Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No. 100978-EG

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED LOAN

IN THE AMOUNT OF US$1,000 MILLION TO

THE ARAB REPUBLIC OF EGYPT

FOR A

FIRST FISCAL CONSOLIDATION, SUSTAINABLE ENERGY AND COMPETITIVENESS

PROGRAMMATIC DEVELOPMENT POLICY FINANCING

November 23, 2015

Energy and Extractives Global Practice
Macroeconomics and Fiscal Management Global Practice
Trade and Competitiveness Global Practice

Middle East and North Africa Region

GOVERNMENT FISCAL YEAR

JULY 1 – JUNE 30

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of November 13, 2015)

Currency Unit = Egyptian Pound (EGP)

US$1 = EGP 7.83

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
ASA	Accountability State Authority
CBE	Central Bank of Egypt
CPF	Country Partnership Framework
DPF	Development Policy Financing
ECA	Egyptian Competition Authority
EEAA	Egyptian Environmental Affairs Agency
EEHC	Egyptian Electricity Holding Co.
EFSA	Egyptian Financial Supervisory Authority
EGAS	Egyptian Natural Gas Holding Co.
EGPC	Egyptian General Petroleum Corporation
EgyptERA	Egyptian Electric Utility and Consumer Protection Regulatory Agency
EIA	Environmental Impact Assessment
EU	European Union
FDI	Foreign Direct Investment
FY	Fiscal Year
GAFI	General Authority for Investment and Free Zones
GDP	Gross Domestic Product
GFMIS	Government Financial Management Information System
GoE	Government of Egypt
GRS	Grievance Redress Service
IFC	International Finance Corporation
IMF	International Monetary Fund
IOC	International Oil and Gas Company
LIWs	Labor Intensive Works
LPG	Liquefied Petroleum Gas
MoF	Ministry of Finance
MTDS	Medium-term Debt Management Strategy
NGO	Nongovernmental Organization
NIR	Net International Reserves
PFM	Public Financial Management
SCD	Systematic Country Diagnostic
SDS	Sustainable Development Strategy
SME	Small and Medium Enterprise
SSN	Social Safety Net
SSP	Social Solidarity Pension
TA	Technical Assistance
TKP	Takaful and Karama Program
UNCITRAL	United Nations Commission on International Trade Law
VAT	Value Added Tax

Regional Vice President:	Hafez M. H. Ghanem
Country Director:	Asad Alam
Senior Practice Director:	Anita George / John Panzer (acting) / Satu Kahkonen (acting)
Practice Manager:	Charles Cormier / Auguste Kouame / Najy Benhassine
Co-Task Team Leaders:	Ashish Khanna / Ahmed Kouchouk

ARAB REPUBLIC OF EGYPT

FIRST FISCAL CONSOLIDATION, SUSTAINABLE ENERGY AND COMPETITIVENESS

PROGRAMMATIC DEVELOPMENT POLICY FINANCING

TABLE OF CONTENTS

LIST OF FIGURES

ANNEX FIGURES

LIST OF BOXES

LIST OF TABLES

ANNEX TABLES

The proposed operation has been prepared by the World Bank Group in close cooperation with the African Development Bank. The overall operation was co-led by Ashish Khanna (Lead Energy Specialist, GEEDR) and Ahmed Kouchouk (Sr. Economist, GMFDR); with Sherif Hamdy (Sr. Operations Officer, GTCDR) and Nabila Assaf (Sr. Private Sector Development Specialist, GTCDR) leading the work on business competitiveness. The operation was prepared under the guidance of Charles Cormier (Practice Manager, GEEDR), Auguste Kouame (Practice Manager, GMFDR), Najy Benhassine (Practice Manager, GTCDR); with further support from Benu Bidani (Practice Manager, GPVDR) and Yasser El-Gammal (Practice Manager, GSPDR). The team includes Sara Al-Nashar (Economist, GMFDR), Ulrich Bartsch (Lead Economist, GMFDR), Santiago Herrera (Lead Economist, GMFDR), Sahar Sajjad Hussain (Economist, GMFDR), Thomas Laursen (Lead Economist, GMFDR), Vivien Foster (Lead Economist, GEEDR), Joern Huenteler (Energy Specialist, GEEDR), Mohab Hallouda (Sr. Energy Specialist, GEEDR), Peter Griffin (Consultant, GEEDR), Ola Nour (Operations Officer, GFMDR), Fatma Khalil Ali (Operations Officer, GTCDR), Syed Ahmed (Lead Counsel, LEGAM), Gerard Joseph Mataban Jumamil (Associate Council, LEGAM), Manuel Vargas (Lead Financial Management Specialist, GGODR), Mohamed Yehia (Sr. Financial Management Specialist, GGODR), Tara Vishwanath (Lead Economist, GPVDR), Nistha Sinha (Sr. Economist, GPVDR), Gabriel Lara Ibarra (Economist, GPVDR), Afrah Alawi (Sr. Social Protection Specialist, GSPDR), Africa Olojoba (Lead Environmental Specialist, GENDR), Alaa Sarhan (Sr. Environmental Economist, GENDR), Amal El-Malla (Operations Officer, GTCDR), Andreja Marusic (Sr. Operations Officer, GTCDR), Amal Faltas (Sr. Social Development Specialist, GSURR), Gustavo Demarco (Program Leader, MNC03), Balakrishna Menon Parameswaran (Program Leader, MNC03), Poonam Gupta, (Country Program Coordinator, MNCA3), Ivan Nimac (Sr. Investment Policy Officer, GTCDR), Lire Ersado (Sr. Economist, GSPDR), Maiada Kassem (Finance Officer, WFALA), Laila Ashraf Abdel Kader Ahmed (Financial Sector Specialist, GFMDR) and Martha Licetti (Sr. Economist, GTCDR). Iman Sadek (Team Assistant, MNCEG), Hanzada Tohamy (Team Assistant, MNCEG), Heba Abouelleil (Consultant, MNCEG), Angeline Mani (Program Assistant, GEEDR) and Mark Njore (Program Assistant, GEEDR) provided outstanding administrative support. The team is grateful for the support and guidance from Asad Alam (Country Director, MNC03) and for the close and productive cooperation with the IMF team. The team would is also appreciative of the excellent collaboration from the Government of Egypt throughout various stages of this operation. The team acknowledges the leadership of the inter-ministerial working group set up by the Government of Egypt on Development Policy Financing, led by Her Excellency the Minister of International Cooperation and including the representatives of the Ministry of Finance, the Ministry of Petroleum, the Ministry of Electricity and Renewable Energy, the Ministry of Investment, and the Ministry of Trade and Industry.

SUMMARY OF PROPOSED LOAN AND PROGRAM

ARAB REPUBLIC OF EGYPT

FIRST FISCAL CONSOLIDATION, SUSTAINABLE ENERGY AND COMPETITIVENESS PROGRAMMATIC DEVELOPMENT POLICY FINANCING

Borrower	Arab Republic of Egypt
Implementation Agency	Ministry of International Cooperation
Financing Data	IBRD Loan Amount: US$ 1,000 million. Loan Terms: Variable-spread loan with 35 years maturity, including a five-year grace period.
Operation Type	First operation of a programmatic series of three
Pillars of the Operation And Program Development Objective(s)	The proposed operation is built around three pillars, which are also the Program Development Objectives (PDOs) of the operation: (1) to advance fiscal consolidation through higher revenue collection, greater moderation of the wage bill growth, and stronger debt management, (2) to ensure sustainable energy supply through private sector engagement, and (3) to enhance the business environment through investment laws, industrial license requirements as well as enhancing competition.
Result Indicators	**Pillar 1: Advancing Fiscal Consolidation** • Increased non-sovereign corporate income tax proceeds and sales taxes on goods and services from 5.4% of GDP in FY15 to 6.7% of GDP in FY18 • Reduced central government's wages and salaries bill from 8.2% of GDP in FY15 to 7.5% of GDP in FY18 • Annual publication of an updated Medium-Term Debt Management Strategy. • The internal audit function performed and reported on at least four audits on sectors and entities affiliated with the Ministry of Finance **Pillar 2: Ensuring Sustainable Energy Supply** • Reduced energy subsidies as a percentage of GDP from 6.6% in FY14 to 3.3% in FY16, and further by FY18 (to be determined during preparation of subsequent DPF operations) • Increased average electricity tariff across all consumer groups from EGP 0.226/kWh in FY14 to EGP 0.451/kWh in FY18 • Reduced market share of EEHC (by MW of nameplate capacity) from more than 92% in FY15 to 85% in FY18 • Notification and operationalization of the power supply code and power market rules by FY18 • Reduced difference between peak electricity demand and then available peak capacity from deficit of 5,540 MW in FY 15 to a surplus of 1,000 MW by FY18 • A separate gas transmission tariff, transmission code, market rules, and approval procedures are available by FY18 • A dedicated web portal with all regulations and rules is operationalized by FY18 • Increase in commissioned private sector-owned renewable energy projects from 0 MW (October 2015) to 1,500 MW (end of FY18) **Pillar 3: Enhancing the Business Environment** • Increased number of one-stop-shops with full business start-up and licensing facilitation systems that are operational from 0 in FY15 to 4 by end of FY18 • Reduced average number of days to comply with all industrial licensing

	requirements from 634 days in FY15 to 160 days by end of FY18 (target to be confirmed once Trigger #9.1 has been met) • Increased number of anti-competitive practices prevented/ eliminated from a baseline of 9 (between FY13 and FY15) to a target of 11 decided during the FY16 to FY18 period
Overall risk rating	High
Operation ID	P157704

IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN

TO THE ARAB REPUBLIC OF EGYPT

1. INTRODUCTION AND COUNTRY CONTEXT

1. **Egypt, the largest country in the MENA region with a population of 89 million, and the fourth largest economy with a GDP of US$ 320 billion in 2015, is at an inflexion point within a region laden with instability and conflict.** The 2011 Arab Spring - generated by the long-standing weaknesses in public service delivery, incapacity of growth to produce positive social outcomes, and weak competition and transparency- ushered in a new era. However, the economic dividends of post-2011 have not fully materialized in Egypt, with economic growth picking up only towards the end of FY14 and in FY15. A new President was elected in May 2014 and the Government has taken important initial steps in implementing key reforms that, if sustained, are likely to put the economy on a growth track and increase the chances that future growth will be more inclusive than in the past. The proposed programmatic Development Policy Financing (DPF) series set out in this document aims to support and strengthen these significant new reforms. Although there are important risks, including from the macroeconomic and reform implementation perspectives, the proposed DPF series will play a key role in supporting much needed structural reforms. The World Bank's engagement will also provide global lessons and experience relevant for reform sequencing and implementation. This DPF can play an important catalytic role in helping Egypt increase the chance of success in sustaining reforms and growth that can bring benefits to the broader population.

2. **This programmatic DPF series is aligned with the broadly endorsed World Bank Group (WBG) MENA strategy, which challenges the WBG to consider taking informed risks, when the results can have an important impact on peace and stability in the region.** The DPF series is aligned with pillars of the MENA Strategy, namely renewing the social contract and supporting economic recovery. This programmatic DPF series builds on the analysis and pillars set out in Egypt Systematic Country Diagnostic including the three highest priorities: macroeconomic stabilization, continued energy subsidy reform, and improvement in public governance. As such, the DPF is also aligned with Egypt Country Partnership Framework (see paragraphs 85 and 86), which along with the MENA Strategy, seek to achieve the WBG's twin goals of eradicating extreme poverty and boosting shared prosperity in a sustainable manner.

3. **This DPF series supports Egypt's reform program which aims to:** (1) advance fiscal consolidation through higher revenue collection, achieve greater moderation of the wage bill growth, and strengthen debt management; (2) ensure sustainable energy supply through private sector engagement; and (3) enhance the business environment through investment laws, industrial license requirements as well as enhancing competition. Stepping up to support Egypt in this critical period represents a unique opportunity for the World Bank Group to realign its relationship to a more strategic level, which can yield substantial benefits including: (i) safeguarding the recent improvement in the macroeconomic framework after four years of deterioration; (ii) paving the way for a more strategic partnership with Egypt that enables the full utilization of the Bank knowledge, convening, and financing capabilities, and (iii) supporting reform implementation momentum. This proposed DPF 1, in the amount of US$1 billion, is the first of three operations in a programmatic series, and has been prepared in close coordination with the African Development Bank, which is expected to

provide parallel financing of around US$400-500 million under the first of three envisaged operations in a programmatic series.

4. **Following the January 2011 revolution, Egypt's economic growth slowed down markedly before recording an increase in FY15; but the economy is now facing new headwinds.** Egypt's growth rate fell from an average of 6.2% during FY06-FY10 to an average of 2.1% during FY11-FY14 due to the negative economic ramifications and policy uncertainty following the 2011 revolution. This underperformance was reversed in FY15 with growth reaching 4.2%; mainly on the back of the gradual restoration of stability, improved confidence levels, and strong reforms adopted by the Government. However, the nascent recovery is challenged by the unfavorable and volatile external environment, the impact of lower oil prices on key regional economic partners, regional security challenges and instability, compounded by domestic factors such as the remaining market distortions and delays in the implementation of well-intended reforms.

5. **The post 2011 economic slowdown happened at a time of heightened social demands, the response to which took the form of expensive and inefficient fiscal policy choices that widened Egypt's twin deficit during FY11-FY14.** The economic slowdown negatively affected fiscal revenues. This was compounded by fiscal expansion on the expenditure side as the successive transition governments found themselves under pressure to meet social demands. For example, the wage bill grew from 7.0% to 8.5% of GDP and expenditures related to subsidies, grants and social transfers grew from 9.0% to 10.9% of GDP from FY11 to FY14. Furthermore, the heavy reliance on short-term domestic debt to finance the large fiscal deficits led to an increase in the interest payment bill from 6.2% of GDP to 8.2% of GDP over the same period. These unfavorable expenditure dynamics limited the Government's maneuvering ability to contain the deficit.

6. **Many factors contributed to Egypt's post-2011 economic slowdown, including the frequent power outages that started in 2009** and were driven by a shortage in natural gas, oil and petroleum products, a lack of additions in generation capacity, and distortions in the energy supply chain arising from persistent fuel and electricity subsidies. Apart from being fiscally unsustainable, low energy prices have stifled energy production and boosted demand growth, leading to a widening energy deficit. By the summer of 2014, the situation had become critical with the country experiencing continuous shortages of electricity, and a power generation deficit estimated at 5,540 megawatts, equivalent to one-sixth of the country's installed capacity. Residential consumers, who had not experienced load curtailment for over a decade, experienced outages of up to six hours of daily supply in 2014, and small and medium enterprises (SMEs) were reporting losses of 3.2% of annual sales, leading to severe discontent among the general public. In the 2015 Doing Business Report (DBR), Egypt was 144th out of 189 in world-wide ranking in terms of access to reliable power. Compounding the electricity problem, high subsidies distorted energy consumption thus affecting the performance of the economy in many ways. Energy subsidies favor energy-intensive industries, result in lower investments in labor intensive industries, thus curtailing employment growth. Moreover, these subsidies are regressive, with the richest 20% of Egyptian households capturing 60% of all energy subsidies. The summer of 2015 was largely without power outages as a result of the Government's measures to secure fuel supplies and to add generation capacity.

7. **The economic slowdown worsened the social conditions as reflected in higher unemployment rates, a pick-up in informality, and the persistence of high poverty rates.** Unemployment reached a high of 13.4% by the end of FY14, almost four percentage points higher than the rate realized prior to the economic downturn that started in FY11, with exceptionally high

rates recorded among youth and women. Though it has declined to 12.7% in FY15, the unemployment rate remains high. Even during previous high growth episodes, growth was not associated with adequate job creation. Recent analysis points to the weakness of the private sector in generating formal employment in Egypt. For example, while unemployment decreased from 11.7% to 8.7% from 1998 to 2008, the share of formal employment decreased from 34% to 27% in the same period. Employment has mainly been generated in informal SMEs, yet young and formal enterprises, usually a source of employment growth, do not seem to flourish in Egypt. Unsatisfactory employment outcomes are the result of declining public and volatile private investments; low energy prices that favor capital intensive sectors; and limited private sector dynamism due to an uncompetitive environment. This was made worse in recent years by shortages of, and controlled access to, foreign exchange for most investors but more so for the smaller ones. Egypt's poverty rates remain high. In FY13, the last year for which data are available, 26% of the population were considered poor. Moreover, regional disparities persist, and Upper Egypt is the region with the highest poverty rates, in particular in rural areas where the poverty rate is 50%.

8. In 2014, the Government introduced significant reforms aimed at putting the economy back on track. The Government has taken bold steps towards kick-starting the economy, whilst forging ahead with long-overdue and difficult reforms. These reforms included difficult policy choices that were adopted simultaneously; such as raising taxes, reducing energy subsides, and containing the high growth of the wage bill. Maintaining the reform pace would contribute to further restore confidence and stability. The implementation of reforms along with the gradual restoration of confidence and stability are starting to yield results. Economic activity picked up (during FY15), after four years of subdued growth, the budget deficit is finally declining, and external accounts have been buoyed by exceptional financing from the Gulf States (especially during FY14), in addition to the recovery of key foreign exchange-earning sectors such as tourism and FDI, albeit from a low base.

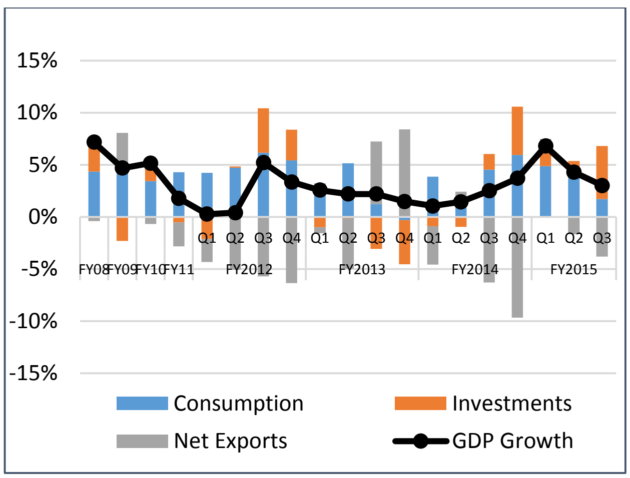
9. However, the recovery remains fragile and needs to be sustained through additional reforms. Growth picked up in the first half of FY15 but has decelerated throughout FY15 (down from 5.6% in the first half of the year to 2.9% in the second half). With the pick-up in the economy in the face of subdued global demand and lackluster performance in major trading partners, the unfavorable external environment, the switch of the energy sector into net importing by around US$ 3.7 billion in FY15, and more recently the tragic crash of the Russian airliner over Sinai, pressures are mounting on the country's external accounts. Egypt's foreign reserves reached a critical level of US$ 16.4 billion by end of October 2015, and market participants are facing shortages in hard currency, thus hampering economic activity and recovery as well as investors' sentiment. Also, importantly, a parallel exchange rate emerged in 2013 which continues to be in place.

10. As Egypt's political transition plan, announced in July 2013, comes to an end with the Parliamentary elections concluding in December 2015, the population has high expectations and demands for improved service delivery, sustained economic growth that creates jobs, and better living conditions. This is exerting additional pressures on the new Government to deliver a private sector-led growth model that is inclusive and capable of generating swift, adequate and productive jobs. These challenges are further complicated by the need to support the recent economic recovery in the face of unfavorable global economic conditions, external and regional vulnerabilities, and foreign currency shortages that are hurting economic activities. Meeting the challenge of sustaining growth in an environment of tight fiscal space will require a steadfast commitment and quick progress in improving the business environment, and removing the constraints facing investors to allow the private sector to drive job creation and growth. The current Government has signaled its commitment to sustain the reform momentum that picked up since July 2014 and confirmed that it would address the key priorities of strengthening macro-fiscal stability, ensuring sustainable energy supply, and improving the business climate by adopting a medium-term reform program.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

11. **After four years of slow growth, Egypt's economic growth picked up in FY15, yet challenges remain.** Growth reached 4.2% in FY15, double the growth during FY11-FY14; which is mainly attributed to the gradual restoration of stability and improved confidence levels, as well as the Government's sizeable public investment program, primarily directed towards financing infrastructure that is starting to crowd in private investments. However, across the economy, the contribution of investment to economic growth remains low – and even negative – during the four years of slow growth. Also, a negative net exports balance has been weighing on growth – with the exception of the second half of 2013 – as the trade balance continued to widen (see Figure 1).



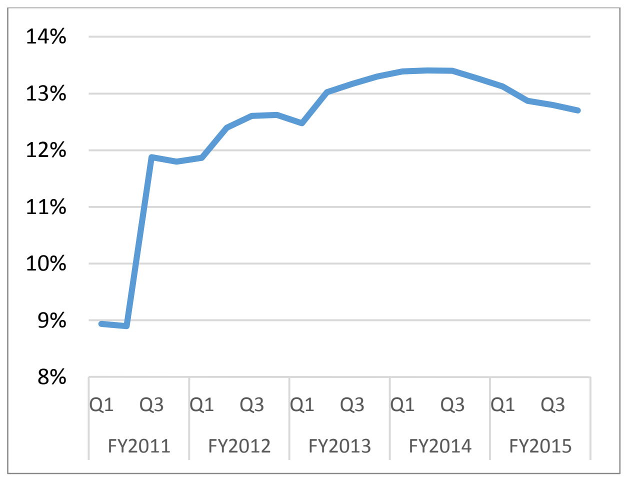


Figure 1. Contribution to Growth, Demand Side **Figure 2: Unemployment Rate**

Source: Minsitry of Planning, Monitoring and Administrative Reform and Central Agency for Public Mobilization and Statistics.

12. **In tandem with the pick-up in economic activity in FY15, unemployment is starting to slowly inch downwards but headline inflation remains a concern, especially with regard to food prices.** The unemployment rate reached 12.7% in the fourth quarter of FY15, down from 13.4% a year earlier, but still almost four percentage points higher than rates realized prior to the economic downturn that started in FY11. Unemployment among males and females recorded 9.3% and 24.1%, respectively, during the fourth quarter of FY15. Out of the 3.5 million currently unemployed, some 65.6% are between 15 and 29 years old, making youth unemployment the main challenge for economic inclusion and stability (see Figure 2). Inflation averaged 11% during FY15 (one percentage point higher than in FY14), mainly due to higher fuel prices higher taxes and excises (as part of the fiscal consolidation plan), supply bottlenecks, and to a lesser extent the gradual devaluation of the

Egyptian pound against the US dollar. Meanwhile, food inflation averaged 10.4% in FY15, primarily on the back of higher prices of fruits and vegetables, disproportionately affecting the bottom quintiles of the population who spend a higher share of their consumption budgets on food.

13. Egypt's fiscal stance improved in FY15, partially reversing the deterioration of FY11-FY14, as key fiscal consolidation measures were adopted. The headline deficit in FY14 was reduced through exceptional receipts of 4.8% of GDP (mainly consisting of financing from the Gulf and the liquidation of government deposits held at the Central Bank of Egypt (CBE)). Removing the effect of these exceptional receipts reveals a notable fiscal consolidation of 4.2% of GDP in FY15, which helped to bring down the overall deficit to 11.5% of GDP in FY15. The primary deficit also declined to reach 3.6% of GDP in FY15 versus 5% of GDP in FY13. These improvements were registered despite countervailing increases in spending: (a) social spending increased by 0.6% of GDP during FY13-FY15 in light of the 2014 constitutional commitment to increase spending on health, education and scientific research to 10% of GDP by FY17 and to enhance spending on social pension; and (b) the increase in capital spending, from 2.1% of GDP in FY13 to 2.5% of GDP in FY15 to address the infrastructure gaps that have been holding back growth and private sector engagement. The fiscal consolidation measures that contributed to the lowering of the deficit in FY15 include reducing energy subsidies (fuel and electricity) that yielded gross savings of around EGP 50 billion (2% of GDP), containing the civil servants' wage bill growth, and introducing structural revenue-enhancement measures in FY15 such as enacting a real estate tax, raising taxes on cigarettes and alcoholic beverages, taxing annual bonuses paid to employees, taxing dividends, and improving custom collection through a clampdown on smuggling. Lower international oil prices have also played a role in reducing energy subsidies in FY15 by a further 1% of GDP relative to budget targets.

14. The FY16 budget was issued with targets that signal the Government's commitment to continuing consolidation efforts. So far the following measures have already been implemented; increasing electricity tariffs for higher residential consumption brackets by an average of 19% and commercial tariffs by 3-14%, ending the built-in inertia for higher wages by delinking the variable component of salary from the basic salary, enacting a new mining law and its executive regulation, and raising fees on airline tickets. In addition, a new income tax law has been enacted in July 2015 unifying corporate income tax at 22.5% down from 25% and eliminates a temporary 5% surcharge tax. Other planned measures include raising an array of fees and duties that had been left unchanged for some time. However, the following two key structural reforms that were embedded in the FY16 budget have not yet been enacted: (i) the introduction of a modern value-added tax (VAT) with a single standard rate and well-defined list of exempted goods and services (condition of effectiveness of DPF 1); and (ii) the implementation of the second phase of fuel price adjustments. Moreover, several one-off measures including the sale of land, issuance of licenses, and collection of fines have been announced but are still not effective. Despite these policy delays, fiscal outturns for the first quarter of FY16 (July-September) indicate robust tax collection; with corporate income taxes and taxes on goods and services increasing year over year by 18% and 26%, respectively. Also, wages and salaries have been contained, witnessing the lowest year over year growth among expenditure chapters (5%) during Q1 of FY16. The combination of price reforms and a steep decline in international oil prices will bring down subsidies as a percentage of GDP from 6.6% in FY14 to a projected 3.3% in FY16, with price reforms contributing two-fifths of the decline.

15. Egypt's external accounts had been under pressure since 2011 revolution, but the pressures have intensified since the beginning of FY16, due to heavy debt repayments, an unfavorable external environment, a rigid exchange rate management policy, and more recently

the tragic crash of Russian airliner over Sinai. Net international reserves (NIR) dropped from US$36 billion in end-December 2010 to US$15 billion in end-December 2012, barely covering three months of merchandise imports. However, exceptional Gulf inflows especially in FY14 helped support the external accounts, driving the NIR to stabilize at slightly higher than three months of commodity imports coverage. Egypt's external accounts were buoyed during FY15 by the rebound of net FDI inflows by 56% (albeit from a low base), the recovery of tourism, and the successful issuance of the Eurobond in June 2015. However, foreign reserves started declining since the beginning of FY16, due to large debt repayments, the unfavorable external environment, as well as CBE's ongoing injection of foreign exchange to meet import needs and foreign currency demand backlogs. As a result, NIR dropped to US$ 16.4 billion at end-October 2015, from $20 billion at end-FY15. The recent crash of Russian airline would augment pressures on external accounts. In the short term (FY16), this incident is estimated to bring down tourist arrivals by 25%, economic growth by 0.6-0.8 percentage points, tourism receipts by US$ 3.3 billion, and the balance of payments by around US$ 2.2 billion. It is also projected to lower tax collection from the tourism sector by 0.2 percentage point.

16. In response to the widening of the "structural" balance of payments, the CBE introduced a foreign exchange auctioning system by end-December 2012, to buy and sell foreign exchange. Since its inception the system has been used by the CBE to only sell foreign currency to commercial banks through regular auctions (held three or four times per week). On average, the CBE has been injecting around US$ 120-160 million per week into the banking sector through the regular auction system since inception. Occasionally, exceptional auctions are held to cover outstanding import needs for priority imports. However, restrictions imposed on the auctions and on the interbank market led to an insufficient supply of foreign exchange at the daily exchange rate determined by the CBE and contributed to the development of a parallel foreign exchange market.

17. Increasingly, there have been signs of shortage in foreign exchange supply, delay in capital movements, and diminished confidence. First, short-term suppliers' credit are at historically high levels both in volume and as a percentage of commodity imports bill (9.2% in FY15 relative to 3.8% in FY08), which might signal delays in due payments to foreign suppliers. Secondly, banks are increasingly liquidating their accumulated foreign exchange assets held abroad to meet foreign exchange needs in Egypt. In addition, banks' borrowing from non-residents reached a record level in FY15 (more than US$ 3 billion); a signal that there is a pickup in foreign exchange demand that is not matched by adequate domestic foreign exchange supplies. Thirdly, individuals' and firms' acquisition of foreign exchange assets abroad doubled in FY15 versus FY11-14 average levels; signaling higher desire to acquire assets abroad. Lastly, despite the pick-up in economic activity in FY15, investment income repayments declined in FY15; signaling the delay in the repatriation of profits by existing foreign direct investors possibly due to difficulty in converting their profits in foreign currency.

18. The distortions in the foreign exchange market are affecting the real economy and the foreign currency shortage stands as the most critical impediment to the realization of the exceptional FDI deals signed recently, especially in the energy sector. The second half of FY15 witnessed a slowdown in private sector economic activities. Net FDI inflows slowed down in FY15 (Q4) to record the lowest level in three years. This is mainly explained by a deterioration in confidence due to: (1) insufficient foreign exchange supplies and/or (2) the delays or inability to repatriate profits abroad. Exports have been negatively affected by the restrictions on and shortages of foreign exchange. Non-petroleum exports denominated in US dollar witnessed sluggish performance; between January and August 2015 there was a decline of 19% reflecting (1) deteriorating competitiveness; and (2) inadequate foreign exchange supplies needed to import essential raw materials. New exporters have been disproportionately affected; the ratio of new exporters to active exporters fell to 3% on average in 2015 from 17% in 2012, whereas that of export value fell to 1% from 19%, respectively.

19. **The authorities are seeking a solution for the foreign currency shortage.** The CBE allowed the Pound to weaken by 2.5% in mid-October 2015 (for the first time since July) to reach EGP 8.03/ US$ at banks. With this devaluation the Pound has weakened by 14.5% during January-October 2015. However, the Pound appreciated against the US dollar by 2.5% in the foreign auction held on November 12, 2015. This occurred at the same time as the CBE attempted to partially clear foreign currency demand backlog worth US$ 1 billion that had been accumulating over the past months. Meanwhile, a parallel exchange rate remains and the premium has been closely following the official exchange rate movements. Going forward, Egypt needs a solution that helps meet the substantial backlog of demand for foreign currency and improves external competitiveness.

Table 1: Egypt's Selected Macroeconomic Indicators, FY11-19.

	2011	2012	2013	2014	2015	2016	2017	2018	2019
	Actual	Actual	Actual	Actual	Preliminary	Forecast	Forecast	Forecast	Forecast
Economic Growth and Prices									
Nominal GDP at market prices (EGP bn)	1,371	1,657	1,844	2,102	2,431	2,782	3,191	3,661	4,200
Nominal GDP at market prices (USD bn)	236	257	286	302	326	339	374	413	455
Nominal GDP per capita (EGP)	2859	2860	2861	2862	2863	2864	2865	2866	2867
Real GDP Growth Rate (y/y)	1.8	2.2	2.1	2.2	4.2	3.8	4.4	4.8	5.2
GDP Deflator (y/y)	11.7	12.6	9.1	11.6	11.8	10.6	10.3	9.9	9.5
CPI Annual Inflation Rate, (Period Average, y/y)	11.0	8.6	6.9	10.1	11.0	9.8	9.5	9.1	8.7
364-day T-bill interest rate (period average)	11.5	14.8	14.4	12	12.2	11.9	11.7	11.5	11.3
Unemployment Rate (End of period)	11.8	12.6	13.3	13.3	12.7	12.5	12.0	11.4	10.7
Government Finance (% of GDP)									
Total Revenues	19.3	18.3	18.7	21.7	19.1	20.0	20.5	20.8	20.8
Total Expenditures	29.3	28.4	31.6	33.4	30.2	30.3	29.4	28.6	28.2
Overall budget deficit [1/]	9.8	10.1	13.0	12.2	11.5	10.6	9.1	7.9	7.4
Primary deficit	3.6	3.8	5.0	3.9	3.6	2.4	1.1	0.0	-0.4
Deficit Excluding Grants	10.0	10.7	13.3	16.7	12.6	10.7	9.2	8.0	7.5
Gross Domestic Budget Sector debt	70.5	74.9	78.3	80.1	83.1	84.5	83.9	81.9	79.6
Energy Sector									
Fuel Subsidies (% of GDP)	4.9	5.8	6.5	6.0	3.0	2.1	1.6	1.0	0.5
Fuel subsidies (% of total Expenditures)	16.8	20.3	20.6	18.0	10.0	7.2	5.4	3.5	1.9
Arrears due on EGPC (USD bn)	3.2	6.3	5.4	5.9	3.5	2.4	1.5	1.2	1.0
Petroleum Trade Balance (USD bn)	2.9	-0.5	-0.5	-0.8	-3.7	-3.9	-3.4	-1.7	0.4
External Accounts (As % of GDP, unless otherwise indicated)									
Trade Balance	-11.5	-13.3	-11.0	-11.3	-11.9	-13.0	-12.9	-11.7	-10.6
Current Account Balance	-2.6	-3.1	-2.0	-0.9	-3.7	-5.6	-5.2	-4.0	-3.1
Net Foreign Direct Investment inflows [2/]	0.9	1.5	1.1	1.5	2.0	3.3	4.3	4.3	4.2
Capital and Financial Account Balance (does not include errors & omissions)	-1.8	0.4	3.4	1.8	5.4	3.9	3.9	4.2	3.2
Overall Balance of Payments	-4.1	-4.4	0.1	0.5	1.1	-1.7	-1.2	0.2	0.1
Net International Reserves (NIR) (end of period before closing the financing Gap, USD bn)	26.6	15.5	14.9	16.4	20.1	14.3	9.7	10.7	11.0
External Debt	14.8	13.4	15.1	15.3	14.7	14.8	13.0	12.1	11.0
Selected Monetary Accounts (Annual growth , End of period)									
Broad Money Annual growth rate	10.0	8.4	18.4	17.0	16.4	16.9	16.2	15.7	15.5
Private Sector Credit Annual growth rate	0.8	7.3	8.5	5.3	15.2	13.0	14.0	15.0	16.0
Private Sector Credit Annual **real** growth rate	-10.2	-1.3	1.6	-4.9	4.2	3.2	4.5	5.9	7.3

Sources: Ministry of Planning, Monitoring and Administrative Reform, CAPMAS, Ministry of Finance, Central Bank of Egypt; World Bank Staff estimates.
[1]Projected deficit figures assume that the constitutional pledges will be realized by FY19. This entails an additional fiscal burden during FY16-19 of around 1.5% of GDP, assuming that (1) the Government will (a) use 3-year averages of GDP to calculate spending targets/ceilings and (b) will redefine the Government's total spending on the health and education sectors to include relevant spending by other entities (Ministry of Defense, Ministry of Interior, Al-Azhar University, etc.).
[2] Assumes additional annual FDI inflows into the energy sector of around 1.3% of GDP during FY16-19, yet these FDI inflows would have a high import component (75%), and hence would be almost matched by additional non-oil imports with minimal impact on the overall balance of payments.

20. The CBE has kept policy rates unchanged, domestic liquidity growth has been roughly stable and the banking sector remains healthy. The CBE has been holding key policy rates unchanged since cutting them back in January 2015, despite higher recorded prices especially during the first half of FY15. This reflects CBE's attempt to support the ongoing fragile economic uptick while capitalizing on a favorable international price outlook. Domestic liquidity growth has been roughly stable throughout FY15, driven mainly by continued strong credit extended to the Government and an uptick in credit extended to the private sector and households, recording end of period growth rate of 15.2% in FY15 and average year-over-year growth rate of 10.2% in FY15. The banking sector continues to post healthy financial soundness indicators, but its asset base is becoming highly concentrated in light of sustained government lending.

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

21. Egypt's economic activity is projected to recover over the medium term as long as the twin deficits are contained and adequately financed. Economic growth is projected to slightly slowdown in FY16 to reach 3.8% in light of the adverse economic implications of the Russian airliner crash over Sinai, however, growth would gradually recover over the medium term to reach 5.2% by FY19. An important growth driver will be the oil and gas sector, which is expected to recover with the ongoing and planned settlement of accumulated arrears owed to foreign oil companies operating in the country, and finalizing additional upstream agreements and provided gas price amendments. Continuing growth in public investment should also help to crowd in private investments especially for developers and construction companies, although bank financing will remain constrained by large government borrowing.

22. Inflation is expected to slow only gradually and record high single digits throughout the medium term. Inflation is projected to remain higher than the Government targets of 6-8% because of one-off measures related to fiscal consolidation and liberalization measures along with a continuing accommodative monetary policy that attempts to strike a balance between supporting the economy and containing inflationary impacts.

23. Egypt's fiscal stance is gradually tightening, the primary balance is projected to switch to a surplus starting FY18, and the Government is aiming for an adjustment of 4 percentage points of GDP by FY19. Following the sharp adjustment in FY15, the Government's plan for the coming years is more modest and gradual, but will continue to focus on supporting inclusive growth, fulfilling its constitutional obligation, and upgrading Egypt's public infrastructure. The overall budget deficit is expected to come down to about 10.6% of GDP in FY16, and fall gradually to about 7.4% of GDP by FY19. Overall, the Government aims to reduce current expenditures by 2.3 percentage points of GDP by FY19 while raising tax revenues by around 2-2.5 percentage points. This is to be achieved while fulfilling the constitutional obligations to increase health, education, and scientific research spending. Meeting these obligations is assumed to entail additional expenditures of around

1.5-2% of GDP during the period FY16-19. This additional spending needs to be anchored through a well-articulated strategy to ensure that these funds are used efficiently and lead to better service delivery and outcomes. At the beginning of FY16, the Government signaled its commitment to the fiscal consolidation plan by increasing electricity tariffs for commercial and industrial users, as well as for the three highest residential consumption brackets. Further measures to reign in the rate of growth of the civil servants' wage bill have been taken in July 2015, targeting a 1% decline in the ratio of wages and salaries to GDP over the next five years, which would bring the wage bill to GDP ratio close to its FY11 level. With the above measures, the primary deficit is forecast to decline from 3.6% of GDP in FY15 to 0% of GDP in FY18 and to record a small surplus in FY19.

Table 2: Egypt's Key Fiscal Indicators, FY11-19.

	In percent of GDP								
	2011 Actual	2012 Actual	2013 Actual	2014 Actual	2015 Preliminary	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
Total Revenues	**19.3**	**18.3**	**18.7**	**21.7**	**19.1**	**20.0**	**20.5**	**20.8**	**20.8**
Taxes	14.0	12.5	13.6	12.4	12.6	13.9	14.7	15.1	15.1
Grants	0.2	0.6	0.3	4.6	1.0	0.1	0.1	0.1	0.1
Other Revenues	5.2	5.2	4.8	4.8	5.5	6.0	5.6	5.6	5.6
Total Expenditures	**29.3**	**28.4**	**31.6**	**33.4**	**30.2**	**30.3**	**29.4**	**28.6**	**28.2**
Wages and Salaries	7.0	7.4	7.6	8.5	8.2	7.8	7.6	7.5	7.3
Purchase of Goods and Services	1.9	1.6	1.4	1.3	1.3	1.4	1.5	1.7	1.8
Interest Payments	6.2	6.3	8.0	8.2	7.9	8.2	8.0	7.9	7.8
Subsidies, Grants and Social Transfers	9.0	9.1	10.7	10.9	8.2	8.3	7.6	7.0	6.6
Other Expenditures	2.3	1.9	1.9	2.0	2.1	2.0	1.9	1.8	1.8
Investments	2.9	2.2	2.1	2.5	2.5	2.7	2.8	2.8	2.9
Cash Deficit	**10.0**	**10.1**	**12.9**	**11.6**	**11.0**	**10.3**	**9.0**	**7.8**	**7.4**
Net Acquisition of Financial Assets	-0.2	0.0	0.1	0.5	0.5	0.3	0.2	0.1	0.1
Overall Deficit	**9.8**	**10.1**	**13.0**	**12.2**	**11.5**	**10.6**	**9.1**	**7.9**	**7.4**
Primary Deficit	**3.6**	**3.8**	**5.0**	**3.9**	**3.6**	**2.4**	**1.1**	**0.0**	**(0.4)**
Deficit Excluding Grants	**10.0**	**10.7**	**13.3**	**16.7**	**12.6**	**10.7**	**9.2**	**8.0**	**7.5**
Underlying Deficit (Exclude exceptional receipts and payments)	**9.8**	**10.1**	**13.0**	**16.3**	**12.2**	**11.7**	**9.8**	**8.4**	**7.7**

Source: Ministry of Finance and World Bank staff estimates.

24. **Although the fiscal deficit is projected to gradually decline, the Government's financing needs would remain high in the short term.** There is no open financing gap on the fiscal side expected in FY16, with around EGP 25 billion of financing projected to come from external borrowing and the rest of government borrowing needs financed from domestic sources, mainly the banking sector. Implementing the Government's reform program would help attract financing and mitigate the impacts of adverse macroeconomic events. Furthermore, the financing strategy for Egypt's fiscal deficit going forward is expected to benefit from: (1) improved debt dynamics due to a pick-up in real growth and projected switch from a primary deficit to a primary balance in FY18 and to a primary surplus thereafter; (2) additional external financing from bilateral and multilateral sources; (3) a

healthier and more liquid domestic banking sector that would benefit from the Government's strategy to issue new debt instruments; and (4) enhanced borrowing from international financial markets in order to diversify sources of financing, lengthen debt maturity, and reduce the cost of borrowing. These sources can combine to increase the amount of financing available to the Government without crowding out the private sector. However, securing these financing sources will be subject to the sustained implementation of the reforms underpinning the external financing arrangements agreed with Egypt's partners. Also, the external financing plan is subject to the cost of borrowing on international financial markets in light of the expected interest increase by the US Fed.

25. Egypt external accounts will be under pressure over the medium term. At a target level of NIR of three months of the next year's imports of goods and services, an external financing gap is projected in FY16 of around US$ 7.5 billion, and a higher gap that fluctuates around US$ 12 billion annually is projected in the following years. Unlike in FY14-FY15, the projected external accounts assumes no inflows from the Gulf countries except a credit facility worth US$ 2.8 billion that has been extended by Saudi Arabia in FY16. A similar facility was provided by the United Arab Emirates in FY15. Other key assumptions include the timely repayment by the Government of due external obligations and prevalence of an oil trade deficit that narrows starting only in FY18. In light of the large signed FDI deals in the energy sector worth US$ 36-38 billion over the coming three years, the macroeconomic framework takes into account only confirmed deals in the energy sector, stretches their realization over a four-year period with only 15% assumed to materialize in FY16, and to a large extent matches these additional FDI inflows with additional imports. Thus, the exceptional projected pick-up in FDI inflows during FY16-19 will have a limited net effect on the overall balance of payments.

Table 3: Egypt's Balance of Payments Financing Requirements and Sources, 2015/2019.

	In Million US$; unless otherwise indicated				
	2015	**2016**	**2017**	**2018**	**2019**
	Preliminary	**Projected**	**Projected**	**Projected**	**Projected**
Gross Financing requirements	**14,419**	**22,282**	**22,260**	**18,934**	**16,404**
External Current Account Deficit	12,183	19,045	19,315	16,525	14,302
External Medium and Long term Debt Amortization	2,236	3,237	2,945	2,409	2,102
Available Financing	**18,143**	**16,499**	**17,631**	**19,898**	**16,703**
Capital Account	(123)	(5)	22	(35)	(6)
Foreign Direct Investments	6,148	10,987	15,444	16,960	18,468
Portfolio Investments (include bonds repayments)	(592)	(782)	(942)	648	596
Medium and long term disbursement	1,300	2,771	2,912	2,575	2,662
Other Capital Inflows	11,410	3,529	195	(251)	(5,017)
Change in Gross International Reserves	**3,724**	**(5,783)**	**(4,629)**	**964**	**299**
Financing Gap (Indicative figures)	**--**	**7,490**	**12,420**	**11,884**	**12,713**
Multilateral Institutions		1,500	--	--	--
Regional Institutions		1,000	--	--	--
International market borrowing (Euro Bond)		1,500	--	--	--
Unidentified Sources		3,490	--	--	--
Memorandum Items:					
Current Account Deficit (in percent GDP)	3.7	5.6	5.2	4.0	3.1
Overall Fiscal Deficit (in percent of GDP)	11.5	10.6	9.1	7.9	7.4

Source: Ministry of Finance and World Bank staff estimates. (--) No confirmation yet.

26. Egypt's FY16 external financing gap can be closed, yet under less favorable conditions than those prevailing in FY15. The macroeconomic framework assumes that Egypt's external financing can be partially covered as follows: (i) US$ 1.5 billion from Multilateral Institutions (the World Bank will provide US$ 1 billion through this DPF operation and the African Development Bank (AfDB) will provide USS$ 0.5 billion), (ii) the Islamic Development Bank (IsDB) will provide US$1 billion in the form of a line of credit which Egypt has recently secured, and (iii) the issuance of sovereign bonds in the international market for an indicative amount of US$ 1.5 billion as spelled out by the authorities. The Government has the ability to issue up to US$ 8.5 billion in sovereign bonds without further legal requirements. However, Egypt is likely to borrow at conditions that are less favorable than in June 2015, when the country successfully issued a Eurobond in the amount of US$ 1.5 billion. With the mobilization of the above mentioned resources, there will an estimated uncovered financing gap of around US$ 3.5 billion that can be closed through a more competitive exchange rate, a larger volume of sovereign bond issuances than the indicative US$ 1.5 billion assumed under this DPF, Sukuk issuance that might attract regional inflows, tapping the Asian Financial markets, and seeking greater financing from official sources.

27. A recent Debt Sustainability Analysis (DSA) conducted by the World Bank indicates that Egypt's debt would be sustainable over the medium term, as long as a pro-growth fiscal consolidation path is adopted. The projected primary deficit during FY16-17 and positive real interest rates would limit a fast reduction in indebtedness, however, positive debt dynamics from GDP growth along with the switch of the primary deficit into a balance position in FY18 and further recording a surplus in FY19, would more than compensate and allow the debt to GDP ratio to decline to 85% by FY20 and further to 82% of GDP by FY21, down from 91% of GDP in FY15. The decline in debt ratios is a positive development, but the debt ratio to GDP would remain high and debt servicing bill would continue to exert pressures on public spending. Moreover, this envisaged decline in the debt to GDP path over the medium term can be reversed if the projected economic recovery is not sustained and fiscal consolidation efforts lose momentum. The institutional reforms supported by the proposed operation can strengthen the Government's debt management capacity and help achieve a longer average maturity of the debt stock (currently at two years) and reduce the high level of costly re-financing requirements. Egypt's external government debt remains low at 8% of GDP in FY15 and is projected to remain at low and favorable levels throughout the medium term. Further details and assumptions are provided in Annex 4.

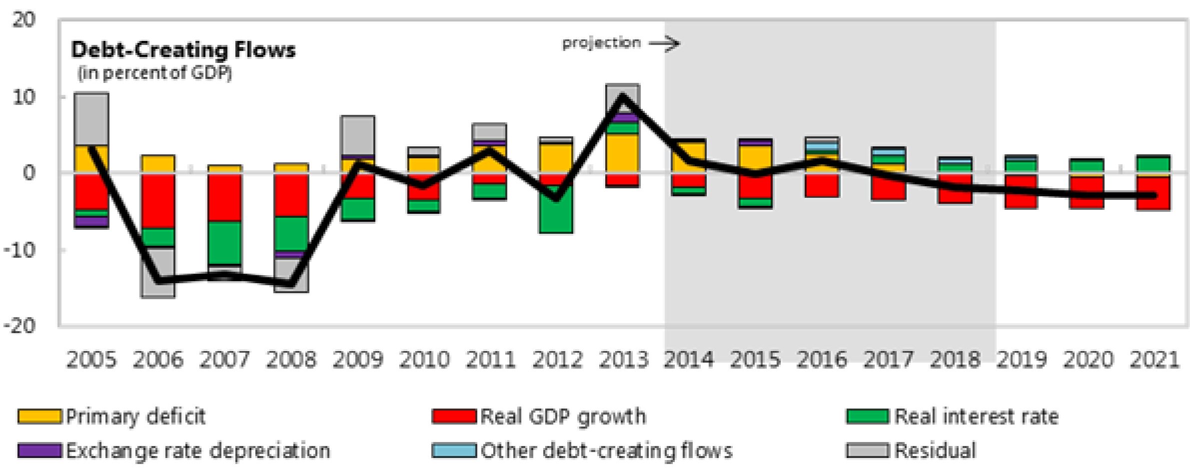


Figure 3: Egypt's Debt Dynamics; contributions to change in Debt-to-GDP ratio.

Source: Ministry of Finance and World Bank staff estimates.

28. Buoyancy in domestic demand and weakness in external demand are initially expected to widen the trade balance, but a recovery in the oil and gas sectors should lead to improvements in the external profile starting in 2017. The giant gas field discovered by Eni in the summer of 2015 off the northern coast of Egypt is ambitiously targeted to come on stream towards the end of 2017, which would allow the net petroleum balance (oil and gas) to return to positive territory by 2019. However, the projected sluggish recovery of the Euro area (Egypt's main export market) and the slowdown in emerging markets' performance, especially China, would limit global demand of Egypt's non-oil exports. Moreover, the prolonged low international oil prices may gradually affect remittances inflows and FDIs from the Gulf.

29. While the macroeconomic policy framework is adequate for the proposed operation, substantial downside risks exist and must be properly addressed. Even under optimistic scenarios, significant FDI will be required to sustain solid economic recovery and to help avoid an unsustainable balance-of-payments deficit. However, changing global financial conditions could abruptly curtail inflows of both FDI and public debt financing. Egypt's reliance on international capital markets in the next two years can also increase cost of external debt service burden, especially in the face of large exchange rate adjustment. However, to mitigate the transmission of external volatility into domestic output, more exchange rate flexibility is needed. Otherwise the burden of adjustment will fall primarily on fiscal policy with negative economic repercussions. Maintaining the reform momentum will be key in achieving and maintaining a sound macroeconomic framework. The domestic political economy and the uncertainty in the external environment will test authorities' political will and ability to sustain and perhaps accelerate the implementation of needed reforms. The prior actions and indicative triggers selected for this program are designed to help contribute to the mitigation of these risks and to support Egypt's efforts to reestablish macroeconomic stability, enhance the effectiveness of public spending, and reduce the cost and risk of its debt portfolio. Further details are provided in the section on risks and risk mitigation below.

2.3 IMF RELATIONS

30. The IMF resumed its Article IV consultations with the Egyptian authorities in 2014 and the latest article IV report was published in February 2015. More recently, the IMF fielded a staff visit to Cairo during September 2015 to review recent economic developments and the mission concluding statement and key recommendations are broadly consistent with those of the DPF operation and supported reforms. The IMF press release issued at the end of the mission highlighted the importance of a steadfast implementation of the authorities' plans and indicated that a gradual move toward a more flexible exchange rate policy focused on achieving a market-clearing rate would serve Egypt's interests. It also highlighted the importance of lowering fuel and electricity subsidies, the implementation of the VAT, and pursuing other key structural reforms to improve and strengthen the budget, reduce the financing needs, and foster growth and jobs. Staff from the IMF and the World Bank also closely collaborate on the analysis of macroeconomic developments, framework and policy reforms. For example, the Bank staff held several meetings jointly with the IMF during their latest mission to Cairo. The Bank staff also organized several internal meetings with the IMF team to discuss polices, plans and envisaged reforms in areas related to financial inclusion, social protection, energy, and business environment.

3. THE GOVERNMENT'S PROGRAM

31. **The Government of Egypt has articulated a long-term vision and a medium-term economic strategy that provides the anchor for this DPF.** The Government presented its long-term vision Egypt's 2030 Sustainable Development Strategy (SDS) along with a coherent medium-term policy framework "Strat-EGY" during the Economic conference held in March 2015. The presented vision was developed in close consultation with civil society and the private sector to ensure their buy-in and ownership. The Government's program highlights four main themes: macro-fiscal stabilization; private sector-led growth; transparency and accountability; and social and economic inclusion.

3.1 Macro-Fiscal Stabilization

32. **Macro stabilization is a key pillar of the Government's program, and an essential prerequisite for restoring confidence, sustaining growth, and making broader progress on development.** Inefficient energy subsidies and inadequate revenue mobilization have been among the dominant factors contributing to the large structural budget deficit. The Government announced its commitment to restore macroeconomic stability through a balanced fiscal consolidation program that would also preserve and support inclusive growth and social objectives. The government's program is anchored in strengthening fiscal consolidation to bring the deficit and debt levels on a firm downward path, while continue the reprioritization of expenditures towards physical and human capital formation. This will provide the basis for a more inclusive growth led by the private sector and complemented by an expansion in the scope and targeting of Social Safety Nets (SSNs) to provide adequate support to the most vulnerable groups and the poor.

33. **A number of recent reforms have been adopted to enhance revenue collection by widening the tax base.** The top income tax rate was unified at 22.5% for all economic actors operating in Egypt, including new businesses located in special economic zones (to inhibit tax arbitrage). The progressivity of the personal income tax has also improved in FY16. The Government also started to implement the real estate tax law, and introduced a 10% new tax on dividends and annual bonuses paid to employees. A new mining law has been ratified and is expected to unlock the untapped revenue potential of this sector. The Government is working on modifying the Tax on Goods and Services (GST) Law to move to a fully-fledged VAT that will broaden the tax base, increase the tax buoyancy and reduce market distortions. This reform has long been advocated by the business community, and will be particularly helpful for SMEs.

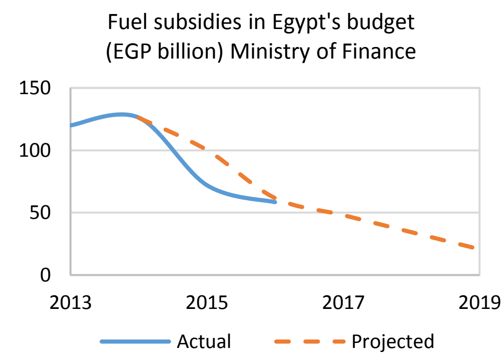
34. **As part of its reform program, the Government embarked on a number of reforms aimed at improving service delivery and promoting sustainable energy supply that will have a positive fiscal impact.** To achieve this objective, Egypt is committed to transitioning to a competitive market for electricity and gas that promotes private sector participation and investment. This requires the liberalization of electricity and gas markets with the opportunity for the private sector to enter and compete in wholesale market segments, while the retail market remains regulated. Underpinning the reforms is the strengthening of modern regulatory institutions so that they can impartially implement regulatory oversight. The Government is also keen to attract private capital and structure contracts that provide an adequate balance between risk and reward.

35. A bold energy subsidy reform program is in place and has so far yielded savings of 3.3% of GDP. As articulated in the recent White Paper entitled "Energizing Egypt 2015", the Government is committed to reforming energy subsidies over the five-year window 2014-2019. Following a significant adjustment to the prices of major fuel categories and electricity of between 40-78% in 2014, the share of energy subsidies in GDP fell by half saving around 3.3% of GDP. In the case of electricity, an explicit five-year tariff trajectory has been publicly announced and the first two years of tariff reforms have been implemented on schedule. The Government's policy is to channel a part of the fiscal savings from energy subsidies towards social spending and investments aimed at boosting inclusive growth. The Government is also seeking to improve service delivery, which is an essential pre-requisite of successful subsidy reforms.

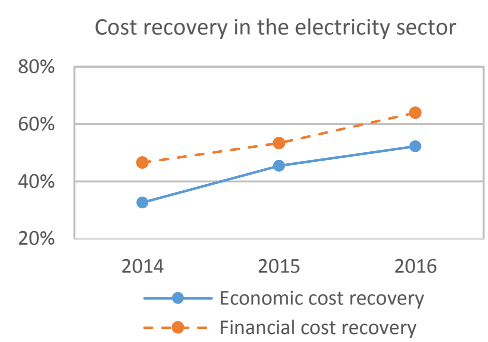
36. The government's program aims to also implement administrative reforms and measures to enhance transparency. Public finance management reforms include developing a cash management system, enhancing the automation of public wages and other revenue and expenditure payments, developing new internal auditing mechanisms, and moving toward the implementation of program-based budgeting. In addition, the regular issuance of the Citizen's budget, the mid-year review and the year-end review are part of the Government's plan to enhance transparency.

Box 1: Egypt's Energy Price Reforms

Egypt's energy subsidies have been on a long term growth trajectory. Since the early 1990s, low fuel prices have declined continually in real terms. Low prices stimulated demand and a burgeoning subsidy bill that rose at a compound annual rate of 26% during 2002-13. As a result, the budget share of energy subsidies increased from 9% to 22% over the same period, while their share in Egypt's GDP grew from 3.0% to 7.0%, representing a major contributor to the fiscal deficit.



In July 2014, the Government increased prices of electricity and major categories of fuels by 40%-78%, and laid out its plans to reform subsidies in the next five years to reach 0.5% of GDP by 2019 through periodic increases of fuel and electricity prices. Another increase of electricity tariffs by 19% was implemented in July 2015. (Liquefied petroleum gas (LPG) was excluded from the reform to mitigate the impact on poverty.) The combination of price reforms and a steep decline in international oil prices brought down subsidies as a percentage of GDP from 6.6% in FY14 to a projected 3.3% in FY16, with the price reforms contributing about two-fifths of the decline. Estimated economic cost recovery ratios improved from 33% to 52% for electricity; 55% to 75% for natural gas; 38% to 84% for fuel oil; and 29% to 83% for gasoline. The evolution of subsidies till FY16 has been consistent with the target of reaching 0.5% of GDP by FY19.



The 2014 reform changed how fuel subsidies are allocated between the electricity and oil and gas sectors. Since the power sector represents about three-fifths of natural gas consumption, the price at which gas is sold to the sector affects the extent to which the overall subsidy volume is accounted to the fuel sector or the electricity sector. As part of the 2014 fuel price reform, the power sector purchase price for natural gas was increased by 69% from US$ 1.77/MMBtu to US$ 3.00/MMBtu. How future changes in fuel cost, including gas price increases due to larger liquefied natural gas (LNG) imports, are passed through to the electricity sectors is therefore critical for the allocation of subsidies between the two sectors, and will determine the extent to which the two sectors remain in line with the cost recovery trajectory set by the Government.

Energy subsidy reform is supporting the redirection of fiscal resources towards social spending. Historically, energy subsidies have far exceeded other categories of social spending, outstripping social security spending by a factor of 50, the health budget by a factor of five, food subsidies by a factor of three, and the education budget by a factor of two. The comprehensive subsidy reforms announced in July 2014 set aside more than half of the subsidy savings for boosting expenditures on health, education and social protection. As a result, government spending on health and education outstripped –for the first time- spending on energy subsidies in FY15. This is in line with the new Constitutional commitment to increase spending on social sectors to 10% of GDP.

The 2014 reform had a relatively small impact on poverty, while improving the distribution of welfare. Distributional analysis shows that the overall effect of the price reform on the poverty rate was an increase of 0.5 percentage points from 26.3% to 26.8%. However, the Gini coefficient fell from 29.8 to 29.7, due to the fact that the impact of the price reforms fell more heavily on the higher quintiles of the distribution. Direct poverty effects were relatively small and overwhelmed by indirect effects as increasing prices of transportation fuels led to general price inflation. The exclusion of LPG from the 2014 pricing reforms helped to contain the size of the poverty impacts, as that is the fuel most heavily consumed by the poor. These estimates do *not* take into account the offsetting effect of mitigation measures, such as the mentioned increase in social spending and the concurrent freezing of the price of food staples as well as the increase in social spending.

Sources**:** World Bank Staff estimates; Sudeshna Ghosh Banerjee, Heba El Laithy, Peter Griffin, Kieran Clarke, Mohab Hallouda (2014) Egypt: Energy Subsidies and the Path Toward Sustainable Reform, World Bank, Washington DC.

3.2 Private Sector-Led Growth

37. The Government envisions a much more prominent role for the private sector in leading economic development. The Egyptian economy has traditionally been characterized by a strong role of the state and a high concentration of economic power. The Government's new strategy entails closer collaboration between public and private sectors on major economic projects, as well as removing barriers to entry and cutting red tape to provide more space for SMEs and entrepreneurs. As a first step, the Government has been solving outstanding investor disputes and paying due obligations. Going forward, concrete efforts and policies will be adopted to enhance business entry to ensure more dynamism and competition in all economic sectors. Also, the Government will work to gradually streamline and address the existing bureaucratic challenges such as access to investment incentives, access to land, construction permits, and receipt of a license, inspections, customs and tax compliance, as well as sector-specific regulations. By addressing these challenges, investment decisions would be based on solid fundamentals rather than distortive investments. This along with improved policy certainty can lead to higher private investment path with more investments going into productive labor intensive sectors that can create adequate productive sustainable jobs.

38. The Government's recent efforts to enhance capital spending focused mainly on addressing pressing infrastructure gaps in roads, energy and public utilities and pursuing a number of mega projects. This policy succeeded to crowd in private investment that witnessed a sizeable increase during the first nine months of FY15 to reach EGP 148 billion (two-thirds of total executed investments), which represent an annual growth rate of 24%. Going forward, the Government objective is to pave the way for a private sector-led economy. In doing so the Government plans to partner with the private sector in implementing a number of mega projects with the Government primarily providing the land, basic infrastructure needs, and a conducive regulatory environment and in return the private sector taking the lead in implementing, financing and managing these projects.

39. Concerted reform efforts have reinvigorated private investment in the upstream gas sector. The reduction in arrears to international oil and gas companies from US$ 6.3 billion in June 2013 to US$ 2.9 billion by October 2015 has provided a positive signal to investors and partners, paving the way for the signature of 62 new upstream agreements with minimum investment commitments of more than US$ 15 billion on exploration (with another 12 agreements in the pipeline). This has contributed to extensive exploration activities that led to the discovery of the largest gas field in the Mediterranean – the Zohr gas field – with up to 30 trillion cubic feet of gas in place, worth well over US$ 100 billion at current prices. Egypt is taking measures to accelerate production from existing gas fields including price revision for new gas from old fields. In particular, an agreement has been reached with the North Alex Gas Project partners, led by British Petroleum (BP), with proven reserves of 5.5 trillion cubic feet of gas and 55 million barrels of condensates. Egypt's external balance and growth prospects will benefit significantly from the upstream gas FDI of around US$ 22 billion expected during FY16-18, which comes in addition to an estimated US$ 10 billion in power generation and US$ 3 billion in renewables.

40. Following decisive short-term measures to ensure sustainable energy supply, attention is now turned to structural reforms that will create competition and increase private sector participation. Energy supply shortages experienced in 2014 led to power cuts and public discontent as well as disruption to economic activity. Supply-demand balance was restored in 2015, thanks to decisive measures to procure emergency generation and LNG import facilities. Egypt has moved swiftly to secure new LNG import contracts to bridge the short term supply-demand gap, leading to a Floating Storage and Regasification Unit (FSRU) that has been in operation since March 2015 and a second one being commissioned from October 2015, and thereby will provide an outage-free summer in FY16 with secured gas supplies. To bring greater dynamism to the sector going forward, the Government's energy White Paper lays out a roadmap for market liberalization, involving creation of independent transmission companies for electricity and gas offering third party access to national networks for the private sector. Egypt will address deficiencies in fuel infrastructure that currently act as supply bottlenecks. This will entail expanding and upgrading oil and gas refineries in Suez, Assiut, Cairo, and Alexandria. Ongoing project investments in upgrading refineries amount to US$ 5.9 billion, while the planned projects investments are US$ 3.5 billion. The two-fold strategic objectives are to develop Alexandria and Suez into world class refining centers while linking the lagging regions, the Delta Region and Upper Egypt, through energy infrastructure. Another significant dimension of the ongoing structural reforms relates to the creation of regional energy infrastructure - be it resumption of gas flow between Jordan and Egypt in 2015, or construction of 3000 MW interconnection between Egypt and Saudi Arabia due for commissioning in 2018.

41. Fostering private sector-led job creation through improvements to the business climate is an essential complement to the fiscal consolidation and energy security reforms to enable inclusive growth, and is central to the Government strategy. What fundamentally constrains the growth of a business sector are the complexity of the regulatory environment and the unequal access to regulatory services; the ongoing reform of the energy subsidies will favor the growth of more labor-intensive industries only if the complexity and uncertainty that businesses face in complying with regulations and accessing services are significantly reduced. Complexity and uncertainty have characterized many areas of government-business interaction: access to investment incentives, access to land, construction permits, receipt of a license, inspections, customs and tax compliance, and sector-specific regulations. The Government's program to reform these regulations and services has begun with two key areas, the investment framework and the industrial licensing regime which will enhance simplicity, predictability and transparency of government regulation and government services to businesses. These reforms are fundamental to enable other public interventions and to spur private-sector-led growth to succeed, including broadening the benefits of macro reforms and large investment programs to include the small business base.

3.3 Transparency and Accountability

42. Many of the government's on-going reforms include features designed to enhance transparency and accountability to the public. For example, fiscal consolidation efforts have been accompanied by the launch of a Citizen Budget to enhance public information about revenue collection and expenditure allocations to citizens in a transparent and accessible manner. The Ministry of Finance further institutionalized this process by the issuance of decree No. 503/2015 that mandates: (i) the timing and period of publication; and (ii) the budget data and information to be disclosed to the Citizen Budget. Also, the Government has presented and published its medium-term macro-fiscal framework, which informs the public about the Government's macro-fiscal and debt targets and expected reforms. Looking ahead, the Government intends to establish an internal audit function to oversee controls over public resource use. The energy reform involves the creation and strengthening of regulatory agencies that will enhance consumer protection and accountability; while governance of the state-owned enterprises responsible for electricity and gas transportation will also be improved. Business environment reforms involve improved transparency for industrial licensing and the secure rights registry, as well as the establishment of a one stop shop for the General Authority for Investment and Free Zones (GAFI) and improved institutions for business regulation. Many of these measures are particularly favorable to SMEs.

3.4 Social and Economic Inclusion

43. Creating broader economic opportunities for small businesses calls for a complete overhaul of the business regulation environment. The Government's plan is anchored by addressing key constraints that hinder the growth of a vibrant smaller-scale business sector. This plan includes working to address the complexity of the regulatory environment, the unequal access to regulatory services and (subsidized) inputs and factors, and the uncertainty this imposes on businesses. The Government will work to further develop the financial sector and promote financial inclusion. This includes reforming and amending the legal and regulatory framework to level the playing field for all economic actors including SMEs and entrepreneurs. The Government's plan includes amending the investment, companies, commercial register, bankruptcy and customs laws. These legislations would be supplemented by efforts to streamline licensing and regulation at both the central and local levels. Additional resources and efforts would be directed to enhance access to services and enabling infrastructure between metropolitan and non-metropolitan areas.

44. Finally, economic reforms will be supported by a national program to strengthen the Social Safety Net. Fiscal consolidation measures are designed to redirect part of the fiscal savings towards building well targeted social safety nets and enhancing human capital expenditure. In 2012, with a joint support from the US$200 million World Bank loan and Euro 67 million from the EU, Egypt established a Labor Intensive Works Program (LIWs) that targets the able-to-work poor and unemployed youth, with focus on those living in poor and lagging regions. During the period 2013 – 2015, the LIWs program delivered over 12 million employment days benefiting a total of 80,000 poor individuals, of which 60% were females. To provide adequate support to the vulnerable and the poor, the Government initiated a new conditional cash transfer program (Takaful or solidarity) along with an unconditional program (Karama or dignity) that would cover in its first phase some 1.5 million beneficiaries located in Upper Egypt's poorest districts by end-2017. Moreover, the food subsidy system has been overhauled during FY15, to improve the quality of food staples, and widen the choice of commodities provided to the public, while substantially reducing leakages. The old "in-kind/quota" system was phased out and replaced by a new "semi cash transfer/points" system[1], allowing the eligible consumer to choose among nearly 100 subsidized commodities.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

45. The proposed operation in the amount of US$1 billion is the first in a programmatic series of three single-tranche DPF operations. Use of the programmatic approach will ensure continued support to the Government's ambitious medium-term reform agenda, and provide sustained budget support over 2015-2017.

46. The design of the DPF program incorporates lessons from earlier engagements in Egypt and globally. As per the IEG 2009 Country Assistance Evaluation report entitled, "Egypt: Positive Results from Knowledge Sharing and Modest Lending", two key recommendations were: (i) to continue promoting improvements to systems that improve governance (citizen budgeting, simplification of taxation and business procedures, and information acts); and (ii) focus on policy and institutional reforms in energy and business competitiveness. This DPF operation directly supports the Government reforms that would address these issues. The first pillar includes as prior actions and triggers several reforms and policy measures that would enhance fiscal transparency and management, including institutionalization of the issuance of key fiscal reports, the publication of a debt management strategy to be followed by monitoring, analyzing, and reporting on contingent liabilities, and the establishment of an internal audit function at the Ministry of Finance. The second pillar includes several key institutional and policy reforms that would improve the reliability of energy supplies and open the market for private sector. The third pillar focuses entirely on streamlining and simplifying licensing and businesses procedures and creating a level playing field for all economic actors.

47. The DPF program is structured under three development objectives each supported by a corresponding pillar: (1) advance fiscal consolidation through enhancing revenue collection, greater moderation of the wage bill growth, and stronger debt management; (2) ensuring sustainable energy supply through private sector engagement; and (3) enhance the business environment by streamlining laws, regulations and license requirements as well as enhancing competition. The first pillar will support the Government's fiscal consolidation program, geared towards narrowing the deficit, improving the structure of spending, and putting public debt on a downward path. The second pillar will support the Government's aim of achieving energy security by improving the sustainability and governance of the sector. The third pillar will support the Government's commitment to private sector-led growth by improving the regulatory environment for business as well as by fostering open competition. The timing and size of the following operations would be contingent upon the

[1] The unused monthly allowance of *Baladi* bread can be converted into points and used to buy other food commodities within the same smart card system. This offered an incentive for citizens to ration their use of *Baladi* bread while allowing them to set their consumption priorities of available food commodities.

demonstration of a robust macroeconomic framework, the achievement of the triggers, IBRD's lending capacity and demands from other borrowers.

48. **The proposed DPF contributes across the four major themes of Egypt's development strategy: macro-fiscal stabilization; private sector-led growth; transparency and accountability; and social and economic inclusion.** The measures supported in the DPF series carry strong government ownership and are clearly nested within Egypt's own reform program (see Box 2). All of the DPF pillars make multiple contributions across the four main themes of the country's development strategy. Macro-fiscal consolidation will be supported by a range of measures to improve revenue collection, and reduce expenditures, in particular by lowering energy subsidies. Private sector-led growth will be advanced through a package of reforms designed to cut red tape, reduce barriers to entry, and promote better competition policies; while the liberalization of energy markets will create significant opportunities for private sector engagement. Many of the measures in the proposed DPF include features that enhance transparency and accountability, by strengthening regulatory institutions for energy and business sectors, publishing information on the Government's budget and debt framework, and increasing transparency on business regulations and licensing procedures. Many of the fiscal and business environment measures will be particularly helpful to SMEs, thereby favoring broader economic inclusion. Moreover, energy subsidy reforms are intended to redirect part of fiscal savings towards social spending.

49. **The policy matrix supported by the programmatic DPF series is included in Annex 1.** The policy matrix is designed with carefully selected DPF 1 prior actions (highlighted in bold font in Annex 1) and DPF 2 and DPF 3 indicative triggers that are critical for achieving the results of the reform program supported by the DPF series. The policy measures included in the policy matrix are also aligned with the Government's own short- and medium-term reform programs, for which the Government has already made encouraging progress during the first year.

. Box 2: Contribution of DPF Actions to the Government of Egypt's Reform Program.

Themes	GOVERNMENT OF EGYPT'S REFORM PROGRAM			
	DEVELOPMENT POLICY FINANCING PROGRAM			
	Pillar 1: Advancing Fiscal Consolidation	**Pillar 2: Ensuring Sustainable Energy Supply**	**Pillar 3: Enhancing the Business Environment**	**Additional Reforms Being Undertaken Beyond DPF Pillars**
Macro-Fiscal Stabilization	• Income tax reform • Delinking variable pay from basic pay • Debt management • Value Added Tax	• Energy subsidies • FDI in Energy	• Enhanced Private Sector Investments	• Real Estate Tax • Property Tax reform • Capital Gains Tax reform • Excise and cigarette tax rise
Private Sector-Led Growth	• Unifying income tax • Value Added Tax	• Free entry for power and gas companies • Renewable Energy	• Investment Law • Competition Law • Industrial Licensing	• New Suez Canal Development Project • National Project for Roads • Mining Law • Settle investor disputes • Investments in upstream Gas contracts • Energy security through LNG imports
Transparency and Accountability	• Mid-year review statement • Contingent Liabilities • Macro-Fiscal Framework • Public Debt Strategy • Wage Automation	• Competitive power and gas markets • Strengthen EgyptERA • New gas Regulator • New generation companies SOE Reforms for Transmission Cos.	• GAFI published regulatory requirements • Reduced discretion and increased transparency in industrial licensing • Strengthened Competition authority	• Civil Service Law reform • Ports automation • Electronic tax collection • Project automation • PFM Strategy
Social and Economic Inclusion	• SME tax harmonization	• Energy subsidy savings to social spending • Rooftop solar program for SMEs		• **Takaful and Karama SSN** • **Unified registry** • **Upper Egypt development** • **Rural sanitation project** • **Agricultural competitiveness** • **Social housing project** • **Natural gas connections** • **Skills & education project** • **Mortgage finance initiative** • Microfinance Law

Note: Measures in bold are supported by WBG under the proposed new Egypt CPF (2015-2019). .

4.2 PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Advancing Fiscal Consolidation

Objective 1.1: Enhancing Government Revenues

50. **Rationale:** Over the past four years successive governments have introduced changes to the income tax code that contributed to policy uncertainty, adding to long-standing tax distortions and limited tax base, and led to a deterioration in tax buoyancy. To ensure a sustained and effective fiscal consolidation plan, the Ministry of Finance is working on broadening the tax base and addressing tax exemptions and preferential rates. The new Income Tax Law is the first step in this direction. A more substantial step will be the introduction of the VAT (condition of effectiveness of DPF 1, whereas the trigger for DPF 2 is the assessment of its implementation) which is at an advanced stage of preparation. For DPF 3, the Government envisages simplifying the taxation of micro and small businesses to reduce compliance cost and boost private business growth.

51. **Solution:** The new Income Tax Law No. 96/2015 paves the way for a stable and predictable income tax policy which is intended to remain unchanged for the next 10 years, as announced by the Government. The amended law unifies the top corporate income tax rate of 22.5% for all economic actors operating in Egypt matching the highest personal income tax rate, including for those operating in special economic zones formerly subject to a lower rate of 10%. The new unified rate is applied to all economic actors operating in Egypt, including those located or based in special economic zones. By addressing the preferential treatment in special economic zones, Egypt can widen its tax base and improve revenue buoyancy going forward in light of the current Government's plans to expand the economic zone model across the country. In addition, the VAT law aims to broaden the tax base by designing a system that limits exempted goods and services heavily consumed by the poor and that introduces an effective credit/refund mechanism which reduces distortions to production and investment decisions. This should allow for a better allocation of productive resources in the economy, and hence enhance growth. In addition, the law would impose a single unified rate that applies equally to all consumers relative to their consumption.

DPF 1 Prior Action #1: The decree promulgating Law No. 96 of 2015 has been issued which amends the Income Tax Law by unifying the top income tax rate for all economic actors operating in the Borrower's territory. The amendments unify the top income tax rate at twenty-two and one half percent (22.5%) for all economic actors operating in the Borrower's territory, including those operating in special economic zones formerly subject to a lower rate of ten percent (10%).

DPF 2 Indicative Trigger 1.1: The Government has done an initial assessment of the implementation of the proposed [Valued Added Tax and Excise Tax Law] which introduces the following features of the value added tax regime: (i) a single unified tax rate for all goods and services; (ii) a clearly stated table detailing excise taxes; (iii) a well-identified list of exempted goods and services; (iv) a full-fledged tax credit system for direct and indirect inputs; and (v) a tax refund system for expenses related to the purchase of equipment and machinery. The *assessment includes the initial revenue effect of the VAT as well as the adequacy of the institutional capacity to implement the VAT, along with recommendations for institutional capacity strengthening.*

DPF 3 Indicative Trigger 1.2: The Ministry of Finance issues a decree that introduces a harmonized and simple tax regime for micro and small businesses based on turnover.

52. Expected Results: Enhancing income tax revenues can be measured in terms of the income tax and taxes on goods and services paid by non-sovereign corporates relative to nominal GDP. In FY15, this ratio was 5.4% of GDP and the Government's decision to unify the income tax rate and to address the preferential tax treatment for economic zones along with implementing the VAT is expected to bring in additional tax receipts of around 1.3 percentage points of GDP in FY18.

Objective 1.2: Containing the Wage Bill

53. Rationale: The wage bill was on an accelerated path and unsustainable trajectory during FY11-14 in light of the adoption of several populist measures. The Ministry of Finance data indicate that wages and salaries grew faster than any other spending chapter during the four-year period of 2011-2014 and reached EGP 179 billion in FY14 versus EGP 96.3 billion in FY11. As a result, the wage bill reached 8.5% of GDP in FY14 up from 7% of GDP back in FY11.

54. Solution: The President has endorsed the national budget for FY16 by issuing a decree promulgating Law No. 32/2015. The endorsed budget law for FY16 sets instructions that will contain the growth of the wage bill, enhance equity and transparency of employees' wages and remuneration schemes across various budgetary entities, and improve and simplify the wage setting process. The budget law and enforced policies would contain the long standing built-in inertia and automatic increases in employees' total wages and salaries bill, improve the management of the Government's payment system and address the fragmented wage bill, facilitate access to salary information for auditing and analysis, allow policy makers electronic access to payroll reports in real time, and reduce discrepancy between payments across various budgetary entities.

DPF 1 Prior Action #2: The decree promulgating Law No. 32 of 2015, endorsing the national budget for FY16, has been issued which includes administrative instructions to all government budgetary entities to contain the wage bill. The administrative instructions are to (i) cap bonuses and rewards of their respective employees in FY16 at the level of FY15; and (ii) delink the variable portion of government employees' salaries from the basic salary component.

DPF 2 Indicative Trigger 2.1: The Ministry of Finance publishes a time-bound plan with procedures and measures that facilitate and enforce the automation of wages and salaries payments for all government employees to: (i) enable the Government to have a reliable data base to guide a more informed decision-making process, (ii) enhance financial inclusion by requiring all employees to have bank accounts, and (iii) reduce cost of managing the Government's payroll system.

DPF 3 Indicative Trigger 2.2: The Cabinet approves a medium-term plan/rule that sets a cap on the number of new recruits in the public sector relative to the total number of retirees.

55. Expected Results: Progress on containing wages can be measured in terms of the size of the Central Government's wages and salaries bill to nominal GDP. In FY15, this ratio was 8.2%, with a target to lower it to 7.8% of GDP by FY16, and to 7.5% of GDP in FY18 and further to 7.3-7.4% of GDP by FY19. This also would imply a 17 percentage-point reduction in the wage-to-tax ratio, from 68.6% in FY14 to 51% by 2019. Achieving this target would be a positive achievement, but would still leave Egypt above the 46.7% wage-to-tax revenue ratio registered in FY09 and above international standards. Going forward this might imply further advancements on broadening the tax base and enhancing tax collection.

Objective 1.3: Strengthening Debt Management

56. Rationale: Egypt's debt is of relatively short average maturity and debt servicing is expensive. The Government's interest payments on its debt have been increasing and the portfolio's exposure to risk has modestly improved due to recent efforts to gradually lengthen average maturity. A reform of debt management practices is underway and is essential to manage this risk and to reduce the cost of debt servicing. The Government's reform program seeks to reinforce macroeconomic resilience by better integrating the objectives and goals of fiscal policy, monetary policy, and debt management. The Medium-Term Debt Management Strategy (MTDS) will help improve Egypt's debt profile by properly accounting for debt risks in addition to financial costs. Credit risk assessments will illustrate the cost and risk tradeoffs in the MTDS. In addition, there is currently no function in the Ministry of Finance or in the line ministries that carries out internal audit over the effectiveness of public sector governance, risk management and internal controls. The absence of a functionally independent, risk-based internal audit is a shortcoming of the public financial management system performance.

57. Solution: The adoption and publishing of an MTDS will enhance the predictability of debt issues, especially in the domestic credit market. This will help to better inform investors and lenders about the Government's intended policies and plans, which can help the Government to diversify sources of budget deficit financing and further elongate the average maturity of the debt profile. By sharing key debt management goals, investors would have higher certainty about market developments which can reduce risk premiums. Furthermore and as part of its efforts to strengthen controls over the use of public resources, the Ministry of Finance intends to gradually build a professional internal audit function for the public sector, starting within the Ministry of Finance. The internal audit function will report directly to the Minister, and its purpose, authority, and responsibility will be set in a charter based on applicable international standards. The function is expected to be set up in FY16 and to undertake its first audit engagements in FY17. After the function becomes operational in the Ministry of Finance, it is expected to serve as a model and central harmonization unit for other line ministries.

DPF 1 Prior Action #3: The Ministerial Decree No. 515 of 2015 has been issued which mandates the publication of the Medium-Term Debt Management Strategy.

DPF 2 Indicative Trigger 3.1: The Ministry of Finance establishes and operationalizes an internal audit function within the ministry, with adequate budget and staff and a mandate aligned with international standards.

DPF 3 Indicative Trigger 3.2: The Ministry of Finance sets up a comprehensive administrative system including a dedicated unit, manuals, and standard reports, that identifies, monitors, and facilitates the management of contingent liabilities and sovereign guaranteed liabilities.

58. **Expected Results:** An updated MDTS will be published on an annual basis. Implementing the strategy's main recommendation of lengthening the maturity of Egypt's public debt profile and tapping new investors through issuance of new financial instruments can help the Government bring down its hefty debt servicing burden. By the end of the DPF series, the internal audit function in the Ministry of Finance would have performed and reported on at least four audits on sectors and entities affiliated with the ministry.

Pillar 2: Ensuring Sustainable Energy Supply

Objective 2.1: Reforming Energy Subsidies

59. **Rationale**: Egypt has long relied on generalized energy subsidies as a central instrument for social protection and sharing of hydrocarbon wealth. Since the early 1990s, energy prices have declined continually in real terms. The longstanding divergence between power tariffs and underlying costs has led to mounting financial imbalances that undermine the governance of the sector, and the ability of the state-owned companies to operate as commercial entities. By FY14, energy subsidies had escalated to 6.6% of GDP; of which fuel subsidies represented 6.0% and electricity subsidies 0.6% of GDP. The allocation of the overall subsidy volume between electricity and fuels depends on the price at which natural gas is charged to the power sector. Based on a recent policy decision this price was increased from US$ 1.77/MMBtu to US$ 3.00/MMBtu.

60. **Solution:** The Government has committed to a five-year reform period starting from 2014/15 during which energy subsidies will gradually be reduced from 6.6% of GDP in FY14 to 0.5% of GDP by FY19, with remaining subsidies covering only LPG and electricity consumption of the poorest households. The Government has a stated policy of redistributing part of the fiscal savings from subsidy reform to social transfers as well as to health and education, to help meet the constitutional mandate of allocating 10% of GDP to social spending.

61. **The process began in July 2014 when fuel prices were adjusted between 40-78% and electricity tariffs rose on average by 31%.** These price adjustments reduced energy subsidies from 6.6% to 4.1% of GDP, of which fuel subsidies represent 3.0% and electricity subsidies 1.2% of GDP. In the case of electricity, an explicit five-year tariff trajectory has been announced. The second scheduled electricity tariff adjustment took place in July 2015 and resulted in an overall average tariff increase of 19%, which for social reasons was implemented in such a way as to freeze tariffs for smaller residential consumers using less than 200 kilowatt-hours per month while applying higher percentage adjustments to larger consumers. Further electricity tariff adjustments are scheduled in 2016 and 2017 and will be triggers for subsequent DPF operations. The social acceptability of recent electricity tariff increases has been critically dependent on parallel improvements in energy security over this period, which have made it possible to avoid the disruptive power cuts of summer 2014, which have nonetheless contributed to increasing costs. This underscores the important linkages between improved service delivery and the achievement of financial sustainability.

62. The magnitude of energy subsidies is influenced by exogenous changes in the international oil and gas markets as well as the exchange rate. At present, there is no explicit policy for allocating evolving fuel costs among the Ministries of Petroleum, Electricity and Finance in such a way as to ensure that overall energy subsidy targets are met. The definition and implementation of such a policy will be triggers for DPF 2 and DPF 3, respectively.

DPF 1 Prior Action #4: The Prime Ministerial Decree No. 2259 of 2015 has been issued for implementing the second annual electricity tariff adjustment as part of a five year tariff reform plan outlined in the Prime Ministerial Decree No. 1257 of 2014 to reform the gas and electricity subsidy.

DPF 2 Indicative Trigger #4.1: (i) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues an order for implementing the third annual electricity tariff adjustment as part of a five-year tariff increase plan outlined in the Prime Minister's Decree No. 1257/2014 to reform the gas and electricity subsidy. (ii) The Cabinet formulates and implements the policy for financing variations in actual fuel costs, compared to budgeted estimates.

DPF 3 Indicative Trigger #4.2: (i) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues an order for implementing the fourth annual electricity tariff adjustment as part of a five-year tariff increase plan outlined in the Prime Minister's Decree No. 1257/2014 to reform the gas and electricity subsidy. (ii) The Cabinet implements the policy for allocating fuel costs financing variations in actual fuel costs, compared to budgeted estimates.

63. Expected Results: The results of these reforms can be gauged by tracking the value of energy subsidies as a percentage of GDP. These are expected to fall from 6.6% in FY14 to 3.3% in FY16. The target for FY18 will be confirmed during preparation of subsequent DPF operations. The increased rate of cost recovery in the electricity sector can be tracked through the increase in the average electricity tariff across all consumer groups that is projected to increase from EGP 0.226/kWh in FY14 to EGP 0.451/kWh in FY18.

Objective 2.2: Improving Energy Governance

Power Sector

64. **Rationale:** Electricity supply in Egypt is still subject to monopoly provision by the Egyptian Electricity Holding Company that is engaged in generation, transmission and distribution activities. Recent electricity shortages have indicated the need for a more dynamic and commercially-oriented sector that can bring in new investments over time. The electricity regulator, EgyptERA, was created in the year 2000 by a Presidential Decree and has established a sound reputation, yet would benefit from enhanced powers and a stronger legal foundation.

65. **Solution:** The new Electricity Law No. 87/2015 approved in July 2015 paves the way for a substantial reform of the electricity sector, and will be supported in 2016 by the issuing of executive regulations. The law envisages the separation of the Egyptian Electricity Transmission Company as a Transmission System Operator independent of generation and distribution sectors, and this process of separation will begin with the legal establishment of the company in 2016. Once the market regulations are fully in place, the Transmission System Operator will provide third party open access to the national power transmission grid, allowing the private sector to enter and compete to supply eligible large consumers, while the retail market remains regulated. The Government intends to establish new generation companies to own and operate some 17 GW of gas-fired electricity generation plants currently under construction that would compete in the wholesale market alongside the Egyptian Electricity Holding Company (EEHC). The law significantly increases the autonomy and accountability of the electricity regulator, EgyptERA, providing for substantial consumer representation on its board. EgyptERA will further enhance transparency and accountability by issuing regulations for public hearings of important regulatory decisions in 2016. The law also includes measures to improve energy efficiency particularly among large industrial consumers, and distribution companies are expected to submit plans for their implementation in 2016.

DPF 1 Prior Action #5: The decree promulgating Law No. 87 of 2015 has been issued mandating the promotion of competition in the electricity sector and the separation of the Egyptian Electricity Transmission Company. Specifically, the law mandates (i) the creation of a competitive wholesale electricity market providing direct access between generation companies and eligible large consumers; (ii) the separation of the Egyptian Electricity Transmission Company as an entity independent from the generation and distribution sectors; and (iii) the institutionalization of energy efficiency audits across all major consumers.

DPF 2 Indicative Trigger #5.1: (i) The Ministry of Electricity and Renewable Energy issues executive regulations implementing the Electricity Law. (ii) The Ministry of Electricity and Renewable Energy re-establishes the Egyptian Electricity Transmission Company as a functionally independent utility in compliance with the Electricity Law and the above executive regulations. (iii) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues guidelines for the implementation of the measures to improve energy efficiency for consumers above 500kW and distribution licensees, in compliance with Articles 48 and 49 of the Electricity Law.

DPF 3 Indicative Trigger #5.2: (i) The Cabinet transfers the ownership of the new gas-fired generation assets to new generation companies; (ii) The Egyptian Electric Utility and

Consumer Protection Regulatory Agency issues regulations on methodology for public hearings and consultations on important regulatory decisions.

66. Expected Results: Overall, the achievement of energy security for the power sector is measured in terms of the ratio between peak generation capacity and peak demand, which is projected to turn from a deficit of 5,540 MW in FY15 to a surplus of 1,000 MW in FY18. Progress towards the establishment of a competitive power market can be traced through the reduction in the market share of the incumbent generator EEHC from more than 92% in FY15 to 85% in FY18, as well as notification and operationalization of the associated supply code and market rules by FY18.

Gas Sector

67. Rationale: Like electricity, gas supply is still subject to monopoly provision by the state-owned enterprise Egyptian Natural Gas Holding Co. (EGAS). Moreover, there is no regulatory agency to oversee the sector and provide consumer protection.

68. Solution: The draft gas law, which passed the Cabinet approval stage in October 2015, paves the way for a substantial reform of the gas sector. Promulgation of the law and its supporting Executive Regulations is expected in 2016. The law mandates the creation of a new independent gas regulator. The regulator will be responsible for the development of a subsequent application of the gas transmission codes, the issuance of a gas transmission tariff, and the market entry of new shippers and suppliers apart from EGAS and the Egyptian General Petroleum Corporation (EGPC). The new regulatory agency is expected to improve transparency in the sector by providing on-line public access to all regulations and approval procedures. An independent Transmission System Operator will be nominated which will enable third-party suppliers to access to the gas transportation infrastructure, and is expected to be licensed by 2017. The speed and steps of the gradual opening of the gas market will take into account the need for an orderly transfer to a more competitive regime allowing eligible consumers to choose their suppliers freely.

DPF 1 Prior Action 6: The Cabinet has endorsed a draft gas law that provides for open access to the gas infrastructure and the establishment of an independent gas sector regulator.

DPF 2 Indicative Trigger #6.1: (i) The President/ Parliament enacts the new gas law, and the Ministry of Petroleum and Mineral Resources issues the executive regulations implementing the new gas law. (ii) The Ministry of Petroleum and Mineral Resources establishes a new independent gas sector regulator pursuant to the new gas law.

DPF 3 Indicative Trigger #6.2: (i) The Ministry of Petroleum and Mineral Resources nominates the independent transmission system operator in compliance with the requirements set by the gas sector regulator, and the gas sector regulator issues a license to the independent transmission system operator. (ii) The Cabinet, based on advice from the gas sector regulator, identifies consumers eligible to choose a gas supplier in the open market, pursuant to the new gas law.

69. **Expected Results:** The new gas law is expected to provide greater choice to large consumers of gas. Early progress can be gauged by the timely issuing of regulations for gas transmission tariffs and market rules.

Objective 2.3 Enabling Private Sector Investments in Renewable Energy

70. **Rationale:** Egypt has just begun to develop its rich renewable energy resources, which include the highest wind energy potential of any country in the MENA Region, as well as high intensity direct solar radiation throughout its territory. Egypt's early investments in renewable energy have been government-owned, however the current ambitious expansion plans to double to 20% the share of its generation capacity coming from renewable sources by 2022, will call for a substantial scale-up in private investment.

71. **Solution:** The new renewable energy Law No. 203/2014 ("Regarding the Stimulation of Producing Electricity from Renewable Energy Sources") reduces risks and increases profitability of investments in wind power and solar photovoltaics, improving the climate for private sector investment. The law and its associated feed-in-tariff regulations provide incentives for the first 4,300 MW (wind and solar PV), as well as a regulatory framework for further private investment via competitive bidding mechanisms for Independent Power Producers (IPPs). As per policy, the electricity regulator EgyptERA has already issued 10 interim licenses to private developers which are automatically converted to full licenses on achievement of financial closure of the project. Increased investment in renewable energy will reduce Egypt's dependence on fossil fuels, which currently contributes over 90% of power generation and will make the economy less vulnerable to fluctuations in fossil fuel prices.

DPF 1 Prior Action #7: (a) The decree promulgating Law No. 203 of 2014 has been issued for the stimulation of producing electricity from renewable energy sources.

(b) The Egyptian Electric Utility and Consumer Protection Regulatory Agency has issued interim licenses to ten (10) private developers pursuant to Law No. 203/2014.

DPF 2 Indicative Trigger #7.1: The Ministry of Petroleum and Mineral Resources and the Ministry of Electricity and Renewable Energy set up energy efficiency units with dedicated staff within their respective ministries.

DPF 3 Indicative Trigger #7.2: The Egyptian Electricity Transmission Company completes a competitive bidding process for the renewable energy program.

72. **Expected Results:** The successful implementation of the renewable energy law will be measured in fully commissioned (wind and solar) renewable generation capacity financed by the private sector, which the Government aims to increase from a baseline of 0 MW (October 2015) to 1,500 MW at the end of FY18.

Pillar 3. Enhancing the Business Environment

Objective 3.1: Improving Investment Regime and Facilitation

73. **Rationale:** The Income Tax Law of 2005 unified income tax in all sectors (except in Free Zones) and abandoned the sectoral approach to providing tax breaks. However, the Investment Guarantees and Incentives Law No. 8 of 1997 was not amended at that time to reflect a new approach to granting investment incentives and had further deficiencies in investor rights and protections. Furthermore, while a broad institutional reform was undertaken in the Investment Authority in 2004, the facilitation role of the GAFI was still inadequately defined in the law.

74. **Solution:** In October 2014, the Government of Egypt amended the investment law No. 8 of 1997. On investor protection, the amendments to the investment law provide protections consistent with Egypt's obligations under international investment agreements. On investor facilitation, the law requires GAFI to establish conditions and procedures for refusal of licensing and to act as a facilitator for the investor (and in some sectors, the sole facilitator) to complete all registration and licensing procedures.

75. **Paired with the completion of reforms to streamline the industrial licensing process, proposed as Prior Action 9 and associated triggers, these reforms would substantially impact the licensing bottleneck**. More broadly, on investment policy, while these amendments constitute an important step forward, a World Bank technical assistance program with the Ministry of Investment seeks to assess these legal amendments and their implementing regulations with an eye to further improvement. Subsequent proposed actions would capture the outcome of this review and encompass institutional development at the Ministry of Trade and Industry and GAFI to enable the implementation of the regulatory reforms.

76. Moreover, the DPF 2 indicative trigger consolidates and strengthens the Government's efforts to enhance the transparency of its economic regulatory system. The Government has taken various steps towards increasing access to information and transparency on regulations and procedures related to economic governance. Egyptian Regulatory Reform and Development Activity (ERRADA) has established an e-registry of governmental procedures, and GAFI is planning to establish an online business registration and licensing portal. The investment law amendments also include language concerning the promotion of transparency around the granting of incentives. The DPF 2 indicative trigger would solidify this direction through the publication of incentives available and all business registration and licensing procedures and requirements.

DPF 1 Prior Action #8: The decree promulgating Law No. 17 of 2015 and the Prime Ministerial Decree No. 1820 of 2015 have been issued which, respectively, introduced and implemented amendments to the Investment Guarantees and Incentives Law defining investor rights and improving investment facilitation services. This includes: (i) defining conditions and procedures for non-approval of licenses; (ii) designating GAFI as the sole interface with investors for certain investment activities; (iii) explicitly granting investor rights to establish and expand investment projects and to gain and transfer profits; and (iv) streamlining dispute resolution and liquidation mechanisms.

DPF 2 Indicative Trigger #8.1: (i) Extend GAFI's Cairo one-stop-shop capabilities beyond registration to licensing and other investment services in at least one sector. (ii) In order to enhance transparency and access to information for investors and the general public: (a) the Ministry of Investment/General Authority for Investment and Free Zones publishes a complete inventory of available investment incentives and eligibility criteria; (b) the Ministry of

Investment/General Authority for Investment and Free Zones publishes all licensing and permits procedures and requirements for all activities and sectors.

DPF 3 Indicative Trigger #8.2: The General Authority for Investment and Free Zones extends its one-stop-shop capabilities beyond registration to include post-registration licensing facilitation and other investment services to other sectors.

77. **Expected Results:** The number of one-stop-shops with full business start-up and licensing facilitation systems that are operational is expected to increase from zero in FY15 to 4 by end of FY18.

Objective 3.2: Reforming Industrial Licensing

78. **Rationale:** Industrial licensing is a severe impediment to industrial development in Egypt. The industrial licensing framework, while being subject to a variety of regulatory amendments, has seen little improvement since its enactment in the 1950s. It takes on average 634 days and 663 steps for a business to complete the process. Due to this complexity, less than 20% of industrial firms manage to complete it successfully. The rest operate in informal or semi-formal environment which limits their growth and job creation potential, and constrains their ability to seize business opportunities.

79. **Solution:** Given the complexity of the legal, institutional and procedural reforms needed to improve the industrial licensing regime, the issuing of a Prime Ministerial Decree sends a clear and strong signal that reforms are imminent. These reforms, which are further developed in the indicative triggers, begin with formulating an action plan for fundamental reform of industrial licensing, followed by a series of legislative reforms that encompass the entire industrial licensing regime. The primary policy objective of these reforms is to limit licensing activities to those necessary for the enforcement of regulations on human safety and security, environmental protection, and land use requirements rather than as a means of economic monitoring and control.

DPF 1 Prior Action #9: The Prime Ministerial Decree No. 2807 of 2015 has been issued launching the reform of the industrial licensing regime, including setting the principles of the reform. Specifically (i) limiting the scope of industrial licensing to risk-based enforcement of health, safety, security, environment, and land use requirements by responsible agencies; (ii) separating policy making, regulation and facilitation functions; and (iii) further decentralizing the provision of licensing services, beginning with the establishment of an inter-ministerial committee mandated to prepare and submit to the Cabinet a comprehensive reform plan.

DPF 2 Indicative Trigger #9.1: (i) Industrial licensing reform action plan, consistent with the reform principles laid down in the Prime Ministerial Decree has been endorsed by the Cabinet. (ii) The Government has started implementation of the industrial licensing reform by simplifying at least one regulatory area in a manner that significantly reduces compliance requirements.

DPF 3 Indicative Trigger #9.2: Cabinet has submitted to Parliament the package of proposed amendments to implement the industrial licensing reform action plan.

80. **Expected Results:** The reforms to the industrial licensing framework is expected to reduce the average number of days it takes to comply with all industrial licensing requirements from 634 days in FY15 to 160 days by end of FY18 (target to be confirmed once Trigger #9.1 has been met).

Objective 3.3: Strengthening the Competition Framework

81. **Rationale**: The implementation of pro-competitive policies in Egypt are at the heart of reforming the investment and business climate. Amendments to the Competition Law passed in 2014 were a positive step forward, but further actions to bring these amendments to light on the ground are necessary.

82. **Solution:** This program supports the implementation of amendments to the Competition Law which were enacted in 2014 by supporting the enactment and implementation of its executive regulations, which implement the Egyptian Competition Authority's (ECA) enhanced enforcement of anti-cartel policies. They also further strengthen the Authority's independence by enabling it to initiate court proceedings.

DPF 1 Prior Action #10: Draft executive regulations have been submitted to the Prime Minister to implement Law No. 56 of 2014 which introduced amendments to the Competition Law to enhance anti-cartel policy to prosecute the most harmful competition offences.

DPF 2 Indicative Trigger #10.1: The Cabinet approves the executive regulations on anti-cartel policy implementation and ECA institutional independence and adoption of administrative regulations to further strengthen anti-cartel enforcement policy.

DPF 3 Indicative Trigger #10.2: Enhancing antitrust enforcement by enacting further amendments or executive regulations to the Competition Law in order to include the necessary tools and enforcement mechanisms for protecting markets from non-competitive behavior.

83. **Expected Results:** The implementation of Competition Law reforms will contribute to the increase in the number of anti-competitive practices prevented/eliminated, with a target of increasing the number of anti-competitive practices prevented/eliminated from a baseline of nine (between FY13 to FY15) to a target of eleven decided during the FY16-18 period.

Table 4: DPF Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings
Pillar 1: Advancing Fiscal Consolidation	
Prior Action 1: The decree promulgating Law No. 96 of 2015 has been issued which amends the Income Tax Law by unifying the top income tax rate for all economic actors operating in the Borrower's territory.	• Promoting Poverty Reduction and Shared Prosperity, A Systematic Country Diagnostic, World Bank, 2015. • Government of Egypt. Strat-EGY. Egypt's five year macroeconomic framework and strategy FY14/15 – FY18/19. • Egypt Economic Monitor-Paving the Way for a Sustained Recovery, World Bank, 2015. • Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa, World Bank. 2014. • IMF. Taxes in Practice. Finance & Development, March 2015, Vol 52, No. 1. • Tax Policy in MENA Countries: Looking Back and Forward. IMF Working Paper 15/98.
Prior Action 2: The decree promulgating Law No. 32 of 2015, endorsing the national budget for FY16, has been issued which includes administrative instructions to all government budgetary entities to contain the wage bill.	• Promoting Poverty Reduction and Shared Prosperity, A Systematic Country Diagnostic, World Bank, 2015. • Alba, Pedro, Al-Shawarby and Iqbal. Fiscal and Public Debt Sustainability in Egypt. Working Paper Series. No. 38. The World Bank. September 2004
Prior Action 3: The Ministerial Decree No. 515 of 2015 has been issued which mandates the publication of the Medium-Term Debt Management Strategy.	• IMF and World Bank. Revised Guidelines for Public Debt Management. April 2014. • MTDS strategy (completed in cooperation with WB Treasury Department). • Promoting Poverty Reduction and Shared Prosperity, A Systematic Country Diagnostic, World Bank, 2015.
Pillar 2: Ensuring Sustainable Energy Supply	
Prior Action 4: The Prime Ministerial Decree No. 2259 of 2015 has been issued for implementing the second annual electricity tariff adjustment as part of a five-year tariff reform plan outlined in the Prime Ministerial Decree No. 1257 of 2014 to reform the gas and electricity subsidy.	• Transparency and Social Accountability in the Egyptian Power Sector, World Bank, 2015. • Assessment of Private Sector Participation in the Power Sector of Egypt, World Bank, 2014. • 5 Year Medium Term Action Plan (White Book) for the Integrated Sustainable Energy Strategy to 2035, European Union, 2015. • Technical Assistance for Institutional Capacity building of Egyptian Electric Utility and Consumer Protection Regulatory Authority—Phase 1 Market Design, European Union, 2012 • Tapping a Hidden Resource – Energy Efficiency in the Middle East and North Africa, World Bank, 2009
Prior Action 5: The decree promulgating Law No. 87 of 2015 has been issued mandating the promotion of competition in the electricity sector and the separation of the Egyptian Electricity Transmission Company.	• Egypt Energy Strategy to 2030, Nexant, 2009. • Egypt's Gas Supply Deficit, Wood McKenzie, 2014. • EU Gas Study, Mercados, Adetef, 2014. • 5 Year Medium Term Action Plan (White Book) for the Integrated Sustainable Energy Strategy to 2035, European Union, 2015. • Egypt: The Economic Cost of Natural Gas, PB, ECA, 2007.

Prior Action 6: The Cabinet has endorsed a draft gas law that provides for open access to the gas infrastructure and the establishment of an independent gas sector regulator.	• Arab Countries in Transition: Economic Outlook and Key Challenges, IMF, 2015. • Arab Republic of Egypt 2014 Article IV Consultation—Staff Report, IMF, 2015. • Egypt Energy Subsidies: Just-In-Time Advisory Services to the Ministry of Petroleum, World Bank, 2015. • MENA Economic Monitor—Corrosive Subsidies, World Bank, 2014. • Subsidy Reform in the Middle East and North Africa—Recent Progress and Challenges Ahead, IMF, 2014. • Vagliasindi, Maria. Implementing Energy Subsidy Reforms: An Overview of Key Issues, World Bank, 2012. • Reforming Energy Subsidies in Egypt, AfDB, 2012. • Energy Pricing Strategy, ESMAP, World Bank, 2009 (Kantor Management Consultants, EQI) • Egypt – Toward a More Effective Social Policy -- Subsidies and Social Safety Net, World Bank, 2005. 33550-EG. • The Impact of Phasing out Subsidies of Petroleum Energy Products in Egypt, Alternatives for Reform, ECES, 2010.
Prior Action 7: (a) The decree promulgating Law No. 203 of 2014 has been issued for the stimulation of producing electricity from renewable energy sources; (b) the Egyptian Electric Utility and Consumer Protection Regulatory Agency has issued interim licenses to ten (10) private developers pursuant to Law No. 203/2014.	• Assessment of Private Sector Participation in the Power Sector of Egypt, World Bank, 2014. • 5 Year Medium Term Action Plan (White Book) for the Integrated Sustainable Energy Strategy to 2035, European Union, 2015.
Pillar 3: Enhancing the Business Environment	
Prior Action 8: The decree promulgating Law No. 17 of 2015 and the Prime Ministerial Decree No. 1820 of 2015 have been issued which, respectively, introduced and implemented amendments to the Investment Guarantees and Incentives Law defining investor rights and improving investment facilitation services.	• Promoting Poverty Reduction and Shared Prosperity, A Systematic Country Diagnostic, World Bank, 2015. • More Jobs, Better Jobs: A Priority for Egypt. World Bank Group, 2014. • A Sustainable Competitiveness Strategy for Egypt, Egyptian National Competitiveness Council, 2012. • General Authority for Investment (GAFI) Quarterly Reports (2013-2014). • Doing Business in Egypt, World Bank, 2014. • Ongoing Technical Assistance on Investment Policy • Egypt Investment Climate Assessments and FIAS reports.
Prior Action 9: The Prime Ministerial Decree No. 2807 of 2015 has been issued launching the reform of the industrial licensing regime including setting the principles of the reform.	• Egypt's National Industrial Development Strategy, 2006. • Strategic assessment and recommendations: Industrial Licensing in Egypt. IFC 2008 • Egypt Investment Climate Assessment, World Bank, 2009. • Enterprise Survey 2008 • Enterprise Survey 2012 • Ongoing World Bank Technical Assistance on Industrial Licensing

Prior Action 10: Draft executive regulations has been submitted to the Prime Minister to implement Law No. 56 of 2014 which introduced amendments to the Competition Law to enhance anti-cartel policy to prosecute the most harmful competition offences.	• From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa, World Bank 2009. • Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa. World Bank Group 2014. • Ongoing Technical Assistance on Competition

4.3 LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

84. **This programmatic DPF series is fully aligned with the analysis and pillars set out in Egypt's Systematic Country Diagnostic and its three priorities: macroeconomic stabilization, continued energy subsidy reform, and improvement in governance focusing on improving the business environment.** The policy and institutional reforms supported by this programmatic DPF series would directly contribute to addressing these urgent challenges in a coherent and sustainable manner and can yield multiple dividends. Progress in these areas would also enable the Government to entrench confidence and stability, both essential to maintain and sustain the reform momentum.

85. **WBG support under the World Bank Group's proposed Egypt Country Partnership Framework (CPF) (2015-2019) is focused on the twin goals of eliminating extreme poverty and boosting shared prosperity in a sustainable manner, and is organized under three interdependent focus areas: (i) improving governance; (ii) private sector job creation; and (iii) social inclusion.** The reforms supported by this DPF series would help achieve some of the key goals identified in the proposed CPF. These include supporting macroeconomic stability; improving the transparency and efficiency of public administration through strengthening citizens' ability to hold the state accountable through access to information, improving the business climate for private investors, ensuring Egypt's energy security and diversification, and supporting financial sustainability of the energy sector. The proposed DPF, in alignment with the CPF, focuses on increasing the role of the private sector and integrating transparency and accountability across Government's economic programs. Complementing the proposed DPF's focus on macro-fiscal consolidation and private sector-led growth, the investment projects identified in the proposed new CPF (2015-2019) target the social and economic inclusion agenda, picking up issues of social safety nets, basic services, social housing, financial inclusion and agriculture.

86. **The proposed DPF is closely aligned with the WBG's MENA regional strategy.** The proposed DPF supports the renewal of the social contract underscored in the new MENA Strategy by pursuing private sector-led growth, implementing business policies that broaden economic opportunity, and improving citizen engagement through improved transparency and accountability.

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

87. **The proposed DPF has been prepared jointly with AfDB with joint mission and meetings held across all three pillars and coordinated jointly with the inter-ministerial**

working group that was set up by the Government for the DPF. The proposed DPF involved close cooperation and collaboration across management and staff of the World Bank and AfDB. The private sector perspective was incorporated based on discussions of the program with IFC country management. The Ministry of International Cooperation organized a consultation meeting with all donors and development partners based outside Egypt on November 2, 2015 to share the economic reform program of the Government, with focus on the pillars of the proposed DPF program.

88. The proposed DPF is based on Egypt's economic strategy outlined in Egypt 2030 vision and Strat-EGY. The Egypt 2030 Strategy was developed through a detailed consultation process with civil society, the private sector, Egyptian youth, and international development partners. Each aspect of Egypt 2030 was discussed by respective ministries and coordinated by Ministry of Planning across a process lasting months. Strat-EGY was prepared in consultation with domestic and international private investors participating in the Economic Conference of March 2015.

89. The pillars of the DPF and actions have been based on consultative process across different departments of the Government, as well as wider stakeholder groups within the country. Critical laws like the proposed VAT law have been discussed extensively with both industry associations and groups of industries that are likely to be impacted. Similarly, the Electricity Law was discussed by EgyptERA with multiple stakeholder including civil society institutions, think tanks, industry groups and was disseminated through websites and newspapers inviting comments and discussions. The draft gas law was discussed with a wide group of stakeholders, including donors and key industry groups, in discussions chaired by the Minister of Petroleum. The Investment Law and its amendments were based on extensive discussions and comments received from different stakeholders and industry groups. The Law on Secured Transactions is based on an extensive consultations and feedback regarding constraints of doing business by SMEs in Egypt.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

90. The GoE is undertaking a number of deep and structural reforms, the benefits of which will take time to be realized and may have adverse distributional impacts in the short term. The program of reforms supported by the DPF series are areas identified in the Egypt SCD as being important for poverty reduction and shared prosperity in Egypt. For instance, better governance in the power and gas sectors can help improve delivery of these services, potentially benefitting all customers. Several measures can indirectly support private sector job creation which would offer a more sustainable way to raise welfare and living standards because households with employed members are significantly less likely to be among the bottom 40%. Fiscal transparency measures such as citizen budgets can educate the public about the Government's activities and help build public support for difficult policy reforms provided there is a strong outreach to citizens to raise awareness about such measures. The GoE has committed to reallocating a share of the resources used for energy subsidies to human development sectors, and this can help households raise their welfare in the long term through better education and health outcomes. Overall, the realization of the long run benefits of these reforms depends on how well they are implemented and how the GoE manages the associated distributional and social consequences in the short term.

91. This DPF supports a planned schedule of electricity tariff adjustments beyond the one implemented in FY15 that could affect households' welfare. The analysis conducted on the direct impacts of these changes found small effects on poverty and welfare. The Government envisaged tariff adjustments for all electricity consumption blocks during FY15-FY19 as part of a process to reforms electricity subsidies (see Annex 3). The first tariff increase took place in July 2014 (effective through FY15). The second scheduled electricity tariff adjustment took place in July 2015 and resulted in an overall average tariff increase of 19%. For social reasons, tariffs (in nominal terms) were frozen for residential consumers using less than 200 kWh per month ("lifeline blocks") while applying higher percentage adjustments to larger consumers. Based on international experience, one could expect that tariff reforms would have important effects on households' welfare because electricity is typically an important energy source for lighting and cooling. However, electricity represents on average 1.8% of household total consumption expenditure in Egypt (Table 5), much below the 10% expenditure share typically considered as an indicator of affordability. Additionally, the data show that lower income households are not the majority of consumers of the "lifeline block" of 200 kWh or less (Figure 4), rather that households from all quintiles are roughly equally represented. Against this backdrop, households' consumption and electricity expenditure paths were projected using information from GDP per capita growth, inflation and electricity tariff increases (see more details in Annex 3). Under an adverse scenario where the incomes of the bottom 40% remain constant in real terms, poverty rates are expected to remain largely unchanged in FY16 from 26.3% in the baseline, and decline slightly to 25.3% in FY19. This result is mainly a reflection of the low budget shares for electricity among households and the associated small changes in expenditures due to tariff increases. If incomes of the poor grow, then the poverty impacts are further moderated.

92. The changes to the fuel subsidies and initial assessment of implementation of the proposed VAT law planned as part of DPF 2 must be monitored as they could have significant effects on households' well-being. Table 5 highlights the patterns of consumption for electricity and fuel products. It is evident that for the bottom two quintiles, LPG is the fuel with the highest expenditure share, and this share decreases as households get richer. A simulation of the projected effects on household consumption and poverty under a hypothetical reform plan where fuel prices for three products (gasoline, diesel and fuel oil) are assumed to go up to full cost recovery in one FY, leads to a very small rise in poverty (0.3 percentage points). Crucially, the exemption of LPG in this scenario partly explains the low effects found on poverty. Planned and future changes to the fuel subsidy reform program will be closely monitored and their potential impacts (direct and indirect) on welfare will be analyzed. The distributional implications of the proposed VAT law will also be monitored and assessed when more details become available. In general, exempting certain goods, such as staples and food consumed by the poor (accounting for about 50% of their total budget) from the proposed VAT law can be equity enhancing and protect the impact felt by the less well-off households. However, the introduction of proposed VAT law on other goods and services could spill-over to affect the less well-off households via their consumption of non-staples. These indirect effects on less well-off households will be assessed as part of the preparation of DPF 2 and DPF 3 in order to better understand the potential negative effects on poverty.

Table 5: Share of Household Expenditure Allocated to Electricity and Fuels

	Wood/Solid fuels	Gasoline	LPG	Natural Gas	Kerosene	Electricity	All Energy Sources
Quintile 1	0.07%	0.08%	1.31%	0.03%	0.04%	1.89%	3.42%
Quintile 2	0.04%	0.13%	1.08%	0.05%	0.03%	1.82%	3.14%
Quintile 3	0.03%	0.18%	0.97%	0.07%	0.02%	1.76%	3.03%
Quintile 4	0.02%	0.27%	0.84%	0.10%	0.01%	1.70%	2.94%
Quintile 5	0.01%	0.73%	0.56%	0.16%	0.01%	1.68%	3.14%
Total	0.03%	0.33%	0.89%	0.09%	0.02%	1.75%	3.11%

Source: Calculations based on HIECS 2012/13.

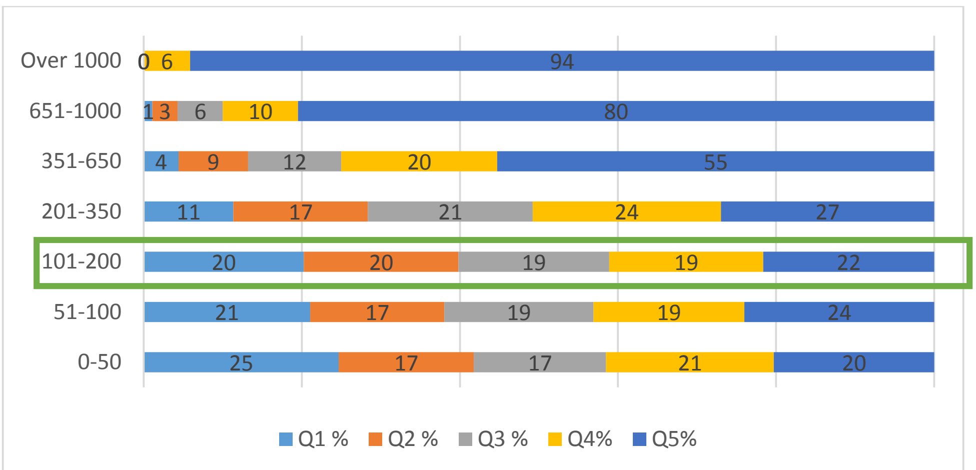


Figure 4: Distribution of households within consumption blocks

Source: Data from HIECS 2012/13. Quintiles based on national per capita consumption expenditure.

93. **Given that the GoE is undertaking a number of deep and structural reforms, the benefits of which may take time to be realized for all especially those in the bottom 40%, a well-designed public outreach and communications strategy along with a strong targeted Social Safety Net (SSN) system are needed to ensure sustainability and wellbeing of the poor.** International experience, summarized in the recent paper on phasing out fossil fuel subsidies for the G20 meetings,[2] suggests that an important complementary policy is to develop an effective communication program to strengthen public acceptance and "foster understanding of the political decisions that underpin the reform". The key feature of this communication effort must be that it conveys the reform as a means of achieving economic and social objectives such as better service delivery and sustainable and secure energy sector. The Bank is supporting the GoE in preparing a stakeholder engagement strategy for the fuel and electricity subsidy reforms. Recent introduction of poverty-targeted SSN programs (Labor Intensive Works and Takaful and Karama programs) offer a promising avenue in the medium term for the GoE to reach the poor and vulnerable and help mitigate adverse impacts on their welfare. Another set of mitigation measures that the GoE

[2] World Bank, 2014. Transitional policies to assist the poor while phasing out inefficient fossil fuel subsidies that encourage wasteful consumption, *Contribution by the World Bank to G20 Finance Ministers and Central Bank Governors*

could consider in the case of electricity reforms would be to help households manage their demand for electricity through energy efficiency improvements of residential buildings and promoting use of energy efficient appliances.

94. Egypt has recently undertaken a number of changes, with the ultimate goal of moving away from universal and costly subsidies to poverty targeted and efficient programs. Prior to 2012, Egypt's largest non-subsidy SSN was limited to the Social Solidarity Pension (SSP) that delivers cash transfers to nine categorical groups. SSP has an overall coverage of 1.6 million households but has been deemed an inefficient program. Recent significant changes to the SSN include the following. First, changes were made to the food subsidy system where instead of subsidizing the flour for bakeries producing *Baladi* bread, the Government subsidizes the final product (loaves of bread distributed by the bakeries to consumers) through the smart card system. Second, the ration food system is moving away from subsidized commodities to an allowance-based system.[3] Third, in 2012, with the support of IBRD (US$ 200 million) and the EU (Euro 67 million), Egypt established a Labor Intensive Works Program (LIWs) that is designed to target the able-to-work poor and unemployed youth, with focus on those living in poor and lagging regions. During the period 2013 – 2015, the LIWs program delivered over 12 million employment days benefiting a total of 80,000 poor individuals of which 60% were females and 70% were youth (18 to 29 years of age). Fourth, an ongoing initiative to establish a Unified National Registry (UNR) with technical assistance from the World Bank, will support different SSN programs and facilitate coordinated targeting and delivery of social services.

95. A promising SSN program that could be used to mitigate adverse distributional impacts is the recently introduced poverty targeted Takaful and Karama Program (TKP) aimed at protecting the poor through income support. Takaful provides conditional cash transfers to poor families with children (co-responsibilities for school attendance and child health visits) and Karama is an unconditional income support program targeted to poor households with elderly (age 65 and older) or with persons with severe and permanent disabilities.[4] TKP, which is supported through a US$ 400 million IBRD loan, uses a combination of geographical and proxy means test–based targeting to identify households meeting the eligibility requirements. The program is expected to enroll about 1.5 million beneficiary households by end 2017, with a phased rollout in three consecutive waves. The Wave 1 roll-out has begun in the 19 poorest districts (with estimated poverty at 60% or higher), all of them in Upper Egypt, and aims to cover about 500,000 households by 2015.While the decision to establish TKP is significant, Egypt is still a long way from putting in place an efficient SSN system. TKP excludes a large number of poor population that do not meet the categorical eligibility requirements (i.e., presence of children under 18, persons with severe and permanent disabilities, and/or elderly family members age 65 and older). With establishment of the TKP, Egypt has an opportunity to overhaul its SSN system, using targeted SSN as an anchor and moving away from generalized food and energy price subsidies. To institute a consolidated and better-integrated SSN system, Egypt would first need to gradually consolidate the old SSP program with TKP and make TKP the national flagship cash transfer (CT) program available to all poor and vulnerable households. Second, sustain the LIWs program to target poor

[3] The unused monthly allowance of *Baladi* bread can be converted into points and used to buy other food commodities within the same smart card system. This offered an incentive for citizens to ration their use of *Baladi* bread while allowing them to set their consumption priorities of available food commodities.

[4] Takaful provides a base amount of EGP 325 per household per month and with additional top-ups depending on the number of children attending school, up to a maximum amount per household of EGP 650 per month. In Karama, the benefit size is EGP 350 per beneficiary with a maximum amount per household of EGP 1,050.

job-seekers, especially the youth and women in geographical areas or seasons when the labor market is stagnant or shrinking. Third, ensure that the country is implementing flagship CT and LIWs programs with well-tested targeting approaches supported by the UNR, which can also be a key instrument to guide access of the SSN beneficiary households to social services, e.g. health and education.

5.2 ENVIRONMENTAL ASPECTS

96. As per OP 8.60, the World Bank assessed whether specific country policies supported by the DPF are likely to cause significant effects on the country's environment, forests, and other natural resources. The assessment concluded that the policies supported by the proposed DPF are not likely to have negative impacts on the country's environment or its natural resource base. Over the last 21 years, the Government has made significant strides in developing a framework for environmental management and mainstreaming environmental sustainability in its projects. The strategic objective of the environmental policy in Egypt is to introduce and integrate environmental concerns relevant to protecting human health and managing natural resources into all national policies, plans, programs and projects of the national development plan. As for the short-term objective of the environmental policy, it aims at reducing the pollution levels, minimizing health hazards, and improving the quality of life for citizens and residents in Egypt.

97. Egypt has a comprehensive Environmental Framework (Law No. 4 of 1994) which addresses the institutional arrangements and mandates for environmental management and protection as well as the substantive rules and principles governing, inter alia, several issues such as land pollution control; materials and toxic waste; air pollution control; water pollution control; penalties and the associated enforcement-related provisions. Environmental assessment for projects is also included in Law No. 4 of 1994 modified by Law No. 9 of 2009 (that is, the Law for the Environment), which is the main legislation regulating environmental protection in Egypt. Both the Ministry of State for Environmental Affairs (MSEA) and its executive agency: the Egyptian Environmental Affairs Agency (EEAA) are the environmental regulators in Egypt. According to Law No. 4 of 1994 the Environmental Impact Assessment (EIA) is a licensing requirement for development projects that are likely to cause impacts to the environment. EEAA has issued Guidelines for preparing EIAs in 2005, which have then been modified in 2009. The existing guidelines are currently under review for further updating.

98. Overall, the Egyptian EIA system has been found to be generally comparable with the Word Bank Environmental Assessment Policy (OP/BP 4.01). However, a few gaps exist regarding the preparation and follow up of the Environment Management Plans (EMPs), consultations, disclosure and dissemination of the EIA reports. Further assessment by the World Bank indicated that significant progress has been made in strengthening the institutional framework pertaining to the EIA process as well as to monitoring and enforcement. That is, since 2009, there have been serious efforts by EEAA to improve the EIA information dissemination through the design of an EIA database. Many of the identified gaps were filled. The requirements for consultation and dissemination of EIA reports have been officially added to the EIA requirements in the new Guidelines issued by EEAA in 2009. These Guidelines have been finalized with support from the World Bank and are in compliance with its general requirements.

99. The proposed DPF operation is expected to result in overall positive effects on Egypt's environment and natural resources. That is, Pillar 2 of this proposed operation which pertains to enhancing sustainable energy supply, comprises a number of policy interventions that are expected to bring about changes in the country's energy profile. This will essentially take place through a planned increase in fuel switching to natural gas by the production sectors of Egypt. Other planned changes include the shift towards more renewables and cleaner forms of energy in the energy generation mix. Furthermore, it is anticipated that the planned gradual increase in electricity tariffs will lead to lower consumption through rationalization and higher efficiency of energy end-use. Taken together, the proposed interventions will clearly result in environmental and health benefits, including decrease in greenhouse gas (GHG) emissions and a decrease in lower emissions of air pollutants.

100. The policy actions under the energy pillar directly contribute to all four of Egypt's GHG mitigation strategies, as highlighted in its Intended Nationally Determined Contribution (INDC) submission to the United Nations Framework Convention on Climate Change (UNFCCC). In its INDC, Egypt laid out its intention to promote to more efficient use of energy; increased use of renewable energy; the use of advanced locally-appropriate and more-efficient fossil fuel technologies; and phasing out energy subsidies within a period of 3-5 years. The proposed operation directly contributes to all four of these mitigation strategies. The World Bank estimates that, through the measures supported in the proposed DPF, GHG emissions are likely decline by 11 to 21% by FY19 compared to the baseline trajectory, driven by the following effects: fuel switching from heavy fuel oil to natural gas, the demand response to higher end user prices (a higher impact is envisaged if energy efficiency measures have high market penetration), efficiency in the supply of electricity, and the introduction of renewable energy.

5.3 PUBLIC FINANCIAL MANAGEMENT[5], DISBURSEMENT AND AUDITING ASPECTS

101. Egypt's PFM reforms have made progress on various fronts, though important challenges remain. PFM reforms to date have been undertaken in a fragmented manner, thus the Ministry of Finance is developing a sequenced PFM Action Plan with technical support from the World Bank.

102. The Constitution provides the legal basis for the budget, for appropriating and spending public funds, and for preparing and approving the final accounts of the state budget. A range of laws deal with specific aspects of financial management; in addition, there are specific laws for entities such as economic authorities and special funds.

103. The state budget covers the activities of the Central Government, governorates, and public service authorities. However, a number of special accounts and funds, while nominally in-budget, function under separate provisions with limited transparency. Their aggregate balance has been decreased in recent years. The annual budget calendar provides for an orderly and timely budget formulation and appropriation process. A pre-budget statement has been prepared in 2015 to include the general framework for fiscal policy, budget aggregates, and the related priorities. The interface between the Ministry of Finance and the Ministry of Planning, Follow up and Administrative Reform in the planning and management of capital investment could be improved.

[5] The Bank is providing PFM TA support to the Government. As part of this engagement, Bank staff conducted an analysis of the current status of major PFM systems and reforms (2015), which served as basis for this summary.

The recent introduction of program budgeting for nine sectors pursues sound objectives, but the roll-out process seems in need of recalibration and attention to capacity development.

104. The Government has drafted an amendment of the Public Procurement Law to align it with international practice. While the legal framework is subject to improvement, important challenges remain in the consistency of application of the current legislation. The Government has implemented a government procurement portal (http://etenders.gov.eg) for mandatory publication of bidding opportunities, documents, bid evaluations and results. This tool will increase transparency and efficiency, while enhancing the coverage and system functionalities, such as "e-contract management", bringing about significant additional benefits.

105. The ex-ante control system is implemented by MoF's financial controllers and includes transaction-based compliance controls. These cover payments, recording of transactions, and production of accounts at the unit level. However, there are variations in performance, and timeliness, as well as incomplete controls on budget commitments. The MoF recently issued a financial control manual that will help to standardize controls and make their application more predictable. The MoF also has the intention to develop a risk-based ex-post internal audit function.

106. Government Financial Management Information System (GFMIS) has been rolled out partially. It is used to record budget allocations and modifications, and to execute the budget through general ledger transactions. However, the full budget execution process chain remains largely manual, with only a subset of accounting units utilizing the "procurement-to-pay" functionalities. Further deployment of the GFMIS will need enhancements in project management, a new implementation plan, and retraining.

107. The Ministry of Finance exercises monitoring of cash transactions and balances of the accounting units included in the state budget and maintained in the Central Bank of Egypt (CBE). The introduction of the treasury single account (TSA) law, the closing of many special accounts and funds in commercial banks, and the ongoing implementation of centralized e-payments, have strengthened cash management. However, as stated earlier, a number of special accounts and funds remain with separate cash management processes.

108. Accounting is cash-based for the state budget. Consequently, no information on accounts receivable and accounts payable (including expenditure arrears) is available. Significant cross balances among government entities need to be reconciled and settled. Unaudited annual accounts are issued and published on a timely basis (within six months after fiscal year-end). The enacted budget, citizen's budget, in-year budget reports, and year-end budget reports are made public. Conversely, the audited annual accounts are not made public.

109. The Accountability State Authority (ASA) has a comprehensive scope of coverage and is known to issue its audit report on the Government annual accounts on a timely basis. The 2014 Constitution introduced elements to strengthen ASA's independence and transparency. ASA (formerly known as the Central Auditing Organization (CAO)) reports will need to be submitted to Parliament, the President of the Republic, and for public opinion. However, in absence of enabling legislation, the provision for publication of audit reports has not yet been made effective.

110. The 2013 IMF Safeguards Assessment of the CBE is not yet available. The CBE started publishing its audited financial statements in 2012. The financial statements as of June 30, 2014 were audited jointly by the ASA and a known local audit firm, who issued an unqualified ("clean") opinion. World Bank disbursements for several investment loans are channelled in a satisfactory manner through designated accounts maintained in the CBE.

111. The PFM system operates well enough, however, as described above, several shortcomings remain, such that the fiduciary risk is considered substantial. The risk is mitigated by the Government's renewed emphasis on PFM reform and the recent gains in fiscal transparency. In line with the CPF, the Bank will continue the policy dialogue and provision of technical assistance to support implementation of PFM reforms.

112. Normal disbursement procedures for single-tranche DPFs will apply to this operation. The Bank will disburse the loan proceeds into a dedicated account in US Dollars that forms part of the country's official foreign exchange reserves held by the CBE, and an amount equivalent to the loan proceeds will be credited not later than five business days in local currency to an account of the Ministry of Finance's Treasury Single Account, thus becoming available to finance State Budget expenditures. The Government will confirm this transaction through written confirmation within 30 days of disbursement. Moreover, the Bank will reserve the right to request the borrower to arrange for an independent audit of the dedicated account transactions, to be performed by auditors and in accordance with terms of reference acceptable to the Bank. In that case, the audit report would be submitted to the Bank not later than four months after the date of the Bank's request. If the Bank determines at any time that an amount of the loan was used to make a payment for an excluded expenditure, the Borrower shall, promptly upon notice from the Bank, refund an amount equal to the amount of such payment to the Bank. Amounts refunded to the Bank upon such request will be cancelled.

5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

113. The Ministry of International Cooperation will be the main coordinating agency for monitoring and evaluation among the five other participating ministries. The prior actions detailed in this operation are the prime responsibility of five ministries: Ministry of Finance; Ministry of Electricity and Renewable Energy; Ministry of Petroleum; Ministry of Investment and Ministry of Trade and Industry. The inter-ministerial working group created for the DPF would remain functional during the course of the three-year programmatic DPF series. The Ministry of International Cooperation would be the coordinator with other ministries on monitoring of the results indicators, which are based on routinely published sector indicators. Technical Assistance would be provided to Ministry of International Cooperation for creation of a Management Information System to monitor quarterly data collection from all relevant ministries for monitoring of indicators and outcomes of the program.

114. The program outcomes will be monitored through the measurement of the progress toward the achievement of results indicators included in the policy and results matrix (Annex 1). This measurement seeks to assess progress toward the implementation of the policy and institutional measures supported by the proposed DPF series and will be evaluated following the disbursement of the DPF 1. The Ministry of International Cooperation will have the responsibility of presenting the information related to the reform implementation and progress made towards results on time and in a format satisfactory to the Bank.

115. Grievance redress. Communities and individuals who believe they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a Bank supported DPF may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or to the Bank's Grievance Redress Service (GRS). Complaints to the GRS are promptly reviewed.

116. Affected communities and individuals may submit their complaint to the Bank's independent Inspection Panel, which determines whether harm occurred or could occur as a result of Bank noncompliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the Bank's attention and the Bank management has been given an opportunity to respond. Information on how to submit complaints to the Bank's corporate GRS is available at http://www.worldbank.org/GRS. Information on how to submit complaints to the Bank's Inspection Panel is available at www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

117. The overall risk rating of this operation is high. The major risks to the operation's ability to achieve its development objective include: (a) macroeconomic challenges associated with the high fiscal deficit and low levels of foreign exchange reserves; (b) the potential spillover effects of regional, geopolitical and governance challenges; (c) challenges on sector strategies; and (d) weak institutional and implementation capacity. These risks, if materialized, could singularly or jointly impact the Government's ability to implement the reforms or make the outcome of the development agenda less successful.

118. High geopolitical and governance challenges persist. The regional risks of security, conflict and political instability have an adverse impact on Egypt. The political transition from a new Constitution to the formation of the Parliament is just nearing completion, and there are uncertainties regarding the ability of these new institutions to continue structural reforms. The SCD and CPF highlight the need for improving governance as a key pillar for Egypt's inclusive and sustainable growth. A significant number of new laws have been enacted across sectors to eliminate monopolies and reduce bureaucratic costs involved in running business, but the extent to which the implementation of these new laws will face resistance is uncertain. On a positive note, the Government has implemented and is continuing to implement substantial reforms that had been postponed for years, which indicates the resolve of the current regime to address key economic challenges. This operation proposes to engage, and support the Government in its decision-making process and implementation of reforms. The Bank will continue to monitor political and governance risks. These risks will be mitigated through a number of measures, including working with the technical inter-ministerial working group, measures for citizen's engagement in decision making, and a robust grievance redress mechanism to address any significant concerns. In addition, the newly elected Parliament will open new channels and opportunities for citizen engagement and oversight of government policies.

119. Macroeconomic risks are high. The fiscal deficit has declined but remains high, reserves are at about three months of imports coverage, the foreign exchange is in short supply, and the risk of social unrest remains as its underlying causes – absence of national efficient and well targeted SSN schemes, shortage of formal-sector jobs, high unemployment and underemployment among Egyptian youth, and exclusion of poor segments of the population – need time to be fully addressed through the policies adopted and to be implemented by the Government. There is also a need for an aggressive strategy to bridge the external financing gap that coincides with weak external demand, the challenge to sustain an accelerated fiscal consolidation plan without limiting growth, the need to diversify sources of financing, and manage the exchange rate in a manner that contributes to private sector-led growth and job creation. The Government acknowledges these challenges and is addressing them through the implementation of an ambitious reform program aimed at tackling macroeconomic imbalances and achieving higher, sustainable and inclusive growth over the medium term through both fiscal and structural reforms. The right pace and sequencing of reforms coupled with measures to correct for the structural deficiencies of high inflation along with the twin deficits (fiscal and trade) are key to enhancing sustainability of the macroeconomic framework and to create adequate buffers that ensure resilience in the face of external shocks arising from weakening global demand, increased volatility and risk aversion, the possibility of an increase in the Federal Reserve's benchmark interest rates in the United States, volatility in the EU and deceleration of Chinese growth. These buffers are also much needed to mitigate any delay in implementing reforms. In addition, several of envisaged reforms such as controlling the wage bill, lowering energy subsidies, and advancing tax reforms involve difficult political economy challenges. There would be significant risk in the event the Government reversed fiscal consolidation due to populist demands. However, the Government has already shown high commitment by initiating energy subsidy reform that saved 3.3% of GDP over two years, while ushering in additional bold fiscal consolidation measures equivalent to about 2% of GDP over the last two years. Implementation of envisaged reforms related to private sector-led growth and enhancing transparency and accountability remain critical to advance inclusion, but these reforms may be opposed by various groups, reflecting high risk of this operation.

120. To partially address some of these risks, the Government plans to focus on accelerating the tax administration reform to ensure that recently adopted key tax reforms such as enacting the real estate tax, taxing capital gains, and taxing the mining sector are yielding intended results. In addition, the Government can enhance tax compliance and enforcement while improving service delivery for tax payers. Furthermore, by advancing fiscal consolidation efforts and reducing government gross financing needs as well as lengthening the debt profile and reducing interest rates, the Government can bring down its debt service burden by an additional 0.3-0.5% of GDP over the coming few years. Moving forward with DPF 2 would be contingent on the adequacy of the macroeconomic policy framework, especially addressing distortion created by lack of adequate foreign exchange supplies.

121. The banking and private sectors' exposure to large exchange rate adjustments seem to be well contained as the banking sector's (CBE and commercial banks) foreign assets exceed foreign liabilities. As of September 2015, the ratio of CBE foreign assets to liabilities was 96% and for commercial banks 122%. In addition, the dollarization ratio (foreign currency deposits as percent of money supply) stands at 15% as of end September 2015 versus 15.4% a year ago and 16.2% in December 2010. Private sector foreign debt indicators are also quite favorable, with private sector external debt standing at around US$ 3.7 billion in March 2015, which represent 1% of GDP in FY15 and 5% of current account receipts in FY15. The growth path could be augmented if an enhanced structural reforms agenda is timely adopted along with an accelerated materialization of projects and deals signed during Egypt's March Economic Conference. Well planned and executed public investments in infrastructure and human capital, including health and education, can lead to productivity gains and crowd in higher private sector activities, positively supporting growth over the medium-term. In addition, resolving exchange rate concerns would help reduce the external financing gap on the backdrop of increased portfolio investment flows and a pick-up in non-oil exports. On the fiscal side, acceleration of public financial management reforms can lead to efficiency gains and optimize the utilization of public resources.

122. The risks with sector strategies, stakeholders and technical design of the program are rated substantial. In addition, the institutional capacity for implementation and sustainability faces substantial challenges. As identified by the SCD and the CPF, Egypt has a history of policies and laws that have not been implemented well. For improving private sector investment, Egypt has simultaneously initiated legal and institutional reforms encompassing the investment law, industrial licensing, and competition law, liberalization of electricity and gas sectors and promoting renewable energy; where the capacity of the respective sector ministries and their institutions in implementing reforms and navigating change would be tested. There is a need for a focused effort at implementing comprehensive and integrated sector strategies. Building strong institutions in respective sectors usually requires an engagement over the medium to long term, and the risk is that Egypt may not have the luxury of time. The DPF program seeks to support a medium-term three-year framework to lock in institutional measures and outcomes expected from the deep structural changes being undertaken in Egypt across fiscal, energy and business competitiveness pillars. The risk of not focusing adequately on cross sectoral implications of issues like energy subsidies and industrial licensing could hinder progress. To partially address some of these risks, an extensive technical assistance program is underway on areas of medium-term debt strategy, power sector reforms and strengthening state owned enterprises, gas sector law and institutional reforms in gas sector, energy efficiency, investment law, secured transactions law, and industrial licensing reforms. Such an extensive technical assistance has been underway for the last two years and is expected to continue over the next three years. This would assist the Government in monitoring the progress of the reforms and strengthen sectoral institutional and regulatory capacity.

123. Fiduciary, environmental and social risks are substantial and need careful monitoring. The World Bank has now engaged with Government on far reaching PFM reforms where there are significant issues that need to be addressed (please refer to section 5.3 for details). The social protection mechanisms to cover the entire marginalized and poor groups of the population have advanced through better targeting and efficient programs, such as the introduction of new cash transfer programs and the overhaul of the food subsidy system. However, the policies and institutions for expanding the reach of social protection need to match with the pace of reforms envisaged in the DPF program, especially on energy subsidies, fiscal revenue expansion and wage control. To mitigate these risks, the Bank will support the Government on a comprehensive communication strategy on its reform program, and require the institutionalization of a grievance redress mechanism and a citizen outreach program to build greater acceptability of reforms within society.

124. The risk of not engaging outweighs the program risks: The region is experiencing an unprecedented turmoil with ongoing conflicts in Egypt's neighborhood. Regional stability, sustainable growth, and social inclusion in the region require a stable Egypt. Any risk for instability in Egypt has enormous implications for MENA, Europe and the wider global community. Egypt has taken significant steps towards sustainable private sector-led growth that is focused on job creation, and the World Bank Group has a unique opportunity to realign its relationship and facilitate the continued implementation of Egypt's reform program over the medium term.

Category	Risk	Rating
1	Political and Governance	H
2	Macroeconomic	H
3	Sector strategies and policies	S
4	Technical design of project or program	S
5	Institutional capacity for implementation and sustainability	S
6	Fiduciary	S
7	Environment and social	S
8	Stakeholders	S
	Overall	H

H=High; S=Substantial; M=Moderate; L=Low.

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions and Triggers			Results
Prior Actions under DPF 1	**Triggers for DPF 2**	**Triggers for DPF 3**	
Pillar 1 --- Advancing Fiscal Consolidation			
Objective 1.1 Enhancing Government Revenues			
Prior action #1 The decree promulgating Law No. 96 of 2015 has been issued which amends the Income Tax Law by unifying the top income tax rate for all economic actors operating in the Borrower's territory. The amendments unify the top income tax rate at twenty-two and one half percent (22.5%) for all economic actors operating in the Borrower's territory, including those operating in special economic zones formerly subject to a lower rate of ten percent (10%).	**Trigger #1.1** The Government has done an initial assessment of the implementation of the proposed Valued Added Tax law which introduces the following features of the value added tax regime: (i) a single unified tax rate for all goods and services; (ii) a clearly stated table detailing excise taxes; (iii) a well-identified list of exempted goods and services; (iv) a full-fledged tax credit system for direct and indirect inputs; and (v) a tax refund system for expenses related to the purchase of equipment and machinery. The assessment includes the initial revenue effect of the VAT as well as the adequacy of the institutional capacity to implement the VAT, along with recommendations for institutional capacity strengthening.	**Trigger #1.2** The Ministry of Finance issues a decree that introduces a harmonized and simplified tax regime for micro and small businesses based on turnover.	Increased proceeds from non-sovereign corporate income tax and sales tax on goods and services as percent of GDP from 5.4% in FY15 to 6.7% in FY18.

Objective 1.2 Containing the Wage Bill			
Prior action #2 The decree promulgating Law No. 32 of 2015, endorsing the national budget for FY16, has been issued which includes administrative instructions to all government budgetary entities to contain the wage bill. The administrative instructions are to (i) cap bonuses and rewards of their respective employees in FY16 at the level of FY15; and (ii) delink the variable portion of government employees' salaries from the basic salary component.	**Trigger #2.1** The Ministry of Finance publishes a time-bound plan with procedures and measures that facilitate and enforce the automation of wages and salaries payments for all government employees to: (i) enable the Government to have a reliable database to guide a more informed decision-making process, (ii) enhance financial inclusion by requiring all employees to have bank accounts, and (iii) reduce cost of managing the Government's payroll system..	**Trigger #2.2** The Cabinet approves a medium-term plan/rule that sets a cap on the number of new recruits in the public sector relative to the total number of retirees.	Reduced the Central Government's wages and salaries bill to nominal GDP, from 8.2% in FY15 to 7.5% of GDP by FY18.
Objective 1.3 Strengthening Debt Management			
Prior action #3 The Ministerial Decree No. 515 of 2015 has been issued which mandates the publication of the Medium-Term Debt Management Strategy.	**Trigger #3.1** The Ministry of Finance establishes and operationalizes an internal audit function within the ministry, with adequate budget and staff and a mandate aligned with international standards.	**Trigger #3.2** The Ministry of Finance sets up a comprehensive administrative system including a dedicated unit, manuals, and standard reports, which identifies, monitors, and facilitates the management of contingent liabilities and sovereign guaranteed liabilities.	The annual publication of an updated Medium-term Debt Management strategy. The internal audit function has performed and reported on at least four audits on sectors and entities affiliated with the Ministry of Finance.

<table>
<tr><td colspan="4">Pillar 2 --- Ensuring Sustainable Energy Supply</td></tr>
<tr><td colspan="4">Objective 2.1 Reforming Energy Subsidies</td></tr>
<tr><td>Prior action #4 The Prime Ministerial Decree No. 2259 of 2015 has been issued for implementing the second annual electricity tariff adjustment as part of a five-year tariff reform plan outlined in the Prime Ministerial Decree No. 1257 of 2014 to reform the gas and electricity subsidy.</td><td>Trigger #4.1 (i) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues an order for implementing the third annual electricity tariff adjustment as part of a five-year tariff increase plan outlined in the Prime Minister’s Decree No. 1257/2014 to reform the gas and electricity subsidy.

(ii) The Cabinet formulates and implements the policy for financing variations in actual fuel costs, compared to budgeted estimates.</td><td>Trigger #4.2 (i) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues an order for implementing the fourth annual electricity tariff adjustment as part of a five-year tariff increase plan outlined in the Prime Minister’s Decree No. 1257/2014 to reform the gas and electricity subsidy.

(ii) The Cabinet implements the policy for allocating fuel costs financing variations in actual fuel costs, compared to budgeted estimates.</td><td>Reduction of energy subsidies as a percentage of GDP from 6.6% in FY14 to 3.3% in FY16. Target for FY18 to be confirmed during subsequent DPFs.

Increase in the average electricity tariff across all consumer groups from 0.226 EGP/kWh in FY14: to 0.451 EGP/kWh in FY18.</td></tr>
<tr><td colspan="4">Objective 2.2 Improving Energy Governance</td></tr>
<tr><td>Prior action #5 The decree promulgating Law No. 87 of 2015 has been issued mandating the promotion of competition in the electricity sector and the separation of the Egyptian Electricity Transmission Company. Specifically, the law mandates (i) the creation of a competitive wholesale electricity market providing direct access between generation companies and eligible large consumers; (ii) the separation of the Egyptian Electricity Transmission</td><td>Trigger #5.1 (i) The Ministry of Electricity and Renewable Energy issues executive regulations implementing the Electricity Law.

(ii) The Ministry of Electricity and Renewable Energy re-establishes the Egyptian Electricity Transmission Company as a functionally independent utility in compliance with the Electricity Law and the</td><td>Trigger #5.2 (i) The Cabinet transfers the ownership of the new gas-fired generation assets to new generation companies

(ii) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues regulations on methodology for public hearings and consultations on important regulatory decisions.</td><td>Decrease in the market share of the EEHC (by MW of nameplate capacity), from more than 92% in FY15 to 85% in FY18.

Notification and operationalization of the power supply code and power market rules by FY18.

Difference between</td></tr>
</table>

Company as an entity independent from the generation and distribution sectors; and (iii) the institutionalization of energy efficiency audits across all major consumers.	above executive regulations. (iii) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues guidelines for the implementation of the measures to improve energy efficiency for consumers above 500kW and distribution licensees, in compliance with Articles 48 and 49 of the *Electricity Law*.		peak electricity demand and then available peak capacity to reduce from deficit of 5,540 MW in FY15 to a surplus of 1,000 MW by FY18
Prior action #6 The Cabinet has endorsed a draft gas law that provides for open access to the gas infrastructure and the establishment of an independent gas sector regulator.	**Trigger #6.1** (i) The President/ Parliament enacts the new gas law, and the Ministry of Petroleum and Mineral Resources issues the executive regulations implementing the new gas law. (ii) The Ministry of Petroleum and Mineral Resources establishes a new independent gas sector regulator pursuant to the new gas law.	**Trigger #6.2** (i) The Ministry of Petroleum and Mineral Resources nominates the independent transmission system operator in compliance with the requirements set by the gas sector regulator, and the gas sector regulator issues a license to the independent transmission system operator. (ii) The Cabinet, based on advice from the gas sector regulator, identifies consumers eligible to choose a gas supplier in the open market, pursuant to the new gas law.	A separate gas transmission tariff, transmission code, market rules, and approval procedures are available by FY18 A dedicated web portal with all regulations and rules is operationalized by FY18.
Objective 2.3 Enabling Private Sector Investments in Renewable Energy			
Prior action #7 **(a) The decree promulgating Law**	**Trigger #7.1** The Ministry of Petroleum and Mineral Resources and the Ministry of Electricity and	**Trigger #7.2** The Egyptian Electricity Transmission Company completes a	Increase in commissioned private sector-owned

No. 203 of 2014 has been issued for the stimulation of producing electricity from renewable energy sources. **(b) The Egyptian Electric Utility and Consumer Protection Regulatory Agency has issued interim licenses to ten (10) private developers pursuant to Law No. 203/2014.**	Renewable Energy set up energy efficiency units with dedicated staff within their respective ministries.	competitive bidding process for the renewable energy program.	renewable energy projects from 0 MW (October 2015) to 1,500 MW (end of FY18).
Pillar 3 --- Enhancing the Business Environment			
Objective 3.1 Improving Investment Regime and Facilitation			
Prior action #8 The decree promulgating Law No. 17 of 2015 and the Prime Ministerial Decree No. 1820 of 2015 have been issued which, respectively, introduced and implemented amendments to the Investment Guarantees and Incentives Law defining investor rights and improving investment facilitation services. This includes: (i) defining conditions and procedures for non-approval of licenses; (ii) designating GAFI as the sole interface with investors for certain investment activities; (iii) explicitly granting investor rights to establish and expand investment projects and to gain and transfer profits; and (iv) streamlining dispute resolution and liquidation mechanisms.	**Trigger #8.1** (i) Extend GAFI's Cairo one-stop shop capabilities beyond registration to licensing and other investment services in at least one sector. (ii) In order to enhance transparency and access to information for investors and the general public: (a) the Ministry of Investment/General Authority for Investment and Free Zones publishes a complete inventory of available investment incentives and eligibility criteria; (b) the Ministry of Investment/General Authority for Investment and Free Zones publishes all licensing and permits procedures and requirements for all activities and sectors.	**Trigger #8.2** The General Authority for Investment and Free Zones extends its one-stop-shop capabilities beyond registration to include post-registration licensing facilitation and other investment services to other sectors.	Number of one-stop-shops with full business start-up and licensing facilitation systems that are operational increases from zero in FY15 to 4 by end of FY18.

Objective 3.2 Reforming Industrial Licensing			
Prior action #9 The Prime Ministerial Decree No. 2807 of 2015 has been issued launching the reform of the industrial licensing regime, including setting the principles of the reform. Specifically (i) limiting the scope of industrial licensing to risk-based enforcement of health, safety, security, environment, and land use requirements by responsible agencies; (ii) separating policy making, regulation and facilitation functions; and (iii) further decentralizing the provision of licensing services, beginning with the establishment of an inter-ministerial committee mandated to prepare and submit to the Cabinet a comprehensive reform plan.	**Trigger #9.1** (i) Industrial licensing reform action plan, consistent with the reform principles laid down in the Prime Minister Decree has been endorsed by the Cabinet. (ii) The Government has started implementation of the industrial licensing reform by simplifying at least one regulatory area in a manner that significantly reduces compliance requirements.	**Trigger #9.2** Cabinet has submitted to Parliament the package of proposed amendments to implement the industrial licensing reform action plan.	Average number of days to comply with all industrial licensing requirements is reduced from 634 days in FY15 to 160 days by end of FY18 (target to be confirmed once Trigger #9.1 has been met).
Objective 3.3 Strengthening the Competition Framework			
Prior action #10 Draft executive regulations have been submitted to the Prime Minister to implement Law No. 56 of 2014 which introduced amendments to the Competition Law to enhance anti-cartel policy to prosecute the most harmful competition offences.	**Trigger #10.1** The Cabinet approves the executive regulations on anti-cartel policy implementation and ECA institutional independence and adoption of administrative regulations to further strengthen anti-cartel enforcement policy.	**Trigger #10.2** Enhancing antitrust enforcement by enacting further amendments or executive regulations to the Competition Law in order to include the necessary tools and enforcement mechanisms to prevent non-competitive behavior.	Increased number of anti-competitive practices prevented/ eliminated from a baseline of 9 (between FY13 and FY15) to a target of 11 decided during the FY16-FY18 period.

ANNEX 2: LETTER OF DEVELOPMENT POLICY

Ministry of International Cooperation
The Minister

Dr. Jim Yong Kim
President
World Bank Group

November 12, 2015

Arab Republic of Egypt
Economic Reform Program
(2014-2018)
Letter of Development Policy

Dear President Kim,

The Government of Egypt, in June 2014, launched a well-structured comprehensive Economic Reform Program (2014-2018), with the objective of restoring macroeconomic imbalances, addressing social inclusion priorities, and achieving high, sustainable and well-diversified growth. The Government has made clear strides toward restoring confidence in the economy through serious and comprehensive reforms, while moving steadily on advancing its political roadmap. To get the economy back on track, the Government has developed a credible, sustainable and effective reform Program with a clear vision. The Program comprises of three key pillars, namely: (i) advancing fiscal consolidation; (ii) ensuring sustainable energy supply; and (iii) improving the business environment.

The Program is designed to restore confidence in the economy's prospects by tackling Egypt's macroeconomic imbalances, addressing social needs, and eliminating infrastructure deficits, including the shortfalls in1` the power and transportation sectors. It establishes a new foundation for sustainable growth by incentivizing productivity, investment and job creation. Above all, it puts the economy on course to meet the legitimate demands of the Egyptian people for lives of greater stability, security and dignity, as well as to deliver a meaningful improvement in the quality, range, and accessibility of services to which they are entitled, attaining their aspirations of a better future.

The Government's key objective is to create a productive, efficient, private sector-led and ultimately more dynamic economy and to ensure that future growth is high, sustainable and inclusive. Structural steps have been taken to enhance the business environment through streamlining investment procedures, strengthening the competition framework and upgrading the industrial licensing regime. Among the boldest moves so far was the Government's decision to slash wasteful energy subsidies bill by 30 percent in July 2014, signaling its political will to confront even the most difficult issues in its quest to reinvigorate the economy. Other decisive steps have included measures to improve tax buoyancy and widen the tax base, to contain the wage bill, to diversify the energy mix, to begin the process of liberalizing the power sector generation and distribution activities and to reposition the role of the state to that of regulator and supervisor.

In effect, the Government is reengineering the Egyptian economy through a comprehensive set of coherent policies, programs and projects. The Government is committed to restoring macroeconomic imbalances within the context of a plan that concurrently focuses on social protection, health and education priorities, alongside policies to facilitate job-creating private sector investments.

Ministry of International Cooperation

The Minister

The macroeconomic policy framework and structural reform program rest on three fundamental principles:

- First, pursuing prudent macroeconomic policies in tandem with long-term economically viable developmental projects with high labor intensity and concrete efforts to improve the quality and accessibility of services offered to the public.
- Second, reforming the legal apparatus, and investing in basic infrastructure in order to create a stable and predictable business environment, while the private sector is being increasingly empowered and encouraged to resume its leading role in driving economic growth. The growth model will be based on a constructive partnership between the Government and the private sector.
- Third, ensuring that growth is inclusive, as well as, sustainable, with public expenditure being reprioritized and savings generated by reforms being partially redistributed to fund social protection programs and to invest in Egypt's abundant and young human capital. The approach will strike a balance between macroeconomic stabilization including advancing pro-growth fiscal consolidation and social justice objectives.

Within this overall framework, three areas of the Government's program will be particularly critical to its success. These are addressing fiscal consolidation, ensuring sustainable energy supply and improving the business environment.

Advancing Fiscal Consolidation

The Government's recent five-year macroeconomic framework and strategy (Fiscal Year (FY) 14/15-FY18/19) were presented at the Egypt Economic Development Conference in March 2015.

Fiscal consolidation to narrow the deficit and put Government debt on a firm downward path while creating room to shift spending to more effective and productive uses is a key pillar to achieve macroeconomic stabilization. Among others, increased spending on physical and human capital, including higher outlays on education, health and research and development constitutes part of an integrated strategy for achieving inclusive growth.

Early in FY15, the Government frontloaded the consolidation program with several structural revenue and expenditure measures, bringing the overall deficit down to about 11.5 percent of gross domestic product (GDP). Accounting for additional outlays needed to enhance social services, the Government is targeting a further 3—4 percent decline in the deficit over the four years through FY19. By the end of the plan, the budget deficit will fall to around eight percent of GDP and Government debt will fall to 80—85 percent of GDP.

The medium-term fiscal program will not merely focus on narrowing the deficit and reducing the debt (although these are critical primary goals), but will also bring about a more efficient, well-functioning economy. Moreover, thanks to its design, the fiscal consolidation is not expected to negatively impact the economy's growth prospects as it will primarily rely on phasing out inefficient spending, reprioritizing public expenditure, enhancing public financial management and widening the revenue base. Finally, the Government's comprehensive reform program is self-reinforcing by setting up a virtuous cycle of fiscal consolidation and growth. As the Government phases out inefficient spending, it not only frees up room for more productive uses of spending but also crowds in the private sector. This will drive growth, supported by the legislative and structural reforms to the business environment. In turn, the pickup in growth will enhance fiscal revenue performance and further reinforce the fiscal consolidation effort.

Tax policy aims to widen the tax base to create a fairer and more equitable system. This started with amending the income Tax Law No. 91 of 2005 to pave the way for a stable and predictable income tax policy. The amended law unifies the corporate income tax rate for all firms and establishments at 22.5 percent, matching the highest personal income tax rate. The new unified rate will be applied to all economic actors operating in Egypt, including those located or based in Special Economic Zones. By addressing the preferential treatment in these zones, Egypt can address current tax arbitrage, widen its tax base and improve revenue buoyancy going forward in light of the Government's plans to expand the economic zone model across the country.

The Government is also committed to advance the Value Added Tax (VAT) law that aims to broaden the tax base and promote a fairer and more equitable tax regime that departs from the distortions embedded in the current goods and services tax (GST) regime. By unifying the tax rate and introducing an effective credit/refund mechanism, the VAT regime will serve to improve firm cash flow while reducing the need of businesses to resort to debt to finance normal operations. In fact, moving to a fully-fledged VAT regime and advancing tax efficiency has been a longstanding demand from the business community. Equally important, the new VAT law is being carefully designed to mitigate adverse impacts on the poor by maintaining exemptions on the goods and services they consume. The Government also envisages introducing a harmonized and simple tax regime for micro and small businesses based on turnover, to reduce compliance costs and encourage private business growth.

Furthermore, the Government has taken bold measures to control wages and avoid future wage creep. This has become a pressing priority in light of the considerable increase in the wage bill post 2011, driven in part by the permanent hiring of temporary workers, increasing wages of various groups in a non-harmonized manner, and by two hikes in the minimum wage. A shift in policy began in FY14 and continued in FY15 as the Government adopted reforms to: (i) abolish the tax exemption of the new bonus component of civil servants' compensation; (ii) discontinue the practice of adding the special bonus to the basic pay after five years; (iii) delink the variable portion of employees' salaries from the basic salary component; (iv) improve and simplify the wage setting process; (v) centralize all new hiring through the first chapter of the budget only; and (vi) contain further increases in bonuses and rewards to all government employees, including those self-funded through public entities' own resources. These steps will be complemented by a plan encompassing procedures and measures that facilitate the automation of wages and salaries payments for all government employees. These reforms are projected to reduce the wage bill by 1.5 percent of GDP during FY14—19.

The Government continues to pursue its key debt management objectives over the medium-term, focusing on further lengthening the average maturity of the debt profile, diversifying sources of financing, and reducing the average cost. Fiscal consolidation to reduce the deficit to around eight percent of GDP by FY19 will be the main tool to sustain confidence and support the debt management policy, in addition to enhancements to the Government's treasury function. Moreover, the Government will seek to expand its sources of financing both domestically and internationally as well as to develop new instruments to widen the investor base. With the combination of these various strategies, the Government is targeting to steadily expand the average life of the tradeable domestic debt to at least three years by FY19.

The Government is also committed to work on enhancing transparency and accountability. This started with the Ministry of Finance resuming the launch of the Citizen's Budget to enhance public engagement in the decision making process by presenting information about the policies underlying revenues collection and expenditure allocations in the general state budget to citizens in a transparent and accessible manner. Also, the Government has presented and published its medium-term macro-fiscal framework, which informs the public about the Government's macro-fiscal and debt targets and expected reforms. Looking ahead, the Government intends to publish other key fiscal documents and to enhance citizen engagement at all stages of the budget process. The Ministry of Finance will also establish an internal audit function to oversee controls over public resource use, in addition to implementing a broad array of public financial management reforms.

Ensure Sustainable Energy Supply

The Government of Egypt has a clear concrete strategy, and has already undertaken numerous measures to ensuring sustainable energy supply and enhance energy security. The Government's medium term plans for the energy sector were laid out in our recent White Paper, *Energizing Egypt*, that was presented at the Egypt Economic Development Conference in March 2015.

With the recent passage of the new Electricity Law No. 87 of 2015, the electricity sector has embarked on a process of market liberalization to encourage private sector investment in both conventional and renewable energy. This will entail gradually sharing responsibility for power generation and distribution between public and private sector. In particular, the Government is committed to transferring a substantial share of some of the new power generation plants currently under development to new companies with a majority share of private sector participation. Responsibility for the transmission network, along with system and market operations will be retained by a newly established Transmission System Operator and Market Operator, that shall provide open access to the national power grid. The new law also significantly strengthens the powers of the electricity regulator, the Egyptian Electric Utility and Consumer Protection Regulatory Agency (EGYPTERA), providing a stronger voice for consumer participation in its governance structure.

A similar set of market-oriented reforms is also underway for the gas sector, a key supplier of primary fuel for power generation. The Cabinet has recently endorsed a new gas bill that will provide open access to gas transportation infrastructure to allow for competitive supply, and establish an independent gas regulator to protect consumer interests.

The move to adjust energy prices in July 2014 (an adjustment that alone amounted to two percent of GDP) heralded the start of a medium-term plan to reform the energy subsidies to 0.5 percent of GDP by 2018/19. Prices increases ranging from 40 to 78 percent were introduced for the majority of fuel products, whereas a detailed five-year plan for the adjustment in electricity prices for various uses was enacted by Prime Minister Decree No. 1257 of 2014. The latter was slightly adjusted in 2015 to shift the burden of adjustment to higher consuming segments, with the aim of alleviating the burden upon lower income groups. By the end of the five-year horizon, this plan would retain only those subsidies for vital fuel products and basic electricity consumed by the poor. Recognizing that the achievement of this target can be affected by movements in international fuel prices, the Government has tasked a tri-partite ministerial committee, comprising the Ministries of Finance, Petroleum and Electricity, to agree upon a mechanism for financing of changes to actual fuel cost due to variations in international oil prices and exchange rates, and passing through those costs in a transparent methodology to consumers.

The addition of new power capacity installed this year backed by new liquefied natural gas (LNG) import contracts, as well as efforts to reinvigorate domestic gas exploration and production through repayment of pending arrears to foreign oil companies, and issuing new production sharing agreements all these efforts resulted in no power outages during the summer of 2015. This will also ensure the provision of adequate power to serve both residential and industrial demand. The Government will continue to meet the growing economy's demand for power in a proactive fashion over the coming years, supported comprehensive energy market reform and the elimination of energy subsidies, as outlined above.
Egypt strives to become a regional leader in renewable energy. With the issuance of the Renewable Energy Law No. 203 of 2014, a policy framework has been set in place to reach the target of 20 percent of energy through renewable sources by 2022. This has been followed by a transparent process of issuing regulations for Feed in Tariff, and award of interim licenses. A private sector led program for 4,000 MW of grid connected solar projects, and 300 MW of decentralized solar applications has the potential of transforming the clean energy sector in Egypt, sparking a stream of local entrepreneurs and the creation of jobs.

These reforms are expected to curb the growth in energy demand through the gradual shift towards cost reflective pricing, and to reduce the use of heavy fuel oil and diesel in favor of natural gas and clean energy. This in turn will reduce greenhouse gas (GHG) emissions in the power sector by about 20 percent, which contributes more than one third of GHG emissions in Egypt.

The importance of the subsidy reform has multiple dimensions. First, it shifts incentives away from capital-intensive economic activity toward the labor-intensive activity that Egypt needs. Second, it also signals an essential qualitative improvement in the nature of Government spending, with the Government shifting away from wasteful and regressive areas of spending in order to create room for expenditure on capital investment, public services and targeted cash transfers. Reflecting this shift, the budgetary allocation in FY 2014/15 for health and education exceeded energy subsidies for the first time in many years. This was a policy choice that the Government made well before the sharp decline in global oil prices after October 2014 further reduced the weight of energy subsidies in the budget.

Ministry of International Cooperation

The Minister

Improving the Business Environment

The Government is committed to enhancing the domestic investment environment as part of its broader macroeconomic strategy prioritizing private investment-led growth. To that end, it has engaged in an active and wide-ranging process of legal and regulatory reforms in order to cut red tape and streamline procedures for doing business, to foster transparency, and to ensure a level playing field. In addition, the Government has been solving outstanding investor disputes to demonstrate its commitment to a strong investment environment.

A number of laws have been amended or newly introduced to strengthen the domestic business environment and reinforce the rule of law. Highlights of legislative reform include the new investment law, which enhanced the scope of services provided by the one-stop shop, thereby streamlining various processes for investors. The new investment law, addresses the obstacles that face investors and significantly enhances the business environment in accordance to international standards. By enabling the General Authority for Investments (GAFI) to facilitate registration, licensing procedures, and other services by all Government entities on behalf of the investor, the law simplifies investment procedures for investors and significantly reduces the time needed for issuing investment licenses, procuring land, and obtaining utilities services for investors. The new investment law also includes a dispute resolution mechanism based on international best practices. Other important legislations that have recently been passed to enhance the conditions for doing business in Egypt are the microfinance law and amendments to the competition law.

The main purpose of the amendments introduced to the competition law and proposed amendments to its executive regulation is to create a more competitive marketplace for investors by enhancing the role of the Competition Authority in regulating markets and ensuring competitive practices. The law ensures the Authority's independence by allowing it to file lawsuits and settle cases against violators independently. In addition, the law strengthens the Authority by enabling it to enforce anti-cartel policies. The Government will continue to enable and enhance implementation of the law through enactment of the executive by laws and regulations.

The Government is laying down better foundations for the growth and development of the small and medium enterprise (SME) sector through enhancing financial inclusion. The microfinance law, passed in November 2014, has opened a channel for microfinance to grow and support the SME sector. Furthermore, a law for secured transactions is being drafted to enable SMEs to use movable assets as collateral.

Improving the ease of doing business is a policy priority of the Government. This entails a thorough review of business procedures in Egypt including those with regard to access to land, issuance of permits and licenses, inspection procedures, customs clearance, tax payments and compliance, and other sector-specific regulations. Accordingly, and as a first step, the Government has prioritized a review of the process of industrial licensing, whereby inter-ministerial committee has been formed to propose a roadmap for complete overhaul of the industrial licensing process by the middle of 2016.

Inclusion

As Egypt moves forward with these needed reform programs, the Government has taken important steps to mitigate potential adverse impacts on the most vulnerable segments of the society. Such mitigation measures have paramount importance for today's Egypt, given the unique and distinctive development challenges that the country is facing. Egypt's own experience showed that growth alone will not result in poverty reduction or improvements in shared prosperity.

Fiscally, expensive and inefficient policy choices in the past have resulted in large public debt and the erosion of external and domestic buffers. Geographically, Egypt is one of the most agglomerated countries in the world, with 95 percent of the population living on only five percent of the land and with the poverty rate in rural Upper Egypt at over 50 percent, compared to less than ten percent in metropolitan Egypt. Demographically, Egypt faces a "double" youth bulge, with a large generation currently in its mid-to-late 20s and even larger generation below age of ten that will soon enter the labor market.

Through effective social protection measures, the Government will promote more inclusive growth, reduce regional disparities, improve human development and protect the poor and vulnerable, while pursuing the necessary economic and structural reforms. In this regard, as stated elsewhere, Egypt has already initiated the process of establishing a more efficient social safety net system that would enhance opportunities for the poor and disadvantaged and move away from the inefficient subsidy system. The Government is committed to meeting the provisions of the Constitution for increasing social sector expenditure to ten percent of GDP.

In fact, significant changes to the Social Safety Nets (SSN) include the following:

- The recently introduced poverty-targeted Takaful and Karama Program (TKP), aims at protecting the poor through direct income support. Takaful provides conditional cash transfers to poor families with children (co-responsibilities for school attendance and child health visits) and Karama is an unconditional income support program targeted to poor households with elderly (age 65 and older) or with persons with severe and permanent disabilities.[1]
- The food subsidy scheme was overhauled, whereby the Government currently subsidizes the final product (loafs of bread distributed by the bakeries to consumers) through the smart card system instead of subsidizing the flour for bakeries producing Baladi bread.
- The in-kind food system has been shifted to a semi-cash transfer scheme which allows beneficiaries to decide on their own consumption patterns, replacing the old four commodity system. The enhanced system offers an allowance of LE15 per individual per month that can be spent on over forty commodities widely used by Egyptian households. During the early

[1] Takaful provides a base amount of EGP 325 per household per month and with additional top-ups depending on the number of children attending school, up to a maximum amount per household of EGP 650 per month. In Karama, the benefit size is EGP 350 per beneficiary with a maximum amount per household of EGP 1,050. The program is expected to enroll about 1.5 million beneficiary households by end 2017, with a phased rollout in three consecutive waves. The Wave 1 roll-out has begun in the 19 poorest districts (with estimated poverty at 60 percent or higher), all in Upper Egypt, and aims to cover about 500,000 households by 2015.

Ministry of International Cooperation

The Minister

stage of implementation, the system has witnessed significant success attested to by the surge in participation rates.

- Egypt established a Labor Intensive Works Program (LIWs) that targets the able-to-work poor and unemployed youth, with a focus on those living in poor and lagging regions. During the period 2013-2015, the LIWs program delivered over 12 million employment days benefiting a total of 80,000 poor individuals of whom 60 percent were females and 70 percent were youth (18 to 29 years of age).
- An ongoing initiative to establish a Unified National Registry (UNR) with technical assistance from the World Bank will support different SSN programs and facilitate coordinated targeting and delivery of social services.

The Government is committed to the massive re-engineering of Egypt's entire economic apparatus. The economy is being restructured and retrofitted so that it can reach its full potential. At the same time, lessons learned from Egypt's last economic boom during the mid-2000s are being applied to make sure that this time around, growth will benefit all Egyptians and not just the few. This means that we will ensure that the fruits of the growth are fairly distributed and that the burden of adjustment falls most on those with the capacity to shoulder the impact, while the most vulnerable are protected.

This comprehensive reform program is already yielding promising results. Growth has accelerated to 4.6 percent during July-March FY 2014/15, following several years of annual growth hovering at only two percent; unemployment rates decreased significantly to reach 12.7 percent in 2015; the deficit as a percentage of GDP declined, amounting to 12.5 percent of GDP; and the fuel subsidies as percentage of GDP has been cut into half to reach 3 percent only.

The expected outcome of all these policies, programs and projects is two-fold: to ensure long-term sustainability by correcting the country's microfinance imbalances, and to create a dynamic, competitive and private sector-led new platform for inclusive growth.

Sincerely,

Sahar Nasr

Ministry of International Cooperation

ANNEX 3: POVERTY AND SOCIAL IMPACT ANALYSIS

1. **The PSIA is designed to provide an analysis of the potential impacts on welfare and poverty of the policy actions outlined in the DPF.** While this assessment focuses on the quantitative assessment of policies under the sustainable energy pillar, an overview of the expected results from other policy actions are also described.

2. **The GoE has set up a clear path of annual electricity tariff adjustments that aim to reduce the subsidy burden in its budget.** Tariffs for each consumption block have been set for the period FY15 through FY19 at which point subsidies are expected to be eliminated. Electricity tariffs follow an increasing block rate structure consisting of 7 blocks (Table A 1). The first tariff increase took place in July 2014 (effective through FY15). The second scheduled electricity tariff adjustment took place in July 2015 and resulted in an overall average tariff increase of 19%; which for social reasons was implemented in such a way as to freeze tariffs (in nominal terms) for residential consumers using less than 200 kWh per month ("lifeline blocks") while applying higher percentage adjustments to larger consumers.

Table A 1: Electricity Tariffs in Piasters per KWh for Residential Customers Based Blocks of Monthly Consumption in kWh (Nominal Prices, Increasing Block Rates)

	2014 pre increase	Post July 2014 increase	July 2015 planned	July 2015 actual (FY16)	July 2016 (FY17)	July 2017 (FY18)	July 2018 (FY19)
Up to 50	5	7.5	9	7.5	10	11	12
51–100	12	14.5	17	14.5	19	21	23
101–200 (pre- July 2014)	12	–	–	–	–	–	–
0–200 (July 2014 onwards)*	–	16	20	16	26	31	37
201–350	19	24	29	30.5	35	45	55
351–650	29	34	39	40.5	44	50	55
651–1,000	53	60	68	71	71	76	86
Above 1,000	67	74	78	84	81	86	86

Note: Starting on FY15, those consuming more than 100 kWh face this rate as their basic block for all kWh consumed up to 200. Source EgyptERA.

3. **The effects of electricity subsidies become evident when we compare the share of expenditures Egyptian spend on electricity and their high consumption levels.** Egyptian households on average spend 1.8% of their household total consumption expenditure on electricity. This budget share varies slightly across households: the budget share for the first quintile is 1.96%, whereas for the fifth quintile is 1.70%. Moreover, these shares are much below the 10% expenditure share typically considered as an indicator of affordability[6].At the same time, Egyptian households consume on average, 234 kWh every month (212 kWh for rural households and 260

[6] The data source is the national Household Income, Expenditure, and Consumption Survey (HIECS) conducted in 2012–2013. The calculations use the official national measures of consumption expenditure and the official poverty line. From this survey data on annual household expenditure on electricity is available. The 2012–2013 (pre-July 2014 tariff change) is the 'base year' for the PSIA. In the base year, from reported expenditure on electricity costs such as meter rental and service charges are excluded before applying the appropriate tariff schedule (pre-July 2014) to estimate baseline consumption in kWh per month for each household. We assume that residential consumers pay meter rental of LE0.5 per month and service charges differentiated by block are taken from EgyptERA's website.

kWh for urban) which is much higher than 120 kWh per month often considered as a minimum electricity requirement in low income countries.[7]These high consumption levels reflect that households use electricity not only for lighting and running appliances but also for cooling (fans, air conditioning) during long summers. Overall, low electricity expenditure shares are consistent with high levels of electricity consumption under the context of a highly subsidized electricity tariff scheme.

4. **Households at different incomes quintiles follow similar consumption electricity patterns, with the large majority consuming between 100 kWh and 350 kWh**. It is important to understand which type of households belong to each of the electricity consumption blocks identified in the block tariff structure. Across consumption quintiles and region (rural-urban), most consumers are in the 101–200 kWh per month block or in the 200–350 kWh per month block (Figure A 1). For example, 62% of the rural households in the first quintile and 47percentof rural households who belong to quintile 5 consume less than 200 kWh; for urban households these shares are 57% for quintile 1 households and 26percentfor quintile 5 households. More importantly, using the lens of identifying which households belong to the lifeline block, we find that freezing tariff increases for households consuming less than 200 kWh will have two effects. The freezing protects households who have low incomes, but it also protects households in the richer quintiles: about 41% of consumers in this block are the top two quintiles (Figure A 2).

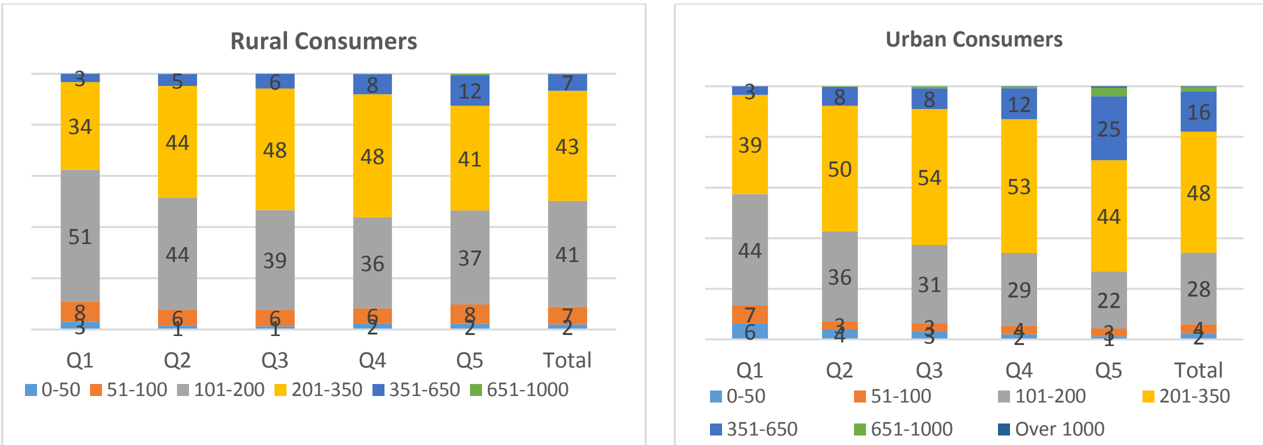
5. **Against this backdrop, the PSIA has conducted the analysis of the direct effects of the proposed increases in electricity tariffs. The analysis shows that there are no significant impacts on poverty under the preferred scenario.** The changes in electricity tariffs impact a household's welfare via the adjustments to quantities and expenditures it has to make after such changes. This welfare loss aims to represent the amount of consumption households must give up to attain same welfare as before tariff increase.[8] Simulations are based on household survey information and consumption patterns observed in the HIECS 2012/13. To simulate the evolution of electricity consumption, tariff changes and welfare losses over time, we rely on the projections of inflation rate and the implied real per capita GDP growth of the MoF (shown in Table 1 of the main text). A first set of simulations assume that the GDP per capita growth translates completely to households' consumption growth. These estimations show that that poverty declines over the FY15–FY19. Poverty decline in this scenario is mainly explained by the strong growth of households' consumption and relatively smaller negative effects of the expected changes in electricity tariffs (Figure A 3**Error! Reference source not found.**, panel A). However, other work as highlighted that the Egyptian economy growth may not fully translate into growth of households' consumption. For example, the Egypt SCD showed that in the 2004–2010 period exhibit low correlation between GDP growth and household consumption growth. We thus revise the unlikely scenario described above and estimated a second set of results where we assume that households' consumption for the bottom 40% do not grow in real terms, while for those in the top 60%, consumption grows at the same rate as the economy (see annex 1 for the Program Document Inflation and Growth Rates). Under this scenario, the changes in poverty are much smaller (Figure

[7] See discussion in Balancing Act (World Bank 2013).

[8] For all the estimations we also assume an own price elasticity demand for electricity of −0.25 allowing households to cut back some amount of electricity consumption in response to tariff change. Given the period of time analyzes, households consumption is expected to increase as the economy grows. Thus, the distributional impacts reported also allow all households' consumption of electricity to grow assuming an elasticity of 0.8.

A 3**Error! Reference source not found.**, panel B). Poverty at baseline is estimated at 26.3%, and y FY19 poverty rates are estimated at 25.3%.

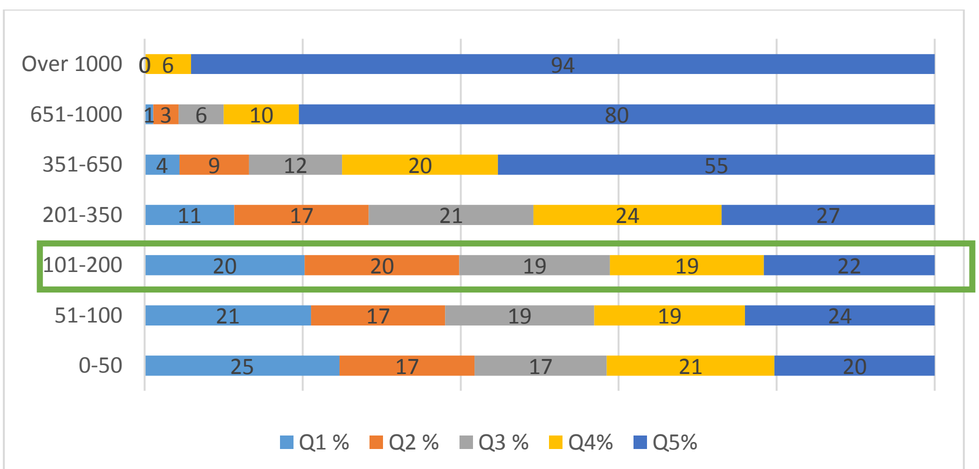
Figure A 1: Distribution of Rural and Urban Consumers across Consumption Blocks by Consumption Quintiles



Source: Data from HIECS 2012/13. Quintiles based on national per capita consumption expenditure.

Note: Within each quintile, figure shows percentage of households in each consumption block.

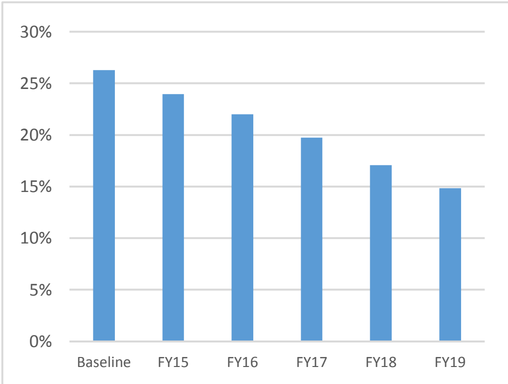
Figure A 2: Distribution of Households within Consumption Blocks



Source: Data from HIECS 2012/13. Quintiles based on national per capita consumption expenditure.

Figure A 3: Direct Impacts Using Program Document Inflation and Growth

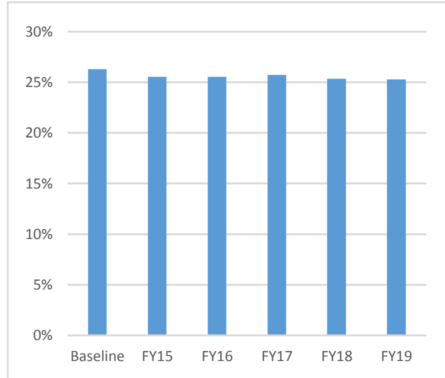
(A)



Source: Calculations based on HIECS 2012/13.

Note: Simulated Poverty Rates (based on Year-by-Year Impacts) assuming GDP growth translates fully into households' consumption.

(B)

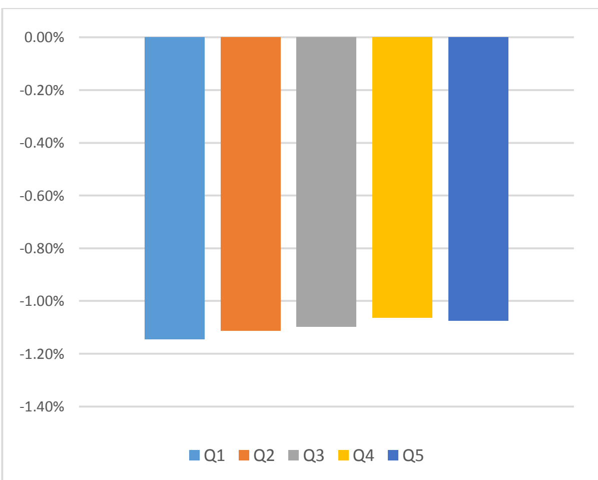


Source: Calculations based on HIECS 2012/13.

Note: Simulated Poverty Rates (based on Year-by-Year Impacts) assuming GDP growth translates only to consumption growth of top 60% households.

Figure A 4: Welfare Losses Using Program Document Inflation and Growth

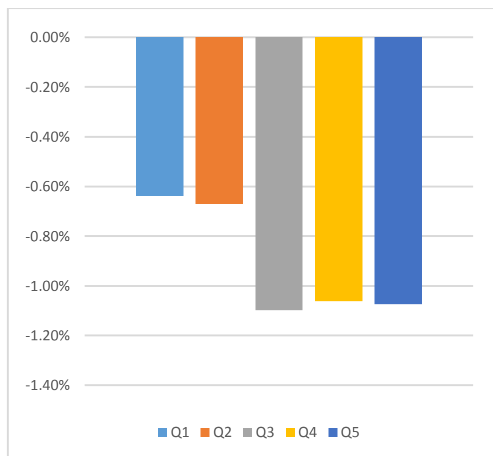
(A)



Source: Calculations based on HIECS 2012/13.

Note: Cumulative Direct Impact of Tariff Change between FY15 and FY19 assuming GDP growth translates fully to household consumption

(B)



Source: Calculations based on HIECS 2012/13.

Note: Cumulative Direct Impact of Tariff Change between FY15 and FY19 assuming GDP growth does not translate into households in the bottom 40% consumption.

ANNEX 4: DEBT SUSTANABILITY ANALYSIS

1. Egypt's macroeconomic framework has shown improvements in FY15. In order to assess the medium-term debt-to-GDP trajectory, the World Bank team conducted a Debt Sustainability Analysis (DSA), under baseline assumptions that (a) real growth declines slightly in FY16, as the economic recovery is undermined by the Russian airplane crash over Sinai, before the gradual economic uptick is resumed in FY17 and onwards (b) the primary deficit continues to decline with the advancement of fiscal consolidation efforts and switches into a balance by FY18, and to a primary surplus thereafter (table 5.1). The baseline scenario of the DSA shows that the debt-to GDP ratio is projected to reach 82% of GDP by FY21, down from 91% of GDP in FY15. The decline in debt to GDP ratio however would be partially diluted by the positive real interest rates projected over the medium term.

Table A 2: Egypt Public Sector Debt Sustainability Analysis - Baseline Scenario

(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of October 15, 2015	
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021	Sovereign Spreads	
Nominal gross public debt	90.4	90.8	90.8	92.2	92.1	90.2	87.8	85.0	82.0	Bond Spread	369
Real GDP growth (in percent)	4.6	2.2	4.2	3.8	4.4	4.8	5.2	5.5	5.9	Ratings	
Inflation (GDP deflator, in percent)	10.9	11.5	11.0	10.2	9.9	9.4	9.0	9.0	8.6	Moody's	B3
Nominal GDP growth (in percent)	16.0	14.0	15.7	14.4	14.7	14.7	14.7	15.0	15.0	S&Ps	B-
Effective interest rate (in percent) [4/]	7.9	10.5	10.1	11.0	11.9	11.3	11.1	11.6	11.3	Fitch	B
Primary balance	-2.7	-3.9	-3.5	-2.4	-1.1	0.0	0.4	0.5	0.5		

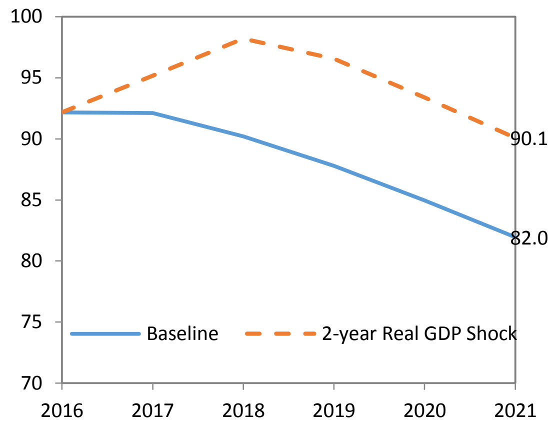
Stress Tests

2. In order to check the sensitivity of these projections, the World Bank team undertook basic stress tests. A **Real GDP shock** scenario assumes a two-year drop in the real growth rate; reverting back to average growth prior to the ongoing economic recovery (2%, annually), before growth gradually bounces back up (table A2). Under this scenario debt to GDP would continue to deteriorate in FY17–18 before improving thereafter to reach 90.1% of GDP by FY21 (almost in line with the current debt ratio).

Table A 3: Real GDP Growth Shock

Table A2: Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	2.0%	2.0%	4.5%	5.5%	5.9%
Inflation (GDP Deflator change)	10.2%	9.3%	8.7%	8.8%	9.0%	8.6%
Revenue-to-GDP ratio	20.0%	20.5%	20.8%	20.8%	20.9%	20.9%
Non-interest expenditure-to-GDP ratio	22.4%	22.2%	22.2%	20.4%	20.4%	20.4%
Primary Balance	-2.4%	-1.7%	-1.4%	0.4%	0.5%	0.5%
Nominal Exchange Rate -- average (LCU/USD)	8.2	8.5	8.9	9.2	9.5	9.8
Nominal Exchange Rate -- end of period (LCU/USD)	8.4	8.6	8.9	9.3	9.6	9.9
Interest rate shock (bps) compared to baseline	0	0	0	0	0	0

Figure A 5: Real GDP Growth Shock

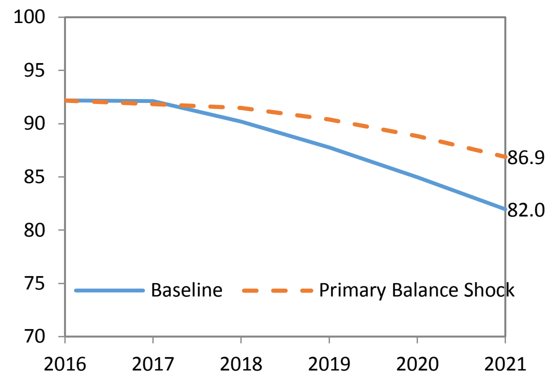


3. A **Primary Balance** shock assumes a slight slowdown in the fiscal consolidation efforts; such that the primary deficit continues to narrow at a slower pace and hence would remain in deficit throughout the forecast horizon. This scenario is assumed to be mainly stemming from lower than anticipated implementation of revenues enhancement measures along with additional burden on the expenditures side, including the possibility of higher and more accelerated request to meet constitutional targets in health, education and scientific research. This scenario entails a slower decline in the debt-to-GDP ratio which reaches 87% in FY21, instead of 82% under the baseline.

Table A 4: Primary Balance Shock

Table A3: Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	4.4%	4.8%	5.2%	5.5%	5.9%
Inflation (GDP Deflator change)	10.2%	9.9%	9.4%	9.0%	9.0%	8.6%
Revenue-to-GDP ratio	20.0%	20.1%	20.0%	20.1%	20.2%	20.4%
Non-interest expenditure-to-GDP ratio	22.4%	21.9%	21.5%	21.1%	21.0%	21.0%
Primary Balance	-2.4%	-1.7%	-1.5%	-1.0%	-0.8%	-0.6%
Nominal Exchange Rate -- average (LCU/USD)	8.20	8.53	8.87	9.23	9.50	9.80
Nominal Exchange Rate -- end of period (LCU/USD)	8.39	8.63	8.91	9.26	9.63	9.94
Interest rate shock (bps) compared to baseline	0	16	37	35	31	28

Figure A 6: Primary Balance Shock

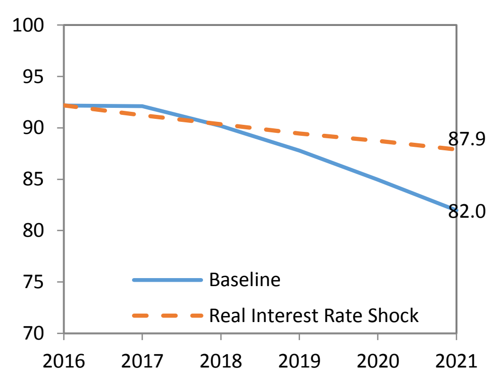


4. Finally, under the assumption that both growth pick-up and fiscal consolidation efforts are maintained, a sustained **Real Interest Rate** shock of 400 basis-points through FY17–FY21, will also lead to a slower debt-to-GDP decline, reaching around 88% of GDP in FY21, instead of 82% under the baseline.

Table A 5: Interest Rate Shock

Table A4: Interest Rate Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	4.4%	4.8%	5.2%	5.5%	5.9%
Inflation (GDP Deflator change)	10.2%	9.9%	9.4%	9.0%	9.0%	8.6%
Revenue-to-GDP ratio	20.0%	20.5%	20.8%	20.8%	20.9%	20.9%
Non-interest expenditure-to-GDP ratio	22.4%	21.6%	20.8%	20.4%	20.4%	20.4%
Primary Balance	-2.4%	-1.1%	0.0%	0.4%	0.5%	0.5%
Nominal Exchange Rate -- average (LCU/USD)	8.2	8.5	8.9	9.2	9.5	9.8
Nominal Exchange Rate -- end of period (LCU/USD)	8.4	8.6	8.9	9.3	9.6	9.9
Interest rate shock (bps) compared to baseline	0	400	400	400	400	400.0

Figure A 7: Interest Rate Shock



Risks to Debt Sustainability

5. The risks that may lead to the disruption of the downward trajectory of the debt-to-GDP ratio are mainly stemming from policy slippage, such that the primary deficit remains constant

(2.2% of GDP) throughout the forecast horizon. This is called a **Slippage** scenario where growth stalls at 4.4% throughout the medium-term and the fiscal consolidation path is not further sustained. Similarly, a **sustained drop in economic activity** (by a 2 percentage points drop in real growth compared to the baseline scenario) throughout the forecast horizon will in turn affect the Government's revenues, and the primary deficit, and will also lead to an unsustainable debt trajectory.

Table A 6: Slippage

Table A5: Slippage	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	4.4%	4.4%	4.4%	4.4%	4.4%
Inflation (GDP Deflator change)	10.2%	9.9%	9.4%	9.0%	9.0%	8.6%
Revenue-to-GDP ratio	20.0%	20.5%	20.8%	20.8%	20.9%	20.9%
Non-interest expenditure-to-GDP ratio	22.4%	22.7%	23.0%	23.0%	23.1%	23.1%
Primary Balance	-2.4%	-2.2%	-2.2%	-2.2%	-2.2%	-2.2%
Nominal Exchange Rate -- average (LCU/USD)	8.20	8.53	8.87	9.23	9.50	9.80
Nominal Exchange Rate -- end of period (LCU/USD)	8.39	8.63	8.91	9.26	9.63	9.94
Interest rate shock (bps) compared to baseline	0	0	0	0	0	0

Figure A 8: Slippage

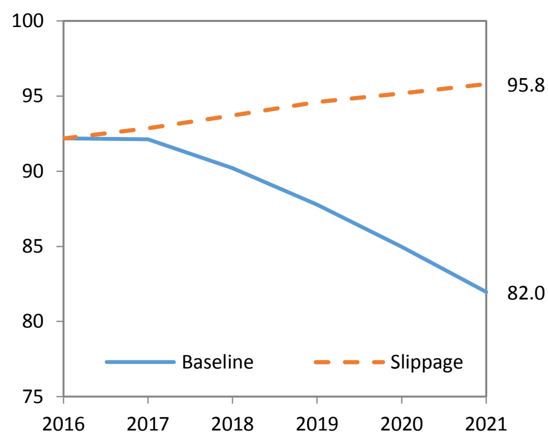


Table A 7: Permanent 2% Drop in Growth

Table A6: Permanent 2%-pt drop in growth	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	2.4%	2.8%	3.2%	3.5%	3.9%
Inflation (GDP Deflator change)	10.2%	9.9%	9.4%	9.0%	9.0%	8.6%
Revenue-to-GDP ratio	20.0%	18.5%	18.8%	18.8%	18.9%	18.9%
Non-interest expenditure-to-GDP ratio	22.4%	21.6%	20.8%	20.4%	20.4%	20.4%
Primary Balance	-2.4%	-3.1%	-2.0%	-1.6%	-1.5%	-1.5%
Nominal Exchange Rate -- average (LCU/USD)	8.2	8.5	8.9	9.2	9.5	9.8
Nominal Exchange Rate -- end of period (LCU/USD)	8.4	8.6	8.9	9.3	9.6	9.9
Interest rate shock (bps) compared to baseline	0	25	25	25	25	25

Figure A 9: Permanent 2% Drop in Growth