Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 17-Mar-2024 | Report No: PIDIC00095

BASIC INFORMATION

A. Basic Project Data

Project Beneficiary(ies)	Operation ID	Operation Name	
Egypt, Arab Republic of	P504910	Generating Resilience, Opportunities, and Wealth for a Thriving and Harmonious Egypt	
Region	Estimated Approval Date	Practice Area (Lead)	Financing Instrument
MIDDLE EAST AND NORTH AFRICA	30-May-2024	Finance, Competitiveness and Innovation	Development Policy Financing (DPF)
Borrower(s)	Implementing Agency		
Ministry of Finance	Ministry of International Cooperation of Egypt		

Proposed Development Objective(s)

The Development Objective is to foster a competitive, resilient and green economy.

Financing (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)? Yes

Is this project Private Capital Enabling (PCE)? Yes

SUMMARY

Total Financing	**700.00**

DETAILS

Total World Bank Group Financing	**700.00**
World Bank Lending	700.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **Egypt stands at an inflection point in its social and economic development journey.** While reforms implemented since 2016 had helped to improve economic buffers, economic imbalances remained. These imbalances were exacerbated by external shocks - including the Covid-19 pandemic, the Russian invasion of Ukraine and, more recently, the conflict in the Middle East and the Red Sea escalation. The resultant costs have highlighted the importance of shifting priorities towards more private sector participation, better macroeconomic and fiscal resilience, and a greener growth trajectory that are essential for sustainably reducing poverty and increasing shared prosperity. Commitment to these objectives is clear in Egypt's Sustainable Development Strategy Vision 2030 and National Climate Change Strategy (NCCS) 2050 which center around Green, Inclusive and Resilient Development (GRID) and emphasize the symbiotic relationship between socioeconomic development and the impact of climate change on development.

2. **This proposed US$500 million operation is the first in a programmatic series of three single-tranche development policy financings (DPFs) to support the Government of Egypt (GoE) in addressing current economic challenges and advancing a next generation of reforms**. The Program Development Objective (PDO) is to (i) enhance economic competitiveness through increased competition and an improved business environment for more private sector participation; (ii) build macroeconomic resilience to external shocks, through higher domestic revenue mobilization, debt reduction and improved fiscal reporting; and (iii) supports the green transition by strengthening resilience to climate change, promoting low carbon development, scaling up renewable energy and increasing electricity and water and sanitation sectors efficiency. To support the program, the WBG will carry out consultations with a range of stakeholders prior to the Decision Meeting. Other development partners are considering providing parallel finance linked to the same reform matrix. Their support is expected to be approved within months of this DPF. A shareholder guarantee to IBRD, is also being considered which could enable the Bank to raise a bigger IBRD loan amount.

3. **Egypt has considerable room to realize its growth potential and benefit from its strategic geolocation to boost its exports and attract FDI, but several factors hinder its economic competitiveness.** As highlighted in the Egypt Country Private Sector Diagnostic (CPSD) released in December 2020, the widespread presence of SOEs across the economy, coupled with restrictive government regulation, affects competition, and distorts market outcomes. Latest available product market regulations (PMR) data suggest that Egypt compares unfavorably on the economywide score (2.84), which is higher than that of most comparator countries. Breaking down that score shows that Egypt's standing is influenced not only by State control (notably public ownership), but also by barriers to entrepreneurship that may limit or discourage entry in certain segments of industries. Another major constraint to competitiveness and to participation of the private sector to the economy concerns weaknesses in commercial justice. Egypt suffers from delays and weak enforcement in the court system—scoring 0.27 points out of 1 for the timeliness of civil and commercial justice and 0.28 for effective enforcement (WJP Rule of Law Index 2023) – which hamper both domestic and foreign businesses.

4. **Building macroeconomic resilience remains crucial as the Russian invasion of Ukraine and, more recently, the conflict in the Middle East and Red Sea escalation exposed pre-existing vulnerabilities.** Egypt showed resilience to the Covid-19 pandemic but the focus on the health crisis delayed much needed structural reforms that were important for the recovery. In addition, high public debt and large rollover needs exposed the country to external shocks. With a rigid exchange rate mechanism, the outbreak of the war following the Russian invasion of Ukraine led to large capital outflows and, more recently, the conflict in the Middle East and Red Sea escalation, has led to a decline in key foreign income sources - exacerbating the economy's precarious initial conditions. The authorities took several policy actions to restore buffers, including allowing some depreciation in the exchange rate, but global uncertainty still threatens Egypt's economy

and there is a need to advance deep structural reforms to support a shift to the tradeable sector. With respect to public finances, efforts are needed to increase domestic revenue mobilization, reduce the debt burden, and gain greater control of fiscal activity outside the budget. The tax-to-GDP ratio remains low at 12.4 percent and government debt is reported at 95.2 percent of GDP in FY2022/23, with the interest burden taking up sizable budget space.

5. **Climate change is a major risk that exacerbates Egypt's existing vulnerabilities, emphasizing the need to prioritize climate policies and the transition to a low-carbon development.** Climate change raises concerns over increased mean temperatures and heat extremes in an already dry, arid environment, alongside high uncertainty around the timing and volume of Nile River water available. The cost of limited action on climate change and the associated economic losses, lives lost and decreased health, can outweigh the cost of early action. The World Bank Country Climate Development Report (CCDR) underscores the urgent need for policy actions to mitigate the growing climate change risk to Egypt's competitiveness, macroeconomic stability, and energy transition. Estimates suggest that the combined impact of climate change on water resources, tourism revenue, coastal resources, agriculture and human health through air pollution and water stress, represent between 2 and 6 percent of Egypt's GDP by 2060. There is a dire need to promote water use efficiency and water conservation practices to address the country's climate-induced water scarcity.

6. **Sustained implementation of macroeconomic policy adjustment measures—including those supported by the ongoing IMF EFF—is critical for the adequacy of the macroeconomic policy framework.** Egypt's renewed commitment to macroeconomic stabilization and structural reforms are anchored by the IMF program, as well as this prospective DPF. Pursuing a flexible exchange rate, in addition to the mobilization of foreign financing as well as FDI can help support reserves. Resilient formal channel remittances and foreign portfolio investments in government securities are expected to boost reserves in the outer years of the forecast horizon (by FY2026/27). Egypt also displays sound financial indicators. Strong and sustained implementation of structural adjustment reforms are critical. Ratings agencies, for example, have recently cut Egypt's sovereign rating (Moody's in February and October 2023, Fitch in May and November 2023 and S&P in October 2023) in addition to revising their outlooks (the latest of which is Moody's revision in January 2024). These highlight the notable risks to implementation around the baseline macroeconomic policy framework.

Relationship to CPF

7. **This DPF operation is well aligned with the World Bank Group (WBG) identified priorities in Egypt.** The series selectively addresses three priorities identified in the 2021 Egypt SCD to embark on a new growth model that will bring productive jobs, create pathways out of poverty for the poor and create opportunities for a stronger middle class, i.e., (i) improve public sector spending efficiency and strengthen macroeconomic resilience, (ii) boost private sector investment, firm growth, and productivity, and (iii) promote resilient, efficient, and sustainable natural resource use. The program of reforms also aims to strengthen fiscal sustainability through adequate domestic revenue mobilization and debt management. The PDO is also fully aligned with the key high-level objectives (HLOs) identified in the new Egypt Country Partnership Framework (CPF) FY23-27, which include more and better private sector jobs, improved and inclusive human capital development, and greater resilience to shocks. Lastly, the program's focus on strengthening competitiveness, macroeconomic stability, and green transition draws upon an important set of analytical tools that were recently completed by the World Bank (in particular the CPSD, PER, CCDR and Infrasap).

C. Proposed Development Objective(s)

The proposed DPO series aims to: (1) enhance economic competitiveness through increased competition and an improved business environment for more private sector participation; 2) build macroeconomic resilience to external shocks, through higher domestic revenue mobilization, debt reduction and improved fiscal reporting; and (3) supports the green transition by strengthening resilience to climate change, promoting low carbon development, scaling up renewable energy and increasing electricity and water and sanitation sectors efficiency.

Key Results

8. The proposed measures in pillar 1 are expected to improve governance of SOEs and reduce the challenges to the private sector of a large State footprint, improve the overall regulatory framework for competition, and improve the efficiency of commercial justice procedures and provide a more certain and less costly resolution process. The reforms supported in pillar 2 are expected to increase domestic revenue mobilization, improve competition and efficiency in the domestic debt market and reduce the cost of government funding, and enhance public finance transparency and fiscal reporting. Finally measures supported in pillar 3 will support climate change mitigation and adaption through the establishment of a cross government management and reporting system, enable the development of the carbon credit market in Egypt, increase the share of renewable energy in the generation mix and private sector participation, and improve the financial viability and sustainability of the electricity and water and sanitation sectors.

D. Project Description

9. The proposed Development Policy Financing (DPF) aims at fostering competitiveness, resilience, and green transition in Egypt. The areas selected are in line with the Egypt 2030 Vision, and the GoE’s top priorities outlined in the three-year National Structural Reform Program (NSRP) announced in April 2021 and “The Strategic Directions of the Egyptian Economy” (2024-2030). Reform areas include three pillars: (1) Pillar 1 focuses on enhancing competitiveness by addressing the State's footprint and improving governance of SOEs, as well as strengthening competition and commercial justice frameworks; (2) Pillar 2 aims to strengthen resilience through measures such as mobilizing revenues, developing domestic debt markets, and enhancing fiscal reporting mechanisms; (3) Pillar 3 seeks to advance the green transition, by implementing robust MRV systems, developing carbon credit markets, facilitating the transition to green energy, and enhancing the efficiency and sustainability of the electricity and water and sanitation sectors.

E. Implementation

Institutional and Implementation Arrangements

10. **The Ministry of International Cooperation (MoIC) is the main coordinating agency for monitoring and evaluation.** The prior actions detailed in this operation are the prime responsibility of nine agencies: MoIC, The State Council, Ministry of Planning, Ministry of Finance, Ministry of Justice, Ministry of Energy, Ministry of Environment, Ministry of Housing, and the Financial Regulatory Authority. MoIC will be the coordinator with other ministries on monitoring of the results indicators, which are based on routinely published sector indicators, custom reports, and/or surveys developed and agreed with the aforementioned agencies.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

11. **Most of the reforms supported by this operation are not expected to have substantial negative distributional and social impacts while indirectly contributing to poverty reduction through fostering a more competitive and resilient economy.** The policy measures supported under Pillars 1 and 2 aim to support competitiveness, private sector growth, and macro-fiscal resilience, which could lead to positive impacts on labor incomes. No direct adverse effects on poverty are expected from three actions under Pillar 3, but two prior actions may have poverty, distributional, and social

impacts. Moving toward tariffs reflective of the service provision cost would mean a tariff increase for most consumers, though the law amendments also include a more targeted subsidy mechanism to protect vulnerable consumers through social tariffs. At the same time, enhancing water resource management is critical for Egypt's climate resilience, which is important for the poor particularly, who rely more on nature-based livelihood activities and are often disproportionately affected by water resource scarcity and climate change. Incentivizing the electricity distribution companies to implement their loss reduction program while avoiding passing the costs to end-users should reduce costs to end-users. However, further assessment will determine whether there is any risk of higher electricity tariffs passed onto residential consumers. Finally measures supported under this DPF could also benefit women by increasing female labor force participation and by improving SMEs' access to commercial justice and to pension funds (given that a higher percentage of women own and/or work for smaller companies).

Environmental, Forests, and Other Natural Resource Aspects

12. **The reforms and policy actions supported by the proposed operation will have an overall positive impact on the country's environment, forests, and other natural resources in the medium-term.** The policy actions under Pillar 3 aimed at supporting the green transition will have positive environmental impacts, by encouraging different economic sectors, especially the private sector, to invest in projects which aim at reducing GHG emissions and generate Voluntary Carbon Credits. They will also encourage more private sector investments in renewable energy, low carbon technologies, energy efficiency and green hydrogen production. Increasing water efficiency at the national level will have direct positive impact in conserving freshwater resources which are currently under severe stress. However, the potential projects to produce renewable energy will be accompanied by environmental risks typically associated with new construction and operation of new infrastructure projects. These risks will be mitigated through the implementation of the national environmental legal requirements, which mandates the preparation of Environmental Impact Assessment studies for each project to mitigate any potential risks and impacts. Egypt has the necessary legal infrastructure which manages such type of risks. Thus, the anticipated environmental risks associated with these policies can be managed using existing national systems and resources.

G. Risks and Mitigation

13. **The overall risk rating of this DPF is high.** The major risks to the operation's ability to achieve its development objective include: (a) macroeconomic challenges associated with the uncertainty surrounding the global environment and the path to more stability in the exchange rate, and its adverse feedback effects on economic activity, inflation, interest rates, and the public debt-to-GDP ratio; (b) institutional challenges in the continued implementation of structural reforms; (c) a shift in sector strategies and policies or in stakeholders' commitment/ownership; and (d) the potential spillover effects of regional and geopolitical instability. These risks, if materialized, could affect the Government's ability to implement the reforms or make development outcomes less successful.

14. **Risks to the macroeconomic outlook are high.** The main source of risk pertains to the debt sustainability, arising from the maturity and currency structure, the elevated debt servicing cost and financial interlinkages with extra-budgetary entities. Another source of fiscal risk stems from the potentially scarring effects of expanding untargeted subsidies and tax exemptions. The footprint of the State, including SOEs, is another source of risk to the country's dynamism and potential output. To mitigate these risks, strong commitment from the Government to put in place substantive measures to restore the macro-context, along with close follow-up by the Bank's team in the context of this DPF as well as the ongoing IMF EFF program, will help boost confidence and bolster macro-fiscal stability, while continuing to advance key structural reforms.

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APPROVAL

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