



EUROPEAN
COMMISSION

Brussels, 15.3.2024
SWD(2024) 461 final

COMMISSION STAFF WORKING DOCUMENT

ex-ante evaluation statement

Accompanying the documents

**Proposal for a COUNCIL DECISION on providing short-term macro-financial
assistance to the Arab Republic of Egypt
and**

**Proposal for a DECISION OF THE EUROPEAN PARLIAMENT AND OF THE
COUNCIL on providing macro-financial assistance to the Arab Republic of Egypt**

{COM(2024) 461 final} - {COM(2024) 460 final}

Ex-ante evaluation statement
EU Macro-Financial Assistance to the Arab Republic of Egypt

Table of Contents

| | |
|---|----|
| 1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT | 2 |
| 1.1 Introduction | 2 |
| 1.2 Egypt's macroeconomic situation..... | 3 |
| 1.3. IMF and other donor support | 5 |
| 1.4. External financing needs | 6 |
| 1.5. Structural reforms..... | 7 |
| 2. OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE..... | 9 |
| 2.1. Objectives..... | 9 |
| 2.2 Monitoring indicators..... | 9 |
| 3. DELIVERY MECHANISMS AND RISK ASSESSMENT | 10 |
| 3.1 Delivery mechanisms | 10 |
| 3.2 Risk assessment..... | 10 |
| 4. ADDED VALUE OF EU INVOLVEMENT | 11 |
| 5. CHARACTERISTICS OF MACRO-FINANCIAL ASSISTANCE | 11 |
| 5.1 Exceptional Character and Limited Time-frame..... | 11 |
| 5.2 Political preconditions and EU-Egypt relations | 12 |
| 5.3 Complementarity | 12 |
| 5.4 Conditionality..... | 12 |
| 5.5 Financial Discipline..... | 14 |
| 6. EVALUATION AND COST-EFFECTIVENESS..... | 14 |
| 6.1 Evaluation..... | 14 |
| 6.2 Achieving cost-effectiveness..... | 14 |

1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT

1.1 Introduction

The European Union ('EU') and Egypt have agreed to deepen their relationship and develop a strategic and comprehensive partnership for shared prosperity, stability and security, based on joint interest and mutual trust and building on the already existing positive agenda in EU-Egypt relations. The Strategic and Comprehensive Partnership will cover specific areas of cooperation and its implementation will unleash the full potential of the EU-Egypt relationship.

Underpinning the partnership will be a financial package of EUR 7.4 billion consisting of short- and longer-term support for the necessary macro-fiscal and socio-economic reform agenda. This financial package will be provided in a challenging economic situation where Egypt continues to have sizeable and unmet financing needs. In this context, the Egyptian authorities requested support through macro-financial assistance ('MFA') from the EU on 12 March 2024 after an International Monetary Fund ('IMF') staff level agreement on an augmented Extended Fund Facility of USD 8 billion was announced on 6 March 2024.

Egypt's macroeconomy has shown resilience during the period before Russia's invasion of Ukraine, largely due to first wave of structural reforms implemented since 2016 in the context of successive IMF-supported programmes. Egypt was one of the few countries to maintain positive economic growth during the COVID-19 pandemic. However, over the past two years, Egypt's macro-fiscal situation has faced significant challenges and deteriorated noticeably over recent months, as external pressures have intensified and debt has increased further, amid sluggish implementation of reforms agreed on in the October 2022 staff level agreement with the IMF. Russia's war on Ukraine has led to protracted capital outflows. The repercussions of the Hamas terrorist attacks across Israel on 7 October 2023 resulted in lower services exports, notably from tourism and Suez Canal proceeds. Egypt continues to face very significant challenges, including high inflation, the state's entrenched economic footprint, inefficiencies in the foreign exchange market, and the spillovers from the conflict in Gaza, which further weakened Egypt's economic stability and put pressure on the country's external and fiscal position while increasing the country's overall vulnerability to external shocks.

In December 2022, the IMF adopted a USD 3 billion Extended Fund Facility (EFF) to support Egypt, but progress had been limited. As a result, no review had been completed and no disbursement had been made (except for the initial USD 347 million disbursement at Board adoption) until January 2024, when a review mission (first and second) began. The IMF and the Egyptian authorities agreed on a new staff level agreement and programme augmentation by USD 5 billion to USD 8 billion upon conclusion of this review mission.

Compared to the 2022 programme, Egypt's external overall financing gap had widened substantially from USD 15 billion to around USD 28.5 billion over the programme period of FY22/23-FY26/27. The IMF identified continued sizeable financing needs, with the external overall financing gap estimated at USD 9.3 billion in the upcoming fiscal year (FY, July-June) 2024/25, and USD 17.7 billion during FY24/25-26/27.

Given Egypt's critical economic and financial situation and Egypt's role as an important stabilising factor amid geopolitical tensions in an increasingly volatile region, the Commission proposes to support Egypt with a macro-financial assistance (MFA) operation of up to EUR 5 billion. This

could help bridge the significant external financing gap identified by the IMF, while supporting progress with key reforms to address the root causes of the crisis and thus help Egypt help itself.

As further elaborated in this Commission Staff Working Document accompanying the proposals, the Commission considers, based also on the assessment of the political situation made by the European External Action Service, that the economic preconditions for the proposed MFA operation are satisfied, while progress in relation to the political pre-conditions will be monitored continuously so as to ascertain that compliance with the criteria moves in a satisfactory direction.

1.2 Egypt's macroeconomic situation

Growth slowed down on the back of both domestic and external factors. Following a strong post-pandemic recovery of 6.7% during FY21/22, real GDP growth eased to 3.8% in FY22/23 and continued to ease to 2.6% year on year during the July-September 2023 quarter. High inflation, uncertainty surrounding the exchange rate and sluggish reform implementation weighed on consumption and investment. The previously strong services exports have come under pressure as the conflict in Gaza dampens tourism and the Houthi attacks in the Red Sea roughly halved the usual Suez Canal proceeds, amounting to a monthly loss of around USD 400-500 million (around 0.1% of annual GDP). Non-oil private sector activity, gauged by the Purchasing Managers' Index, remained contractionary in February 2024 as order books weakened and output declined. Business expectations deteriorated under ailing client demand. By December 2023, unemployment receded slightly to 6.9%. The outlook is subject to significant downside risks in relation to the ongoing regional tensions related to the conflict in Gaza and the Red Sea attacks. It will also be affected by the implementation of the USD 35 billion United Arab Emirates (UAE) investment deal announced on 23 February 2024, although its ultimate impact on real GDP growth and Egypt's external balance remains to be seen, as additional domestic investment will be accompanied by corresponding higher imports.

Inflation has remained high, amid a very volatile parallel exchange rate which diverged substantially from the virtually stable official exchange rate throughout most of 2023 and early 2024. Consumer price inflation stood at 29.8% year on year in January 2024, following an annual average of 33.8% in 2023. Importantly, food price increases moderated somewhat but were still high at 47.9% in January, where corresponding spending accounts for roughly one third of the consumer basket. Already before the current crisis, around 30% of the population was in poverty, thereby particularly affected by the higher food price inflation. While official reserves inched up slightly to USD 35.3 billion or around 7½ months of imports in January, and total net foreign assets of the financial system reached a negative position of USD 27.2 billion in December 2023, both are expected to improve on account of the UAE investment inflows and the new flexible exchange rate regime. As the official exchange rate was fixed at around 31 Egyptian pounds per US dollar since the last devaluation in February 2023 until March 2024, foreign exchange shortfalls gave rise to an increasing parallel market with rates fluctuating between 50 and 70 EGP/USD. When the SLA with the IMF was signed on 6 March 2024, the authorities enacted a flexible currency regime and the EGP settled at around 50 EGP/USD. The Central Bank of Egypt (CBE) accompanied the move to a flexible exchange rate with a sizeable interest rate hike of 600 bps in an attempt to curb inflation.

The fiscal deficit deteriorated over spiralling interest payments while public debt remains high. The overall budget deficit had remained broadly stable in FY22/23 at around 6% of GDP. However, the first half of FY23/24 (July-December 2023) has seen a 75.3% year-on-year increase

in the deficit in nominal terms as expenditure growth outpaced revenue growth, notably owed to a doubling in interest payments which now eat up as much as 97.8% of total budget revenues during the same period. For FY23/24 as a whole, the IMF projects interest payments to reach 87.2% of total budget revenues. The overall budget deficit is projected at 6.3% of GDP in FY23/24. Public debt stood at 95.9% of GDP at end-FY22/23, up from 88.5% the FY before and the highest since 2017, and is projected to rise to 96.4% this FY.

The current account improved but regional crises pose risks. At the same time, the UAE investment deal will probably raise imports. Following a deficit of 3.5% in FY21/22, the current account deficit narrowed to 1.2% last FY and improved by another 12% year on year in nominal terms during the July-September quarter. While tourism and Suez Canal proceeds provided strong support, goods exports eased. Remittances declined strongly as Egyptians abroad avoided the overvalued official exchange rate. Strong import compression helped keeping the overall deficit low. High-frequency data suggest that the usually strong income earners tourism and Suez Canal proceeds have since been hit particularly hard by the conflict in Gaza and the Red Sea attacks. The unification of the previously fragmented exchange rate system is likely to help lure remittances back into official channels. At the same time, implementing the UAE investment deal on the ground in early 2025 will probably push up imports.

In FY22/23, Egypt nearly reached its goal of USD 10 billion in FDI inflows, up by 12.3% over FY21/22. This included public asset sales under the new state ownership policy. The UAE investment deal will provide a further boost to FDI still this FY, although it remains unclear whether the state-directed investment by the Emirati sovereign fund will also induce market-driven investment from elsewhere. Portfolio investment flows, previously a significant although volatile source of hard currency, have not yet returned to Egypt after the massive outflow that started when Russia's war on Ukraine began, reflecting a key vulnerability for Egypt. The so far existing backlog of domestic reforms, including the long overdue exchange rate unification and, most recently, uncertainty due to the conflict in Gaza are likely to have deterred capital inflows further. Moody's lowered Egypt's sovereign credit outlook from stable to negative in mid-January 2024, citing the risks from growing interest service, the exchange rate rebalancing and mounting external pressures. Earlier in October 2023, Moody's, S&P and Fitch all downgraded Egypt's sovereign debt to below-investment grade due to record inflation, a chronic foreign currency shortage and the government's growing public debt.

Table 1: Egypt – Selected macro-economic indicators, FY17/18-FY22/23

| Egypt | FY17/18 | FY18/19 | FY19/20 | FY20/21 | FY21/22 | FY22/23 | Latest | Date of Latest |
|---|---------|---------|---------|---------|---------|---------|--------|----------------|
| Nominal GDP, USD billion | 263.2 | 317.9 | 382.5 | 423.3 | 475.2 | 398.4 | | |
| Nominal GDP per capita, USD | 2710.2 | 3240.5 | 3802.4 | 4145.9 | 4587.2 | 3770.1 | | |
| Real GDP, % change | 5.3 | 5.5 | 3.6 | 3.3 | 6.7 | 3.8 | 2.6 | Jul-Sep 2023 |
| Consumer price inflation, %, end-period | 13.8 | 9.4 | 5.6 | 5.0 | 13.1 | 35.8 | 29.8 | Jan 24 |
| Key monetary policy rate, %, end-period | 16.8 | 15.8 | 9.3 | 8.3 | 11.3 | 18.3 | 27.3 | Mar 24 |
| Unemployment rate, % | 10.9 | 8.6 | 8.3 | 7.3 | 7.3 | 7.2 | 6.9 | Dec 23 |
| General government balance, % of GDP | -9.7 | -8.0 | -7.0 | -7.2 | -6.2 | -6.0 | | |
| Public debt, % of GDP | 87.9 | 80.1 | 86.2 | 89.9 | 88.5 | 95.9 | | |
| Current account balance, % of GDP | -2.3 | -3.4 | -2.9 | -4.4 | -3.5 | -1.2 | | |
| International reserves, USD billion | 44.3 | 44.5 | 38.2 | 40.6 | 33.4 | 34.8 | 35.3 | Jan 24 |
| International reserves, months of imports | 7.0 | 6.7 | 6.3 | 5.7 | 5.6 | 6.8 | 7.6 | Jan 24 |
| Gross external debt, % of GDP | 37.0 | 36.0 | 33.9 | 32.6 | 33.0 | 40.3 | | |
| Net foreign direct investment, % of GDP | 2.9 | 2.6 | 1.9 | 1.2 | 2.0 | 2.6 | | |

Fiscal year is from July to June.

Sources: National authorities, IMF.

1.3. IMF and other donor support

On 16 December 2022, the IMF Executive Board approved a 46-month Extended Fund Facility for Egypt with an amount of around USD 3 billion. The Executive Board's decision allowed for an immediate disbursement of USD 347 million to help Egypt meet the balance of payments need and provide support to the budget. As mentioned, none of the two reviews planned for 2023 took place over concerns about insufficient reform implementation, while the overall external financing gap widened, also following spillovers from the conflict in Gaza starting in October 2023.

In January 2024, the IMF conducted the first and second formal review mission in Cairo, followed by continued virtual discussions, which resulted in the signing of a new staff level agreement on 6 March. The IMF agreed with the Egyptian authorities on augmenting the financial support by USD 5 billion, leading to a total envelope of USD 8 billion of the revamped programme. Driven by lower FDI and portfolio flows, weaker oil and gas receipts and the spillovers from the conflict in Gaza, Egypt's overall external financing gap had widened substantially. While the UAE investment deal will boost FDI in the current fiscal year and help rebuild some buffers, its medium-term implications on domestic investment, imports and the role of the state in the economy are not yet fully clear. Additional financial support from other bi- and multilateral donors amounts to USD 5.2 billion over the whole programme period and include the AIIB, AfDB, the Arab Monetary Fund, the China Development Bank, the Abu Dhabi Commercial Bank, the UAE central bank, Japan, France, and the UK. The World Bank contributes USD 2.6 billion.

The main elements of the augmented EFF arrangement remain similar to the original programme design:

- Reforming monetary and exchange rate policy by anchoring monetary policy firmly in a medium-term inflation objective and by making the exchange rate durably flexible.
- Focusing fiscal policy on putting public debt on a declining path, including the implementation of the medium-term revenue strategy, a strengthened debt management strategy and enhanced public financial management, in combination with adequate and targeted social spending to protect vulnerable groups.

- Strengthening private sector development by reducing the role of the state in the economy, improving SOE transparency and governance, and leveling the playing field between public and private companies.
- Following the 2024 review and signing of the new SLA, the IMF and authorities agreed on the necessity to limit and monitor infrastructure spending, notably if operated outside the regular budget oversight.

1.4. External financing needs

The IMF's estimates the overall external financing gap to amount to USD 28.5 billion during the FY22/23-FY26/27 period (see table). While the ongoing fiscal year's unidentified residual financing need, taking all multilateral and bilateral partners' existing contributions into account, is zero following the UAE investment, the IMF still expects a sizeable external financing gap for FY24/25 and beyond as portfolio inflows are expected to keep lagging initial projections and depleted buffers in official reserves need to be rebuilt. EU support through an MFA could help narrow these gaps. The IMF notably estimates these to have a front-loaded profile, with an overall external financing gap of USD 9.3 billion for FY24/25, USD 5.2 billion in FY25/26 and USD 3.2 billion in FY26/27, taking into account both increased foreign direct investment in the short-run and a deteriorating current account balance on the back of slumping remittances.

The IMF's augmented programme foresees disbursements over four years totalling USD 7.7 billion¹ following the new SLA in March 2024. This corresponds to 30.2% of the overall external financing gap for the remaining programme period (FY23/24-FY26/27). The combined IMF/World Bank contributions add up to USD 10 billion over the remaining programme period, FY23/24-26/27, covering 39.2% of the corresponding overall external financing gap.

Projected asset sale proceeds of USD 7.7 billion are expected during the four-year period (of which USD 6.4 billion are frontloaded in FY23/24-FY24/25).

¹ Resulting from the augmented total programme amount of USD 8 billion, deducting the initial USD 347 million disbursement of December 2022.

Table 2: Egypt's External Financing Gap (USD billion)

| | FY22/23 | FY23/24 | FY24/25 | FY25/26 | FY26/27 |
|---|-------------|--------------|-------------|-------------|--------------|
| 1 Current account balance | -4.7 | -21.8 | -7.8 | -9.0 | -10.7 |
| 2 Capital and financial account | 7.2 | 29.1 | 7.2 | 14.8 | 15.1 |
| 3 Errors and omissions | -3.3 | 1.4 | 0.0 | 0.0 | 0.0 |
| 4 Overall balance (1+2+3) | -0.8 | 8.7 | -0.6 | 5.8 | 4.4 |
| 5 Gross reserves (- increase) | -4.8 | -12.0 | -3.0 | -8.0 | -6.0 |
| 6 IMF repayments | -1.3 | -4.5 | -5.8 | -3.1 | -1.7 |
| 7 Other below-the-line adjustments* | 3.9 | 0.0 | 0.1 | 0.0 | 0.0 |
| 8 Overall financing gap (4+5+6+7) | -3.0 | -7.8 | -9.3 | -5.2 | -3.2 |
| 9 Exceptional financing by the IMF and WB | 0.7 | 1.9 | 3.2 | 3.1 | 1.8 |
| IMF | 0.3 | 1.6 | 2.5 | 2.5 | 1.2 |
| World Bank | 0.4 | 0.3 | 0.7 | 0.6 | 0.6 |
| 10 Residual financing gap (after IMF and WB) | -2.3 | -5.9 | -6.1 | -2.1 | -1.4 |
| 11 Other prospective financing | | | | | |
| AIIB | 0.0 | 0.0 | 0.3 | 0.0 | 0.0 |
| African Development Bank | 0.3 | 0.2 | 0.0 | 0.0 | 0.0 |
| Arab Monetary Fund | 0.0 | 0.3 | 0.0 | 0.0 | 0.0 |
| China Development Bank | 0.0 | 1.0 | 0.0 | 0.0 | 0.0 |
| Abu Dhabi Commercial Bank | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| UAE Central Bank | 0.0 | 1.4 | 0.0 | 0.0 | 0.0 |
| Sales of state-owned assets (including to GCC) | 0.0 | 2.8 | 3.6 | 0.9 | 0.4 |
| New deposits at CBE (to be converted in divestment) | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Japan | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 |
| France | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| United Kingdom | 0.0 | 0.0 | 0.2 | 0.2 | 0.0 |
| Unidentified financing | 0.0 | 0.0 | 2.1 | 1.0 | 1.0 |

Source: IMF.

*Includes changes in gold valuation and a statistical correction for programme purposes, eliminates transfers from Tier 1 to Tier 2 from errors and omissions.

1.5. Structural reforms

Reform achievements on IMF programmes in 2016-2023

Egypt has made considerable reform efforts since its reengagement with the IMF in 2016, although progress has slowed in recent years. The most urgent reforms to achieve macroeconomic stabilisation included a significant currency devaluation, accompanied by monetary policy reforms focused on an inflation target corridor. Fuel subsidy reform was coupled with a significant

strengthening of a targeted social transfer system with World Bank assistance. Public finance management was strengthened by developing medium-term revenue and debt management strategies. The authorities also began improving the governance of state-owned enterprises (SOEs) by compiling financial data of SOEs and other state-connected entities in a systematic manner. Structural reform efforts, however, experienced repeated setbacks as the focus shifted back to macroeconomic and social stabilisation under the significant external shocks related to the COVID-19 pandemic, the Russian invasion of Ukraine, the consequences of the Hamas terrorist attacks across Israel of 7 October 2023.

In the framework of Egypt's renewed IMF-supported reform programme, agreed in October 2022, the authorities adopted and published a state ownership policy in December 2022, aiming at reducing the large and distorting presence of the state in the economy and clarifying the rationale of continued state involvement in certain strategic sectors. The authorities achieved state asset sales of USD 1.9 billion by the end of FY22/23, although the numerical target agreed under the EFF was slightly missed and not all sales generated the envisaged foreign exchange inflows. Given the economic uncertainty created by the recent regional tensions, the authorities and the IMF have agreed to backload the asset sales while keeping the overall target for the full programme period. The recent UAE investment is separate from the state ownership policy; the government will assume a 35% share in the new real estate development project. In an effort to level the playing field between public and private companies, parliament adopted a law to abolish tax privileges of SOEs, although the effects of potential exemptions on the basis of national security remain unclear so far. Until early March 2024, Egypt had not implemented its commitment to make the currency durably flexible, leading to a largely stable official exchange rate since the last managed devaluation in early 2023, and a substantial parallel market with a highly volatile rate at about half the value of the official rate. This fragmentation presented a major drag on foreign investment and exacerbated the divide between public companies with access to the official exchange rate, and private companies and consumers who were depending on the parallel market rate. Eventually, the fresh liquidity thanks to the UAE investment deal facilitated the flexibilization of the exchange rate on 6 March 2024, enabling the unification of rates.

Main government reform priorities ahead

Egypt's reform priorities as spelt out in the IMF-supported programme adopted in December 2022 remain valid, as reflected in the new SLA from 6 March 2024. The authorities aim at anchoring monetary policy firmly in a medium-term inflation objective and allowing the exchange rate flexibility to reflect underlying market and balance of payment dynamics. Fiscal policy priorities include an overall fiscal consolidation to strengthen debt sustainability, accompanied by implementing the medium-term revenue strategy, fostering debt management to lower the high interest burden, and further enhancing public financial management by promoting transparency and better managing fiscal risks. This path of fiscal prudence shall be accompanied by more adequate levels of social spending to protect vulnerable groups. The authorities also committed to empower private sector development through implementing the state ownership policy and continuing state asset sales, strengthening the transparency and governance of public companies and improving the competition environment.

In addition to these previously existing priorities, the IMF and the Egyptian authorities also agreed on introducing a new framework to slow down infrastructure spending, notably with regard to operations outside the regular budget oversight, supported by a new monitoring mechanism.

Moreover, the Egyptian authorities are currently working on a more detailed reform matrix together with the World Bank, which is set to also reflect the main areas of IMF-supported reforms within a broader framework that could be expected to also involve measures addressing other important structural issues facing Egypt such as the need to improve its business environment and public services or to facilitate the green transition.

2. OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE

2.1. Objectives

The objectives of the proposed MFA operation are to:

- i) Contribute to covering the external financing needs of Egypt in the context of a sizeable external financing gap brought about by persistent macroeconomic imbalances and external shocks.
- ii) Support the fiscal consolidation effort and external stabilisation expected in the IMF programme.
- iii) Support structural reform efforts aimed at improving overall macroeconomic management, strengthening economic governance and transparency, and improving the conditions for sustainable growth.
- iv) Facilitate and encourage efforts by the Egyptian authorities to implement measures identified under the EU-Egypt Association Agreement and in the context of bilateral cooperation programmes (including capacity-building), and strengthen the EU's economic policy dialogue with the authorities.

2.2 Monitoring indicators

The fulfilment of the objectives of the assistance will be assessed by the Commission, including in the context of the ex-post evaluation (see below), on the basis of the following indicators:

- i) Progress with macroeconomic and financial stabilisation, notably by assessing the degree of adherence to the IMF-supported programme.
- ii) Progress with the implementation of structural reforms, notably the specific policy actions to be identified as conditions for disbursement of the assistance, which will be included in a Memorandum of Understanding to be negotiated between the Commission and the Egyptian authorities.

3. DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1 Delivery mechanisms

The proposed new MFA operations would cover part of the residual financing gap for the 2024-2027 period and amount to up to EUR 5 billion in loans, divided into a short-term MFA operation of up to EUR 1 billion to be disbursed in one instalment, and a regular MFA operation of up to

EUR 4 billion to be disbursed in three instalments. As usual, these loans would have favourable conditions in terms of long maturities (of up to 35 years and an interest rate corresponding to the EU's favourable credit rating, at which it borrows the funds in the international capital markets).

As the proposed amount is significant in terms of its share in the coverage of the residual financing gap (i.e. by 56.7% during the period of FY24/25-FY26/27), it is important to ensure the MFA's value added, notably by providing the EU with sufficient leverage to promote reforms. To that end, policy conditions will be attached to the MFA's disbursements, with each instalment, including the first one, being subject to good progress with the IMF programme and the specific actions agreed with the EU in the Memorandum of Understanding as well as progress in relation to the political preconditions.

3.2 Risk assessment

Any MFA operation faces external and domestic risks. On the external side, Egypt has experienced significant shocks related to the COVID-19 pandemic, Russia's invasion of Ukraine and the consequences of Hamas terrorist attacks across Israel of 7 October 2023. Further escalation of the regional tensions could adversely impact Egypt's economic situation and further increase its external financing needs. On the domestic side, risks relate to potential underperformance of macroeconomic and structural reforms, linked to political perceptions of possible social unrest and to resistance to reforms from vested interests in SOEs or other state-connected entities. Taken together, these risks could endanger macroeconomic stability and prevent the effective disbursement of the MFA, but also highlight the need for urgent action to start to address the root causes of Egypt's problems and is hence the very reason to propose this MFA package in the first place.

Moreover, in line with the requirements of the Financial Regulation, the Commission services will carry out before the implementation of the MFA an Operational Assessment of the financial and administrative circuits of Egypt in order to ascertain that the procedures in place for the management of programme assistance, including MFA, provide adequate guarantees.

Finally, the assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Anti-Fraud Office (OLAF), and the European Court of Auditors.

Having made a thorough assessment of the risks, the Commission services consider that there are sufficient grounds and guarantees to proceed with the proposed MFA to Egypt.

The Commission services will maintain close contacts with the Egyptian authorities during the implementation of the macro-financial assistance in order to address quickly any concerns that may arise.

4. ADDED VALUE OF EU INVOLVEMENT

The Union's financial support to Egypt including under the new Strategic and Comprehensive Partnership reflects the country's strategic importance to the EU in the context of the European Neighbourhood Policy. The MFA instrument is a policy-based instrument directed to alleviate short- and medium-term external financial needs. As a part of the overall EU package of assistance under the Strategic and Comprehensive Partnership, composed of financial instruments, such as guarantees and blending instruments, as well as support for specific priorities implemented under

the Neighbourhood, Development and International Cooperation Instrument (NDICI), it would contribute to fostering the Union's objectives of economic stability and economic development in Egypt. By supporting the authorities' efforts to establish a more stable macroeconomic framework and improve economic governance, the proposed assistance would help improve the effectiveness of other EU financial assistance to the country. The proposed MFA would increase substantially the EU's leverage on policy making in Egypt, helping steer the country towards a reform trajectory that should help maintain macroeconomic stability, address structural economic problems and boost potential growth in the longer run.

Moreover, the MFA is part of an international joint effort, effectively complementing the programmes and resources provided by the IMF, the World Bank and other bilateral and multilateral donors. In combination, the financing provided by the multilateral and bilateral creditors/donors (including state asset sales, including to the GCC) other than the EU to cover the overall financing gap over the envisaged MFA period from FY24/25-FY26/27 would cover at least 77% of the overall external financing gap, ensuring reasonable burden sharing between the Union and other donors, as well as the added value of the overall Union involvement.

5. CHARACTERISTICS OF MACRO-FINANCIAL ASSISTANCE

5.1 Exceptional Character and Limited Time-frame

The planned assistance package would be divided into two MFA operations: a short-term MFA operation, under a strictly limited timeframe of 9 months to be provided via one instalment to ensure a disbursement still in 2024, which therefore has a clear exceptional character. This would be followed by a regular MFA operation of 2.5 years, to be disbursed in three instalments.

The legal basis for the proposal for the second, medium-term part of the MFA package would be Article 212 TFEU, while for the proposal for the short-term MFA operation it would be Article 213 TFEU. Using Article 213 TFEU is clearly a second-best option, but a first disbursement still in 2024 in response to Egypt's particularly acute financing needs this year would appear impossible if the decision was to be adopted by both the Parliament and the Council in accordance with Article 212 TFEU under the ordinary legislative procedure, taking into account the constraints imposed by the upcoming end of the Parliament's legislative period in conjunction with the time still needed thereafter to fully enact the MFA, including for agreeing on a set of policy reforms to underpin the assistance. The Commission considers it therefore justified to use Article 213 TFEU providing for the adoption of the decision by the Council only for the first part of the package, without prejudice to other future, regular MFA operations. The recognition of the second-best nature of relying on Article 213 motivates the split of the package into two proposals, rather than one proposal under Article 213 for the entire support, where the limited share of the first part within the overall volume of support under the package has been calibrated taking this into account, in addition to Egypt's urgent financing needs.

5.2 Political preconditions and EU-Egypt relations

Human rights challenges in Egypt remain significant, particularly in relation to the protection of fundamental freedoms, governance and the rule of law. However, in the last few years, the political leadership in Egypt has taken several steps putting greater emphasis on the importance of the respect for human rights; it abolished the state of emergency (apart from areas in the Sinai), launched the first ever National Strategy for Human Rights, relaunched the Presidential Amnesty

Committee, releasing over 1000 political prisoners, and embarked on the National Dialogue. Further, Egypt has intensified its engagement on human rights with the EU, allowing for the first time the visit of the EU Special Representative for Human Rights to Cairo in 2022. Egypt has also recently started engaging in international fora and it is cooperating with the UN OHCHR in an EU funded project that aims to establish an EU-UN partnership, joining synergies to reinforce respect of human rights in Egypt. Egypt has further declared in its National Strategy for Human Rights its intention to reform the law on pre-trial detention, ameliorate detention conditions, limit the number of crimes punished by death sentence and enhance the respect of human rights across all government institutions. Effective implementation is needed, progress having so far been made in the institutional track.

In light of the above, it can be assessed that Egypt has taken some relevant steps towards fulfilling the criteria. At the same time, effective progress on implementation needs to continue, notably in the framework of Egypt's own National Strategy for Human Rights. Progress will be monitored continuously throughout the implementation of the MFA so as to ascertain that compliance with the criteria moves in a satisfactory direction.

5.3 Complementarity

As outlined above, the planned MFA would be part of a joint effort with other multilateral and bilateral donors in the context of the IMF-supported programme, where it would thus complement other international assistance. This is consistent with standard practices on burden-sharing for MFA operations (for a country with an Association Agreement, the upper limit would be 60% according to the Council conclusions of 8 October 2002), taking into account the assistance pledged to Egypt by other bilateral and multilateral donors.

The MFA would also complement additional assistance under the Strategic and Comprehensive Partnership to be agreed between the EU and Egypt. This assistance, which will be programmed under the NDICI, will consist of financial instruments, such as guarantees and blending instruments, aimed at mobilising public and private investments with the objective of generating substantial new investments, as well as programmes to support specific priorities under the Strategic and Comprehensive Partnership through individual projects and technical assistance.

5.4 Conditionality

Disbursements under the proposed MFA operation would be subject to successful reviews under the IMF programme and on the effective drawing by Egypt on IMF funds, as well as on continued monitoring of progress in relation to the political precondition. In addition, the Commission – on behalf of the EU – and the Egyptian authorities would agree on a specific set of structural reform measures, to be defined in two Memoranda of Understanding, one for each of the two operations. These reform measures would support the authorities' reform agenda and complement the programmes agreed with the IMF, the World Bank and other donors, as well as the policy programmes associated with the EU's budget support operations. A structural reforms matrix that is currently being agreed under World Bank coordination can further inform the prioritisation of reform measures to be associated with the EU assistance. The reform measures would also be consistent with the main economic reform priorities agreed between the EU and Egypt in the context of the Association Agreement and the Partnership Priorities.

The agreed reform priorities could, in principle, include the key areas of reducing the state's economic footprint, reducing inefficiencies in the foreign exchange market, improving public financial management. This remains important to increase external financial inflows and foster investment both being necessary requirements to underpin a more resilient and sustainable economic recovery.

- **Reducing the state's economic footprint**

The state's significant footprint in the economy is a major drag on economic growth and at the root of many of Egypt's economic and fiscal issues. The excessively high state involvement in the Egyptian economy causes economic inefficiencies, crowds out private sector activity and weighs on the business and investment climate. Moreover, it is weighing on Egypt's fiscal space, which is urgently needed given persistent fiscal deficits and growing public debt. In this regard, it is important that the Egyptian Competition Authority has sufficient resources to supervise and enforce competitive neutrality independently, and that the state asset sale programme is duly implemented.

- **Reducing inefficiencies in the foreign exchange market**

Following the signature of the new staff level agreement in March 2024, the authorities floated the exchange rate and committed to allowing the exchange rate to be determined by market forces. Beforehand, the pound had remained fixed at an overvalued level, which had led to the emergence of a parallel market with a significant mark-up. Experience from other countries has shown the inefficiency and high costs of multiple exchange rate regimes for businesses and households while benefitting a privileged few with exclusive access to the official rate. It will therefore be important to monitor the effective implementation of the authorities' commitment to keep the exchange rate durably flexible.

- **Improving public financial management (PFM)**

Egypt has structurally relatively low budget revenues, and is in ongoing discussions with the World Bank on how to enhance budget generation. It would be important for Egypt to improve its public finance management framework (including for debt management) and implement the PFM law, including the adoption of a medium-term revenue strategy. Other areas of PFM warranting reform are public procurement and social transfer mechanisms.

In addition to these core objectives, it is clear that Egypt needs a broader set of reforms. The Egyptian authorities are currently devising a reform matrix in collaboration with donors including the World Bank, which could serve as a guiding document for the selection of further reforms that could be supported by the MFA, also to help ensure ownership from the Egyptian side.

5.5 Financial Discipline

The proposed MFA assistance package of up to EUR 5 billion in loans for Egypt would be divided into two MFA operations. First, a short-term MFA operation under a strictly limited timeframe of 9 months to be provided via one instalment to ensure a disbursement still in 2024. This would be followed by a regular MFA operation of 2.5 years, to be disbursed in three instalments of broadly similar size between 2025 and 2027. The required provisioning at a rate of 9% of the External

Action Guarantee will be programmed under the NDICI, for a total amount of EUR 450 million (budget line 14 02 01 70 “NDICI – Provisioning of the Common Provisioning Fund”)².

To ascertain that the beneficiary has in place a sound financial management in line with the requirements of the Financial Regulation, the Commission will undertake an Operational Assessment that should provide a report on the reliability of the financial circuits and administrative controls at the Ministry of Finance and the Central Bank of Egypt, before the first disbursement would take place.

6. EVALUATION AND COST-EFFECTIVENESS

This assistance is of exceptional and macroeconomic nature and its evaluation will be undertaken in line with the standard Commission procedures.

6.1 Evaluation

Ex-post evaluations of MFA operations are foreseen in the Multi-Annual Evaluation Programme of the Commission's Directorate-General for Economic and Financial Affairs. An ex-post evaluation of the proposed MFA to Egypt will be launched within a period of two years after the availability period has expired. A provision for the ex-post evaluation is included in the proposed Decision for the assistance and will also be included in the Memorandum of Understanding. Budget appropriations from the macro-financial assistance grant budget line will be used for this evaluation.

6.2 Achieving cost-effectiveness

The proposed assistance would entail a high degree of cost effectiveness for several reasons:

- i) Since the assistance would be leveraged by that provided by the international financial institutions, with which, as noted, it would be closely coordinated, its ultimate impact could be very significant compared to its cost. Moreover, in negotiating specific policy conditions, the Commission will be able to draw on the expertise of those institutions, including the IMF and the World Bank, and to influence their conditionality as well in ways that will take into account the EU's views.
- ii) Providing coordinated macroeconomic support to Egypt on behalf of the EU countries, the MFA would be more cost efficient than the provision of a similar total amount of financial support by EU Member States individually.
- iii) As the proposed assistance would be provided in the form of loans, the budgetary impact of which is more limited.

² The budget line will be reinforced from a geographical NDICI budget line.

- iv) Finally, the Commission will aim at achieving synergies with other EU policies and instruments used to support the implementation by the beneficiary of the relevant measures (notably in the area of PFM).

EUROPEAN EXTERNAL ACTION SERVICE



Managing Director

MD-MENA Middle East and North Africa

Brussels, 11 March 2024

ASSESSMENT ON DEMOCRACY, HUMAN RIGHTS, RULE OF LAW AND REFORMS IN THE ARAB REPUBLIC OF EGYPT

Human rights challenges in Egypt remain significant, particularly in relation to the protection of fundamental freedoms, governance and the rule of law. However, in the last few years, the political leadership in Egypt has taken a few steps putting greater emphasis on the importance of the respect for human rights; it abolished the state of emergency (apart from areas in the Sinai), launched the first ever National Strategy for Human Rights, relaunched the Presidential Amnesty Committee, releasing over 1000 political prisoners and embarked on the National Dialogue. Further, Egypt has intensified its engagement on human rights with the EU, allowing for the first time the visit of the EUSR for Human Rights to Cairo in 2022. Egypt has also recently started engaging in international fora and it is cooperating with the UN OHCHR in an EU funded project that aims to establish an EU-UN partnership, joining synergies to reinforce a culture of human rights in Egypt. Egypt has further declared in its National Strategy for Human Rights its intention to reform the law on pre-trial detention, ameliorate detention conditions, limit the number of crimes punished by death and enhance the culture of human rights across all government institutions. Effective implementation is needed, progress having so far been made in the institutional track.

In light of the above it can be assessed that Egypt has taken some relevant steps towards fulfilling the criteria. At the same time, effective progress on implementation needs to continue, notably in the framework of Egypt's own National Strategy for Human Rights. Progress will be monitored continuously throughout the implementation of the MFA so as to ascertain that compliance with the criteria moves in a satisfactory direction.