table presents the proposed program for the next three fiscal years.

Arab Republic of Egypt: Summary of Nonlending Services

As of 4/13/01

Product	Completion FY	FY	Cost (US$000)	Audience	Objective
Recent completions	Export Promotion	01	20.3	G, B	PS
	Safety Net	01	9.5	G, B	PS
	Agriculture Reports	01	170.2	G, B, D	PD, PS
	Cairo Traffic	00	31.0	G, B	PS
	Business Environment	01	143.9	G, B, D	PD, PS
Ongoing	Social & Structural Review	01	164.7	G, B, D, P	KG, PD
	Nile Basin Initiative	01-04	108.6	G, B, D	KG, PS
	Water Notes	01/02	67.8	G, B	KG, PD
	CDF for Education	01	276.8	G, B, D	KG, PD
	Private Investment in Public Infrastructure	01	166.0	G, B, D	KG, PD
	Project Analysis for Training (WBI)	01	-	G	PS
	Economic Monitoring	01-04	150.0	B, G	KG
Planned	Poverty Assessment	02	200.0	G, B, D, P	KG, PD, PS
	CPAR Update	02	30.0	G, B	KG, PS
	Health Insurance	02	75.0	G, B, D	PS
	Gender Assessment	02	75.0	G, B, D	KG, PS
	Early Childhood Development	02	50.0	G, B, D	KG
	Corporate Governance Assessment	02	40.0	G, B	PS
	CFAA	03	50.0	G, B, D	KG, PS
	Public Expenditure Review	03	250.0	G, B, D	KG, PS
	Irrigation Improvement Sector Review	03	100.0	G, B, D	KG, PS
	Drainage and Wastewater Reuse	03	100.0	G, B, D	KG, PS
	Financial Sector Assessment	03	150.0	G, B	PS, KG
	Social & Structural Review II	04	250.0	G, B, D, P	KG, PD
	Evaluation of Health Sector Reform	04	100.0	G, B, D	KG, PS
	CAS	04	150.0	G, B, D, P	PD, PS

G = Government; B = Bank; D = Donors; P = Public Dissemination
KG = Knowledge Generation; PD = Public Debate; PS = Problem Solving

Egypt, Arab Rep. Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1993-99	M. East & North Africa	Lower-middle-income
POPULATION					
Total population, mid-year (millions)	36.3	46.5	62.7	290.3	2,093.0
Growth rate (% annual average for period)	1.9	2.6	1.9	2.0	1.1
Urban population (% of population)	43.5	43.9	45.0	58.2	42.9
Total fertility rate (births per woman)	5.4	4.6	3.3	3.5	2.1
POVERTY					
(% of population)					
National headcount index	..	..	22.9	..	..
Urban headcount index	..	..	22.5	..	..
Rural headcount index	..	..	23.3	..	..
INCOME					
GNI per capita (US$)	340	640	1,380	2,060	1,200
Consumer price index (1995=100)	6	21	120	114	137
Food price index (1995=100)	..	23	116	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	28.9	..	..
Lowest quintile (% of income or consumption)	5.8	..	9.8	..	..
Highest quintile (% of income or consumption)	48.1	..	39.0	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	1.8	2.2	2.3
Education (% of GNI)	5.1	6.3	4.8	5.2	4.8
Social security and welfare (% of GDP)	4.7	5.2	0.1	..	..
Net primary school enrollment rate					
(% of age group)					
Total	63	..	93	87	99
Male	75	..	98	90	100
Female	49	..	88	83	99
Access to an improved water source					
(% of population)					
Total	..	90	95	89	80
Urban	..	93	96	96	94
Rural	..	61	94	80	69
Immunization rate					
(% under 12 months)					
Measles	..	74	96	91	87
DPT	..	95	95	92	87
Child malnutrition (% under 5 years)	..	..	12	..	9
Life expectancy at birth					
(years)					
Total	53	59	67	68	69
Male	52	58	65	67	67
Female	55	61	68	69	72
Mortality					
Infant (per 1,000 live births)	139	92	49	44	32
Under 5 (per 1,000 live births)	235	175	61	56	40
Adult (15-59)					
Male (per 1,000 population)	255	257	193	183	191
Female (per 1,000 population)	179	204	168	151	133
Maternal (per 100,000 live births)	..	..	170	..	..
Births attended by skilled health staff (%)	..	..	56	..	..

Note: 0 or 0.0 means zero or less than half the unit shown. Net enrollment ratios exceeding 100 indicate discrepancies between the estimates of school-age population and reported enrollment data. Latest year for access to improved water source data is 2000.

2001 World Development Indicators CD-ROM, World Bank

Egypt, Arab Rep. - Key Economic Indicators

Indicator	Actual			Estimate		Projected			
	1996	1997	1998	1999	2000	2001	2002	2003	2004
National accounts (as % of GDP)									
Gross domestic product[a]	100	100	100	100	100	100	100	100	100
Agriculture	17	18	17	17	17	16	15	14	13
Industry	32	32	32	32	34	32	32	33	33
Services	51	51	50	51	50	52	53	53	54
Total Consumption	89	87	86	86	81	82	82	81	80
Gross domestic fixed investment	16	18	19	20	22	24	24	25	25
Government investment	5	6	7	7	7	6	6	5	5
Private investment	11	12	12	13	14	18	18	19	20
Exports (GNFS)[b]	20	20	17	16	16	17	18	19	20
Imports (GNFS)	26	25	23	24	22	24	25	25	26
Gross domestic savings	11	13	14	14	19	18	18	19	20
Gross national savings[c]	17	20	21	21	24	23	23	23	24
Memorandum items									
Gross domestic product (US$ million at current prices)	67591	75516	82539	89016	99459	102884	107123	114628	120177
GNP per capita (US$, Atlas method)	1100	1200	1280	1380	1610	1670	1700	1750	1820
Real annual growth rates (%, calculated from 1992 prices)									
Gross domestic product at market prices	5.0	5.5	5.6	6.0	6.4	5.5	5.6	5.7	5.9
Gross Domestic Income	3.7	6.6	5.3	4.5	8.7	4.3	5.2	5.3	5.6
Real annual per capita growth rates (%, calculated from 1992 prices)									
Gross domestic product at market prices	3.1	3.6	3.8	4.3	4.7	3.8	3.9	4.0	4.2
Total consumption	1.9	2.2	-0.1	2.5	2.9	4.0	2.6	2.6	2.5
Private consumption	2.3	2.1	-0.1	2.5	2.6	4.7	3.1	3.1	3.0
Balance of Payments (US$ millions)									
Exports (GNFS)[b]	13415	14534	13503	13537	15975	17539	19402	21651	24071
Merchandise FOB	4609	5345	5128	4445	6388	7219	7960	9008	10417
Imports (GNFS)[b]	17660	19528	21795	21109	22756	24746	26527	28806	31038
Merchandise FOB	14263	16718	15321	16969	17861	19234	20454	21822	23356
Resource balance	-4245	-4994	-8292	-7572	-6781	-7207	-7125	-7155	-6967
Net current transfers	3521	4145	4600	4869	4679	4660	4530	4694	4473
Current account balance	-185	119	-2479	-1709	-1171	-1865	-2225	-2237	-2411
Net private foreign direct investment	612	723	967	655	1613	1613	1855	2133	2453
Long-term loans (net)	-354	-255	-105	-522	-788	-864	-955	-1026	-1144
Official	21	-51	0	-298	-587	-522	-587	-621	-724
Private	-374	-205	-105	-224	-201	-342	-368	-405	-420
Other capital (net, incl. errors & ommissions)	497	1326	1481	-542	-2679	-1400	-1400	-1300	-1200
Change in reserves[d]	-570	-1912	135	2117	3025	2516	2724	2430	2302
Memorandum items									
Resource balance (% of GDP)	-6.3	-6.6	-10.0	-8.5	-6.8	-7.0	-6.7	-6.2	-5.8
Real annual growth rates (YR92 prices)									
Merchandise exports (FOB)	-12.8	-2.4	24.0	-9.5	31.7	6.0	13.7	15.6	15.8
Primary	-16.1	-10.9	2.5	-27.7	33.7	9.5	11.3	9.5	9.6
Manufactures	-21.9	-13.6	61.3	26.4	40.3	10.0	15.0	20.0	20.0
Merchandise imports (CIF)	6.9	10.8	19.5	4.2	7.0	5.0	4.8	5.0	5.0

Egypt, Arab Rep. - Key Economic Indicators

Indicator	Actual				Estimate		Projected		
Indicator	1996	1997	1998	1999	2000	2001	2002	2003	2004
Public finance (as % of GDP at market prices)[e]									
Current revenues	25.1	23.7	22.8	22.2	21.3	21.0	20.8	20.4	20.0
Current expenditures	22.6	20.8	19.9	20.2	20.2	20.8	20.7	20.6	20.4
Current fiscal surplus (+) or deficit (-)	2.5	2.9	2.9	2.0	1.1	0.1	0.0	-0.2	-0.4
Capital expenditure	5.2	5.2	5.4	8.2	6.8	5.8	5.5	5.1	4.7
Foreign financing	-0.6	-0.6	-0.5	-0.6	-0.8	-0.5	-0.6	-0.6	-0.7
Monetary indicators									
M2/GDP	73.4	75.7	75.1	77.6	75.3	75.1	75.1	75.1	75.1
Growth of M2 (%)	10.5	15.1	8.6	11.4	8.8	10.5	9.8	9.9	10.1
Private sector credit growth / total credit growth (%)	80.1	83.8	98.1	73.9	75.4	38.0	73.5	74.0	74.6
Price indices(YR92 =100)									
Merchandise export price index	107.5	127.8	98.9	94.7	103.3	110.1	106.8	104.6	104.5
Merchandise import price index	112.3	111.8	101.6	97.8	96.3	98.7	100.2	101.8	103.8
Merchandise terms of trade index	95.8	114.4	97.4	96.8	107.3	111.5	106.6	102.7	100.6
Real exchange rate (US$/LCU)[f]	123.0	129.4	146.6	152.8	164.6	160.4	152.7	149.7	144.1
Real interest rates									
Consumer price index (% change)	7.3	6.2	3.8	3.8	2.8	3.4	3.5	3.8	4.1
GDP deflator (% change)	7.1	5.9	3.6	1.7	5.4	5.0	4.0	4.0	4.0

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.

Egypt, Arab Rep. - Key Exposure Indicators

Indicator	Actual			Estimate		Projected			
	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total debt outstanding and disbursed (TDO) (US$m)[a]	31613	30319	30313	29955	28988	28124	27170	26143	24999
Net disbursements (US$m)[a]	-476	522	-105	-522	-788	-545	-583	-618	-624
Total debt service (TDS) (US$m)[a]	2378	1926	1642	1769	1793	1827	1840	1873	1973
Debt and debt service indicators (%)									
TDO/XGS[b]	175.2	152.8	157.1	154.8	134.5	118.4	106.9	95.7	85.8
TDO/GDP	46.8	40.1	36.7	33.7	30.0	28.8	26.6	24.5	22.3
TDS/XGS	13.2	9.7	8.5	9.5	8.7	7.7	7.2	6.9	6.8
Concessional/TDO	63.0	75.6	76.2	76.8	78.5	79.5	80.3	81.1	81.7
IBRD exposure indicators (%)									
IBRD DS/public DS	11.0	10.4	9.1	7.2	6.8	6.4	6.2	6.1	6.1
Preferred creditor DS/public DS (%)[c]	29.9	31.1	30.9	28.6	27.3	28.6	28.9	28.7	27.5
IBRD DS/XGS	1.6	1.3	1.2	0.8	0.6	0.5	0.4	0.4	0.4
IBRD TDO (US$m)[d]	1075	869	846	761	639	579	573	587	605
Of which present value of guarantees (US$m)									
Share of IBRD portfolio (%)	..	..	..	..	..	..	..	..	..
IDA TDO (US$m)[d]	1090	1206	1242	1273	1266	1289	1324	1359	1384
IFC approvals (US$m)	85.5	82.2	78.8	81.0	15.5	177.2			
Loans	42.5	69.0	67.5	76.7	8.8	133.7			
Equity and quasi-equity /c	16.0	13.0	11.3	4.3	2.8	2.5			
GSR (Guarantee/Standby/Risk Mgt)	27.0	0.2	0.0	0.0	4.0	41.0			
MIGA									
MIGA guarantees (US$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.

CAS Annex B8 - Egypt, Arab Republic

Status of Bank Group Operations (Operations Portfolio)

As of May 18, 2001

Active Projects		Last PSR Supervision Rating			Original Amount in US$ Millions					Difference Between Expected and Actual Disbursements [a/]	
Project ID	Project Name	Development Objectives	Implementation Progress	Fiscal Year	IBRD	IDA	GRANT	Cancel.	Undisb.	Orig.	Frm Rev'd
P005157	AGRICULTURAL MODERNI	S	S	1994	54	67	0	0	6.0	2.6	0.0
P005161	BASIC EDUCATION PROJ	S	S	1993	0	55.5	0	0	7.7	-5.5	-13.4
P049166	EG-EAST DELTA AG.SERV.	S	U	1998	0	15	0	0	13.4	6.6	0.0
P005169	EG-ED.ENHANCEMENT PROG.	S	S	1997	0	75	0	0	41.9	13.4	2.9
P045175	EG-HEALTH SECTOR	S	S	1998	0	90	0	0	79.2	21.7	0.0
P045499	EG-NATIONAL DRAINAGE II	S	S	2000	50	0	0	0	50.0	0.0	0.0
P004981	EG-RED SEA COASTAL	S	S	1993	0	0	4.8	0	0.9	-0.3	-0.9
P005173	EGYPT IRRIGATION IMP	S	S	1995	26.7	53.3	0	0	53.2	37.5	12.6
P005153	MATRUH RESOURCE MANA	S	S	1993	0	22	0	0	1.7	-4.2	-6.1
P041410	P. S. REHAB. III	S	S	1999	120	0	0	0	119.5	43.2	0.0
P054958	POLLUTION ABATEMENT	S	S	1998	20	15	0	0	23.5	10.6	-6.6
P005163	POPULATION	S	S	1996	0	17.2	0	0	13.3	9.0	5.0
P053832	PRVT SECT.& AG. DEV.	S	S	1999	100	75	0	0	169.5	48.2	0.0
P005168	PVT SEC TOURISM INF & ENV	S	S	1993	260	0	0	189.5	8.0	67.5	2.5
P005152	SCHISTOSOMIASIS CONTROL	S	S	1992	0	26.8	0	0	10.7	4.5	4.5
P050484	SEC EDUC ENH PROG	S	S	1999	0	50	0	0	46.0	2.0	0.0
P066336	SOC PROT INIT PROJ	S	U	1999	0	5	0	0	4.7	0.5	0.0
P052705	SOCIAL FUND III	S	S	1999	0	50	0	0	47.9	17.7	0.0
P040858	SOHAG RURAL DEV.	S	S	1999	0	25	0	0	23.7	5.4	0.0
Total					**630.7**	**641.8**	**4.8**	**189.5**	**720.9**	**280.5**	**0.6**

IBRD/IDA * **Closed Projects: 86**

Total Disbursed (Active)	324.10
of which has been repaid	4.88
Total Disbursed (Closed)	3,942.10
of which has been repaid	2,850.30
Total Disbursed (Active + Closed)	4,266.28
of which has been repaid	2,855.14
Total Undisbursed (Active)	719.96
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	719.96

a/ Intended disbursements to date minus actual disbursements to date as projected at appraisal.

Arab Republic of Egypt

Statement of IFC's Held and Disbursed Portfolio

As of April 30, 2001

(In US Dollars Millions)

	IFC Held				IFC Disbursed			
Company	**Loan**	**Equity/QE**	**Guar/RM**	**Partic**	**Loan**	**Equity/QE**	**Guar/RM**	**Partic**
ANSDK	8.57	22.59	19.85	0.00	8.57	22.59	0.00	0.00
Abu Soma Develop	0.00	1.45	0.00	0.00	0.00	1.13	0.00	0.00
CIL	0.00	1.65	0.00	0.00	0.00	0.88	0.00	0.00
Carbon Black-EGT	13.00	2.96	0.00	0.00	13.00	2.96	0.00	0.00
Club Ras Soma	2.45	2.37	0.00	0.00	2.45	2.37	0.00	0.00
Cmrcl Intl Bank	0.00	15.59	0.00	0.00	0.00	15.59	0.00	0.00
ECC	0.00	0.00	34.40	0.00	0.00	0.00	0.00	0.00
EFG Hermes	30.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Egypt Trust	0.00	5.00	0.00	0.00	0.00	5.00	0.00	0.00
HC Investment	0.00	1.41	0.00	0.00	0.00	1.41	0.00	0.00
IT Worx	0.00	2.50	0.00	0.00	0.00	0.00	0.00	0.00
MGDK	0.00	1.47	0.00	0.00	0.00	1.47	0.00	0.00
Meleiha Oil	0.00	30.82	0.00	0.00	0.00	0.00	0.00	0.00
Misr Compressor	9.70	3.77	0.00	0.00	9.70	3.77	0.00	0.00
Orascom	16.00	4.85	0.00	0.00	16.00	4.85	0.00	0.00
Orix Leasing EGT	0.00	0.89	0.00	0.00	0.00	0.89	0.00	0.00
Port Said	45.00	0.00	0.00	152.50	0.00	0.00	0.00	0.00
Suez Gulf	45.00	0.00	0.00	152.50	0.00	0.00	0.00	0.00
UNI	7.06	0.00	0.00	0.00	7.06	0.00	0.00	0.00
Total Portfolio	**176.78**	**97.32**	**54.25**	**305.00**	**56.78**	**62.91**	**0.00**	**0.00**

Approvals Pending Commitment

	Loan	Equity/QE	Guar/RM	Partic
AAC	4.74	0.00	0.00	0.00
Sidi Krir	70.00	0.00	0.00	122.00
ACB Expansn III	5.00	0.00	0.00	0.00
OLE - CL	6.00	0.00	0.00	0.00
Total Pending Commitment:	**85.74**	**0.00**	**0.00**	**122.00**

ANSDK Guarantee/RM held is presently showing only the Guarantee amouunt.

EGYPT COUNTRY PROGRAM MATRIX, FY02-04

DIAGNOSIS	STRATEGY/ACTION	PROGRAM INDICATORS/BENCHMARKS	BANK GROUP INSTRUMENTS	OTHER DONOR ACTIVITIES
I. INTERVENTIONS SUPPORTING HIGHER AND SUSTAINED GROWTH				
Macroeconomic Stability & Growth ➢ Recent increase in the fiscal deficit current budget process makes it difficult for government to implement its policies and assess outcome of expenditures.	➢ Maintain fiscal discipline. Establish a medium-term framework for public expenditure planning. Prioritize and scale back implementation of mega projects. Shift gradually toward results-oriented budget.	➢ Fiscal deficit cut below 4% of GDP. Current and investment budgets consolidated. Investment projects prioritized on economic grounds. Major tax reform completed (extension of GST, tax admin, corporate tax system).	➢ AAA: Public Expenditure Review; Social & Structural Review II; Economic Monitoring; Project Appraisal & Evaluation (WBI/IDF).	IMF; USAID
Export Promotion ➢ Distorted incentives framework; inefficient and high cost infrastructure services; institutional and bureaucratic constraints led to disappointing export performance.	➢ Flexible management of exchange rate. Tariff reform (reduction in level and dispersion of tariffs). Adherence to requirements of COMESA, PAFTA and EU. Removal of non-tariff barriers (customs reform, quality controls). Enhancing private provision of infrastucture.	➢ Non-oil exports increase by at least 10% p.a. Reduce maximum tariffs from 40% to 30%. Bring all tariffs that were between 20%-30% to 20%; bring them between 15%-20% to 10%. Eliminate the customs surcharge.	➢ New operation: Agricultural Exports Project. IFC loans & equity: Investment in export-oriented companies. Investment in IPPs in power. Potential investments in diverse sectors such as water and waste water, ports, airports. Non-lending: Agricultural Trade and WTO (WBI).	IMF; USAID; EU; Arab Fund; Kuwait Fund; Japan
Private Sector Development ➢ Unfavorable business environment with a particularly unsupportive SME environment.	➢ Streamlining of tax and customs administration. Strengthen commercial and legal system. Reform labor legislation. Bankruptcy and intellectual property rights legislation.	➢ Improved perception of business environment (surveys). Increased private domestic investment and FDI.	➢ Non-lending:TA to strengthen business environment. Corporate governance TA. IFC loans, equity & TA: Focused lending to facilitate access to finance (credit lines, risk capital, guarantees, leasing, etc.). Extended African Project Development Facility. Selected direct investments in companies with clear development impact.	USAID; EU; UK; UNDP; Germany; Italy; CIDA; AFDB

DIAGNOSIS	STRATEGY/ACTION	PROGRAM INDICATORS/BENCHMARKS	BANK GROUP INSTRUMENTS	OTHER DONOR ACTIVITIES
Financial Sector ➢ Dominance of publicly-owned institutions has limited scope and depth of financial markets. Range of products available insufficient to meet needs of private sector, especially SMEs. Slight increase in non-performing loans. No mortgage market to facilitate housing finance. Need to modernize and better regulate capital markets and insurance sector.	➢ Strengthen bank supervision. Gradually privatize the public financial institutions. Develop non-bank financial institutions. Deepen and broaden capital markets.	➢ Privatize at lease one state-owned bank. Stronger bank supervision capacity in place. Mortgage market development initiated.	➢ IFC loans, & equity: TA on, and investment in, innovative financial instruments to build mortgage finance institutions, underwrite and trade of bonds. Medium & long-term loans to banks and non-bank financial intermediaries. Become a shareholder of secondary mortgage market institution. Non-lending: Mortgage development and capital market development. Financial Sector Assessment Program (FSAP).	IMF; USAID; EU; UK
Privatization ➢ After impressive progress during 1995-99, marked slowdown in privatization. Share of public sector still 30% in economic activity.	➢ Government plans to divest most of remaining enterprises during next 2-3 years.	➢ Substantial progress in completing industrial sector and non-industrial privatizations.	➢ Information Infrastructure Project (Telecoms & Post). TA to improve performance of public entities. Advisory services and selected transactions (IFC).	USAID; EU; Germany; CIDA
ICT Sector ➢ Weak capacity of the telecom regulatory authority (TRA). Inadequate postal services. Incomplete legal framework for E-Commerce.	➢ Build TRA capacity. Reform and modernize postal sector. Develop necessary legal framework for E-Commerce.	➢ Fully functional TRA. Major improvement in postal services. Significant growth in E-Commerce activities.	➢ Information Infrastructure Project. Direct investments by IFC.	USAID
II. TARGETED INTERVENTIONS FOR POVERTY REDUCTION				
Education ➢ Despite near universal basic education, inequity remains in certain area. Low student performance at all levels, especially in problem-solving and technology skills.	➢ Increase demand for education in disadvantaged areas through parental participation and provision of early childhood education. Improve the quality of student learning for all. Reform curricula and provide enhanced learning environment at all levels.	➢ Annually increase enrollment for girls by 2% and for boys by 1.2% until universal 8 years of basic education reached. Improvement in student achievement score, particularly in problem solving and technology skills.	➢ Ongoing operations: Basic Education; Education Enhancement; Secondary Education. New operations: Early Childhood Development. Non-lending: Early Childhood Development.	USAID; AFDB; UNICEF; CIDA; EU; ESDF; Japan; Kuwait; Netherlands; Germany

DIAGNOSIS	STRATEGY/ACTION	PROGRAM INDICATORS/BENCHMARKS	BANK GROUP INSTRUMENTS	OTHER DONOR ACTIVITIES
➢ Despite improved access for girls' education over past two decades, more needs to be done to bridge the gender gap.	➢ Provide additional basic education for girls, especially in rural areas. Train female teachers, improve teaching methods. Provide mothers education and encourage involvement in school activities. Facilitate procedures for obtaining birth certificates for children not registered at birth.	➢ Increased female literacy; increased female participation in formal economy.	➢ AAA: Gender Assessment.	Netherlands; Italy; UNICEF; USAID
Health ➢ Free public health services available in principle, but poor quality of services, especially in poor rural and urban areas render them ineffective.	➢ Support expansion of family medicine practice to establish quality standards and accreditation mechanisms, and provide an integrated primary care service responsive to needs of whole family, with greater emphasis on prevention and community participation.	➢ Preparation and implementation of governorate Master plans in new target sites (Upper Egypt). Increase number of accredited family medicine practitioners to meet the needs identified in Masterplans.	➢ Ongoing: Population Project and Social Fund Project (health component).	USAID; EU; SFD; (Multi-donor Support); Kuwait; Spain; UNICEF; UNDP; Denmark
➢ Health delivery systems at all levels inefficient in operations and maldistribution of physical and human resources, leading to duplication, wastage and inequity.	➢ Rationalize investments in health infrastructure and human resources through health service standards, preparation of government Health Masterplans and GIS mapping to identify needs, gaps and duplication in service delivery.	➢ Implementation of an integrated national information system to support the communicable disease surveillance system.	➢ New: Health Sector II Project.	EU
➢ Public health services supply driven and fragmented through proliferation of many vertical & disease specific interventions.	➢ Strengthen integration of public health programs through improved disease surveillance system and greater governorate and district capacity to monitor and identify areas of need.	➢ Expansion of community development programs in "hot spot" villages in Egypt with very high fertility rates and high Schisto infection rates.	➢ Ongoing: Schistosomiasis Control Project, and Population Project.	UNICEF; WHO
➢ Social health insurance coverage limited to formal sectors, students and infants, leaving most women and families in informal sector without effective insurance protection.	➢ Phased expansion of social insurance coverage for basic primary health care services by governorates, and institutional capacity building of insurance functions at governorate levels. Undertake actuarial analysis to quantify financing implications of expanding social health insurance.	➢ Expansion of Family Health Fund in selected governorates to finance primary care social insurance program, and enrollment of uninsured population in targeted governorates.	➢ Ongoing: Health Sector I Project. New: Health Sector II Project. AAA: Health Care Financing Study and Workshop.	EU; USAID

DIAGNOSIS	STRATEGY/ACTION	PROGRAM INDICATORS/BENCHMARKS	BANK GROUP INSTRUMENTS	OTHER DONOR ACTIVITIES
Poverty Analysis & Social Safety Nets ➢ Limited updated information on the magnitude and nature of poverty makes it difficult to develop pro-poor policies and strategies.	➢ Government to complete Household Survey and make results available. Government to develop revised Poverty Strategy.	➢ Government to update poverty figures and establish poverty line. Complete Poverty Assessment.	➢ AAA: Poverty Assessment.	UNDP; UK; Italy; USAID; WFP; Netherlands; Denmark
➢ Need for better understanding of distributional impact of public expenditures.	➢ Beneficiary analysis of public expenditures.	➢ Complete Public Expenditure Review (PER).	➢ AAA: Public Expenditure Review (PER) and WBI Workshop.	USAID
➢ Need to improve social safety net components in terms of coverage, efficiency and effectiveness, based on recommendations of Bank TF report submitted to government.	➢ Government to take steps to improve food subsidies, cash transfers, Social Fund and/or social insurance.	➢ Government addresses safety net issue in poverty strategy. ➢ Incorporate safety net beneficiary assessment in PER.	➢ AAA: Bank report on Safety Nets submitted to government. PER.	
Rural Development ➢ 63% of the poor and 74% of the ultrapoor in Egypt live in rural areas. Increasing the productivity of agriculture essential for increasing rural incomes.	➢ Improved water availability, reduced soil salinity and water logging, better rural services for the poor.	➢ Reduced soil salinity and water logging. Increased agricultural production in poor rural areas.	➢ Ongoing: Matruh Natural Resources Management Project includes rain harvesting techniques, water shed management. New: Natural Resource Management Project II; Rural Water/Sanitation Project.	USAID; Germany Netherlands; Japan
III. INTERVENTIONS WITH MAJOR INDIRECT POVERTY REDUCTION IMPACT				
Higher Education & Skills Development ➢ Graduates of secondary and higher education lack market-relevant skills. Need for strengthening skills in managerial entrepreneurial and technical skills in a viable manner.	➢ Better align curricula and assessment with the skills needs of employers and further learning. Strengthen education management information system and introduce accountability based on student outcomes. Strengthen financial & administrative autonomy of higher education institutions and their partnership with private sector.	➢ Increased employer satisfaction with graduates as measured by tracer studies. Policy decision-making based on performance indicators and objective criteria. 50% of higher education budget will be allocated to higher education institutions as block grant.	➢ Higher Education Project; Skills Development Project.	EU; ILO; USAID; Germany

DIAGNOSIS	STRATEGY/ACTION	PROGRAM INDICATORS/BENCHMARKS	BANK GROUP INSTRUMENTS	OTHER DONOR ACTIVITIES
Water, Irrigation, Drainage Improvement				
➢ Per capita availability of water in Egypt is low (less than 1,000 cu.m. per capita per year). Improving productivity of scarce water resources a key issue. In addition, cooperation with Nile riparian countries is critical to assure long-term cooperative management of the Nile.	➢ Government plans to invest in water pumping stations, irrigation improvement and drainage (I&D) to improve productivity of water use. Active involvement in the Nile Basin Initiative (NBI) for "win-win" activities in the Nile. Institutional and management improvements, including water user participation and cost sharing programs.	➢ Agriculture output per unit of water. Conveyance efficiency, reduced soil salinity. Identification of "win-win" activities on the Nile Basin Initiative. Improved management of reuse. Recovery of O&M and capital cost as proportion of actual costs.	➢ Ongoing: IIPs, NDP, Pumping Stations, and NDP II Projects. New: Irrigation/Drainage Improvement Project. Private Sector role in Water Management (IFC). AAA: Drainage & Wastewater Reuse; NBI; Irrigation Improvement Sector Review.	Germany; Netherlands; Japan; USAID; UNDP; CIDA; AFDB; FAO; Kuwait Fund; Abu Dhabi Fund
➢ Deteriorating water quality. Continuing problem of salinity, pollution and rural sanitation.	➢ Sub-surface drainage problem a national priority. Strategy for reuse of drainage water under implementation.	➢ Monitoring system of water quality operational.	➢ New: Rural Water & Sanitation Project.	Germany; Netherlands; CIDA; USAID
Environment				
➢ Costs of environmental degradation considerable but need to be better quantified for policy decision-making.	➢ Support policy dialogue on environment through systematic economic assessments of Egypt's environment issues.	➢ Estimation of the cost of environmental degradation as % of GDP.	➢ Non-lending: METAP Study on cost of environmental degradation.	CIDA; Denmark; Netherlands; Germany; Italy; Japan; UNDP; UK; USAID
➢ Linkages between energy and environment poorly understood in electricity, petroleum and transport sectors.	➢ Enable Egypt to identify and implement local environment management projects which bring global benefits.	➢ Sector strategy developed for energy, addressing links to global environment concerns.	➢ Non-lending: TF Study on energy-environment review. GEF work on wind, solar/ thermal energy and biodiversity issues.	
➢ Private sector and especially SMEs would be particularly affected by negative/positive implications of complying with strict environmental standards on exports/imports as a result of Egypt's Association Agreement with EU.	➢ Support private sector in reducing risks and exposures to environmental regulations.	➢ Percentage change in imports/ exports due to changes in environmental regulations.	➢ Non-lending: METAP Country Assessment of environmental regulations on trade and competitiveness.	
➢ Poor environmental management at local level.	➢ Improve access to environmental information and help promote better environmental management.	➢ Number of staff trained on environmental management in local administration.	➢ Non-lending: DGF for environmental training at the local level.	

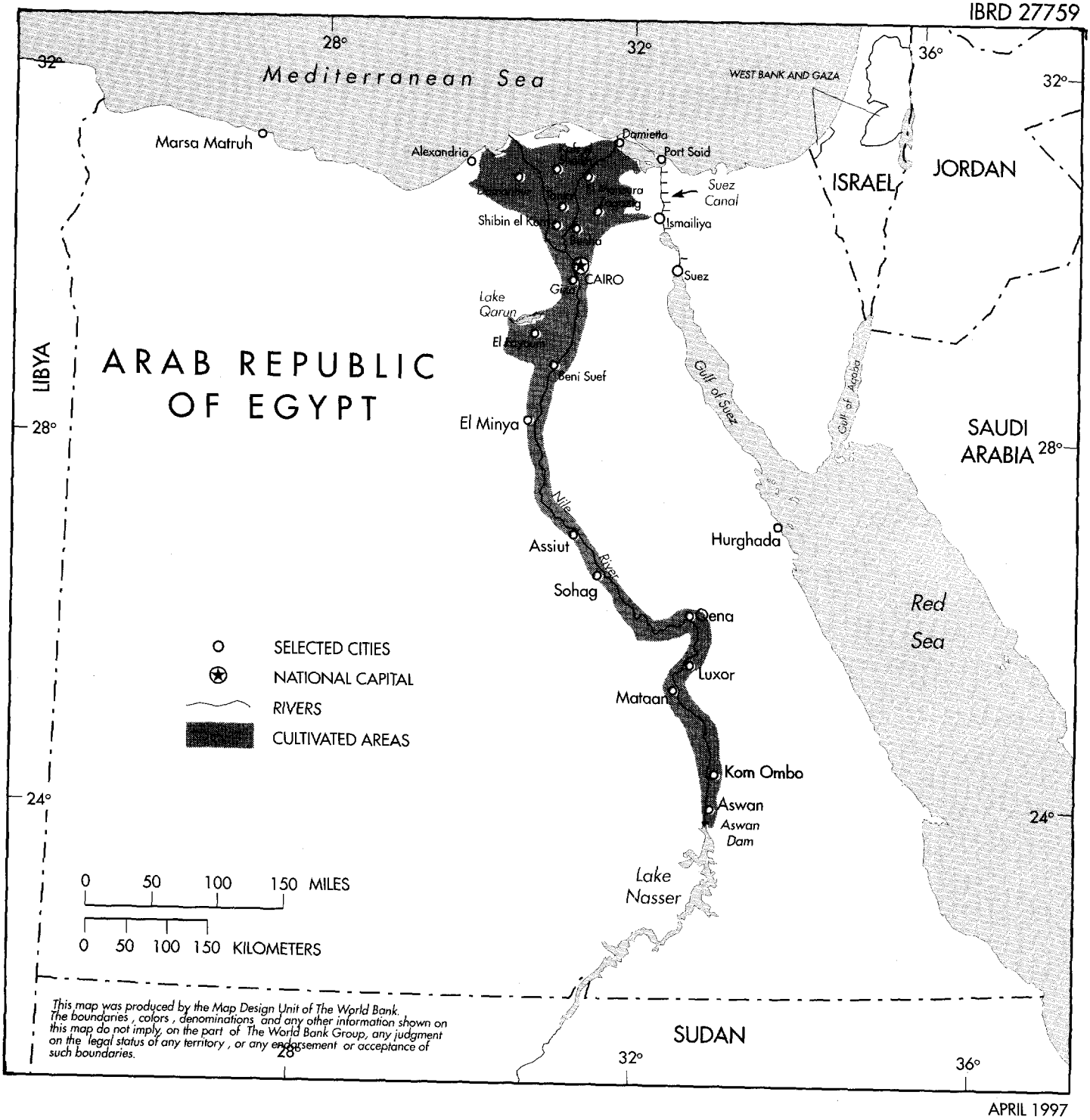
DIAGNOSIS	STRATEGY/ACTION	PROGRAM INDICATORS/BENCHMARKS	BANK GROUP INSTRUMENTS	OTHER DONOR ACTIVITIES
Governance				
➢ Absence of transparency and ineffectiveness by government officials increases cost of business. Also tax incentives tend to offset each other with little incremental benefit, but room for petty corruption.	➢ Need for improvements in administration and tax code.	➢ Set up easily monitorable performance standards in all major revenue collection functions, starting with duty drawback and sales tax rebates for exports. Abolish most tax incentives.	➢ AAA: Governance Issues Report.	IMF; USAID; UNDP; Spain
➢ Commercial legal system too slow and cumbersome in resolving commercial legal disputes.	➢ Increase number of judges and improve their remuneration.	➢ "Clearance rate" for commercial dispute resolution (% of filed cases actually resolved) to increase from about 40% at present to 50% by 2005.	➢ AAA: Task Force Report on Business Environment (completed).	USAID; CIDA
➢ With Egypt's increasing exposure to globalization and its need to tap domestic and international capital markets, corporate governance standards will need to improve to give investors the protection required to encourage them to provide capital.	➢ Egypt to undertake an assisted self-assessment of corporate governance standards.	➢ Completion of Corporate Governance Assessment.	➢ AAA: Corporate Governance Assessment. Seminar to disseminate findings.	USAID

CAS Summary of Development Priorities

Network area	*Country performance* [a]	*Major issue* [b]	*Country priority* [c]	*Bank priority* [c]	*Reconciliation of country and Bank priorities* [d]
Poverty Reduction & Economic Management					
Poverty reduction	F	Lack of credible data	H	H	Poverty Assessment
Economic policy	G	Fiscal stability, exchange rate management and privatization	H	H	PER; Coordination with IMF
Public sector	F	Civil service reform; administrative decentralization	M	M	Policy dialogue on best practices
Gender	G	Gender-differentiated data	H	H	Gender Assessment
Human Development Department					
Education	G	Efficiency and quality / curriculum reform	H	H	
Health, nutrition & population	G	Overstaffing / health insurance coverage	H	H	
Social protection	F	Effectiveness of government programs	M	M	
Environmentally & Socially Sustainable Development					
Rural development	F	Rural incomes	M	M	
Environment	F	Water / air quality	M	H	Bilateral donors taking lead
Social development	F	Lack of decentralization	M	M	
Finance, Private Sector & Infrastructure					
Financial sector	F	Lack of transparancy	M	H	Proposed FSAP
Private sector	F	Slow pace of privatization; low FDI	M	H	Bilateral donors taking lead
Energy & mining/Infrastructure	G	Private Participation/Cost Recovery	M	M	

a. Use "excellent," "good," "fair," or "poor."
b. Indicate principal country-specific problems (e.g., for poverty reduction, "rural poverty;" for education, "female secondary completion;" for environment, "urban air pollution").
c. To indicate priority, use "low," "moderate," or "high."
d. Give explanation, if priorities do not agree; for example, another MDB may have the lead on the issue, or there may be ongoing dialogue.

ARAB REPUBLIC OF EGYPT



APRIL 1997