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INDEPENDENT EVALUATION GROUP
EGYPT COUNTRY ASSISTANCE EVALUATION
APPROACH PAPER

Country Background

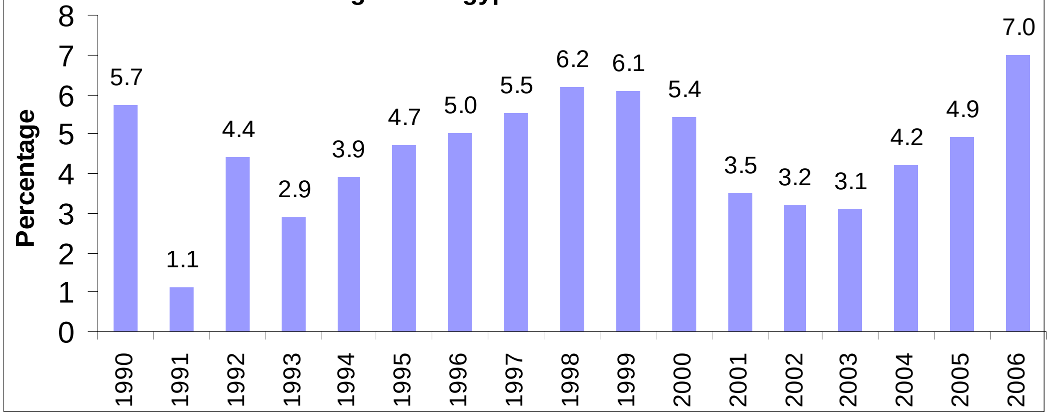
1. Egypt is a country of over 74 million people, has a per capita income of $1,250 (GNI, Atlas method) in 2005 and occupies a crucial position in the geopolitics of the Middle East. Less than 5 percent of Egypt's total 1 million sq. km. land area is settled and cultivated. Most of the rest of the land is uninhabitable desert, so that more than 97 percent of the population lives in the narrow strip of the highly fertile Nile valley and its delta. Population density in non-desert areas is therefore high. Government concerns about the destabilizing social problems resulting from overcrowding were the main impetus behind the Southern Valley development project that aims to reclaim a large swathe of desert by pumping water from Lake Nasser. There are major differences in poverty and inequality across regions in Egypt, with poverty worst in Upper Egypt (south), both rural and urban, and the lowest in metropolitan areas and Lower Egypt (north). Successive governments have persistently shown strong concern for social equity and political stability. This is reflected in the significant public resources that have been allocated to social-spending items. In addition to domestic resources, Egypt has been a recipient of large external financial assistance flows, mostly in the form of grants, provided mainly by the United States, the European Union and Arab countries.

2. The economic policy framework and GDP growth have gone through well-pronounced cycles in Egypt during the last three decades. Governments have instituted stabilization and reform programs when GDP growth has stalled and balance of payments problems have mounted. The "crisis" is triggered either through external shocks or internal fiscal mismanagement. Stabilization cum reform cycles usually start with a devaluation, which then is followed by fiscal tightening and reduction in fiscal deficits and inflation, and limited attempts to undertake reforms in key policy areas which have been identified as constraints to growth. These areas include: encouraging private sector activity through deregulation and privatization, undertaking trade reforms, and improving the financial sector. After each stabilization episode, some reforms have been implemented in each of these areas. However, none of these reforms have been sufficient to overcome the strong anti-export bias and the public sector dominance in the economy, both through excessive regulation and significant public ownership. This explains why the episodes are repeated and the same policies, which had been implemented only partially in the previous reform round, are picked up again.

3. In 1991 Egypt began an ambitious program of stabilization and structural reform, supported by donors. The first phase, up to 1996, consisted of controlling fiscal deficits; exchange rate reform; liberalizing most prices and interest rates; reducing import tariffs; and initiating the privatization of public enterprises. With the effective fiscal adjustment and sound monetary policy management, inflation was brought down from over 20 percent in 1991 to below 10 percent in 1995. From being one of the most heavily indebted countries in the world

at the end of the 1980s, Egypt reduced its debt to 60 percent of GDP by 1995, in part as a result of the 1991 Paris Club agreement of external debt restructuring as well as of debt forgiveness by the United States and Gulf countries. Macroeconomic stabilization led to a strong recovery. GDP growth rose from the stagnation of the early 1990s to 4.7 percent in 1995 and continued its upward momentum into 1996 (see Figure 1).

Figure 1: Egypt - GDP Growth Rates



4. In 1996, realizing the need to deepen the reforms, the Government began to speed up privatization and pursue other reforms more aggressively: in less than two years, it sold its controlling interest in 65 companies and minority interest in another 16;[1] it removed most quantitative restrictions on imports and reduced tariffs; decontrolled many rents; liberalized investment procedures; passed a new investment law; and undertook financial sector and tax reforms. Results over the next several years were good: private investment grew to almost 13 percent of GDP compared with 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 in 1998. Egypt should be given considerable credit for carrying out fundamental reforms in the 1990s without igniting unrest and for maintaining sound macroeconomic performance in the face of the financial crisis that hit many emerging markets in the 1997-99 period.[2]

5. Rapid growth in incomes and employment in the late 1990s led to a drop in poverty in Egypt for the first time since the early 1980s, to less than 17 percent of the population in 1999/2000 from over 19 percent in 1995/96. Approximately 10.7 million Egyptians in 2000 were poor according to the Households Income, Expenditure and Consumption Survey. The distribution of the poor was quite uneven across the regions. Most of the poor were concentrated in Upper Egypt. Thirty four percent or 5.8 million, were poor in the Upper rural region. In the Upper urban region the poverty rate was lower, but still reached 19 percent. In summary, in the 1995-2000 period, income distribution worsened slightly for Egypt as a whole in the Upper Egypt regions in particular, but Lower Egypt (the Nile delta region) had pro-poor growth.

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[1] The companies that were privatized have been spread over a number of sectors including agriculture, real estate and construction, food and beverages, milling, cement, chemicals and fertilizers, and textiles.

[2] Egypt: Country Assistance Evaluation, IEG, June 26, 2000.

6. Egypt's GDP growth rate decelerated, again, between 2001 and 2003, averaging only around 3.2 percent per annum. The contributing factors were vulnerabilities of services to regional instability (e.g., September 11 events, Iraq war, and Luxor massacre) and a decline in OECD growth. The loss of growth momentum was accompanied by decreases in both private and public investment. Private investment declined from around 13 percent of GDP in 1998 to around 8 percent in 2003. Public investment fell from around 15 percent of GDP in 1998 to around 8 percent in 2003. Fiscal deficits began rising after 1998, following a long period of improvement. Net public debt level stood at 88 percent of GDP at the end of fiscal 2004. The most recent (preliminary) figures show that the poverty headcount increased slightly from 18.4 percent in 2000/Q3 to 19.6 percent in 2004/Q3. Unemployment rose in the early 2000s and reached about 11 percent in 2003. The young and women, in particular, suffer from the highest unemployment rates.

7. The Government appointed in July 2004 has embarked on a far-reaching reform program. Several reforms have been pursued to give the private sector a greater role: the needed correction of the exchange rate and its management eliminated the distortions generated by the parallel market premium; simplified the tariff structure and reduced the weighted average tariff from 14 to 9 percent; tax rates were lowered and the base broadened; privatization has been revived; and significant progress has been achieved in the implementation of the "financial sector reform program". Since then, the economy has grown faster, employment has risen and investment (including FDI) has surged. Inflation fell sharply in 2005 and real interest rates turned positive.

8. Economic growth has surged to a twenty-year high of 7 percent in 2006. The external sector remains an important engine of growth, but the expansion has become more broad-based, with construction and services now increasing at a healthy rate. Privatization in 2005/06 exceeded expectations, and reforms in the fiscal area have prepared the ground for fiscal consolidation to go forward. The privatization of the fourth-largest state bank (Bank of Alexandria) was completed in early 2007. Private investment steadily increased from 8 percent of GDP in 2003 to a projected 14 percent of GDP in 2006/07. Egypt's stock market was the strongest performer in the region in 2005/2006.

9. During the last twenty years or so, human development indicators have improved substantially in Egypt. For example, infant and under-5 mortality rates have declined to almost one-quarter of their levels in 1990, while gross primary and secondary school enrollment have increased substantially. Moreover, many social indicators are better in Egypt than in countries with comparable income levels. However, though diminishing over time, regional disparities in education and health indicators remain relatively large. In 2004, adult illiteracy was as high as 43.5 percent in Upper Egypt while it was only 35.1 percent in Lower Egypt. Life expectancy at birth increased from 67.5 years in 1997 to 70.2 years by 2004, thus surpassing the Middle East and North Africa region average which is currently at 68.6 years.

10. Egypt has made sustained progress toward achieving the Millennium Development Goals related to water and sanitation, infant and child mortality, and maternal mortality. However, there was slow progress in poverty reduction and in promoting gender equality and women empowerment. In addition, environmental policies remain at the margin, and this is

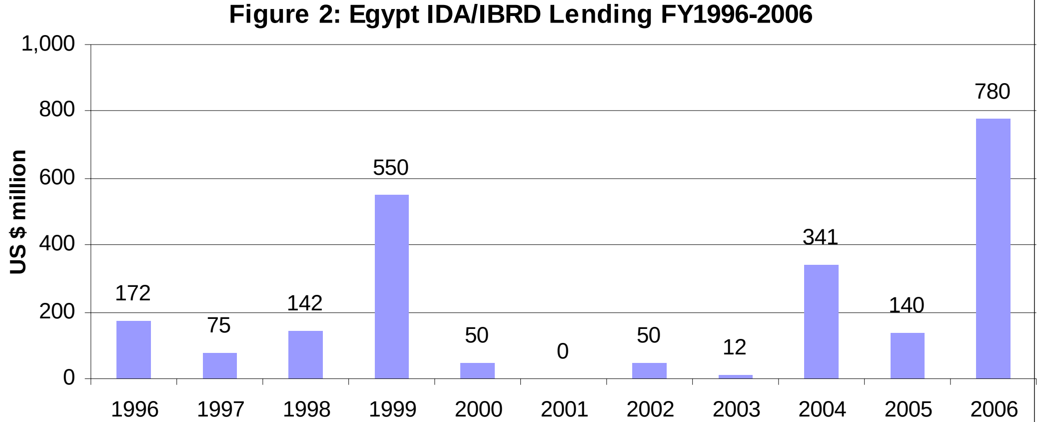
reflected in a constrained Ministry of State for environment, and weak law enforcement capabilities.[3]

The World Bank Program

11. The first Bank loan to Egypt was in 1959 to help further develop the Suez Canal. Total commitments grew in the 1980s, but even at their peak in the 1990s, Bank commitments remained modest compared to the huge amounts of aid provided to Egypt by the United States and European Union. Thus, the Bank has always had a relatively small role in assistance to Egypt. Since the first loan, the Bank has approved 113 operations for Egypt, valued at about $7.8 billion. The country graduated from IDA in June 1999. From fiscal 1999 to fiscal 2006, IDA/IBRD made commitments of $1.9 billion for 16 investment credits and one adjustment loan (see Figure 2). The Bank's lending to Egypt fluctuated widely from year to year during this period. The current portfolio has 15 active projects with a commitment value of about $1.7 billion. The sectoral composition of the current portfolio is as follows: 32 percent for financial sector, 20 percent for transport, 19 percent for rural sector, 16 percent for energy, 8 percent for education, and 5 percent for health.

12. Egypt has been a member of IFC since 1976; the first IFC resident mission in the world was opened in Cairo in 1978. IFC's strategy, as reflected in joint-CAS documents, has been focused on delivering technical assistance and broadening its presence in the financial sector, on supporting exports and on providing assistance to the privatization program through individual transactions. Investments are in a range of sectors including the financial sector, infrastructure, small and medium enterprises, manufacturing, chemicals, and tourism. At the end of fiscal 2006, the committed IFC portfolio in Egypt stood at $290 million.

Figure 2: Egypt IDA/IBRD Lending FY1996-2006



13. An IEG Country Assistance Evaluation (CAE) was submitted to the Board in January 2000. It covered the period from fiscal 1991 to fiscal 1998. The CAE found that the overall outcome of Bank assistance was marginally satisfactory. The Bank's role in Egypt was 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 was the absence of work on poverty alleviation. IEG also prepared a Review of the country assistance

[3] Egypt: Human Development Report 2005, UNDP.

strategy completion report on Egypt in June 2005. The Review concluded that the objectives of the 2001 assistance strategy appropriately focused on Egypt's development priorities. Bank assistance supported effectively the objective of developing human resources, followed by developing natural resources, and with little success, sustaining high growth to reduce poverty and unemployment. The Review rated the overall outcome of the Bank's assistance program as moderately satisfactory. The CAE will provide an opportunity for IEG to revisit this assessment and an in-depth review covering a longer period.

14. This CAE will cover the nine-year period from July 1998 to June 2007. During that period, the Bank's assistance to Egypt has been guided by three country assistance strategies (CASs) in the late 1990s, 2001, and 2005. The objectives of all three were to support rapid and sustained growth, to alleviate poverty, to narrow inequalities, and especially to generate sufficient employment. In addition, the three CASs were joint IFC-Bank documents, developed in collaboration with key stakeholders in Egypt and contained a list of expected results against which their success was to be monitored. The assistance strategy in the late 1990s had four areas of focus: export development, private sector development, human resource development, and rural infrastructure and environmental protection. The 2001 CAS had three areas of focus: interventions that support higher and sustained growth, targeted interventions for poverty reduction, and interventions with major indirect poverty reduction impact. This CAS, for the first time, added the main issue of public sector governance and the political dominance of the state over economic decisions. The 2005 CAS had three key strategic objectives: facilitating private sector development, enhancing the provision of public services, and promoting equity.

General Approach to Evaluation

15. The CAE will evaluate the relevance of Bank objectives in the context of the development constraints facing Egypt at the time the CASs were prepared, and the realism of Bank assistance objectives in view of the political environment for development and the capacity of the government. The CAE will ask whether the Bank's assistance strategies have recognized the *sui generis* factors affecting Egypt (availability of large grants from other donors, rich natural resource endowments, strategic geographical location, Suez Canal and tourism revenues, workers' remittances) and generic factors (governance, growth, poverty, employment and environment). How did the relative importance of these two sets of factors play out during program implementation?

16. In evaluating the Egypt program, the study will also draw on the evidence and findings in recent and ongoing IEG evaluations of Bank support for Trade, Natural Disasters, Environment, Public Sector Reform, and Middle-Income Countries, as well as specific Project Performance Audit Reports and ICR Reviews on the Egypt portfolio. It will also draw on work by the Quality Assurance Group, and other relevant Bank documents.

17. The CAE will examine the degree to which the CAS objectives and planned results have been achieved and what role the Bank's support has played in this achievement. In each of the three areas named in para. 19, the CAE will use a set of indicators, with end-1998 as the baseline, to evaluate the achievements by the end of 2006. These indicators will be drawn mainly, but not exclusively from the Bank's strategy documents. It will also assess the relative contribution to attainment of the objectives of the Bank's interventions, taking into account the

contributions of the government and those of other donors, which have been exceptionally important for Egypt. IEG–IFC will undertake a parallel evaluation of IFC activities in Egypt and produce a Country Evaluation Note (CEN). Coordination will be ensured between the CAE team and the CEN team so that each provides an up-to-date reflection of the other's findings.

Issues Focus of the Evaluation

18. Poverty reduction has been an overarching theme that cuts across all activities in the Bank's assistance program to Egypt. During the review period, the Bank's analytical and advisory assistance (AAA) program on poverty produced four major reports to assist the authorities in monitoring developments with respect to income distribution and poverty. What could the Bank have done differently or more of to help make the pattern of Egypt's economic growth more pro-poor? Were the growth policies complemented with sufficient pro-poor education, health, and other relevant social programs to protect the poor and vulnerable?

19. The three strategic objectives that will be the focus of the CAE are:

(i) ***Promotion of High Economic Growth through Structural Reform***. This entails providing support for macroeconomic stability and better public sector governance, private sector development, financial and corporate sector restructuring and modernization, improving competitiveness and the business climate, and trade policy reforms. The evaluative questions that will be used to assess each of these are as follows:

- *Maintaining macroeconomic stability and improving public sector governance.* How effectively did the Bank program contribute to Egypt's efforts and what was the quality and effectiveness of the Bank's advice and AAA in this area? Was the Bank's assistance to improve public sector expenditure management relevant, and what have been the outcomes? Did the Bank undertake comprehensive public expenditure reviews on a regular basis? What was the role of the Bank program in revenue enhancement and expenditure control measures to reduce the budget deficit; debt management; and enhanced transparency through public release of budget data? What has been the contribution of the Bank program on governance and anti-corruption?
- *Financial sector modernization*. What was the role of the Bank in enhancing the soundness and competitiveness of the banking sector; including through the sale of government shares in joint ventures; restructuring and privatization of state-owned banks; and new legislation on accounting and auditing of capital market entities including the insurance and mortgage sectors?
- *Privatization and improvement in the regulatory environment.* The objectives of the CASs have been to reduce the number of state enterprises and minimize the role of the state in areas where private sector enterprises can function effectively. Has the role of state-sponsored economic enterprises declined in the economy? Did public sector performance improve? Has the business climate improved significantly over the review period? Has the cost of doing business declined?
- *Trade policy reforms including export administration and trade facilitation.* The objectives of the CASs have been to reduce the anti-export bias by

reducing the level and dispersion of tariffs, eliminating most of the import control measures, and introducing more efficient export administration. Has the trade regime reduced its anti-export bias, and has this led to increases in the share of Egypt in world trade?

(ii) ***Development of Agriculture and Water Resources, Infrastructure and Environment.***

- *Agriculture and Water Resources*. The Bank has been Egypt's principal partner for three decades, operating via parallel loans and technical assistance to the sector's three main branches—water delivery, pumping and drainage, and community-based rural development and natural resource management. Previous support to irrigation and drainage was relatively successful, with satisfactory outcomes and likely sustainability.[4] Has this success continued in the review period of this CAE? Have these interventions contributed effectively to rural development? Has the Nile's scarce water been used efficiently and to what extent have water tariffs facilitated this? Has the Bank strategy adequately allowed for regional programs, particularly the Nile Basin Initiative?
- *Infrastructure*. The Bank was absent from the main infrastructure sectors from fiscal 1999 until fiscal 2004. There were no transport loans in the period until the very large project ($335 million) for airports in 2004. This was followed by another large loan ($270 million) to the power sector in fiscal 2006. Was Egypt willing to borrow from the Bank for public infrastructure in the intervening years, or was the lack of lending a preference of the Bank? What progress has been made in improving infrastructure in transportation and energy? What has been the progress in reducing large energy subsidies? What were the effects of the fuel subsidies on poverty, fuel choices and emissions, and fiscal balance?
- *Environment*. Has progress been made in improving environmental policies and regulations? Has the Bank developed an operational program in environment that is adequate to support its CAS objectives?

(iii) ***Development of Human Resources.*** The Bank's human resource development strategy focused on improving equity (enhancing access in remote poor areas and access by girls), on enhancing quality at all levels, and on managing population growth.

- *Health, Nutrition and Population (HNP).* In the review period, the Bank worked with other donors and the government on health sector-related analysis and completed three traditional projects approved earlier. Could the Bank's assistance have had a larger, nationwide impact? What should the Bank have done differently in this sector? Why did it have no new lending for HNP during the nine-year review period?
- *Education and Training*. A new generation of five "enhancement" projects for individual subsectors was under implementation at the end of the period. Most

[4] Egypt: Country Assistance Evaluation, IEG, June 26, 2000.

were based on studies done by the government and the Bank together, and with other donors. The projects and studies covered all subsectors of education: basic, secondary, higher, skills development, and early childhood education. How was the Bank able to create and sustain such a broad relationship with the government in education? Did the Bank move Egypt enough toward a flexible modern system of education? Did the projects and studies help improve learning outcomes? Were graduates attractive to employers and were labor markets sufficiently flexible to absorb them?

- *Gender.* Apart from a country gender assessment, both education and health sector lending had important gender focus or implications. Could the Bank have done more to lessen the gender disparity in education, health, and employment?
- *Social Protection*. The Bank's previous lending through the Social Fund for Development (SFD) was quite successful in creating some permanent and much-needed temporary employment and useful local (economic and social) infrastructure through public works programs and community-based programs, and also covered training.[5] Did the success of SFD continue in the most recent period? What was the effectiveness and efficiency of subsidy programs in reducing poverty, including in the country's lagging regions?

20. The performance of Bank products and services (lending, analytical and advisory services, and aid coordination) intended to contribute to the achievement of CAS objectives will be examined. The Bank's program in Egypt over the period under review relied heavily on analytical reports and project lending, and the adjustment lending has been consistently below the middle income country average. The CAE will examine whether the Bank selected the right mix of instruments and sectors to implement its strategy. It will also examine whether the Bank was able to leverage its limited financial assistance through AAA and aid coordination to increase its impact.

21. The CAE will attempt to connect the country-specific lessons that emerge for Egypt to more general policy and institutional issues whose relevance extends beyond Egypt, in order also to draw lessons which might be applicable to other middle-income countries, particularly on the following policy and institutional issues: (i) the transition from IDA to IBRD; (ii) the Bank's role in a multi-donor framework; and (iii) intra-Bank-Group collaboration.

CAE Outputs and Timetable

22. The CAE will be carried out under the general supervision of Ali Khadr (Senior Manager, IEGCR). The task team will consist of Ismail Arslan (Task Team Leader, IEGCR), Ataman Aksoy (Macro-economy, Trade and Financial Sector), Joseph Goldberg (Agriculture, Infrastructure and Environment), David Berk (Social Programs) and Victor Orozco (Governance and Statistical Support). Agnes Santos will provide administrative support. Peer reviewers are Steve Webb (IEGCR), Marilou Uy (AFTFP), and John Nash (LCSSD). The CAE team will visit Egypt from June 20 to July 6, 2007. The CAE is expected to be delivered to CODE in March 2008.

[5] Egypt: Country Assistance Evaluation, IEG, June 26, 2000.