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FAST TRACK BRIEF

July 14, 2008

The IEG report "Egypt: Country Assistance Evaluation, Fiscal 1999-2007," was discussed by CODE on July 14, 2008

Egypt: Country Assistance Evaluation

- **Between fiscal 1999 and fiscal 2007, the period under review in this CAE, Egypt's economic performance improved substantially, particularly after 2004, following improvements in economic management, structural reforms, and correction of the exchange rate. The GDP growth rate averaged about 5 percent per year over this period, rising to almost 7 percent in 2006 and 2007, translating into a per capita income growth of almost 3 percent per year, a strong performance.**
- **The Bank's financial assistance to Egypt has been modest (providing only about 4 percent of total official development assistance) compared to that of other donors, particularly USAID. From FY99 to FY07, IDA/IBRD commitments amounted to $2.1 billion for 18 investment credits and one policy-based loan. The country graduated from IDA in June 1999. The Bank's assistance program largely met its objectives and contributed significantly to policy and institutional changes, especially in the financial sector, privatization, pension system, and private sector development. For three decades the Bank has been Egypt's principal development partner in irrigation and water management and the largely renewed irrigation system has contributed to recent increases in agriculture productivity and exports. Bank efforts in rural finance have been less successful. The Bank has also contributed to improvements in Egypt's human development indicators, although large income disparities persist between Lower and Upper Egypt.**
- **Future Bank strategy should reflect Egypt's middle-income status by including a flexible lending program and an emphasis on knowledge services, including reimbursable technical assistance. The Bank can further strengthen the recent successful partnership by: (i) identifying direct and indirect interventions that could help reduce income disparities through improving the targeting of social safety nets; (ii) focusing analytic work on macroeconomic analysis and income disparities, and improving its dissemination; (iii) pursuing further financial sector reforms and promoting reforms that indirectly combat corruption (public financial management, simplification of taxation and business procedures, and an information act); and (iv) emphasizing sectoral strategies and policy and institutional reforms in infrastructure and energy.**

Background

Egypt is a country of over 74 million people and a per capita income of $1,580 (as of 2006), occupying a crucial position in the geopolitics of the Middle East. Less than 5 percent of Egypt's total land area is cultivated, the remainder being uninhabitable desert. Thus, more than 97 percent of the population lives in the narrow strip of the highly fertile Nile valley and its delta, and population density in these areas is high. There are major differences in poverty and inequality across regions in Egypt, with the highest poverty in Upper Egypt (south), both rural and urban, and lowest in metropolitan areas and Lower Egypt (north). Social equity and political stability have been continuing concerns, reflected in the allocation of significant public resources to social spending.

Prior to the period under review, Egypt had begun a program of stabilization and structural reform, supported by donors. The combination of fiscal discipline, exchange rate and modest trade reforms, some price liberalization, and selected privatizations yielded results: inflation came down from over 20 percent in 1991 to below 10 percent in 1995, while GDP growth rose from the stagnation of the early 1990s to 4.7 percent in 1995. In addition, partly as a result of the 1991 Paris Club agreement on external debt restructuring, the debt was reduced from very high levels (Egypt was one of the most heavily indebted countries in the world in the late 1980s) to a modest 60 percent of GDP by 1995. In 1996, the government further deepened earlier reforms. Although fiscal deficits began to increase again, private investment grew to almost 13 percent of GDP in 1998 compared to less than 10 percent in the early 1990s; growth was 5.3 percent per annum between 1995 and 2000; and inflation continued to decline to less than 4 percent by 1998. Thus, at the beginning of the period under review, Egypt had been undergoing a series of economic reforms that had yielded positive results.

Bank Assistance

During the CAE period, Bank assistance to Egypt was guided by three Country Assistance Strategies (CASs) in 1997, 2001, and 2005. Their dominant and consistent themes were: (i) promoting higher, more sustainable economic growth through structural reforms; (ii) development of water resources, infrastructure and the environment; (iii) development of human resources and poverty reduction. The focus of the CASs was relevant and consistent with the key development objectives of the government, but both the 1997 and 2001 CASs were overly optimistic about the amounts and focus of Bank lending that could be put in place and the government's willingness to use policy-based lending. Although governance was not an explicit objective of the Bank's strategy and program, the Bank was able to find an entry point through the Investment Climate Assessments to provide input into anticorruption efforts.

From FY99 to FY07, IDA/IBRD approved $2.1 billion for 18 investment credits and one adjustment loan. This was modest relative to official aid flows, representing only about 4 percent of total (between FY99 and FY05, the latest year for which data are available on official aid). For almost four years following Egypt's graduation from IDA in 1999, the government was reluctant to borrow significant amounts on IBRD terms, and lending declined to about $30 million/year. During this period, the Bank focused on economic and sector work and cleaning up the problem projects in the portfolio. The late addition of a large airports development project in FY04, not foreseen in the CAS, changed the dynamic, and combined with a new reform-oriented government, the Bank's assistance began to ramp up. The Bank provided key analytic work in poverty, investment climate, financial sector, energy, and environment, partly through a new instrument, reimbursable technical assistance, and established fruitful policy dialogue in a number of key ministries. The Bank made a large development policy loan in support of wide-ranging financial sector reforms. The quality of the Bank's portfolio improved dramatically, with a reduction in the portfolio at risk and an improvement in disbursement rates. Over the CAE period, the IFC was active, with loans and investments totaling $842 million across a diversified portfolio, and delivery of advisory services totaling $12 million.

Findings of the Evaluation

Under the first pillar, *promotion of higher, more sustainable growth through structural reforms,* outcomes of the CAS objectives were uneven, slower to materialize in the first part of the period, but good in the latter period. Between 1999 and 2003, economic growth slowed, averaging only around 3.2 percent per annum, accompanied by a decrease in both private and public investment. Fiscal deficits increased again after 1998, driven initially by declining public revenues rather than rising public expenditures, which remained stable. Capital expenditures declined, but public debt reached 80 percent of GDP and inflation surged to 8 percent in 2004. During this period, the exchange rate appreciated significantly, ad hoc controls were being implemented in the trade regime, and public banks were effectively bankrupt due large nonperforming loans.

The reformist government that took office in June 2004 set a major agenda for structural reforms including (i) simplifying the trade regime and reducing trade tariffs; (ii) improving exchange rate management and floating the currency; (iii) reducing tax rates and simplifying the tax structure; (iv) accelerating privatization; (v) limiting regulatory impediments to business entry and licensing; (v) streamlining cash and debt management; and (vi) partially adjusting energy prices. Bank support for these reforms was primarily through economic and sector work and reimbursable and other technical assistance, rather than through lending.

The economy responded positively to the reforms. Economic growth accelerated from 4.5 percent in 2005 to 6.8 percent in 2006, largely driven by expansion of private investment and aided by a favorable external environment. Exports and imports increased rapidly in 2005 and 2006, and foreign direct investment surged to 5.7 percent of GDP. Private investment increased from 8 percent in 2003 to 11 percent in 2006 and Egypt's stock market was the strongest performer in the region in 2006. The Bank's 2008 Doing Business Report puts Egypt at the top of the "most improved business climate" list of countries. Privatization in 2005/06 exceeded expectations, and fiscal reforms progressed well, but primary and overall budget deficits remained high. Inflation was contained to single digits, except for fluctuations in 2006 and early 2007.

Nevertheless, inflationary pressures from strong domestic demand and rising world food prices persist. Employment grew 4.6 percent per year between 1998 and 2006, more than the labor force (3.9 percent), leading to a decline in the unemployment rate from 11.7 percent in 1998 to about 8 percent in 2006. An ambitious financial sector reform program was undertaken, supported by the Bank with a development policy loan of $500 million in 2006 (which mobilized a total of $2.2 billion, including other donors), based on a Bank-IMF financial sector assessment. The outcome of the first pillar of Bank assistance—promoting higher, more sustainable growth through structural reforms—is rated as moderately satisfactory.

Under the second pillar, *development of water resources, infrastructure and environment,* progress was good. The Bank has been Egypt's principal partner for three decades in irrigation, pumping and drainage, and community-based rural development, and Bank-financed projects account for the renewal and improvement of a large proportion of Egypt's water infrastructure. The Bank has generally been effective in strengthening institutions in Egypt's water resources sector, specifically the Egyptian Public Authority for Agricultural Drainage Projects. The Bank has been less successful with efforts to build institutional capacity at the Mechanical and Electrical Department of the Ministry of Water Resources and Irrigation. It has been instrumental in establishing water users association and their effective involvement in water resources management. The Bank also played a significant role in helping the government to implement its Integrated Water Resources Plan. As a result of this long-term engagement, agricultural sector growth and export performances were impressive during the review period. There was no progress, however, in reducing disparities in living standards between Upper and Lower Egypt, even though the Bank's two rural development projects (Matruh and Sohag) contributed to living standard improvements in project areas.

The Bank was absent from the main infrastructure sectors, transport and energy in particular, from FY99 until FY04. But the Bank responded quickly to a government request for an Airports Development Project (FY04, $335 million), preparing, approving, and declaring the project effective within nine months. While the strategic relevance of Bank funding of airports development in Egypt can be questioned on the grounds that the link to poverty reduction is not immediate, the Bank's role in these investments helped bring about a fundamental change in Bank-Egypt relations, and was followed by another large loan ($270 million) to the power sector in FY06. The Bank produced a number of analytic and policy-oriented notes in energy, urban transport, railways, telecommunications, and information technology. Airport capacity, as a result of the Bank project, has been significantly increased, thus reducing a potential barrier to tourism. In the energy sector, installed power generation capacity increased and chronic shortages were avoided. Energy reforms are underway, including unbundling and some regulatory strengthening, although a large agenda remains. Despite recent adjustments, energy prices remain heavily subsidized. The telecommunications sector has been liberalized, allowing private mobile operators and expanding telephone service dramatically. In environment, the Bank had a small lending program of two loans and carried out several studies; since 2005, air and water quality indicators have started to improve. Outcomes of Bank assistance for this second pillar are rated satisfactory.

For the third pillar, *development of human resources and poverty reduction,* the Bank's assistance strategy was less effective in helping Egypt in implementing a broad range of social programs. Outcomes are rated as moderately satisfactory, although in the area of gender, disparities have been reduced substantially in education and health during the review period. The Bank's inputs contributed significantly to the present strength of the National Council of Women, a focal point of government's gender efforts. Overall, Bank gender work in Egypt has been a pioneer and a model for the MENA region.

Education indicators improved over the period under review. Compulsory education was lengthened from eight to nine years; net enrollment ratios in primary education increased by about 9 percent for both boys and girls, to 100 percent and 97 percent, respectively. Those in preparatory increased much more, 21-22 percent each, to 84 percent for boys and 82 percent for girls. Thus Egypt made good progress on reducing or eliminating remaining problems of access to basic education. Secondary enrollments increased faster, from 2.7 million to 3.2 million, or by 17 percent. The enrollment rate in secondary education rose from 33 percent to 39 percent.

While Egypt has achieved considerable progress on indicators in health, nutrition and population, the Bank's contribution to this has been modest, as Egypt did not borrow from the Bank in this area after it graduated from IDA. Nevertheless, the Bank financed both targeted interventions—national schistosomiasis control (FY92); population in Upper Egypt (FY96); and an innovative Health Sector Reform Program (HSRP, FY98)—implemented during the review period with good outcomes, and provided a series of policy notes on health issues. The government has now requested support from the Bank for health insurance reform.

Egypt made some progress in poverty reduction during the review period, but this has been disappointing overall. The poverty headcount fell from 19.4 percent (1996) to 16.7 percent in 2000, but following a period of slower economic growth, by 2005, it had risen to 19.6 percent again. With high GDP growth in 2005 through 2007, it is likely that poverty has fallen, but not necessarily everywhere and recent figures are not available yet. Upper Egypt has lagged behind Lower Egypt, and both its rural and urban poverty headcounts increased even during the rapid growth of the late 1990s, and continued to rise slowly through 2005. The safety net in Egypt consists mainly of subsidies on a small number of basic foodstuffs, particularly bread. These subsidies have lifted some out of poverty, but they do not reach enough of the poor and are not well-targeted. Finally, Egypt has made sustained progress toward achieving the Millennium Development Goals related to education, infant and child mortality, maternal mortality, and safe water and sanitation.

In sum, there was progress on many of the objectives of Bank assistance, and the *overall outcome of the Bank's assistance program is rated moderately satisfactory,* although the Bank's contribution to a number of outcomes was often very small in financial terms. On the other hand, the Bank produced well-timed and good-quality knowledge products which have been highly respected by both government and the donor community, and which have assisted in policy formulation and reform. In lending, the Bank could have focused more sharply on reducing poverty and inequality, particularly in human development, aiming more of its interventions towards Upper Egypt, where poverty is more pronounced.

The *institutional impact of Bank assistance is rated as substantial.* The quality of macroeconomic management improved, and progress was made on the institutional reforms in tax administration, customs, and the financial sector. In public financial management, progress was made in transparency and public procurement. The Bank made significant contributions to institutional development in water resources management by helping the government to establish small and large scale water user associations. The present strength of National Council of Women benefited from the Bank's assistance program.

Although the Bank continued to be overly optimistic on Egypt's interest in borrowing or in using policy-based lending in the first part of the period, it did pursue analytic work on poverty and was pro-active in improving the performance of its portfolio. It also carried out other good-quality analytic work in many sectors, and produced a series of timely policy notes. The Bank was responsive to the government's request for a rapid appraisal and approval of an airport development project that had not been part of the Bank's strategy. This responsiveness, combined with a buildup of technical expertise in the Cairo office and the ability to harness knowledge from around the world on a wide range of issues of interest to the new reform-minded government, brought about a dramatic shift in the Bank's role in the recent reforms and allowed the Bank to make substantive contributions to the recent progress on structural reforms and economic growth. The risks to development outcomes in Egypt would appear to be moderate at this time, but they remain real in view of the continued presence of large pockets of poverty and the recent unprecedented increase in international food prices.

Future Bank strategy should reflect Egypt's middle-income status by including a flexible lending program and an emphasis on knowledge services, including reimbursable technical assistance The Bank can further strengthen the recent successful partnership by:

- Improving program focus on *reduction of poverty and inequality,* with a view to identifying direct and indirect interventions that could help reduce income disparities between Upper and Lower Egypt, and including improving targeting of social safety nets through the introduction of a program of conditional cash transfers.
- Giving priority in *analytic work* to macroeconomic analysis, water resources development, infrastructure, and Upper Egypt, and on improving engagement of stakeholders around findings and recommendations.
- *In financial sector and public sector governance:* (i) pursue lending support for continued financial sector reforms (banking reforms including specialized banks, supervisory framework, capital markets, and non-banking financial institutions); and (ii) continue promoting improvements to systems that improve governance and indirectly combat corruption (public financial management, simplification of taxation and business procedures, and information act).
- *In infrastructure and energy:* (i) assist Egypt in developing its infrastructure strategy dealing with issues of public investment and public-private partnerships; and (ii) move beyond capital investments and focus on policy and institutional reforms.

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Contact IEG:

Director-General, Evaluation: Vinod Thomas
Director: Cheryl Gray (IEG-WB)
Task Manager: Ismail Arslan (IEGCR)

Copies of the report are available at:
http://www.worldbank.org/ieg/cae
IEG Help Desk: (202) 458-4497
E-mail: ieg@worldbank.org