

**PROGRAM-FOR-RESULTS INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: 126364

Program Name	Additional Financing to Sustainable Rural Sanitation Services Program for Results
Region	Middle East and North Africa
Country	Arab Republic of Egypt
Sector	Sub-National Government, Health, Sanitation
Lending Instrument	Program for Results
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Borrower	Ministry of Investment and International Cooperation
Implementing Agency	Ministry of Housing, Utilities and Urban Communities
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I. Country Context

1. Egypt has adopted a bold and transformative reform program to restore macroeconomic stability. Egypt is a lower-middle-income country with a population of 96 million (Census 2016) and a gross domestic product (GDP) per capita of US\$2,048. Following a build-up of macroeconomic imbalances that had resulted in declining growth, rising debt, and a widening current account deficit, the Egyptian authorities undertook decisive policy actions since the launch of the reform program in 2016. In November 2016, the currency was floated eliminating the overvaluation and the shortage in foreign exchange shortage, and the authorities moved forward with important fiscal consolidation measures, including significant energy subsidy reforms, and introducing a value-added tax (VAT). This is in addition to critical pieces of legislation necessary to strengthen the business climate, attract investments, and promote growth, including the adoption of an industrial licensing law, a new investment and insolvency law. The government's reform program is widely endorsed, including through the World Bank's programmatic DPF series (FY16-18) and the IMF's three-year Extended Fund Facility approved in November 2016 in the amount of estimated US\$12 billion.
2. Real GDP grew by 4.2% in fiscal year 2016/17, in line with 4.3% the year before, despite the fiscal consolidation efforts. Furthermore, growth accelerated to 5.2% in the first half of FY2017/18, compared to 3.6% in the same period of the previous year. Medium-term growth prospects are favorable, provided growth-friendly policies and reforms continue to be implemented. Downside risks include slower implementation of reforms, which would undermine fiscal sustainability and private investment. Annual headline inflation has fallen to 14.4% in February 2018, from a peak of 33% in July 2017. The rapid decline in inflation over the past six months reflects the unwinding impact of the steep currency depreciation, hikes in administered prices and the introduction of VAT.

3. While the economy is recovering and macroeconomic imbalances are starting to narrow, social conditions remain challenging. Poverty rates, based on national poverty thresholds, place about a third of the population below the poverty line in 2015. Regional income disparities are an enduring characteristic, with Upper Rural Egypt lagging other regions. The unemployment rate is 12% (at end-FY2016/17), a decrease from 12.5% the year before, while the youth unemployment rate is 25.7%. The government is strengthening social safety nets through the expansion of cash transfer schemes and increases in social pensions and food subsidy allocations. Although Egypt has made significant strides in human development in the areas of child mortality, life expectancy, primary and secondary school enrollment and literacy rates, there are persistent challenges with large inequalities in access to and quality of basic social services.
4. In the past two decades Egypt has made significant progress in providing direct access to safe drinking water at the household level (96 percent) and basic sanitation services (82 percent). However, geographical and socio-economic disparities remain - an estimated 90 percent of urban households are covered by public sewers compared to only 18 percent in rural areas. Currently, in rural areas, an estimated 77 percent of collected wastewater is treated but most treatment plants do not achieve Egyptian effluent standards. Rural areas of the Nile Delta are particularly affected due to high population density, shallow groundwater levels, and the discharge of untreated sewage directly into the water system. This situation is expected to worsen due to climate change.
5. Government is pursuing important fundamental institutional change to service delivery systems to address critical service delivery needs of poor communities. The consequences of inadequate sanitation services in rural communities is a highly visible example of the failure of centralized approaches to meet the basic needs of Egypt's most vulnerable citizens and to produce a healthy environment. About 50.66 million people in the rural areas are underserved by proper sanitation services and are often faced with overflowing sewage from traditional septic tanks. Add to it the challenge faced by Egypt that has high water tables that are being contaminated by the inadequate sanitation services. Government has recognized the urgency to address the sanitation issue in rural Egypt and, equally important, an opportunity to pursue a different approach to service delivery. The Additional Finance (AF) will build on the parent operation switching the focus from centralized infrastructure investment to accountability for service delivery at the local level. The AF comprises of structural shifts in responsibility from centralized agencies to local water and sanitation utilities; reform of their public finance – including the introduction of transparent and predictable fiscal transfers and linkage of such transfers to service delivery performance; building of mechanisms that ensure bottom-up and top-down accountability through citizen report cards (including greater voice for women), grievance mechanisms, audit reforms, and independent verification and the linking of performance grants to this feedback. The AF will also focus on measures that are critical for the long-term sustainability of the sector and improved service delivery. This will include supporting the development of a financial model that will allow for sustainable cost recovery for water and sanitation services; developing a national water and sanitation sector strategy and action plans; and strengthening the Egyptian Water Regulatory Authority (EWRA) to deliver its mandate.

II. Sectoral (or multi-sectoral) and Institutional Context

6. The sanitation is of particular concern in the rural areas of the Nile Delta compared to other areas in Egypt due to high groundwater levels and the discharge of untreated sewage directly into the Nile Delta water system. With increased household water use resulting from household water supply connections, the traditional bayaras (sanitation trenches used as septic tanks) are failing particularly in the Nile Delta, where the water table is high and soil has low percolation. As a result, the sewage overflows into the streets, and, in some areas has undermined building foundations resulting in the collapse of houses. To prevent the overflow, households must clean their bayaras frequently (up to once a week), and pay up to EGP 250 every month to have them emptied, which in many cases largely exceeds the costs that households would pay for conventional sanitation solutions and is unaffordable for the rural poor. Even when the bayaras are emptied, most septic-emptying services are informal, privately operated, and unregulated, and they regularly dispose of the sewage directly into open irrigation canals and drains, where the water flows through populated areas and is reused for agricultural production. As a result of the high water table and discharge of untreated wastewater, Egypt's scarce freshwater resources are increasingly polluted, and the health of millions is at risk. The prevalence of diarrhea in children under the age of five is highest in rural lower Egypt and disproportionately impacts the poorest. The situation is particularly critical in villages along the Nile River and its many branches and tributaries, which are the lifeline of the country and which supply water to tens of millions of people.
7. Despite significant Government and donor financing for rural sanitation improvements, progress has been far below expectations. While investments have made some progress, they have generally suffered from: (i) very slow implementation; (ii) inflated construction costs and poor quality; (iii) poor coordination between major infrastructure such as wastewater treatment plants (WWTP) and local network connections; and (iv) use of technologies which result in high operation and maintenance costs relative to service needs.
8. Many of the problems faced stems from stalled institutional evolution in the sector which has resulted in an inefficient service delivery model. At the core of many problems of the water and sanitation sector are the centralized models of decision making, infrastructure investment, and service delivery. Government, with support from USAID and other partners, developed an institutional road map which consolidated most of the water and wastewater service providers under a Holding Company for Water and Wastewater (HCWW) with the intention of corporatizing the entities as individually accountable utilities for all aspects of water and wastewater services. However, the process was stalled prior to initiating a gradual shift of responsibility for planning and implementing infrastructure development from the centralized construction agencies to the individual water and sanitation companies (WSCs). Currently, infrastructure investments in the sector are included in the Five Years Plans and financed out of sector budget allocations in the annual budget. The mode of financing is based on estimated requirements for specific investment projects and do not match with the actual requirements of WSCs in terms of their capital investment and service delivery needs. Moreover, the financing tends to be ad-hoc and unpredictable, as a result of which WSCs are not in a position to realistically plan and implement capital investment projects. Financially, they are heavily subsidized by the central Government and have no independent authority to raise tariffs, which are set by the Cabinet. The cost of insufficiencies in the wastewater sector have been estimated

at EGP 7.1 Billion per year. The fiscal transfers to cover operating inefficiencies, below cost tariffs, excessive wastewater infrastructure and financing costs represent 1.25 percent of 2007 GDP.

9. The sector's centralized institutional model has exacerbated the challenge with infrastructure developed by the National Organization for Potable Water and Sanitary Drainage (NOPWASD) while operation and maintenance (O&M) is the responsibility of the governorates' Water and Sanitation Companies (WSCs). This disconnect has resulted in under-utilized or under-performing assets – due to both technical and financial constraints. Further, the WSCs have low levels of cost recovery associated with poor operational efficiency. This has resulted often in inappropriate choice of investment projects with little attention paid to maintenance and institutional aspects of services as well as poor accountability on the part of the WSCs in terms of utilizing these investments to enhance the quality and efficiency of sanitation services. Institutionally, these WSCs are beholden to the central level organizations from which they have inherited assets which they must manage and maintain.
10. Low water and wastewater tariffs have jeopardized the financial sustainability of the sector, resulting in the deterioration of the already weak financial performance of the WSCs, Water and sanitation operations and investments are funded entirely through the Government budget. The Ministry of Finance (MoF) provides budget allocations to the Ministry of Housing, Utilities and Urban Communities (MHUUC) for operating subsidies and infrastructure development grants. Low tariffs and inadequate financial incentives for reducing operational and maintenance costs and capital expenditures impede financial sustainability of the WSS services. The sporadic tariff increases implemented since 2004 have been marginal, on a very low base, until 2015, where the Government started to make gradual higher increases. The Egyptian Water Regulatory Authority (EWRA) advises the Cabinet on tariff related matters, but its role and independence are limited under the current legal framework.
11. The Government recognizes the urgency of addressing the country's sanitation challenges and, through its US\$ 11.3 billion National Rural Sanitation Program (NRSP – a key Presidential Program), aims to provide universal access to rural sanitation services and to encourage improved performance and sustainability at the WSC level.
12. The Program, including the AF, is in line with the existing Country Partnership Framework (FY 2015-2019) Focus Area 1- improving governance and institutional reform – by promoting transparency and efficiency, supporting inclusive institutions, and promoting citizen engagement and voice. Water and sanitation are also highlighted in the CPF as needing attention (Focus Area 3, Social Inclusion), including improvements to water service delivery, water quality, and sanitation services – all of which are supported under the Program. The Program is also aligned with the first pillar of the World Bank's regional strategy for MENA (“Economic and Social Inclusion for Peace and Stability in the Middle East and North Africa: A New Strategy for the World Bank Group”).

III. Program Scope

13. The Bank-financed Sustainable Rural Sanitation Services Program (SRSSP) finances a geographic slice of NRSP in six governorates (Beheira, Dakahliya, Damietta, Gharbiya, Menoufiya and Sharkiya) that discharge into the highly polluted Al Salam and Rosetta Branch waterways in the Delta. SRSSP is focused on three key results areas (RA) and eight Disbursement Linked Indicators (DLI). Improving access to sanitation is under RA 1. Improving the Performance of the WSCs is under RA 2. Strengthening National Sector Framework is RA 3. Under the Program, the six Governorates shall have access to sanitation which will be provided for about 1.71 million people living in villages and satellite areas where the water ways are highly polluted. Performance-based Capital Grants (PBCGs) will be made by MHUUC to the WSCs to carry out priority rural sanitation investments in network expansion and wastewater treatment plants construction/rehabilitation. Under the Program' RA 2s, the WSCs' performance in operational, financial, institutional and citizen engagement areas will be strengthened. For RA 2, activities will focus on capacity building for key institutions within the sector and strengthening the enabling environment for efficient and accountable rural sanitation service delivery, with a focus on (i) supporting the development of a financial model that will allow for sustainable cost-recovery, (ii) developing a National Water and Sanitation Sector Strategy, (iii) mainstreaming and updating the standard operating procedures for land acquisition for the sector, and (iv) supporting EWRA to deliver its mandate.
14. The GoE has requested an AF from the Bank to co-finance with the Asian Infrastructure Investment Bank (AIIB) with an amount of US\$ 600 which will be cost shared equally between both institutions to build on the success and strong impact of the original Program by scaling up activities into three new governorates that discharge into the same highly polluted channels (a total of 175,000 additional connections) whilst furthering the reform agenda (primarily building capacity of EWRA to drive sector accountability and financial sustainability).
15. The proposed additional loan would help finance the expenditures associated with the scaling up the Program to three additional governorates and their respective WSCs with the aim of i) improving access to sanitation services by extending access to an additional 175,000 households scaling up the Program to three additional governorates and their respective Water and Sanitation Companies (WSCs) to; ii) improve the WSC operational systems and practices; (iii) further strengthening the national sector framework, the sector's institutions (especially the EWRA), policy and monitoring and evaluation (M&E) framework; and iv) introducing an Investment Project Financing (IPF) component for Technical Assistance on strategic sector issues.
16. Government will continue pursuing an institutional approach which encourages greater sustainability of the financial framework, as well as measures to strengthen service delivery and the enabling environment. The Government will apply the system of fiscal transfers on the additional three WSCs as part of the reform strategy in the sector so that financial resources are available to WSCs on a transparent and predictable manner and to provide incentives to enhance institutional performance and accountability in the sector. The GoE is also working with development partners including the Bank to strengthen the capacity of the WSCs.

17. Strengthening accountability is a core aspect of the Government's service delivery reform strategy and its National Rural Sanitation Program. In accordance with its policy of decentralizing service provision, the GoE will continue strengthening the social contract between the service delivery organizations such as the WSCs and the citizens who avail themselves of these services. Moving away from a top down approach to the planning and execution of infrastructure services, the Government will enhance the formal and informal accountability relationships of service providers by putting in place systems and practices for active citizen engagement as part of the WSCs planning and management systems. By continuing the downward accountability of the WSCs to their customers, the Government expects the investment and service delivery decisions of WSCs to be more responsive to local priorities and intends as well that the quality of service delivery will be improved through active feedback from citizens and civil society.

IV. Program Development Objective(s)

18. To strengthen institutions and policies for increasing access and improving rural sanitation services in the selected governorates in the Arab Republic of Egypt.

V. Environmental and Social Effects

19. The Addendum that has been prepared for the parent Program's environmental and social system assessment (ESSA – July 2015) to cover the three AF Governorates and their WSCs, concluded that the ESSA analysis and conclusions apply to the new geographic coverage of the AF as the environmental and social context is highly similar to the governorates of the parent Program. The overall environmental and social impacts are expected to be positive and the risks/impacts could be minimized/mitigated through the existing system with some gap-filling measures. AF investments are not of significant adverse impacts that are sensitive, diverse, or unprecedented on the environment and/or affected people, and any such investments were excluded and measures will be taken to exclude any investments that might entail high risk on the Program. The Addendum included measures to further strengthen the environmental and social systems. Those measures were/will be integrated in the legal covenants, PAP, the verification protocol for some of the DLIs and the TA component of the PforR.
20. The TA IPF component will involve contracting consultants to carry out strategic studies on water supply and sanitation. The National Water and Sanitation Strategy (NWSS) included in TA IPF could lead to some environmental and social impacts related to the approach in providing water supply and sanitation services and the technologies that will be supported by the strategy. The TA will entail the preparation of studies, plans and programs that may also involve topics related to land acquisition and associated issue. Therefore, the TA is classified as Category B, and the following safeguard policies are triggered: OP 4.01 Environmental Assessment, OP 4.12 Involuntary Resettlement, and OP 7.50 Projects on International Waterways.
21. The safeguards instrument that will be prepared will be a Strategic Environmental and Social Assessment (SESA) and a Poverty and Social Impact Analysis (PSIA). The ToRs for both instruments were prepared and will be disclosed before appraisal. Regarding the OP7.50, although the TA will involve water and sanitation strategies that could result in plans for

abstracting water from the River Nile and discharging treated wastewater to the drainage system, the TA fulfills the conditions for exemption from notification as it is limited to strategic studies and it is related to the extreme downstream of the river without any possible effect on riparian countries.

22. The Resettlement Policy Framework will take the form of Standards Operations Procedures (SOP) for land acquisition. The SOPs were already prepared by the Government of Egypt under the parent Program, reviewed by the Bank team and are now being implemented in the three WSCs of the parent Program. Under the AF, the SOP will be reviewed to align with OP 4.12 and function as an RPF that will apply to the whole Program. The update of the SOP will be reviewed and approved by the Bank and will be applied in all the WSCs participating in the Program.

VI. Financing

Financing Source	Parent Program	AF	Total
BORROWER/RECIPIENT	\$ 170	\$ 94	\$ 264
IBRD/IDA	\$ 550	\$ 300	\$ 850
OTHER ¹	\$ 0	\$ 300	\$ 300
TOTAL	\$ 720	\$ 694	\$1,414

23. **AIIB Co-Financing:** AIIB has confirmed their intention to mobilize US\$300 million in co-financing the HH connections under DLI 1, thus significantly leveraging the Bank’s support and demonstrating confidence in the Program’s approach. This provides the resources for a seamless scale up and deepening of the Program, which will be most efficiently achieved through AF. The AIIB Board approval is expected to take place by September 2018. The Bank will be responsible for providing implementation support by reviewing progress in implementation and achievement of Program results and DLI, and providing support for implementation issues as well as monitoring systems’ performance. The Bank will also be responsible for validating the verified results for achieved DLI/DLRs. The AIIB and Bank teams will maintain regular communication about the progress of the Program and may undertake joint implementation support missions. The Program implementation support arrangements will be spelled out in detail in the Co-lenders Agreement between the Bank and the AIIB.

VII. Program Institutional and Implementation Arrangements

24. The AF will inherit the same institutional and implementation arrangements as the parent project to include three additional WSCs, as described below. The MHUUC is the Ministry in charge of the rural sanitation sector and as such, it will lead implementation of the Program through the PMU. Key responsibilities of the PMU include: (i) coordinate implementation of the NRSP; (ii) prepare a full-scale strategic action plan; (iii) supervise the procurement activities; (iv) follow up the implementation of the projects at the governorate level; (v) review and approve the investment plans relating to the villages sanitation projects, including the executive plans; (vi) ensure that the different Project implementation agencies submit periodic

¹ Planned AIIB co-financing.

follow-up and evaluation reports; (vii) ensure that the project's designs and implementation activities are performed in accordance with the Project's conditions agreed to by the financiers; (ix) specify the reasons for plan deviations, if any, and propose remedial actions; and (x) work with donors and partners who finance the Projects in accordance with the strategic plan.

25. Formal implementation responsibility has been established as follows: WSCs, HCWW, EWRA and the PMU will all be responsible for implementation of Results Area 1 (Improved Sanitation access)– although the majority of the responsibility falls to the WSCs as they will be empowered and incentivized to manage their performance and investment planning; WSCs and HCWW will be responsible for implementation of Results Area 2 (Improved operational Systems and Practices of WSCs); and, the MHUUC through the PMU will be responsible for implementation of Results Area 3 (Strengthened National Sector Framework), and in collaboration with EWRA on activities related to the tariff and monitoring and evaluation.

VIII. Contact point

World Bank

Contact: Osama Hamad

Title: Task Team Leader

Email: ohamad@worldbank.org

Borrower: The Arab Republic of Egypt

Responsible Agency: Ministry of International Cooperation

Contact Person: Badr El Din Hassan Nour Eldin Hafez

Telephone No.: +201006354735

Email: Bhassan@Miic.gov.eg

Implementing Agency

Name of Agency: Ministry of Housing, Utilities and Urban Communities

Contact Person: Eng. Randa El Menshawy

First Undersecretary and

Director of Program Management Unit

Tel: +2-012-82000-209

Email: rmensho@hotmail.com