Board Meeting of May 29, 1997  
Statement by Andrei Bugrov  

**Egypt - Country Assistance Strategy**

We support the proposed joint Bank-IFC Country Assistance Strategy for the Arab Republic of Egypt and commend the Staff for the preparation of this high quality document.

In our view, the suggested World Bank Group strategy is fully appropriate for the country’s development goals and objectives. It adequately responds to the concerns and changing needs of the client by giving substantial emphasis to non-lending services in the form of analytical support and policy advice. At the same time its lending program, which is constrained to a mutually agreed level, can readily be increased should there be a demand for additional financing. I would like to note that the joint strategic framework of the CAS provides for closer Bank-IFC collaboration, including, in my view, very promising joint guarantee/lending operations.

We would like to congratulate the Egyptian authorities on the continued strong performance on macroeconomic stabilization program which has allowed them to put inflation under control, bring down fiscal deficit and external current account deficit, accumulate an all time high official foreign exchange reserves, reduce the foreign debt burden and fully restore external creditworthiness. The success of stabilization has induced quick resumption of growth, restoration of investor confidence and a financial market boom.

Egypt’s medium-term economic outlook is quite promising given the Government’s strong commitment to growth-oriented structural reforms which, in fact, have been significantly accelerated over the last several months. Included are privatization, trade liberalization, creation of more friendly environment for private investment. Generation of sustainable economy-wide and private sector-led growth is absolutely indispensable for employment creation which is currently considered in Egypt as priority number one. In order to stimulate sufficient demand for labor, annual GDP growth has to be at least 6 percent.

But the future pace and strength of the reform process remains uncertain even though it is these factors which in many respects will determine the actual rate and quality of growth. As is
stated in the CAS, too ambitious a structural reform program runs the risk of self-destruction because of the associated impact on the social and political stability to which the Government has traditionally given high priority.

The rate and quality of growth will also depend on the level and composition of investment. In order to support rapid (6 percent) growth, investment needs to be raised above 25 percent of GDP. This will not be possible, in our view, without substantial external financing in all forms, including non-concessional borrowing, and from different sources, including the World Bank Group. In this connection, it would be useful to estimate to what extent and in what areas Egypt could rely on other donors. If such estimates have already been made by the recent Consultative Group meeting for Egypt, I would appreciate Staff comments on that.

The issue of portfolio investment deserves, in my opinion, special attention. As recent experience of Mexico and other Latin American countries suggests, post-stabilization surge in capital inflows present a very serious challenge. While dependence on volatile portfolio capital is deepening, the vulnerability of the economy heightens. Naturally, maintaining the course of prudent macroeconomic management will help keeping up favorable market sentiment and lessen the risk associated with reliance on foreign saving in meeting Egypt's growing investment demand. However, the fundamental objective of economic policy, we believe, should be raising the level of national savings (public, corporate, private) to finance the investment requirements, thus reducing the degree of structural dependence on volatile private flows.

National savings could be boosted by expeditious financial sector reforms aimed at strengthening Egypt's capital markets and banking system. Tight monetary policy, including enforcement of financial sector prudential regulations, would also be helpful. A more efficient and healthier financial system could mobilize more domestic resources and provide a lower-cost and safer alternative to external financing. Therefore, we welcome the attention given to this theme in the Private Sector Strategy paper (CAS Attachment 1) which identifies the financial sector, and particularly the development of capital markets as one of the areas where the World Bank Group could play a role. At the same time we would encourage the Group's sustained assistance to the Egyptian Authorities in developing the financial sector and careful monitoring of the situation in and around it.