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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

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

November 29, 2016

Energy and Extractives, Macroeconomics and Fiscal Management, and Trade and Competitiveness Global Practices
Middle East and North Africa Region

THE ARAB REPUBLIC OF EGYPT - GOVERNMENT FISCAL YEAR

JULY 1 – JUNE 30

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of November 23, 2016)

Currency Unit = Egyptian Pound (EGP)

US$1 = EGP 17.625

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
ASA	Accountability State Authority
CBE	Central Bank of Egypt
CPF	Country Partnership Framework
DPF	Development Policy Financing
DSA	Debt Sustainability Analysis
ECA	Egyptian Competition Authority
EEAA	Egyptian Environmental Affairs Agency
EEHC	Egyptian Electricity Holding Company
EETC	Egyptian Electricity Transmission Company
EFF	Extended Fund Facility
EGAS	Egyptian Natural Gas Holding Company
EGCP	Egyptian General Petroleum Corporation
EgyptERA	Egyptian Electric Utility and Consumer Protection Regulatory Agency
EIA	Environmental Impact Assessment
FDI	Foreign Direct Investment
GAFI	General Authority for Investment and Free Zones
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GoE	Government of Egypt
GRS	Grievance Redress Service
GST	Generalized Sales Tax
HIECS	Household Income and Expenditure Consumption Survey
IFC	International Finance Corporation
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contribution
IPO	Initial Public Offering
LPG	Liquefied Petroleum Gas
MENA	Middle East and North Africa
MOF	Ministry of Finance
MOP	Ministry of Petroleum and Mineral Resources
MSME	Micro, Small, and Medium Enterprise
MTDS	Medium-Term Debt Management Strategy
NCW	National Council of Women
PDO	Program Development Objective
PFM	Public Financial Management
PSIA	Poverty and Social Impact Analysis
SCD	Systematic Country Diagnostic
SME	Small and Medium Enterprise
SSN	Social Safety Net
SOE	State-Owned Enterprise
TA	Technical Assistance
VAT	Value Added Tax

Vice President:	Hafez M. H. Ghanem
Country Director:	Asad Alam
Senior Practice Directors:	Riccardo Puliti/Carlos Felipe Jaramillo/Anabel Gonzalez
Practice Managers	Erik Fernstrom/Auguste Kouame/Najy Benhassine
Task Team Leaders:	Ashish Khanna/Ibrahim Chowdhury

THE ARAB REPUBLIC OF EGYPT

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

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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 Ibrahim Chowdhury (Sr. Economist, GMFDR), with Sherif Hamdy (Sr. Private Sector Specialist, GTCDR) leading the work on business competitiveness.

The project was prepared under the guidance of Erik Fernstrom (Practice Manager, GEEDR), Auguste Kouame (Practice Manager, GMFDR), and Najy Benhassine (Practice Manager, GTCDR), with further support from Benu Bidani (Practice Manager, GPVDR).

The team includes Sara Al-Nashar (Economist, GMFDR), Sahar Sajjad Hussain (Economist, GMFDR), Hoda Youssef (Senior Economist, GMFDR), Rana Nayer Safwat Fayez (Consultant, GPV05), Vivien Foster (Lead Economist, GEEDR), Joern Huenteler (Energy Specialist, GEEDR), Mohab Hallouda (Sr. Energy Specialist, GEEDR), Peter Griffin (Consultant, GEEDR), Fatma Ibrahim (Private Sector Specialist), Nabila Assaf (Sr. Private Sector Specialist), Andreja Marusic (Global Lead on Business Competitiveness), Eman Wahby (Communications Officer, MNAEC), Renaud Seligmann (Practice Manager, Governance), Robert Beschel (Lead Public Sector Management Specialist, GG017), Edouard Al-Dahdah (Senior Public Sector Specialist, GGOOS), Syed Ahmed (Lead Counsel, LEGAM), Nightingale Rukuba-Ngaiza (Senior 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), Alaa Sarhan (Sr. Environmental Economist, GENDR), Amal Faltas (Sr. Social Development Specialist, GSURR), Gustavo Demarco (Program Leader, MNC03), Nahla Zeitoun (Sr. Social Protection Specialist), Tracey Mary Lane (Program Leader, MNC03), Poonam Gupta (Country Program Coordinator, MNCA3), Aissatou Diallo (Senior Maiada Kassem (Finance Officer, WFALA), Junxue Xu (Division Manager), Georges Tony Abou Rjaily (Finance Analyst, WFALN), Graciela Miralles Murciego (Economist, GTCTC), and Martha Licetti (Lead Economist, GTCDR). Iman Sadek (Team Assistant, MNCEG), Heba Abuelleil (Team Assistant, MNCEG), and Mark Njore (Program Assistant, GEEDR) provided outstanding administrative support.

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SUMMARY OF THE PROPOSED LOAN AND PROGRAM

THE ARAB REPUBLIC OF EGYPT

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

Borrower	The Arab Republic of Egypt
Implementation Agency	Ministry of International Cooperation
Financing Data	IBRD Loan Terms: IFL - Variable Spread Loan with thirty-five years maturity and five years grace period Amount: US$1,000 million
Operation Type	Second operation of a programmatic series of three consecutive Development Policy Financing (DPF) operations
Pillars of the Operation and Program Development Objectives	The proposed operation is built around three pillars, which are also the program development objectives (PDOs) of the programmatic series: (1) advance fiscal consolidation through higher revenue collection, greater moderation of the wage bill growth, and stronger 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.
Result Indicators	The DPF is anchored in the Government's medium-term reform program. **Pillar 1: Advancing Fiscal Consolidation** • Increased non-sovereign corporate income tax and sales/VAT on goods and services as a percentage of GDP from 5.4% in FY15 to about 6.7% in FY18 • Reduction of the ratio of the Central Government's wage and salary bill to nominal GDP, from 8.2% in FY15 to 7.4% of GDP by FY18 • Publication of an annual updated Medium-Term Debt Management Strategy • At least four audits performed on sectors and entities affiliated with the Ministry of Finance by FY18 **Pillar 2: Ensuring Sustainable Energy Supply** • Reduction of energy subsidies as a percentage of GDP from 6.6% in FY14 to 1.5% in FY18 • Increase in the cost recovery level of electricity tariffs from 50% in FY14 to 70% by FY18 • Notification and operationalization of supply code, transmission tariff, and market rules by FY18 • Reduced difference between peak electricity demand and available peak capacity from deficit of 5,540 MW in FY15 to a surplus of 1,000 MW by FY18 • Public disclosure of tariff methodology for computation of electricity tariffs • Increased domestic gas production from 4,020 MMSCFD in FY16 to 4,700 MMSCFD by FY18 • A separate gas transmission tariff, transmission code, market rules, and approval procedures are published by FY18 • A dedicated web portal with all rules and regulations operational by FY18 • Financial closure of private-sector-owned renewable energy projects from 0 MW (October 2015) to 1,500 MW (end of FY18) **Pillar 3: Enhancing the Business Environment** • Increase in business entry, including small businesses, as measured by the number of single-person companies registered from 0 in FY15 to 500 in FY18 • Increase in the number of GAFI one-stop shops registering single-person companies from 0 in FY15 to 4 by the end of FY18 • Average number of days to issue license by notification for low-risk industrial activities not to exceed 7 days by the end of FY18 • Average number of days to comply with all industrial licensing requirements is reduced from 634 days in FY15 to 160 days by the end of FY18 • Increase in the number of anti-competitive practices prevented/eliminated from a

	baseline of 9 (between FY13 and FY15) to a target of 11 decided during the FY16–18 period
Overall Risk Rating	High
Climate and Disaster Risks	(i) Are there short and long-term climate and disaster risks relevant to the operation (as identified as part of the SORT environmental and social risk rating)? Yes ☐ No ☒ If yes, (ii) summarize briefly these risks in the risk section and what resilience measures may help address them?
Operation ID	P161228

IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO THE ARAB REPUBLIC OF EGYPT

1. INTRODUCTION AND COUNTRY CONTEXT

1. **Egypt has embarked upon a program of major reforms that are needed to address some of the longstanding structural constraints to inclusive growth and macroeconomic stability.** The 2011 Arab Spring—generated by the long-standing weaknesses in public service delivery, non-inclusive growth, which had limited positive social outcomes, and weak competition and transparency—ushered in a new era. However, the economic dividends of the post-2011 developments have not fully materialized in Egypt. In fact, over the past five years, domestic barriers to inclusive growth—including poor governance, uncertainty linked to the post-2011 political transition, significant economic distortions such as an overvalued exchange rate and an inefficient foreign exchange allocation system, a business environment characterized by lack of competition, and an energy sector that held back rather than powered economic activity—were compounded by external shocks in the form of terrorism, regional instability, and declining workers' remittances from the Gulf countries.

2. **This operation is part of an international package aimed at supporting the economic reform program of the Government of Egypt (GoE) to bring the economy back on track amid macroeconomic and social vulnerabilities**. The Government's reform agenda is expected to restore macroeconomic stability, but the contractionary and inflationary impacts associated with some measures (such as the energy price adjustments) will have to be mitigated by policies aimed at improving the business environment and strengthening safety nets (see section 3) to better protect the poor. At the same time, social woes remain acute, despite ongoing efforts to improve social safety net (SSN) programs, with high rates of poverty and unemployment and discontent with the quality of public service delivery, further exacerbated by high inflation.

3. **The DPF series' approach to help address these issues is grounded in the World Bank Group (WBG) MENA Strategy, which aims to renew the social contract so that it is based on greater citizen trust; more effective protection of the poor and vulnerable; inclusive, transparent, and accountable service delivery; and a stronger private sector that can spur job creation.** The operation builds on the analysis and pillars set out in the Systematic Country Diagnostic (SCD) for Egypt, including the three highest priorities: macroeconomic stabilization, continued energy subsidy reform, and improvement in public governance. The DPF series is fully aligned with the Country Partnership Framework (CPF) for Egypt, which, along with the MENA Strategy, seeks to achieve the WBG twin goals of eradicating extreme poverty and boosting shared prosperity in a sustainable manner. Additionally, the operation is closely aligned with the World Bank's new MENA Climate Change Action Plan, which commits to support critical policy reforms to remove distortive prices and regulations, open up fiscal space, and catalyze private investments. Although there are important risks, including from the macroeconomic and reform implementation perspectives, the proposed DPF series is expected to play a key role in supporting much needed structural reforms. The DPF series has been prepared in close coordination with the African Development Bank (AfDB), which provided parallel financing for DPF 1 and is expected to provide around US$500 million for DPF 2, and is closely aligned with a three-year US$12 billion Extended Fund Facility (EFF) of the International Monetary Fund (IMF), which was approved by the IMF Board on November 11, 2016.

4. **The programmatic series focuses on three pillars.** First, by enhancing macroeconomic and fiscal stability the operation will help boost investor confidence and free up domestic financing for the private sector and make public resources available for social spending. Second, by creating a more dynamic and commercially oriented energy sector, the operation will improve service delivery and enable a scale-up in private investment. Third, the operation will help improve competition and the regulatory environment for businesses. Implementation of the first wave of reforms under the three pillars was modest at first but has

made significant progress since the parliament's endorsement of the Government's reform program in April 2016. Against this backdrop, there are high expectations and demands of the population for improved service delivery, sustained economic growth that creates jobs, and better living conditions.

5. **Long-overdue fiscal reforms are ongoing, but further measures are needed to restore the sustainability of public debt.** Egypt's fiscal deficit surged after the Arab Spring as the post-2011 economic slowdown coincided with heightened social demands, the response to which took the form of expensive and inefficient fiscal policy choices that widened Egypt's twin deficit during FY11–16. The Government's flagship fiscal reform, a new value added tax (VAT) that was two decades in the making, became effective in September 2016, followed by a new law for tax dispute resolution. On the expenditure side, the state budget continues to maintain the wage controls introduced in FY16. The civil service reform law, which overhauls the administration of public sector workers, was approved by the parliament in October 2016. Further, three successive electricity tariff increases and a major petroleum price reform have successfully reduced energy subsidies from 6.6 percent to 2.6 percent of gross domestic product (GDP) between FY14 and FY17 (as budgeted). This is putting Egypt on track to reach its objective of reforming energy subsidies to 0.5 percent of GDP by FY19, with the remaining subsidies covering only liquefied petroleum gas (LPG) and electricity consumption of the poorest households.

6. **Energy sector reforms are crucial for providing fiscal space for enhanced social sector spending, bringing in foreign direct investment (FDI), reducing import dependency, and showcasing a new model of sector governance.** Due to structural barriers to investment and underpricing of energy along the value chain, Egypt became a net importer of oil in FY09 and of natural gas in FY15 and started to experience severe power cuts in 2011. 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 percent of annual sales, leading to discontent among the general public. Subsidies rose sharply as the higher cost of energy imports were not passed on to consumers. The petroleum sector's net contribution to fiscal revenues reversed from a net contribution of EGP 2 billion in FY10 to a net drain of EGP 43 billion in FY14 (equivalent to 6.8 percent of the Government's budget). Emissions from the sector surged, as Egypt had to rely on more costly and polluting fuel oil for power generation, and the cement sector was forced to shift to coal when the Government halted supplies of gas. In response, the Government has taken a number of measures to (a) improve efficiency of the electricity and gas sectors while improving transparency; (b) streamline the decision-making process and sector policies to attract private investment in domestic energy supply; and (c) raise prices to cover the remaining revenue gap. The reforms are yielding initial results, such as new gas field discoveries, including the largest gas field in the Mediterranean ('Zohr', with 30 tcf of gas resources).

7. **The reforms in the energy sector are closely aligned with Egypt's contribution to the Paris Agreement on climate change.** Over 70 percent of Egypt's greenhouse gas (GHG) emissions come from the energy sector. Emissions from electricity generation in particular have grown rapidly in recent years (by 19.8 percent in FY12-15) as fuel oil filled the gap left by shortages in the supply of natural gas. In its submission to the Paris Agreement, Egypt lays out four priority actions to mitigate GHG emissions: (a) more efficient use of energy, especially by end-users; (b) increased use of renewable energy; (c) use of advanced locally appropriate and more efficient conventional energy technologies; and (d) reforming energy subsidies. The DPF series is supporting reforms across all four priority areas, which are expected to reduce GHG emissions in the energy sector by between 11 and 21 percent by FY19 compared to the baseline trajectory.

8. **Major legislative reforms to the business environment are envisaged to overcome barriers for SMEs, but significant challenges remain in their implementation.** The Egyptian economy has traditionally been characterized by a strong role of the state, a high concentration of economic power, and a focus on

mega projects. This model has not delivered on job creation. Employment has mainly been generated in informal SMEs, yet young and formal enterprises do not seem to flourish in Egypt. This was made worse in recent years by shortages of—and controlled access to—foreign exchange, especially for smaller businesses. The business environment remains challenging for SMEs, as reflected in Egypt climbing only four ranks in the World Bank's Doing Business ranking (improvements were made in 'Getting Electricity', up from 129th in 2016 to 88th in 2017, and 'Starting a Business', from 70th to 39th). Industrial licensing, a regulatory area not measured by Doing Business, continues to represent a key impediment to industrial activity. Despite some reforms, particularly on anti-cartel behavior, Egypt still ranks low among comparator countries in its degree of competition and has more work to do to foster a competitive business environment and promote contestable and open markets. Access to land remains a major impediment, as does the predictability in the implementation of regulations.

9. **Significant challenges remain as high poverty rates, persistent informality, and the lack of opportunities for sustainable jobs remain significant, especially in lagging regions, but the Government is committed to protecting the poor.** In 2015, 27.8 percent of the population was considered poor, with poverty reaching almost 60 percent in rural Upper Egypt. The unemployment rate stands at 12.5 percent in the second half of FY16, down only slightly from 12.7 percent a year earlier. The female unemployment rate remains high at 25.6 percent and more than two-thirds of those in the age group of 20 to 29 years are unemployed. Labor force participation (46 percent) is still lower than the pre-2011 levels of above 50 percent, in part due to youth seeking job opportunities abroad. Unsatisfactory employment outcomes are the result of declining public and volatile private investments, capital-intensive investment, and limited private sector dynamism due to a noncompetitive environment. The Government is committed to protecting the poor as it implements its economic reform program, including by reallocating a share of the resources used for energy subsidies to the human development sectors and through a further expansion of the food subsidy and cash transfer programs. The Government announced on November 5, 2016 an expansion of its cash transfer programs Takaful and Karama to reach 1.7 million households (7.3 million beneficiaries); an expansion of the social pension budget to reach another 1.7 million households; an increase in the general pension budget by 15 percent; an expanded school meals program; new gas connections for the poorest districts; and public works projects in five governorates in Upper Egypt. Furthermore, the food subsidy system is in the process of being overhauled to improve the quality of food staples and widen the choice of commodities provided to the public, while substantially reducing leakages. The implementation of reforms along with the gradual restoration of confidence and stability is expected to restore momentum in the economy up after four years of subdued growth.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

10. **Economic growth has been held back in FY16 by the shortage in foreign exchange, an overvalued exchange rate, and an unfavorable regional and global environment.** The economy is estimated to have grown by 3.8 percent in FY16, down from 4.2 percent the year before. While this is higher than the growth recorded during FY11–14, economic activity continues to be below potential. Sluggish growth in Europe (Egypt's main trading partner) and a drop in remittances from the Gulf countries due to lower international oil prices were partly to blame for lackluster growth in FY16. However, the primary driver was an overvalued Egyptian pound and a shortage of foreign currency, resulting from the delayed decision to liberalize the exchange rate and a sharp decline in tourism.[1] On November 3, 2016, the Central Bank of

[1] Over the past months, the Government has upgraded airport security, which is expected to lead to a lifting of the ban of flights operated by the Russian Federation and the United Kingdom.

Egypt (CBE) abandoned its currency peg and moved to a market-determined exchange rate regime. The long-awaited policy action is an important step to restore external competitiveness, support exports, further rebuild reserves, and attract foreign investment.

11. **Despite subdued growth, inflationary pressures have intensified in 2016.** Domestic financing of government deficits, a sharply widening gap in the currency value between the official and parallel market, upward adjustments to 'administered' prices, and rising food prices have led to higher inflation. Headline inflation increased to 14.1 percent in September from 9 percent in early 2016, while core inflation rose to 13.9 percent from 9 percent during the same period.

12. **Despite some retrenchment in expenditure, the fiscal accounts deteriorated in FY16 on account of sharply lower revenues.** The overall budget deficit, including grants, widened to an estimated 12.2 percent of GDP in FY16 from 11.5 percent the year before. Delays in the shift from the generalized sales tax (GST) to the VAT Law as well as lower-than-anticipated revenues from the newly introduced real estate tax led to lower tax revenues. Nontax revenues also declined on account of lower Suez Canal revenues, while foreign grants also decreased. The deterioration in the fiscal account occurred against a backdrop of falling expenditure, which was largely driven by a lower wage bill and energy subsidies, the latter reflecting lower oil prices and increases in electricity tariff rates. Interest payments increased due to higher debt.

13. **In FY17, the Government advanced the fiscal reform agenda and implemented important fiscal reforms on both the expenditure and revenue sides**. In August 2016, the parliament approved the long-awaited VAT Law, which became effective in September and is expected to increase tax revenues by about 1 percent of GDP in FY17. In the same month, the Government increased electricity tariffs by 33 percent. In early November, the Government increased fuel prices across different fuel products by 30 percent to almost 90 percent. Meanwhile, the state budget continues to maintain the wage controls introduced last year. Overall, these fiscal consolidation efforts are expected to bring down the budget deficit from 12.2 percent of GDP in FY16 to 10 percent of GDP in FY17.

14. **The macroeconomic reforms have been accompanied by a gradual scale-up of social spending.** The reduction of energy subsidies has freed up resources to increase social expenditures. Allocations to the health and education sectors (5.3 percent of GDP in FY15) have surpassed the energy subsidy bill (4 percent of GDP in the same year). In addition, the Government is expanding a cash transfer program (Takaful and Karama) that started in January 2015, to increase coverage to 1.7 households by June 2017 and to 2 million households (8–9 million beneficiaries) across Egypt by FY19. The eligibility criteria of the food subsidy program, which currently represents 1 percent of government spending and has wide coverage (around 67 million beneficiaries), will also be revised to target its coverage to the bottom 50–60 percent. Through the expansion of these and other programs, the Government seeks to increase public spending on human development to around 10 percent of GDP from FY18 onward, as mandated by the new constitution.

15. **The steady deterioration in external competiveness caused by high inflation and a fixed exchange rate regime coupled with an unfavorable regional environment led to growing balance of payment pressures.** The current account deficit widened to 5.5 percent of GDP during FY16 compared to a deficit of 3.7 percent of GDP in FY15. This was mainly due to the drop in exceptional receipts and remittances from the Gulf, in addition to a widening goods and services balance. The capital and financial account registered an increase in net inflows of US$19.9 billion (5.8 percent of GDP) in FY16, compared to US$17.9 billion (5.5 percent of GDP) in FY15, due to an increase in FDI (albeit from a very low level). In addition, 'other investments' improved, albeit reflecting higher borrowing by the CBE as well as banks (liabilities to be paid in the future). Finally, net errors and omissions registered a larger net 'outflow' of US$4 billion (1.2 percent of GDP), compared to US$3 billion (0.6 percent of GDP) in the previous year,

potentially signaling more unrecorded capital flight. In light of these developments, the overall balance of payment position reversed into a net outflow of US$2.8 billion (0.8 percent of GDP) from an inflow of US$3.7 billion (1.1 percent of GDP) a year earlier. As a result, net international reserves dropped to US$17.5 billion in end-FY16 from US$20.1 billion the year before but have since increased moderately to US$19 billion at end-October 2016, covering about four months of the FY17 projected merchandise imports.

16. **To restore external competitiveness, support exports, rebuild international reserves, and attract foreign investment, the CBE switched to a flexible exchange rate regime in early November.**[2] The CBE devalued the Egyptian pound to an initial guidance level of 13 to the U.S. dollar, up from 8.9 on the official market. A CBE foreign exchange auction was held following the switch to a flexible exchange rate to allow supply and demand to determine the value of the pound, and banks were allowed to operate on weekends for foreign exchange transactions to eliminate the gap between official and informal market rates. At the auction, the CBE sold US$100 million, which led to an average closing price of the pound of 14.6 to the US dollar, which is further changing as banks are free to trade dollars at market levels. The Egyptian pound has seen some fluctuation since the liberalization of the exchange rate and as of end-November stood at around 17.50 against the US dollar. With the liberalization of the exchange rate, the Government switched from the CBE-led auction to an interbank system. The market for the interbank system is being developed as banks seek to attract dollars and gradually provide greater dollar liquidity. The Government further abolished the priority list for imports (food staples, pharmaceuticals and essential intermediate goods) while maintaining foreign exchange deposit limits on importers of nonessential goods. The liberalization of the exchange rate is expected to alleviate the dollar shortage, which has gravely hampered private sector activity. As the foreign exchange situation improves, foreign investments (both direct and portfolio) are also expected to increase.

17. **Following the introduction of a flexible exchange rate system, the CBE adopted a significantly tighter monetary policy stance to mitigate additional inflationary pressures that could arise from a depreciated exchange rate and encourage an adequate inflow of foreign capital.** The CBE raised its key interest rates by 300 basis points with the overnight deposit rate, the overnight lending rate, and the rate of the CBE's main operation now standing at 15.75 percent, 15.25 percent, and 15.25 percent, respectively. The recent increase in policy rates followed two earlier hikes in policy rates, which took place in the aftermath of the March 2016 devaluation of the official exchange rate. Cumulatively, policy rates have increased by 550 basis points since March 2016. Special bank deposit schemes with high interest rates have been introduced to mop up excess liquidity, including a 1.5-year certificate of deposits with an annual interest rate of 20 percent, offered by Egypt’s two largest state-owned banks. A tighter monetary policy should help contain inflation. The CBE’s agreement with the Ministry of Finance (MOF) to gradually phase out monetary financing of the budget deficit over the coming months will further reduce inflationary pressures. This objective is also consistent with the Government’s commitment to prudent fiscal policies, which will contribute to decreasing the budget deficit and public debt.

[2] Under the exchange rate peg, access to foreign exchange was ‘rationed’ through the central bank’s auctioning system, and hard currency deposits in the banking system were subject to limits. This in turn has led to increasing shortages in foreign exchange, a surging parallel market, and constrained production, as well as exports due to the inability to import the necessary inputs. Importers deferred their payments in hard currency, thus creating a backlog of liabilities that will need to be met in the future.

Table 1. Key Economic Indicators

Last updated November 2016	FY2010 Actual	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Actual	FY2015 Pre-actual	FY2016 Forecast	FY2017 Forecast	FY2018 Forecast	FY2019 Forecast
Real Sector and Prices										
Real GDP Growth Rate (y/y)	5.1	1.8	2.2	2.1	2.2	4.2	3.8	4.0	4.7	5.4
Population (in millions)	78.70	80.40	82.40	84.70	86.70	89.00	91.20	N.A.	N.A.	N.A.
Unemployment Rate (last Q of FY)	9.2	11.8	12.6	13.34	13.3	12.7	12.5	12.4	11.4	10.0
CPI Annual Inflation Rate, (Period Average, y/y)	11.7	11.0	8.6	6.9	10.1	10.9	10.2	18.0	13.0	9.8
Public Finance (% of GDP)										
Total Revenues	22.2	19.3	18.3	19.0	21.7	19.1	17.5	20.7	18.8	19.2
Tax revenues	*14.1*	*14.0*	*12.5*	*13.6*	*12.4*	*12.6*	*12.2*	*13.8*	*14.2*	*14.7*
Grants	*0.4*	*0.2*	*0.6*	*0.3*	*4.6*	*1.0*	*0.1*	*0.1*	*0.0*	*0.0*
Non-tax revenues	*7.7*	*5.2*	*5.2*	*5.1*	*4.8*	*5.5*	*5.1*	*6.8*	*4.5*	*4.5*
Total Expenditures	30.3	29.3	28.4	31.9	33.4	30.2	29.1	30.2	27.0	24.9
Current expenditures	*26.3*	*26.4*	*26.3*	*29.8*	*30.9*	*27.6*	*26.6*	*25.9*	*24.8*	*22.6*
Capital expenditures	*4.0*	*2.9*	*2.2*	*2.1*	*2.5*	*2.5*	*2.5*	*4.3*	*2.2*	*2.3*
Net Acquisition of Financial Assets	0.0	-0.2	0.0	0.1	0.5	0.5	0.5	0.4	0.0	0.1
Overall Budget Balance Including Grants	-8.1	-9.8	-10.1	-13.0	-12.2	-11.5	-12.2	-10.0	-8.3	-5.8
Primary Balance	-2.1	-3.6	-3.8	-5.0	-3.9	-3.6	-3.4	-0.9	1.1	2.1
Budget Balance Excluding Grants	-8.5	-10.0	-10.7	-13.3	-16.7	-12.5	-12.3	-10.0	-8.3	-5.9
Gross Budget Sector Debt (Domestic + External)	79.0	82.0	79.6	88.3	90.5	93.6	99.7	98.7	93.5	88.7
External Sector										
Trade Balance (% of GDP)	-11.5	-11.5	-12.4	-10.7	-11.3	-11.7	-10.9	-12.5	-12.6	-11.6
Current Account Balance (% of GDP)	-2.0	-2.6	-3.7	-2.2	-0.9	-3.7	-5.5	-5.2	-4.4	-3.0
Net Foreign Direct Investment Inflows (% of GDP)	3.1	0.9	1.5	1.3	1.4	1.9	2.0	3.3	3.4	3.3
Capital and Financial Account Balance (% of GDP) (does not include errors & omissions)	3.8	-1.8	0.4	3.4	1.8	5.5	5.8	2.0	4.3	2.2
Net International Reserves (NIR) (end of period, USD bn) (after closing the external financing gap)	35.2	26.6	15.5	14.9	16.7	20.1	17.5	23.0	30.0	34.0
NIR in months of merchandise imports	8.6	5.9	3.1	3.1	3.3	3.9	3.7	4.9	5.9	6.5
External Debt (% of GDP)	15.4	14.8	13.4	15.1	15.3	14.7	14.1	22.9	26.9	28.2
External Government Debt (% of GDP)	12.0	11.5	9.9	10.0	9.6	7.8	8.1	17.1	20.8	19.8
Monetary Sector										
Broad Money Annual growth rate (period average)	10.4	10	8.4	18.4	17.0	16.4	18.8	16.7	20.6	16.3
Private Sector Credit Annual growth rate (period average)	7.7	0.8	7.1	9.8	7.4	16.7	14.2	8.3	15.9	13.6
Private Sector Credit Annual **real** growth rate (period average)	-4.0	-10.2	-1.5	2.9	-2.7	5.8	4.0	-9.7	2.9	3.8

Source: World Bank staff calculations based on official data.

18. **Although the banking sector remains generally sound and stable, it has struggled to play a catalytic role.** As highlighted in the Egypt SCD, weak financial inclusion and intermediation, and concentration of bank lending to large firms and the government has hampered real credit growth to the private sector in recent years, and in addition to supply-side constraints has weighed negatively on economic growth. More recently, shortages in foreign exchange liquidity have forced banks to draw down their foreign assets,[3] although local currency liquidity remains strong. As a result, the banking sector's net foreign asset position has moved into negative territory since late 2015. The banking system, however, remains sound as the sector is profitable and well capitalized and remains liquid as evidenced by a loan-to-deposit ratio at about 42 percent at the end of 2015. While banks' willingness to finance the deficit has increased concentration risks, it has also contributed to the sector's profitability as T-bills have provided a relatively secure stream of earnings. The share of nonperforming loans to total loans has been declining since 2012 and stood at 6.8 percent at the end of 2015, with 99 percent of nonperforming loans have been provisioned. In light of the relatively small dollarization of corporate and household balance sheets, the impact of a weaker exchange rate on banks' credit risks is expected to be small.

[3] Net foreign assets of the banking system dropped sharply, reaching EGP −111.8 billion (that is, a net liability of US$12.6 billion in the end of September 2016).

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

19. **Egypt's macroeconomic conditions are expected to improve following the liberalization of the exchange rate.** Macroeconomic imbalances are expected to narrow gradually, as authorities have taken steps on exchange rate realignment and further advanced the consolidation of public finances through energy price reforms, containing the wage bill as well as enhancing public revenues. While tighter monetary policy and fiscal consolidation will constrain domestic demand, the elimination of foreign exchange shortages in addition to the correction of the overvaluation of the exchange rate will provide a positive stimulus to the economy. The economy is projected to grow at 4 percent in FY17, up from 3.8 percent in FY16. Growth will be driven by private consumption supported by a rebound in remittances, a pick-up in public investment due to scaled-up social investments and a recovery in net exports. As economic reforms progress and key sectors recover, especially manufacturing, oil and gas extractives (including from the new gas discoveries), and as the tourism sector rebounds real GDP growth is expected to rebound to 4.7 percent in FY18, and to increase further to 5.4 percent in FY19.

20. **The budget deficit is projected to narrow as the Government implements the envisaged fiscal consolidation measures.** The budget deficit is expected to decline by 2.2 percentage points to 10 percent of GDP in FY17, driven by strong revenue mobilization (3.2 percent of GDP) achieved through both higher tax and nontax revenues, which outweighs the projected moderate increase in expenditures (about 1 percent of GDP). The projected increase in tax revenues by 1.6 percent of GDP in FY17 is largely attributed to the VAT, which is envisaged to yield almost 1 percent of GDP in tax revenues. In addition, tax revenues will also benefit from the new tax dispute settlement law, increased collection from existing taxes, and improvements in tax administration. Nontax revenues are expected to increase by about 1.6 percent of GDP, which is largely due to increased revenues from levies and fees earmarked for the new social investment programs. Overall expenditures are projected to increase by about 1 percent of GDP in FY17, notwithstanding a further reduction in energy subsidies to 2.6 percent of GDP due to upward adjustments in electricity tariff rates and fuel price adjustments[4] and a further reduction in the civil service wage bill-to-GDP ratio to 6.7 percent due to provisions in the FY17 budget law. The moderate increase in expenditure is largely driven by a higher public investment ratio and a pick-up in interest payments.[5] Beyond FY17, the budget deficit is projected to reach single digits in FY18 when the primary budget balance turns into a surplus. The medium-term projections are underpinned by the steady implementation of structural reform measures that the Government is undertaking, supported by the IMF EFF as well as the World Bank's programmatic DPF series.

[4] Even after taking into account the recent devaluation. See Box 1 for additional details.

[5] The increase in the public investment ratio for FY17 is the result of the inclusion in the budget of social investment programs. On the revenue side, the increase in investment will be matched with increased revenues from levies and fees earmarked for the new social programs. This is consistent with the government's plan to increase spending on infrastructure and to avail affordable social housing through a program that is self-financed and does not create any fiscal burden on the state budget.

Table 2. Key Fiscal Aggregates

In Percent of GDP	FY2010 Actual	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Actual	FY2015 Pre-actual	FY2016 Forecast	FY2017 Forecast	FY2018 Forecast	FY2019 Forecast
Total Revenues	**22.2%**	**19.3%**	**18.3%**	**19.0%**	**21.7%**	**19.1%**	**17.5%**	**20.7%**	**18.8%**	**19.2%**
Tax Revenues	14.1%	14.0%	12.5%	13.6%	12.4%	12.6%	12.2%	13.8%	14.2%	14.7%
Grants	0.4%	0.2%	0.6%	0.3%	4.6%	1.0%	0.1%	0.1%	0.1%	0.0%
Non-Tax Revenues	7.7%	5.2%	5.2%	5.1%	4.8%	5.5%	5.1%	6.8%	4.5%	4.5%
Total Expenditures	**30.3%**	**29.3%**	**28.4%**	**31.9%**	**33.4%**	**30.2%**	**29.1%**	**30.2%**	**27.0%**	**24.9%**
Wages and Salaries	7.1%	7.0%	7.4%	7.8%	8.5%	8.2%	7.6%	6.7%	6.3%	6.0%
Purchase of Goods and Services	2.3%	1.9%	1.6%	1.4%	1.3%	1.3%	1.2%	1.3%	1.7%	1.5%
Interest Payments	6.0%	6.2%	6.3%	8.0%	8.2%	7.9%	8.8%	9.1%	9.4%	8.0%
Subsidies, Grants and Social Benefits	8.5%	9.0%	9.1%	10.7%	10.9%	8.2%	7.2%	7.1%	6.1%	5.6%
Energy Subsidies	*5.5%*	*5.0%*	*6.3%*	*7.0%*	*6.6%*	*4.0%*	*3.0%*	*2.6%*	*1.4%*	*0.6%*
Other Expenditures	2.4%	2.3%	1.9%	1.9%	2.0%	2.1%	1.8%	1.7%	1.3%	1.4%
Investments	4.0%	2.9%	2.2%	2.1%	2.5%	2.5%	2.5%	4.3%	2.2%	2.4%
Cash Deficit	**8.1%**	**10.0%**	**10.1%**	**12.9%**	**11.6%**	**11.5%**	**12.2%**	**10.0%**	**8.3%**	5.8%
Net Acquisition of Financial Assets	0.0%	-0.2%	0.0%	0.1%	0.5%	0.5%	0.5%	0.4%	0.0%	0.1%
Overall Deficit	**8.1%**	**9.8%**	**10.1%**	**13.0%**	**12.2%**	**11.5%**	**12.2%**	**10.0%**	**8.3%**	**5.8%**
Overall Deficit Excluding Grants	**8.5%**	**10.0%**	**10.7%**	**13.3%**	**16.7%**	**12.5%**	**12.3%**	**10.0%**	**8.3%**	**5.9%**
Primary Balance	**-2.1%**	**-3.6%**	**-3.8%**	**-5.0%**	**-3.9%**	**-3.6%**	**-3.4%**	**-0.9%**	**1.1%**	**2.2%**
Sources of financing of projected overall budget deficits										
External borrowing								*2.3%*	*2.9%*	*2.1%*
Domestic sources of financing								*7.7%*	*5.4%*	*3.7%*

Source: MOF and World Bank staff calculations.

21. **Egypt's fiscal financing needs are projected to be met in FY17, but at higher financing costs than in FY16.** The FY17 projected fiscal deficit is expected to be fully financed through domestic and external borrowing. The government is expected to finance the deficit through the issuance of treasury bills and bonds targeted at domestic banks as well as non-resident investors. Disbursements under the IMF EFF, the World Bank DPF 1 and DPF 2, as well as the AfDB loan will contribute in financing the budget deficit. In addition, the potential issuance of a Eurobond is also expected to be used to finance the deficit. These financing sources will help to phase out the need for the monetary financing of the deficit. The financing costs of external loans expressed in domestic currency terms are expected to increase following the weakening in the official exchange rate. Similarly, the financing costs of domestic borrowing by the Government will increase further following the CBE's recent decision to increase policy rates.

22. **Inflation is expected to spike in FY17 on the back of the exchange rate realignment, energy price adjustments, and the introduction of the VAT.** Average headline inflation is expected to reach 18 percent in FY17, compared to 10 percent in the previous year, as a weaker official exchange rate, electricity tariff and fuel price adjustments, and, to a lesser extent, the VAT push headline inflation figures upward. With the unemployment rate at 12.5 in FY16 and higher rates among the youth and women, high inflation is likely to disproportionally affect the bottom quintiles of the population, who spend a higher share of their consumption budgets on food and other essentials.

23. **Egypt's external current account balance is expected to improve gradually.** The exploration of new gas fields and competitiveness gains from real depreciation of the Egyptian pound should support export recovery. Tighter fiscal and monetary policy should contain import demand, with imports of investment goods financed in part by increasing FDI. The external financing gap in FY17, estimated at US$16.3 billion, is expected to be met through a combination of multilateral, bilateral, and other external financing. The macroeconomic framework assumes that Egypt's external financing needs can be covered as follows: (a) US$6.5 billion from multilateral institutions of which the World Bank has already provided US$1 billion under DPF 1 in September 2016 and will provide US$1 billion through this operation, US$4 billion

from the IMF (annual disbursement), and US$0.5 billion from the AfDB; (b) US$4.3 billion from bilateral sources including a US$2.7 billion currency swap with China, US$1 billion from a United Arab Emirates deposit, and US$600 million from some G-7 countries; and (c) US$5.5 billion in other external borrowing, including US$3.2 billion from rollover loans from Afreximbank, US$1.35 billion from a repo transaction with international commercial banks, and US$950 million from the possible issuance of a Eurobond. For the outer years FY18 and FY19, the financing gaps are much smaller and estimated at US$9.4 billion and US$8.9 billion, respectively. In FY18 and FY19 slightly more than 40 percent of the projected external financing gap is expected to be met through the IMF program. The remainder could be covered through rollovers of some maturing liabilities, and some new financing. The World Bank envisages a third DPF in FY18 with the amount to be determined by the country's priorities, implementation of the reform program, as well as global economic developments, which affect IBRD's financial capacity.

Table 3. Egypt's Balance of Payments, Financing Requirements, and Sources, FY15–19

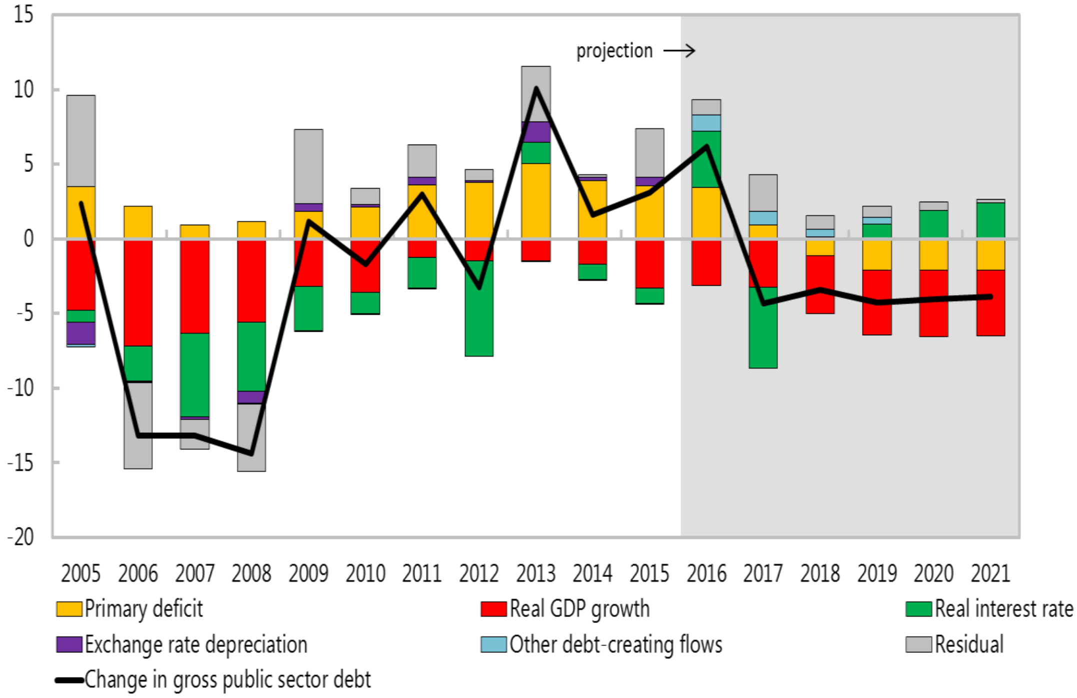
	Preliminary	Preliminary	Projections		
(in USD million)	FY15	FY16	FY17	FY18	FY19
Gross Financing Requirements	**14,378.6**	**21,246.8**	**19,438.0**	**15,300.0**	**11,700.0**
External Current Account Deficit	12,142.6	18,659.4	14,938.0	13,200.0	9,800.0
External Debt Amortization	2,236.0	2,587.4	4,500.0	2,100.0	1,900.0
Available Financing	**20,164.9**	**22,438.9**	**10,356.8**	**15,026.3**	**9,180.0**
Capital Account	(122.9)	(141.4)	(141.4)		
Foreign Direct Investment (net of outflows)	6,156.5	6,674.0	8,500.0	10,235.8	10,835.8
Portfolio Investment (net of portfolio outflows)	(591.4)	(1,094.7)	200.0	1,500.0	2,430.7
Medium and Long Term Disbursements	1,753.5	2,080.8	1,115.0	2,000.0	1,000.0
Other Capital Inflows	12,969.2	14,920.2	683.2	1,290.5	(5,086.5)
Net Errors and Omissions	(2,061.4)	(4,005.1)	-	-	-
Change in Reserves					
(before closing the financing gap) ('-' indicates and increase)	(3,724.9)	2,813.0	9,081.2	273.7	2,520.0
Financing Gap (indicative figures)	-	-	**16,300**	**9,400**	**8,900**
Sources of External Financing	-	-	**16,300**		
Multilateral Institutions	-	-	6,500		
Bilaterals	-	-	4,300		
Others	-	-	5,500		

Source: CBE and World Bank staff estimates.

24. **Egypt's public debt is sustainable over the medium term as long as a pro-growth fiscal consolidation path is adopted, but there are considerable risks to debt sustainability.** Large fiscal deficits have led to rising public debt ratios with the debt-to-GDP ratio increasing to almost 100 percent of GDP in FY16 from 80 percent in FY12. Taking into account the recent exchange rate devaluation, the Debt Sustainability Analysis (DSA) shows that under the baseline scenario, which assumes a gradual pickup in economic growth and a continuation of the fiscal adjustment program (as outlined in Table 2), the debt-to-GDP ratio is projected to decline to about 80 percent by FY21. Despite the improved debt outlook, the debt ratio will remain high and debt-servicing costs will continue to exert pressures on public spending. Risks to debt sustainability stem particularly from slower economic growth and fiscal adjustment. The envisaged decline in the debt-to-GDP path over the medium term could be reversed if the projected economic recovery is not sustained and fiscal consolidation efforts lose momentum. These risks are mitigated by a captive domestic investor base and low external government debt at about 8 percent of GDP. External government debt indicators are projected to remain favorable throughout the medium term notwithstanding the potential increase in foreign borrowing (to close the external financing gap under the IMF EFF). 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 refinancing requirements. Additional details about the DSA and stress tests to the baseline scenario are presented in annex 6.

Figure 1. Egypt's Debt Dynamics: Contributions to Debt-to-GDP Ratio



Source: Produced in the DSA tool by World Bank staff.

25. **Egypt's macroeconomic policy framework is adequate for this operation, particularly in light of the recent policy actions to float the exchange rate and adjust the price of fuel products, but downward risks are significant.** The liberalization of the exchange rate is an important step to restore external competitiveness, support exports, further rebuild reserves, and attract foreign investment. The CBE will have to resist pressure to manage the exchange rate, which in turn could lead to a loss of reserves and the reemergence of the parallel market. There is also the risk of a slowdown or reversal in fiscal reforms. Fiscal risks, including contingent liabilities, and slower growth could undermine debt sustainability and increase financing needs although a large captive domestic investor base and moderate external debt levels are important mitigating factors. In addition, tighter global financing conditions may increase borrowing costs. Sluggish recovery of Egypt's main trading partners in Europe and the Arab world and a delay in the resumption of flights to key tourist destinations in Egypt pose additional downside risks to Egypt's growth outlook. Moreover, any further buildup of arrears in the oil and gas sector can constrain growth in the energy sector. However, the steadfast implementation of fiscal consolidation policies and structural reforms could boost confidence and restore macroeconomic stability more rapidly than anticipated and lead to higher growth. The prior actions and indicative triggers selected for this DPF series and the recently approved IMF program are designed to help contribute to the mitigation of important risks and support Egypt's efforts to restore macroeconomic stability, enhance the effectiveness of public spending, and reduce the cost and risk of its debt portfolio.

2.3 IMF RELATIONS

26. **On November 11, 2016, the IMF Board approved a three-year EFF for US$12 billion equivalent.** The approval of the EFF allows for an immediate disbursement of about US$2.75 billion. The EFF-supported program will help Egypt restore macroeconomic stability and promote inclusive growth. Policies supported

by the program aim to correct external imbalances and restore competitiveness, place the budget deficit and public debt on a declining path, boost growth, and create jobs while protecting vulnerable groups.

3. THE GOVERNMENT PROGRAM

27. **The DPF is anchored in the Government's medium-term reform program.** The GoE has developed a long-term vision—Egypt's 2030 Sustainable Development Strategy—and a medium-term reform plan. This medium-term reform plan was developed in consultation with civil society and the private sector and was endorsed by the parliament in April 2016. Significant measures toward implementation of the program have been taken over the past two years, especially in the first half of FY17.

28. **The reform program sets ambitious targets for sustainable, private sector-led growth and job creation, to be achieved by FY19 through reforms grouped under four main themes: macro-fiscal stabilization, private sector-led growth, social and economic inclusion, and transparency and accountability.** Overall objectives of the economic program include: (a) achieving sustainable and high real GDP growth reaching 5.5–6 percent by FY19; (b) lowering poverty rates from 27.8 percent in 2015 to 24 percent in 2019; (c) increasing the pace of private sector job creation to reduce unemployment to 10–11 percent and in particular to address the high youth unemployment rate; (d) achieving greater efficiency and fairness in government spending while bringing down the fiscal deficit to around 7 percent of GDP; (e) lowering government debt burden within the range of 90–92 percent of GDP; (f) reducing inflation to single digits around 7–8 percent thereafter; and (g) increasing foreign exchange reserves to cover about 5.5 months of imports over the medium term.

29. **Macro-fiscal stabilization is seen as an essential prerequisite for restoring business confidence and making broader progress on development.** On the fiscal side, the reform program includes the civil service law to improve public sector performance (approved by the parliament in October 2016); an electricity tariff reform (August 2016); the new VAT and revised excises (September 2016); a simplified tax regime for SMEs and a new tax dispute settlement scheme (September 2016); tax administration reforms (ongoing); and continued fuel subsidies reform (three electricity price reforms in FY15–17 and two fuel price reforms in July 2014 and November 2016). These reforms have already yielded estimated savings of 3.9 percent of GDP in FY17. On the monetary side, the Government is committed to reducing inflation and preserving foreign exchange reserves by moving to an orderly and flexible foreign exchange market.

30. **Private sector-led growth is the objective of reforms aimed at improving the business climate and opening up new sectors for investment.** The Government is implementing ambitious reforms of the electricity and gas sectors, one objective of which is to attract more private sector investment in energy infrastructure. These include the renewable energy feed-in tariff program, under which Egypt aims to attract private sector investment for up to 4,300 MW in solar photovoltaic (PV) and wind power. A total of US$3 billion of international financial institution debt financing is currently under consideration for the first 2 GW of PV projects. Private investment is also foreseen in conventional energy assets, including 12 GW of new gas-fired power plants for which the Government is looking to sell minority stakes, and new upstream gas investments, which are promoted through a reformed production pricing regime. Beyond the energy sector, the key economy-wide business environment reforms include an ambitious initial public offering (IPO) program for state-owned enterprises (SOEs), the issuance of the Single-Person Company Law, reform of industrial licensing, a modern insolvency law, a strengthened competition policy with improved competition regulations, and an improved investment regulatory framework. The aim of these reforms is to increase: (a) private investment—domestic and foreign—and promote SME growth by eliminating regulatory constraints as well as distortions that favor energy-intensive and/or capital-intensive investments and (b) private sector-led job creation.

31. **Social and economic inclusion is an important pillar of reforms with enhanced budgetary allocation and effectiveness of government spending on SSN and human development.** The Government is reprioritizing spending away from energy subsidies toward efficient social programs targeting lower-income groups. The focus is on programs that improve living conditions and the business environment in Upper Egypt, as 70 percent of the poor live in Upper Egypt Governorates. To enable better targeting, the Government is constructing a unified national registry that can identify the vulnerable and allows exclusion of high-income groups from programs funded through public resources. New cash transfer programs (Takaful and Karama) started in January 2015, focusing first on Upper Egypt, and will expand their coverage to reach 2 million families (8–9 million beneficiaries) across Egypt by FY19. The eligibility criteria of the food subsidy program, which currently represents 1 percent of government spending and has wide coverage (around 67 million beneficiaries), will be revised to ensure that only the bottom 50–60 percent benefit. Through the expansion of these and other programs, the Government seeks to increase public spending on human development to around 10 percent of GDP from 2017–2018 onward, as mandated by the new constitution.

32. **The National Council of Women (NCW) in Egypt has outlined a three-year work plan 2015–2018 emphasizing the necessity of women's participation in all phases of the development process including in the political, social, and economic sphere as a means to enhanced social justice, equal opportunity, and equitable development.** The NCW seeks to achieve this through both policies and programs as well as through legislative reforms (when needed). The areas of focus include: (a) economic empowerment through increasing women's participation in the labor force, skills development, and a special program for women-headed households, looking at women in the informal sector; (b) social empowerment through combating violence against women, including female genital mutilation and early marriage, equal opportunity at the workplace within government units, advocacy and communication, cash transfers, improving basic services, that is, reproductive health and education, combating high fertility rates, establishing gender units within government units at the central and local levels, and special focus on rural women; and (c) political empowerment through training potential and existing women parliamentarians, legislative reforms, and advocacy and communication. All this will be achieved while establishing linkages with the Egypt Sustainable Development Vision 2030,[6] the SDGs, and all United Nations conventions ratified by Egypt related to women. The work plan will be carried out in full partnership and collaboration with all stakeholders, including the Government, political parties, parliamentarians, civil society, the media, the private sector, and international partners.

33. **Transparency and accountability to the public are considered critical for achieving the reform objectives.** Fiscal consolidation efforts have been accompanied by the launch of a citizen's budget to enhance public information about revenue collection and expenditure allocations to citizens. The Government has presented and published its Medium-Term Fiscal Framework 2016–2019, 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 control of 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 SOEs responsible for electricity and gas transportation will be improved. The World Bank has also partnered with a local think tank, the Economic Research Forum, to call for essays from youth on unemployment, to promote youth inclusion in Egypt within the World Bank portfolio. Business environment reforms involve improved transparency in the process of granting industrial licenses and in government incentives to businesses as well as the publication of laws and regulations governing business. On the social side, the Government aims to engage civil society in executing some of the new social programs. The Government has streamlined the process of

[6] The NCW is conducting a gender mainstreaming exercise for all Sustainable Development Strategy pillars.

energy tariff determination in line with budgeted subsidies according to the proposed Medium-Term Fiscal Framework 2016–2019.

Box 1. Egypt's Energy Price Reforms and Its Impact on Structural Reforms

In 2014, Egypt embarked on an ambitious energy subsidy reform and laid out its plans to phase out subsidies within five years to reach 0.5 percent of GDP by 2019, with the remaining subsidies covering only LPG and electricity consumption of the poorest households. The fiscal burden of Egypt's energy subsidies had grown continuously over two decades up to 2014. Since the early 1990s, fuel and electricity prices, which are capped by the Government, had declined continually in real terms. Low prices stimulated demand and led to a burgeoning subsidy bill that rose at a compound annual rate of 26 percent from 2002 to 2013. As a result, the budget share of energy subsidies increased from 9 percent to 22 percent over the same period, while their share in Egypt's GDP grew from 3.0 percent to 6.6 percent, representing a major contributor to the fiscal deficit.

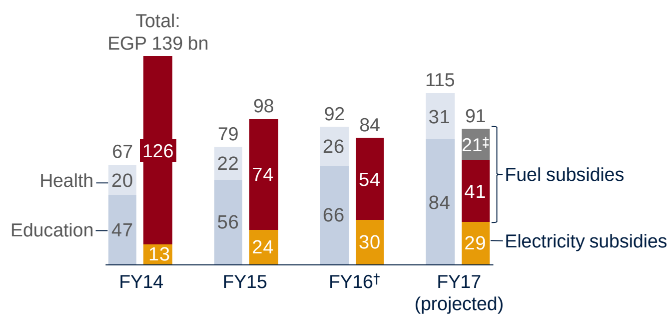


Figure 2: Budgeted Health, Education, and Energy Subsidy Spending.

Note: †World Bank estimate. ‡MOF estimate of impact of FY17 devaluation.

Energy pricing reforms in Egypt have followed a three-phase process. In Phase 1 from FY15 to FY16, a target of 0.5 percent of subsidy as proportion of GDP by 2019 was defined, and a five-year tariff trajectory based on revenue path was defined for electricity. Given the budgetary impact of variations on exchange rates, international oil prices, and significant investments under way in the energy sector, Phase 2 was initiated in FY17 when the tariff trajectory was replaced with a subsidy cap, to ensure that medium-term fiscal targets for subsidy were adhered. In addition, the Supreme Energy Council approved the regulatory pass-through of variations in actual energy costs compared to budget basis based on an annual basis to begin with. Going forward, Phase 3 will be initiated in FY18 when an automatic fuel indexation mechanism applied on a quarterly basis will allow pass-through of impact due to variations in oil prices and exchange rates, along with progression on the trajectory to reduce subsidies to reach 0.5 percent of GDP by FY19.

The prices for electricity have risen cumulatively over the last three years by more than 85 percent across consumer categories, while fuel prices have been raised twice, ranging from an accumulated increase of 60 percent to 150 percent across different fuel products from FY15 to FY17. Three successive electricity tariff increases and two major petroleum price reforms since 2014 have reduced energy subsidies from almost 7 percent to around 2.6 percent of GDP between FY14 and FY17 (as projected).

Reforming energy subsidies and improving sector governance have the potential to dramatically improve Egypt's fiscal situation and reduce significant distortions in other sectors with multiple benefits: improved incentives for more labor-intensive investments, improved urban transport efficiency, greater efficiency and productivity in the private sector, and thus expanded job opportunities, encouraging more sustainable growth and more funding for social programs.

Energy subsidy reforms have also freed up urgently needed resources for 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 5, food subsidies by a factor of 3, and the education budget by a factor of 2. 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—unlike ever before—spending on energy subsidies since FY15, as shown in figure 2. This is in line with the new constitutional commitment to increase spending on social sectors to 10 percent of GDP.

34. **The energy sector is being prioritized for governance reforms due to its higher institutional capacity.** In the electricity sector, the Ministry of Electricity and Renewable Energy has decided to have

modern governance structure for new generation assets, through separate companies set up for each of the three 4.4 GW combined cycle gas plants under construction, based on international norms of staffing and skills. Other initiatives include (a) setting up an internal audit department in the Egyptian Electricity Holding Company (EEHC) for the first time, (b) publishing the methodology for determining electricity tariffs across consumer categories for the first time based on Cabinet approval, (c) initiating a business planning framework for all sector entities, and (d) implementing the decision of the Egyptian Electric Utility and Consumer Protection Regulatory Agency (EgyptERA) to conduct public hearings on key policy issues from FY18.

35. **In the petroleum sector, the Ministry of Petroleum and Mineral Resources (MOP) is designing a modernization program for the sector, including ambitious governance and accountability reforms.** Based on an intensive consultative process, a modernization program has been launched in the MOP with the objectives of (a) improving sector governance and organizational health and (b) improving sector operations and performance (see section 4.2.2 for details).

36. **The reforms targeted at energy subsidies, efficiency, and governance of the sector represent the lowest hanging fruits to mitigate carbon emissions from Egypt's energy sector.** Over 70 percent of Egypt's greenhouse gas (GHG) came from the energy sector in 2015, where underpricing and shortages in the availability of natural gas have pushed up CO_2 emissions in recent years. Emissions from the power sector grew by 19.8 percent between FY12 and FY15 as oil filled the gap left by the unavailability of natural gas. There is significant improvement in policy and institutional setup in Egypt to promote renewable energy, mainstream energy efficiency, improve alternate fuels for industries, enhance integration of renewable energy into grid, and promote rooftop and decentralized applications of solar energy**.** These reforms initiated over the last two years will help unlock energy efficiency potentials and replace costly oil by renewables and natural gas, thus reducing CO_2 emissions at net negative cost.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

37. **The design of the DPF program incorporates lessons from DPF 1 as well as earlier engagements in Egypt and globally.** The Independent Evaluation Group 2009 Country Assistance Evaluation report entitled 'Egypt: Positive Results from Knowledge Sharing and Modest Lending' concluded with two recommendations: (a) to continue promoting improvements to systems that improve governance (citizen budgeting, simplification of taxation, and business procedures) and (b) to focus on policy and institutional reforms in energy and business competitiveness. This DPF operation directly supports the government reforms in these areas. The pillars and prior actions of DPF 1 were based on a homegrown program of the Government, selectively choosing top policy priorities of the Government backed by deep analytical engagement of the World Bank in these prioritized policy areas. The programmatic nature of the DPF has ensured continued focus on sustainable outcomes in the areas of revenue maximization, expenditure control, energy subsidy reform, an improvement in competitiveness of the private sector, and structural reforms for governance and efficiency in the working of the Government and its key departments. The programmatic nature also provides flexibility to adjust the triggers for DPF 3 if the reforms retain the original direction but need some midcourse correction.

38. **The DPF program is structured under three development objectives, each supported by a corresponding pillar**: (1) advance fiscal consolidation through higher revenue collection, greater moderation of the wage bill growth, and stronger 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. The first pillar will support the

Government's fiscal consolidation program, geared toward 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 open competition. The timing and size of the third operation will be contingent upon the demonstration of a robust macroeconomic framework and the completion of all triggers, in particular those that have been moved to the third operation, as they are critical for the achievement for results under the programmatic series, in addition to the impact of global economic developments, which affect IBRD's financial capacity.

39. **The proposed DPF contributes across the four major themes of Egypt's development strategy: macro-fiscal stabilization, private sector-led growth, social and economic inclusion, and transparency and accountability.** The measures supported by the DPF series carry strong government ownership and are clearly nested within Egypt's own reform program (see Table 4). All of the DPF pillars make multiple contributions across the four main themes of the country's development strategy. A range of measures to improve revenue collection and reduce expenditures, in particular by reforming energy subsidies, will support macro-fiscal consolidation. 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 electricity tariffs, 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 toward social spending.

40. **The policy matrix supported by the programmatic DPF series is included in annex 1.** It includes DPF 1 and DPF 2 prior actions and indicative triggers. The policy matrix is designed with carefully selected prior actions that are critical for implementation of subsequent triggers and 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.

Table 4. Contribution of DPF Prior Actions to the GoE's Reform Program

Four Themes of GoE's Reform Program	DPF Operation			Additional Reforms Being Undertaken Beyond DPF Pillars
	Pillar 1: Advancing Fiscal Consolidation	Pillar 2: Ensuring Sustainable Energy Supply	Pillar 3: Enhancing the Business Environment	
1. Macro-fiscal stabilization	• Income tax reform • VAT • Delinking variable pay from basic pay • Debt management • Medium-term Fiscal Framework	• Reduction in energy subsidies • FDI in energy	• Enhanced private sector investments • Easier tax dispute settlement	• Real Estate Tax • Property Tax reform • Capital Gains Tax reform • Excise and cigarette tax rise • Tax dispute settlement • Upgrading the tax administration function • Public expenditure reform • Civil Service Law reform
2. Private sector-led growth	• Unifying income tax • VAT	• Free entry for power and gas companies • Renewable	• Extending limited liability protection to sole proprietors	• New Suez Canal Development Project • National Project for Roads • Mining Law

Four Themes of GoE's Reform Program	DPF Operation			Additional Reforms Being Undertaken Beyond DPF Pillars
	Pillar 1: Advancing Fiscal Consolidation	**Pillar 2: Ensuring Sustainable Energy Supply**	**Pillar 3: Enhancing the Business Environment**	
		energy • Natural gas exploration and production	(single-person companies) • Improved competition environment • Simplified industrial licensing	• Settling investor disputes • Investments in upstream gas contracts • Energy security through liquefied natural gas imports • Amending the bankruptcy law • IPOs of public sector companies
3. Social and economic inclusion	• SME tax harmonization	• Energy subsidy savings redirected to social protection • Rooftop solar program for SMEs under the FIT program	• General Authority for Investment and Free Zones (GAFI) one-stop shop registration of single-person companies	• Takaful and Karama SSN • Unified registry • Upper Egypt development • Rural sanitation project • Agricultural competitiveness • Social housing project • Natural gas connections • Skills and education project • Microfinance Law • Enhancing accessibility to land and to urban communities
4. Transparency and accountability	• Midyear review statement • Managing contingent liabilities • Public Debt Strategy • Wage automation	• Strengthen EgyptERA • New gas regulator • Corporate governance reforms in SOEs • Policy and Strategy Unit	• GAFI published regulatory requirements and incentives • Reduced discretion and increased transparency in industrial licensing • Strengthened competition authority	• Civil Service Law reform • Ports automation • Electronic tax collection • Project automation • PFM Strategy

Note: Measures in grey-filled columns are supported by the World Bank Group under the Egypt DPF.

4.2 PRIOR ACTIONS, RESULTS, AND ANALYTICAL UNDERPINNINGS

Pillar 1: Advancing Fiscal Consolidation

1.1 Enhancing Government Revenues

DPF 2 Prior Action 2.1: The Borrower enacted Law No. 79 of 2016 *Finalization of Taxation Disputes* and published said law in its Official Gazette.

DPF 3 Indicative Trigger 3.1: The Ministry of Finance of the Borrower issues a decree that introduces a harmonized and simplified tax regime for micro and small businesses based on turnover.

41. Tax revenues during FY11–15 have averaged only 13 percent of GDP. In an effort to enhance government revenues, the MOF has embarked on an ambitious tax reform agenda with the aim to broaden the tax base, enhance the role that the tax policy plays in the economy, and build an effective and fair tax system. The new Income Tax Law (prior action for DPF 1), which paves the way for a stable and predictable income tax policy, was the first step in this direction. It sets a new unified rate that is applied to all economic actors operating in Egypt, including those located or based in special economic zones.

42. A key part in Egypt's tax reform agenda has been the introduction of the VAT (essential for the macroeconomic framework) in September 2016. The VAT, which replaces the previous GST, exempts basic goods and services to protect the poor and will help streamline the tax collection system and reduce evasion. The introduction of the VAT with an initial rate of 13 percent in FY17 has enhanced revenue mobilization. According to recent data on VAT collection from the Ministry of Finance, VAT revenues are accruing and have grown by 16 percent in October and 40 percent as of November 17, 2016 on a month-to-month basis. In addition, more than 5,000 new taxpayers have registered under the VAT, thus contributing to tax base broadening. The VAT rate will increase to 14 percent with the start of the following fiscal year, with the aim to further increase tax revenues and narrow the fiscal deficit.

43. The new VAT Law clarifies the tax treatment in a number of areas that were unclear under the GST legislation. This will reduce potential disputes between taxpayers and the tax authority. The VAT Law also allows for a more expedited tax refund process, according to which refunds will be processed within 45 days as opposed to three months under the GST Law. The Ministry of Finance is currently undertaking a thorough consultation process with industry group in order to finalize the executive regulations of the VAT Law. These regulations cover a number of areas under the VAT Law for which guidance is to be provided including on billing procedures and payment mechanisms, filing procedures at the Tax Registrar, and tax deductions, among others.

44. The MOF has also completed an initial assessment of the implementation of the VAT (original trigger for DPF 2), which 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 (original trigger for DPF 2). For example, to develop and improve the efficiency of tax administration and tax collection, the MOF has launched a Tax Modernization Project with focus on enhancing technical skills of employees and modernizing the tax IT system.

45. In August 2016, the parliament approved a tax dispute legislation, initially valid for one year, to deal with the backlog of dispute cases—Prior Action 2.1. The new law is based on pragmatic provisions that are expected to make the dispute resolution process easier, more efficient, and final. According to a conservative estimate by the MOF, this legislation will yield additional revenue of EGP 10–15 billion during the current fiscal year. These revenues are expected to at least offset any foregone receipts due to the revisions of the VAT Law.

46. For DPF 3, the Government envisages simplifying the taxation of micro and small businesses to reduce compliance cost and boost private business growth. The objective is to create a tax system for micro and small businesses that is simpler and less costly to administer, allowing vital small businesses to focus on growth.

47. **Expected results.** Enhancing income and VAT revenues can be measured in terms of the income tax and sales/VAT on goods and services paid by non-sovereign corporates relative to nominal GDP. In FY15, this ratio was 5.4 percent 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.

1.2 Containing the Wage Bill

DPF 2 Prior Action 2.2: (i) The Borrower enacted Law No. 8 of 2016 *Assessing the Public Budget of the State*, endorsing the national budget for FY17, which contains administrative instructions to all government budgetary entities to contain the wage bill, including provision for delinking bonuses and rewards of their respective employees' salaries from the basic salary component and published said law in its Official Gazette. (ii) The Ministry of Finance of the Borrower issued a wage bill report entitled *Government Wages, Key Reforms* dated November 2016 notifying that at least forty-five percent (45%) of the wage bill is automated.

DPF 3 Indicative Trigger 3.2: (i) The Borrower's Cabinet approves a medium-term plan/rule that sets a cap on the number of new recruits in the public sector relative to the number of retirees. (ii) The Ministry of Finance of the Borrower issues a wage bill report notifying that at least 75 percent of the wage bill is automated and develops an action plan for the completion of the automation process.

48. The wage bill was on an accelerated path and unsustainable trajectory during FY11–14. Increases in the number of permanent employees in the Government, higher bonuses granted to various groups and segments every year, and increases in the minimum wage from EGP 700 to EGP 1,200 per month led to a rapid rise in the wage bill. In fact, 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 billion in FY11. The wage bill increased further to about EGP 199 billion in FY15, but the pace of increase was considerably slower than in previous years. With regard to GDP, the wage bill has been on a declining path since FY14 when it stood at 8.5 percent. The wage bill reached 8.2 percent of GDP in FY15 and fell further to an estimated 7.6 percent of GDP in FY16.

49. In FY15, the Government started to introduce measures to control and reduce the wage bill to a sustainable footing. The budget law for FY15 and FY16 set instructions that have helped limit 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 contains the long-standing built-in inertia and automatic increases in employees' total wage and salary bill. These provisions continue to prevail in the budget law for FY17—Prior Action 2.2 (i)—demonstrating strong policy continuity by the Government to contain the wage bill.

50. The MOF has been making considerable efforts in the automation of the payroll system. Even though the authorities have not yet published a time-bound plan with procedures and measures that facilitate and enforce the automation of wages and salaries payments for all government employees (original trigger for DPF 2), the authorities have made progress on this front. An early phase of payroll automation took place in FY10, which resulted in a mere 0.1 percent of the total payroll being automated. However, this ratio increased to 19 percent in FY14 and 26 percent in FY15. The automation of wages and salaries progressed further to an impressive 45 percent in FY16 and is targeted to reach 57 percent this fiscal year. In fact, after the first quarter of FY17, more than 45 percent of the total wage bill has been automated—Prior Action 2.2 (ii). For DPF 3, the Ministry of Planning is developing a plan to limit the

number of new recruits in the public sector relative to the total number of retirees, which will help further rationalize wage bill spending.

51. **Expected results.** Progress on containing wages can be measured by the ratio of the Central Government's wage and salary bill to nominal GDP. In FY15, this ratio was 8.2 percent, with a target to lower it to 7.4 percent of GDP in FY18.

1.3 Strengthening Debt Management and Aspects of Public Financial Management

DPF 2 Prior Action 2.3: The Ministry of Finance of the Borrower issued Decree No. 247/2016 to establish and operationalize a Public Finance Management Improvement Unit with the following mandates: (a) setting-up an internal audit function; (b) monitoring fiscal risks of Economic Authorities and SOEs, including their contingent liabilities; and (c) enhancing government accounting and financial control.

DPF 3 Indicative Trigger 3.3: The Ministry of Finance: (i) establishes the internal audit dedicated unit with adequate staffing, budget and procedures aligned with international standards; and (ii) establishes the Economic Authorities and SOEs fiscal risk monitoring dedicated unit with adequate manuals and standard reports, which identifies, monitors, and facilitates the management of contingent liabilities and sovereign guaranteed liabilities.

52. The short average maturity of debt and the high debt-servicing costs manifest Egypt's debt-related vulnerabilities. The MOF is striving to lengthen the average term to maturity, which has risen back above its pre-2011 levels, exceeding two years. Meanwhile, the Government's interest payments on its debt have been increasing and stood at just below 8 percent of GDP in FY15. 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), which was issued in December 2015, will help improve Egypt's debt profile by properly accounting for debt risks in addition to financial costs. In addition, the MOF recently established and operationalized a Public Financial Management (PFM) Improvement Unit to set up functions on internal audit and fiscal risk monitoring. These are important steps toward strengthening public sector governance, risk management, and internal controls, which will contribute to achieving a more effective resource allocation and improving the quality of public service outcomes.

53. The adoption and publishing of an MTDS will enhance the predictability of debt issues, especially in the domestic credit market. This will help better inform investors and lenders about the Government's intended policies and plans, which can help the Government diversify sources of budget-deficit financing and further elongate the average maturity of the debt profile. By sharing key debt management goals, investors would be given 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 MOF intends to build a professional internal audit function for the public sector, starting within the MOF. To this end, the MOF has created, in June 2016, a PFM Improvement Unit with sub-functions including internal audit and fiscal risk monitoring. The internal audit function will have its purpose, authority, and responsibility formalized in an 'Internal Audit Charter' based on applicable international standards. The PFM Improvement Unit has already identified its first two audit engagements. After the function becomes fully operational in the MOF, it is expected to serve as a model and central harmonization unit for other line ministries.

54. **Expected results.** An updated MTDS 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 MOF would have performed and reported on at least four audits on sectors and entities affiliated with the ministry. In

addition to strengthening debt management, the policy area was extended to better reflect the PFM aspects that this DPF series aims to tackle under Pillar 1.

Pillar 2: Ensuring Sustainable Energy Supply

2.1 Reforming Energy Subsidies

DPF 2 Prior Action 2.4: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 436 of 2016 implementing a third annual electricity tariff adjustment that goes beyond the former five-year tariff adjustment plan adopted in the Prime Minister's Decree No. 1257/2014, as recommended by the Borrower's Egyptian Electric Utility and Consumer Protection Regulatory Agency. (ii) The Supreme Energy Council of the Borrower adopted a policy for financing variations in actual energy costs compared to the budget estimates in the Borrower's Medium Term Fiscal Framework (2016-19).

DPF 3 Indicative Trigger 3.4: (i) The Borrower's Cabinet implements the annual energy price adjustment for FY17–18 consistent with passing through unanticipated changes in the cost of energy to achieve subsidy ceilings set in the Medium-Term Fiscal Framework 2016–2019, pursuant to the Supreme Energy Council Policy Decision of 2016. (ii) The Supreme Energy Council adopts a policy for automatic periodic indexation of energy prices.

55. **The above prior actions capture the Government's efforts toward reforming energy subsidies to 0.5 percent of GDP by FY19.** Egypt has long relied on energy subsidies as a means of sharing its hydrocarbon wealth. However, when Egypt became a net importer and international energy prices soared in 2011–2014, subsidies became unsustainable, reaching 6.6 percent of GDP by FY14. The Government committed to a five-year reform program from FY15, during which energy subsidies would gradually be reduced to 0.5 percent of GDP by FY19, with remaining subsidies covering only LPG and electricity consumption of the poorest households. The process began in July 2014 when fuel prices were adjusted between 40 percent and 78 percent and electricity tariffs rose on average by 31 percent. In the case of electricity, an explicit five-year tariff trajectory was announced. The second scheduled electricity tariff adjustment took place in July 2015 (as Prior Action 1.4 of DPF 1) and resulted in an overall average tariff increase of 19 percent on average, which for social reasons was applied differentially across customer groups in such a way as to protect small residential consumers. The energy subsidy bill subsequently fell from 6.6 percent of GDP in FY14 to 3.1 percent of GDP in FY16, of which 1.1 percent of GDP was for electricity and 2.0 percent of GDP for fuels. About 44 percent of this progress in subsidy reduction was attributable to the aforementioned tariff adjustments. The remaining 56 percent resulted from the steep decline in the international oil prices from over US$110 per barrel in FY14 to an average of US$43.25 in FY16.

56. **Prior Action 2.4 captures further reform actions taken in FY17 relating to the pricing of electricity, petroleum fuels, and natural gas.** In the electricity sector, Trigger 2.4 (i) envisaged the application of the scheduled third annual electricity tariff adjustment, by an average of 17 percent as planned under the five-year tariff trajectory published in 2014. However, by mid-2016 it was clear that sector cost for FY17 would be higher than expected in 2014 due to a higher share of oil in power generation, the currency devaluation, and increased capital costs due to the rapid expansion of generation capacity. In response, the Government enacted a much higher tariff increase, effective July 1, 2016, by an average of 33 percent. This price adjustment, included in the policy matrix as **Prior Action 2.4 (i)**, brings the cumulative electricity price increase for the three-year period 2014–2016 to 107 percent in nominal terms, well above the planned increase of 77 percent for the entire five-year period 2014–2019. The tariff reform was supported by a proactive communications effort. A multimedia public communications campaign about the electricity tariff adjustment, which emphasized the scope for counteracting the price increase by adopting energy efficiency measures, helped improve the social acceptability of this relatively large tariff adjustment. To stimulate efficiency improvements by large consumers, the increase was implemented in

such a way to create a strong price penalty for households consuming above 1,000 kWh per month, incentivizing a switch to more energy efficient appliances.

57. **Prior Action 2.4 (ii) captures the Government's new policy to adjust prices annually in a way that ensures progress on the multiyear subsidy trajectory while taking into account unexpected changes in fuel cost.** In October 2016, the Supreme Energy Council—a subcommittee of the Cabinet bringing together the MOF, MOP, and Ministry of Electricity and Renewable Energy—adopted a policy to undertake adjustments of energy prices consistent with passing through unanticipated changes in the cost of energy while continuing to make progress toward cost recovery so as to achieve subsidy ceilings set in the Medium-Term Fiscal Framework 2016–2019. The policy will be implemented starting from FY18. This marks an important policy change toward a mechanism of adjusting prices to reflect changes in costs beyond the control of the energy sector. Previously, the Government targeted a specific 'price path' and allowed any unanticipated changes in costs to be absorbed in the subsidy budget. The new approach is to target a specific 'subsidy path', based on the MOF's Medium-Term Fiscal Framework 2016–2019, and adjust prices to ensure that this target is met by passing through any unanticipated changes in costs to consumers. This prior action has significant climate co-benefits associated with reduction in subsidy from 6.6 percent in FY 14 to expected level of 1.5 percent by FY18.

58. **In the electricity sector, the process is led by EgyptERA, the electricity regulator.** EgyptERA will present to the Cabinet for the years FY18 and FY19 (a) the current average electricity tariff charged to consumers; (b) the calculation of the average electricity tariff consistent with cost recovery based on the actual fuel costs, fuel mix, and foreign exchange costs applicable in each year; and (c) the calculation of the average electricity tariff consistent with the electricity subsidy targets. Based on these inputs by EgyptERA, the Cabinet takes a decision on the average tariff, and the Board of EgyptERA will approve the associated tariff structure. This will subsequently be issued by the ministerial decree. The institutional process, which strengthens the position of the regulator compared to the previous setup, is underpinned by the new Electricity Law No. 87/2015 and supporting executive regulations and has been successfully piloted during the tariff revision for FY17, enabling the regulator to raise tariffs beyond the original five-year trajectory.

59. **In the petroleum sector, the process is led by the MOP.** The MOP will advise the Cabinet each year on (a) current subsidy levels for individual fuels as well as the overall subsidy requirement of the sector based on actual fuel costs, fuel mix, and foreign exchange costs applicable in each year and (b) alternative scenarios of subsidy adjustments for individual fuels that will keep the overall subsidy requirement for the sector that is consistent with the fuel subsidy ceiling for that year according to the Medium-Term Fiscal Framework 2016–2019 and with sound economic and social principles on the relative pricing of fuels. Based on the subsidy scenario recommendation by the Cabinet from among those presented under item (b) above, the MOP will calculate the prices of individual fuels and submit them for issuance through a prime ministerial decree.

60. **Expected results.** The higher-than-expected tariff adjustment in July 2016 brings the current level of electricity tariffs to EGP 0.46 per kWh, already exceeding the target value of EGP 0.451 per kWh set as the target value for FY18 in the original results indicator. However, the depreciation of the Egyptian pound has eroded some of the resulting gains in cost recovery. The results indicator for electricity tariffs was therefore replaced by the cost recovery level of electricity tariffs, which is expected to increase from below 50 percent in FY14 to at least 70 percent by FY18.[7] The second results indicator is the total level of energy

[7] Cost recovery is defined here as the electricity sector's financial cost recovery, including Operational and Capital expenditure, following EgyptERA's cost-of-service methodology.

subsidies as a percentage of GDP. The target value of energy subsidies for FY18 has been determined at 1.5 percent of GDP.

2.2 Improving Energy Governance

DPF 2 Prior Action 2.5: The Ministry of Electricity and Renewable Energy of the Borrower issued Decree No. 230/2016 notifying the Executive Regulations of Electricity Law of the Borrower that, inter alia, include measures to improve the energy efficiency of large electricity consumers and published said Regulations in the official Gazette of the Borrower. *DPF 3 Indicative Trigger 3.5: (i) The Ministry of Electricity and Renewable Energy of the Borrower reestablishes the Egyptian Electricity Transmission Company as a functionally independent utility in compliance with the Electricity Law and the above executive regulations. (ii) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues regulations on methodology for public hearings and consultations on important regulatory decisions.*

61. **Egypt's electricity sector is operated by the EEHC, which holds over 90 percent generation and has a monopoly on transmission and distribution activities.** Following the electricity shortages of summer 2014, the sector has advanced on a major investment program aimed at improving security of supply. However, significant inefficiencies remain in both the dispatch of the generation plant and the operation of the transmission and distribution networks. The new Electricity Law No. 87/2015 (DPF 1 Prior Action 1.5) envisages a full modernization of the sector. Its provisions strengthen the authority and transparency of the regulator and provide for an eight-year transition process toward a competitive market. A critical first step is the separation of the Egyptian Electricity Transmission Company (EETC) from its current situation as a subsidiary of the EEHC, to become an independent network operator independent of generation and distribution activities, improve transparency and accountability of state-owned entities, promote competition and private investment in the sector, and provide nondiscriminatory third-party access to the grid.

62. **Prior Action 2.5 captures the Government's progress toward implementation of the governance reform captured by the Electricity Law.** The executive regulations of the Electricity Law have been issued and provide a detailed framework for tariff setting, energy efficiency, and sector organization. The new procedures for tariff setting are already having a noticeable impact on the financial sustainability of the sector (see Prior Action 2.4). The executive regulations also provide clear guidelines for energy efficiency actions expected from large consumers in excess of 500 kWh. All large customers are required to appoint an official responsible for improving the energy efficiency of the establishment. The highest consuming group, above 10 MW, is required to collect detailed information on the energy consumption and efficiency performance of individual devices and develop feasibility studies for concrete measures to improve the efficiency of energy use. All large consumers submitted energy efficiency plans to the regulator, EgyptERA, in 2016. The action on energy efficiency will have significant climate co-benefits.

63. **The DPF 2 trigger capturing the functional separation of the EETC was moved to DPF 3, as the authorities require more time to ensure a smooth transition**. The EEHC is making good progress toward establishing the functional independence of the EETC, which is required by the Electricity Law. Functional separation, which is the first stage in the establishment of an independent company, will require legal amendments to the company's Articles of Association as well as separate regulatory tariff-setting process (already established). Detailed terms of reference for the functional, financial, and operational restructuring have been developed and endorsed by an interagency Steering Group comprising the EEHC, the Ministry of Electricity and Renewable Energy, and EgyptERA. A dedicated Project Management Unit for this process has been created within the EETC and staffed with a cross-section of relevant skills, and a number of capacity-building activities are planned including study visits to established transmission system operators in other countries.

64. **Expected results.** Egypt is already making significant progress in strengthening energy security, measured by the ratio between peak generation capacity and peak demand. Thanks to new capacity and energy efficiency measures, this ratio has already turned from a deficit of 5,540 MW in FY15 to a reserve margin or surplus of 2,000 MW during summer peak in 2016, already exceeding the 1,000 MW surplus target for FY18. A second results indicator for this sub-objective, which captured the anticipated decline in the EEHC's market share, was dropped from the policy and results matrix as the Government has decided on a sequence of reforms that will first see minority ownership in generation companies from the private sector through IPO and majority ownership only after the end of the DPF program. In its place, a governance and transparency indicator for the public disclosure of the tariff methodology for the computation of electricity tariffs has been added. In addition, the notification and operationalization of the supply code, transmission tariff, and market rules by FY18 is also a result indicator of transparency and progress toward a competitive market**.**

DPF 2 Prior Action 2.6: (i) The Borrower's Cabinet approved the draft *Gas Activities Regulatory Law* and submitted it to the Borrower's Parliament for consideration. (ii) The Ministry of Petroleum and Mineral Resources of the Borrower issued Decree No. 1631/2016 to establish a new Policy and Strategy Unit detailing the charter, functions and authority to spearhead the modernization of the petroleum sector.

DPF 3 Indicative Trigger 3.6: (i) The Ministry of Petroleum and Mineral Resources of the Borrower issues the executive regulations implementing the new Gas Activities Regulatory Law pursuant to its approval by the parliament. (ii) The Ministry of Petroleum and Mineral Resources of the Borrower establishes a new independent gas sector regulator pursuant to the new Gas Activities Regulatory Law. (iii) The Ministry of Petroleum and Mineral Resources of the Borrower nominates the independent transmission system operator in compliance with the requirements set by the gas sector regulator.

65. **Egypt has seen a decline in its gas production since 2009, reversing its position from net exporter to net importer in 2015 and leading to subsequent shortages in gas for electricity generation.** The decline in gas supplies was driven in part by security incidents during and after the Arab Spring, but production was already on a downward trends by 2010 because Egypt lacked an attractive investment framework. Since 2014, the Government has taken decisive action to revitalize the gas sector. First, gas prices for consumers were raised in 2014 and again in 2016 to make the downstream sector financially sustainable. Second, Egyptian Natural Gas Holding Company (EGAS) and Egyptian General Petroleum Corporation (EGPC) leased two liquefied natural gas import terminals ('floating storage and regasification units') to access gas imports. Third, the Government paid down arrears to international oil companies to regain investor confidence. Fourth, a new contractual framework for upstream investments offers more attractive offtake conditions in gas exploration and production. Fifth, as outlined below, the Government has initiated legislative reforms to create a competitive market for gas, with an independent transmission system operator, third-party access to the grid and an independent regulator. These measures have started paying off. New gas discoveries include the largest field in the Mediterranean ('Zohr'), for which the development contracts were signed in record time. Besides restoring domestic gas production, the Zohr field will also make a substantial macroeconomic contribution by bringing in US$11–16 billion of FDI and eventually displacing a significant amount of imported gas, thus saving foreign exchange.

66. **Prior Action 2.6 (i) captures the legislative reform of the gas sector.** Gas supply is still subject to monopoly provision by the SOE Egyptian Natural Gas Holding Company. Moreover, there is no regulatory agency to oversee the sector and provide consumer protection. The new draft gas sector law ('Gas Activities Regulatory Law') envisions substantial reforms to the gas sector. The draft law would facilitate a competitive wholesale market for gas, the creation of an independent transmission system operator to provide nondiscriminatory third-party access to gas networks and the creation of a new independent gas regulator. The regulator will be responsible for development of the gas transmission codes, gas transmission tariff, and entrance of new shippers and licensing of alternative suppliers apart from the EGAS

and EGPC. The law was recently submitted to the parliament. The backlog of legislation requiring approval following the resumption of the parliament in January 2016 had delayed its consideration. Approval of the law and its supporting executive regulations is expected in 2017.

67. **Prior Action 2.6 (ii) captures the initiation by the MOP of a major modernization program for the sector that complements the legislative and regulatory reforms.** As an important complement to the reforms to the legal and regulatory framework, efforts are under way to modernize the management and governance of the sector. To spearhead this process, the MOP recently established a Policy and Strategy Unit with a clear mandate for modernization and key positions already staffed. The unit will be tasked with clear charter of roles, responsibility, staffing levels with appropriate skills and requisite authority to program manage the modernization plan and streamline strategic decision making in the sector. The unit is already staffed with more than 10 staff picked from across the companies based on their strong performance and the passion to lead change.

68. **The specific objectives of the modernization program are to improve transparency and accountability, enhance operational efficiency and attract private investment**. The first objective of improving sector governance and transparency will be addressed by (a) streamlining current concession process and testing new forms of concession agreements;[8] (b) restructuring the sector for clearer definition of roles and responsibilities by having separate companies each on upstream, midstream, and downstream sectors and creating a separate unit or organizational entity in charge of licensing and regulatory issues; and (c) reworking process flows to address conflicts of interest among senior management, backed by a comprehensive assessment of talent and human resources policies for the employees of the sector. The second objective of improving sector operations and performance identifies three critical work streams on (a) optimizing midstream and downstream operational performance; (b) enhancing upstream output through modifying incentives for international oil companies for incremental production that could be ring-fenced to pay for arrears; and (c) developing a strategy to optimize and leverage existing oil and gas transport and storage infrastructure to build a regional hub in Egypt.

69. **Expected results.** The revitalization of the Egyptian gas sector is leading to improved energy security. Domestic gas production is projected to increase from 4,020 MMScf/day in FY16 to 4,700 MMScf/day by FY18, feeding also into the indicator for improved electricity generation (since about 70 percent of electricity is generated using gas). In addition, enhanced transparency in sector regulations is envisaged through a functioning web portal with all regulations and all application formats available online by FY18, as well as publication of a separate gas transmission tariff, transmission code, market rules, and approval procedures by FY18**.**

2.3 Enabling Private Energy Investments

[8] The process of decision making has already been streamlined and made faster in the MOP, wherein the development lease for the Zohr project (the largest Mediterranean gas project with gas reserves estimated to be valued at around US$100 billion) was signed within four months (compared to historical norms of greater than one year), with the first gas expected to be produced in a two-year time frame against the international benchmark of four years for gas wells with similar geology.

DPF 2 Prior Action 2.7: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 244 of 2016 to set up an energy efficiency unit with dedicated staff to lead the implementation of the Borrower's National Energy Efficiency Action Plan. (ii) The Borrower's Cabinet issued Decree No. 2533 of 2016 announcing the revised Feed-in-Tariff policy for renewable energy.

DPF 3 Indicative Trigger 3.7: The Ministry of Electricity and Renewable Energy of the Borrower announces new policy measures for promoting private investments in clean energy.

70. **Egypt has barely begun to develop its rich renewable energy resources, which include excellent conditions for commercially viable wind power 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 the share of its generation capacity coming from renewable sources to 20 percent by 2022 to reduce reliance on fossil fuels will call for a substantial scale-up in private investment. The new renewable energy law (No. 203/2014) reduces risks and improves financial viability 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 through competitive bidding mechanisms for IPPs. Moreover, recent increases in grid electricity tariffs combined with declining costs of renewable energy are increasingly making renewable energy solutions more competitive from an end-user perspective.

71. **Prior Action 2.7 (ii) captures the overhaul of the feed-in tariff program introduced in September 2016.** The first phase of the feed-in tariff program did not move as rapidly as expected due to issues raised by investors and lenders on arbitration and currency conversion issues as well as government concerns about the high level of the feed-in tariff for solar energy (at US$0.14 per kWh for utility-scale plants) relative to rapidly declining market benchmarks. As a result, the Cabinet issued a second phase feed-in tariff decree in September 2016, addressing the concerns raised by developers as well as lowering the tariff level for solar energy to US$0.084 per kWh for solar projects (20–50 MW scale). Projects totaling about 100–300 MW are expected to be commissioned based on the first round of feed-in tariff regulations, with the bulk of the remaining projects under development expected to roll over to the second feed-in tariff, which is limited to the developers who prequalified for the first phase.[9] International multilateral finance institutions led by the International Finance Corporation (IFC) and European Bank for Reconstruction and Development are leading the program to arrange the financing for a large proportion of the revised feed-in tariff program for 2,000 MW of grid connected solar projects, which is valid till October 2017. Furthermore, 250 MW of wind power projects being developed under build-operate-own projects with the private sector at a rate of US$0.04 per kWh are in the final stages of contract negotiation. Renewable energy is associated with significant climate co-benefits.

72. **Prior Action 2.7 (i) captures the operationalization of the energy efficiency unit in the Ministry of Electricity and Renewable Energy.** Progress with energy efficiency in Egypt has been held back by an absence of institutional capacity dedicated to this issue. The Ministry of Electricity and Renewable Energy established an energy efficiency unit in 2014, but the head of the unit was appointed only on May 7, 2016. The unit is now fully staffed with the mandate of designing and implementing the National Energy Efficiency Action Plan. The unit at the ministerial level is complemented with energy efficiency units in all distribution companies and a dedicated team in EgyptERA with an institutional mechanism for coordination within different entities within the sector as well as energy efficiency applications across

[9] If the 2,000 MW capacity for solar and 2,000 MW capacity for wind are not reached, new investors will be prequalified to participate in the feed-in tariff program.

other sectors such as transport and municipalities. Institutional measures on energy efficiency have climate co-benefits.

73. **Expected results.** The success of the Renewable Energy Law will be measured in financial closure of 1,500 MW of (wind and solar) renewable generation capacity financed by the private sector by the end of FY18.

Pillar 3: Enhancing the Business Environment

3.1 Improving the Investment Regime and Its Transparency, Particularly for MSMEs

DPF 2 Prior Action 2.8: The Borrower's Cabinet approved the draft Single-Person Company Law that includes limited liability protection, and submitted it to the Borrower's Parliament for consideration.

DPF 3 Indicative Trigger 3.8: (i) Executive regulations of the Single-Person Company Law issued. (ii) The General Authority for Investment and Free Zones of the Borrower registers single-person companies. (iii) The General Authority for Investment and Free Zones of the Borrower publishes all licensing and permits procedures and requirements for all activities and sectors. (iv) The General Authority for Investment and Free Zones of the Borrower publishes a complete inventory of available investment incentives and eligibility criteria.

74. Sole proprietors, which represent an estimated 72 percent of formal establishments,[10] are not governed by the current Company Law. They are excluded from the protections against personal liability afforded to companies. This means that small, sole-proprietor businesses are exposed to greater risks, which translates into less access to finance, less scope for growth, and unequal treatment under the law compared to larger firms. This also leads to lesser incentives for informal firms to formalize, since formalization will not result in any liability protection.

75. **DPF 2 Prior Action 2.8** supports the introduction of the Single-Person Company Law, which will improve the business environment for small enterprises and facilitate entry. This reform is an extension of the Government's previous efforts to enhance investor rights, protections, and incentives under the Investor Guarantees and Incentives Law revised in 2015. The Single-Person Company Law will allow sole proprietors to register as companies, with all the provisions under the Company Law, as well as grant sole proprietors access to a number of the guarantees and incentives under the Law of Investment Guarantees and Incentives. This action will contribute to equalizing the treatment of small and large investors under the law, giving small businesses greater security and a better chance to grow. Having a registered company status will afford many small businesses—currently either unregistered or registered as sole owners with no liability protections—better access to finance, markets, and legal protections. Coupled with a simplified industrial licensing regime, also supported by this DPF, the Single-Person Company Law will transform the regulatory context in which many small businesses operate in Egypt.

76. **Expected results.** The implementation of the Single-Person Company Law is expected to result in an increase in business entry, particularly small businesses, as measured by the number of single-person companies registered, from 0 in FY15 to at least 500 in FY18 (subject to the date of the effectiveness of the law). An increase in the number of GAFI one-stop shops registering single-person companies from 0 in FY15 to 4 by the end of FY18 will ensure accessibility to registration services for single-person companies. The targets set are indicators that the registration system for the single-person companies is active and accessible.

[10] Estimated from the 2012/2013 Economic Census, Central Agency for Public Mobilization and Statistics (CAPMAS).

3.2 Reforming Industrial Licensing

DPF 2 Prior Action 2.9: (i) The Borrower's Cabinet approved the draft *Law on Streamlining the Procedures of Granting Licenses for Industrial Establishments* that includes measures for simplified licensing by notification for low-risk industrial activities, and submitted it to the Borrower's Parliament for consideration. (ii) The Borrower's Minister of the Ministry of Trade and Industry issued Ministerial Decree number 1071 of 2016 approving the implementation plan of the Borrower's Industrial Licensing Reform Program.
DPF 3 Indicative Trigger 3.9: (i) Issuance of the executive regulations of the Law on Streamlining the Procedures of Granting Licenses for Industrial Establishments, including regulations for implementation of simplified licensing by notification for low-risk industrial activities. *(ii) The Licensing Prerequisites Committee, provided for under the Law on Streamlining the Procedures of Granting Licenses for Industrial Establishments, makes available online all requirements related to establishment, operation, and termination of industrial activities.*

77. Following the issuance of the Prime Ministerial Decree 2807 of 2015 on the reform of industrial licensing (DPF 1 prior action), the Industrial Licensing Reform Committee was formed and led by the Minister of Trade and Industry with the mandate to develop the implementation plan of Egypt's industrial licensing reform program , within the reform framework set by the decree. Recommendations on the direction of the reform not only led to the preparation of an implementation plan but also went further to produce a framework law—now approved by the Cabinet and submitted to the parliament—to reform the industrial licensing regime with executive regulations currently under preparation.

78. **Prior Action 2.9** supports the approval of the draft industrial licensing law (Law on Streamlining the Procedures of Granting Licenses for Industrial Establishments') by the Cabinet and its submission to the parliament and the adoption of the industrial licensing reform implementation plan by the Minister of Trade and Industry. The law includes a key reform that will simplify industrial licensing requirements for industrial firms with low environmental and social risks using a 'licensing by notification only' process. This will represent a major simplification of the process for a majority of industrial firms that will not be subject to the full process anymore but only to a notification procedure. This reform is expected to affect the vast majority of firms, in particular micro, small, medium enterprises (MSMEs), most of which will fall into the low-risk category. The new 'law further includes reforms to rationalize and publish all licensing requirements and provide for a grievance mechanism. **Trigger 3.9** takes the reform further, by supporting the issuance of the executive regulations to implement the plan, including the regulations to introduce notification-based licensing for the low-risk category of firms. These executive regulations are currently under preparation. The implementation plan of Egypt's industrial licensing reform program ensures that al prerequisites and requirements to implement the new law have been satisfactorily completed.

79. **Expected results.** The reforms to the industrial licensing framework are expected to reduce the average number of days to issue license to no more than 7 days, by the end of FY18, to comply with the simplified notification requirements of industrial licensing for low-risk activities, which are expected to represent the majority of industrial firms. In addition, the reform is expected to reduce the average number of days for licensing for all industrial firms from 634 days in FY15 to 160 days by the end of FY18.

3.3 Strengthening the Competition Framework

DPF 2 Prior Action 2.10: (i) The Borrower's Cabinet issued Decree No. 2509/2016 notifying the Executive Regulations of *Protection of Competition and Prohibition of Monopolistic Practices Law* 1316/2005 for implementing the Borrower's anti-cartel policy and strengthening the institutional independence of ECA. (ii) The ECA adopted administrative regulations dated December 2015 to further strengthen anti-cartel enforcement policy.

DPF 3 Indicative Trigger 3.10: The ECA adopts secondary legislation to further strengthen anti-cartel enforcement policy by (i) clarifying the procedures and conditions to receive exemptions from the prohibitions of the competition law; (ii) developing a full-fledged leniency program; and (iii) adopting guidelines for antitrust fines and

80. **Prior Action 2.10** supports approval by the Cabinet of amended Executive Regulations to the competition law ('Protection of Competition and Prohibition of Monopolistic Practices Law') that strengthens anti-cartel enforcement and the institutional independence of the Egyptian Competition Authority (ECA). This executive regulation implements the 2014 amendment of the competition law aimed at fostering more dynamic and open markets in Egypt by preventing anticompetitive behavior, notably cartels, while allowing those practices that overall have efficiency-enhancing effects on the market. Moreover, a stronger position of the ECA, with regard to both enforcement and advocacy, will be key to avoid nontechnical interference in the decisions of the authority as well as to mainstream competition principles in other regulatory instruments and public policies through the ECA's enlarged advocacy powers. Coordinating policy efforts to generate a competitive business environment and promote contestable and open markets in Egypt will be key to creating incentives for entrepreneurship and increase pressures to innovate.

81. As a complement to the implementing regulation approved by the Cabinet**, Prior Action 2.10** also supports the administration by the ECA of new internal administrative procedures to enhance the effectiveness of its cartel investigations by focusing on gathering physical and digital evidence of the anticompetitive conduct. The instrument approved provides key methodological steps to conduct dawn raids according to successful international experience. Increasing the ability of sanctioning and deterring anticompetitive behavior not only will contribute to enhance the Egyptian business climate but can also generate important savings for Egyptian consumers, particularly by eliminating cartels in basic food products and commodities that typically result in overcharges of more than 20 percent.

82. Stemming from these and other efforts, the perceived degree of competition in Egyptian markets is improving as confirmed by the Global Competitiveness Report 2015–2016. In just one year, Egypt has moved up in the ranks on all three Global Competitiveness Report indicators on goods market efficiency, especially with regard to the effectiveness of their anti-monopoly policy as well as on the extent of market dominance. Nonetheless, competition is still perceived to be weak and Egypt ranks low among comparator countries in terms of its degree of competition.

83. **Trigger 3.10** will further leverage the efforts of the Egyptian government to promote competition in key markets of the economy by supporting the ECA's adoption of additional regulations to further strengthen its anti-cartel enforcement policy. These measures will include (a) clarifying the procedure and conditions to receive exemptions from the prohibitions of the competition law; (b) developing a full-fledge leniency program; and (c) adopting guidelines for antitrust fines and settlements.

84. **Expected results.** The implementation of pro-competition reforms to the existing regulatory framework will contribute to the increase in the number of anticompetitive practices prevented/eliminated, from a baseline of 9 (between FY13 to FY15) to a target of 11 decided during the FY16–18 period.

Table 5. Status of DPF 2 Triggers and Proposed Changes

Trigger for DPF 2 at Board approval of DPF 1	Changes to trigger, if any	Prior Action for DPF 2
Pillar 1:Advancing Fiscal Consolidation		
1.1 Enhancing Government Revenues		
Trigger 2.1: 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 was strengthened.** The authorities have completed an initial assessment of the implementation of the VAT, meeting Trigger 2.1. VAT revenues are accruing and have grown by 40 percent as of November 17, 2016 on a month-to-month basis. In addition, more than 5,000 new taxpayers have registered under the VAT. Given the importance of fiscal consolidation, a new prior action on tax dispute legislation was added, which is an important law, aimed at clearing the backlog of dispute cases.	**Prior Action 2.1**: The Borrower enacted Law No. 79 of 2016 *Finalization of Taxation Disputes* and published said law in its Official Gazette.
1.2 Containing the Wage Bill		
Trigger 2.2: 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 was revised and strengthened.** Egypt has made significant progress in reducing the wage bill, which is projected to drop to below 7 percent of GDP in FY17, down from 8.5 percent in FY14. Progress on wage automation has been significant, even in the absence of publishing a plan with measures to enforce payroll automation. In addition, the FY17 budget law continues to include a provision to contain wage bill pointing to policy continuity. DPF 3 trigger supports further progress on wage automation, which will continue to play a pivotal role in this DPF series.	**Prior Action 2.2:** (i) The Borrower enacted Law No. 8 of 2016 *Assessing the Public Budget of the State*, endorsing the national budget for FY17, which contains administrative instructions to all government budgetary entities to contain the wage bill, including provision for delinking bonuses and rewards of their respective employees' salaries from the basic salary component and published said law in its Official Gazette. (ii) The Ministry of Finance of the Borrower issued a wage bill report entitled *Government Wages, Key Reforms* dated November 2016 notifying that at least forty-five percent (45%) of the wage bill is automated.

1.3 Strengthening Debt Management and Aspects of Public Financial Management		
Trigger 2.3: 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 was retained and strengthened.** The Ministry of Finance has established a Public Finance Management Improvement Unit with different mandates, including setting up the internal audit function. The trigger was retained as Prior Action 2.3 and revised to reflect the expanded scope of the unit. The MOF has asked for more time to align the function with international standards, which is now a trigger for DPF 3.	**Prior Action 2.3:** The Ministry of Finance of the Borrower issued Decree No. 247/2016 to establish and operationalize a Public Finance Management Improvement Unit with the following mandates: (a) setting-up an internal audit function; (b) monitoring fiscal risks of Economic Authorities and SOEs, including their contingent liabilities; and (c) enhancing government accounting and financial control.
Pillar 2: Ensuring Sustainable Energy Supply		
2.1 Reforming Energy Subsidies		
Trigger 2.4: (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.	**Trigger was retained and strengthened.** Trigger 2.4 (i) was retained in the matrix as Prior Action 2.4 (i). The wording of Trigger 2.4 (ii) was revised (substance is unchanged) and retained in the matrix as Prior Action 2.4 (ii).	**Prior Action 2.4**: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 436 of 2016 implementing a third annual electricity tariff adjustment that goes beyond the former five-year tariff adjustment plan adopted in the Prime Minister's Decree No. 1257/2014, as recommended by the Borrower's Egyptian Electric Utility and Consumer Protection Regulatory Agency. (ii) The Supreme Energy Council of the Borrower adopted a policy for financing variations in actual energy costs compared to the budget estimates in the Borrower's Medium Term Fiscal Framework (2016-19).
2.2 Improving Energy Governance		
Trigger 2.5: (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	**Trigger was partially retained but revised to reflect changes in Government's reform timeline.** Trigger 2.5 (i) was retained in the matrix as Prior Action 2.5. Trigger 2.5 (ii) on the establishment of the EETC as an independent entity moved to DPF 3 in view of the additional preparation time needed for the same in line with provisions of the new law. Trigger 2.5 (iii) was included as part of the	**Prior Action 2.5:** The Ministry of Electricity and Renewable Energy of the Borrower issued Decree No. 230/2016 notifying the Executive Regulations of Electricity Law of the Borrower that, inter alia, include measures to improve the energy efficiency of large electricity consumers and published said Regulations in the official Gazette of the Borrower.

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.	executive regulations of the law and has therefore been included in Prior Action 2.5.	
Trigger 2.6: (i) The Borrower's Cabinet approved the draft gas law and submitted it to the Borrower's Parliament for consideration. (ii) The Ministry of Petroleum and Mineral Resources establishes a new independent gas sector regulator pursuant to the new gas law.	**Trigger was revised to reflect expanded reform objectives and changes in the Government's reform timeline.** The MOP has embarked on a much larger institutional modernization process of the oil and gas sectors than anticipated during DPF 1 preparation. The Policy and Strategy Unit (added as Prior Action 2.6 (ii)) was set up to steer this process and was therefore prioritized over the setup of the regulator (Trigger 2.6 (ii)). The Government remains committed to the new gas law ('Gas Activities Regulatory Law '), but the passing of the law requires extensive deliberation by the parliament, and hence its effectiveness is expected only by DPF 3.	**Prior Action 2.6:** (i) The Borrower's Cabinet approved the draft Gas Activities Regulatory Law and submitted it to the Borrower's Parliament for consideration. (ii) The Ministry of Petroleum and Mineral Resources of the Borrower issued Decree No. 1631/2016 to establish a new Policy and Strategy Unit detailing the charter, functions and authority to spearhead the modernization of the petroleum sector.
2.3 Enabling Private Energy Investments		
Trigger 2.7: 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.	**Trigger was revised and strengthened** to capture significant additional policy action in this pillar**.** The energy efficiency unit in the Ministry of Electricity and Renewable Energy was retained as Prior Action 2.7 (i). The energy efficiency unit in the petroleum sector was removed as the much broader modernization effort in the sector (see Prior Action 2.6) assigned responsibility for energy efficiency strategy to the Policy and Strategy Unit. Prior Action 2.7 (ii) was added to capture the new feed-in tariff policy, which resulted from intensive dialogue with the Government and represents a major milestone for the CPF and private sector engagement in Egypt's renewable energy sector.	**Prior Action 2.7:** (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 244 of 2016 to set up an energy efficiency unit with dedicated staff to lead the implementation of the Borrower's National Energy Efficiency Action Plan. (ii) The Borrower's Cabinet issued Decree No. 2533 of 2016 announcing the revised Feed-in-Tariff policy for renewable energy.
Pillar 3: Enhancing the Business Environment		
3.1 Improving the Investment Regime and Its Transparency, Particularly for MSMEs		
Trigger 2.8: (i) Extend GAFI's Cairo one-stop shop capabilities beyond registration to licensing and	**Trigger was replaced and strengthened.** The trigger has been amended to include the new	**Prior Action 2.8**: The Borrower's Cabinet approved the draft Single-Person Company Law

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.	Single-Person Company Law that will extend the liability protections and other benefits to sole proprietors. These were previously only available to investors registered as companies. The original Trigger 2.8 (i), which planned to include licensing in GAFI one-stop shops, was removed because the ongoing industrial licensing reform (the law and follow-on regulations) is expected to affect the manner in which licensing services are administered and delivered (possibly no longer through the GAFI). This is yet to be determined in the executive regulations. Trigger 2.8 (ii) was shifted to the next fiscal year since the investment law is currently under review and is expected to be revised, and a revision to the industrial licensing legislation has been submitted to the parliament. Hence, the publication of the sectoral licensing requirements and investment incentives as well as licensing and permit procedures and requirements that may be changed within the year is not advisable.	that includes limited liability protection, and submitted it to the Borrower's Parliament for consideration.
3.2 Reforming Industrial Licensing		
Trigger 2.9: (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 was retained and strengthened.** The Government, under the coordination of the Ministry of Trade and Industry, is planning deep reforms to industrial licensing through the introduction of a new Industrial Licensing Law. Rather than implement a reform in a single regulatory area under the existing legislation, the Government has proceeded with a more ambitious agenda and introduced a new piece of legislation that has received Cabinet approval and has been submitted to the parliament.	**Prior Action 2.9:** (i) The Borrower's Cabinet approved the *draft Law on Streamlining the Procedures of Granting Licenses for Industrial Establishments* that includes measures for simplified licensing by notification for low-risk industrial activities, and submitted it to the Borrower's Parliament for consideration. (ii) The Borrower's Minister of the Ministry of Trade and Industry issued Ministerial Decree number 1071 of 2016 approving the implementation plan of the Borrower's Industrial Licensing Reform Program.
3.3 Strengthening the Competition Framework		
Trigger 2.10: The Cabinet approves the executive regulations on anti-cartel policy implementation and ECA institutional independence and adoption	**Trigger was retained.** The wording of the trigger was changed but the substance remains unchanged.	**Prior Action 2.10:** (i) The Borrower's Cabinet issued Decree No. 2509/2016 notifying the *Executive Regulations of Protection of*

of administrative regulations to further strengthen anti-cartel enforcement policy.		*Competition and Prohibition of Monopolistic Practices Law* 1316/2005 for implementing the Borrower's anti-cartel policy and strengthening the institutional independence of ECA. (ii) The ECA adopted administrative regulations dated December 2015 to further strengthen anti-cartel enforcement policy.

4.3 LINK TO CPF, OTHER BANK OPERATIONS, AND THE WORLD BANK GROUP STRATEGY

85. **This programmatic DPF series is fully aligned with the analysis and pillars set out in the Egypt's SCD 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 operation will directly contribute to addressing these urgent challenges in a coherent and sustainable manner yielding multiple dividends. Progress in these areas will also enable the Government to build confidence, which is essential to maintain and sustain the reform momentum.

86. **The World Bank Group's support under the CPF 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:** (a) improving governance, (b) private sector job creation, and (c) social inclusion. The reforms supported by this programmatic DPF operation will help achieve some of the key goals identified in the 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 operation is focused on institutional policy reforms and selectivity linked to the SCD. The proposed DPF, in alignment with the CPF, focuses on increasing the role of the private sector and integrating transparency and accountability across GOE's economic programs. Complementing the proposed DPF's focus on macro-fiscal consolidation and private sector-led growth, the investment projects identified in the Egypt CPF 2015–2019 are targeted on the social and economic inclusion agenda, picking up issues of SSNs, basic services, social housing, financial inclusion, and agriculture.

87. **The proposed DPF is aligned with the World Bank Group's MENA Regional Strategy.** The proposed DPF supports the *renewal of the social contract* pillar of the MENA Regional Strategy, by pursuing private-sector-led growth, implementing business policies that broaden economic opportunity, and improving citizen engagement through improved transparency and accountability.

88. **The operation is aligned with the World Bank's new MENA Climate Change Action Plan and forms part of a broader World Bank engagement in Egypt to promote sustainable energy supply.** The reform program supported by the DPF is an integral part of Egypt's intended climate mitigation contributions under the United Nations Framework Convention on Climate Change (details below in section 5.2). The operation is closely aligned with the World Bank's new MENA Climate Change Action Plan, which commits to support critical policy reforms to "remove distortive prices and regulations, open up fiscal space, and catalyze private investments." The World Bank engagement through the DPF is complemented by several World Bank Group lending and technical assistance interventions supporting climate change agenda, including the Wind Power Development Project under which the World Bank Group supports transmission investments to connect wind plants to the grid (IBRD); technical assistance and policy advisory to Egypt's renewable energy program (IFC, IBRD); advisory to energy-intensive industry on energy efficiency (IFC); technical assistance to support energy subsidy reforms (IBRD); and investments in natural gas-fired power plants and natural gas household connections (IBRD).

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

89. **The second DPF of the program continues to be jointly prepared with the AfDB, including joint mission and meetings held across all three pillars and coordinated jointly across 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, task team leaders, and team members between the

World Bank and the 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 development partners in Egypt on November 20, 2016, to share the economic reform program of the Government supported by the proposed DPF. A meeting with civil society representatives to discuss the DPF-supported program operation took place on November 20, 2016.

90. **The proposed DPF is anchored in the Egypt's economic strategy outlined in the Egypt 2030 vision and the medium-term economic growth strategy approved by the parliament.** The Egypt 2030 Sustainable Development Strategy was developed through a detailed consultation process with civil society, the private sector, Egyptian youth, and international development partners. Each aspect of the strategy was discussed by the respective ministries and coordinated by the Ministry of Planning across a process lasting months. The new medium-term economic program backed by a medium-term fiscal management program has been extensively discussed with the parliament during the approval process, while being presented to international investors as well.

91. **The DPF prior actions have been based on consultative process across different departments of the Government as well as wider stakeholder groups within the country.** Critical laws such as the VAT have been discussed extensively with both industry associations and groups of industries that are likely to be affected. Similarly, the Electricity Law was discussed by EgyptERA with multiple stakeholders, including civil society institutions, think tanks, and industry groups and was disseminated through websites and newspapers inviting comments and discussions. The proposed gas sector law was discussed with a wide group of stakeholders, including donors and key industry groups, in discussions chaired by the MOP.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

92. **The reform program supported by the three-year DPF programmatic series is expected to have a positive effect on economic growth, employment, and poverty alleviation over the long term.** The structural reforms will likely have short-term negative impacts on households as outlined in the poverty and social impact analysis (PSIA) but in the long term will contribute to inclusive and sustainable growth in Egypt. The PSIA analyses presented here simulates the impact of VAT and energy prices changes on household budgets using the 2012-13 household budget survey. It does not incorporate the impacts from behavioral changes by economic agents, including possible non-competitive actions in some product markets or macroeconomic policy measures to contain inflationary pressures.

93. **The PSIA focuses on identifying potential negative impacts of prior actions that are expected to affect households; the analysis also examines mitigation measures.** Among the prior actions supported by the DPF, the following are expected to affect households directly—the move from GST to VAT and the third annual increase in electricity tariffs and fuel price adjustment in line with the goal to reduce energy subsidies. These reforms are taking place against a backdrop of high inflation (15.5 percent in August 2016) driven at least partially by the March 2016 currency devaluation. Between June and November 2016, the Government sought to protect the population from the impact of price increases by raising the value of subsidy offered through food smart cards from EGP 15 to EGP 21 per person. The inflationary impact of devaluation announced in early November 2016 has been factored in the baseline.

94. **The overall direct impacts of the reform package due to electricity tariff increase, VAT and fuel price adjustment amount to little over 2 percent of the household budget.** These effects are calculated from the electricity tariff changes that became effective in July 2016 (33 percent increase on average), the replacement of the GST by the VAT (due to a higher rate and the list of exempt goods), and the fuel price

adjustments such as natural gas, gasoline, LPG, and kerosene. The first electricity tariff increase took place in July 2014. The second scheduled electricity tariff adjustment took place in July 2015, 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. In July 2016, tariffs were raised for all consumption blocks for an average tariff increase of 33 percent from FY16, as the focus shifted to social protection through social programs of the government rather than through electricity tariff structures or fuel prices. The VAT replaced the Generalized Sales Tax (GST) in early FY17. The analysis focuses on the features of the VAT that are most relevant for PSIA – higher tax rate and large list of exemptions. The VAT introduces one standard rate of 13 percent for all goods and services (up from 10 percent under the GST). As businesses pass on the higher tax rate to consumers, households will experience an increase in prices. With the goal to protect the less well off, the VAT exempts some 57 basic goods and services (baby milk and food, bread, tea, coffee, dairy, education, health, electricity) many of which were not exempt under the GST. The VAT is therefore expected to have very little impact on prices of items like food and beverages that account for 47 percent of total spending by quintile 1 (poorest 20 percent) and 31 percent of total spending by quintile 5 (richest).

95. **Using data from the 2012/13 household survey, the direct impacts of the fuel price and electricity tariff increases are estimated to be slightly regressive across the distribution**. The FY17 fuel price and electricity tariff reforms are estimated to lead to an average direct welfare loss of 1.44 percent of household budget (table 6). The welfare losses arising from energy price changes as a share of household budget are regressive – the largest impacts are experienced by the poorest households. For electricity, Q1 households lose 0.81 percent of their budget, while Q5 losses are estimated at 0.70 percent. For electricity tariffs, the cumulative impact of FY15-17 tariff increases is also regressive with the highest impact on quintile 1 households who experience a loss of 1.54 percent of total household spending (Figure 3). This cumulative impact of FY15-17 electricity tariff increases on the bottom quintiles may have been protected somewhat by the freezing of tariff increases for those consuming less than 200 kWh per month in FY15. For fuel, the corresponding effects are 0.75 percent and 0.66 percent, respectively. The uniformity of the welfare losses across the distribution can be explained by two key features: (a) households across the consumption distribution show little variation in the share of expenditures on energy and electricity (Q1's share is 3.42 percent, while Q5's share is 3.14 percent), and (b) the variation of effects is 'averaged out' across quintiles because consumption patterns vary across products: while gasoline and natural gas are used by richer households, LPG, kerosene and electricity represent larger expenditure shares among the poorest households. Moreover, these mixed consumption patterns translate to an attenuation of the heterogeneous effects found across regions in the country. Half of the Q1 households are found in Upper Rural Egypt, and over 50 percent of Q5 households are in the Metropolitan and Lower Urban regions. Thus, the (low) variation in effects across regions arises from the consumption patterns of households who live there.

96. **The introduction of the VAT is simulated to result in an average welfare loss of 0.69 percent of household spending, but unlike for energy prices, the impact is larger on better-off households.** This pattern arises from the exemption of essentials items from VAT.

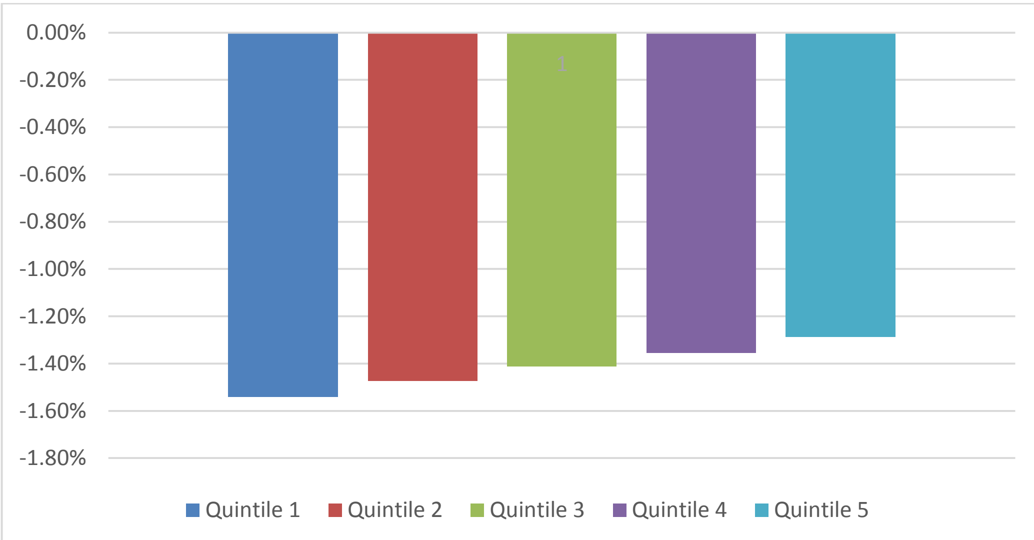
Table 6: Welfare Loss from VAT and FY17 Energy Price Reforms

	FUEL % of Household Budget	ELEC - Welfare Loss as % of Household Budget	VAT - Welfare Loss as % of Household Budget	Total Direct Impact (%)	INDIRECT Impact of FUEL & ELECT	TOTAL Impact of FUEL, ELEC, VAT (%)	TOTAL Impact of FUEL, ELEC, VAT (EGP/yr)
Quintile 1	-0.75%	-0.81%	-0.63%	-2.19%	-1.19%	-3.38%	-148
Quintile 2	-0.68%	-0.78%	-0.64%	-2.11%	-1.20%	-3.30%	-203
Quintile 3	-0.67%	-0.76%	-0.68%	-2.11%	-1.19%	-3.30%	-251

Quintile 4	-0.66%	-0.73%	-0.72%	-2.11%	-1.20%	-3.31%	-322
Quintile 5	-0.66%	-0.70%	-0.77%	-2.13%	-1.15%	-3.28%	-601
Average	-0.68%	-0.76%	-0.69%	-2.13%	-1.19%	-3.32%	-306

Source: World Bank staff simulations using HIECS 2012-13.

Figure 3: Cumulative Welfare Loss (as % of Household Budget) from FY15-FY17 Electricity tariff Increases.



Source: World Bank staff simulations using HIECS 2012-13.

97. **The PSIA also examined how impacts vary across social groups (location and gender) to identify if certain groups are disproportionately affected by reforms.** The PSIA finds that direct welfare impacts vary by households' location (table 7). Households in the metropolitan region experience the highest direct welfare loss as a share of household spending for both fuel price increases (welfare loss of 0.75 percent of household spending) and introduction of VAT (loss of 0.74 percent of household spending). Upper urban households also experience high welfare loss in particular for FY17 electricity tariff increase (loss of 0.85 percent of household spending). Total impact is highest for upper urban households (total loss of 2.28 percent of household spending).

98. **While direct welfare loss from electricity tariff reforms fall more heavily on female-headed households and VAT reforms fall more heavily on male-headed households, these two effects average out so that the overall impact of the reform program is about the same for both types of households.** Because expenditure data are collected at the household level, it is often easier to study gender differences by comparing male- and female-headed households. An estimated 12.5 percent of the Egyptian population lives in a household headed by a woman. While in 2012–2013, poverty among female-headed households was lower (22 percent) than among male-headed households (26.9 percent), there were significant differences in demographic composition across the two types of households. Compared to male-headed households, female-headed households were smaller with fewer younger children, more elderly, and a larger share of women. Table 7 shows that the simulated welfare loss of VAT introduction is higher for male-headed than female-headed households, which is consistent with their consumption patterns. Gender-differentiated impacts of tariff reforms for electricity and price reforms for fuels occur even though access to both in Egypt is essentially universal, because differences in labor market participation and earnings between male and female heads of households can lead to differentiated impacts on energy affordability. Energy budget shares do not differ significantly; however, the ownership of appliances tends to be lower among female-headed than male-headed households. Still for female-headed households, the direct welfare loss of FY17 electricity tariff increase is estimated to be 0.07

percentage points higher than for male-headed households. The intensity of use can influence how smoothly households can adapt to energy price increases, but this information is not available in the survey. Fuel price increases are estimated to have a similar welfare loss for both types of households. The assistance on communication includes advice on gender-sensitive communication, for example, considering men's and women's distinct social circles and interests and presenting information in a way that is more likely to reach women.

Table 7: Direct Welfare Loss (as Share of Household Spending) by Location and Gender

	Fuel	Electricity	VAT	Total
Location				
Metropolitan	-0.75%	-0.72%	-0.74%	-2.21%
Lower Urban	-0.66%	-0.81%	-0.67%	-2.14%
Lower Rural	-0.61%	-0.71%	-0.68%	-2.00%
Upper Urban	-0.73%	-0.85%	-0.70%	-2.28%
Upper Rural	-0.73%	-0.77%	-0.66%	-2.16%
Gender				
Male headed	-0.69%	-0.75%	-0.69%	-2.13%
Female headed	-0.67%	-0.82%	-0.64%	-2.13%

Source: World Bank staff simulations using HIECS 2012-13.

99. **Indirect impacts of energy and electricity price changes were estimated to represent an average loss of 1.19 percent. Aggregate effects of the analyzed reforms are on average 3.32 percent (table 6).** In line with the previous literature, the indirect effects almost double the negative impact of price increases on households' welfare. There is no clear pattern of indirect effects across quintiles of consumption, with the poorest households experiencing a 1.19 percent loss and the richest losing about 1.15 percent (table 6). Taking both direct and indirect effects of energy and electricity price changes, households are expected to lose about 2.63 percent of their purchasing power. Adding direct and indirect effects of fuel price increases and electricity tariff increases to the direct effect of VAT introduction, the overall welfare loss for households is of the order of 3.32 percent of their budget. Overall, these welfare losses imply an increase in poverty of 3.24 percentage points (with Upper Rural Egypt experiencing an increase of 4.4 percentage points).

100. **The financial cost of compensating the bottom 40 percent for this overall short term welfare impact of the analyzed reforms is estimated at EGP 6.69 billion (taking into account indirect effects of energy price adjustments).** The PSIA suggests that households in Q1 (Q2) would lose in the short term about EGP 148 (203) per capita per year, which amounts to an estimated required compensation of EGP 2.8 billion for the bottom 20 and EGP 3.8 billion for the Q2 households. In addition, taking into account the loss in purchasing power coming from the inflationary pressures of the November 2016 devaluation, the bottom 40 percent is expected to need around EGP 18.57 billion in compensatory transfers. The Government has set aside EGP 21 billion for social protection measures in the budget, with additional EGP 10 billion as contingency for social protection measures (total amounting to 1 percent of GDP) to ease the short-term impact of macroeconomic reforms. The PSIA suggests that the monetary value of total direct welfare (expenditure) loss experienced by Q1 and Q2 households (the bottom 40 percent) due to energy price increases and introduction of VAT is about EGP 6.69 billion per year. Egypt's SSN system consists of food subsidies; public works programs; Takaful and Karama cash transfer programs; and school feeding programs. None of these programs is considered to be fully ready to be scaled up and quickly provide targeted compensatory measures. The mitigation package will therefore have to combine different interventions, which is in line with what the GoE has recently announced. Identifying the efficient way to compensate the bottom 20 or bottom 40 will be crucial. The GoE has announced the intention to expand targeted programs such as the Takaful to 1.7 million households (increase of 70 percent). The GoE has also

announced top-ups for food smart cards. Food smart card top-up appears to be the most promising mitigation option to reach the bottom 40 in the short term, easier to scale up given its high coverage nationwide (88.6 percent of the population). However, the program includes poor and non-poor households. It will be important for the GoE to improve the targeting of the food smart card program by accelerating the development and finalization of measures to reduce inclusion errors. The recent increase in food subsidy to EGP 21 per month per registered ration card beneficiary will help compensate ration card holders for the direct welfare losses from the above-mentioned reforms.

101. **A broader strategy to enhance World Bank support for lagging regions and for social protection is in place** with technical assistance program on energy reforms and social protection, and lending operations supporting the targeted cash transfer programs Takaful and Karama, along with focused support in Upper Egypt (where poverty is concentrated) through the Upper Egypt Local Development Program-for-Results, the Household Natural Gas Connections project, and public works through the Social Fund for Development.

5.2 ENVIRONMENTAL ASPECTS

102. **Pursuant to OP 8.60, the World Bank assessed whether specific policies in Egypt supported by the DPF are likely to cause significant effects on the country's environment, forests, and other natural resources, concluding that the policies supported by the proposed DPF are not likely to have negative impacts on Egypt's environment or its natural resource base.** Since 1994, the Government has made significant strides in developing a framework for environmental management and mainstreaming environmental sustainability in its projects. This was reflected through the promulgation of its first comprehensive Environmental Protection Law No. 4 for 1994 and its executive regulations issued in 1995. 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. The short-term objective of the environmental policy aims at reducing the pollution levels, minimizing health hazards, and improving the quality of life for its population.

103. **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, addresses the institutional arrangements and mandates for environmental management and protection in the country.** In addition, the law addresses the rules and principles governing, among others, several issues, such as land pollution control, materials and toxic waste, air pollution control, water pollution control, and penalties, and the associated enforcement-related provisions. An environmental assessment for projects is also included in Law No. 4 of 1994 and its amendment. Both the Ministry of State for Environmental Affairs and its executive agency, the Egyptian Environmental Affairs Agency (EEAA), are the environmental regulators in Egypt. Law No. 4 of 1994 stipulates that development projects that are likely to cause impacts on the environment would require, for licensing, to undergo the Environmental Impact Assessment (EIA) process. In 2005, the EEAA has issued guidelines for preparing EIAs, which have been modified in 2009.

104. **Upon assessment by the World Bank, the Egyptian EIA system has been found to be generally comparable with the World Bank Group Environmental Assessment Policy (OP/BP 4.01).** However, a few gaps existed essentially pertaining to the preparation and follow-up of the Environment Management Plans, consultations, disclosure, and dissemination of the EIA reports. Further assessment of the EIA

process in Egypt by the World Bank[11] revealed that many of the identified gaps have been filled. Significant progress has been made in strengthening the institutional framework as well as in enhancing both monitoring and enforcement functions. In addition, the EEAA has been strengthening the EIA information dissemination, which was carried out through the design of an EIA database. The requirements for consultation and dissemination of EIA reports have been officially added to the EIA requirements in the new guidelines issued by the EEAA in 2010.

105. **The EEAA has also carried out a reorganization and restructuring to enhance the EIA process.** As a consequence, two additional central departments were established, namely the Central Department for Environmental Inspection and Environmental Compliance, consisting of a General Directorate for Compliance and a General Directorate for Inspection, and the Central Department for the Protection and Improvement of Industry, Environment, and Energy. Both departments are fully functional. More recently, the environment management sector at the EEAA has established a Directorate for the Technical Office consisting of one coordinator. Its function is to follow up on the EIA mitigating measures during the construction phase of projects with the assistance from other technical departments. Follow-up of the mitigating measures during the operation phase is supposed to be carried out by the Central Department for Environmental Inspection and Environmental Compliance.

106. **The proposed DPF operation is expected to result in overall positive effects on Egypt's environment and natural resources, as Pillar 2 comprises a number of policy interventions that are expected to make Egypt's energy supply more environmentally sustainable.** One of the planned interventions entails a planned increase in fuel switching to natural gas as well as an increase in overall efficiency in electricity use. It is also envisaged under this pillar that the planned third annual increase in electricity tariffs will lead to lower consumption levels through rationalization and increased efficiency in electricity use. Such proposed interventions will lead to the accrual of environmental benefits emanating from the reduction in emissions of air pollutants and the associated decrease in health risks and the decrease in GHG emissions, which supports Egypt's commitment to carry out climate actions as outlined in its Intended Nationally Determined Contribution (INDC).

107. **The anticipated growth in SMEs and industrial investments, supported by the measures under Pillar 3, entails environmental risks, but the environmental regulatory framework and institutional capacity in Egypt are believed to be sufficient to ensure that the necessary mitigation measures are in place.** The implementation of the Industrial Licensing Reform Implementation Plan, following the adoption of the new Industrial Licensing Law (that is, Pillar 3) entails environmental risks by virtue of the expected surge in industrial licensing and increase in industrial production, coupled with the change in the licensing procedure. However, the proposed new law entails the introduction of a new system for licensing by means of notification only for industries that do not result in high safety, health or environment risks. Furthermore, the proposed new law emphasizes the role of the Ministry of Environment in identifying those facilities that, while classified as low-risk, would still need to carry out the environmental due diligence according to Law 34 for 1994 (amended by law #9 for 2009). Since the 1990s, the World Bank in collaboration with several development partners including the EU, AfD and JICA, have been working in partnership with the GoE to support industrial enterprises in complying with the environmental standards. In general, the environmental regulatory framework and institutional capacity in Egypt are believed to be sufficient to ensure that the necessary mitigation measures are in place to avoid, reduce and/or mitigate

[11] Arab Republic of Egypt: Safeguards Diagnostic Review for Piloting the Use of Egyptian Systems to Address Environmental Issues in the Proposed GEF-Financed Egypt Sustainable Persistent Organic Pollutants Management Project, the World Bank, 2014.

any negative environmental impacts arising from the establishment of new SMEs, the expansion in the capacity of the existing ones, as well as an overall increase in industrial production.

108. **The policy actions under the energy pillar directly contribute to all four of Egypt's GHG mitigation strategies, as highlighted in its INDC submission to the United Nations Framework Convention on Climate Change.** In its INDC, Egypt has laid out its intention to promote 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 of energy subsidies within a period of 3–5 years. The proposed operation directly contributes to all four of these mitigation strategies: Prior Actions 2.4 and 2.7 promote end user efficiency, 2.7 contributes to renewable energy development, 2.5 and 2.6 promote the efficient utilization of natural gas, and 2.4 contributes to the phase-out of fossil fuel subsidies. The World Bank estimates that, through the measures supported in the proposed DPF, GHG emissions would be reduced between 11 percent and 21 percent 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 PFM, DISBURSEMENT, AND AUDITING ASPECTS

109. **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 a PFM Improvement Unit was created by Minister of Finance Decree No. 247 in June 2016. The unit reports to the Vice Minister of Finance for Fiscal Policies and Institutional Reform. It consists of three working groups in charge of the following three aspects: (a) government accounting and financial control; (b) internal audit and inspection; and (c) risk management of economic authorities and units.

110. **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 deals with specific aspects of financial management; in addition, there are specific laws for entities such as economic authorities and special funds.

111. **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 since 2012 to include the general framework for fiscal policy, budget aggregates, and the related priorities. The interface between the MOF and the Ministry of Planning, Monitoring, and Administrative Reform in the planning and management of capital investment could be improved. The introduction of program budgeting for nine sectors pursues sound objectives, but its full implementation will take some time. The rollout process will also need recalibration and attention to capacity development.

112. **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, yet enhancing the coverage and system functionalities, such as 'e-contract management', could bring about significant additional benefits.

113. **The ex ante control system is implemented by the MOF's financial controllers and includes transaction-based compliance controls**. These cover payments, recording of transactions, and production of accounts at a unit level. However, there are variations in performance, timeliness, and deficient controls on budget commitments. The MOF issued a financial control manual in 2014 to help standardize controls and make their application more predictable. The MOF has also launched the development of a risk-based ex post internal audit function through the Public Financial Management Improvement Unit as indicated earlier.

114. **The Government Financial Management Information System 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 Government Financial Management Information System will need enhancements in project management, a new implementation plan, and retraining.

115. **The MOF exercises monitoring of cash transactions and balances of the accounting units included in the state budget and maintained in the CBE**. The introduction of the treasury single account 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.

116. **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 as well as year-end budget reports are made public. Conversely, the audited annual accounts are not made public.

117. **As the Supreme Audit Institution in the country, 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 the ASA's independence and transparency. According to the constitution provisions, the annual reports of the regulatory and oversight bodies (including the ASA) shall be submitted to the parliament, president of the country, and prime minister. The reports shall also be made publicly available. However, in absence of a legal amendment to the ASA's law requiring public availability, the provision for publication of audit reports has not yet been made effective.

118. **The 2013 IMF Safeguards Assessment of the CBE was not made available.** The CBE started publishing its audited financial statements in 2012. The financial statements as of June 30, 2016, were audited jointly by the ASA and a known local audit firm, which issued an unqualified 'clean' opinion. World Bank disbursements for several investment loans are channeled in a satisfactory manner through designated accounts maintained in the CBE.

119. **The PFM system operates well enough for DPF lending purposes; however, as described earlier, 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, an area of support of this DPF operation. The latest citizen budget issuance of FY16–17 was disseminated in a conference on September 29, 2016, and was supported by the World Bank. In line with the CPF, the World Bank will continue the policy dialogue and provision of technical assistance to support implementation of PFM reforms.

120. **Disbursement procedures for single-tranche DPFs will apply to this operation.** Once the loan becomes effective and provided that the World Bank is satisfied with the program being carried out by the Borrower, and with the appropriateness of the Borrower's macroeconomic policy framework, the World Bank will disburse the loan proceeds into a deposit account in U.S. dollars (foreign currency deposit account) 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 immediately credited in local currency to an account of the MOF'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. Based on the review of the CBE's audited financial statements and the experience with bank accounts held in the CBE for World Bank-financed projects, no weaknesses in the controls over banking arrangements were identified. As part of the loan fiduciary safeguards, the World Bank will require an audit of the foreign currency deposit account.

5.4 MONITORING, EVALUATION, AND ACCOUNTABILITY

121. **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: the MOF, Ministry of Electricity and Renewable Energy, the MOP, Ministry of Planning, and Ministry of Trade and Industry. The interministerial working group created for the DPF will remain functional during the course of the programmatic DPF framework where the Ministry of International Cooperation will be the coordinator with other ministries on monitoring of the results indicators, which are based on routinely published sector indicators.

122. **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. The Ministry of International Cooperation will have the responsibility of presenting the information related to the reform implementation and progress made toward results on time and in a format satisfactory to the World Bank.

123. **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. Affected communities and individuals may submit their complaint to the Bank's independent Inspection Panel, which determines whether harm occurred or could occur because 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

124. **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 public debt; (b) the potential spillover effects of regional, geopolitical, and governance challenges; (c) challenges on sector strategies; and (d) institutional and implementation capacity. These risks, if materialized, could singularly or jointly affect the Government's ability to implement the reforms or make the outcome of the development agenda less successful.

125. **High degree of governance challenges persist.** The violence, security, conflict, and political instability in the MENA region have had an adverse impact on Egypt. In addition, the SCD and CPF highlight the need for improving governance as a key pillar for Egypt's inclusive and sustainable growth. While a significant number of new laws have been enacted across sectors to eliminate monopolies and reduce bureaucratic costs involved in running a business, the implementation of these new laws could face resistance. 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. The parliament has also approved significant laws, such as the VAT, civil services reforms, and tax dispute resolution laws after significant deliberations involving multiple stakeholders including public, think tanks and industrial associations. At the same time, measures in other domains raise concerns about the space for civil society to discuss, debate and advocate on a number of issues. The World Bank will continue to monitor political and governance risks. These risks will be mitigated through a number of measures including deepening our technical assistance program supporting all pillars of the DPF, working with the technical inter-ministerial working group, putting in place measures for citizen engagement in decision making, and establishing a robust grievance redress mechanism to address any significant concerns. In addition, the newly elected parliament has opened new channels and opportunities for citizen engagement and oversight of government policies. The recently enacted civil service reforms law could potentially provide a platform for sustaining wider governance reforms. At a sector level, improvements in corporate governance practices have been institutionalized in electricity and petroleum SOEs, and a modernization program to enhance accountability, transparency, and governance of these enterprises has been launched with World Bank's technical assistance support.

126. **Political risks need to be addressed**. Political economy challenges are substantial as vested interests will likely feel threatened from proposed changes in governance and underlining incentive structures. In addition, several of the envisaged reforms, such as controlling the wage bill, reforming energy subsidies, and advancing tax reforms involve winners and losers, with the losers sometimes being politically powerful. It would be a significant setback if the Government reversed fiscal consolidation due to populist demands. However, the Government has already shown high commitment by initiating energy subsidy reforms that saved more than 4 percent of GDP over three years while ushering in additional bold fiscal consolidation measures equivalent to about 2 percent 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 various groups, reflecting the high risk of this operation, may oppose these reforms, even though they benefit the broader public. Sustained national understanding and acceptance of the necessary modernization and reform initiatives will depend on the ability of authorities to effectively communicate the measures being implemented and demonstrate tangible benefits to the population in the short term. This would help create a virtuous cycle of change and support for the reform effort. Crucial to this process will be a sustained, active engagement with civil society and an open and inclusive dialogue with all stakeholders.

127. **Macroeconomic risks are High.** Notwithstanding recent economic reforms, Egypt faces large near-term challenges, such as shortages in foreign currency and limited policy buffers, which in combination with continued structural constraints, including high inflation, shortage of formal sector jobs, high unemployment, in particular among the Egyptian youth, and exclusion of poor segments of the population, could affect the implementation, impact, and sustainability of the reforms supported by this DPF series. 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. These buffers are also much needed to mitigate any delay in implementing reforms.

128. **The sector strategies risk is rated High, while stakeholders, technical design of the program, and institutional capacity risks are rated Substantial.** 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 and liberalization of electricity and gas sectors and promotion of renewable energy, where the capacity of the respective sector ministries and their institutions in implementing reforms and navigating change will be tested. A more than double tariff increase in electricity tariffs as compared to original targets has not witnessed widespread protests owing to absence of shortages and improved quality of service. An ambitious modernization program is being implemented in both electricity and petroleum sectors that seeks to reduce energy subsidies, enhance efficiency in operations, increase gas and electricity supply, promote private sector-led FDIs in the sector, undertake extensive communication campaigns with the public, and create models of governance and efficiency with SOEs that could be replicated across other sectors. To address these needs, an extensive technical assistance program is under way and is proposed to be expanded with the United Kingdom's multi-year programmatic technical assistance support on improving policy, capacity building, and implementation support to programs. This will assist the Government in monitoring the progress of the reforms and strengthen sectoral institutional and regulatory capacity.

129. **Fiduciary risk and environmental risk is rated Substantial while social risks are High.** The World Bank has now engaged with the Government on far-reaching PFM reforms where there are significant issues that need to be addressed (refer to section 5.3 for details). The social protection mechanisms to cover the marginalized and poor groups of the population have advanced through better targeting and efficient programs, such as the expansion of the 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-supported program, especially on energy subsidies, fiscal revenue expansion, and wage control. To mitigate these risks, the Government proposes a comprehensive communication strategy on its reform program and intends to institutionalize a grievance redress mechanism and a citizen outreach program to build greater acceptability of reforms within society. The World Bank has already enhanced its portfolio to Upper Egypt, which has the highest concentration of the poor through programs on targeted cash transfers, local area development, natural gas connections, public works, and technical assistance to support the unified registry.

130. **The risk of not engaging outweighs the program risks.** The region is experiencing an unprecedented turmoil with the 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 toward sustainable private sector-led growth that is focused on job creation, and the World Bank Group has a unique opportunity to reinforce its relationship and facilitate the continued implementation of Egypt's reform program over the medium term.

Table 8. Summary Risk Ratings

Risk	Rating (H, S, M, or L)
1. Political and governance	H
2. Macroeconomic	H
3. Sector strategies and policies	H
4. Technical design of project or program	S
5. Institutional capacity for implementation and sustainability	S

Risk	Rating (H, S, M, or L)
6. Fiduciary	S
7. Environment and social	H
8. Stakeholders	S
Overall	H

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

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions and Triggers			Results
Prior Actions under DPF 1	**Prior Actions for DPF 2**	**Triggers for DPF 3**	
Pillar 1: Advancing Fiscal Consolidation			
1.1 Enhancing Government Revenues			
Prior Action 1.1: 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%).	**Prior Action 2.1: The Borrower enacted Law No. 79 of *2016 Finalization of Taxation Disputes* and published said law in its Official Gazette.**	**Trigger 3.1:** The Ministry of Finance of the Borrower issues a decree that introduces a harmonized and simplified tax regime for micro and small businesses based on turnover.	Increased non-sovereign corporate income tax and sales/VAT on goods and services as a percentage of GDP from 5.4% in FY15 to about 6.7% in FY18.
1.2 Containing the Wage Bill			
Prior Action 1.2: 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.	**Prior Action 2.2***:* **(i) The Borrower enacted Law No. 8 of 2016 *Assessing the Public Budget of the State*, endorsing the national budget for FY17, which contains administrative instructions to all government budgetary entities to contain the wage bill, including provision for delinking bonuses and rewards of their respective employees' salaries from the basic salary component and published said law in its Official Gazette.** **(ii) The Ministry of Finance of the Borrower issued a wage bill report entitled *Government Wages, Key Reforms* dated November 2016 notifying that at least forty-five percent (45%) of the wage bill is automated.**	**Trigger 3.2:** (i) The Borrower's Cabinet approves a medium-term plan/rule that sets a cap on the number of new recruits in the public sector relative to the number of retirees. (ii) The Ministry of Finance of the Borrower issues a wage bill report notifying that at least 75 percent of the wage bill is automated and develops an action plan for the completion of the automation process.	Reduction of the ratio of the Central Government's wage and salary bill to nominal GDP, from 8.2% in FY15 to 7.4% of GDP by FY18.
1.3 Strengthening Debt Management and Aspects of Public Financial Management			
Prior Action 1.3: The Ministerial Decree No. 515 of 2015 has been issued which mandates the publication of the Medium-Term Debt Management Strategy.	**Prior Action 2.3: The Ministry of Finance of the Borrower issued Decree No. 247/2016 to establish and operationalize a Public Finance Management Improvement Unit with the following mandates: (a) setting-up an**	**Trigger 3.3:** The Ministry of Finance: (i) establishes the internal audit dedicated unit with adequate staffing, budget and procedures aligned with international standards; and (ii) establishes the Economic	Publication of an annual updated Medium-Term Debt Management Strategy. At least four audits performed

	internal audit function; (b) monitoring fiscal risks of Economic Authorities and SOEs, including their contingent liabilities; and (c) enhancing government accounting and financial control.	Authorities and SOEs fiscal risk monitoring dedicated unit with adequate manuals and standard reports, which identifies, monitors, and facilitates the management of contingent liabilities and sovereign guaranteed liabilities.	on sectors and entities affiliated with the Ministry of Finance by FY18.
Pillar 2: Ensuring Sustainable Energy Supply			
2.1 Reforming Energy Subsidies			
Prior Action 1.4: 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.	**Prior Action 2.4: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 436 of 2016 implementing a third annual electricity tariff adjustment that goes beyond the former five-year tariff adjustment plan adopted in the Prime Minister's Decree No. 1257/2014, as recommended by the Borrower's Egyptian Electric Utility and Consumer Protection Regulatory Agency. (ii) The Supreme Energy Council of the Borrower adopted a policy for financing variations in actual energy costs compared to the budget estimates in the Borrower's Medium Term Fiscal Framework (2016-19).**	**Trigger 3.4:** (i) The Borrower's Cabinet implements the annual energy price adjustment for FY17–18 consistent with passing through unanticipated changes in the cost of energy to achieve subsidy ceilings set in the Medium-Term Fiscal Framework 2016–2019, pursuant to the Supreme Energy Council Policy Decision of 2016. (ii) The Supreme Energy Council adopts a policy for automatic periodic indexation of energy prices.	Reduction of energy subsidies as a percentage of GDP from 6.6% in FY14 to 1.5% in FY18. Increase in the cost recovery level of electricity tariffs from 50% in FY14 to 70% in FY18.
2.2 Improving Energy Governance			
Prior Action 1.5: 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.	**Prior Action 2.5: The Ministry of Electricity and Renewable Energy of the Borrower issued Decree No. 230/2016 notifying the Executive Regulations of Electricity Law of the Borrower that, inter alia, include measures to improve the energy efficiency of large electricity consumers and published said Regulations in the official Gazette of the Borrower.**	**Trigger 3.5:** (i) The Ministry of Electricity and Renewable Energy of the Borrower reestablishes the Egyptian Electricity Transmission Company as a functionally independent utility in compliance with the Electricity Law and the above executive regulations. (ii) The Egyptian Electric Utility and Consumer Protection Regulatory Agency issues regulations on methodology for public hearings and consultations on important regulatory decisions.	Notification and operationalization of supply code, transmission tariff, and market rules by FY18. Reduced difference between peak electricity demand and available peak capacity from deficit of 5,540 MW in FY15 to a surplus of 1,000 MW by FY18. Public disclosure of tariff methodology for computation of electricity tariffs.
Prior Action 1.6: 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.	**Prior Action 2.6: (i) The Borrower's Cabinet approved the draft Gas Activities Regulatory Law and submitted it to the Borrower's Parliament for consideration.**	**Trigger 3.6:** (i) The Ministry of Petroleum and Mineral Resources of the Borrower issues the executive regulations implementing the new *Gas Activities*	Increased domestic gas production from 4,020 MMSCFD in FY16 to 4,700 MMSCFD by FY18.

	(ii) The Ministry of Petroleum and Mineral Resources of the Borrower issued Decree No. 1631/2016 to establish a new Policy and Strategy Unit detailing the charter, functions and authority to spearhead the modernization of the petroleum sector.	*Regulatory Law* pursuant to its approval by the parliament. (ii) The Ministry of Petroleum and Mineral Resources of the Borrower establishes a new independent gas sector regulator pursuant to the new *Gas Activities Regulatory Law*. (iii) The Ministry of Petroleum and Mineral Resources of the Borrower nominates the independent transmission system operator in compliance with the requirements set by the gas sector regulator.	A separate gas transmission tariff, transmission code, market rules, and approval procedures are published by FY18. A dedicated web portal with all rules and regulations operational by FY18.
2.3 Enabling Private Energy Investments			
Prior Action 1.7 (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.	**Prior Action 2.7: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 244 of 2016 to set up an energy efficiency unit with dedicated staff to lead the implementation of the Borrower's National Energy Efficiency Action Plan. (ii) The Borrower's Cabinet issued Decree No. 2533 of 2016 announcing the revised Feed-in-Tariff policy for renewable energy.**	**Trigger 3.7:** The Ministry of Electricity and Renewable Energy of the Borrower announces new policy measures for promoting private investments in clean energy.	Financial closure of private sector-owned renewable energy projects from 0 MW (October 2015) to 1,500 MW (end of FY18).
Pillar 3: Enhancing the Business Environment			
3.1 Improving the Investment Regime and Its Transparency, Particularly for MSMEs			
Prior Action 1.8: 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.	**Prior Action 2.8: The Borrower's Cabinet approved the draft Single-Person Company Law that includes limited liability protection, and submitted it to the Borrower's Parliament for consideration.**	**Trigger 3.8:** (i) Executive regulations of the Single-Person Company Law issued. (ii) The General Authority for Investment and Free Zones of the Borrower registers single-person companies. (iii) The General Authority for Investment and Free Zones of the Borrower publishes all licensing and permits procedures and requirements for all activities and sectors. (iv) The General Authority for Investment and Free Zones of the Borrower publishes a complete inventory of available investment incentives and eligibility criteria.	Increase in business entry, including small businesses, as measured by the number of single-person companies registered from 0 in FY15 to 500 in FY18. Increase in the number of GAFI one-stop shops registering single-person companies from 0 in FY15 to 4 by the end of FY18.
3.2 Reforming Industrial Licensing			
Prior Action 1.9: The Prime Ministerial Decree No. 2807 of 2015 has been issued launching	**Prior Action 2.9: (i) The Borrower's Cabinet approved the draft Law on Streamlining the**	**Trigger 3.9:** (i) Issuance of the executive regulations of the L*aw on Streamlining the*	Average number of days to issue license by notification for

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.	**Procedures of Granting Licenses for Industrial Establishments that includes measures for simplified licensing by notification for low-risk industrial activities, and submitted it to the Borrower's Parliament for consideration.** **(ii) The Borrower's Minister of the Ministry of Trade and Industry issued Ministerial Decree number 1071 of 2016 approving the implementation plan of the Borrower's Industrial Licensing Reform Program.**	*Procedures of Granting Licenses for Industrial Establishments*, including regulations for implementation of simplified licensing by notification for low-risk industrial activities. (ii) The Licensing Prerequisites Committee, provided for under the *Law on Streamlining the Procedures of Granting Licenses for Industrial Establishments*, makes available online all requirements related to establishment, operation, and termination of industrial activities.	low-risk industrial activities not to exceed 7 days by the end of FY18. Average number of days to comply with all industrial licensing requirements is reduced from 634 days in FY15 to 160 days by the end of FY18.
	3.3 Strengthening the Competition Framework		
Prior Action 1.10: **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 anticartel policy to prosecute the most harmful competition offences.**	**Prior Action 2.10: (i) The Borrower's Cabinet issued Decree No. 2509/2016 notifying the Executive Regulations of Protection of Competition and Prohibition of Monopolistic Practices Law 1316/2005 for implementing the Borrower's anti-cartel policy and strengthening the institutional independence of ECA.** **(ii) The ECA adopted administrative regulations dated December 2015 to further strengthen anti-cartel enforcement policy.**	**Trigger 3.10:** The ECA adopts secondary legislation to further strengthen anti-cartel enforcement policy by (i) clarifying the procedures and conditions to receive exemptions from the prohibitions of the competition law; (ii) developing a full-fledged leniency program; and (iii) adopting guidelines for antitrust fines and settlements.	Increase in the number of anti-competitive practices prevented/eliminated from a baseline of 9 (between FY13 and FY15) to a target of 11 decided during the FY16–18 period.

ANNEX 2: LETTER OF DEVELOPMENT POLICY

جمهورية مصر العربية
وزارة التعاون الدولي

November 24, 2016

Dr. Jim Yong Kim
President
World Bank Group
Washington, D.C.

Arab Republic of Egypt

Economic Reform Program

Egypt is carrying on its economic reforms program to stabilize the macroeconomic environment, create more jobs, improve the competitiveness of its economy and achieve high levels of sustainable and inclusive growth. To that end, the Government has adopted bold reforms in a number of areas which are considered as key to restore confidence in the economy; namely achieving progress on fiscal consolidation efforts, eliminating foreign exchange distortions, encouraging domestic and foreign investment and increasing the private sector contribution to growth and job creation. Given the inflationary pressures, expected in the short-term, of some of these reforms measures, the Government is scaling up and expanding its social programs to meet the pressing needs and protect the most vulnerable groups in the society.

This follows a first wave of reforms started in 2014 to address the vulnerabilities the country has been facing during the political transition. In FY 2014/15, the Government undertook bold fiscal consolidation measures; partially streamlining energy subsidies and introducing revenue-enhancement measures. But the difficult domestic and regional environment and volatile commodity prices in FY 15/16 have taken a toll on confidence and investment and weighed on economic growth.

The Government has launched an ambitious economic and social reforms program this year. Most notably, the Central Bank of Egypt (CBE) has introduced a flexible exchange rate regime in early November 2016, which will play a critical role in preserving competitiveness and serve as an important buffer to external shocks. Fiscal reforms include the issuance of new laws on Value Added Tax (VAT) and Tax Dispute Settlement as important steps to expand the tax-base, improve the business environment and increase public revenues. On the expenditures side, gradual increases in electricity tariffs and recent increases in the price of fuel products will help control government spending and shift towards a better targeted subsidies system. At the same time, a new civil service law was approved and is expected to improve efficiency and transparency of the civil service administration. In its effort to enhance transparency and accountability, the Ministry of Finance is establishing an internal audit function to oversee controls over public resource use and implement key public financial management reforms. Further steps are being taken to enhance the business environment including the issuance of the single-person company law, an ambitious Initial Public Offering (IPO) program for state-owned companies, and the establishment of a Supreme Investment Council to enable domestic and foreign private investment and promote SMEs growth.

The economic and social reforms program strives to create a dynamic economy by addressing macroeconomic imbalances, enhancing productivity and competitiveness and unleashing the growth potential. To achieve this ambitious goal, the Government's reform program rests on three fundamental principles. First, restoring macroeconomic stability and fiscal sustainability which are key to boost confidence, free up public resources and redirect them towards social and growth enhancing spending. Second, creating a more dynamic and commercially oriented energy sector to meet the growing demand, improving service delivery and attracting private investment to support economic activity. Third, improving the business climate in which the private sector operates, enhancing the regulatory environment and fostering competition. The overarching approach is to strike a balance between progressing on important structural reforms while ensuring that the generated growth is truly inclusive, sustainable and the benefits are being reaped by the entire society. Particular attention is also given to ensuring the continuity of the economic reforms program in an efficient and effective manner. These reforms have signaled the Government's commitment to take difficult decisions to address structural imbalances.

Advancing Fiscal Consolidation

Fiscal consolidation plans are carried out to narrow the deficit and put public debt on a downward path while creating room for much needed social spending, and increase the government's ability to shift resources towards productive uses. This includes further investment in infrastructure, in increased spending on social protection programs, as well as in human capital including spending on health, education and research and development.

Despite efforts to control public spending, lower revenues have contributed to a widened fiscal deficit, reaching 12.2 percent in FY16 up from 11.5 percent in the previous year. The recent introduction of the VAT law to replace the generalized sales tax (GST) is an important step in the right direction, as it is expected to widen the tax base and generate an increase in public revenues of around 0.6 percent of GDP in FY17. The Ministry of Finance will be soon issuing the executive regulations of the Law, which provides important guidance on the implementation of the VAT including the process and workings of an effective credit and refund mechanism. In addition, the adoption of the law on Tax Dispute Settlement (Law No. 79 of 2016) will help clearing the backlog of the GST tax disputes. This set of reforms follow previous reforms of tax policy adopted as per law No. 96 of 2015, issued on August 20, 2015, unifying the corporate income tax rate, to widen the tax base and create a fairer and more equitable system. Taken together, these measures are expected to increase non-sovereign corporate income tax and sales/VAT on goods and services as a percent of GDP from 5.4 percent in FY15 to about 6.7 percent in FY18.

On the expenditures side, gradual increases in electricity tariffs (the most recent being by an average of 34 percent in August 2016) and the increased fuel prices across different fuel products from 30 to almost 90 percent are positive steps towards attaining fiscal consolidation. In addition, the Government is committed to contain the wages bill which has become a pressing issue in light of the considerable increase in the wage bill post-2011. Building on previous efforts, the Government is continuing its plans to delink the variable portion of employees' salaries from the basic salary component and contain further increases in bonuses and rewards to all government employees. These steps are complemented by the progress achieved with regards to the automation of wages and salaries payments for all Government employees, with more than 50 percent of the wage bill currently automated. As a result, the ratio of central government's wages and salaries bill to nominal GDP is expected to decline to 7.4 percent of GDP by FY18 from 8.2 percent in FY15.

The Government will continue 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. The Government is committed to publishing an annual updated Medium-term Debt Management strategy, in addition to establishing a Public Finance Management Improvement Unit in charge of internal auditing, monitoring fiscal risks of Economic Authorities and SOEs including their contingent liabilities and enhancing Government accounting and financial control.

Together, all these efforts are expected to reduce the budget deficit by a little more than 2 percentage points of GDP, bringing it down to around 10 percent of GDP in FY17. It is worthy to note that despite such fiscal consolidation efforts, the Government continues to scale up expenditure on infrastructure (investments), as well as on social programs in FY 2016/17. The medium-term fiscal program is designed to minimize the contractionary effect of the consolidation by saving on inefficient spending, channeling part of the saved resources towards more productive uses and in addition to that, crowding in the private sector and enabling it to drive growth and job creation.

Ensuring Sustainable Energy Supply

The performance of Egypt's energy sector, long considered as an engine of growth, has become increasingly compromised in recent years. Declining oil and gas production despite rapidly growing demand for subsidized energy products meant that Egypt became a net importer of oil since 2009 and a net importer of gas since 2015. Domestic energy supply became financially and environmentally unsustainable, leading to an escalating subsidy bill, power outages, shortfalls in gas supply to industry, accumulating arrears to international oil companies and rapidly growing pollutant emissions. The energy sector's contribution to GDP growth fell from +0.8% in FY09 to -0.9% in FY14, turning the sector from a net contributor to a net drain on the budget (net fiscal burden reached EGP 54 bn).

The Government is following a two-pronged strategy to restore and improve the sector's performance. In the short term, the Government procured emergency generation capacity and floating natural gas import terminals to restore stable supply. In the medium to long-term, the Government is pursuing a wide-ranging set of structural reforms, which aim to improve sector governance and restore secure supplies of cost-effective and clean energy. These reforms were laid out in the White Paper "Energizing Egypt" presented at the Egypt Economic Conference in March 2015. Major measures include pricing reforms (upstream and downstream) to restore financial sustainability of the sector and attract new upstream investment; new sector legislation in the electricity and gas sectors, opening them up to wholesale and retail competition; and a renewable energy feed-in tariff to attract private sector investment in renewable energy.

The Government's energy sector reforms are already yielding important results. New gas field discoveries include the largest gas field in the Mediterranean ('Zohr', with 30 Tcf of gas resources). The capacity deficit in the power sector (the gap between peak supply and peak demand) has been closed, eliminating power cuts in the summer of 2016. The energy subsidy bill subsequently fell from 6.6 percent of GDP in FY 2013/14 to 3.1 percent of GDP in 2015/16 (of which 1.1 percent of GDP was for electricity and 2.0 percent of GDP for fuels). As a result, the budgetary allocation in FY 2015/16 for health and education exceeded energy subsidies for the first time in many years.

Energy subsidy reforms. The Government is committed to continue implementing its ambitious reform program in the energy sector. In August 2016, the third scheduled electricity tariff increase was implemented, raising tariffs by an average of 33 percent. Further tariff increases are planned for FY18 and FY19. To ensure that energy subsidy reductions stay on track reaching 1.5 percent of GDP in FY18 and 0.6 percent in FY19, the Supreme Energy Council—a sub-committee of the Cabinet bringing together the Ministers of Finance, Petroleum and Mineral Resources, and Electricity and Renewable Energy—adopted in October 2016 a policy to undertake annual adjustments of energy prices consistent with passing through unanticipated changes in the cost of energy, so as to achieve the subsidy ceilings set in the Medium-Term Fiscal Framework 2016-2019. The policy would be implemented starting from FY18.

Electricity governance reforms. With the adoption of the 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. The new law also strengthened the powers of the electricity regulator, EgyptERA, providing a stronger voice for consumer participation in its governance structure. The executive regulations of the new Electricity Law No.87/2015 have been issued and provide a detailed framework for tariff-setting, energy efficiency, and sector organization; expected to enhance the financial sustainability of the sector. The Executive Regulations also provide clear guidelines for energy efficiency actions expected from large consumers in excess of 500 kW. By Fy18, EgyptERA would disclose the electricity tariff methodology and operationalize the supply code, transmission tariff and market rules.

Gas sector governance reforms. The government is pursuing substantial market-oriented reforms in the gas sector, which has thus far been solely governed by the state-owned EGAS, with no regulatory agency. The new gas law, which was recently submitted to parliament, envisages the creation of an independent transmission system operator to provide non-discriminatory third party access to gas networks, and mandates the creation of a new independent gas regulator. The regulator will be responsible for the development of the gas transmission codes, gas transmission tariff, entrance of new shippers and licensing of alternative suppliers apart from EGAS and EGPC. It will also be key in overseeing the gas sector and providing consumer protection. Furthermore, as an important complement to the legal and regulatory reforms, efforts are underway to modernize the management and governance of the sector. To spearhead this process, the Ministry of Petroleum and Mineral Resources recently established a Policy and Strategy Unit with a clear mandate for modernization and has staffed its key positions already. By FY18, the gas regulator would publish a separate gas transmission tariff, transmission code, market rules, approval procedure and operationalize a dedicated web portal with all regulations and rules. The governance reforms and the pricing reforms cited above are expected to increase domestic gas production from 4,020 MMScf/day in FY 2015/16 to 4,700 MMScf/day by FY 2017/18.

Private sector participation. 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 an award of interim licenses. In September 2016, the Prime Minister overhauled the feed-in tariff program (by issuing a second phase Feed-in-Tariff Decree); addressing the concerns raised by investors previously (related to arbitration and currency conversion), as well as lowering the tariff level for solar energy to US$0.084 per kWh for solar projects (20-50 MW scale), given the declining market benchmark. The new FIT round is expected to achieve financial closure of private sector-owned renewable energy projects from 0 MW (October 2015) to 1,500 MW (end of FY18). Finally, the Ministry of Electricity and Renewable Energy is operationalizing the 'Energy Efficiency Unit' established since 2014, where the head of the unit was appointed on June 16, 2015. The unit is set up at the ministerial level, and is complemented with energy efficiency units in all distribution companies and a dedicated team in EgyptERA with an institutional mechanism for coordination between different entities within the sector as well as energy efficiency applications across other sectors, like transport and municipalities. Such institutional measures on energy efficiency are expected to have a further positive impact on the environment.

Improving the Business Environment

The Government is committed to further improve the domestic investment environment as part of its broader macroeconomic strategy prioritizing private investment-led growth. To this end, it has engaged in active and wide-ranging process of legal and regulatory reforms in order to cut the red tape and streamline procedures for doing business, to foster transparency, and to ensure a level playing field.

In order to further improve the investment regime and its transparency, particularly for MSMEs, the Law on Single-Person Company has been approved by the cabinet and submitted to

Parliament. The new law will improve the business environment for small enterprises and facilitate entry. This reform is an extension of the Government's previous efforts to enhance investor rights, protections, and incentives under the Investor Guarantees and Incentives Law revised in 2015. The Single-Person Company Law will allow sole proprietors to register as companies, with all the provisions under the Company Law, as well as grant sole proprietors access to a number of the guarantees and incentives under the Law of Investment Guarantees and Incentives. This action will contribute to equalizing the treatment of small and large investors under the law, giving small businesses greater security and a better chance to grow. Having a registered company status will afford many small businesses - currently either unregistered or registered as sole owners with no liability protections - to better access to finance, markets, and legal protections. The implementation of the Single-Person Company Law is expected to result in an increase in business entry, particularly small businesses, as measured by the number of Single Person Companies registered, from zero in FY15 to at least 500 in FY18.

The Government has also made further progress to reform the industrial license regime. Following the issuance of the Prime Minister Decree 2807 of 2015 on the reform of industrial licensing, the Industrial Licensing Reform Committee was formed and led by the Minister of Trade and Industry with the mandate to develop the Industrial Licensing Reform Implementation Plan, within the reform framework set by the decree. Recommendations on the direction of the reform led to the preparation not only of an implementation plan, but went further to produce a framework law—now approved by Cabinet and submitted to Parliament—to reform the industrial licensing regime with executive regulations currently under preparation. The Law includes a key reform which would simplify industrial licensing requirements for industrial firms with low environmental and social risks using a "licensing by notification only" process. This would represent a major simplification of the process for a majority of industrial firms that would not be subject to the full process anymore, but only to a notification procedure. This reform is expected to affect the vast majority of firms, in particular MSMEs, most of which would fall into the low-risk category and would allow industrial firms with low environmental and social risks to use a notification procedure, to be reduced to no more than 7 days by end FY18. At the same time, the simplification of the licensing process for all industrial firms is expected to be reduced from 634 days in FY15 to 160 days by end of FY18.

To foster competition, the Government is working on ensuring that Egyptian markets are more dynamic and open. To that end, efforts are carried out to prevent anticompetitive behavior, and to strengthen the institutional independence of the Egyptian Competition Authority (ECA). This is likely to generate a competitive business environment, create incentives for entrepreneurship and foster innovation.

Improving competition and the ease of doing business are key priorities for 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 the review of the process of industrial licensing, whereby a committee of ministers has been formed to propose a roadmap for complete overhaul of the industrial licensing process by the middle of 2016.

Moreover, and in order to foster the Government's efforts towards SMEs, a coordination body is being proposed by the Ministry of Trade and Industry to facilitate access to different services including technical assistance, technology transfer and access to finance through compiling the different bodies working in these domains under one umbrella.

Social protection

As Egypt progresses with its economic reforms program, the Government is taking important steps to mitigate potential adverse impacts expected in the short-term on the most vulnerable groups in the society. As proved by Egypt's recent history, such mitigation measures are critical to the success of the reforms program, preventing reversibility of implemented reforms and ensuring societal buy-in.

Given the inflationary pressures generated by price hikes, the program has an integrated plan to increase spending on social protection, by scaling up and expanding the coverage of its social safety nets. In fact, significant changes to the Social Safety Nets (SSN) include the following:

- Gradually expanding cash transfer programs (Takaful and Karama) to reach 1.7 million households (7.3 million beneficiaries) by June 2017 and to 2 million households (8-9 million beneficiaries) across Egypt by FY19.
- Expanding the food subsidy program with efficiency improvements. The semi-cash transfer scheme (also known as ration cards) replaces the old four commodity system. It offers every individual a monthly allowance to be spent on over forty commodities widely used by Egyptian households. This allowance, which started at LE 15 per beneficiary in 2014/2015 was increased to LE 18 per beneficiary in 2015/2016, and has been further raised to LE 21 per card in November 2016, at a cost of LE 5 billion. The targeting of the program will be enhanced to ensure its efficiency and equity.
- Ensuring social protection of the poorest and the vulnerable groups.
- 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.

- New legislations are submitted to the Parliament on social insurance and pension, disability and child protection laws.

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

Sincerely,

Sahar Nasr

Minister of International Cooperation

ANNEX 3: FUND RELATIONS NOTE

IMF Executive Board Approves US$12 billion Extended Arrangement Under the Extended Fund Facility for Egypt

November 11, 2016

- To address economic challenges, the Egyptian authorities have developed a program of policies and structural reforms that is supported by the Extended Fund Facility (EFF)
- The approval of program, allows for an immediate disbursement of about US$ 2.75 billion.
- Policies supported by the program aim to boost growth and create jobs while protecting vulnerable groups.

On November 11, 2016, the Executive Board of the International Monetary Fund (IMF) approved a three-year extended arrangement under the Extended Fund Facility (EFF) for the Arab Republic of Egypt for an amount equivalent to SDR 8.597 billion (about US$12 billion, or 422 percent of quota) to support the authorities' economic reform program.

The EFF-supported program will help Egypt restore macroeconomic stability and promote inclusive growth. Policies supported by the program aim to correct external imbalances and restore competitiveness, place the budget deficit and public debt on a declining path, boost growth and create jobs while protecting vulnerable groups.

The Executive Board's approval allows for an immediate purchase of SDR 1.970 billion (or about US$2.75 billion). The remaining amount will be phased over the duration of the program, subject to five reviews.

Following the Executive Board discussion, Ms Christine Lagarde, Managing Director and Chair, said:

1. "The Egyptian authorities have developed a homegrown economic program, which will be supported under the IMF's Extended Fund Facility, to address longstanding challenges in the Egyptian economy. These include: a balance of payments problem manifested in an overvalued exchange rate, and foreign exchange shortages; large budget deficits that led to rising public debt; and low growth with high unemployment. The authorities recognize that resolute implementation of the policy package under the economic program is essential to restore investor confidence, reduce inflation to single digits, rebuild international reserves, strengthen public finances, and encourage private sector-led growth.

2. "The liberalization of the exchange rate regime and the devaluation of the Egyptian pound were critical steps toward restoring confidence in the economy and eliminating foreign exchange shortages. The new exchange rate regime will be supported by prudently tight monetary policy to anchor inflation expectations, contain domestic and external demand pressures, and allow accumulation of foreign exchange reserves.

3. "Reducing fiscal deficits considerably and thereby placing public debt on a clearly declining path is an important objective of the authorities' program. To this end, the key policy measures are the introduction of a VAT, a reduction of energy subsidies, and the optimization of the public sector wage bill. To mitigate the impact of the reforms on the poor, the authorities intend to use part of the fiscal savings to strengthen the social safety nets. The planned fiscal consolidation is projected to reduce public debt by almost 10 percentage points of GDP by the end of the program.

4. "Structural reforms are critical for the success of the program. The aim is to address deep-seated structural impediments to growth and job creation, and create an enabling environment for private sector development. The main areas of reforms include business licensing and insolvency frameworks; public financial management, including state-owned enterprises; energy sector and subsidy reforms; and labor market reform to create jobs and increase labor market participation, especially among women and young people.

5. “Risks to program implementation are significant, but are mitigated by the strength of the policy package, frontloading of major measures implemented as prior actions, and broad political support for the objectives of the program and ambitious policy efforts.”

ANNEX

Recent Developments

Since 2011, political and regional developments have taken a significant toll on the Egyptian economy. Underlying structural challenges and the prolonged political transition led to the build-up of macroeconomic imbalances. A significantly overvalued exchange rate undermined competitiveness and depleted reserves. Weak revenue combined with poorly targeted subsidies and a growing public sector wage bill resulted in large deficits and high level of public debt.

The authorities initiated policy adjustment measures in 2014/15. The Central Bank of Egypt (CBE) devalued the Egyptian pound by 5 percent and increased interest rates to contain inflationary pressures. Fuel and electricity prices were raised, and a plan for gradual phasing out of these subsidies was developed. As a result, the subsidy bill fell by nearly 3 percent of GDP in fiscal year (FY) 2014/15. In addition, a new Civil Service law was drafted and a decision was taken to replace the General Sales Tax with VAT. In 2015/16, however, the momentum of reform slowed. Planned fuel price increases were deferred, income taxes were cut, the capital gains tax was postponed and parliamentary consideration of VAT was delayed to 2016/17.

Growth slowed in 2015/16, while inflation increased and external vulnerabilities became more acute. The economy is estimated to have grown by 3.8 percent in 2015/16. Foreign exchange shortages and the overvalued currency hampered the manufacturing sector, while tourism was hard hit by security concerns. Inflationary pressures intensified in the second half of the year. The current account deficit widened further, and in June 2016 reserves stood at about 3 months of prospective imports. The devaluation of the official exchange rate by 13 percent in March 2016 did not restore market equilibrium, and strong pressures on the exchange rate and reserves remained. By the end of September, the parallel market premium widened to more than 30 percent, and the official exchange rate was estimated to be overvalued by about 25 percent in real effective terms.

Program Summary

The authorities’ home-grown program, supported by the EFF arrangement, will address macroeconomic vulnerabilities and promote inclusive growth and job creation.

The program focuses on four key pillars:

1. a significant policy adjustment including (1) liberalization of the foreign exchange system to eliminate forex exchange shortages and encourage investment and exports; (2) monetary policy aimed at containing inflation; (3) strong fiscal consolidation to ensure public debt sustainability;
2. strengthening social safety nets by increasing spending on food subsidies and cash transfers;
3. far-reaching structural reforms to promote higher and inclusive growth, increasing employment opportunities for youth and women;
4. Fresh external financing to close the financing gaps.

The main elements of the program are as follows:

Exchange rate, monetary and financial sector policies: On November 3 the CBE liberalized the foreign exchange system and adopted a flexible exchange rate regime. Maintaining the flexible exchange rate regime, where the exchange rate is determined by market forces, will improve Egypt's external competitiveness, support exports and tourism and attract foreign investment. This will also allow the CBE to rebuild its international reserves. Monetary policy will focus on containing inflation and bringing it down to mid-single digits over the medium term. This will be achieved by controlling credit to government and banks as well as by strengthening the CBE's capacity to forecast and manage liquidity, improving transparency and communication. To further enhance banking sector soundness and promote competition, the CBE will review its supervisory model in line with international best practice, including Basel III principles.

Fiscal policy, social protection and public financial management:

- Fiscal policy will be anchored to setting public debt on a clearly declining path and restoring debt sustainability. Tax revenues are projected to increase by 2.5 percent of GDP over the program, in large part due to the implementation of the value added tax (VAT) approved by parliament in August. At the same time, primary expenditures will be reduced by 3.5 percent owing to reduction of subsidies and containing the wage bill. The fuel price increase announced on November 3 were an important step in that direction.
- Social protection programs will be strengthened to ease the adjustment process. About 1 percent of GDP out of the achieved fiscal savings will be directed to additional food subsidies, cash transfers to the elderly and low-income families, and other targeted social programs, including more free school meals. The aim is to replace poorly targeted energy subsidies with programs that directly support poor households.
- The program also emphasizes strengthening public financial management (PFM) and fiscal transparency. Planned reforms in this area include regularly reviewing the operational performance of the economic authorities; improving oversight of state issued guarantees through the preparation of reports; developing a road map for pension reforms; and preparing a budget statement on economic and public finance developments will be presented to the parliament with every budget.

Structural reforms and inclusive growth. The program will help address the long-standing challenges of low growth and high unemployment. Measures will include streamlined industrial licensing for all businesses, greater access to finance to SMEs, and new insolvency and bankruptcy procedures. Job intermediation schemes and specialized training programs for youth will be encouraged. To support women's labor force participation, availability of public nurseries will be increased and safety of public transportation improved.

Arab Republic of Egypt: Selected Economic Indicators, 2011/12–2016/17[1/]

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
					Prel.	Proj.
Output and prices	2.2	2.1	2.2	4.2	3.8	4.0
Real GDP (market prices)	7.3	9.8	8.2	11.4	14.0	16.6
Consumer prices (end of period)	8.6	6.9	10.1	11.0	10.2	18.2
Consumer prices (period average)						
Public finances						
General Government[2/]						
Revenue and grants	21.1	21.9	23.7	21.9	20.3	25.5
Expenditures (incl. net acquisition of financial assets)	31.1	35.3	36.7	33.5	32.0	33.1
Of which: Interest	5.6	7.3	7.6	7.3	8.1	8.7
Overall balance	-10.0	-13.4	-12.9	-11.5	-12.0	-10.0
Overall balance excl. grants	-10.6	-13.7	-16.5	-12.6	-12.2	-10.1
Primary balance	-4.9	-6.3	-5.8	-4.8	-4.4	-1.8
Gross Debt	74.6	84.8	86.3	89.0	94.6	93.8
External	9.3	10.8	9.9	8.0	7.7	10.1
Domestic	65.3	74.0	76.4	81.0	86.8	83.7
Budget sector[3/]						
Revenue and grants	18.3	19.0	20.8	19.1	17.6	22.9
Expenditures (incl. net acquisition of financial assets)	28.4	32.0	33.9	30.6	29.4	30.5
Of which: Fuel subsidies	5.8	7.0	6.6	4.0	3.0	2.6
Of which: Food subsidies	1.8	1.8	1.7	1.7	1.5	1.4
Overall balance	-10.1	-13.0	-13.1	-11.5	-12.1	-10.0
Overall balance excl. grants	-10.7	-13.3	-16.7	-12.5	-12.3	-10.1
Primary balance	-3.8	-5.1	-4.9	-3.7	-3.5	-0.9

Monetary sector						
Credit to the private sector	7.1	9.8	7.4	16.7	14.2	8.3
Reserve money[6/]	5.1	20.4	14.8	33.3	-1.6	16.1
Broad money (M2)	8.3	18.4	17.1	16.4	18.6	16.7
Treasury bill rate, 3 month (average, in percent)	13.4	13.4	10.9	11.4	11.8	19.7
External sector						
Exports of goods (in U.S. dollars percentage change)	-7.1	7.6	-3.2	-15.5	-15.2	12.8
Imports of goods (in U.S. dollars)	2.7	2.4	3.7	1.7	-7.4	1.7
Merchandise trade balance	-11.3	-10.8	-11.2	-11.7	-11.0	-12.5
Current account	-3.7	-2.2	-0.8	-3.7	-5.5	-5.2
Capital and financial account (incl. errors and omissions)	-3.7	1.1	0.9	5.5	4.6	1.7
Foreign direct investment (net. In billions of US$)	-3.7	3.6	3.8	6.1	6.7	9.4
External debt[4/]	12.5	15.1	15.3	14.3	14.0	22.9
Gross international reserves 9in billions of US$)	15.2	14.5	16.3	19.5	17.1	22.0
In months of next year's imports of goods and services	2.7	2.5	2.7	3.6	3.1	3.7
In percent of short-term external debt[5/]	308.8	138.1	191.9	280.6	267.8	283.1
Financing gap (in billions of US$)	…	…	…	…	0.0	16.3
Memorandum items:						
Nominal GDP (in billions of Egyptian pounds)	1,656.6	1,843.8	2,101.9	2,429.8	2,777.8	3,434.1
Nominal GDP (in billions of US$)	275.8	285.4	301.5	330.2	…	…
GDP per capita (in US$)	3,347	3,370	3,478	3,710	…	…
Unemployment rate (period average, percent)	12.4	13.0	13.4	12.9	12.7	12.3
Poverty rate (percent)	n.a.	26.3	…	…	…	…
Populations (in millions)	82.4	84.7	86.7	89.0	90.2	92.3

Sources: Egyptian authorities; and IMF estimates and projections.

1/ Fiscal year ends June 30.

2/ General government includes the budget sector, the National Investment Bank (NIB), and social insurance funds.

3/ Budget sector comprises central government, local governments, and some public corporations.

4/ Includes multilateral and bilateral public sector borrowing, private borrowing and prospective financing (in 2011/12).

5/ Debt at remaining maturity and stock of foreign holding of T-bills.

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant Positive or Negative Environment Effects (yes/no/to be determined)	Significant Poverty, Social or Distributional Effects Positive or Negative (yes/no/to be determined)
Pillar 1: Advancing Fiscal Consolidation		
Prior Action 2.1: The Borrower enacted Law No. 79 of *2016 Finalization of Taxation Disputes* and published said law in its Official Gazette.	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected. Gender-related impacts have been examined.
Prior Action 2.2: (i) The Borrower enacted Law No. 8 of 2016 *Assessing the Public Budget of the State,* endorsing the national budget for FY17, which contains administrative instructions to all government budgetary entities to contain the wage bill, including provision for delinking bonuses and rewards of their respective employees' salaries from the basic salary component and published said law in its Official Gazette. (ii) The Ministry of Finance of the Borrower issued a wage bill report entitled *Government Wages, Key Reforms* dated November 2016 notifying that at least forty-five percent (45%) of the wage bill is automated.	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Prior Action 2.3: The Ministry of Finance of the Borrower issued Decree No. 247/2016 to establish and operationalize a Public Finance Management Improvement Unit with the following mandates: (a) setting-up an internal audit function; (b) monitoring fiscal risks of Economic Authorities and SOEs including their contingent liabilities; and (c) enhancing government accounting and financial control.	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Pillar 2: Ensuring Sustainable Energy Supply		
Prior Action 2.4: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 436 of 2016 implementing a third annual electricity tariff adjustment that goes beyond the former five-year tariff adjustment plan adopted in the Prime Minister's Decree No. 1257/2014, as recommended by the Borrower's Egyptian Electric Utility and Consumer Protection Regulatory Agency. (ii) The Supreme Energy Council of the Borrower adopted a policy for financing variations in actual energy costs compared to the budget estimates in the Borrower's Medium Term Fiscal Framework (2016-19).	Positive environmental effects are expected. Tariff adjustments (that is, increases) through the price elasticity mechanism will lead to a reduction in demand and consumption of electricity, ultimately resulting in positive environmental effects through reduction in emissions of air pollutants and lower GHG emissions.	Adverse poverty and distributional impacts are expected. The government's reform program with respect to fuel, electricity and VAT is estimated to have an aggregate impact of 3.32 percent on household welfare. To mitigate these impacts, the Government is providing additional resources of about one percent of GDP to its SSN system, which consists of food subsidies; public works programs; Takaful and Karama cash transfer programs; and school feeding programs. Gender-related impacts have been examined.
Prior Action 2.5: The Ministry of Electricity and Renewable Energy of the Borrower issued Decree No.	Positive environmental effects are expected.	Adverse poverty and social impacts are not expected.

230/2016 notifying the Executive Regulations of Electricity Law of the Borrower that, inter alia, include measures to improve the energy efficiency of large electricity consumers and published said Regulations in the official Gazette of the Borrower.	Introducing measures to improve energy efficiency of large electricity consumers will result in positive environmental effects. This is essentially because improving energy efficiency leads to lower electricity consumption, which will ultimately result in improvement in air quality due to lower emissions of air pollutants.	
Prior Action 2.6: (i) The Borrower's Cabinet approved the draft *Gas Activities Regulatory Law* and submitted it to the Borrower's Parliament for consideration. (ii) The Ministry of Petroleum and Mineral Resources of the Borrower issued Decree No. 1631/2016 to establish a new Policy and Strategy Unit detailing the charter, functions and authority to spearhead the modernization of the petroleum sector.	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Prior Action 2.7: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 244 of 2016 to set up an energy efficiency unit with dedicated staff to lead the implementation of the Borrower's National Energy Efficiency Action Plan. (ii) The Borrower's Cabinet issued Decree No. 2533 of 2016 announcing the revised Feed-in-Tariff policy for renewable energy.	Positive environmental effects are expected. The newly established energy efficiency units will lead to overall improvement of energy efficiency, which will have a positive environmental effect due to the reduction in electricity/energy consumption and the subsequent reduction in emissions of air pollutants and GHG. Likewise, the revised feed-in tariff will lead to a higher degree of dependence on renewable energy, which will also result in positive environmental effects through reduction in air emissions of air pollutants and GHG.	Adverse poverty and social impacts are not expected.
Pillar 3: Enhancing the Business Environment		
Prior Action 2.8: The Borrower's Cabinet approved the draft Single-Person Company Law that includes limited liability protection, and submitted it to the Borrower's Parliament for consideration.	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected
Prior Action 2.9: (i) The Borrower's Cabinet approved the draft Law on Streamlining the Procedures of Granting Licenses for Industrial Establishments that includes measures for simplified licensing by notification for low-risk industrial activities, and submitted it to the Borrower's Parliament for consideration. (ii) The Borrower's Minister of the Ministry of Trade and Industry issued Ministerial Decree number 1071 of 2016 approving the implementation plan of the Borrower's Industrial Licensing Reform Program.	Negative environmental effects are expected. The approval of the industrial licensing reform implementation plan and the Industrial Licensing Law could potentially lead to negative environmental impacts by virtue of the expected ease and subsequent increase in industrial licenses granted, thus resulting ultimately in an increase in overall industrial production. However, the current environmental regulatory framework and institutional capacity in Egypt is believed to be sufficient to ensure that the necessary mitigation measures are in place to avoid, reduce, and/or mitigate any negative environmental impacts arising from the	

	increase in industrial production, in general.	
Prior Action 2.10: (i) The Borrower's Cabinet issued Decree No. 2509/2016 notifying *the Executive Regulations of Protection of Competition and Prohibition of Monopolistic Practices Law* 1316/2005 for implementing the Borrower's anti-cartel policy and strengthening the institutional independence of ECA. (ii) The ECA adopted administrative regulations dated December 2015 to further strengthen anti-cartel enforcement policy.	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.

ANNEX 5: DPF PRIOR ACTIONS AND ANALYTICAL UNDERPINNINGS

Prior Actions (abbreviated)	Analytical Underpinnings
Pillar 1: Advancing Fiscal Consolidation	
Prior Action 2.1: The Borrower enacted Law No. 79 of *2016 Finalization of Taxation Disputes* and published said law in its Official Gazette.	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. Fair Taxation in the Middle East and North Africa. IMF Staff Discussion Note SDN/15/16.
Prior Action 2.2: (i) The Borrower enacted Law No. 8 of 2016 *Assessing the Public Budget of the State,* endorsing the national budget for FY17, which contains administrative instructions to all government budgetary entities to contain the wage bill, including provision for delinking bonuses and rewards of their respective employees' salaries from the basic salary component and published said law in its Official Gazette. (ii) The Ministry of Finance of the Borrower issued a wage bill report entitled Government Wages, Key Reforms dated November 2016 notifying that at least forty-five percent (45%) of the wage bill is automated.	Promoting Poverty Reduction and Shared Prosperity, A Systematic Country Diagnostic, World Bank, 2015. Alba, Pedro, Sherine Al-Shawarby, and Farrukh Iqbal. 2000. "Fiscal and Public Debt Sustainability in Egypt." Working Paper Series 38, World Bank, Washington DC.
Prior Action 2.3: The Ministry of Finance of the Borrower issued Decree No. 247/2016 to establish and operationalize a Public Finance Management Improvement Unit with the following mandates: (a) setting-up an internal audit function; (b) monitoring fiscal risks of Economic Authorities and SOEs including their contingent liabilities; and (c) enhancing government accounting and financial control.	IMF and World Bank. Revised Guidelines for Public Debt Management. April 2014. MTDS (completed in cooperation with World Bank Treasury Department). Promoting Poverty Reduction and Shared Prosperity, A Systematic Country Diagnostic, World Bank, 2015.
Pillar 2: Ensuring Sustainable Energy Supply	
Prior Action 2.4: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 436 of 2016 implementing a third annual electricity tariff adjustment that goes beyond the former five-year tariff adjustment plan adopted in the Prime Minister's Decree No. 1257/2014, as recommended by the Borrower's Egyptian Electric Utility and Consumer Protection Regulatory Agency. (ii) The Supreme Energy Council of the Borrower adopted a policy for financing variations in actual energy costs compared to the budget estimates in the Borrower's Medium Term Fiscal Framework (2016-19).	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. Five-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 2.5: The Ministry of Electricity and Renewable Energy of the Borrower issued Decree No. 230/2016 notifying the Executive Regulations of Electricity Law of the Borrower that, inter alia, include measures to improve the energy efficiency of large electricity consumers and published said Regulations in the official Gazette of the Borrower.	Egypt Energy Strategy to 2030, Nexant, 2009. Egypt's Gas Supply Deficit, Wood McKenzie, 2014. EU Gas Study, Mercados, Adetef, 2014. Five-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 2.6: (i) The Borrower's Cabinet approved *the draft Gas Activities Regulatory Law* and submitted it to the Borrower's Parliament for consideration. (ii) The Ministry of Petroleum and Mineral Resources of the Borrower issued Decree No. 1631/2016 to establish a new Policy and Strategy Unit detailing the charter, functions and authority to spearhead the modernization of the petroleum sector.	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, Energy Sector Management and Assistance Program (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, Egyptian Center for Economic Studies (ECES), 2010.
Prior Action 2.7: (i) The Ministry of Electricity and Renewable Energy of the Borrower has issued Decree No. 244 of 2016 to set up an energy efficiency unit with dedicated staff to lead the implementation of the Borrower's National Energy Efficiency Action Plan. (ii) The Borrower's Cabinet issued Decree No. 2533 of 2016 announcing the revised Feed-in-Tariff policy for renewable energy	Assessment of Private Sector Participation in the Power Sector of Egypt, World Bank, 2014. Five-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 2.8: The Borrower's Cabinet approved the draft Single-Person Company Law that includes limited liability protection, and submitted it to the Borrower's Parliament for consideration.	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 Facility for Investment Climate Advisory Services (FIAS) reports.
Prior Action 2.9: (i) The Borrower's Cabinet approved the draft *Law on Streamlining the Procedures of Granting Licenses for Industrial Establishments* that includes measures for simplified licensing by notification for low-risk industrial activities, and submitted it to the Borrower's Parliament for consideration. (ii) The Borrower's Minister of the Ministry of Trade and Industry issued Ministerial Decree number 1071 of 2016 approving the implementation plan of the Borrower's Industrial Licensing Reform Program.	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 2.10: (i) The Borrower's Cabinet issued Decree No. 2509/2016 notifying the *Executive Regulations of Protection of Competition and Prohibition of Monopolistic Practices Law* 1316/2005 for implementing the Borrower's anti-cartel policy	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

and strengthening the institutional independence of ECA. (ii) The ECA adopted administrative regulations dated December 2015 to further strengthen anti-cartel enforcement policy.	the Middle East and North Africa. World Bank Group 2014. Ongoing Technical Assistance on Competition

ANNEX 6: DEBT SUSTAINABILITY ANALYSIS

1. The World Bank team conducted a DSA to assess the trajectory of the budget sector debt-to-GDP ratio. The DSA takes into account the November exchange rate devaluation and assumes under the baseline (as outlined in the macroeconomic framework in section 2) that (a) real growth declines in FY16, before the gradual economic uptick is resumed in FY17 and onward, and (b) an ambitious fiscal consolidation plan is implemented such that the primary deficit switches into a surplus by FY18 (table 6.1). The baseline scenario of the DSA shows that the debt-to-GDP ratio is projected to reach about 80 percent of GDP by FY21, down from 100 percent of GDP in FY16, helped by the projected path of fiscal consolidation and favorable interest rate-growth differential.

Table 6.1. Egypt Budget Sector DSA - Baseline Scenario (in Percentage of GDP Unless Otherwise Indicated)

Debt, Economic and Market Indicators

	Actual			Projections					
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross budget sector debt	90.3	90.8	93.8	100.0	95.7	92.2	88.0	83.9	80.1
Real GDP growth (in percent)	4.6	2.2	4.2	3.8	4.0	4.7	5.4	5.8	6.0
Inflation (GDP deflator, in percent)	10.9	11.5	10.9	9.9	19.0	11.6	9.4	8.7	8.5
Nominal GDP growth (in percent)	16.0	14.0	15.6	14.1	23.8	16.9	15.3	15.0	15.0
Primary balance	-2.7	-3.9	-3.6	-3.4	-0.9	1.1	2.1	2.1	2.1

As of October 27, 2016	
Sovereign Spreads	
5Y CDS Spread (bp)	478
As of May 2016	
Ratings	Local
Moody's	B3
S&Ps	B-

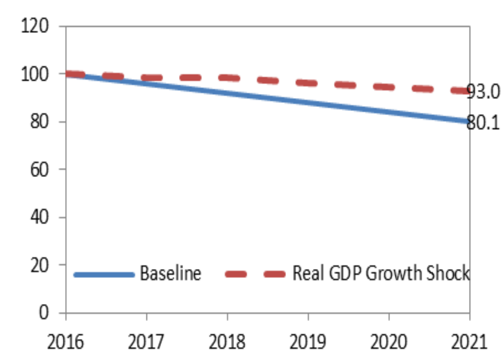
Stress Tests

2. To check the sensitivity of these projections, the World Bank team undertook basic stress tests. A **real GDP growth shock** scenario assumes a 2 percentage points drop in the real growth rate, compared to the baseline scenario. Under this scenario, the debt-to-GDP ratio would decline at a considerably slower pace than under the baseline reaching only 93 percent by FY21 compared to 80.1 percent under the baseline. Slower growth is a key risk to debt sustainability.

Table 6.2. Real GDP Shock

Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	2.0%	2.7%	3.4%	3.8%	4.0%
Inflation (GDP Deflator change)	9.9%	18.5%	11.1%	8.9%	8.2%	8.0%
Non-interest revenue-to-GDP ratio	17.6%	20.7%	18.7%	19.2%	21.1%	21.1%
Non-interest expenditure-to-GDP ratio	21.0%	22.1%	18.5%	17.1%	19.0%	19.0%
Primary Balance	-3.4%	-1.5%	0.3%	2.1%	2.1%	2.1%
Interest rate shock (bps) compared to baseline	0	50	50	50	50	50

Figure 6.1. Real GDP Shock

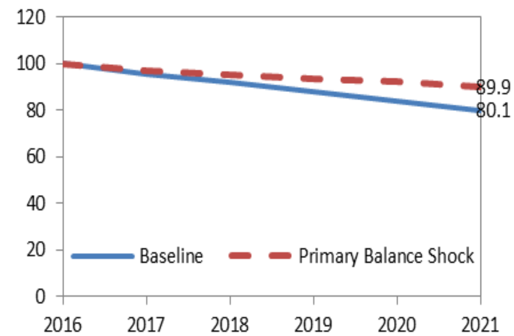


3. A **primary balance** shock assumes a slowdown in fiscal consolidation efforts, as a result of which the primary deficit narrows at a slower pace and remains in deficit through FY18 (compared to a surplus under the baseline). Similar to the real GDP growth shock outlined in table 6.2 and figure 6.1, the debt-to-GDP ratio declines only slowly and remains at close to 90 percent in FY21 (figure 6.2).

Table 6.3. Primary Balance Shock

Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	4.0%	4.0%	4.0%	4.0%	4.0%
Inflation (GDP Deflator change)	9.9%	19.0%	11.6%	9.4%	8.7%	8.5%
Non-interest revenue-to-GDP ratio	17.6%	20.0%	18.1%	18.7%	20.7%	21.1%
Non-interest expenditure-to-GDP ratio	21.0%	22.2%	18.2%	17.7%	19.4%	19.0%
Primary Balance	-3.4%	-2.2%	-0.1%	1.0%	1.3%	2.1%
Interest rate shock (bps) compared to baseline	0	62	62	56	40	0

Figure 6.2. Primary Balance Shock

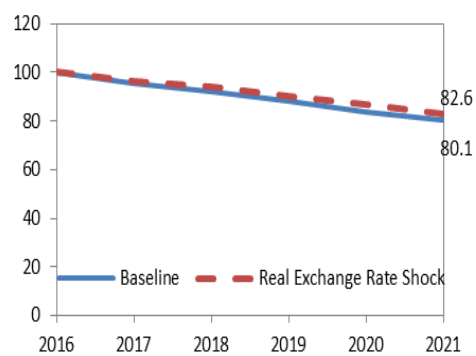


4. Under the assumption that both the gradual increase in real GDP growth and fiscal consolidation efforts are maintained, an additional **real exchange rate** depreciation of 25 percent in FY18 (on top of the large devaluation that already took place in FY17) will lead to a gradual decline in the debt-to-GDP ratio, reaching around 82.6 percent of GDP in FY21. Initially interest rates increase sharply given the exchange rate pass-through to inflation, but the interest rate-growth differential becomes more favorable over time, which, together with the projected path of fiscal adjustment, leads to an improving debt outlook.

Table 6.4. Exchange Rate Shock

Exchange Rate Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	4.0%	4.7%	5.4%	5.8%	6.0%
Inflation (GDP Deflator change)	9.9%	21.0%	11.6%	9.4%	8.7%	8.5%
Non-interest revenue-to-GDP ratio	17.6%	20.7%	18.7%	19.2%	21.1%	21.1%
Non-interest expenditure-to-GDP ratio	21.0%	21.6%	17.6%	17.1%	19.0%	19.0%
Primary Balance	-3.4%	-0.9%	1.1%	2.1%	2.1%	2.1%
Interest rate shock (bps) compared to baseline	0	500	0	0	0	0

Figure 6.3. Exchange Rate Shock



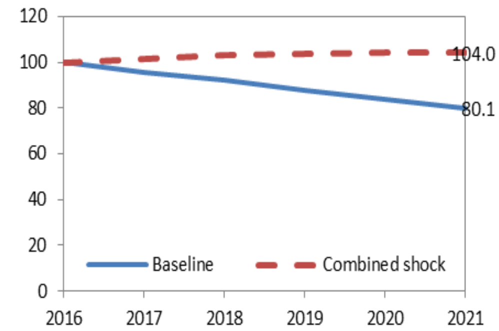
Downside Risks to Debt Sustainability

5. A 'combined macro-fiscal shock' can lead to the disruption of the downward trajectory of the debt-to-GDP ratio. Under this scenario, fiscal consolidation occurs at a slower pace, and the primary balance remains in deficit through FY18 and reaches a smaller surplus thereafter, while interest rates increase. In addition, this scenario also assumes a lower growth trajectory (2 percentage points lower than the baseline). Under the combined macro-fiscal shock, the debt-to-GDP ratio is projected to increase to above 104 percent of GDP by FY21.

Table 6.5. Macro-fiscal Shock

Combined Macro-Fiscal Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	2.0%	2.7%	3.4%	3.8%	4.0%
Inflation (GDP Deflator change)	9.9%	18.5%	11.1%	8.9%	8.2%	8.0%
Non-interest revenue-to-GDP ratio	17.6%	20.0%	18.1%	18.7%	20.7%	21.1%
Non-interest expenditure-to-GDP ratio	21.0%	22.2%	18.5%	17.7%	19.4%	19.0%
Primary Balance	-3.4%	-2.2%	-0.3%	1.0%	1.3%	2.1%
Interest rate shock (bps) compared to baseline	0	500	300	300	300	300

Figure 6.4. Macro-fiscal Shock

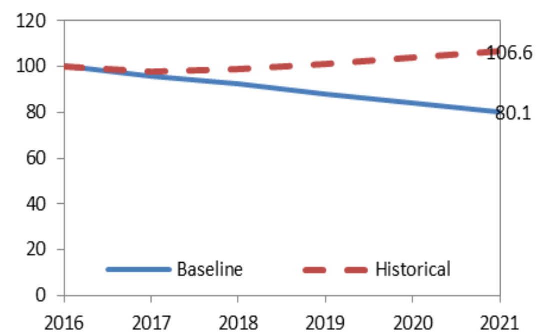


6. Similarly, a 'policy slippage scenario' is expected to lead to an unsustainable debt-to-GDP trajectory. In this scenario, growth stagnates at 4 percent throughout the forecast horizon, and fiscal consolidation efforts also fade, resulting in a primary balance, which remains in deficit through the forecast period. This leads to an increase in the debt-to-GDP ratio to 106.6 percent by FY21.

Table 6.6. Slippage Scenario

Slippage Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	3.8%	4.0%	4.0%	4.0%	4.0%	4.0%
Inflation (GDP Deflator change)	9.9%	19.0%	11.6%	9.4%	8.7%	8.5%
Non-interest revenue-to-GDP ratio	17.6%	20.7%	18.7%	19.2%	21.1%	21.1%
Non-interest expenditure-to-GDP ratio	21.0%	23.5%	21.6%	22.1%	23.9%	23.9%
Primary Balance	-3.4%	-2.8%	-2.8%	-2.8%	-2.8%	-2.8%
Interest rate shock (bps) compared to baseline	0	100	100	100	100	100

Figure 6.5. Slippage Scenario



7. While risks to debt sustainability are considerable, there are also important mitigating factors. These include a captive domestic investor base where public debt is largely held by domestic financial institutions, including the CBE. In addition, external government debt is low at about 8 percent of GDP.