Deauville Partnership

Compact for Economic Governance

Stocktaking Report: Egypt

With the support of the Federal Republic of Germany Foreign Office

Acknowledgements

This report falls within the framework of the country-level implementation of the Compact for Economic Governance adopted by the members of the Deauville Partnership.

This report has been prepared by the OECD with the support of the German Foreign Office and in close consultation with the Egyptian authorities.

The preparation of this report has been co-ordinated by the G20/G7 Sherpa Office and Global Governance Unit within the Cabinet of the Secretary-General of the OECD, under the strategic direction of Gabriela Ramos, Special Counsellor and Sherpa and under the responsibility of Nicolas Pinaud, Head of the Sherpa Office and Nejla Saula, Deputy Head of the Sherpa Office.

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The input from the Egyptian authorities has been coordinated by the Ministry of Foreign Affairs, under the direction of Assistant Foreign Minister for Multilateral and Regional Economic Affairs Ambassador Saïd Hindam, Magby Rady (former Assistant Minister for Multilateral and Regional Economic Affairs), Counsellor and Head of Egyptian Economy Unit at the Ministry of Foreign Affairs Marwa Lasheem and Second Secretary Ahmed Mubarak. A number of Egyptian stakeholders have contributed information, data, documents and comments that have enriched the report. Those include the Ministry of Finance; the Ministry of Investment and International Co-operation; the General Authority for Investment and Free Zones; the Ministry of Planning, Monitoring and Administrative Reform; the Ministry of Industry and Trade; the Ministry of Social Solidarity and the Central Bank of Egypt. The World Bank and the African Development Bank have also supported the preparation of this report.

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Executive Summary

Confronted with a series of structural imbalances and a series of exogenous and endogenous shocks since 2011, Egypt has made significant progress in macroeconomic stabilisation. The impact of the 2008-2009 global financial crisis on trade, investment and remittance flows, the impact of regional security dynamics on tourism and FDI, and the country's complex political transition have compounded with a series of longstanding structural vulnerabilities. These include persistent fiscal and current account deficits, an overvalued currency, and low levels of formal employment. As a result, Egypt's macroeconomic performance since 2011 has been characterized by (a) significantly lower levels of growth compared to the previous decade; (b) mounting inflationary pressures; (c) a widening fiscal deficit (at around 10-13% of GDP since 2011) raising challenges for debt sustainability over the long-run; and (d) significant pressures on the balance of payments, declining levels of international reserves and significant foreign exchange shortages.

The Egyptian authorities have put in place since 2015 an ambitious reform programme aimed at addressing longstanding macroeconomic imbalances and creating the conditions for more robust, inclusive and sustainable growth. A significant reform impulse was initiated in 2014/2015, and accelerated in mid-2016, in parallel to the adoption of the country's longer-term development roadmap under the Sustainable Development Strategy: Egypt's Vision 2030. The government has tried to stabilise the economy and re-ignite growth through a combination of (a) far-reaching fiscal consolidation effort focusing on energy subsidy reform, measures to contain the wage bill and tax collection (including the introduction of a full-fledged VAT); (b) boosting investment-led growth through a series of structural reforms aimed at encouraging FDI, introducing key reforms to the business enabling environment, as well as through a series of high-profile mega-projects (including the landmark expansion of the Suez Canal, the construction of a new capital or massive investments in transportation); and (c) the liberalisation of the foreign exchange system towards a market-based exchange rate, which constitutes a major transformative measure addressing a key structural weakness of the Egyptian economy. In addition, and mindful of the impact of the ongoing policy adjustment, targeted social programmes have been introduced to replace regressive and distortive subsidies and public social spending has increased mitigate the effects of the reforms on the most vulnerable. This ambitious reform agenda has been supported, financially and otherwise, by the IMF and Egypt's main multilateral and bilateral development partners, including G7 countries.

The reform programme is starting to bear fruit. The country has experienced a growth acceleration since 2015 (growth reached 4.2% in 2016/17, 5.3% in the first half of 2017/2018 and is projected to strengthen further to 5.2% in 2017/2018), getting closer to Egypt's potential growth level of about 6%. The country's twin deficits are narrowing, with great progress in consolidating public finances although the level of public debt remains high (at over 100% of GDP). After a period of very high inflation (around 30% during most of 2017), inflationary pressures have significantly subsided to 13.3% in April 2018 and the authorities plan to bring it down to single digits over the medium term. The structural reform agenda has also accelerated, with the adoption of key pieces of legislation (e.g. on VAT, civil service reform, investment law, industrial licensing or insolvency, to cite a few examples), although there is need to broaden the focus of reforms and ensure their practical implementation.

Egypt's most significant long-term development challenge, in particular given its demographic evolution, is job creation. Despite an improvement in recent years, remains still high, at approximately 11.3% of the active population. Even during periods of high growth, the Egyptian economy has struggled to create jobs in the formal sector. Labour participation is low (under 50%) and particularly so for women (3 out of 4 women in working age are unemployed and underemployment affects women and youth in particular) Significant sub-national divides exist. The need for private-sector-led growth capable of creating quality jobs is likely to intensify over time, as an estimated 700,000 young Egyptians join the labour market every year.

Egypt's remarkable progress in macroeconomic stabilisation should continue being accompanied by structural and economic governance reforms. The current structural reform agenda should be further enhanced to boost sustained, resilient and inclusive growth. While macroeconomic stabilisation is a short-term priority to restore confidence, enhance competitiveness and ensure the sustainability of public finances, these efforts should be combined with a longer-term perspective on structural reforms and policy actions across the four pillars of the Deauville Partnership Compact for Economic Governance in order to accelerate growth and increase its inclusiveness. The success in structural reforms, in particular aimed at boosting job creation, will determine whether Egypt goes beyond macroeconomic stabilisation to create sustainable growth, which is essential in the long run for social and economic stability.

The Deauville Partnership Compact for Economic Governance and Egypt's Stocktaking Exercise

The **Compact on Economic Governance** is a roadmap for policy reform in the area of economic governance for Arab Countries in Transition (ACTs). The Compact was adopted under the German Deauville Partnership Presidency in May 2015 building on past action plans on topics such as open government, anti-corruption, asset recovery and SME development. The Compact provides a framework for reform efforts across ACTs aimed at promoting good governance and a sound business climate as preconditions to boost inclusive growth through four key pillars focusing on (I) economic policies for inclusive and sustainable growth, (II) public sector transparency and efficiency; (III) investment climate and private sector development; and (IV) inclusive decision-making.

The Compact is designed as an operational document to inform policy dialogue within the Deauville Partnership through a steady dialogue and consultation process. This takes the form of a peer review and peer learning mechanism supported by the OECD, the Deauville Partnership's international financial institutions (IFIs) as well as relevant coordination platforms. The Compact's priorities are to be operationalised through country-tailored implementation plans under which ACTs identify specific policy measures which could then be supported by G7 and partner countries through technical assistance other supporting measures and which can be subject to a process of progress reporting to measure and monitor policy effectiveness. A methodology for the country-level implementation of the Compact was developed by the OECD and endorsed by Deauville Partnership Senior Officials in November 2016 (see Annex II for more details).

The present report constitutes the first step of the process, aimed at taking stock of economic governance reforms since 2011 in ACTs and developing the skeleton of each ACT's implementation plan. This report has been prepared by the OECD with the support of the German Foreign Office, in consultation with the Egyptian authorities and in cooperation with Deauville Partnership International Financial Institutions.

Against this background, the implementation of the Compact of Economic Governance in Egypt would entail addressing three broad structural priorities for inclusive and sustainable growth. These priorities, which can be seen as cross-cutting across the Compact's different pillars (although they formally belong under Pillar I), are as follows:

- **Consolidating and sustaining macroeconomic stability** by building on the recent progress in tackling Egypt's longstanding imbalances, with a focus on the twin (fiscal and current account) deficits and an effective monetary policy. In this context, the authorities may want to maintain the reform momentum across the key pillars of the ongoing policy adjustment, including fiscal consolidation in order to ensure the long-term debt sustainability and create fiscal space for increased pro-poor and infrastructure spending, the continuation of a market-based foreign exchange policy and monetary policy aimed at achieving price stability over the medium term.
- **Strengthening and expanding existing social protection systems**, in particular to make growth more inclusive and mitigate the short-term effects on the ongoing adjustment on the most vulnerable. In this context, the new cash transfer programmes could be further expanded and improved to replace untargeted subsidies as the main vehicle for social policy.
- **Addressing unemployment and underemployment** through greater emphasis on education quality to complement the focus on physical infrastructure with more efforts in human capital development (including through a change in curricula so that the supply of skills corresponds to the needs of the private sector and the strengthening of technical and vocational education and training). The recent education reforms (including curriculum reform), are good step forward in that direction. Addressing unemployment and underemployment will also require further labour market reforms (by addressing market dualism and upgrading active labour market policies) and a comprehensive approach to informality building on the plan announced in March 2016. These efforts should be complemented with a reconsideration of the government's role in the economy and measures aimed to boost private-sector-led growth.

These broad priorities would also need to be reinforced with further reforms across the three other Pillars of the Compact, building on the ongoing efforts made by the government. Those include:

- **Measures to further strengthen the transparency and efficiency of Egypt's public sector**, making progress on the ongoing reform of the civil service (not just to contain the wage bill but by putting particular emphasis on enhancing the effectiveness of public service delivery); rationalising the organisational complexity of the state; further promoting public governance reforms to improve accountability and participation, leveraging digital government tools; strengthening the rule of law; enhancing the governance and transparency of state-owned enterprises (through, e.g. the implementation of the recently announced IPO program); building on government efforts to better monitor fiscal risks; adopting a comprehensive approach to public financial management) and procurement reforms, ensuring the effective implementation of the 2014 National Anti-Corruption Strategy and strengthening the existing control institutions, and enhancing domestic resource mobilisation through further reforms in the area of tax policy and administration, including those supported by international cooperation.
- **Further reforms to create an attractive environment for investment and private sector development** by, *inter alia*, increasing regulatory effectiveness and transparency and addressing

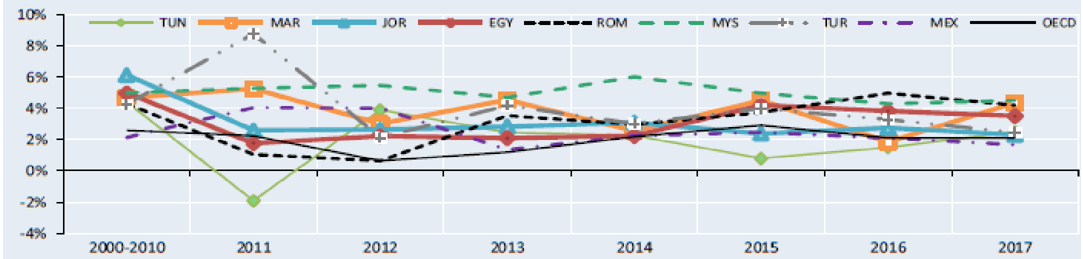
the existing gap between regulation on paper and implementation in practice; continue enhancing regulatory simplification including through the ERRADA programme (with specific attention to key constraints); ensuring the effective implementation of recent reforms regarding, e.g., bankruptcy, industrial licensing and the investment law; pursuing reforms in key sectors for competitiveness (including energy and infrastructure); building on recent reforms, address the key constraints to financial inclusion and promoting competition and greater access in banking and non-banking financial services; and revamping the policy framework for SME development through the operationalisation of the new SME law the new SME agency.

- **Initiatives to further involve the public, civil society and the private sector in decision making** (including through institutionalised platforms for multi-stakeholder consultation and participation allowing for greater voice and accountability) as well as to **promote the political and economic empowerment and inclusion of women and youth** (through second level legislative reforms and support programmes in areas such as financial inclusion, entrepreneurship and labour market insertion).

Compact for Economic Governance: Egypt Indicator Dashboard

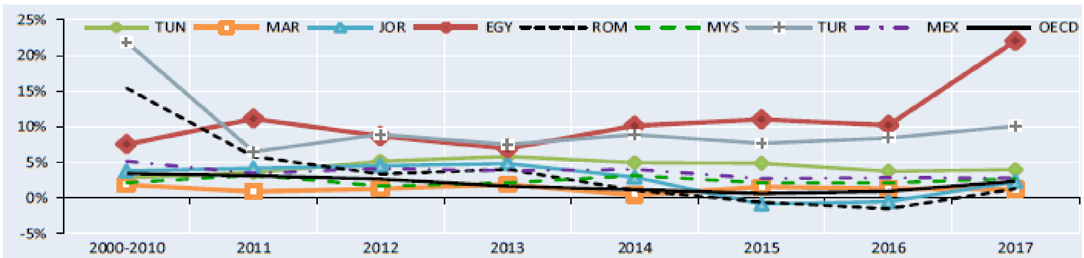
ECONOMIC POLICIES FOR INCLUSIVE AND SUSTAINABLE GROWTH

1- Real GDP growth (% change)



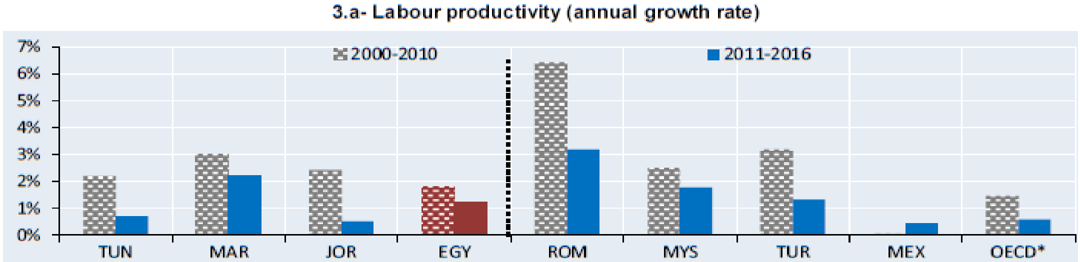
Source: IMF World Economic Outlook databases. Note: 2017 data for all countries are estimates

2- Inflation (average consumer prices)



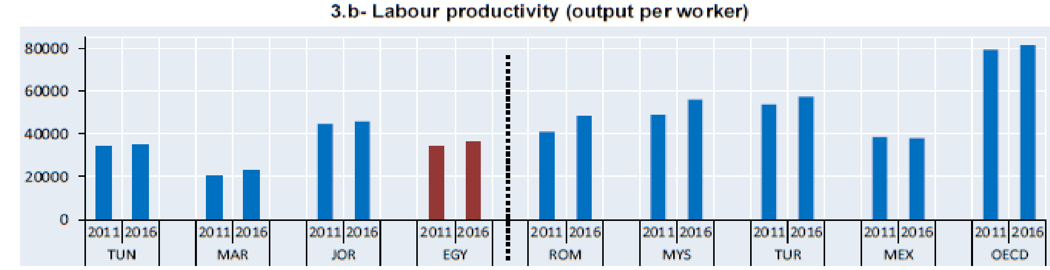
Source: IMF World Economic Outlook Databases. Note: 2017 data for all countries are estimates

3.a- Labour productivity (annual growth rate)



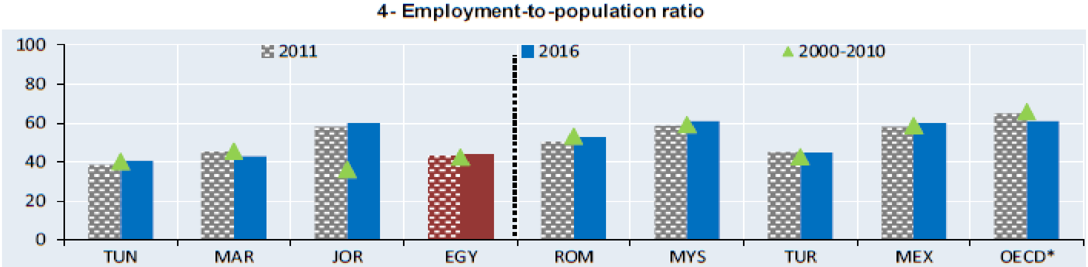
Source: Calculations based on ILO Key Indicators of the Labour Market database, OECD Labour Market Statistics. Note: Labour productivity for OECD countries is measured as GDP per hour worked. For non OECD countries GDP per worker is used instead

3.b- Labour productivity (output per worker)



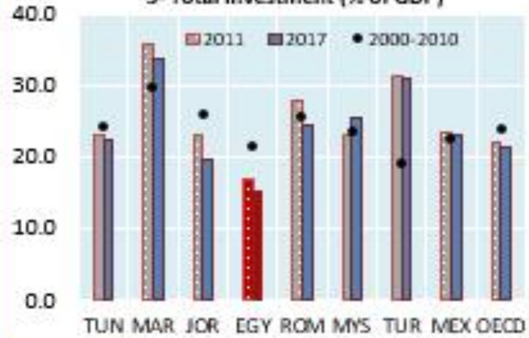
Source: Calculations based on ILO Key Indicators of the Labour Market database, OECD Labour Market Statistics
Note: Labour productivity for OECD countries is measured as GDP per hour worked. For non OECD countries GDP per worker is used instead

4- Employment-to-population ratio



Source: ILO Key Indicators of the Labour Market database, OECD Labour Market Statistics. Note: OECD average is for 2005-2010

5- Total investment (% of GDP)

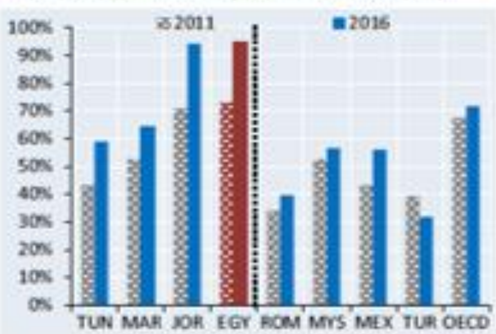


Source: IMF World Economic Outlook Databases

6- Current account balance (% of GDP)

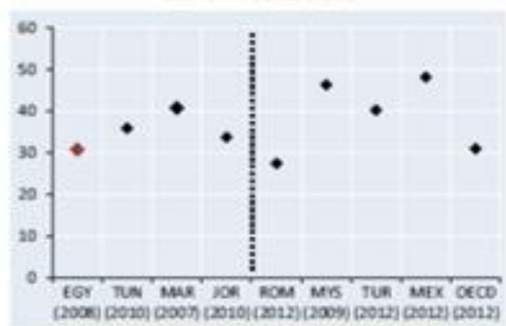
Source: IMF World Economic Outlook Databases

7- General government gross debt (% of GDP)



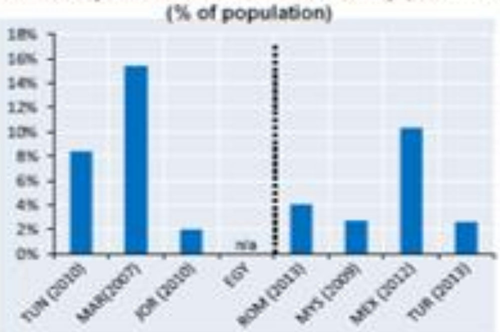
Source: IMF World Economic Outlook Databases

8.a- Gini Coefficient



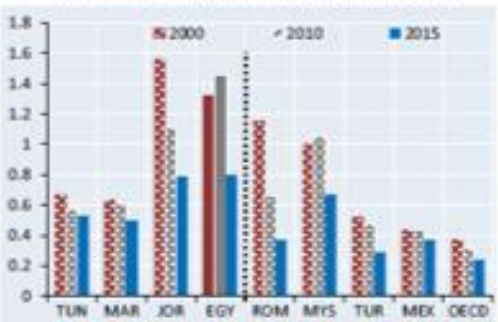
Source: World Bank World Development Indicators, OECD Social and Welfare Statistics

8.b- Poverty headcount ratio at $3.10 a day (2011 PPP) (% of population)



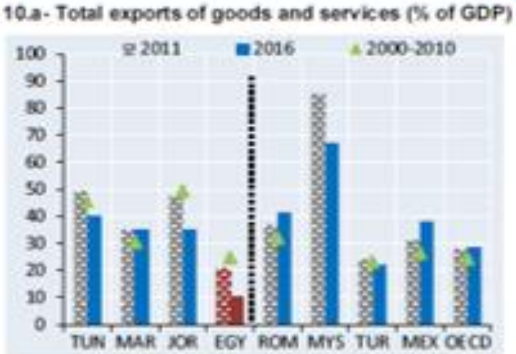
Source: World Bank World Development Indicators, OECD Social and Welfare Statistics, and the World Bank Worldwide Development

9- CO2 emissions (kg per USD 1,000 of GDP)



Source: International Energy Agency

10.a- Total exports of goods and services (% of GDP)



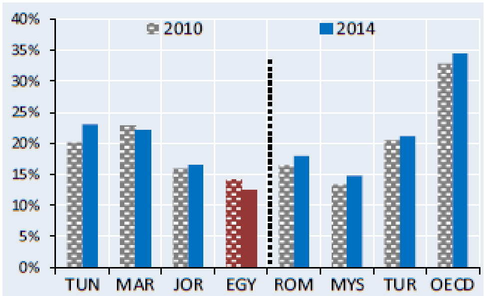
Source: World Bank World Development Indicators. For the OECD, data refer to 2016 instead of 2015

10.b- Trade in Value-Added (TiVA) (foreign value-added share of gross exports)

Source: OECD, Trade in Value Added (TiVA) database and TiVA Nowcast estimates database (2012-2014). Note: For Morocco, data refer to 2012 instead of 2011.

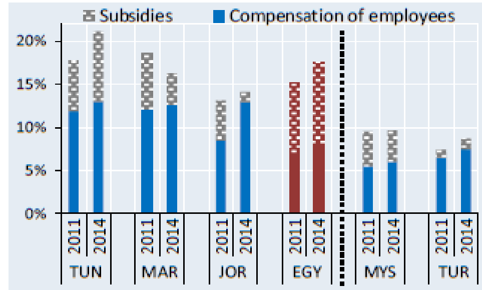
PUBLIC SECTOR TRANSPARENCY AND EFFICIENCY

11- Tax revenue (% of GDP)



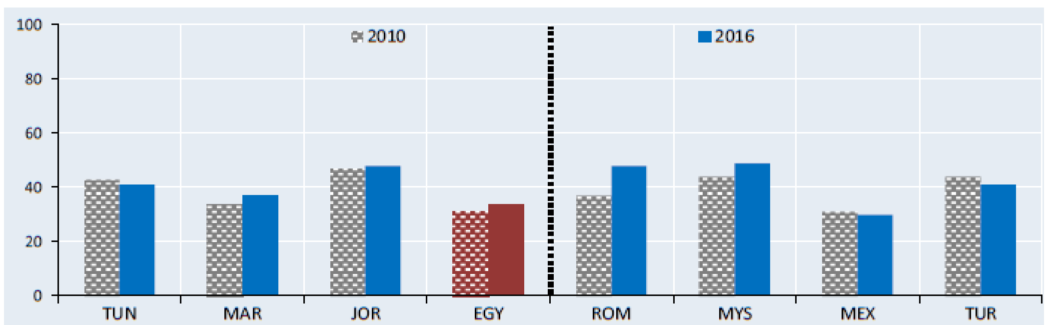
Source: Government Finance Statistics Yearbook, IMF Country Reports for Jordan, Malaysia, Morocco and Tunisia, OECD Revenue Statistics for OECD average. Note: 2014 data for Tunisia is preliminary

12- Government expenditure in (1) compensation of employees and (2) subsidies (% of GDP)



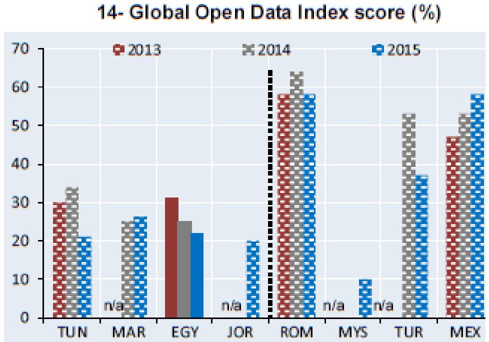
Source: IMF Government Finance Statistics database, Tunisia IMF Country Reports. Note: call figures concern budgetary central government.

13- Corruption Perception Index (0-100)



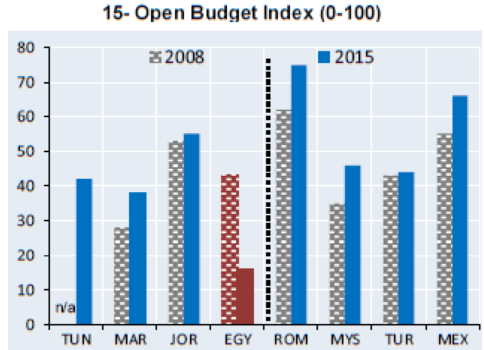
Source: Transparency International, Corruption Perceptions Index 2009-2016. Note: Score 100= very clean; 0= highly corrupt

14- Global Open Data Index score (%)



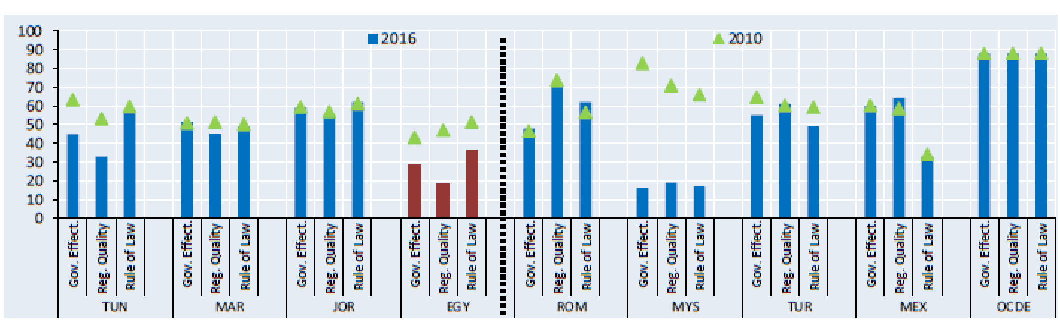
Source: Open Knowledge Global Open Data Index

15- Open Budget Index (0-100)



Source: International Budget Partnership, Open Budget Index

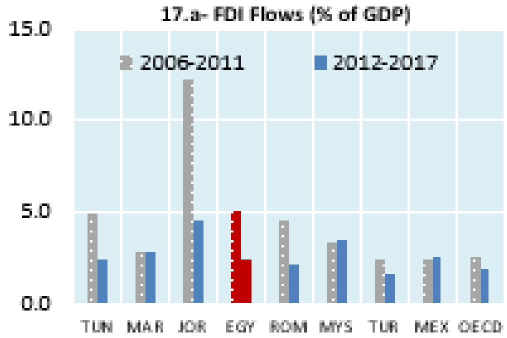
16- Worldwide Governance Indicators (percentile rank, 0-100)



Source: World Bank Worldwide Governance Indicators: (1) Government Effectiveness; (2) Regulatory Quality; and (3) Rule of Law

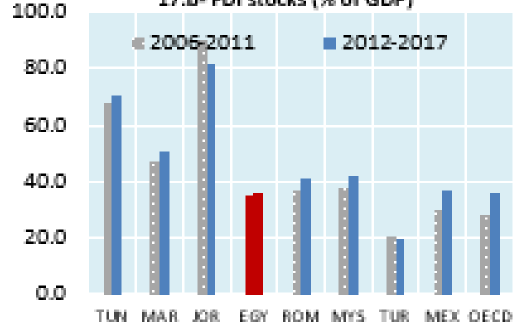
INVESTMENT CLIMATE AND PRIVATE SECTOR DEVELOPMENT

17.a- FDI Flows (% of GDP)



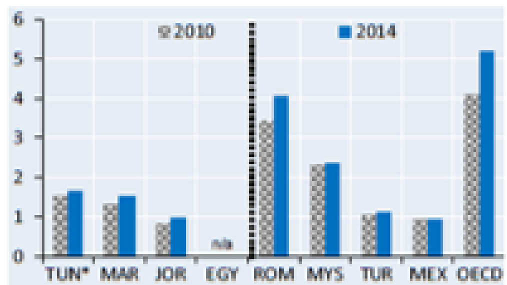
Source: UNCTAD Statistics Database

17.b- FDI stocks (% of GDP)



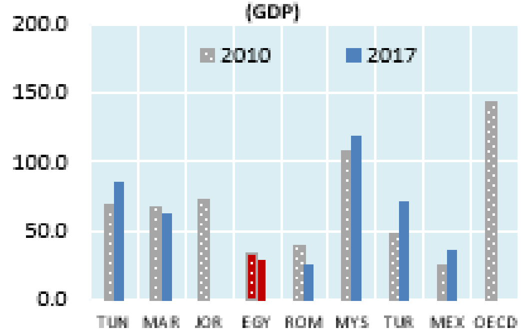
Source: UNCTAD Statistics Database

18- New business density (new limited liability firms per 1,000 working-age people)



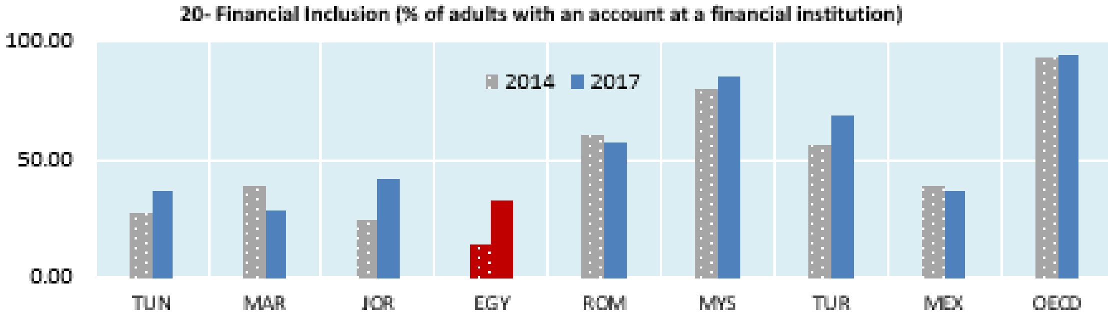
Source: World Bank Entrepreneurship Database.
Note: Data for Tunisia are for 2013 rather than 2014.

19- Domestic credit to private sector (GDP)



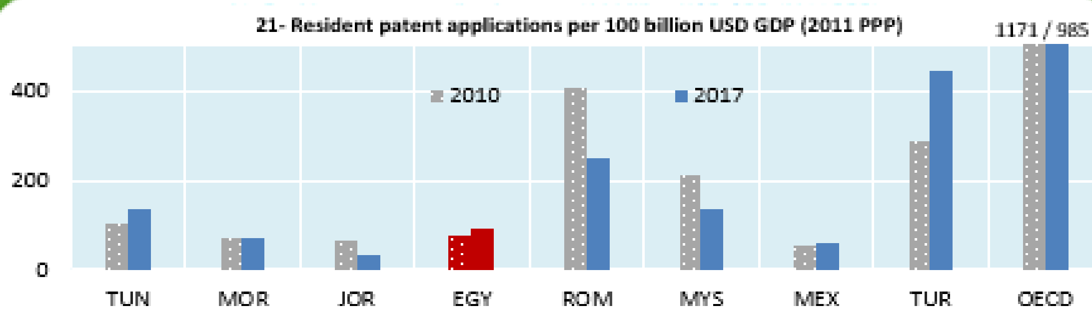
Source: IMF International Financial Statistics

20- Financial Inclusion (% of adults with an account at a financial institution)



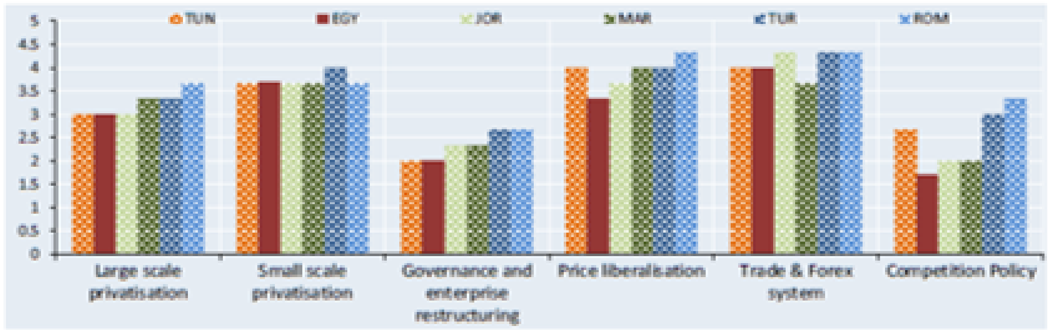
Source: World Bank Global Financial Inclusion Database. Note: Data for 2011 for Tunisia is not available

21- Resident patent applications per 100 billion USD GDP (2011 PPP)



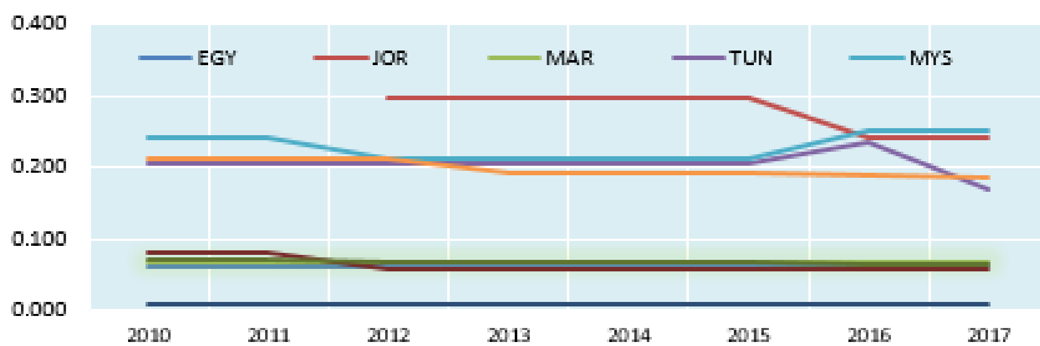
Source: World Intellectual Property Organization Statistics Database. Note: Data for Egypt is from 2016

22 - EBRD Transition Indicators (scale from 1 to 4+)



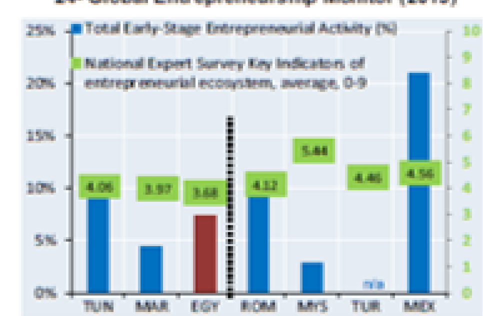
Source: EBRD Transition Indicators, 2014 Database

23- FDI Regulatory Restrictiveness Index (total FDI Index, all types of restrictions, 0-1)



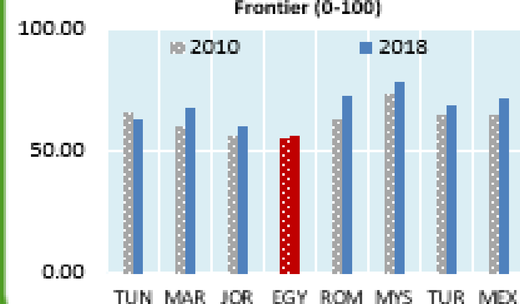
Source: OECD FDI Regulatory Restrictiveness Index. Data for 2010 and 2011 for Jordan is not available. Note: 0 = open; 1 = closed

24- Global Entrepreneurship Monitor (2015)



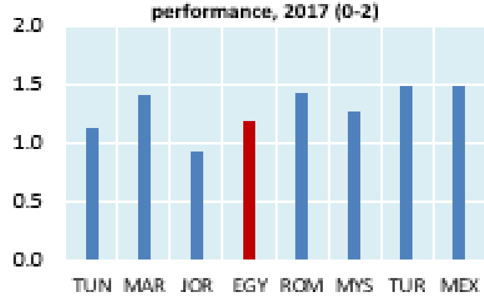
Source: Global Entrepreneurship Monitor. Note: GEM Data for Jordan is not available; TEA data is only available for the other ACTs starting in 2015

25- World Bank Doing Business, Distance to Frontier (0-100)



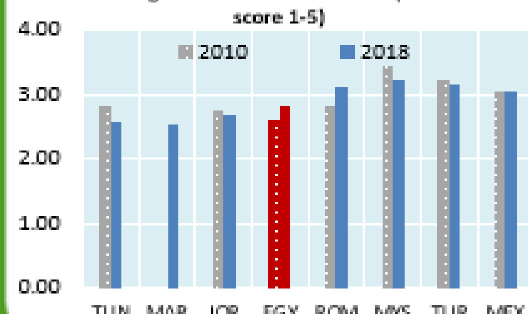
Note: Distance to frontier covering all Doing Business dimensions

26- Average trade facilitation performance, 2017 (0-2)



Source: OECD Trade Facilitation Indicators

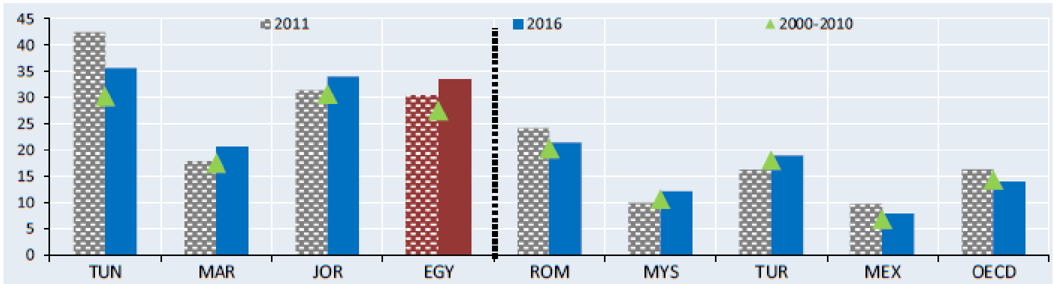
27- Logistics Performance Index (overall score 1-5)



Source: World Bank Logistics Performance Index

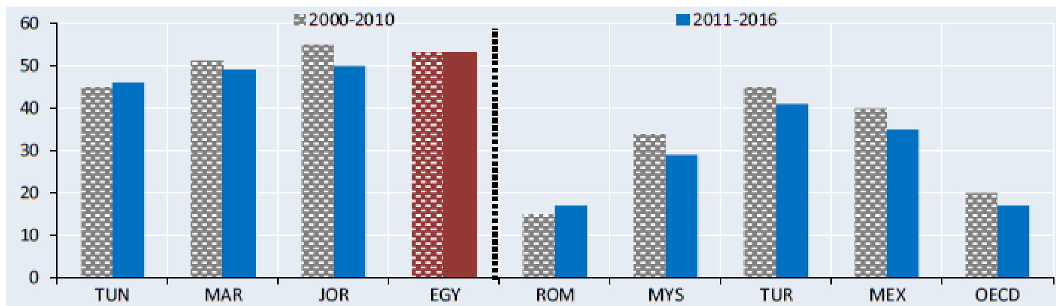
INCLUSIVE DECISION-MAKING

28- Youth unemployment rate (% of total labour force, ages 15-24)



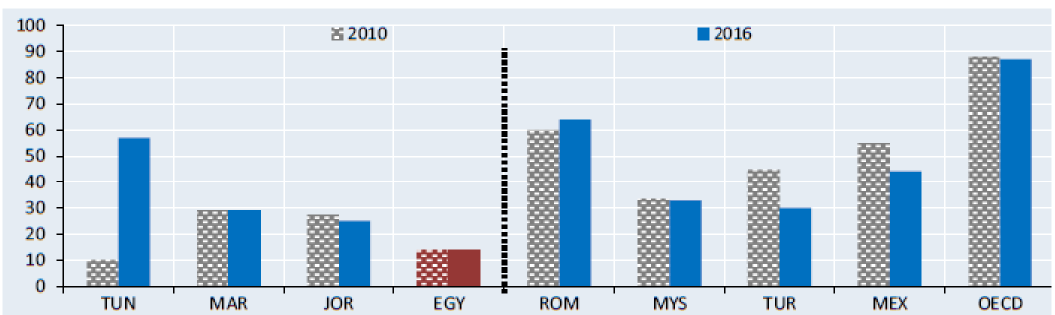
Source: ILO Key Indicators of the Labour Market database; OECD Labour Market Statistics

29- Gender labour participation gap (%)



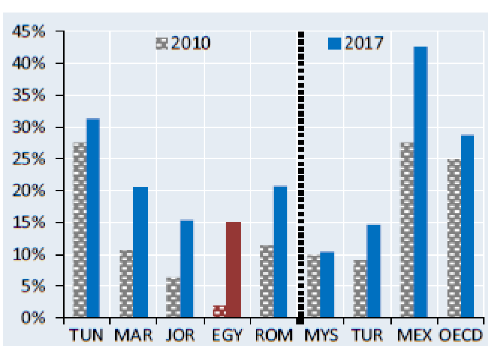
Source: ILO Key Indicators of the Labour Market database; OECD Labour Market Statistics

30- Worldwide Governance Indicator for Voice and Accountability (percentile rank, 0-100)



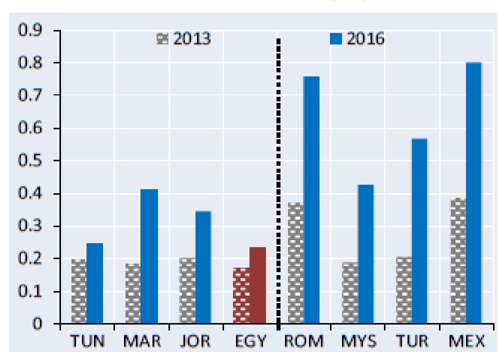
Source: World Bank's Worldwide Governance Indicators

31- Proportion of seats held by women in national parliaments (%)



Source: Inter-Parliamentary Union (figures as of January of each year for lower or single house); OECD Gender Data Portal

32- Political participation score in Commonwealth Youth (0-1)



Source: Commonwealth Youth Development Index

Country Overview

Continued macroeconomic stabilisation and structural and economic governance reforms are key to boost sustained, resilient and inclusive growth in Egypt. In 2015-2016, the Egyptian economy was confronting a twin-deficit crisis as a result of longstanding macroeconomic imbalances and a series of exogenous shocks. Significant reforms have been introduced to address these imbalances since 2015 and, especially, since mid-2016. Macroeconomic stabilisation thus appears as a short-term priority to restore growth, which, despite a slight acceleration since 2014, remains below the country's potential and, crucially, the levels needed to substantially reduce unemployment. With the support of Egypt's international partners, the government is implementing an ambitious programme of reforms to restore macroeconomic stability and lay the foundations for stronger, more resilient and inclusive growth. Macroeconomic stabilisation in the short-term should be combined with a longer-term perspective on structural reforms and policy actions across the four pillars of the Compact for Economic Governance in order to accelerate growth and increase its inclusiveness. The success in structural reforms, in particular aimed at boosting job creation, will determine whether Egypt goes beyond macroeconomic stabilization to create sustainable growth, which is essential in the long run for social and economic stability.

Table 1: The Egyptian Economy at a glance (2017)

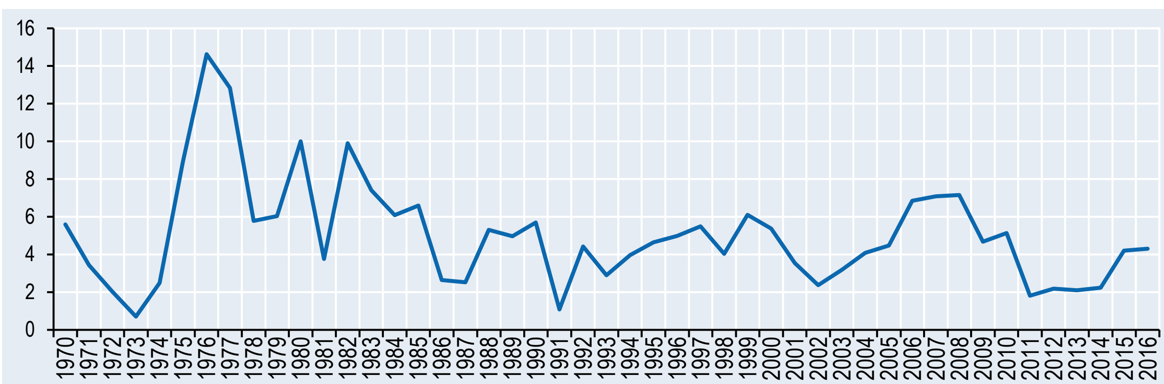
Key economic indicators			
Population	97.55million	**GDP**	235.37 billion USD
Unemployment rate (end-2017)	12.08%	**GDP per capita(current)**	2,412.7 USD
Employment to population ratio	43.7%	**Real GDP growth**	4.18%
Human Development Index (2018	0.696	**Budget Balance (% of GDP)**	-12.5%
Population below poverty line (2015)	27.8%	**Current account (% of GDP)**	-3.79%
Life expectancy at birth (years) (2016)	71.4	**Inflation rate (end of period)**	29.5%
Gini Index (2015)	31.8	**Public debt**	96.90%

Note: Key economic indicators refer to the 2017 unless otherwise specified.
Source: World Bank, Egyptian Central Agency for Public Mobilization and Statistics (CAPMAS), UN.

A historical perspective of the Egyptian economy

The Egyptian economy has long suffered structural issues which are reflected in a volatile long-term growth pattern. Egypt is a low middle-income country. During the 1950s and the 1960s, Egypt's development strategy was primarily based on central planning, import substitution, and wide state intervention in economic activities. Despite its initial success in terms of economic growth and rapid industrialisation, by the end of the 1960s growth levels experienced a marked downward trend, partly due to the wider geopolitical context. After the oil boom in the mid-1970s[1], Egypt attempted to attract the influx of petrodollar funds by opening-up its economy (*Infitah*) to foreign capital and easing import restrictions. Aggregate demand expanded greatly with a significant surge in consumption especially private consumption pulling output and economic growth up. The period between 1974 and 1980 recorded some of the highest annual growth rates in the country's history (14.6% in 1976) although this high growth was accompanied by intense volatility, largely due a high level of exposure to external shocks linked to a strong dependency on external sources of finance (Abdel-Fadil, 1979; Beblawi, 1987) and high fluctuations of oil prices (Figure 1). More crucially, high growth during this period masked Egypt's structural weaknesses. The productive sectors in the economy continued to rely on the ailing public sector which suffered from severe shortage of financial and technical resources. Manufactured exports remained primarily limited to the textile and clothing sectors. Price distortions, high inflation and soaring real exchange rate appreciation rapidly transformed the economy to a typical Dutch disease case where services replaced traditional activities in agriculture, industry and manufacturing. With the decline in the global economy and the subsequent drop in oil prices and capital inflows, the 1980s were presided by low growth and lingering macroeconomic problems such as chronic inflation and significant imbalances in the fiscal and external sectors.

Figure 1: Real GDP (% change) 1970-2016



Source: World Bank.

Reforms in the 1990s and 2000s were successful to stabilise the economy but certain structural issues remained unaddressed. In 1991, and approaching economic meltdown, Egypt embarked on an Economic Reform and Structural Adjustment Program (ERSAP) with the support of the IMF and other development partners. Partly thanks to the writing off a big portion of its external debt, Egypt successfully implemented the stabilisation measures of ERSAP as well as a number of major reforms to transform the economy from an inward-focused, centrally-planned economy to an outward market-based economy. As a result of contractionary fiscal and monetary policy, GDP growth fell significantly during the three years of ERSAP (1991-1993). However, as the economy stabilised and distortions reduced, GDP growth started to pick up again in 1994 and followed an ascending trajectory to reach a peak of 7.2% in 1998. A slowdown in the

[1] Egypt is a major oil producer in Africa – ranking forth in the continent in 2016 behind Nigeria, Angola and Algeria. It possesses also the 5th largest oil reserves in the continent. It is noteworthy that the country was a net exporter of oil until 2007/2008.

reform process towards the end of the decade, together with the East Asian crisis, led to further instability in 2000 in the form of a liquidity crisis. The policy response of the Central Bank of Egypt (CBE) was a comprehensive restructuring of the banking sector and further prudential measures to reduce systemic risks in the sector. In addition, in 2003 CBE abandoned its *de facto* fixed exchange rate policy in favour of a more flexible regime. Further structural reforms were initiated in 2005 to promote private sector development, boost investment (with a particular focus on FDI) and address structural weaknesses. Average real GDP growth improved to 6.2% annually during the period 2005-2010 compared to 4.8% in 2000-2005. Yet, a growth benchmarking exercise carried out by the World Bank suggests that Egypt has struggled to catch up with other middle-income comparators, such as Turkey, Poland and Malaysia, which have instead widened the gap in per capita income with Egypt since the 1980s (World Bank, 2015).

Today, Egypt has a relatively diversified service-oriented economy. Services accounting for 55.7% of GDP compared to agriculture 11.9% and industry: 33.1% (IMF, 2017). The economy is still marked by the importance of the public sector and large SOEs accounting for almost 25% of employment in Egypt while the private sector contributes 60% of GDP and an employment share of 74% (EBRD, 2017). These sectors are facing different challenges and dynamics:

- Agriculture[2] remains a key sector employing 30% of the workforce and accounting for circa 10% of the country's exports. The sector faces multiple challenges including demographics[3], the fragmentation of landholding as well as irrigation water and agricultural land scarcity.
- Services employ 53% of the workforce. Key services are telecommunication, construction, financial services, wholesale and retail trade sectors and main service exports are transportation and tourism. Egypt service exports are low due to their low knowledge and technology content which impedes further integration in the global value chains. While tourism is suffering from the security situation over the past years. Egypt hosted almost 15 million tourists in 2010 contributing to circa 4.3% of the total GDP and the tourism sector employed 11% of the workforce. However, since this peak, the number of tourists fell dramatically to 5.4 million in 2016 contributing to only 2% of GDP, mainly due to the security situation in the region. The recent improvement of the security situation is paving the way for the recovery of the sector, tourism increased by 4% in 2017 (Economist Intelligence Unit).
- The manufacturing sector and extractive sectors employs for around 17% of the workforce. Petroleum and extractive industry contribute to circa 5% of GDP but are on a downward trend whereas manufacturing activities including notably steel, construction material, agribusiness, chemicals, textiles, etc. are recovering following the revolution and should benefit from the devaluation of the Egyptian pound and reforms aiming at boosting private sector development.

Key challenges of the Egyptian economy

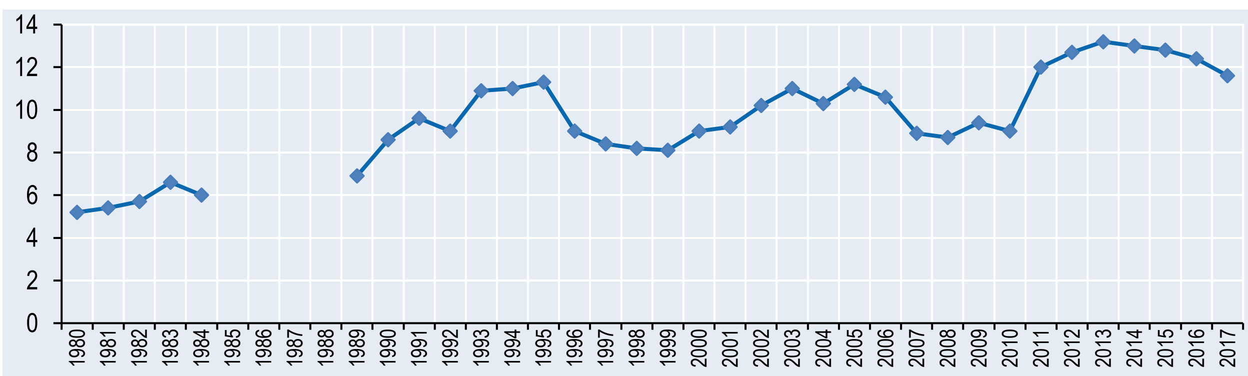
Job creation has been Egypt's main challenge, even in periods of high growth. Like in other countries in the region, Egypt suffers from a weak link between growth and employment. Even during times of

[2] Major crops cultivated in Egypt are rice, cotton, corn, wheat, sugar cane, fruit, vegetables and beans. Noteworthy that Egypt is the largest world - importer of wheat.

[3] The population of Egypt is expected to reach 150 million by 2050 according to UN studies

accelerated growth, such as during the latest growth spike 2005-2010, unemployment did not drop below 8.7%. Since 1980 and with the abandonment of a policy providing for guaranteed public sector employment, unemployment experienced a negative trend (Figure 2). This trend can be attributed to (a) the stunted growth of the Egyptian private sector despite the successive reform attempts, which has pushed many Egyptians to the informal sector (which is typically low paid and low quality); and (b) the apparent decoupling between private sector growth and employment. Even during times of significant private sector growth, employment elasticity has been quite low particularly because private sector growth has been mainly localised in capital intensive sectors (Baha El-Din et al., 2009). Egypt's economy has become increasingly capital-intensive over time, with the share of income going to labour at a low 30-40%, while growth has largely been consumption-oriented and less and less driven by investment and the external sector over time (World Bank 2015). Constrained by low levels of domestic savings, investment has been decreasing steadily from the 1980s, from over 30% of GDP to less than 14.5% of GDP, with a significant reduction in public and, in particular, private investment. These dynamics have translated into low and declining productivity levels as well as an increase in informal labour (according to CAPMAS, the share of employment in the informal private sector increased from 30% in 1998 to over 40% in 2012). Recent reforms are aimed to reverse some of these trends and some early signs of structural change are becoming apparent, including through slight reduction in unemployment.

Figure 2: Unemployment rate 1980-2017



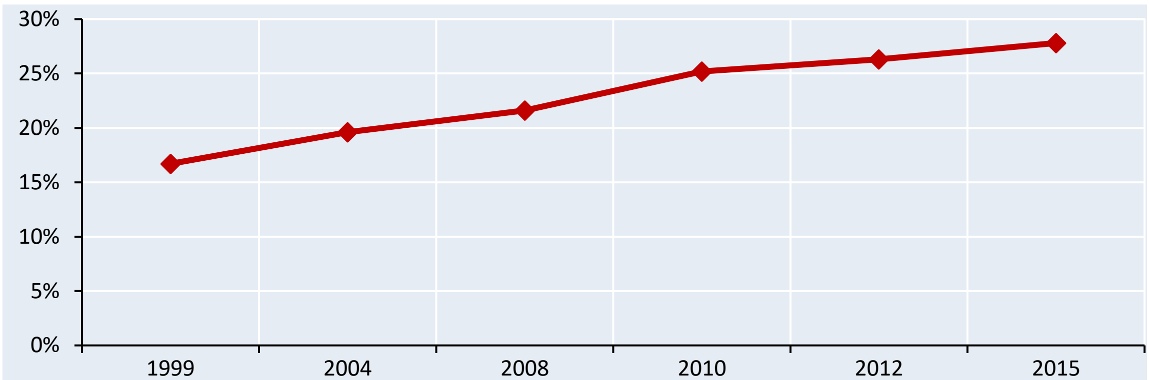
Source: World Bank.

In addition, there is a strong need to increase the inclusiveness of growth to address poverty. During the Nasserist period, a number of pro-poor policies were adopted. Those included decisions with mixed results such as agricultural reform decrees, nationalisation and guaranteed employment as well as with other policies such as universal free health and education services. Poverty and inequality started to increase in the mid-1970s following the reforms to open up the economy (Nagarajan, 2013) and this trend intensified in the 1980s in the midst of high inflation and frail economic growth. A World Bank report estimated that one every four Egyptians were poor (Figure 3) and more than 1 every 10 Egyptians were in absolute poverty (World Bank, 1991). As a measure to limit the impact of ERSAP on the most vulnerable, the Social Fund for Development (SFD)[4] was established by the government of Egypt with the support of

[4] SFD was set up in 1991 at the height of the Gulf crisis. Its main objectives were: to help mitigate the initial and

international development partners. Between 2005 and 2010, a period of relatively strong growth, the poverty rate increased by almost 5 percentage points and the income of the bottom 40 percent (a proxy used by the World Bank for shared prosperity) dropped by 1.3% (World Bank, 2015a).

Figure 3: Egypt: People below the national poverty line (% of population)

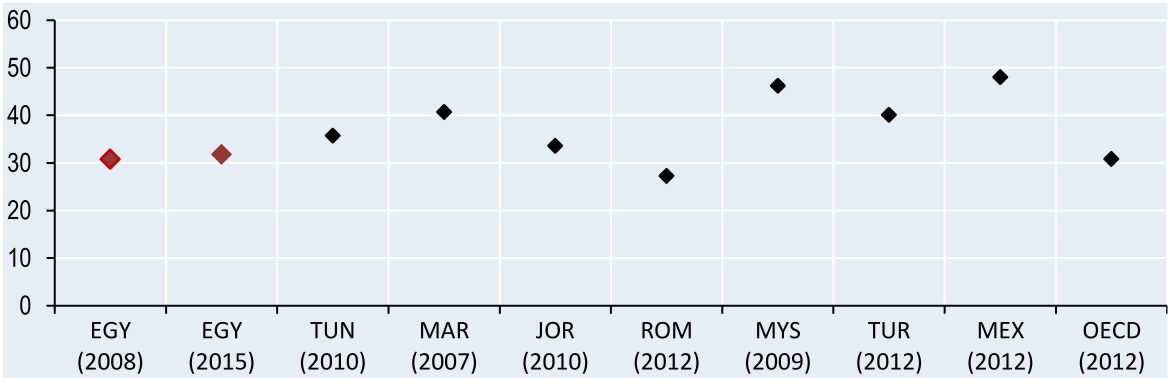


Source: CAPMAS

Inclusiveness is also needed to reduce inequality. While the country's Gini coefficient is not particularly high by regional standards (0.31 in 2008) (White, 2013), this needs to be put in a broader context of increasing unemployment and poverty (Figure 4) and a public perception of rising inequality. This apparent contradiction may be related to (a) limited access to effective safety nets for the most vulnerable and quality public services, especially education and health (e.g. the probability that a most "privileged" child to access higher education in Egypt is almost 18 times the probability of a most "deprived" child (Assad, 2010), which may hamper equality of opportunities and create unsurmountable obstacles to ascend the social ladder; (b) significant regional variations (about half of the population in rural Upper Egypt is poor, compared to a national average of 25.2% in 2010); and (c) the difficulties in adequately capturing the income of the top income group using conventional household surveys which may result in the underestimation of inequality. A recent study has used house prices in Egypt to estimate the real income of the top tail of the distribution, concluding that the Gini coefficient may be 0.47, significantly above the results of the 2008 household survey (van der Weide et al., 2016).

immediate negative impacts of the structural adjustment program; to provide help to the Gulf returnees; and to protect selected target groups (displaced public enterprise workers, households headed by females, and unskilled and semi-unskilled unemployed workers, etc.) from the likely long-term effects of adjustment.

Figure 4: Gini Coefficient

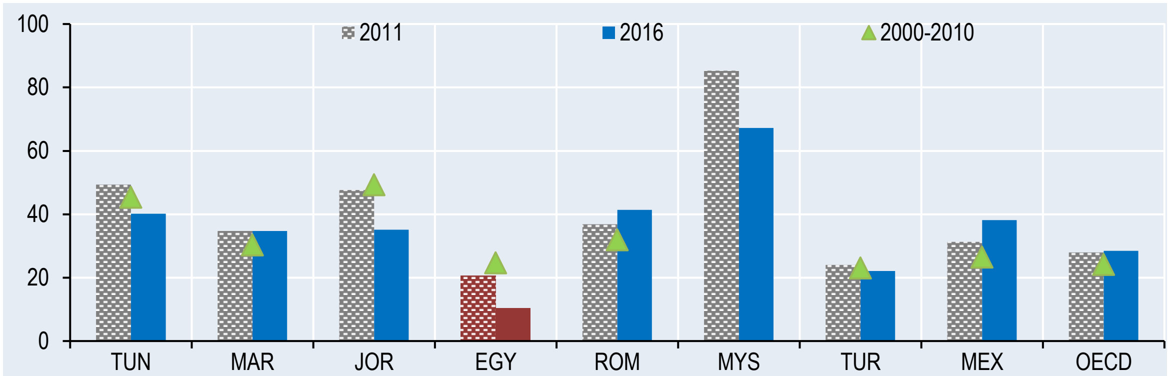


Note: Latest available year is presented for each benchmarking country.
Source: World Bank World Development Indicators, OECD Social and Welfare Statistics.

Egypt's demographic challenge underscores the need for inclusiveness and growth creation. Compared to other countries in the region, which are already starting to experience a demographic transition (e.g. Tunisia), Egypt is experiencing a rapid population growth and a significant "double budge," with a first period of demographic growth 30 years ago followed by a recent and even more important spike. Egypt's average annual population growth over the last 10 years is 2.3%, compared to 1% in Tunisia and Morocco, for instance. An estimated 700,000 young Egyptians join the labour market every year; since 2000 the working-age population has increased by approximately 40% (IMF, 2018a). In this context, creating jobs for this "echo generation" by the time they reach working age (over the next 10-15 years) represents a major challenge for Egypt (Word Bank, 2015).

Egypt needs to diversify its export basked beyond a series of low-added-value product. Egypt underperforms compared to benchmarking countries when it comes to the diversification of its export basket, which remains concentrated in a few products including oil and other mineral products (32% in 2016), chemical products (12%), agricultural products, livestock and other fats (11%) and textiles (10.5%, mainly cotton). This situation has remained largely stable over the years. Manufacturing represents only 36% of total exports over 1993-2012 while the share of high-tech exports has remained negligible at below 1% (World Bank 2015). Following a rapid growth in the external trade sector over the 2000s, Egypt's trade has slowed down significantly since the 2011 Revolution. The value of total exports has declined significantly from an average 26.2% of GDP in over the 2001/2002-2010/2011 period to 16.3% in 2016/2017, the lowest figure amongst comparator countries (Figure 5). Exports distribution by geography is overall diversified with the EU concentrating 34% of the value compared to Arab Nations 27%, Asian countries 13%, USA 9%, other European countries 5% and African countries 3%.

Figure 5: Total exports of goods and services (% of GDP) (2010-2016)



Source: World Bank World Development Indicators.

Egypt has started addressing these challenges in recent years

Following a challenging political transition, starting in 2014 the Egyptian government started to address key structural issues and implement long-awaited reforms. Political instability since 2011 has represented a major challenge for economic policy making, until the May 2014 Presidential election. This instability prevented the adoption of the necessary reforms to address the structural issues discussed above. Political instability was also accompanied of security concerns, which further damaged investor confidence and key economic activities (e.g. tourism), despite an improvement in recent years. Against this background, a reform programme was launched in 2014-2015 with three main pillars:

- Boosting investment-led growth by encouraging FDI and launching a series of high-profile mega-projects (including the landmark expansion of the Suez Canal);
- Pursuing fiscal consolidation through energy subsidy reform and measures aimed at containing the wage bill and increasing tax collection; and
- Moving towards the liberalisation of the exchange rate and the introduction of an inflation targeting regime.

Since November 2016, an ambitious reform programme is currently being implemented with the support of the IMF and development partners following significant pressure in the balance of payments in 2015/2016. While the reform momentum slowed down in 2015/2016, significant pressures in the balance of payments led the government to request an IMF programme in November 2016. The three-year Extended Fund Facility for Egypt (worth USD 12 billion) is aimed at restoring macroeconomic stability and promoting inclusive growth through four pillars: (a) a policy adjustment including the liberalisation of the foreign exchange system, a tight monetary policy to contain inflation and strong fiscal consolidation to ensure public debt sustainability; (b) strengthening social safety nets to smoothen the impact of the adjustment on the most vulnerable; (c) structural reforms aimed at boosting inclusive growth and job creation; and (d) fresh external financing to close the financing gap (where the World Bank, the African Development Bank, G7 countries and other development partners made a decisive contribution through budget support and bilateral financing instruments). This ambitious programme has already led to a number of transformative measures, including the move towards a floating exchange rate. As of April

2018, these reforms had led to a rebound in economic growth, a modest but noteworthy reduction of unemployment, and a reduction of fiscal and external sector imbalances.

The government has developed a long-term development vision for the country encapsulated in the *Egypt 2030 Sustainable Development Strategy (SDS)* as well as a medium-term reform programme presented and approved by Parliament in April 2016, which updates a five-year Macroeconomic Framework and Strategy developed for the Sharm El-Sheikh Economic Development Conference (Box 1).

Box 1: Objectives of the Government's Reform Programme (2019)

- Annual growth rate: 5.5-6% (vs. 4.2% in 2015)
- Poverty rate: 24% (vs. 27.8% in 2015)
- Unemployment rate: 10-11% (vs. 12.8% in 2015)
- Fiscal deficit: 7% of GDP (vs. 11.5% in 2015)
- Gross government debt: 90-92% of GDP (vs. 94.6% in 2015)
- Inflation: single digits % (vs. 11.3% in June 2015)
- Foreign reserves: 5.5 months of imports (vs.3.1 months in 2015/2016)

Reforms included in the government reform programme to achieve the above objectives include greater controls over public salary spending, new taxes, continued fuel and energy subsidy reforms, business environment reforms, sector initiatives to introduce greater efficiency and competition in electricity and gas markets, expanding existing cash-transfer programmes and increasing overall social spending in accordance with the requirements of the new Constitution.

Pillar I: Designing sound economic policies for an inclusive and sustainable market economy

Following the implementation of an ambitious programme of reforms aimed at correcting the country's macroeconomic imbalances, Egypt is confronted with the need to sustain and consolidate macroeconomic stability as well as to create the conditions for higher and more inclusive growth to significantly increase employment while protecting the most vulnerable. These Pillar I priority reforms are thus crucial to guarantee the success of the reforms outlined in the other pillars. Conversely, reforms in areas covered Pillars II to IV (e.g. public-sector efficiency, private sector development, greater participation in policy making in inclusion by women and youth) will also contribute to the broad objectives identified in Pillar I. These priority reforms are:

A. **Consolidating macroeconomic stability** by maintaining the reform momentum and continue correcting Egypt's fiscal and external sector imbalances and curbing inflation. The ambitious reforms put in place since November 2016 are starting to bear fruit, but continued efforts are needed.

B. **Strengthening and expanding existing social protection systems**, in particular to make growth more inclusive and mitigate the short-term effects on the ongoing adjustment on the most vulnerable.

C. **Addressing unemployment and underemployment** through greater emphasis on education quality and labour market reforms and a comprehensive approach to informality.

A. Consolidating macroeconomic stability as a pre-requisite for inclusive growth

Current situation

Egypt's economic reforms since 2015-2016 represent a significant departure from the past. Egypt's ongoing reform programme represents a significant departure from past policies and an ambitious attempt at correcting decades-long macroeconomic imbalances. Significant progress has been achieved in restoring macroeconomic stability, correcting the twin (fiscal and current account) deficits, restoring confidence and accelerating growth. This section describes the scale of this effort by summarising the country's situation prior to the reform effort. The following section (Reform Efforts) describes the basic pillars of the reform programme and the results achieved as of April 2018. The final section (Key Priorities) identifies recommendations for the future.

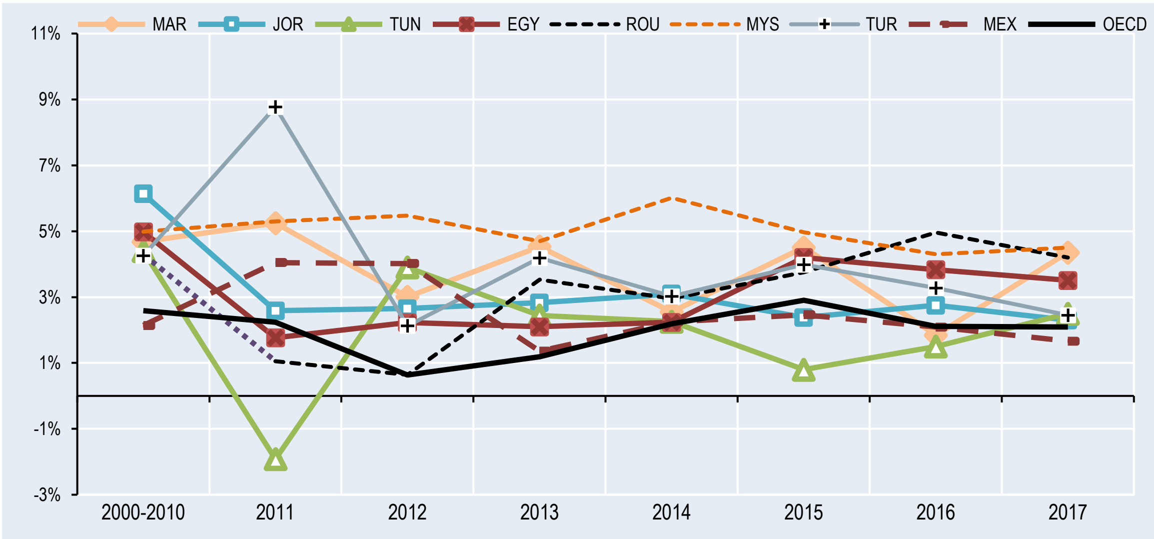
Egypt's economic trajectory in recent decades combined periods of reform with a series of structural vulnerabilities. The reforms initiated in 2005 managed to revitalise the Egyptian economy. Average real growth registered an upbeat 6.2% annually during the period 2005/06-2009/10. The balance of payments (BoP) recorded a surplus in the whole period except for 2008-09, reaching a total surplus of USD 13.9 billion over the five years. The sources of this recorded surplus in the BoP were a slight net deficit in the current account and a significant surplus in the capital and financial account over the period. This buoyant external sector position reinforced the position of the Central Bank of Egypt (CBE) whose reserves amounted to USD 35.2 billion as of June 2010 (equivalent to 8.6 months of merchandise imports). In turn, this comfortable cushion strengthened the position of the Egyptian pound, allowing the CBE to maintain exchange rate stability even with relatively high domestic inflation (an average of 10% during the period of reference). The government deficit followed a U-shaped pattern during the five-year period prior 2011. From a high figure of 9.6% of GDP in 2004/05, the deficit followed a downward trend to 6.8% of GDP in 2007/08 before picking up again to 8.1% in 2010 as the government dealt with the impact of the 2008-2009 global financial crisis. These macroeconomic indicators seemed to indicate that the Egyptian economy was on a positive trajectory. Yet a more careful look can detect a number of vulnerabilities which came to the surface and, in some cases, intensified after the 2011 shock:

- First, the surge in capital inflows (in particular FDI inflows) starting from 2005 produced a substantial surplus in the capital account and, combined with a resilient service sector, masked the weak performance of the merchandise trade sector which averaged a significant deficit of 12.6% of GDP per year on average between 2005/6 and 2010/11.
- Second, monetary and exchange rate policy did not address the progressive erosion in economic competitiveness. A double-digit inflation was accommodated to preserve a *de facto* fixed nominal exchange rate regime. The combination of a stable nominal exchange rate and a positive inflation differential compared to Egypt’s main trading partners led to a continuous real appreciation in the real exchange rate and hence an erosion in Egypt’s competitiveness.
- Third, even during periods of high levels of growth (including 2005-2010); Egypt has traditionally suffered from a significant chronic fiscal imbalance. The lowest recorded deficit during the period 2005-2011 was 6.8% of GDP (in 2008) with an average of 7.8%, which is remarkably high compared to other regional peers (e.g. Tunisia, Morocco, and Jordan).

Partly as a result of the economic cost of political transition as well as exogenous shocks, Egypt’s macroeconomic situation deteriorated since the onset of the political transformation in the beginning of 2011. The combination of longstanding economic imbalances and a series of exogenous shocks (including the impact of the 2008-2009 global financial crisis on key trade partners as well as trade and investment flows, or the effects of the security situation in the region on tourist arrivals) resulted in a fast corrosion in economic fundamentals. Egypt’s macroeconomic performance in the period 2011-2016 was characterised by (a) significantly lower levels of growth, (b) mounting inflationary pressures; and (c) a deterioration in its chronic twin deficit (fiscal and current account). In particular, macroeconomic stability was compromised by significant imbalances in the current account and the government’s fiscal position.

Lower levels of growth were the product of a number of exogenous shocks and endogenous weaknesses. Since 2011, the country experienced a marked economic slowdown as a result of structural, endogenous factors as well as exogenous shocks (e.g. sluggish growth in Europe, Egypt’s main trade partner, a drop in financial support and remittances from Gulf countries, and the impact of regional security dynamics on tourism and FDI) (Figure 6). From an average 5% real GDP growth rate in 2000-2010, the economy grew at a much slower pace between 2011 and 2016 (2.7% on average).

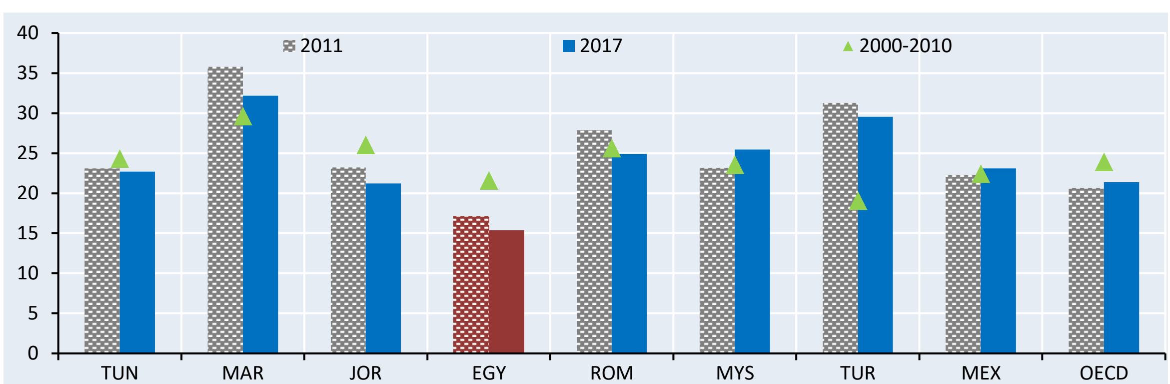
Figure 6: Real GDP (% change) for Egypt, ACTs, emerging economies and the OECD (2000-2017)



Note: 2017 data for all countries are estimates.
Source: IMF World Economic Outlook databases.

A key factor behind this significant deceleration has been low and declining levels of investment. The downward trend in investment levels in Egypt (Figure 7) continued since 2011. From 21.6% of GDP on average over the period 2000-2010, public and private investment reached levels of 13-14% since 2013 – well below other regional peers like Jordan (19.5% in 2016), Morocco (30.2%) and Tunisia (21.7%). From a period of strong FDI inflows in 2004-2008 (close to 9% of GDP in some years), net FDI flows were close to zero in 2011 (0.9%) and inflows did not reach 2% of GDP until 2015. In addition, key sectors of the economy have been underperforming. A case in point is tourism revenue, which decreased from over 5% of GDP in 2009/2010 to just over 1% in 2015/2016, largely as a result of security concerns and the economic slowdown in key sources of tourist arrivals (e.g. the Eurozone) (IMF, 2017).

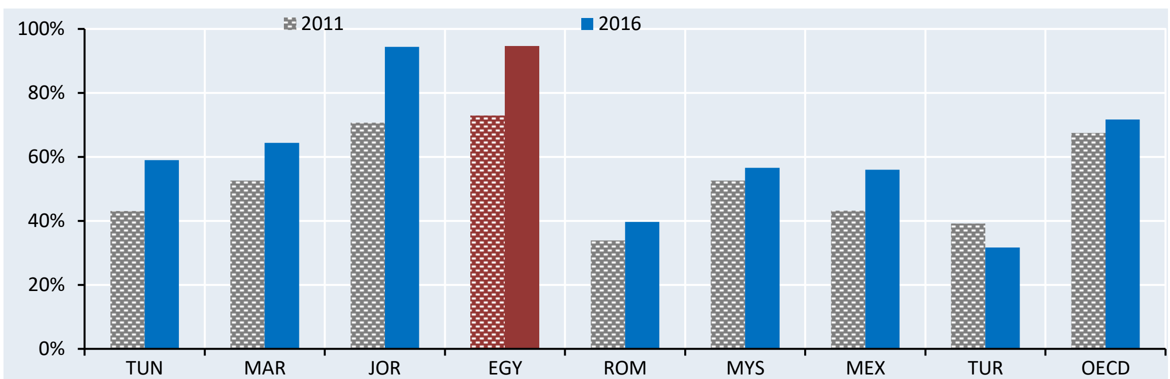
Figure 7: Investment rates (% of GDP)



Note: 2017 Data for all countries are estimates.
Source: IMF World Economic Outlook Databases (Nov. 2017).

The fiscal deficit widened since 2011 raising challenges for debt sustainability over the medium to long term. High budget deficits (at 10-13% of GDP, compared with 7-8% before the Revolution) increased public debt to close to 95% of GDP in 2015/2016, compared with about 70% in 2009/2010). This is largely a structural issue. According to the World Bank, a comparison with other middle-income economies focusing on the last two decades reveals that Egypt was raising revenue at a level similar to other lower-middle-income countries (about 25% of GDP) but spending at a level much closer to upper-middle-income countries like Turkey (35% of GDP) (World Bank, 2015). Successive governments relied on expansionary fiscal policy to minimize the adverse effects of feeble aggregate demand especially from the investment side. Sustained sizeable fiscal deficits have led to a rapid increase in government debt stock (Figure 8). Fiscal deficits have been largely financed by domestic resources, in particular through the banking sector, which has in turn heavily relied on central bank financing. While this mitigates exchange rate risks (external debt remained low at roughly 20% of GDP), significant domestic public borrowing has had a negative impact on growth through a crowding out effect affecting credit to the private sector (Pillar III).

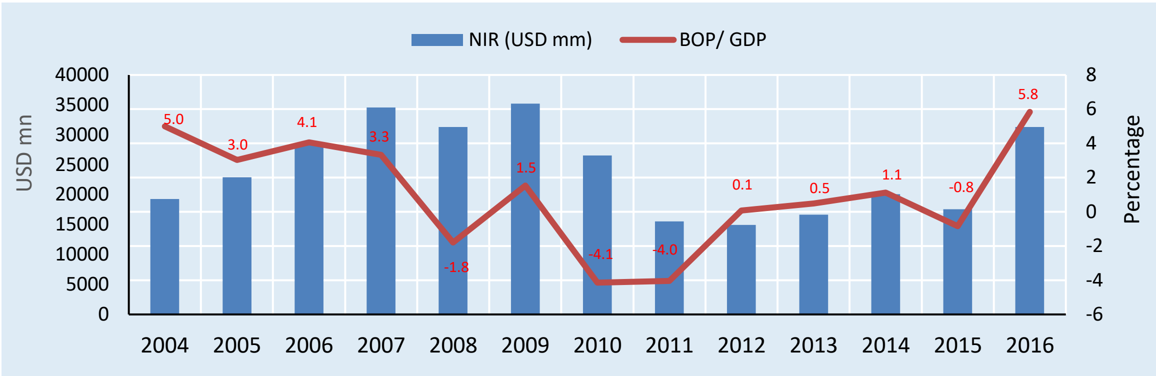
Figure 8: General government gross debt (% of GDP)



Source: IMF World Economic Outlook Database (Nov. 2017).

An overvalued currency undermined competitiveness and depleted international reserves. Political uncertainty and security risks heightened Egypt's risk premium, putting significant pressure on the Egyptian Pound to depreciate. The balance of payments (BoP) dropped from a surplus of USD 3.4 billion in 2009/10 to a deficit of USD 11.3 billion in 2011/12 respectively. Following a slight improvement over 2013-2014, with the reduction in official transfers from Gulf countries, the BoP returned to red in 2015/16 with a deficit amounting to 0.8% of GDP. In particular, the current account deficit worsened over this period, reaching 6 % of GDP in 2016/2017. Efforts to maintain the *de facto* fixed nominal exchange rate by using international reserves to absorb exchange rate market pressure resulted in a loss of an excess of USD 20 billion of reserves (Figure 9 – to reach a level equivalent to 3.3 months of imports in 2014/2015, nearly half of the level in 2009/2010), mounting speculation and the emergence of a parallel foreign exchange market

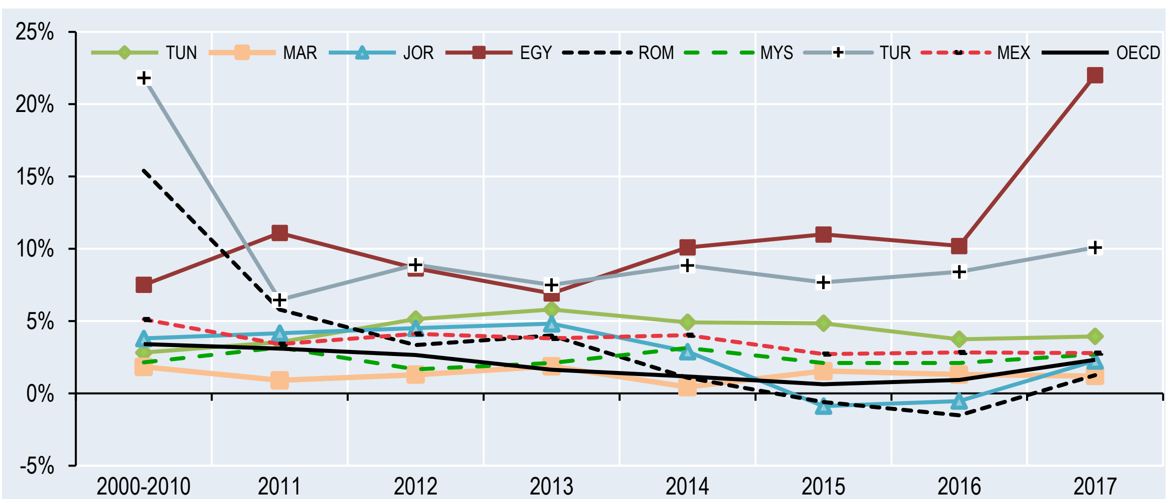
Figure 9: Balance of payments GDP and Net International Reserves FY (2005/06- 2016/17)



Source: Central Bank of Egypt.

Egypt confronted mounting inflation pressures since 2011. In parallel to the progressive devaluation of the Pound, prices increased steadily since 2011. Headline inflation reached 14.0% in June 2016, compared to an average of 7.8% over the 2000-2010 period (Figure 10).

Figure 10: Inflation, average consumer prices (2000-2017)



Note: 2017 data for all countries are estimates.

Source: IMF World Economic Outlook Databases.

Reform efforts

Confronted with the above mounting macroeconomic imbalances, the government adopted a first wave of policy adjustment measures in 2014-2015. Reforms focused in particular on addressing the deteriorating fiscal and current account deficits. A particular emphasis was put on fiscal consolidation the progressive removal of the highly-distortive energy subsidies, which represented over 20% of total government revenues, 18% of total expenditures and 6% of GDP in 2013/2014 – more than the combined public spending in priority social sectors (education and health) as well as public investment. An ambitious reform programme was launched in July 2014, with an initial reduction in subsidies of about 30-35%, leading to fiscal savings of about 3% of GDP. A second priority has been the containment of the wage bill, with various reforms introduced in 2014 and 2015 to tighten recruitment rules and limit pay increases while introducing a merit-based recruitment policy through a new civil service law (Pillar II). These measures (helped by the reduction of oil prices in international markets) managed to reduce the fiscal deficit from 12.2% of GDP in 2013/2014 to 11.5% a year later. However, despite these efforts, these initiatives were piecemeal, lacked continuity and comprehensiveness to stabilise and jumpstart the economy. The reform momentum slowed down in 2015/2016 as a number of important tax measures, such as the introduction of the VAT were postponed, and the schedule for the progressive reduction of fuel subsidies as delayed (IMF, 2017). The fiscal deficit widened as a result to 12.1% of GDP. The CBE continued to use reserves to try to maintain exchange rate flexibility, although a devaluation of about 13% in the official exchange rate with the US Dollar was introduced in March 2016.

A comprehensive reform programme was introduced in 2016 to address the twin deficits and the currency and BoP crises, including a number of far-reaching measures. Following a slowdown in the reform process in 2015, important actions were adopted to restore macroeconomic stability in the second half of 2016, partly in anticipation of the IMF programme approved in November 2016:

- A new round of ***fiscal consolidation initiatives*** were announced and adopted for the short- to medium-term (Pillar II), in parallel to various structural reforms to boost private-sector-led growth (Pillar III). For instance, a value-added tax (VAT) was introduced in August 2016 and another reduction of fuel subsidies (including an increase of electricity tariffs by 40% in July 2016 and of fuel subsidies by 35% in November 2016) was adopted to generate savings worth 2.2% of GDP in 2016/2017. An additional tariff adjustment was introduced in July/August 2017, bringing the total expected savings to EGP 73 billion in 2017/2018. The government is committed to reach a 100% cost recovery ratio for most fuel products in three years and eliminate electricity subsidies over the next five years, in parallel to a comprehensive restructuring of the electricity and petroleum sectors. Ultimately, the ambition is to implement an automatic price indexation mechanism. A draft was prepared in October 2017 and a detailed framework is expected to be finalised by end-2018. The government also introduced additional measures to monitor and control fiscal risks (Pillar II). In addition, the IMF programme will help cover an estimated financing gap of USD 35 billion over three years through the programme's own resources (USD 12 billion) and other multilateral and bilateral financing.

- The CBE moved to a ***flexible exchange rate*** by allowing the currency to float with the aim of eliminating market distortions, stabilising the foreign exchange regime and increasing the availability of foreign exchange while at the same time, eliminating foreign exchange restrictions . Greater flexibility in the determination of the exchange has supported the rebuilding of reserves and is creating a buffer against external shocks. Following the CBE action, the parallel market disappeared. This measure represents a significant departure from the past and corrected a significant source of the imbalances described in the Country Overview of this Report.

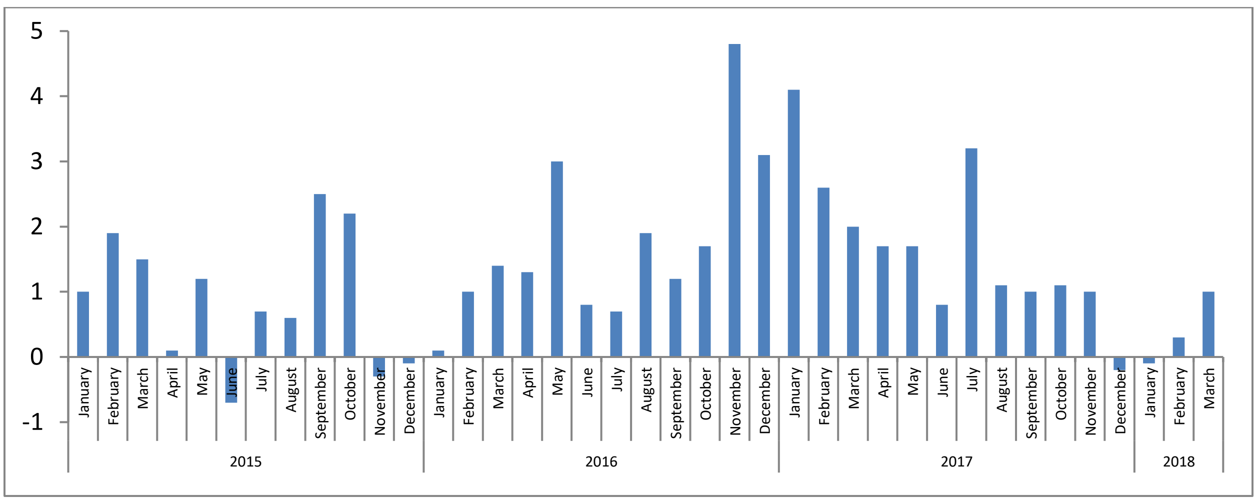
- ***Monetary policy*** was used to contain inflationary pressures, including the second-round effects of the depreciation associated with the liberalisation of the foreign exchange market as well as fiscal consolidation measures. Following the liberalization of the exchange rate and the reform measures implemented by the government, inflation accelerated to a peak of 33.0% year-on-year in July 2017 (compared to 13.6% in October 2016). The CBE tightened monetary policy by raising key policy rates 700 bps between November 2016 and July 2017, with the objective of anchoring inflation expectations, containing demand-side pressures and second round effects of supply shocks. Since August 2017 inflation began to decline to reach 13.3% in March 2018, in the range of the CBE's inflation target of 13% (+/-3%) for 2018 Q4. As underlying inflationary pressures began to subside, the CBE cut policy rates by a cumulative 200 bps during the Monetary Policy Committee meetings in February and March 2018. Moreover, the CBE continued to publish quarterly monetary policy reports since March 2017.

As of April 2018, significant results have been achieved in restoring macroeconomic stability. This includes a narrowing of Egypt's twin deficits.

- **Fiscal consolidation has resulted in a narrowing deficit, although debt remains high.** Subsidy reforms, have managed to reduce subsidy levels from a peak of 8.9 percent of GDP in 2013/14 to 5.8 percent of GDP in 2016/17. The government expects the subsidy bill to decline further to 2.4 percent of GDP in 2017/18. In 2016/2017, fiscal consolidation resulted in a reduction of 1.6 percentage points of GDP on the overall balance from 12.5% to 10.9%. The government is planning to achieve in 2017/2018 the first primary surplus in a decade and then maintain surpluses of about 2% of GDP in the medium-term. Despite these efforts, total government debt increased to 105.9% of GDP at end-March 2017 (MoF, 2018), partly due to the impact of increased borrowing interests (IMF, 2018a). The most recent debt sustainability analysis carried out by the IMF in December 2017 indicated that the overall pubic debt is "sustainable" although "subject to significant risks" (IMF 2018a).
- **The current account deficit has stabilised at about 6% of GDP in FY 2016/2017.**
- **Net international reserves have considerably increased.** They have reached USD 44.03 billion in April 2018, equivalent to 7.3 months of imports of goods and services, compared to just 2.4 months in March 2013.
- **Growth has picked up.** A modest GDP growth surge had already take place in 2014/2015 (4.4% compared to around 2% annually since 2010). Following a slight deceleration in 2015/2016 (3.8%), reforms have led to increased economic activity (with GDP growth at 4.2% in 2016/2017, 5.3% during the first half of the current fiscal year and a forecast of 5.2% in 2017/2018). Tourism is recovering gradually, reaching 4.7 million tourists in the second half of 2017 (compared to 3.1 million one year earlier) (MoF, 2018) and natural gas production has picked up significantly to 20% during the first half of the fiscal year, transforming the growth of the sector from a contraction of an average 10% during the past three years . Private investment has also increased, from 7.3% of GDP in 2013/14 to 9.5% of GDP in 2016/2017, with FDI forecasted to reach USD 10 billion in 2017/2018, according to the Ministry of Investment and International Co-operation, still at modest levels relative to GDP (0.7% in the first quarter of 2018)). However, despite these encouraging signs, Egypt's growth figures remain below an estimated potential growth of about 6% (IMF, 2017). Increased growth has also translated into new jobs as the unemployment rate decreased to 11.3% in the fourth quarter of 2017 (compared to 12.6% in July-September 2016).

- **The spike in inflation in late 2016 and 2017 has been contained in recent months.** Following months of very high levels (around 30% during most of 2017); annual inflation has subsided at a fast pace, reaching 13.33% y-o-yin April 2018, in line with CBE inflation outlook. The CBE eased policy rates by a cumulative 200 bps in February and March 2018, noting that this is still in line with tight real monetary conditions. The CBE aims to reduce inflation to single digits over the medium term. Exchange rate volatility has decreased and the EGP has stabilised at a rate of 17.5 to the USD since March 2017 (Figure 11).
- **Increased market confidence has allowed Egypt to return to the international sovereign debt markets.** In January 2017, Egypt issued international bonds worth USD 4 billion (the first operation since June 2015). This was followed by other issuances worth USD 3 billion in May 2017 and another one worth USD of 4 billion in February 2018. In April 2018, Egypt issued its first Euro-denominated Eurobond (EUR 2 billion). All issuances were at least three times oversubscribed, with the cost of debt consistently declining from one issuance to another.

Figure 11: Monthly inflation rate for urban CPI (in %)



Source: Central Bank of Egypt.

Key priorities

Consolidating macroeconomic stability is a pre-requisite for growth in Egypt. Foreign exchange shortages, the negative impact of an overvalued currency on manufacturing exports, and the significant crowding-out effect resulting from massive government domestic borrowing were all major factors inhibiting private-sector-led growth in Egypt. Likewise, large energy subsidies have not only been a drag for the government's fiscal position but also distorted incentives in favour of capital-intensive industries and to the detriment of labour-intensive sectors, thus contributing to negative labour market outcomes. Addressing macroeconomic fundamentals (including the twin deficits and high inflation) is also instrumental to maximise the impact of reforms under Pillars II to IV. The landmark policy reforms adopted since 2015 represent a significant step to, not only restore macroeconomic stability, but also to create the conditions for more robust growth in the future. The results of those reforms look promising but efforts will need to be maintained to further reduce Egypt's twin deficits and consolidate macroeconomic stability. The Egyptian authorities should therefore continue the ambitious reforms initiated in November 2016 with the support of the IMF programme and the donor community, combining short-term macroeconomic stabilisation with structural reforms aimed at bringing growth closer to its potential level. These include:

- Continuing and deepening **fiscal consolidation efforts** (in particular in the area of fuel subsidy reform) in line with the objectives set in the IMF programme to ensure the long-term sustainability of public debt and create fiscal space for increased pro-poor social and infrastructure spending. The adoption of an **automatic price indexation for fuel products** will be a key step in this direction. In addition, fiscal consolidation and subsidy reform are likely to have a strong structural element.
- Continuing pursuing a **flexible exchange rate regime to rebuild reserve levels** as a buffer against future shocks and create the conditions for an **inflation targeting framework** over the medium term.
- Maintaining a **supportive and prudent monetary** policy aimed at achieving price stability over the medium term in line with the government's single-digits objective.
- Beyond the above short-term priorities, continuing efforts to develop a **sound medium-term macro-fiscal policy framework** to identify the country's broader macroeconomic objectives and better coordinate fiscal and monetary policies; and strengthening the **independence and transparency of the CBE** to enhance its credibility through the reform of the CBE legal framework.

It is important to note, however, that macroeconomic stabilisation is not, by itself, sufficient to accelerate growth and create jobs, as demonstrated by previous episodes (the ERSAP in the 1990s and the reforms in the mid-2000s). These reform efforts were quite successful in stabilising the economy and strengthening fundamentals but, as they placed relatively less emphasis on long-term structural reforms and economic governance, they failed to generate job creation as well as inclusive and sustained growth. Moreover, unless counterbalancing measures are introduced, the short term impact of the key reforms (high inflation as a result of the liberalisation of the exchange rate and the introduction of the VAT and lower levels of government transfers, including energy subsidies) may have a negative impact on poverty and inequality.

B. Strengthening and expanding social protection systems to improve inclusiveness

Current situation

Social protection systems in Egypt are a major priority given high levels of poverty. As described in the Country Overview, even during prosperous times, economic growth has struggled to trickle down to the majority of the Egyptian population in the form of poverty reduction and large-scale job creation. During the 2005-2010 period, the Egyptian economy was growing at an average rate of more than 5%. However, the poverty rate has continued to increase from 16.7% in 2000 to 19.6% in 2005, to 25.2% in 2011 (Sarangi and Abu-Ismail, 2015) and to 27.8% in 2015 (CAPMAS). The poverty rate is close to 60% in rural Upper

Egypt. The severity of poverty also increased over the same time, with the distance between the national poverty line and the income of the average poor household increased over the same period (World Bank, 2015). In addition, despite the noticeable increase in the average income, the welfare of the middle class in Egypt remained stagnant as the fraction of population living on less than USD 5 per day, which constitutes 85% of Egyptian population, did not change between 2000 and 2008 (Ghanem, 2014). A key factor behind these figures is the limited coverage and effectiveness of existing social programmes, despite the progress achieved in recent years.

Social policy in Egypt has traditionally relied on distortive, regressive and ineffective subsidies. Social protection in Egypt has so far been largely limited to untargeted subsidies on the price of electricity, fuel and food products, which represent approximately 6-9% of GDP, compared to just 0.2% for social safety net programmes (World Bank, 2015). Subsidies represented almost 81% social protection expenditure and around 26.8% of total government expenditure in 2013/14. These subsidies are highly distortive for economic incentives and have a detrimental impact on equity and job creation. First, they indirectly promote capital-intensive industries to the detriment of sectors with a higher job creation potential. An evaluation of the initial reforms of energy subsidies adopted in July 2014 shows that reduced subsidies led to lower consumption, significantly higher investment and production shifts from energy-intensive sectors (energy, water, transports) to labour-intensive sectors (construction in particular), with a likely increase of one percentage point in real GDP growth over the long term and a limited impact on inflation (Griffin et al., 2016). Second, evidence suggests that these subsides are also regressive by design. In 2012/2013, the highest income quintile received approximately 60% of all energy subsidies (World Bank, 2015) while approximately 73% of non-poor households benefit from food ration cards (International Food Policy Research Institute, 2013). In contrast, social security and cash transfer programmes have been residual until very recently both in terms of funding and coverage. The only main non-subsidy social programme in Egypt until 2012 was the Social Solidary Pension (SSP), an unconditional cash transfer scheme which covers approximately 1.6 million vulnerable households.

Greater social justice was one of the demands of the 2011 revolution. The 2014 Constitution includes a mandate for the government work towards social justice and work to ensure a decent life for all citizens (Article 8). This general mandate is complemented by articles 17, 18 and 19 which deal with social insurance, health care and education and include spending targets in these areas amounting to 7% of GDP.

Reform efforts

A significant effort on energy subsidy reform has been taking place since 2014. As noted above, considerable efforts have been made to reduce the burden of fuel and electricity subsidies in the budget. Subsidy elimination plans do not include LPG and electricity consumption for the poorest neighbourhoods, in an attempt to minimise the impact on the most vulnerable. A multimedia communications campaign was also put in place. Subsidy reform has also preceded hand-in-hand with ongoing plans to reform the sector and ensure the financial viability of state-owned enterprises. Overall subsidy reform has also been accompanied with the introduction of targeted social programmes to smooth the impact of the subsidy removal on the most vulnerable segments of the population, following the example of other countries[5]. The World Bank has estimated that the welfare losses arising from the recent energy increases could be up to 5.5% of the average household consumption if no mitigated measures were adopted, with the increase of LPG prices being particularly sensitive for the poorest segments of the Egyptian population (World Bank, 2015a).

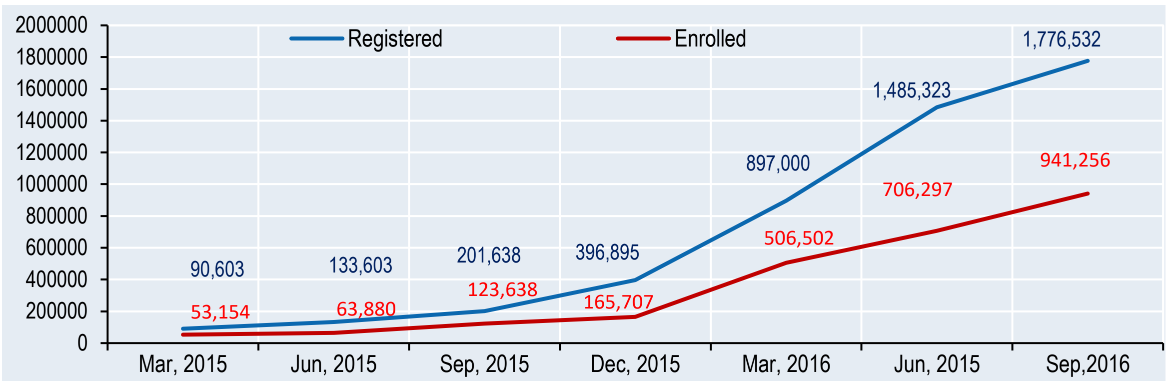
A number of initiatives have been adopted to increase the targeting and efficiency of food subsidies. Approximately 85% percent of the population is included in the food ration programme, with a budgetary allocation of about 1% of GDP. Since mid-2014, the Ministry of Supply, in co-ordination with the Ministry of Planning, Monitoring and Administrative Reforms, has adopted a number of improvements to the functioning of the food card system and reduce leakages (which represent close to 30% of the resources allocated to the system), including: (a) limiting subsidies to the final product (final bread loafs) instead of inputs (e.g. flour); (b) introducing and expanding the use of smart cards while limiting the issuance of new cards to citizens with a monthly income below EGP 1,500; (c) expanding the product coverage of rationing cards' to include more choice up to a limit of EGP 50 per month per person; (c) filtering the ration cards' beneficiaries to exclude double entries and non-eligible individuals; and (d) collaborating with SFD to provide micro loans to youth (EP50,000-100,000) to open outlets of public coops which provide several reduced-price products.

New cash transfer programmes were introduced in 2015 and a broad social reform package was launched in 2017 to mitigate the impact of economic reforms and fiscal consolidation. The Ministry of Social Solidarity launched, with technical and financial support from the World Bank, two flagship cash transfer programmes in 2015: *Takaful* and *Karama* (solidarity and dignity). *Takaful* is a family income support programme for households with children between 0 and 18 years, with conditionality related to enhancing the human capital of beneficial households (e.g. school enrolment, pre- and post-natal care, vaccination). *Karama* is a social inclusion program for the elderly and the disabled who cannot work. Targeting of beneficiaries is done in two stages. The first stage is to identify districts which fall below a certain poverty threshold based on data from 2013/14 Household Income and Consumption Survey (HICS). The second stage is to get applications to enrol in these programmes from potential beneficiaries. The first wave of the programme targets districts with a poverty rate of 50% and higher. The second wave targets poverty rate of 30% and higher whereas the third and final wave has a poverty threshold of 17.9%. As of mid-2017, the *Takaful* and *Karama* programmes served 1.7 million households which are expected to increase to 2.0 million by the end of 2018 (Figure 12)[6]. The programmes' overall objective is to reach 3 million households. As originally designed, he monthly payment under *Karama* amounted to EGP 350 per person and EGP 325 per household with additional of EG60, EG80 and EG100 for each child in elementary, middle and high school respectively. These amounts were increased in 2017 to counter the effects of inflation. Other social initiatives announced by the government in June 2017 to counter the effects of the ongoing macroeconomic adjustment include a budgetary increase for the pension system of about 15%

[5] In 2008 Jordan introduced an energy subsidy reform reducing the subsidy bill from 5.6% to only 0.4% of GDP. This reform was coupled with the implementation of a number of social protection measures to ease the adverse effect of similar move on the poor (Kalkman et al., 2015).
[6] According the officials from the Ministry of Finance, social protection programmes have a priority in terms of providing sufficient financing.

covering 10 million beneficiaries, an expanded school meals scheme, strengthening the Social Housing Project, and improvements in public services and infrastructure projects in Upper Egypt. Other accompanying measures included expanding the product coverage of rationing cards' to include more choice up to a limit of EGP 50 per month per month, tax credits for low-income taxpayers, and two one-off bonuses of 7% and 10% to public sector employees. The government is also developing a new social programme (*Forsa*, Opportunity) aimed at enhancing the employability of the most vulnerable.

Figure 12: Takaful and Karama Programme Uptake (2015-2016)



Source: Ministry of Social Solidarity of Egypt.

The newly-introduced programmes can be a powerful instrument to mitigate the impact of subsidy reform and the broader reform programme. Despite significant efforts to roll out *Takaful* and *Karama*, these programmes still need to be substantially scaled up to create an effective safety net covering Egypt's vulnerable populations, in particular given the impact of the ongoing adjustment on the poor. The programmes also suffer from a few shortcomings that the authorities may want to address in the future. First, they miss many poor and ultra-poor households which reside in districts where the poverty rate is less than 17.5%. Second, these programs depend on *ex ante* districts' poverty rates as calculated in 2013 which have increased over time and are expected to increase even further due to the implementation of the macroeconomic stabilisation programme. Third, monthly payments are not fully indexed; consequently, with the spike in inflation observed in 2017, the real value of payments (and ultimately the programme's effectiveness) may decrease over time unless some degree of indexation is introduced. To address this problem in 2017, the government introduced a one-off increase in the amounts of *Takaful* and *Karama* payments by EGP 100 per household (with a total number of beneficiaries of 1.8 million families) and more than doubled the food subsidy programme from EGP 21/month to 50/month for 70 million beneficiaries.

Key priorities

Conscious of the need to boost social cohesion in parallel to the ongoing adjustment and structural reforms, the Egyptian authorities are trying to lay down the basic pillars of a basic social protection system. The far-reaching reforms adopted since 2016 to correct Egypt's macroeconomic imbalances are likely to have an impact on the most vulnerable, which underscores the need for effective social protection systems. Conscious of this, the reform programme is focusing not only on macroeconomic and structural priorities but also on a broad social agenda. Against this background, the Egyptian authorities should continue and step up the ongoing transformation of social protection schemes from an emphasis on untargeted food and energy subsidies towards a model based on targeted support for the most vulnerable. Key actions in this regard include:

- Expand and deepen the **use of information technologies** (e.g. smart cards, identification technologies, etc.) to reduce transaction costs and enhance the efficiency of social protection systems, promoting financial deepening increasing the demand for banking services, bridging the digital divide for vulnerable groups, and combating corruption (Devereux and Vincent, 2010).
- Accelerate the work to create a **unified registry of beneficiaries** as the cornerstone for a modern social protection system, integrating the beneficiary lists of the main social programmes with other databases (e.g. pension fund, utility bills, vehicle registration).
- **Dedicate part of the fiscal savings arising from fiscal consolidation efforts to social protection and social programmes** in line with the mandate of the 2014 Constitution and the targets of the ongoing IMF programme (1% of GDP in incremental social spending).
- **Continue expanding the coverage of *Takaful* and *Karama* and increasing its effectiveness**. Over time, these programmes could be merged with the existing unconditional cash transfer scheme for vulnerable populations. Finally, a long-run plan should be developed to allow beneficiaries to "graduate" from these programs through human capital development.
- Continue the **reform of the food subsidy scheme**, improving its targeting on the most vulnerable.

C. Creating the conditions for sustained job creation through education and labour reforms and a comprehensive approach to the informal sector

Macroeconomic stabilisation should be done hand-in-hand with structural reforms aimed at increasing the actual and potential growth levels of the economy and, in particular, policies to boost labour participation rates and employment, particularly amongst women and the youth.

Evidence suggests that current levels of high unemployment and underemployment are largely the product of a constrained private sector, which is incapable of generating a demand capable of absorbing the approximately 700,000 job seekers entering the labour market every year. As a result, the analysis and recommendations laid down under Pillar III constitute a significant part of the job creation agenda. But this agenda needs to be complemented by effective reforms regarding both the supply and the demand side of the labour market, as well as increased attention to underemployment and informality. Three key priorities should be considered:

(a) On the supply side, *addressing the skills mismatch and improving the quality of the education system*.

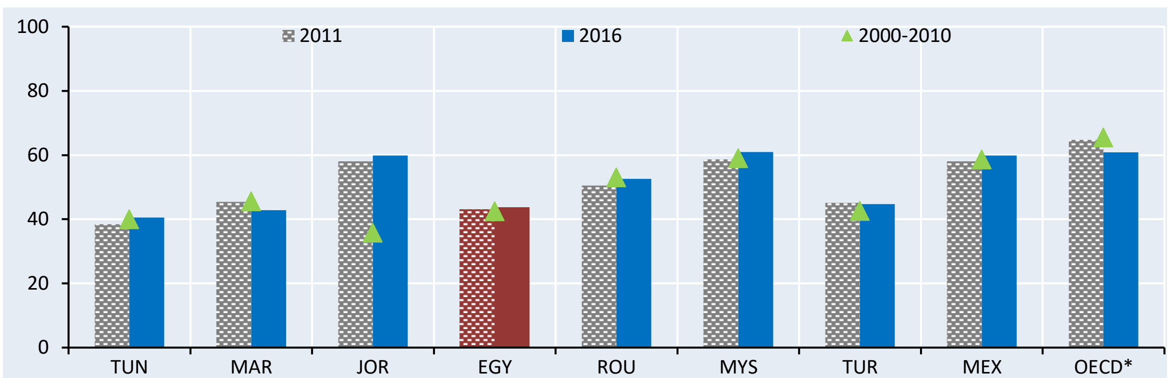
(b) On the demand side, *reforming Egypt's labour laws and institutions to encourage hiring by firms*.

(c) Developing a *comprehensive approach to the main source of job creation in Egypt over the last decades: the informal economy*.

Current situation

Egypt's main long-term development challenge is job creation. As discussed in the Country Overview, Egypt has struggled to create jobs in a sustained manner for over 30 years – even during the occasional periods of high growth. This applies also to the situation since 2011. Unemployment has increased from about 9% in 2010 to an all-time high of 13.2% in 2013, although a slight improvement has been observed since then. The unemployment rate in 2016, prior to the most recent wave of reforms, was 12.5% As a result of recent reforms, the unemployment rate has evolved favourably and stood at 11.3% in the fourth quarter of 2017, the lowest level in six years, although still high. This figure hides significant variations across gender and age. Approximately 70% of the Egyptian jobless people are youth between ages 15 and 29 according to the CAPMAS[7] Labour Force Survey. Female unemployment remains persistently high at 24% (2016). Labour force participation (at below 43% in 2016) remains very low in comparative terms (Figure 13) and still falls short of the pre-2011 levels.

Figure 13: Employment-to-population ratio (2000-2016)



Note: OECD average is for 2005-2010. *Data for 2017 for all countries are estimations. The data for the OECD corresponds to 2016
Source: ILO key indicators of the Labour Market database, OECD Labour Market Statistics.

Like in many other MENA and emerging countries, the informal economy in Egypt represents a significant portion of GDP and employment. Estimates of the extent of the informal economy in Egypt vary widely, depending on the definition and the methodology used. Schneider (2002) has estimated the size of the informal sector to be 35.1% of GNP in 1990/2000. Elshamy (2015) estimates it to be at 33.8% of GDP in 2000, increasing to 37.4% in 2012. A recent study by the African Development Bank concludes that informal activities range between 37% and 68% of GDP depending on the measurement method (currency demand or electricity consumption), which suggests that informality is more prevalent in Egypt than in other MENA countries (AfDB 2016). The informal economy is also Egypt's largest employer. The ILO has estimated that 51.2% of non-agriculture private sector employment was informal in 2009 (ILO, 2013). Likewise, according to the World Bank, only 44% of employment in 2012 was in formal jobs based on either a written contract or social insurance, compared to 53% in 1998, while half of the workers employed by "formal" firms had informal jobs (World Bank, 2015).

[7] CAPMAS: Central Agency for Public Mobilization and Statistics.

Evidence suggests that the informal economy has grown in parallel to unemployment since the 1980s. Regardless of the different estimates of its overall size, the key stylised fact about informality in Egypt is that the size and the importance of the informal sector have continuously increased since at least since the 1980s. The size of the informal sector increased at an average annual growth rate of 1% over the period 1980-2012 (Elshamy, 2015). The evolution of employment trends in Egypt suggest that, in spite of privatisation and the end of government guaranteed employment, public sector employment has continued to increase over the 1990s and 2000s, while the formal private sector has shrunk considerably from over 50% of workers in 1990 to less than 25% in 2008 (AfDB, 2016). This gap has been filled by the informal private sector – which employed approximately 2 million workers in 1990 but grew exponentially to 9 million in 2005 and 11 million in 2008, more than double the employment in the formal private sector (AfDB, 2016). The informal sector has thus become the employer of last resort for Egyptians, particularly young.

High levels of informality have an impact on the quality of employment as well as overall inclusion and productivity. The informal sector is characterised by low quality jobs, with limited or no social protection, low wages, and limited training opportunities. As a result, informality is a drag on productivity and inclusiveness and might be one of the main factors explaining the absence of trickle-down effects in previous episodes of high growth in Egypt.

A number of factors explain the growth in informality and informal employment in Egypt. These include:

- ***High costs of formalisation outweighing benefits for a vast majority of firms.*** These include significant administrative obstacles and bureaucratic barriers to start and operate a business when compared with limited benefits in the form of access to finance or land, which remain limited in Egypt (Pillar III). Moreover, the output elasticity of labour demand is constrained by the array of costs associated with formally hiring or firing workers. In addition, the costs of employing workers are very high: social insurance contributions for formal employees represent 26% and 24% of the basic and variable salary, respectively (World Bank, 2016b). While the dismissal of an employee requires a prior approval from the Ministry of Manpower and may represent costs equivalent to 32 monthly wages (AfDB 2016). If these costs are lifted, it is estimated that there will be a net increase of hiring by 21%, 15% and 9% in manufacturing, tourism and service sectors respectively (Angel-Urdinola and Semlali, 2010).
- ***High levels of labour supply due to demographic trends.*** As noted in the Country Overview, the formal private sector cannot cope with Egypt's demographic trends. As a result, 91% percent of Egyptians between 15-29 years old work informally, according to a school-to-work transition survey carried out in 2014 (Shehu and Nilsson, 2014).
- ***Relatively-high levels of public sector salaries, particularly for low-skilled workers, creating reservation wages and skills mismatches.*** Skills mismatches represent a major constraint for Egyptian firms to employ workers formally as the private sector reports it is unable to fill 600,000 vacancies despite the high levels of youth unemployment, particularly among university graduates (World Bank, 2014). Potential explanations for this phenomenon include the quality of the education system and a relatively high level of public sector wages, which may lead young graduates to "queue" for government jobs (AfDB, 2016).

From a labour supply perspective, Egypt has made significant progress in education enrolment although quality and adequacy to private sector needs remains a challenge. Education is key for the development of human capital, productivity growth development (e.g. Islam, 1995; Nelson and Phelps, 1966; and Temple, 1999) and, in particular in the case of Egypt, to address skills mismatches. Over the last three decades, Egypt has made significant efforts in the supply of education. The country achieved the Millennium Development Goal 2 (MDG2) regarding universal primary education. While a number of regional, income and gender disparities in school enrolment persist (e.g. frontier and Upper Egypt governorates, poor individuals and women are in a clear disadvantage (Khorshid et al., 2013), this is a significant achievement. However, quality of education has been deteriorating in recent years. A combination of factors (including decreasing public investment and real teachers' income, obsolete pedagogical techniques and outdated curricula) explain this phenomenon. For instance, the pupil-to-teacher ratio in primary schools increased from 22 students in 2003 to 28 students in 2010 (World Bank, 2015). Egypt is ranked 139th among 140 countries in terms of the quality of primary education in the 2015-2016 Global Competitiveness Report (GCR, Global Competitiveness Report, 2016). Quality is also an issue in secondary and tertiary education: Egypt's GCR rank in terms of quantity of education at the secondary and tertiary levels is 78 among 140 countries[8], while when quality is considered Egypt is the second worst performing country in the world (Global Competitiveness Report, 2016)[9]. A recent OECD assessment of Egypt's education system identifies a number of factors behind low educational quality, including an inadequate student assessment system (and in particular the secondary school leaving exam), limited autonomy and accountability by schools and principals, poor teacher training and incentives, and a need to reshape secondary education and TVET (OECD, 2015).

Skills development beyond schools and active labour market policies need to be expanded. Some efforts have been put into expanding and strengthening training and vocational education, for instance through the training of teachers. Yet, quality issues remain important. The combination of a low perceived status, a gap between learning outcomes and labour market needs, and minimal coordination with potential employers make vocational education and training in Egypt unattractive option with a very low expected return (Álvarez-Galván, 2015). A number of active labour market programmes have also been implemented with limited success. Labour market intermediation services suffer from inadequate information and market intelligence systems and a mismatch between the primary potential users (university graduates) and the postings available (mostly blue-collar) (AfDB, 2016). Only 21% of Egyptian firms provide training to their employees, according to the 2016 World Bank Enterprise Survey.

Reform efforts

The government has formulated a plan to address informality. A new government programme was announced in March 2016 to respond to the growth of the informal sector. With the overall objective of "merging" the formal and the informal sector, this programme includes a number of measures, including plans to study the trends and characteristics of the sector, regulatory simplification and a gradual

[8] Quantity of education is measured based on two indicators gross secondary education enrollment rate and gross tertiary enrollment rate.

[9] Quality of education is measured based on four indicators: quality of education system; quality of science and math education; quality of management school and finally internet access in schools.

movement away from cash-based transactions to encourage formalisation, leveraging the introduction of the VAT to bring most of the supply chains to the formal sectors, extending social protection to informal sector employees, and providing incentives to transition to formality (e.g. through land). This initiative is the first structured attempt at developing a consistent plan to address the informality phenomenon. In the past, most initiatives have been scattered and mainly focused on reducing administrative obstacles to businesses, offering tax forgiveness in exchange for formalisation (as it happened in 2004 with some success as the number of business registrations increased by 35% between 2005 and 2012 (AfDB, 2016), or supporting SMEs through programmes run by the Social Fund for Development (SFD), now being absorbed under the new SME authority (Pillar III). Furthermore, the government has established the National Payment Council in 2017, to support and stimulate the use of digital financial services as a means for payment. This reduction in the use of bank notes should increase the traceability of transactions and constitute a tool to fight informality. The National Payment Council is headed by the President.

A new Education Strategic Plan for 2014-2030 has been adopted. The Plan identifies the revision of the curricula at all levels as a priority, the development of human resources in the education system as well as greater decentralisation at the governorate and school levels. The new plan also includes a Technical Education Development Programme as well as the continuation of TVET reform with support from the European Union. Implementation is progressing slowly but steadily. A new Ministry for Technical Education has been created. Finally the 2014 Constitution contains a mandate to increase public spending in education to 4% of GDP (of which 2% should be for higher education).

Key priorities

As discussed above, there is strong nexus between unemployment, informality and poor education and skills development in Egypt. Needless to say, structural reforms discussed elsewhere in this report (in particular those aimed at enhancing the business environment) will be key to boost job creation and incomes through higher levels of growth. For instance, the IMF has recently estimated that Egypt needs growth rates in the range of 5-6% over the next 5 years to absorb labour market entrants and reduce unemployment by 30% (IMF, 2018b). More specifically, a comprehensive strategy to address the three connected phenomena of unemployment, informality and weak human capital, is thus necessary across three areas:

- ***Labour market reforms:*** **Review existing labour market legislation** in dialogue with relevant stakeholders with a view to: (a) allow more flexible hiring and firing (including contract termination rules); (b) reducing the cost of "formally" hiring workers by reviewing social insurance contribution levels; (c) gather and disseminate data and information on sectoral average wages and job market trends; and (d) strengthening collective bargaining. In addition, **active labour market policies (including labour market information systems, counselling and training)** should be strengthened.
- ***Education reforms:*** Undertake a **comprehensive reform of the education system** to improve quality and reduce skills mismatches. Special attention should be put in improving education system governance, curriculum reform to adapt it to the needs of the labour market and the private sector (as well as a new pedagogical approach based on critical thinking rather than memorisation), improved teacher training, and strengthening TVET and incentives for firms to

invest in skills development. The government could consider participation in PISA assessments to evaluate student performance at basic levels. From a skills mismatches perspective, particular emphasis should be put on **improving TVET education quality**, in particular by (a) enhancing stakeholder coordination and quality assurance mechanism; (b) increasing the participation of employers (including in the design of the curricula); (c) making greater use of workplace learning (which remains extremely limited in Egypt); and (d) upgrading carrier guidance services.

- ***Informality strategy:*** Implement a **comprehensive strategy to tackle the informality phenomenon**, combining: (1) greater efforts to produce data and statistics to support policy-making in this area (e.g. improved definitions, surveys, etc.); (2) reducing the costs and increasing the benefits of formalisation, following the example of the new turnover-based tax for SMEs (Pillar III); (3) developing targeted capacity building and financial access programmes for informal firms; and (4) extending social and legal protection to informal workers (e.g. through contributory schemes to provide social security and health insurance benefits).

More generally, measures aimed at increasing the labour elasticity of output should be pursued to increase the link between growth and job creation. These include the elimination of market distortions disincentivising labour demand (e.g. energy subsidies), the potential adoption of support schemes for labour intensive industries (e.g. financing), as well as measures aimed at promoting investment and improving the overall business climate (Pillar III).

Pillar II: Enhancing the transparency and efficiency of public institutions and processes

The reform of the Egyptian public sector and the promotion of good governance should be seen as a priority not just as a driver of budgetary savings needed for the Government's fiscal consolidation efforts in the short to medium term, but also as a necessary step to boost public efficiency and effectiveness. This will require a multi-pronged and whole-of-government approach to public sector reform, across the following four areas:

A. Reforming the overall public sector, including continued civil service reform and SOE governance;

B. Stepping up good governance and anticorruption efforts and developing a comprehensive approach to Public Financial Management (PFM) reforms;

C. Enhancing domestic resource mobilization through a modern and efficient tax system; and

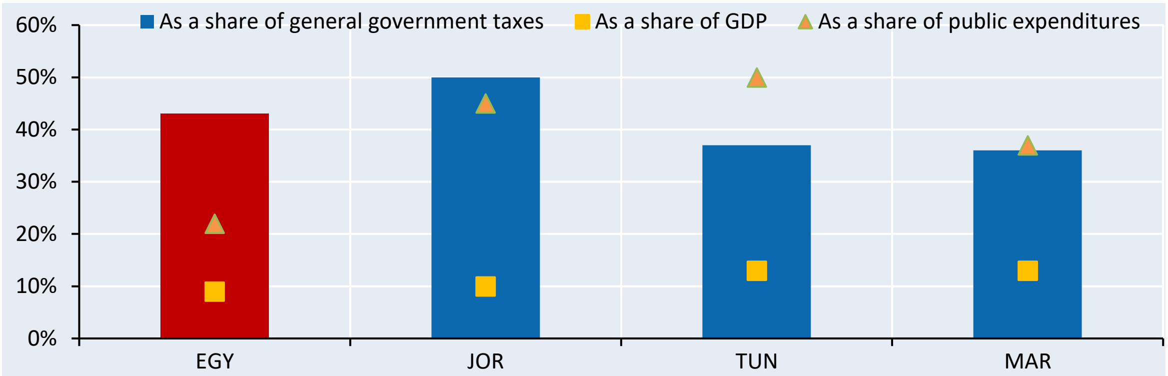
D. Improving regulatory and competition policy frameworks to create a level playing field for businesses and reduce transaction costs.

A. Reforming the overall public sector through improved incentives for public servants and stronger state-owned enterprise governance

Current situation

The Egyptian public sector is very large in comparative terms and has continued to expand since 2011. Public sector employment in Egypt accounts for more than 6.5 million employees representing 24% of employment in Egypt a level three times higher than in Morocco or other emerging countries such as Chile or Mexico. Public sector salaries represent about 7.6% of GDP in FY16 and 25% of the state budget (Figure 14). Between 2011 and 2014 and in response to social pressures and demands, the size of government employment and associated budgetary costs have actually increased: wages and salaries grew faster than any other spending category between 2011 and 2014, although the overall wage bill has experienced a downward trend since then in terms of its share of GDP (World Bank, 2016c). While this problem is common in other MENA countries (Figure 15), limiting the weight of the wage bill in Egypt is not only important for fiscal consolidation efforts but also to create fiscal space to devote resources to priority social spending and public investment.

Figure 14: Compensation of Employees, 2014



Source: IMF.

Another key element affecting the efficiency of the administration is the overall complexity of its organizational structure. The Egyptian administration is characterized by a complex network of ministries and affiliates with sometimes overlapping mandates. It is plagued with frequent overlaps, duplications and suffers from the lack of coordination among and between institutions leading to resource waste and efficiency losses.

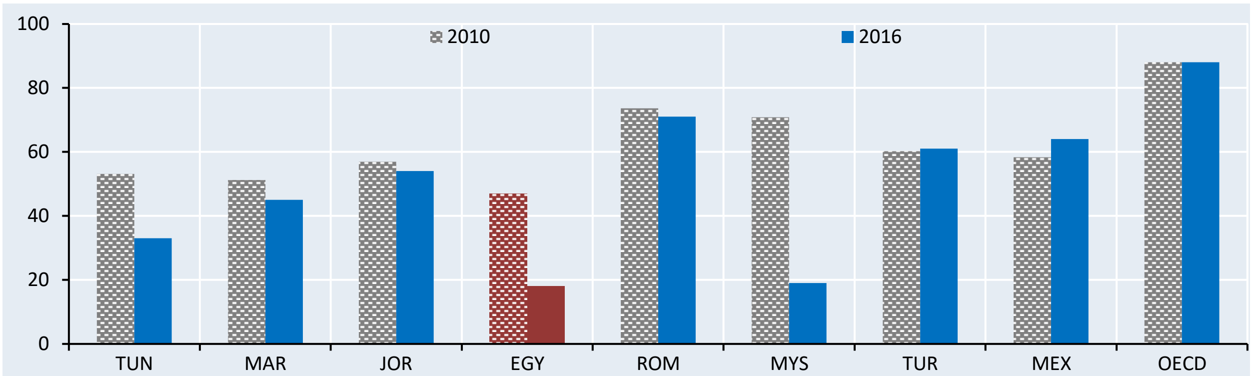
While the public sector attracts a large number of workers thanks to job stability and relatively higher salaries compared to the private sector (for low-skilled workers), managing and retaining talent remains a challenge. In response to complex recruitment rules and uncompetitive compensation packages for high-level positions, at the end of the 1990s a parallel system of supporting technical staff who usually worked as technical advisors to ministers started to emerge. To attract those high calibre professionals, compensation packages were designed at a completely different scale compared to career public servants usually using donor projects' funds. This parallel system managed to circumvent the bureaucracy and raise the efficiency of many ministries and public authorities but created tensions and discontent. This system has been largely dismantled after 2011, including through the adoption of legislation with mandatory minimum and maximum wages for public servants[10]. These changes have led to a more equitable and more transparent public wage structure but raise the problem of attracting and retaining senior-level public servants.

The absence of a modern public employment framework with adequate incentives is a major factor behind the poor quality of public services and limited government effectiveness. Weak incentives by policy makers and public servants (including the selection and advancement mechanisms and lack of transparency and accountability) have a detrimental impact on public service delivery. For instance, a World Bank survey carried out in 2010 found that the level of absenteeism in health facilities in the Alexandria and Menoufia governorates was up to 32% of total staff (World Bank, 2010). More generally, Egypt needs to change the incentive structure of its bureaucracy to achieve better level of efficiency and effectiveness in the government functions (World Bank, 2015). Government effectiveness as measured by the World Governance Indicators has also experienced a downward trend over time as Egypt moved from an average percentile of 44.8 in 2000-2004 to 43 in 2005-2010 and to 27.2 in 2010-2016 (World

[10] Article 27 of the Constitution mandates the establishment of a minimum and a maximum wage for state agencies. Law no. 63, sets the maximum wage to be EGP 42,000 or 35 times the minimum wage.

Bank, 2016a). This negative trend is however partially explained by the significant challenges of political transition and a volatile political context until 2014. While a significant decline was observed since 2011, this trend was reversed in 2016, the last year available, which represents an encouraging sign (Figure 15).

Figure 15: Worldwide Governance Indicator for Government Effectiveness (2010-2016)



Notes: (1) Government effectiveness reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies; (2) It measures percentile rank among all countries (from 0 to 100).
Source: Worldwide Governance Indicators.

Digital government could be further expanded in order to foster the modernisation of the administration and boost efficiency. Digital-government can be a powerful instrument to improve public sector productivity and to improve the relationship of citizens with the public sector. The 2014 OECD Recommendation of the Council on Digital Government Strategies, urges countries to "*use digital technologies as an integrated of governments' modernisation strategies*". Egypt has exerted considerable efforts in the area of digital government and using digital technologies to aid policymaking and to support digital service delivery. The OECD supported the Egyptian Government through an e-Government Review published in 2013 and the country adhered to the mentioned OECD Recommendation in 2014, reflecting the country's commitment to drive the digital transformation of the public sector (OECD, 2013). Indeed, according to the E-government Development Index, the rank of Egypt improved from 99 in 2005 to 79 in 2008. But as a result of political turbulences since 2011 which reflected on government performance and activity, the rank of Egypt went down to 107 in 2012 and to 108 in 2016 (UNDESA, 2016). The OECD report "Benchmarking Digital Government Strategies in MENA Countries" (2017) points to challenges in the perceived quality of regulations and infrastructural limitations in the case of Egypt.

A full-fledged digital government strategy has not yet been formulated and this translates in limited coordination and cooperation across ministries and departments. Digital government projects are done without clear systems that can assure synergies across sectors and levels of governments and also identify their quantitative and qualitative benefits vis-à-vis their cost (OECD, 2013). There are several areas which would benefit greatly from greater use of digital government tools notably in social protection, where a biometric database of Egyptian citizens could improve targeting and reduce inefficiency in social safety nets.

SOEs play a major role in state activities and the economy although further reforms are needed to improve their governance and effectiveness. As of 2015, Egypt had 52 economic authorities, 102 service authorities, and 146 state-owned enterprises affiliated with nine holding companies. SOE governance in Egypt remains weak, particularly vis-à-vis the OECD Guidelines on the Governance of SOEs, suffering from poor monitoring of financial and operational performance, (in some cases) dependence from state subsidies, weak powers of boards of directors and other governance bodies, and general lack of transparency and accountability as the budget remains the only source of financial information (World Bank, 2015c). This is reflected in a poor financial performance, as SOE losses amounted to 5.8% of GDP in 2011 (compared to 0.6% in Tunisia, for instance) (World Bank, 2015c).

Reform efforts

Since the fifties, Egypt underwent several efforts to reform its public administration's structure. Over the last decades, several attempts have been made to reform this sector and reduce its size. None of these reforms have succeeded. Despite various privatization waves since the 1990s, government employment has grown at a rate more than offsetting the decline in public enterprise employment (AfDB, 2016).

A comprehensive Administrative Reform" was adopted as part of the Sustainable Development Strategy (SDS) "Egypt 2030 Vision" launched in March 2015 and approved by Parliament in 2016. The new administrative strategy sets forth an ambitious framework for reforming the bureaucracy through introducing basic principles for career management and remuneration, a set of legislative and institutional reforms as well as capacity building programs and technological development including e-government tools (Box 2).

Box 2: The Administrative Reform Strategy

The "Administrative Reform" was adopted with the aim to: "Create an effective public administration, and characterized by professionalism, transparency, fairness and responsiveness". The Strategy has 5 main pillars:

1. **Legislation reform:** A number of laws have already been issued such as: The Civil Service, no. 81, - 2016. The Industrial Licensing no. 15, 2017. Investment Law no. 72- 2017, Land Allocation Law. Other ongoing legislative reforms include: Bankruptcy Law, New Planning Law, and new Law of Local administration.
2. **Institutional reform:**
    - Review the functions of all governmental bodies.
    - Develop the organisational structure of ministries and authorities.
    - Establish new organizational units through all governmental entities (internal control, strategic planning and monitoring and compliance unit).
    - Establish a new system of performance appraisal for the employees in government entities through "Public Service Observatory" to measure the institutional performance.
    - The establishment of the "National Coordinating Committee" to prevent and combat corruption.
    - Develop an efficient Planning, Monitoring and Evaluation system as part of improving public investment management.
3. **Capacity building and establishing Human Resource Departments:**
    - New employment conditions defined by Civil Service Law 81/2016.
    - Presidential Leadership Programme / Presidential Program for raising youth capacities.
    - Establishment of the National Training Academy (NTA).
    - Cooperation with ESLSCA University.

- Announcement of "Government Excellence Award", which will be a yearly award to enhance the competition between official institutions and employees.
- Developing a national capacity building strategy with training programs for middle management, senior public mangers-and retirees).
- Competency Assessment for Employees

4. **Technological development and moving towards E-Government to provide services to the citizen efficiently.**
   - Government Procurement Platform and online procurement portal.
   - Automation of public services (Birth and Death registry, use of electronic cards in cash transfer systems, etc.)
   - Connecting same service offices (sectorial services) across regions
   - The Fiscal arrangements for facilitating managing and financing public services, by establishing the National Council for Payments according to a presidential decree 89/2017 to improve and enable a safe national payment system and reduce involved risks.
5. **Development of databases to enhance the development of the national Planning and Monitoring system:**
   - Publishing the "Citizen Budgets" since 2013/2014.
   - Formation a committee for identifying "Unutilized State's Assets". (Locating and assessing 2429 assets).
   - First electronic census (2017 census).
   - Launching of "Industrial Investment Map" on October - 2017 (www.invegypt.com).

Source: Government of Egypt

Some initial yet significant steps have been taken to reform the civil service and reduce the overall wage bill. A new Civil Service Law was enacted by Parliament in October 2016[11] after a long and difficult process to streamline the complex legal provisions governing public employment and contain the burden of public wages on the budget. This law is expected to add to a provision in the 2016/2017 budget law eliminating the indexation of bonuses and allowances (which could alone lead to fiscal savings worth 0.9% of GDP (IMF, 2017) by introducing stricter rules on new recruitments. More generally, the new law introduces basic principles for career management and remuneration. Although it is still too early to assess the practical implementation of the new law, the annual growth of the wage bill has declined from a five-year average of 17.5% annually to 5,5% in 2016/2017 In addition, progress has been achieved in the automation of the payroll system, which now covers 45% of the overall salary mass. Stricter controls over salary payments were introduced by the Ministry of Finance in 2016 and 2017. In contrast, relatively less attention has been paid to improving the governance of a very large number of state-owned enterprises and public authorities, many of which are not included in the state budget**.** Some measures have been recently announced as part of a reform programme supported by the IMF loan, in particular in the area of fiscal transparency, but those remain, for the time being, far from a comprehensive reform of the SOE sector. In addition, the launching of a new administrative capital city for Egypt which was announced in March 2015 constitutes an opportunity to leverage the reform efforts, particularly for improving the

[11] The Civil Service Law No.81/2016 issued on Wednesday 2/11/2016 revokes initial law no. 47/1978 that governs civil service employment in Egypt.

organizational set-up and efficiency of the administration. **The SDS strategy also pushes for decentralisation**, in line with article 176 of the Constitution, with the aim of improving the performance of public institutions and help in fighting corruption practices. In this context, a new Planning Law was approved by the Egyptian government on December 2017. It assures equal disbursement of government funding among the country's provinces with the aim to give more flexibility to provincial governors to spend government funds.

Other relevant efforts include the development of a General Guide to Simplification of Administrative Procedures (under finalization) under the lead of the Egyptian Regulatory Reform and Development Activity (ERRADA) and the collaboration of the "Support for Improvement in Governance and Management" SIGMA[12]. This guide aims at enabling the application of the Principles of Good Administration through the review and simplification of existing procedures or during the development of new procedures.

Key priorities

Against the above background, government efforts should focus on:

- Stepping up the **ongoing efforts to modernize the civil service** through the implementation of the new law and the Administrative Reform Strategy. This will require introducing more strategic Human Resource planning, including greater emphasis on merit-based recruitment, particularly at senior managerial level.
- Increasing the efficiency and effectiveness of the administration through the introduction of **administrative simplification measures and Principles of Good Administration**.
- Preparing a **digital government strategy** aimed at improving cooperation and scale up existing tools, improving the governance and institutional set ups for digital government development; enhancing capacities for strategic, coherent and sustainable policy approaches; and increasing citizens participation and collaboration with the public sector through the use of digital technologies.
- Over time, developing a **comprehensive strategy to improve the corporate governance standards and transparency of SOEs**, leveraging the five-year IPO programme for SOEs. The government should proceed with this programme based on clear and transparent criteria for the identification and valuation of SOEs and public assets subject to IPOs.

B. Stepping up good governance and anticorruption efforts and developing a comprehensive approach to Public Financial Management

Current situation

Like in other regional peers and emerging economies, corruption perceptions are a lingering problem in Egypt and represent a major hurdle for doing business. In 2013, 59% of firms participating in the World Bank's Enterprise Survey identified corruption as major constraint and 71.9% of surveyed firms declared

[12] SIGMA is a joint initiative of the OECD and the European Union. Its key objective is to strengthen the foundations for improved public governance.

to be expected to give gifts to get an operating license (compared with 53.2% and 21.2%, respectively, for the MENA region as a whole). Egypt has made a modest improvement in the Transparency International Corruption Perceptions Index and its current score is in line with other ACTs (except Jordan) but falls below other benchmarking countries (Table 2). Its current rank is 104th out of 176. According to Global Corruption Barometer maintained by Transparency International, 65% of Egyptians sampled opined that the judiciary was corrupt or extremely corrupt[13]. This percentage rises to 76% for public officials and public servants and 78% for the police. Local governments appear to be an area of particular concern. According to a paper by the Centre for International Private Enterprise (CIPE), corruption in local governments is distorting the functions and the operations of SMEs; hence reducing their active and effective involvement in the Egyptian economy (CIPE, 2010).

Table 2: Corruption Perceptions Index (CPI)

Country	2009 Score	2010 Score	2011 Score	2012 Score	2013 Score	2014 Score	2015 Score	2016 Score	2017 Score
Malaysia	45	44	43	49	50	52	50	49	**47**
Romania	38	37	36	44	43	43	46	48	**48**
Jordan	50	47	45	48	45	49	53	48	**48**
Tunisia	42	43	38	41	41	40	38	41	**42**
Turkey	44	44	42	49	50	45	42	41	**32**
Morocco	33	34	34	37	37	39	36	37	**40**
Egypt	28	31	29	32	32	37	36	34	**32**
Mexico	33	31	30	34	34	35	35	30	**29**

Note: A higher score = less corruption

Source: Transparency International, Corruption Perceptions Index, 27 January 2017 Survey

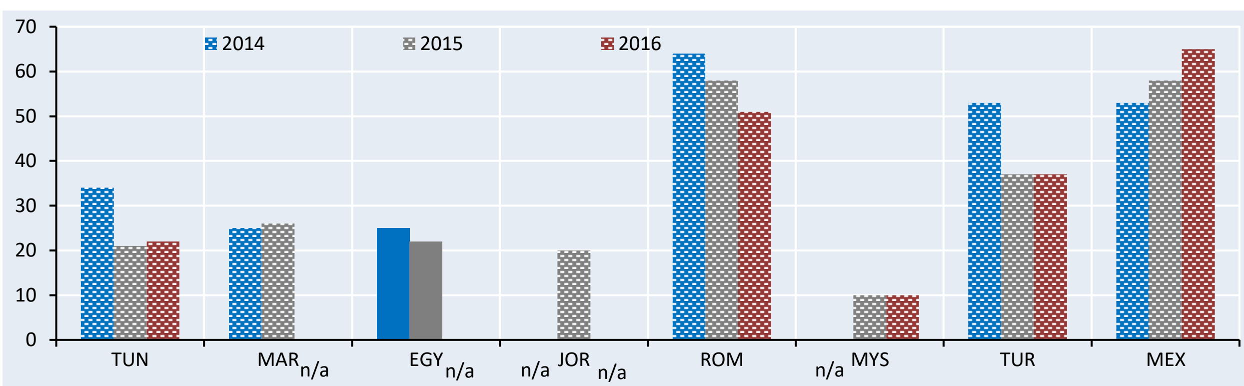
The overall legal framework that supports the fight against corruption needs to be reinforced and more implementation efforts are required. According to Transparency International: "Egypt has a relatively strong legal framework to prevent and stifle corruption, despite the notable lack of a comprehensive anti-corruption law, freedom of information law and whistle-blower protection" (Transparency International, 2015). In addition, Egypt ratified the United Nations Convention against Corruption (UNCAC) in early 2005. This ratification binds Egypt to implement a wide range of legal and institutional anti-corruption provisions. However, the Penal Code seemed ill equipped to fight the full range of bribery related offences, in particular white-collar crimes (OECD, 2009). There is no clear indication that bribing of foreign officials is an offence. Penalties focus on the taking of bribes whiles the prosecution of active bribery (giving, offering, promising) and related corruption offences are difficult. In part this is to be attributed to the fact that criminal sanctions are not adapted to current business practices providing for long prison terms and very low fines. Another challenge appears to be in the enforcement of existing legislation which may be due to an unclear regulatory environment which is insufficiently defined in scope, does not effectively deter and leaves space to discretionary decisions.

[13] For the Global Corruption Barometer 2013, approximately 1,000 people from each of 107 countries were surveyed between September 2012 and March 2013 (https://www.transparency.org/gcb2013/in_detail).

There may also be a particular lack of coordination amongst a very large number of public institutions which suffer, in many cases, of inadequate resources. The Administrative Control Authority (ACA) has investigative powers and has achieved some success fighting corruption, but its independence is limited by the fact that it requires presidential approval to arrest public officials. A new legal framework for ACA was enacted in 2017 to increase its independence.

Egypt's ranking in existing international indices measuring the openness of public administration offer room for improvement. Despite efforts in recent years, public perceptions about the openness of public institutions remain low. For instance, Egypt's score in the 2015 edition of the World Justice Project's Open Government Index is 0.42, slightly below the MENA regional average (0.45), the lowest-ranking region in the world. This places Egypt as 91st out of 113 countries, below Morocco and Tunisia (both with a score of 0.51). Looking closely to the four dimensions of the Index, Egypt performs relatively well regarding the publication of laws and government data (ranking 65th) but performs less well in civil participation (77th) and especially right to information (89th) and complaint mechanism (97th) (World Justice Project, 2016). In terms of open data, Egypt's score in the 2015 Global Open Data Index was 22%, slightly ahead of Jordan (20%) and Tunisia (21%) but below Morocco (26%). The availability of public information is lowest in areas such as public procurement, company registry, or water quality, where very limited information is available to the overall public. In contrast, Egypt presents a relatively high level of data openness regarding election results, national statistics and government budget. In the last two categories a significant improvement has been recorded compared to the 2014 edition of the index (Figure 16).

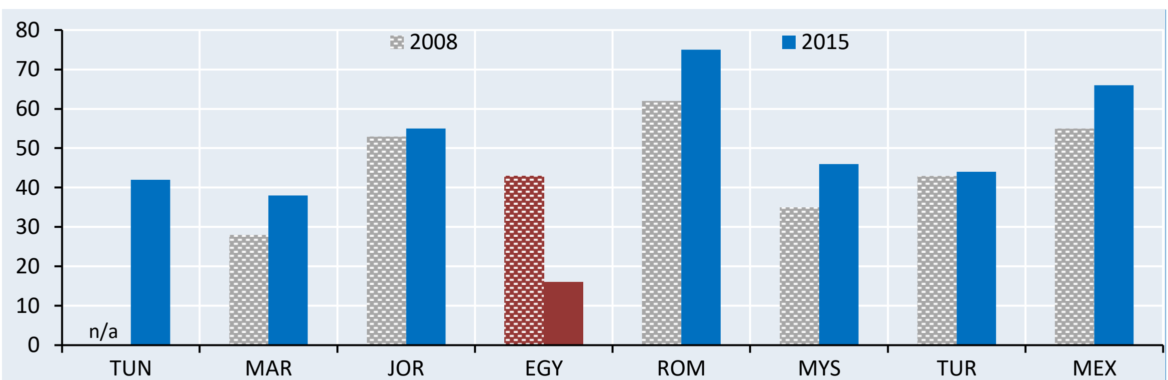
Figure 16: Global Open Data Index score (%)



Source: Open Knowledge Global Open Data Index.

Public Financial Management can be an effective mechanism to prevent corruption and enhance public sector efficiency. Yet in Egypt, PFM systems are in need of further development. Given the importance of megaprojects and infrastructures in the government's development objectives, the frameworks for public investment and contingent liability management (which require strong links between the Ministry of Finance and the Ministry of Planning, Monitoring and Administrative Reform) should be strengthened. This is particularly important for Egypt, which has the lowest level of public investment as a percentage of GDP of all Arab countries in transition and hence faces a stronger need to maximise the impact of government capital expenditure (IMF, 2014). The coverage of the state budget does not encompass a myriad of public authorities and entities. Budget execution remains largely manual (although the government is rolling out an Integrated Financial Management Information System, IFMIS) and cash-based. Internal and external controls need strengthening. Internal control relies mostly on ex-ante controls by financial controllers as an internal audit function does not exist yet, although the Ministry of Planning, Monitoring and Administrative Reform has plans to introduce this function in the near future across government departments. External control is exercised by the Central Audit Organisation (CAO), which issues nearly 30,000 reports each year and produces audits of the annual although those are not publicly available despite a constitutional mandate in this regard (World Bank, 2016c). In terms of overall budget transparency, as of April 2016, the government publishes five of the eight key budget documents in a timeframe consistent with international standards according with the Open Budget Survey. In 2015, Egypt started to publish a citizens' budget and a pre-budget statement, which have translated into a sizeable improvement in the country's score in the Open Budget Index, from 89th in the 2015 edition to 65th in the 2018 edition of the index. Egypt's score (41) is close to the world average of 42. More can still be done to increase public participation in the preparation of the budget and to strengthen the parliament's role in the process (Figure 17).

Figure 17: Open Budget Index (0-100)



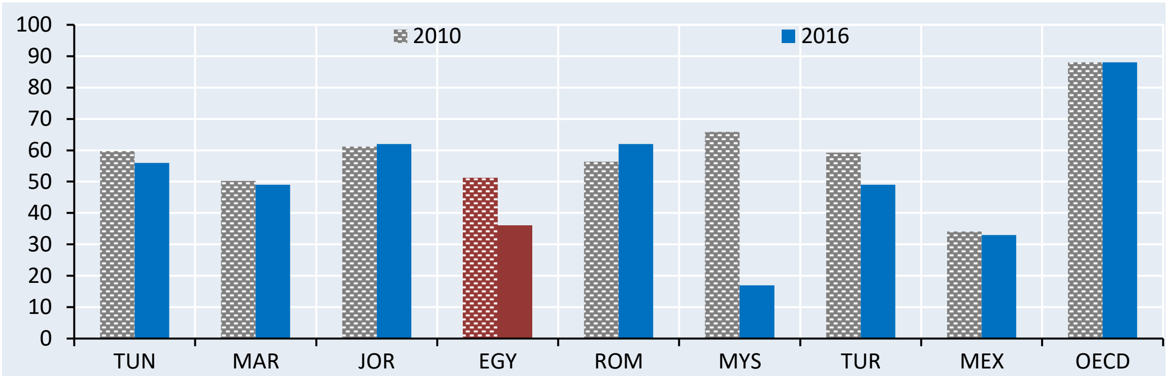
Source: International Budget Partnership, Open Budget Index.

Improvements are also needed to align public procurement with international standards. The public procurement process is described to be "low to medium compliance" vis-à-vis international standards according to an assessment by the European Bank for Reconstruction and Development (EBRD) assessment, which notes that "tendering rules which govern public procurement are inflexible and lack the required transparency in the tendering processes" (EBRD, 2013). More precisely, the study finds that the legislative structure is obsolete and the procurement process itself is characterized by excessive use of direct contracting which reduces transparency and hence the active and fair participation bidders. Improving the public procurement framework, including the legislative framework and the actual procurement practices in line with the 2008 OECD Recommendation on Public Procurement, the Methodology for Assessing Procurement Systems (MAPS) and other international standards would therefore increase the efficiency of government spending and reduce the incidents of unfair practices and corruption. In addition, the capacity of procurement officials is central to the well-functioning of procurement systems. The lack of capacity of procurement officials would hinder the benefits of any procurement reform. Therefore, developing a capacity strategy for officials in charge of procurement activities would be a key step to enhance the procurement system. The current government has taken on board this issue which is now part of the government programme.

Judicial reform is required to improve the effectiveness of the judiciary and affirming the rule of law. Egypt has a long legal tradition and strong justice institutions (including over 10,000 judges). However, and like in many other emerging and even developed countries, justice in Egypt is slow. This is due to limited resources (including a rudimentary court management and case storage system) but also to inadequate procedures and capacity, which have over time created a significant backlog of cases. A good example is the Court of Cassation (CC), the highest judicial body in Egypt, which faces a backlog of 250,000 cases growing by additional 30,000 cases per year. These problems represent a major burden for individuals as well as businesses and investors. According to Doing Business Report, resolving a commercial dispute via the Egyptian court system takes on average takes 1,010 days and costs 26.2% of the value of the claim. This places Egypt in the 162nd position in the world, below many other countries in the region (World Bank, 2016b)[14]. This lingering problem has forced a number of businesses, especially foreign investors, to seek alternative dispute resolution mechanisms; hence adding to the indirect and implicit cost associated with doing business in Egypt. More generally, international indicators suggest that the challenging transition process since 2011 has had an impact on public perceptions on the rule of law (Figure 18), while Egypt performs relatively better compared to regional peers on indicators related to judicial independence compared to those measuring the efficiency of the legal framework in settling disputes (Figure 19).

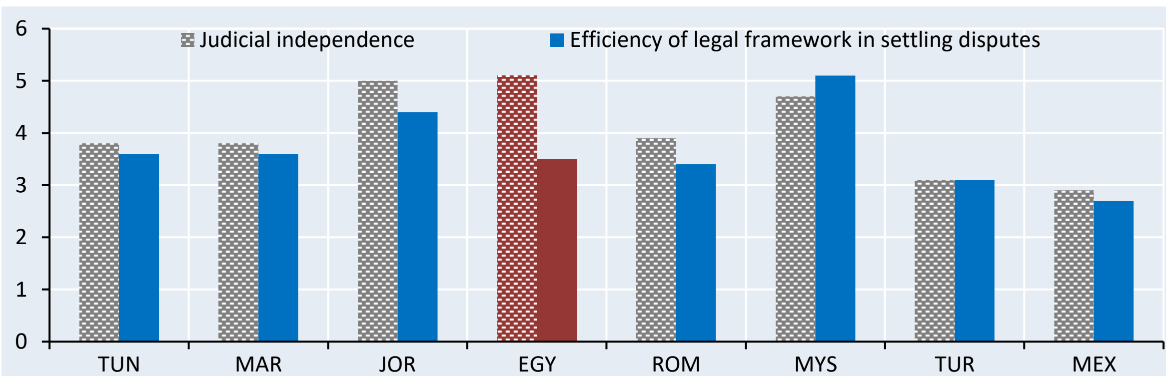
[14] Only Syria is subordinate to Egypt in terms of ranking; whereas Gulf countries are in general way ahead; e.g. Saudi Arabia and United Arab Emirates are in 86th and 18th position respectively.

Figure 18: Rule of Law (percentile rank, 0-100)



Source: World Bank Worldwide Indicators.

Figure 19: Quality of the judiciary framework (2017/2018 scores)



Note: A) Judicial independence (1 = not independent at all; 7 = entirely independent), B) Efficiency of the legal framework in settling disputes (1 = extremely inefficient; 7 = extremely efficient).
Source: Global Competitiveness Report 2017- 2018 - World Economic Forum.

Reform efforts

The adoption of the 2014 Constitution and a new anti-corruption strategy represent positive developments. In the area of the rule of law and the judicial system, the 2014 Constitution represents a significant development towards an independent judiciary (including in the form of financial autonomy). In this regard, a program for executing justice using ICT based approaches is currently implemented in coordination with the Ministry of Planning, Monitoring and Administrative Reform and the Ministry of Justice. A national Anti-Corruption Strategy (2014-2018) has been adopted, based on ten objectives ranging from the review of existing anti-corruption legislation to strengthening the capacity of anti-corruption bodies (Box 3). In November 2014 a Conflict of Interest Law was adopted and the government is working on a code of conduct for public officials. The 2014 Constitution has also strengthened the powers and independence of Central Auditing Office to fulfil its mandate regarding the external control of government activity. More recently, on October 2017, amendments have been made to the anti-corruption law, strengthening ACA's administrative independence and subjecting the appointment of its head to Parliament's approval. The amendments also introduced the creation of a specialised National Academy to train ACA staff to anti-corruption measures and international standards.

A number of important initiatives have been adopted to improve PFM systems. A new unit at the Ministry of Finance was created in 2016 to focus on fiscal risks and PFM reforms. In June 2017, the PFM unit has issued a comprehensive internal assessment of fiscal risks, including macroeconomic risks, implementation risks and risks emanating from contingent liabilities. The Ministry of Finance also considers this unit the embryo of an internal audit function to be rolled out across government entities. A shift to programme-based budgeting is progressing slowly but surely. A few concrete improvements have already been introduced, including the adoption of a Medium-Term Debt Management Strategy in December 2015 (which is expected to enhance the predictability of debt issuing and to be updated on an annual basis), the publication of a citizen's budget aimed at improving budgetary transparency, and the introduction of a medium-term expenditure fiscal framework covering the period 2016-2019. In addition, the Ministry of Finance has overhauled the SOE guarantee framework to have full control over the stock of contingent liabilities and is planning to publish by January 2018 main economic authorities' final accounts for FY 2016/2017 in order to provide information about their operations and financial performance. While these reforms are important, they have been adopted without an overall vision or action plan with clearly-defined goals, targets and indicators, which should be considered for the future.

A number of further improvements, in particular, in the area of fiscal risk management and transparency are part of the government reform agenda. Going forward, the government has plans to strengthen budget planning and improve the identification and management of fiscal risks. Planned initiatives supported by the IMF programme include (1) incorporating economic authorities that serve public policy objectives into the state budget (the government is starting to publish their final accounts as a first step) and strengthening SOE governance (a comprehensive report on SOEs will be prepared in December 2018 as a first step for reform); (2) strengthening the framework governing state guarantees and contingent liabilities (building on the principles published in October 2017); and (3) preparing a fiscal strategy paper outlining the government's medium-term fiscal objective as well as spending ceilings (IMF, 2017; and IMF, 2018b).

A new draft public procurement law is expected to be enacted before the end of 2018. The draft law, which is currently in Parliament, brings about a complete overhaul of public procurement in Egypt. The draft law introduces greater transparency and efficiency in procurement processes, limits the scope of direct purchasing in favour of competitive bidding, regulates sub-contracting and strengthens the complaints review system. It also reserves 10% of public procurement to SMEs and favours contracting to local businesses at the governorate level. The new law will also be followed by the operationalisation of an online procurement portal and, in 2019, by a Code of Integrity for Government Procurement Staff. The General Authority for Government Services is also expected to prepare annual procurement plans, starting in 2018/2019.

Key priorities

Going forward, the government should step up its efforts to upgrade the core building blocks of public integrity in Egypt, including strong PFM systems to enhance efficiency and transparency in the management of public resources. It should also review the legal anti-corruption framework to amend legislation and factor in the most recent developments in white collar crime and step up implementation efforts, as well as reinforce the independence of the judiciary to guarantee the rule of law in the country and improve and increase the dialogue with business, civil society and the media. Key priorities include:

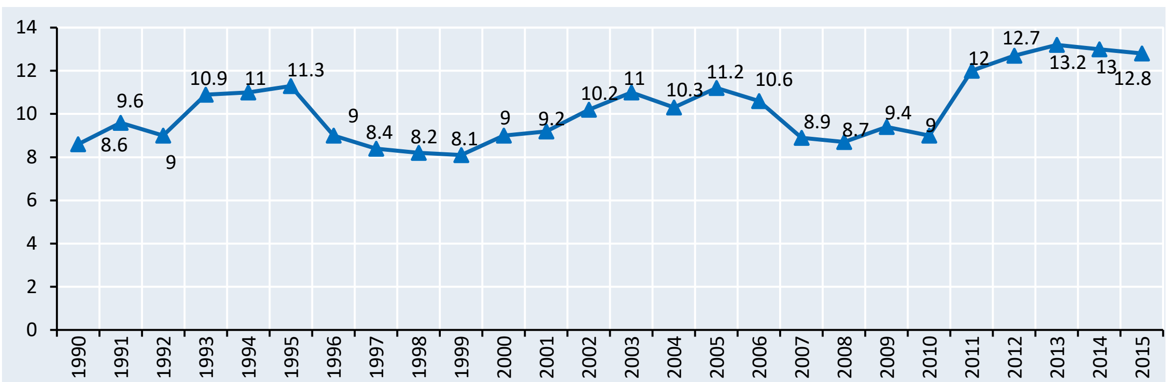
- As an overarching priority, developing a **consistent and integrated vision for reforms in the area of PFM in the form of an Action Plan or a Strategy**. This vision could focus on the following priorities:
    - Improving **fiscal risk transparency**, in particular in the areas of contingent liabilities and economic authority and SOE activities. This should include a comprehensive framework for the issuing of state guarantees, the incorporation of economic authorities' activities in the state budget, and steps towards greater transparency and efficiency in the SOE sector (starting with the report on SOE activities planned for end-2018).
    - Strengthening internal controls through the **progressive establishment of an internal audit function** in government ministries and agencies.
    - Improve the planning and monitoring of public investment projects by strengthening the link between the Ministry of Finance and the Ministry of Planning, Monitoring and Administrative Reform and **developing a full-fledged Public Investment Management System (PIM)**.
    - Enhancing **budget transparency** by publishing mid-term budget reviews; further enhancing mechanisms for **public participation in the budget process** (e.g. public hearings, surveys, focus groups).
- Ensuring the **effective implementation of the 2014 National Anti-Corruption Strategy** and **strengthen the powers, independence and transparency of existing control institutions** (including ACA and CAO). In particular, **CAO should publish audit reports** as mandated by the Constitution, and a **framework for the protection of whistle-blowers** (currently being discussed by Cabinet) should be introduced.
- Conduct a **detailed review of Egypt's legal anti-corruption framework**, benchmarked against the most recent state of the art international anti-corruption developments with a view to introducing adequate legislative amendments which would allow the government to develop suitable means of further institutionalising international legal cooperation thereby brining into full compliance with the UNCAC requirements.
- **Reforming the law on public procurement** (currently planned for November 2018) to align it with international best practices (including the OECD Recommendation on Public Procurement, the OECD Methodology for Assessing Procurement Systems, MAPS) and increasing the **overall transparency of public procurement processes**.
- Introducing new processes and systems (including ICT-based) to **improve the effectiveness and efficiency of the judiciary system** as a first step towards a **comprehensive justice sector reform programme**.

C. Enhancing domestic resource mobilisation through a modern and efficient tax system

Current situation

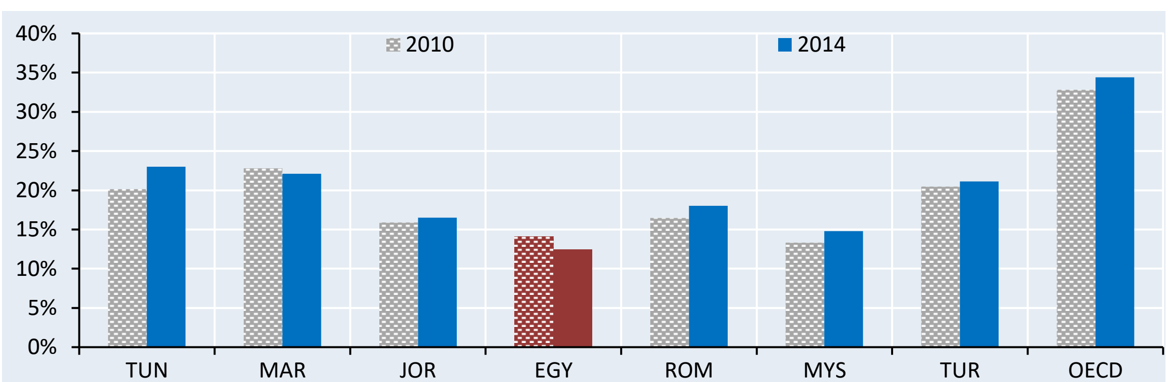
Egypt's tax system is overall complex, and its efficiency is undermined by a wide range of tax expenditures. Tax collection in Egypt is still low compared to peers despite some modest improvement over the years (Figure 20) following a downward trend largely reflecting the loss in trade-related taxes since the 1990s which has not been compensated by other sources of revenue (IMF 2015). As of 2014, this figure was 12.4% of GDP, below Jordan (16.5%), Morocco (22.1%) or Tunisia (23%) and very far from OECD average (over 34%) (Figure 21).

Figure 20: Tax revenue in Egypt over the long run (% of GDP)



Source: World Bank.

Figure 21: Tax revenue (% of GDP)



Source: Government Finance Statistics Yearbook, IMF Country Reports for Jordan, Malaysia, Morocco and Tunisia, OECD Revenue Statistics for OECD average.

Tax bases are also narrow because of the large informal economy and wide-spread tax evasion. Tax evasion is also a serious problem in Egypt with estimates reporting that the country lost circa $38 billion to illicit financial flows between 2002 and 2012 (GFI, 2014). Moreover, the efficiency of the tax system is undermined by a long series of tax exemptions and credits.

There is a need to increase the coverage of the personal income tax. The weight of the personal income tax in overall tax revenue has been declining over time and is currently about 20% of the total tax revenues. It contributed to 1.6% of GDP in 2016 compared to an average 2.6% in emerging countries (IMF, 2017). There is a need to increase tax progressivity and overall compliance notably for professional income (doctors, lawyers…). For instance, Egypt's highest income tax bracket (at a 25% rate) is only paid by those earning at least 10 times the per capita income (IMF, 2016).

Corporate income taxation declined over the recent years, but their levels remain above regional peers. For instance, they declined from 34.4% of total tax revenues in 2014 to 29.1% in 2016 mainly driven by the decline of payments from SOEs[15]. Corporate taxation represented 3.8% of GDP in 2016 remains however above peers (2.9% for emerging countries on average according to the IMF). There is still room for improving corporate income tax performance by addressing base erosion and profit shifting, and reviewing tax incentive schemes for FDI and free economic zones and strengthening compliance (IMF, 2018).

Sales taxes remain low but should improve over the medium term with the recent introduction of a VAT tax while efforts are still required for other taxes. Goods and services taxes remain particularly low in Egypt compared to peers accounting for less than ~~%~~ 6.0% (FY 2016/2017) of GDP versus on Average 6% in the MENA region and 5.7% on average for emerging countries (IMF, 2017). Property taxes doubled over the 2016/2017 period but remain very low accounting for only 1.1% of GDP (IMF, 2017) compared to Tunisia 0.3% of GDP in 2014 and well below Morocco at 1.9% and an OECD average of 1.9%.

Tax revenue can be increased to create fiscal space. The tax effort (measured between the gap between actual and potential revenue) is quite significant in Egypt. An IMF study estimated it to be around 72-73% in 2012 (compared to 93-95% in Morocco and 91% in Tunisia) (IMF, 2014). Egypt has the potential of increasing its revenues by percent of GDP if strong tax policy and tax administration reforms are implemented (IMF, 2018b).

The Egyptian Tax administration (ETA) can also be modernized to improve efficiency in tax collection and reduce costs for taxpayers. The impact of complex tax administration procedures on businesses in Egypt is significant. Firms devote on average 49 full business days and make 29 separate payments per year on average to comply with their tax obligations. Egypt's rank in this World Bank Doing Business indicator is 162nd out of 189 economies, falling well behind other regional peers, such as Morocco (41st), Jordan (79th) or Tunisia (106th) (World Bank, 2016b).

Further integration of the ETA is recommended. The ETA has responsibility for both direct and indirect taxes, but tax administration is not yet fully integrated at the operational level. The ETA is largely structured by tax type under a headquarters structure with separate field office networks for direct tax and VAT that utilize separate IT systems, resulting in duplication of core functions, and separate performance reporting. Core operational processes are generally less strong than is desirable. In addition, the ETA has an extensive field office environment with many small offices and a large workforce. As a

[15] Around 60 percent of the corporate income tax stems from state-owned enterprises such as Egyptian Petroleum Corporation Company (EGPC), the Suez Canal Authority and the Central Bank of Egypt (IMF, 2017).

result, this could lead to risks in tax compliance, institutional management, service delivery, and monitoring and efficiency of filing and payment.

Reform efforts

Raising more tax revenues and reforming the tax system in Egypt is a crucial component of a broader agenda to boost inclusive growth in Egypt. The Ministry of Finance's vision for 2022 is to set a stable policy environment to achieve the fiscal, economic and social objectives for taxation and raise the tax revenue to GDP ratio by 1% annually, to reach approximately 18.5% by fiscal year 2021/22.

The government accelerated its reform efforts in recent years towards these goals. In August 2017, the Ministry of Finance reported that tax collected during the fiscal year 2016/17 surpassed initial targets for the first time. Tax revenues were EGP 462 billion ($24.37 billion): a surge superior to 31.1% compared to the previous fiscal year. In the meantime, tax contributions in the budget revenues increased from 65.8% to 70.1%% between 2015 and 2017 according to the Vice Minister for Tax Policy.

A major reform aiming at increasing tax revenues was the introduction of a VAT tax in 2016. Egypt adopted in September 2016 a VAT tax at 13%[16] in replacement of a general sales tax at a 10% rate, which is a welcome step. The VAT rate is not high compared to regional peers, it expands the scope of the general sales tax but many exemptions for goods are still in place including food, electricity and gas. VAT revenues have increased from EGP 120bn ($68m) in 2015/2016 to EGP 170bn ($96m) in 2016/2017 which represents a 42% increase in VAT revenues and a growth rate of 53% from the previous year.

Other recent important tax reforms include a law for the settlement of tax disputes between taxpayers and the Egyptian Tax Authority, with the goal of reducing the number of outstanding tax disputes. In August 2017, the Ministry of Finance reported that since the ratification of the tax disputes settlement law in September 2016, approximately 4,000 disputes were resolved, bringing EGP 2 billion (approximately $112.6 million) in revenue. At the same time, measures have been introduced to attract investors. The Income Tax Law was amended in 2017 to postpone the application of Egypt's tax on capital gains for three years, and a new investment law was ratified to cut bureaucracy, especially for new projects, and to provide tax incentives for investors.

The effective taxation of Multinational Enterprises is an important source of domestic resource mobilisation in Egypt, as corporate tax represents over 80% of the income tax base. As is the case in other countries, Egypt's corporate tax revenues may be undermined by tax base erosion and profit shifting (BEPS) by Multinational Enterprises that exploit the gaps and mismatches between different tax systems to pay little or no tax. Due to Egypt's reliance on corporate income tax, it is very likely that Egypt suffers disproportionately from BEPS. In particular, Egypt faces risks from abusive and inappropriate transfer pricing, excessive interest payments out of Egypt, the abuse of some of Egypt's tax treaties and the abuse of the definition of permanent establishments.

The government also introduced new legislation aiming at improving the business climate and enhancing the coherence and efficiency of the tax system. A new Investment Law and its executive

[16] VAT tax was initially introduced at 13 percent until 30 June 2017 to be increased at 14 percent, starting on 1 July 2017

regulation has been enacted in May 2017 providing better tax information and services to investors and grants a tax incentive of 30%-50% of the investment cost based on the geographic area up to 80% of the paid-up capital with a 7 years cap (Pillar III). Moreover, a new regime for Small and Micro Enterprises (SMEs) is in progress to reform the complexity of the current system and encourage SMEs to engage in the tax system by filing taxes and to protect the tax base. The government is also drafting a new customs law and its executive regulations as well as a unified tax procedures law that will unify/simplify the tax procedures for taxpayers across all tax types. To facilitate paying taxes, the government has published a new simplified tax declaration in February 2018 whereby the Corporate Income Tax (CIT) declaration has been reduced from 14 to 7 pages and the Personal Income Tax (PIT) declaration has been reduced from 36 to 10 pages.

The Government is also committed to increase automation of the tax administration. It started the following projects: (i) re-engineering the procedures and setting the action plan to develop the infrastructure required for launching the "one-stop shop" for customs purposes; (ii) updating the applications used by the General Authority For Export And Import Control to comply with the new tax smart-card technology; (iii) studying the feasibility of applying the automated audit system (Idea) for the purpose of value added tax; where a plan is currently being developed to examine 800 large taxpayers electronically within 6 months; and (iv) Studying the introduction of the "National Receipts System" for the purpose of VAT. Moreover, work is in progress for the CIT and VAT e-filing and e-payment for the Large Tax Payers Centre and Corporations (box 3).

Box 3: International Tax Agenda and OECD Cooperation with Egypt

The Egyptian government stepped-up its cooperation with the OECD by joining multiple initiatives aiming at strengthening the efficiency of its tax systems and the fight against tax evasion.

1) Egypt joined in May 2016 the **Inclusive Framework (IF) on BEPS (Base erosion and profit shifting)** where 108 countries and jurisdictions are working together on an equal footing to tackle tax avoidance, in particular by preventing tax treaty abuse and introducing Country-by-Country reporting for the activities of Multinational Enterprises. In January 2017, Egypt was appointed to the Steering Group guiding the IF work. As an active IF member, Egypt is committed to implement the measures of the BEPS package, which was released in October 2015, in particular the four minimum standards on Country-by-Country reporting, the prevention of treaty abuse, improving dispute resolution and countering harmful tax practices.
2) In June 2017, Egypt signed the **Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS**, which now covers 71 jurisdictions. This project implementation will start in January 2018.
3) In August 2016, Egypt **joined the Global Forum[17] on Transparency and Exchange of Information** (the Global Forum). As a member of the Global Forum, Egypt is committed to implement the standards on exchange of information on request and on automatic exchange of information on financial accounts. In implementing these standards, Egypt will ensure that its domestic legislation and administrative practice make available reliable legal and beneficial ownership information, accounting records and banking information, that the tax administration has sufficient access powers

[17] The Global Forum has 147 members implementing international standards for transparency and exchange of tax information, a key element in the fight against illicit financial flows.

to obtain this information from the information holders for domestic or exchange of information purposes and that Egypt has a wide network of exchange of information instruments to provide and obtain relevant information for tax purposes. It means that Egypt will have to address its bank secrecy and bearer shares issues. In addition, Egypt will have to set up a proper and equipped exchange of information unit and to train its tax auditors to use exchange of information instrument in tax audits involving a foreign element (e.g. transfer pricing audits, audits of multinational enterprises, etc.). Once Egypt implements the OECD's Common Reporting Standard for automatic exchange of financial account information, Egypt will be able to receive such information relating to its residents without prior request, which will improve their ability to deter and detect offshore tax fraud and evasion.

4) Since 2017, Egypt has been receiving tax audit assistance through the joint **OECD/UNDP Tax Inspectors Without Borders Initiative** (TIWB). Egypt has also been benefitting from an OECD capacity building program carried out in in partnership with the African Tax Administration Forum (ATAF). These programs aim at improving the international tax auditing skills of the Egyptian tax officials.

Key priorities

Despite these promising measures, **further tax reform and a consistent and holistic approach are needed in Egypt** in the form of a clear-defined tax reform strategy. Key Challenges **include the need to:**

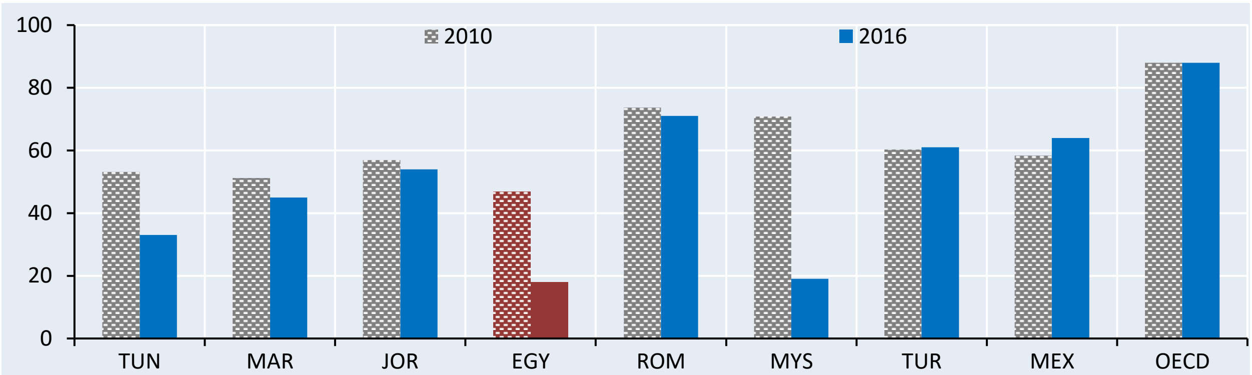
- **Raise more tax revenues**, in particular by expanding the tax base**.**
- **Improve the design of the tax system and enhance the tax system's fairness.**
- **Implement the international tax standards, i.e. BEPS minimum standards and exchange of information standards, which includes** joining the Multilateral Convention on Mutual Assistance in Tax Matters (the MAC**)**, which with over 110 participating jurisdictions is the most powerful instrument to counteract tax evasion.
- **Improve tax administration, in particular through capacity building if tax officials and reduce tax compliance costs.**
- **Improve tax statistics and tax policy assessment tools** by joining 79 other countries in the OECD's global Revenue Statistics project, which provides internationally comparable and transparent revenue statistics to better inform all tax policy analysis and formulation.

D. Improving regulatory and competition policy frameworks to create a level playing field for businesses and reduce transaction costs

Current situation

Regulatory complexity in Egypt is high and regulatory quality appears to be declining since 2011. The Egyptian legal and regulatory system consists of numerous layers mapped into different episodes of Egypt's history (some are dated as far as the French occupation in the 18th century). As a result, the number of laws has been increasing over time to reach almost 120,000 laws (Auf, 2013) while Egypt has catalogued about 36,000 regulatory instruments (IMF, 2014). This staggering number of laws and regulations and their complexity represent a significant obstacle for businesses in Egypt. The impact of political instability since 2011 on regulatory quality appears to be significant, although less pronounced since 2014 (Figure 22).

Figure 22: Worldwide Governance Indicator for regulatory quality (2010-2016)



Notes: (1) Regulatory quality reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development; (2) It measures percentile rank among all countries (from 0 to 100).
Source: The Worldwide Governance Indicators (WGI).

Greater emphasis on transparent and effective implementation of rules and regulations is needed. Evidence suggests that Egypt still suffers from a gap between the laws and regulations as written in the books and actual implementation and enforcement. As noted in a recent World Bank study, Egypt is one of the MENA countries with the largest gap between the quality of rules and regulations on paper and their enforcement in practice (World Bank, 2015). Anti-corruption legislation provides an illustrative example: while Egypt's score in the Global Integrity Indicator for the quality of the legal framework compares favourably with other MENA countries (e.g. Morocco, Jordan) although still considered "weak", the country presents a significant implementation gap: the score for actual implementation of anticorruption rules (34 over 100) is half the one for the overall strength of the legal framework (70). In addition to a large number of rules and regulation, discretional implementation also appears to be an issue. According to a World Bank study, firm entry in sectors dominated by "politically connected firms" is 28% percent lower (World Bank, 2015b). In this context, reducing the complexity of regulation and the discretion of government officials, and strengthening uniform and transparent implementation is key to creating a level playing field for firms and citizens.

An agency and a legal framework for competition are in place however capacity constraints reduce their effectiveness. The Egyptian Competition Authority (ECA) was established under Law 3 in 2005 as an independent agency aiming to protect competition and enforce antitrust provisions. According to the law, individuals have the right to file complaints while the ECA can build cases based on its own initiative as well. Since its establishment, ECA has been active in pursuing its mandate; nevertheless, technical constraints associated with budget and staffing as well as limited co-operation between certain government entities and ECA reduce its overall effectiveness. In addition, the Egyptian Competition Law does not provide for merger control; and firms owned by members of the same family are shielded from cartel laws. These features limit the effectiveness of the competition law framework in Egypt.

Reform efforts

Over the last decade, an ambitious programme has been developed to streamline regulation. In 2008, a government initiative was launched under the name of Egyptian Regulatory Reform and Development Activity (ERRADA) aiming at establishing a system to review and reform the legal and regulatory framework to improve the business climate and support the development of a competitive economy (OECD, 2013). The initiative was very active during the first five years from its inception where it managed to reach a number of milestones including (a) the compilation of more than 30,000 legal instruments (35% of which were not published) and the publication of those free of charge under an electronic portal[18]; (b) filtering these regulations by removing the contradictory and redundant among them (about 2,000 instruments were actually removed) with the active contribution of the private sector and the civil society; (c) using the Standard Cost Model (SCM) adopted by the OECD to remove unnecessary administrative steps, especially for investors; and (d) increasing government revenue through the revision of the fees associated with a number of economic activities some of which had not been updated for decades. Institutional instability has been a constraint for ERRADA's operation as the programme moved to the Finance Ministry in 2011, then, after a period of inactivity for 20 months, it was transferred to the Ministry of Investment (now Ministry of Investment and International Cooperation) in 2014 and, finally, in the same year, to the Ministry of Industry and Trade. It should be noted that, despite the vast potential benefits of such initiative, its work is limited, for the time being, to 11 ministries and 3 governorates.

The Egyptian Government is also making efforts to improve the quality of new regulation. The Ministry of Justice is currently preparing a manual that may pave the way to adopt a policy on better law making to reflect the *Recommendations of the OECD Council on Regulatory Policy and Governance (OECD, 2012).*

The competition law framework is being strengthened. The Competition Law was amended in 2015. Cabinet adopted in 2016 executive regulations of the law to strengthen the powers and independence of the Egypt Competition Authority and improve the effectiveness of cartel enforcement procedures (e.g. by giving ECA the power to initiate court proceedings and to settle procedures, and by introducing stricter confidentiality clauses for ECA's employees).

New initiatives such as the new Suez Canal Economic Zone (SCZone) represent an opportunity for implementing important regulatory reforms. Established in 2015, the SCZone is governed by the SCZone Authority (SCZA) who possesses independent authority to implement zone-specific regulations. Through the 2017 OECD-EU project *Supporting the Development of the Suez Canal Economic Zone*, the OECD provided the SCZA with a needs assessment and action plan across six priority areas related to governance, management and operational processes. These included recommendations on establishing sound regulatory governance processes to strengthen their ability to design and delivery good regulatory policies and outcomes, as well as promote a business-friendly environment.

[18] http://eregistry.errada.gov.eg

Key priorities

Against this background, the government could focus its efforts to improve the quality of the regulatory and competition law frameworks and their actual implementation around the following priorities:

- Continuing and scaling up **business regulation streamlining and simplification in the context of the Egyptian Regulatory Reform and Development Activity (ERRADA)**, focusing in particular on industrial licensing, access to land (including public land) and other key constraints to private sector activity.
- Considering the introduction of **ex-ante mechanisms to improve the quality of new regulations**, including regulatory impact assessment (RIA) and stakeholder engagement in the rule-making process.
- Considering the introduction of **ex-post mechanism to review and manage the regulatory stock**.
- Introducing an **effective merger control regime**.
- Enabling the ECA to **perform competition assessments** of the impact of draft regulation as part of institutional Regulatory Impact Assessment (RIA).
- **Building the capacity of the ECA** as a valuable tool for the effective enforcement of competition legislation in Egypt. ECA should foster competition in the food retail market a major source of inflation in the Egyptian economy
- Continue working with SCZA to **implement good regulatory governance processes** that will enable the effective design and delivery of business-friendly regulations in the SCZone.

Pillar III: Building an attractive environment for investment and private sector development

As noted in Pillar I, Egypt's long-term development priority is the creation of quality jobs to meet its massive demographic challenge over the next 10-15 years. While the reform priorities identified in Pillar I (macroeconomic stability, more inclusiveness and the improvement of the labour market) will help creating the right conditions for job creation, the Egyptian authorities will need to continue to undertake significant reforms to overhaul the business enabling environment to boost growth, productivity and, ultimately, job creation.

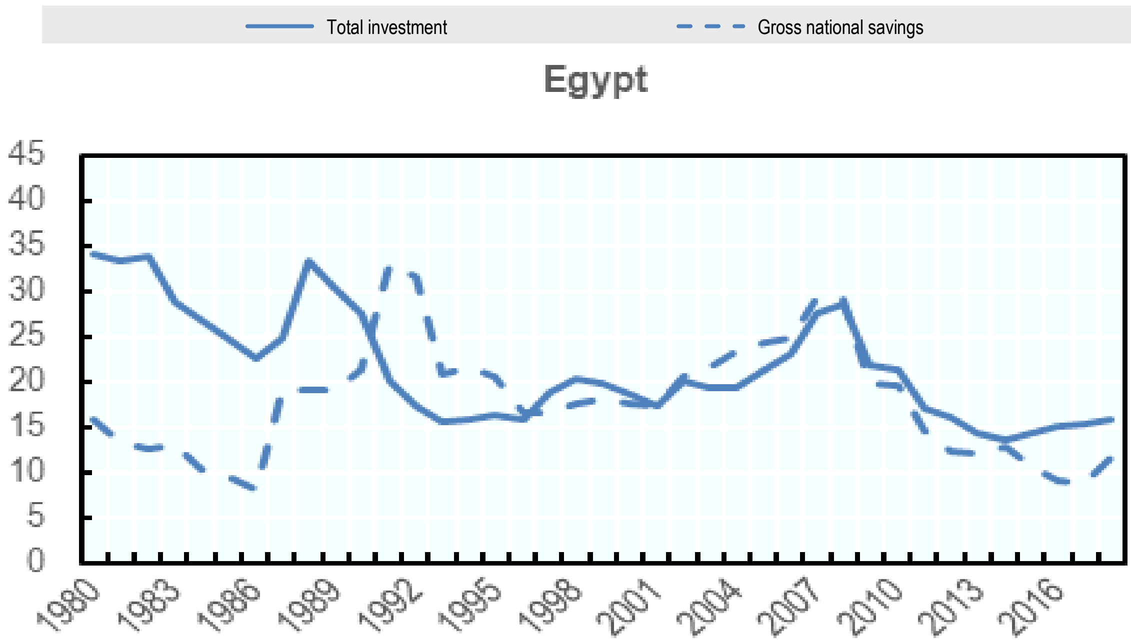
This Pillar will provide a brief overview of the investment situation and the private sector in Egypt and will focus on the two of the main obstacles to private sector growth and investment in Egypt: a complex and burdensome regulatory framework and a series of significant constraints to financial access for firms and individuals.

A. Landscape of the Egyptian private sector

Low investment levels in Egypt are explained by a series of longstanding structural issues. As noted in the Country Overview, the contribution of investment to GDP has declined since 1980 despite the progressive opening of the Egyptian economy to the private sector, initiated in the 1970s. The investment-to-GDP ratio in 2017 was 15% - which remains lower than comparable developing economies. . This is largely due to the retrenchment of public investment and the limited response of private investment to fill the gap, showing that private investment and public investment are not perfect substitutes, in the sense that not all public investment can be replaced by the private sector. During the boom period 2006-2009, real investment in electricity, health and education dropped by 23%, 5% and 21% respectively mainly due to the reduction in public investment. In any case, despite the significant growth rate in investment the surge in FDI during this boom period, the ratio of investment to GDP has generally been modest and did not exceed 20% on average. A key element explaining this performance has been the failure of the financial sector to play its intermediation role and turn savings into productive investment. Indeed, Egypt has suffered a continuous drop in the lending deposit ratio and private credit to GDP since 2000. As a result of the credit crunch which started in the end of 1990s driven by large amounts of nonperforming loans, the CBE adopted a conservative credit policy. Interestingly, this position continued during the boom period, with private credit (private business sector) to GDP reaching 32.6% in 2008 down from 52.8% in 2002. This evolution is also partly explained by a fly to safety towards government securities and treasury bills, a trend running in parallel to the increase in government borrowing since the 2000s. Finally, investment levels have been affected by the global context following the 2008 financial crisis and the political transition and instability in Egypt since 2011.

Figure 23: Foreign Direct Investment (FDI) stocks (2005-2016)

In percent of GDP



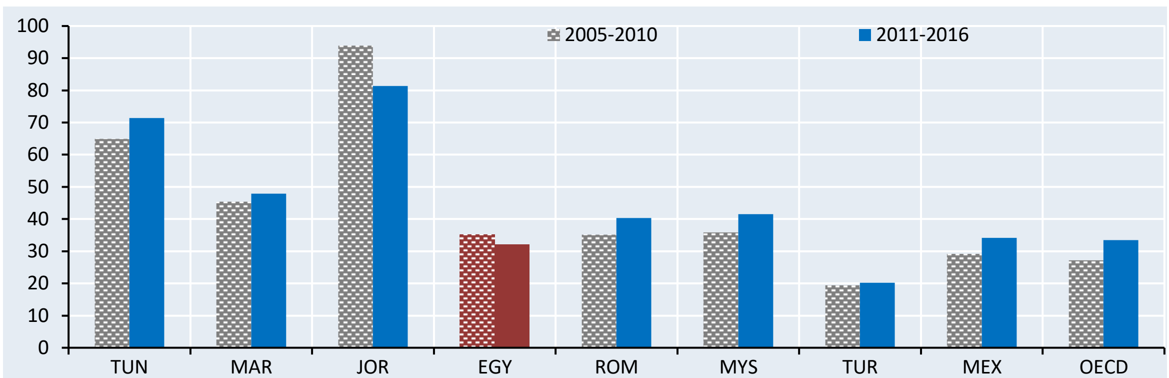
Source: OECD (2019).

Egypt's formal private sector has traditionally showed limited dynamism despite its great potential to create quality jobs. As noted under Pilar I, employment in the formal private sector has decreased almost by half over the last two decades. Market entry is limited compared with other regional peers. For instance, the number of new firms registering in Egypt between 2004 and 2009 was 60 times less than in Jordan and 100 times less than in Turkey (World Bank, 2015); while firms' turnover remains low compared with other emerging economies. Egyptian formal businesses also face important obstacles to grow. For instance, according to the surveys conducted by the Global Enterprise Monitor (GEM), entrepreneurial activity in Egypt was 7.4%, compared to 10.1% in Tunisia. Like in other MENA countries, the private sector also remains constrained by a significant amount of government ownership and participation in economic activities: despite the privatisation waves of the 1990s and 2000s, the public sector still controls 16% of manufacturing and services in Egypt (EBRD, 2013).

The private sector is dominated by micro small and medium enterprises that face important constraints limiting their growth and development. An estimated 2 million MSMEs represent 90% of active enterprises, and over 80% of GDP (EBRD, 2013) and approximately 40% of non-agricultural employment (MoIC, 2016). Micro-enterprises alone are estimated to employ 68% of workers, well above the levels of Tunisia and Jordan (37% and 40%, respectively) (EBRD, 2017). Sole proprietor firms represent about 72% of all formal businesses (World Bank, 2016c). Levels of internationalisation remain very limited, with only 5% of firms engaging in export activities (EBRD, 2017). However, their profitability and growth remain limited, particularly constrained by limited access to finance. More than half of Egypt's SMEs are located in five cities in Lower Egypt (Felkner et al., 2012) and the existing support services are also located there, while rural areas remain underserved.

Private sector investment and FDI levels in Egypt remain low compared to benchmarking countries despite an appreciable improvement since 2016. At an average of 11.4% of GDP in the period 2000-2016, total private sector investment remains below the levels of other emerging economies (IMF 2018b). Partly as a result of the political instability following 2011, net FDI inflows into the country dropped dramatically from about 4.0 % of GDP on average between 2000 and 2010 to less than 2% since 2011 although an improvement has been observed in response to the reforms undertaken since 2016: FDI inflows increased to 2.1% and 3.4% in 2015/2016 and 2016/2017 respectively FDI is also concentrated in certain sectors (e.g. oil and mining and real estate, which account for 75% of FDI (IMF, 2018b). In 2016, Egypt was for the first time the largest recipient of FDI flows in the MENA region, ahead of Saudi Arabia. It accounted for nearly 30% of total FDI flows received in the MENA region as a whole, compared to between 8% and 20% in 2005 and in 2014 respectively, excluding the negative FDI inflows recorded in 2011. (OECD, 2019).The overall FDI stock in the country between 2011 and 2016 remains limited at about 32% of GDP, well below peers in the region (Figure 24).

Figure 24: Foreign Direct Investment (FDI) stocks (2005-2016)



Source: UNCTAD Statistics Database.

B. Streamlining the regulatory framework for investment and enterprise development

Current situation

Despite a long-term deterioration in international indices measuring policy environment for the development of the private sector, some reforms are starting to pay off, leading to, in some cases, positive trends over the past few years. Indices assessing the business climate across countries such as the Doing Business Report and Global Competitiveness Report show a long period of decline, only corrected in the last 1-2 years. Egypt's rank in the Doing Business indicators fell from 94th in 2011 to 126th in 2016, 122nd in 2017 and 128th in 2018. Recent reforms have however started to contribute to improving its position in the ranking, and Egypt has improved by eight places in 2019, from 128th to 120th). In terms of the distance to the frontier, Egypt has remained stagnant for the last six years and has the lowest score amongst benchmarking countries (Table 3). In terms of the World Economic Forum's Global Competitiveness Index (GCI), out of 140 countries Egypt went down from the 94th place in the 2011-2012 edition to the 119th in 2014-2015, 115th in the 2015-2016, and 100th in the 2017-2018 report.

Table 3: World Bank Doing Business (2011-2017) (Overall Ranking)

Country	2011	2016	2017	2019
Malaysia	21	18	23	15
Romania	56	37	36	52
Mexico	35	38	47	54
Morocco	114	75	68	60
Turkey	65	55	69	43
Tunisia	55	74	77	80
Jordan	111	113	118	104
Egypt	94	131	**122**	**120**

Source: World Bank, Doing Business Report.

Despite reform efforts, business regulation offers room for improvement. There are still significant inefficiencies in the business registration process, including lack of progress with e-registration and the involvement of several agencies (AfDB, 2016). Nonetheless, government has taken action, in particular through the investment law of 2017 which introduced simplification measures and mainstreaming of business procedures which include e-signature, digital transformation of business registration and services. Implementation of these measures is still ongoing and further results should be expected from its full implementation. On another front, the government tackled one the most paradigmatic example of cumbersome regulation in Egypt: industrial licensing through the adoption in May 2017 of new Industrial licensing law, which used to take on average approximately 634 days and 663 steps for any business to complete this process and only 20% of industrial firms managed to complete the procedure.

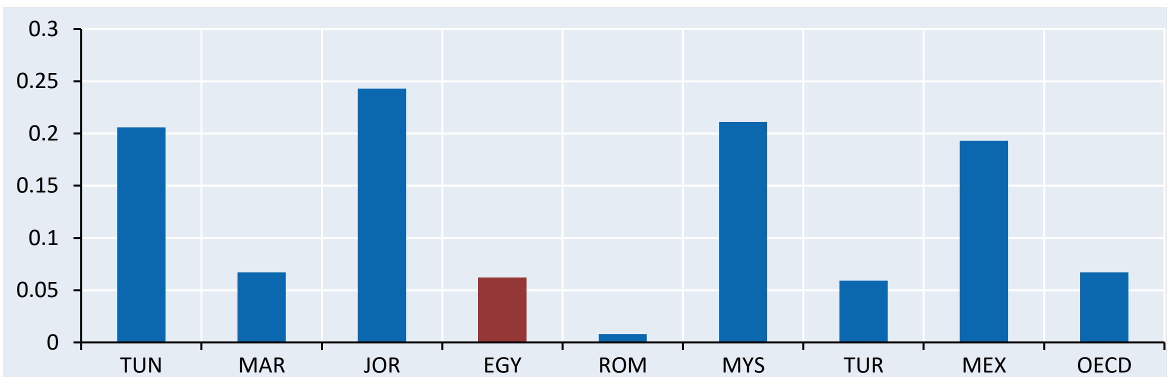
SMEs represent the lion's share of the Egyptian economy and would benefit from a comprehensive approach to SME development policy. Public policy for SME development was fragmented, with a large number of entities involved and often with overlapping mandates. The institutional framework includes the Micro, Small and Medium Enterprises Development Agency (MSMEDA) (for micro and small enterprises), GAFI (for medium-sized companies with growth potential), and the Ministry of Industry and Trade through the Industrial Modernisation Centre (on SMEs active in industrial zones, for instance) (OECD et al., 2014). To address this policy fragmentation, significant efforts have been made to streamline the institutional framework, including through the merger of the MSMEDA and the SFD.

Egypt's investment framework still presents a number of weaknesses; although significant efforts have been made to improve it since the mid-2000s and more particularly over the past four years; and the level of restrictions to FDI is limited. The legal framework governing investment has been repeatedly revised and amended over the past decade. However, it is important to recall that the surge in investment and FDI during the 2005-2009 period took place under this sub-optimal legislation structure. Egypt created a wide network of free-trade zones (FTZs) and industrial zones since the 1990s Nonetheless, the effectiveness of these zones in boosting trade and investment is hampered by infrastructure gaps (including multimodal transport systems), excessive bureaucracy and limited trade facilitation support

(World Bank, 2015). In general terms, Egypt compares quite favourably with regional peers and other emerging economies in terms of the openness of its regulatory framework to FDI (Figure 25). The Government of Egypt has progressively introduced, over the past few years, a modernised regulatory environment for investment starting with the adoption of a new investment law issued by Law No. 72 of 2017, which replaced the Investment Law No. 8/1997 and its subsequent amendments.

Access to land and land allocation has traditionally identified as one of the most burdensome obstacles to investment. Land allocation to the private sector remains limited despite recent efforts further progress can still be made to enhance the efficiency and the transparency of the allocation system. Land is offered by the government at a fixed price on a "first-come-first-served" basis (IMF, 2018a) in the absence of a market mechanism.

Figure 25: OECD FDI Regulatory Restrictiveness Index for 2016 (0 = open; 1 = closed)



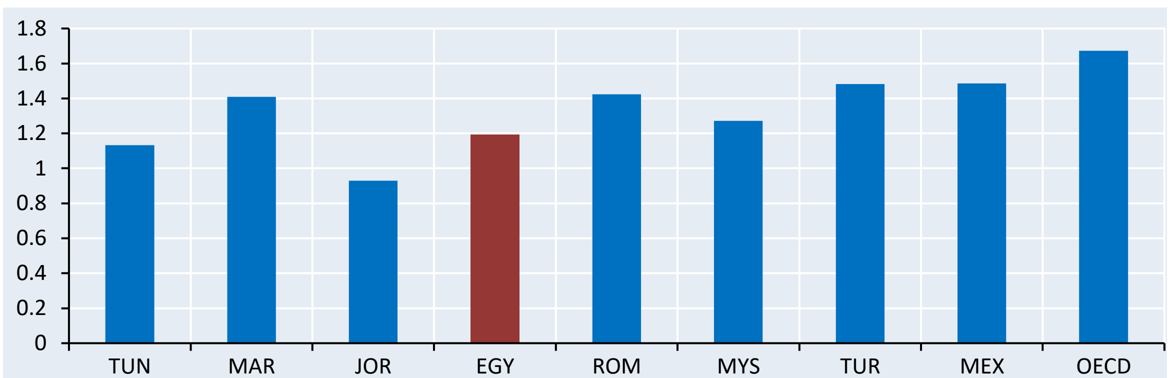
Note: The OECD FDI Regulatory Restrictiveness Index covers only statutory measures discriminating against foreign investors (e.g. foreign equity limits, screening & approval procedures, restriction on key foreign personnel, and other operational measures). Other aspects of an investment climate are not considered (e.g. the quality of implementation of regulations or existence of state monopolies).
Source: OECD.

Egypt has had a Public Private Partnership (PPP) programme since 2006 and a PPP law in line with international standards since 2010 in order to boost private sector investments notably in infrastructure projects. The law designed a comprehensive institutional structure for the governance of PPPs in the country. The law provided for the creation of a PPP Supreme Committee, a PPP Central Unit (PPPCU) in the Ministry of Finance as well as satellite units in the different ministries. Despite the difficulties of the political transition since 2011, three PPP projects were successfully tendered in 2012. Over the 2012-2015 period, the system remained largely untested in practice and pilot projects (including at the municipal levels) were only developed. However, and since 2015[19], the government announced very ambitious projects that are relying considerably on the contribution of the private sector and targeting 11-13 PPP projects per year. The capacity of the PPPCU remains low, which has limited PPP uptake, particularly in the transport sector (EBRD, 2017). Official government statistics suggest that 46 PPP projects worth USD 16 billion are currently in operation or being developed (MIIC, 2016).

[19] Egypt Economic Development Conference May 2015

Trade is an area that can be further strengthened by the Egyptian Government as the country performs worse than regional peers in logistics and trade regulation including trade facilitation and tariff and non-tariff barriers require greater attention. Overall, trade regulation in Egypt is extremely complex and burdensome for both importers and exporters. Trade tariffs in Egypt are the highest amongst Arab countries in transition (IMF, 2014) and, in February 2016, tariff rates on imported luxury goods (such as pet food, kitchen appliances and textiles) were increased and additional registration requirements for importers were also introduced as part of the authorities' efforts to preserve exchange rate stability. Egypt ranks 171th in the Doing Business Indicator for Trading across Borders, showing in particular room for improvement in the area of import procedures (e.g.at 240 hours, the average time to import merchandise to Egypt is nearly twice the MENA average). Egypt is the lowest-performing country amongst regional peers and comparator countries in the OECD Trade Facilitation Indicators (Figure 26). In addition, logistics costs, which represent approximately 20% of GDP, well above the global average (about 10-12%) (World Bank, 2015), hinder the economy's competitiveness.

Figure 26: OECD Trade Facilitation Indicators (2017)



Source: OECD Trade Facilitation Indicators.

The elimination of foreign exchange restrictions has had a major positive impact on the private sector. Prior to November 2016, foreign currency shortages (especially in the banking sector) and made it increasingly difficult for firms to import raw materials, machinery and capital goods necessary for production. For foreign firms, the problem was particularly significant as they also could not repatriate their own profits outside Egypt. The change in the exchange rate policy of the CBE and the elimination of all foreign currency restrictions (including foreign currency transfers, cash withdrawals and deposits of foreign currency) had a positive impact on the private sector and investment in Egypt by restoring the competitiveness of Egyptian firms and facilitating the access to foreign currency at market prices.

Reform efforts

The Government of Egypt has progressively modernised its regulatory environment for investment. It has, over the past few years, continued to take concrete steps to improve its business climate and to attract more FDI. There is a strong political will to further improve the business environment and the competitiveness of the country. These changes have concretely taken the form of the adoption of a new investment law issued by Law No. 72 of 2017, which followed the 2015 amendment to the Investment

Guarantees and Incentives Law and the replacement of the Investment Law No. 8/1997 and its subsequent amendments.

The current law contains key protection guarantees for both domestic and foreign investors and presents foreign direct investment as a key driver for growth. The new investment framework improves transparency over investor rights by clarifying the conditions for the rejection of license applications, granting rights for investors to establish and expand investment projects, and to transfer profits. Institutional improvements including reinforcing the role of GAFI in investment facilitation and streamlining the dispute resolution framework. A number of implementing decrees were also adopted. The 2015 revision granted investors a right to repatriate the full extent of their profit and capital, provide an extensive number of tax incentives. In an attempt to better arm the government over the increased number of investment dispute cases that have arisen in the aftermath of 2011, the 2015 amendment also created Ministerial Committees to manage dispute settlement, as well as a supreme Investment Council. Despite a clear political will to move ahead with investment reforms, the regulatory landscape suffered from inconsistencies and overlaps, and some of the implementing decrees that have been adopted in the immediate aftermath of the ratification of the law were not fully implemented.

The creation of the High Presidential Council for Investment has already led to a number of short-term measures to kick-start investment in particular in disadvantaged regions. At its first meeting, the Council took a series of decisions, including: (i) allocating land free of charge to industrial projects in Upper Egypt through the Industrial Development Agency; (ii) tax exemptions for land reclamation projects and new industrial and agricultural projects located in Upper Egypt for 5 years; (iii) a five-year tax holiday for new projects involving the production of strategic products which are imported or exported; (iv) offering a 35% discount on the paid value of the land price until the end of December 2016; (v) giving the Industrial Development Agency the authority to issue temporary industrial licenses to factories for one year; and (vi) a 25% discount on the set price of land in the new administrative capital and other new cities in Port-Said, El-Alamen, El-Galala and Ismalia.

Egypt enacted a new Investment Law in May 2017 (Investment Law No. 72 of 31 May 2017) after several months of consultations by the Ministry of Investment and International Cooperation with all relevant stakeholders in an effort to re-ignite investment. The new Law repeals the Investment Guarantees and Incentives Law No. 8 of 1997 and its successive amendments, including the 2015 amendment. The new Investment Law No. 72 aims to promote foreign investments by offering further incentives, reducing bureaucracy, reinforcing legal guarantees and access to contract enforcement, and simplifying and enhancing processes, in particular through the creation of an investors' service center that will act as a one-stop shop for issuing all licenses. 54 entities are operating under this center, which is expected to provide 90% of its services through automated means. Electronic signature is being introduced to facilitate these procedures. Executive regulations of the 2017 law have been passed in October 2017. The law provides for three types investment regimes, including the traditional free zones, the newer investment zones (currently 5 in operation with 150 projects and a further 11 under construction) as well as technological zones (currently 2 in operation with more than 100 ICT projects). The objective of the government now is to move ahead with the implementation of the new legal and institutional framework for investment, notably through the development of a national investment strategy.

Beyond the new investment law, a number of reforms have been put in place or are in the pipeline to improve a business enabling environment in Egypt. In addition to the revamping of ERRADA and the amendment of the Competition Law (Pillar II), those include:

- The Parliament has enacted a new **law for single-proprietor companies** to promote enterprise creation. Sole proprietor firms represent about 72% of all formal businesses (World Bank, 2016c). The new law will allow them to register as companies through GAFI and benefit from limited liability as well as to get access to investment guarantees and incentives, ultimately moving towards the creation of a level playing field for small and large investors.
- Bankruptcy and Insolvency law, which facilitates safe exit from the market, solve bankruptcy issues of investors, and to have an amicable settlement of investors' debts for insolvent businesses.
- An **Export Development Agency** has been established to promote trade facilitation and improve access to foreign markets for Egyptian exporters. The new agency is expected to increase capacity building efforts and provide business services for export development. Trade facilitation efforts have translated into a reduction of the number of documents required to export from 9 to 5 and to import from 11 to 6 in the course of 2017. Also, the electronic signature[20] plan that followed the issuance of the electronic signature law in 2004 will be completed for Alexandria and Damietta ports. The government plans to complete the National Single Window in mid-2018.
- In April 2017, the Parliament adopted a long-awaited **new industrial licensing law**. After two years of preparatory work, the new law eliminates a long and cumbersome licensing process and establishes more simplified procedures that will no longer require pre-approval, including by Civil Defence and Fire Safety authorities, and provides for automatic renewal of existing business licenses. In industries that do not have vital public functions, businesses are required to comply only with health, safety and environmental norms. For industries with vital public functions the requirements are more stringent, but considerably simpler than before. The new law is expected to reduce the time needed to obtain a license from more than 634 days to 7 days for 80% of activities and a maximum of 30 days for industrial establishments. It also significantly reduces the scope for corruption in the licensing process. The number of authorities involved has been reduced to one (from 11 before the reform) and the total number of procedures has gone down from 154 to just 19, using an automated issuance system and a network of licensing centres. . Also, the new law has re-configured the industrial register for statistics purposes only (instead of an additional barrier to start industrial activities, as it used to be the case prior to the reform). The implementation of the new industrial licensing is ongoing, following the adoption of the implementing regulations.
- Improving Investment Regime and Facilitation by extending the General Authority for Investment's One-Stop-Shop/ISC capabilities beyond registration to licensing and other investment services. In order to enhance transparency and access to information for investors

[20] Electronic signatures allow people/corporations to submit documents to authorities and banks via their digital signature and also sent registered letters from any computer they want. They can be safer, time-saving and more cost effective.

and the general public: (a) the Ministry of Investment and International Cooperation publishes a complete inventory of available investment incentives and eligibility criteria; (b) the Ministry also publishes all licensing and permits procedures and requirements for all activities and sectors.

- The Ministry of Investment and International Cooperation launched the Investment Map that provides a comprehensive view of investment opportunities across the country. The map allows potential investors to search for investment opportunities by geographical location, economic sector, this map includes all major national projects including the mega projects. It also shows provides information about the different the related incentives, including industrial, investment, technology, and economic zones, in addition to development projects categorized by the relevant development partners, and utilities of each of the investment areas. It provides investors with case studies and information about other investors operating within the market.

- **Additional improvements in the business enabling environment** have been recorded in the Doing Business Report in recent years, although the overall ranking has not experienced noticeable improvements yet. The report praised Egypt for passing a legislation in 2016/2017 that increased corporate transparency requirements and reinforced the shareholders' role in company management. In addition, Egypt strengthened minority investor protections by increasing their rights and role in major corporate decisions. However, the country was criticised as it made registering property more difficult and sales contract more costly to verify and ratify (Doing Business, 2018).
- The government has approved a a **comprehensive amendment of the companies law** to (a) ease the procedures for establishing and operating a company (which would grant the company legal personality from the moment it is registered in the commercial registry and reduce the requirements for capital increases); (b) protect minority shareholders' rights (by ensuring their representation at general assemblies and boards of directors); and (c) facilitate voluntary liquidation and market exit (through an overhaul of bankruptcy and insolvency procedures).
- A **new legal framework for the commercial register** based on international standards and on the development of a **collateral registry** is being developed by the government.
- A **new SME agency** (Micro, Small and Medium Enterprises Development Agency- MSMEDA) has been launched to coordinate and implement SME policy and to provide strategic direction to SME development. Established under the auspices of the Ministry of Trade and Industry, the new agency will work to upgrade and develop this sector by offering financial and non-financial services. It will replace the Social Fund for Development (SFD) with the inclusion of the entire Industrial Training Council (ITC) in the new institution, as well as some departments from the Industrial Modernisation Centre (IMC) and the Technology Innovation and Entrepreneurship Centre (TIEC). More recently, a draft SME law was submitted to the parliament for approval, as part of the national strategy to develop SMEs and start-ups in the Egyptian 2030 vision. This law should enable the MSMEDA to provide financial (directly or indirectly) as well as technical support to SMEs and start-ups. The new agency is expected to centralise and co-ordinate all SME support schemes, building on the work of existing entities. For instance, The Ministry of Investment and

International Cooperation adopted the Egypt Entrepreneurship Program (EEP) launch through the campaign, “Fekretak Sherketak”, in September 2017 to encourage the entrepreneurial ecosystem through identifying entrepreneurial talents with potential to build fast-growth companies. Also, the Bedayah Centre for Entrepreneurship, dependent from the Ministry of Investment and International Cooperation, has initiated a number of pilot projects to promote entrepreneurship and facilitate the formalisation of small companies. In addition, in order to promote formalisation and SME development, the government plans to introduce simplified tax regime for SMEs based on a flat rate on annual turnover in FY 2017/2018.A new initial **public offering (IPO) programme** was launched in 2018 to promote portfolio investment in SOEs, which may also have positive effects on the governance and transparency of those enterprises. The first phase of the programme covers divestitures of between 15-30% of shares in more than 20 companies (covering sectors such as petroleum and petrochemicals, logistics, financial services or real estate) and it has an estimated value of EGP 80 billion.

- Stronger efforts to **increase the availability of industrial land** have resulted in the allocation of close to 16 million square miles of land in 2016/2017 alone, compared to 9.5 million in the period 2007-2015. Since 2016, the General Authority for Industrial Development (IDA) has centralised this function and operates a new land allocation system. Beyond industrial land, the 2017 Investment Law has also attributed powers to GAFI to facilitate land acquisition for investment projects. GAFI has already launched an investment map identifying concrete investment opportunities (including the necessary land allocation).
- In order to encourage innovation, a new **National Strategy for Science, Technology and Innovation** has been developed by the Ministry of Higher Education and Scientific Research. The strategy includes a number of actions to promote scientific research and encourage industry-research links as well as private participation in R&D, including through the adoption of a new law on innovation.

The above horizontal reforms are also being accompanied by significant sectoral initiatives aimed in particular to deregulate and liberalise key economic activities which have long been dominated by the public sector. For instance, reforms in the governance of the energy sector include the adoption of an Electricity Law in 2015 to introduce greater transparency and competition in the sector (through, e.g. the separation of transmission from distribution and generation activities, the strengthening of the regulator’s independency, and the opening of generation companies to private capital), the adoption of a Gas Sector Law in July 2017 following a similar approach (with the establishment of a new regulator and the promotion of private sector participation and competition in downstream markets), and a Renewable Energy Law in 2014 providing for a feed-in tariff scheme, which has been gathering pace slowly to reach 30 transactions as of end-2017 and is expected to expand renewable energy production by 1.8 GW over 2 years by attracting private investments of USD 2.5 billion. The government is currently planning to restructure the Egyptian Electricity Holding Company to improve its financial soundness and reduce state support. A new mining law was also adopted to improve the attractiveness of the sector for prospective investors, including a new tax and royalty structure and streamlined administrative procedures. The government also wants to enhance competition in the transport sector, as it plans to create an independent regulatory authority by mid-2018. The Railway Act, approved by Parliament in March 2018, opens the sector for private sector participation in developing, managing and operating railway projects. The River Transport Authority is planning to issue a tender to have the private sector develop and run ports along the Nile in early FY2018-19. In the same vein, the Underground Law, currently at the Parliament, also contemplates private sector participation in operating and maintaining the Cairo Metro. Finally, a new law was adopted in 2015 to regulate the operation of the new special economic zone that has been created as part of the Suez Canal Area development project.

During the last two years, the government has launched a number of mega projects aiming to jumpstart investment and contribute to unemployment alleviation. The Suez Canal was expanded in just one year to double its capacity. 2,400 kilometres of new roads had been built by April 2017 (a 15% increase to existing roads). A network of industrial parks and 22 industrial clusters are being built. While there may be a potential positive impact on investment, growth and employment in particular by improving logistics and connectivity, it is unclear whether the selection and identification of these projects was based on thorough socio-economic evaluation and appraisal, including their impact on the government's fiscal position.

Key priorities

Building on the recent reforms, further comprehensive reforms of business and investment regulations are needed. Recent government initiatives go in the right direction but the efforts could be broadened and deepened, in particular to ensure the implementation of enacted reforms in practice. The following priorities could be considered:

- Continuing and stepping up efforts to streamline and modernise business regulation, with a focus on key constraints to private sector growth, including (a) **implementing the new industrial licencing law**; (b) implementing the new **sole proprietorship law**; (c) introducing a **collateral registry**; and (c) further streamlining **customs regulations**. Over the medium term, ERRADA could be used to undertake a **comprehensive review of the company law**, including corporate governance standards.
- **Revamping the policy framework for SME development**, including by implementing the SME law with a clear definition of the sector; operationalising the new agency and adopting a comprehensive strategy to enhance the competitiveness of SMEs.
- In the area of investment, **fully putting into effect the new investment law and its implementing regulations and ensuring further coherence of the overall legal framework for investment**. This may also be accompanied of complementary actions, such as (a) considering continued efforts in streamlining registration processes as well as dispute settlement procedures and institutional frameworks; (b) improving institutional coordination, e.g. between GAFI, MIIC and other line ministries; (c) unifying special investment regimes created in Free Trade Zones, Industrial Zones and Special Economic Zones.
- Step up the efforts to **increase the availability of industrial land**, including through the introduction of transparent land allocation processes (e.g. a competitive bidding process).

- Ensuring that the **selection and governance of megaprojects** is done in accordance with best international practices in key areas (e.g. procurement, private sector involvement, impact assessments, etc.) and considering the development of **linkage programmes with domestic SMEs** to spread the benefits of FDI, megaprojects, and large industrial investment.
- Developing and implementing an **action plan to revamp the export promotion regime and reduce non-tariff barriers to trade.**

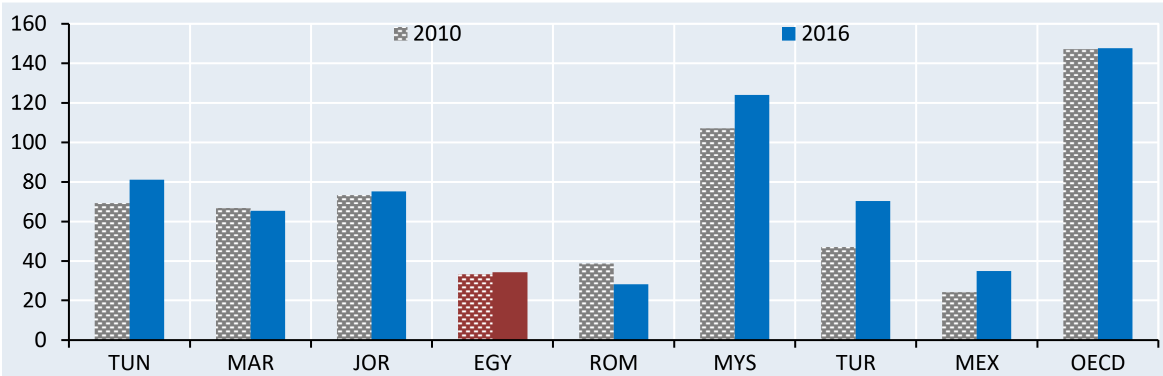
C. Addressing the key constraints to access to finance

Current situation

The Egyptian financial sector has weathered well the ongoing macroeconomic instability. This resilience is in large part due to the banking sector restructuring implemented in the mid-2000s (where more than 20 banks were merged or restructured) and the effective prudential supervision of the CBE. Average risk-weighted capital remained at a healthy 15.2 % in December 2017, while reported non-performing loans (NPLs) represent 4.9% of all lending in the at the end of 2017 (compared to 8.5% in 2014) with provisioning close to 100% of the outstanding value of those loans. The depreciation of the point and the increase in interest rates have not have a significant impact on the soundness and profitability of the Egyptian banking sector.

Yet, the financial sector has struggled to play its intermediation role to boost growth and inclusion amidst decreasing levels of lending and limited financial access. The share of total credit channelled to the private sector has decreased constantly since the early 2000s. Indeed, private credit to the private sector went down from 34.7 % of GDP in June 2010 to just 28.3% in June 2017.in 2015 – well below regional peers like Jordan, Morocco and Tunisia (at between 64-79%) (Figure 27). Access to finance is the second most significant problem for businesses surveyed by the 2013 World Bank Enterprise Survey after political instability. Close to 30% of firms considered financial access to be a major constraint. Perhaps more worrying is the low level of access reported by surveying firms: only 6% of firms reported to have a loan or line of credit (5% of small firms), which compares with a MENA average of 25.6%. This low figure does not seem to be the result of limited financing needs: over 42% of surveyed firms who requested a loan got their application rejected (with 75% of medium-size loan applicants reporting this). Financial inclusion at the level of the general population is also very limited as Egypt is ranked among the bottom 10 countries in the world in terms of financial inclusion (World Bank, 2015). For instance, only 13.6% of adults had an account at a financial institution in 2014, compared to 24.6% in Jordan, 27.3% in Tunisia and 39.1% in Morocco.

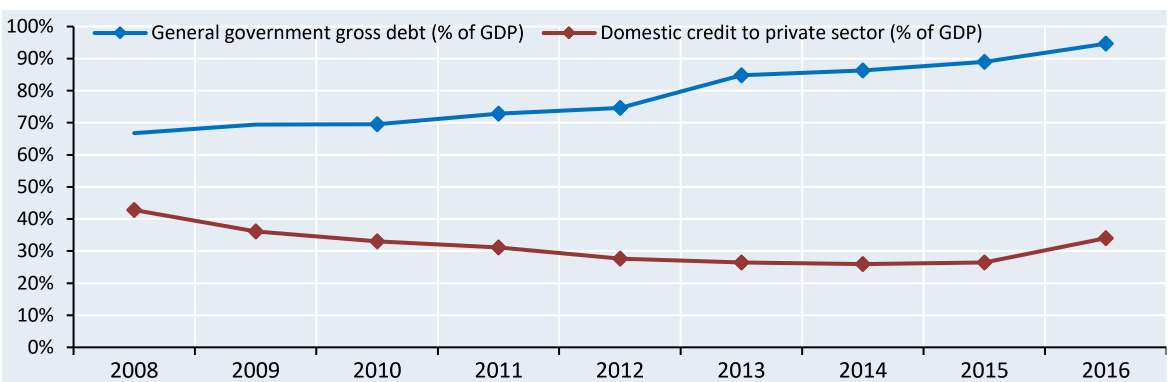
Figure 27: Domestic credit to the private sector as share of GDP (2010-2016)



Source: IMF International Financial Statistics.

Limited financial inclusion is at least partly due to a significant crowding out effect arising from significant government borrowing, although recent reforms are starting to show positive effects. Lending to the government has increased six-fold since 2005: net claims on government as a ratio of total credit has increased from 49% to 63.6% between 2011 and 2017 (June) according to the CBE, while domestic credit to private investors as a percentage of GDP decreased continuously between 2008 and 2015. A reversal of this trend seems to be taking place, as credit has recovered since 2016 in response to the reforms introduced since 2016, which have decreased the reliance of the government on domestic borrowing to finance the deficit (Figure 28).

Figure 28: Government borrowing and domestic credit to the private sector in Egypt (2008-2016)



Source: IMF World Economic Outlook Databases (Oct. 2016) and International Financial Statistics.

Low levels of financial inclusion in Egypt are also the product of a combination of supply and demand factors:

- On the supply side, there is **limited competition between banks, a tendency to concentrate lending in a few large borrowers, and short-term tenures**.
- On the demand side, problems include **limited levels of financial literacy** (including amongst SMEs), as well as **lack of transparency** due to inadequate corporate governance and limited use of audited financial statements. Loans provided to small and micro finance SMEs in Egypt only accounted for 5.8% of all bank loans in 2017.

- **Lack of adequate financial infrastructure** is also a key factor explaining low financial inclusion. At present there is no collateral registry in Egypt facilitating the use of moveable property as collateral, despite the adoption of the executive regulations of the Movable Asset Law in December 2016. Credit information remains limited and the insolvency system is costly and inefficiency, which discourages lending. The coverage of the credit bureau is limited, at 21.6% of the adult population, while it takes on average 2.5 years on average to go through a bankruptcy process, which may cost up to 22% of the estate (World Bank, 2016b). As a result, 92.4% of all loans require collateral (above a MENA average of 79%) and the average collateral required by lenders is a staggering 272.5% of the value of the loan (compared to 202.6% in the region).
- **Non-bank finance remains under developed.** Insurance penetration is very low (with premiums representing just 0.7% of GDP in 2013). Leasing activities are also negligible (0.5% of GDP). Stock market capitalisation stood at 19.8% of GDP in June 2017, a drastic decrease since over 90 % in June 2008, when the stock exchange was being used to privatise a significant number of public enterprises. No state-owned companies have been listed on the exchange market since 2005.

Reform efforts

A National Financial Inclusion is currently under preparation and a number of other initiatives have been adopted or are ongoing. For instance, a new microfinance law was passed in November 2014, opening the market to NGOs and commercial companies. The new law sets clear licensing rules as well as prudential and governance standards. The law also gives the Egyptian Financial Supervisory Authority (EFSA) the necessary powers to regulate and supervise the microfinance sector, which, as of 2013, comprised 400 institutions (including four banks). Beyond microfinance, the government is also promoting mobile banking to expand financial inclusion including in rural areas. A new mobile banking regulation was introduced in 2016 and the Mobile Interoperability Scheme was launched in June 2017 to allow transactions between different mobile payment systems. Four mobile banking operators have entered the Egyptian market in recent years (AfDB, 2016b).

Other recent or planned legal reforms aim at improving financial infrastructure and reduce collateral requirements, with the new bankruptcy law being a major positive development. In November 2015, a new law was enacted to create a new regime for pledging a wide range of movable assets and centralising security registration. Yet, a comprehensive movable collateral registry is not yet available. In December 2016, a draft Financial Leasing law was submitted to cabinet, aiming at diversifying the sources of finance beyond bank lending. Finally, the new bankruptcy law was enacted by parliament in 2018 introduces restructuring as an alternative to company liquidation, de-criminalises insolvency, and simplifies the procedures for insolvency procedures. The implementation of the new law has the potential to improve the efficiency of the bankruptcy system, which is currently exceeds 20% of the estate, against an average 7% among emerging economies in the MENA region (Doing Business, 2018).

Financial support schemes for SMEs remain a priority for the Egyptian authorities. The government and the Central Bank have been launching several initiatives to provide loans to SMEs at preferential conditions and, more generally, to incentivise lending to SMEs. Since January 2016, CBE has required banks to lend to SMEs over a four-year period at a highly discounted interest rate (5%), offsetting the amount of the loans against obligatory reserves at CBE. These loans target in particular capital expenditure and working capital by SMEs. Banks are also requested to allocate 20% of their portfolio to SMEs. In the first 18 months of operation, this support scheme provided loans worth EGP 7 billion. It is however important to note that the use of subsidised interest rates remains questionable as it may distort the market allocation of credit and harm the portfolio quality of banks. The government is thus committed to keeping these programmes to a cumulative level of EGP 45 billion.

Key priorities

The government's ambitious fiscal consolidation agenda (Pillar I) is likely to increase financial inclusion indirectly. However, the government could consider a number of financial sector policies:

- Continue **strengthening the regulatory and supervisory framework for banks**, in particular by adopting outstanding Basel II and Basel III principles.
- Promoting **competition in the banking sector**, including through increased transparency and reporting requirements.
- Building on existing CBE initiatives to **promote financial education and literacy**, including the development of a national strategy in this area and specific actions concerning SMEs and informal firms.
- Refocusing the **existing financial support to SMEs towards guarantee schemes** or measures less distortive than subsidised lending schemes.
- Implementing the new microfinance legislation and **reinforcing the capacity of EFSA to carry out its supervisory duties**.
- Promoting **access to finance through the development of financial infrastructure** (including the introduction of a **collateral registry**) and the **revision of the insolvency legal framework** in line with international best practices.
- More generally, promoting the **development of alternative sources of finance to offer alternatives to bank lending**, including equity finance and leasing.

Pillar IV: Involving the public and civil society and the business community in decision-making

It could be argued that one of the main reasons behind the eruption of Arab Spring was the weak economic, political and social inclusion of vital segments of the society such as women and youth, as a symptom of a deeper problem regarding the lack of inclusiveness in governance. Egypt fitted perfectly into this description. This Pillar looks into the inclusiveness of policy-making in terms of the participation of stakeholders and the general public and then focuses more specifically on the political and economic inclusion of women and youth.

A. Enhancing public participation in policy-making

Current situation and reform efforts

Civil society in Egypt is showing dynamism but further reforms in the legal framework may be needed. The 2014 Constitution enhances the protection of civil society organisations (CSOs) and provides for the possibility of establishing new organisations without prior government approval. The number of CSOs registered with the Ministry of Social Solidarity has increased from 26,000 in 2010 to over 48,000 in 2016, showing the dynamism of Egyptian civil society. After years of preparatory work, which started in 2011, a new Associations Law was adopted in November 2016. The law was reportedly adopted after consultations with over 600 CSOs under the coordination of the General Federation of CSOs (MoIC, 2016). However, restrictions on the operations of CSOs may still remain, in particular to receive foreign funding. The Ministry of Social Solidarity has established a unit to monitor and coordinate with international NGOs. The government intends to review the Associations Law as a response to demands from members of parliament and civil society organisations, taking into consideration the fact that the new law has not yet been implemented.

The involvement of stakeholders in public-policy making in Egypt remains largely *ad hoc due to the* absence of structured mechanisms and fora. Despite the absence of a formal framework for civil organisation consultation, the government and several ministries took some initiatives to involve stakeholders in certain decisions through informal or formal consultations. For instance, the preparation of the Egypt 2030 Vision Sustainable Development Strategy (SDS) followed a participatory approach, including the participation of civil society organization, academia, experts, government officials as well as international organisations (MoIC, 2016). After it was issued, working groups were created to monitor implementation. In that context, Egypt has participated in the first voluntary reporting on SDGs in 2016 and is currently preparing the second report on the development of SDGs implementation in 2018. The formulation of the SDS constitutes a very good precedent towards increasing public participation in policy-making and could be replicated in a more systematic manner. Moreover, *social justice* is one of the four pillars of the SDS and strongly supports citizen's right to participate in policy processes (Box 4).

Box 4: SOCIAL JUSTICE PROGRAMSUNDER THE SDS 2030

- Reviewing and developing laws and legislations related to social justice and integration.
- Institutionalizing the partnership between the state and the civil society.
- Developing and expanding the role of state authorities concerned with transparency and protection.
- Improving the social protection and subsidy systems and expanding their coverage.
- Reducing the social intergeneration and gender gaps.

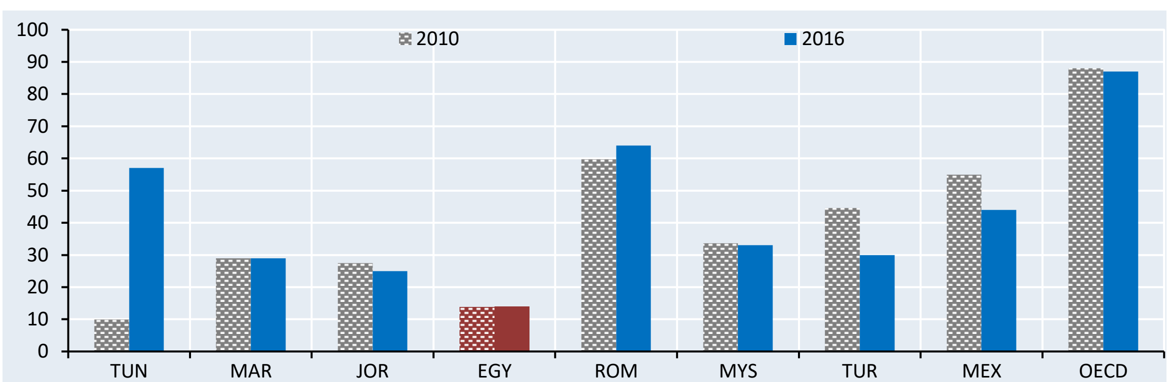
Achieving a balanced geographical distribution of services.

Source: Government of Egypt

Another valuable instrument for public participation introduced in recent years is the citizens' budget. A law adopted in 2015 institutionalised the instrument of the citizens' budget providing details on the timing for the publication as well as the data to be provided. The government has already published three editions of the budget (2014/15, 2015/16 and 2016/17).

More generally, Egypt has historically presented comparatively low levels of voice and accountability although a noticeable improvement has been witnessed since 2011. According to the World Governance Indicators, the percentile rank of Egypt for voice and accountability between 2005 and 2010 was 15%. With the 2011 events and the momentum for public, the rank witnessed its highest value ever in 2013 to reach 26.5 but unfortunately it dropped again below 20 during the three subsequent years (World Bank, 2016a) (Figure 29).

Figure 29: Worldwide Governance Indicator for Voice and Accountability 2010-2016



Notes: (1) Voice and Accountability reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media; (2) It measures percentile rank among all countries (from 0 to 100).
Source: The Worldwide Governance Indicators (WGI).

Key priorities

Against this background, the government could consider the following priorities to improve participatory processes and enhance inclusiveness in decision-making:

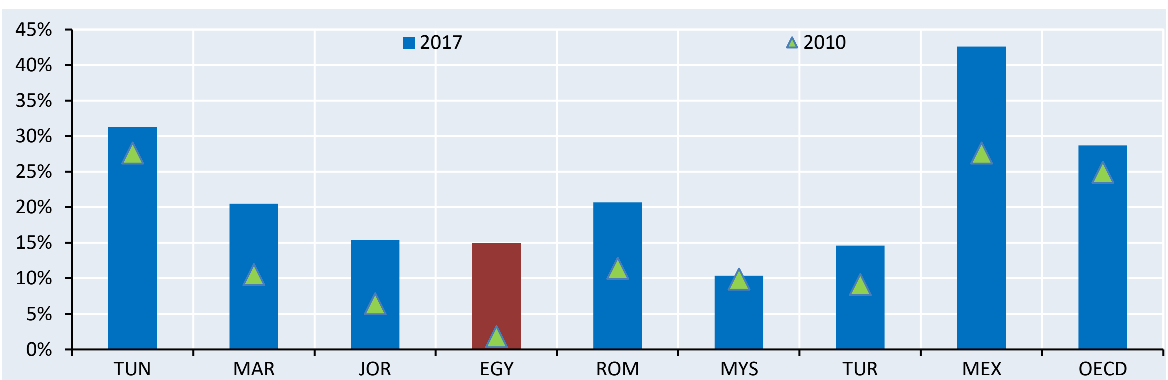
- Developing **formalised and transparent mechanisms and platforms for public consultation and dialogue with stakeholders**, including the private sector and CSOs at all stages of the policy cycle, from design to monitoring and evaluation;
- **Strengthening the capacity of CSOs** and enhance their autonomy by further **reducing the level of government controls**.

B. Promoting women and youth economic and political empowerment

Women economic and political empowerment

There are encouraging signs of greater political participation of women. Article 11 of the 2014 Constitution mandates the government to take the necessary actions to empower women politically. The latest parliamentary elections held in 2015 followed the reinstatement of an electoral quota that allocates 56 of the 596 parliamentary seats (almost 10%) to women (Law 46/2014 on the House of Representatives) (El Baradei, L. et al., 2013). In addition, 20 women were able to win open seats previously held by men, 14 were appointed by the President. As a result, the percentage of women in parliament has experienced a significant increase and now stands at 14.9%, compared to just 2% in 2013 (Figure 30). Also 4 out of 34 ministries are currently headed by women.

Figure 30: Percentage of Women in National Parliaments (lower house or single house)



Source: Inter-Parliamentary Union as of 17 December 2017.

While these improvements are encouraging, the proportion of elected women parliamentarians in Egypt remains low compared to other countries in the region (e.g. Morocco: 20.5%; Tunisia: 31.3%) and among countries of the OECD (OECD average in January 2017: 28.8%).

Yet legal, economic and social obstacles still prevent for women's political participation. The 2014 Constitution strengthens women's status by guaranteeing gender equality. President Al-Sisi declared 2017 as the year of women. However, active involvement of women in the Egyptian society is hindered by a series of economically discriminatory provisions including the lack of recognition of women as heads of households and the inability of women to tax-deduct expenses paid toward childcare just to cite two examples (Al Ashmawy, 2016). Further barriers highlighted in OECD's assessment of women's political participation in Egypt (OECD, 2017, Preliminary Version) includes the economic inequality between men and women that affects women's ability to mount effective, well-resourced political campaigns and tends to reduce their bargaining power. Furthermore, gender stereotypes including in the Media and social traditions hamper women's empowerment in public life. Structural barriers such as lack of work-life balance in politics and the limited development of social infrastructure (such as childcare or parental leaves) also limit women's empowerment in public life. Moreover, violence against women discourage women from running for office and make campaigning more difficult for them[21].

The National Council for Women (NCW) is the main participatory body for mainstreaming policies aimed at women empowerment in Egypt. The NCW's priorities include: (i) economic empowerment (including increasing labour force participation and a special programme for women-led households focusing on women working in informality); (ii) social empowerment (including addressing violence against women); and (iii) political empowerment (including training for women parliamentarians and candidates as well as legislative reform). The Council has developed indicators for measuring gender equality in various areas, supported the roll out of Equal Opportunity Units in ministries and government departments (including the Ministry of Finance), and introduced gender mainstreaming into national development planning activities (MoIC, 2016). The Council has also been instrumental in Egypt's progress towards the eradication of female genital mutilation, with a decrease in the prevalence of this practice from 75% in 2008 to 61% in 2014 (MoIC, 2016).

The NCW developed and the President endorsed Egypt's National Women's Strategy 2030 in March 2017. The strategy builds on the progress recorded notably in the 2014 Egyptian constitution and is aligned with the SDG goals. It has 4 main pillars: (i) political empowerment and leadership promotion; (ii) economic empowerment; (iii) social empowerment; and (iv) protection and two mainstreamed pillars which are legislation and culture. It sets ambitious targets for women empowerment by 2030 notably an increase of women participation in the workforce from 24% to 35% and of parliamentarian women from 15 % to 35 %. The Strategy is being followed up with concrete actions, such as the plans to work with UN Women to introduce gender budgeting in the 2018/2019 budget or to facilitate access to national identification cards. In April 2017, a joint committee involving several ministries as well as the NCW, academia and the business sector was established to tackle the question of women labour participation (IMF 2018a).

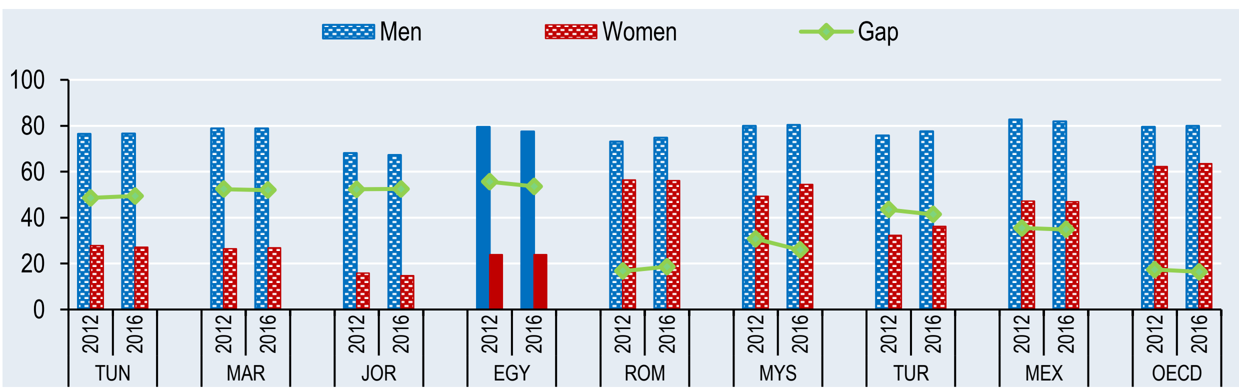
Some concrete initiatives have also been put in place to promote women economic empowerment although a significant gender gap exists in labour market outcomes. Overall, in 2017 more than 1.3 million women benefited from SME loans in the first half of 2017 and more than 1.6 million benefited from micro finance projects. The NCW has also signed a MoU with the Central Bank to foster financial inclusion, and other initiatives such as the development of life insurance policy schemes seek to improve financial safety of women and their families. A National Programme for the Economic and Social Empowerment of Women has been launched to promote entrepreneurship, provide training on key aspects of running a business, and providing women with access to markets. The programme is implemented by the government in partnership with CSOs and the private sector. As of end-2017, 1,384 women had participated in the "One Village One Product" project to integrate them into local supply chains. Other similar projects, often funded by international partners, also exist. The *Takaful* programme

[21] OECD, Women's economic empowerment in selected MENA countries. The impact of legal frameworks in Algeria, Egypt, Jordan, Libya, Morocco, and Tunisia. 2017.

(Pillar I) is also geared towards greater female empowerment by using women as entry points to support the entire household and making support conditional on women health check-ups.

Notwithstanding all these efforts, a significant gender gap persists in the labour market. Despite the significant advances in education enrolment, women labour participation is very low. For instance, only 19.2% of employees in Egypt's non-agricultural sector were women. The gap in labour participation between men and women in Egypt (currently at over 53%, the result of a male participation rate of over 76% and a female rate of just 22.8%) has remain largely stable for the last couple of decades and is the largest amongst comparator countries (Figure 31). The absolute number of unemployed women is more than double the figure for men: 24.2% compared to 9.4% in 2015 according to CAPMAS. Moreover, the ratio of female to male wages in Egypt was 0.77 between 2007 and 2010 and the level of participation of women in business ownership and management is also limited (OECD 2014b). Finally, the overall wage gap between men and women is estimated to be around 12% on average, and up to 40% in the formal private sector (IMF, 2018a).

Figure 31: Gender labour participation gap (%) (2011-2016)



Source: ILO Key Indicators of the Labour Market database; OECD Labour Market Statistics.

The ongoing IMF programme also includes measures to improve female labour market outcomes. In this context, the government plans to create a joint committee involving representatives from key ministries (Finance, Social Solidarity and Trade and Industry), the Women's Council, academia and civil society to identify measures aimed at improving women labour market participation, including greater availability of public nurseries (with a budget allocation of EGP 250 million in 2016/2017 and EGYP 500 million in 2017/2018, aimed at expanding nursery coverage from 8 to 25% of 0-4 year children) as well as initiatives in the area of transportation safety.

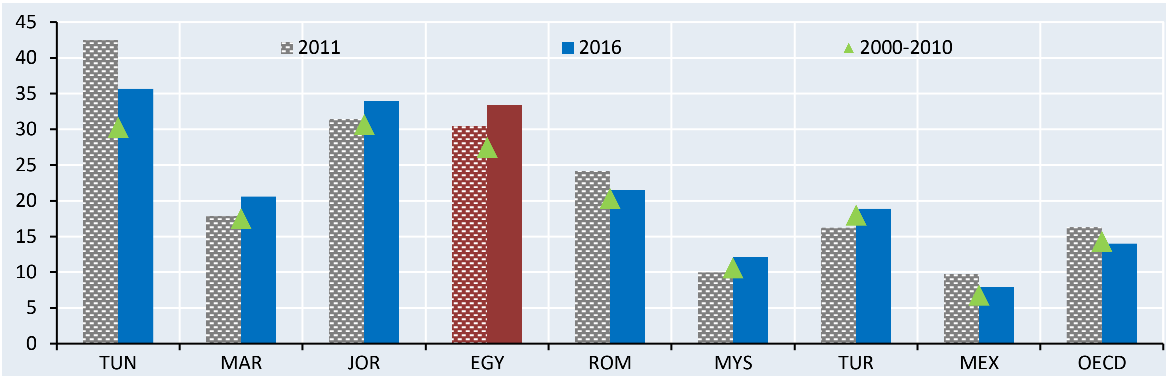
Youth economic and political empowerment

Policy-making is showing greater attention to youth considerations The 2014 Constitution has introduced a number of measures aimed at promoting the participation of young men and women in the political process. A 10% quota for MPs under the age of 35 years old exists in parliament and a similar quota of 25% apply for municipal elections. President Al-Sisi declared 2016 to be the "Year of the Youth". In addition, he has called for a number of initiatives to better integrate youth into their society such as the initiative to appoint youth advisors to ministers and to governors. Youth conferences have been organised as dialogue mechanism to promote the voice of youth. The Ministry of Social Solidarity has started an initiative to promote the participation of young people in the public sphere, implemented in cooperation with the Ministry of Youth and CSOs, with the objective of reaching 45,000 beneficiaries. Also, in the context of the Sustainable Development Strategy which was put in place after consultation with civil society stakeholders, a digital application is being launched “Sharek 2030” which allows youth to follow up and update Egypt's Vision 2030.

However, these efforts suffer from the absence of a fully-fledged strategy targeting the youth and their concerns. As the OECD report (2016) “Youth in the MENA region – How to bring them in” stresses, some MENA economies are currently in the process of formulating or implementing national youth strategies to unite different ministerial departments, agencies and non-governmental youth stakeholders behind a joint vision for youth. The implementation of youth policy in Egypt continues to be hampered by the lack of such an overarching strategy which could potentially overcome the fragmented delivery of the various services young people demand for a successful transition to adulthood.

Youth unemployment is perhaps Egypt’s most fundamental challenge over the medium to long term. As noted in the Country Overview and Pillar I, Egypt faces a dramatic situation regarding youth unemployment. Youth employment has improved 2.1 percentage points from 2015 (35.5%) to 2016 (33.4%). At 35.5% in 2015, this figure is the highest in the region, although countries like Tunisia (34.5.75%) and Jordan (33.44%) experience similar dynamics in 2016 (Figure 32). 9 out of 10 unemployed are below the age of 30 years (Ghafar, 2016). A number of youth-focused programmes exist, often funded by development partners. One example is the “Beidak” Programme, supported by the UAE, which is aiming at training over 100,000 young Egyptians to equip them with the tools they need to access the labour market. The National Training Plan for Employment has very ambitious targets (training over 1.5 million Egyptians a year) (MoiC, 2016). A Youth Employment National Action Plan has been prepared. Several training programs for youth have also put in place, including the creation of the National Academy for Youth and the Presidential Leadership Program. In spite of these initiatives, youth unemployment has increased about 6 percentage points compared to the 2000-2010 average, a trend which can also be found in other countries in the region. This problem is unlikely to be resolved through scattered training programmes but instead through structural transformations of labour market institutions, the education system, and the private sector, as discussed in Pillars I and III.

Figure 32: Youth unemployment rate (% of total labour force, ages 15-24)



Source: ILO Key Indicators of the Labour Market database; OECD Labour Market Statistics.

Faced with limited opportunities, Egyptian youth resort to emigration and, to a lesser extent, entrepreneurship. As Egyptian youth find it more and more challenging to secure a well-paid work opportunity, many young people have turned to emigration. The less fortunate who could not secure for themselves a good quality job nor an opportunity outside Egypt have only two options left: to start their own business or to find a job within the informal sector. Data reveals that indeed entrepreneurship activities went up to 4% in 2014 compared to 1.2% in 2009 (The Population Council, 2015). However, this modest increase cannot absorb the massive yearly new entrants in the job market. As a result, the second option has dominated as the source of employment of last resort. In fact, estimates suggest that more than 50% of youth employment is within the informal sector.

NEET youth presents a particular challenge. NEET refers to youth (typically individuals between 15 and 30 years old) "Not in Employment, Education or Training". NEET is part of the Sustainable Development Goals, as it is a good indicator to measure inactivity. In Egypt, a recent study based on a survey of over 10,000 youth, suggests that 40.7% of youth may be NEET and that this problem affects in particular women (60.4% of all young women in urban areas and a staggering 69.7% in rural Egypt) (World Bank 2016d).

Key priorities

The empowerment of women and youth is likely to involve a number of far-reaching measures, some of which have been discussed in other pillars and others go well beyond the scope of this report. In addition, the Egyptian government may want to focus on the following priorities:

- Preparing a **multi-dimensional youth empowerment strategy or plan** covering economic, social and political aspects to address the fragmented delivery of relevant public services.
- R**eview legislation that may discourage young people from participating actively in public life and institutionalise dialogue with non-governmental youth stakeholders.**
- Developing **active labour market policies, including specialised programmes for the youth and job intermediation schemes**.
- Developing a **comprehensive plan to improve women participation in the labour market**, including promoting entrepreneurship and access to finance, expanding the availability of public

nurseries, introduce more flexible working arrangements (e.g. maternity leave, parental services), developing new initiatives to improve the safety of public transportation for women.

- **Removing any remaining legal provisions which discriminate against women** (e.g. tax), lift reservations on the Convention on the Elimination of all Forms of Discrimination against women (CEDAW) and develop and apply anti-discrimination and anti-harassment policies.

Annex I. Egypt Compact Implementation Plan

Pillar	Short Term (1 year)	Medium to Long Term (> 1year)
I. Designing sound economic policies for an inclusive and sustainable market economy	1. Continue **fiscal consolidation in line with the objectives set in the IMF programme** with a specific focus on **fuel subsidy reform** (automatic fuel indexation) and mitigation of **fiscal risks** (including contingent liabilities) 2. **Maintain a prudent monetary policy** to contain inflation and bring it down to the single digits over the medium term; revise the Law of the Central Bank and the Banking System 3. Maintaining a **flexible exchange rate regime** to rebuild reserve levels as a buffer against future shocks 4. Dedicate part of the fiscal savings arising from fiscal consolidation efforts to **social protection and social programmes** 5. Continue **strengthening the coverage, effectiveness and targeting of social protection programmes, including *Takaful* and *Karama*** ; mitigating the impact of high inflation	1. Strengthen the **independence and transparency of the CBE** and prepare the ground for an **inflation-targeting approach to monetary policy** 2. Accelerate the work to create a **unified registry of beneficiaries** for social safety net programmes 3. **Review existing labour market legislation** to address key constraints to job creation; strengthen **active labour market policies** 4. Undertake a **comprehensive reform of the education (including TVET) system to improve quality and reduce skills mismatches**. 5. Design and implement a **comprehensive strategy to tackle the informality phenomenon**
II. Enhancing the transparency and efficiency of public institutions and processes	6. Step up the ongoing efforts to modernise the civil service by review the operational performance of **economic authorities**, considering their inclusion in the state budget 7. Develop a consistent and **integrated vision for reforms in the area of PFM in the form of an Action Plan or a Strategy**. 8. Ensure the **effective implementation of the 2014 National Anti-Corruption Strategy and strengthen the powers, independence and transparency of existing control institutions** (including ACA and CAO). 9. Finalise the parliamentary approval of a new **public procurement law** based on international best practices and introduce an online procurement portal 10. Continue expanding the tax base, including by **avoiding the introduction of new tax exemptions and tax credits** 11. Improve **tax administration and reduce tax compliance costs**, including through a simplified, turnover-based tax regime for SMEs. 12. Continuing and scaling up **business regulation streamlining and simplification under ERRADA**	6. Prepare a **digital government strategy** 7. Develop a **comprehensive strategy to improve the corporate governance standards and transparency of SOEs**, leveraging the IPO programme 8. Improve the planning and monitoring of public investment projects through a full-fledged **Public Investment Management System** (PIM), following on existing discussions. 9. Introduce ICT systems to improve the effectiveness and efficiency of the judiciary and undertake a **comprehensive justice sector reform programme**. 10. Developing and communicating a **comprehensive vision for tax reform in the form of a clearly-defined strategy**. 11. Enhancing Egypt's engagement on **international tax cooperation, including by joining the Multilateral Convention on Mutual Assistance in Tax Matters** 12. Adopting **ex-ante and ex-post mechanisms to enhance regulatory quality** (e.g. RIA, ex-post evaluation systems)
III. Building an attractive environment for investment and private sector development	13. Ensure the effective implementation of recent reforms including (a) **new industrial license law and implementing regulations**; (b) **sole proprietorship law**; (c) **customs regulatory simplification**. 14. **Implementing the new policy framework for SME development** (i.e. new law) and develop a strategic approach to SME development 15. Develop an **investment strategy** building on the approval of the new law. 16. Adopt key measures to **strengthen financial infrastructure** (including the introduction of a **collateral registry**) and implement the recently-adopted **insolvency law** in line with international best practices.	13. Develop a comprehensive approach to facilitate **access to land**, including greater transparency and efficiency in the allocation of industrial land 14. Strengthen **competition enforcement**, building the capacity of ECA 15. Develop and implement a **comprehensive export promotion strategy** led by the Export Development Authority. 16. Building on recent reforms, undertake a **comprehensive review of the company law**, including corporate governance standards 17. **Promote financial education and literacy**, including the possible development of a national strategy with specific actions concerning SMEs and informal firms

		18. Promote the **development of alternative sources of finance to offer alternatives to bank lending, including equity finance and leasing**
IV. Involving the public and civil society and the business community in decision-making	19. Develop **a multi-dimensional youth empowerment strategy** 20. Developing **active labour market policies, including specialised programmes for the youth and job intermediation schemes**. 21. Develop and implement a **comprehensive and multifaceted plan to improve women participation in the labour market** in co-ordination with the National Council of Women	17. **Develop structured and transparent mechanisms and platforms for public consultation and dialogue with stakeholders** (including public-private dialogue) 18. **Removing any remaining legal provisions which discriminate against women** 19. Enhance CSO autonomy by **reducing the level of government controls and reviewing the Associations Law**

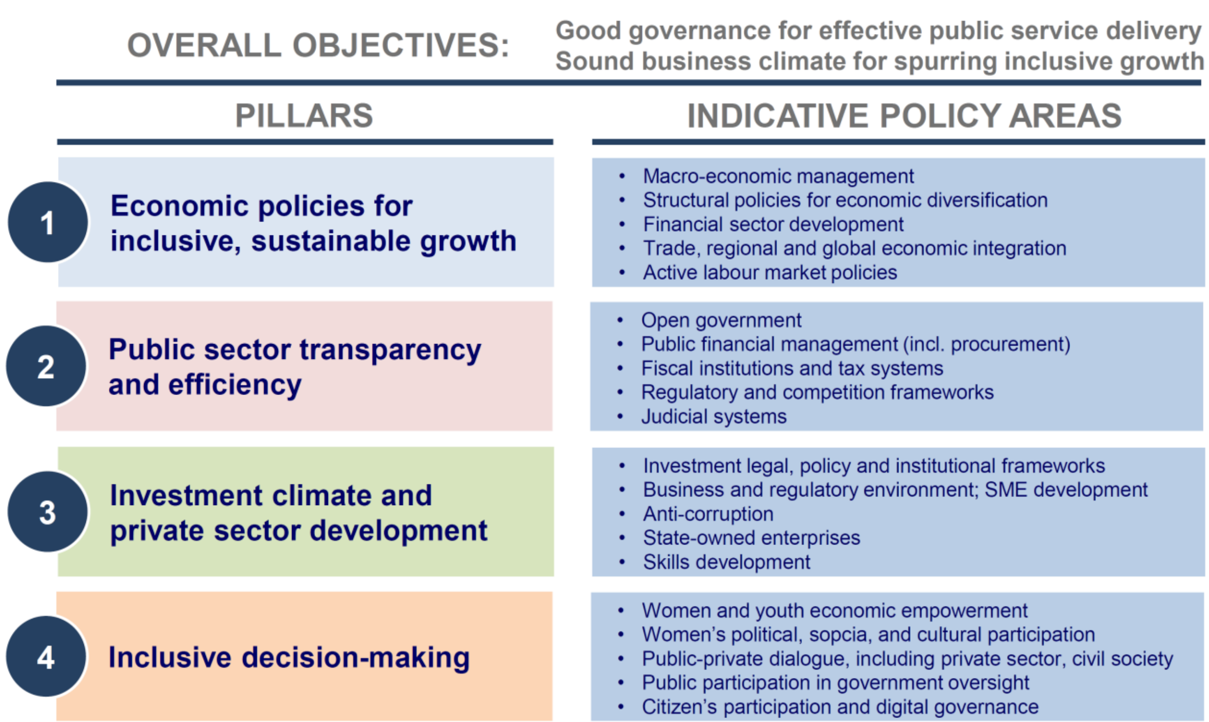
Annex II. The Compact for Economic Governance: Technical Aspects and Methodology

The Compact for Economic Governance

On 6 May 2015, Senior Officials of the Deauville Partnership unanimously adopted the **Compact on Economic Governance**. Following past action plans on topics such as open government, anti-corruption, asset recovery and SME development, the Compact provides a framework for reform efforts across Arab Countries in Transition (ACTs) aimed at promoting good governance and a sound business climate as preconditions to boost inclusive growth. G7 Leaders' welcomed the agreement on the Compact in the 2015 Schloss Elmau summit declaration as well as "the shared commitment to implement [it]" in the 2016 Ise Shima summit declaration.

The Compact was prepared by the German G7 Presidency with support from the OECD with the overall objective of identifying key policy objectives and reform priorities across four main pillars (Figure 1).

Figure 1: Compact for Economic Governance: Overall Objectives, Pillars and Policy Areas



The Compact is designed not as a mere declaration but rather as an operational document to inform policy dialogue within the Deauville Partnership. Indeed, the Compact refers explicitly to "follow up" in the form of a "steady dialogue and consultation process", in particular through **a peer review and peer learning** mechanism supported by the OECD, the Deauville Partnership's international financial institutions (IFIs) as well as relevant coordination platforms. The Compact's priorities are to be operationalised through **country-tailored implementation plans** under which ACTs identify specific policy measures which could then be supported by G7 and partner countries through technical assistance (including under the umbrella of the MENA Transition Fund) and other supporting measures. Finally, the Compact underscores the need to measure and monitor policy effectiveness as part of these plans. To this end, both qualitative measures and internationally established indices are used to benchmark progress towards reaching policy objectives.

Overall Approach to the Country-Level Implementation of the Compact

With the support of the German Foreign Office, the OECD is assisting ACTs in the preparation and monitoring of country-tailored Implementation Plans, starting with Tunisia and Egypt as pilot countries. This support is structured as a two-step exercise:

- ***Phase 1 – Stock-taking***: The OECD supports ACTs in identifying priority areas for intervention by assessing and benchmarking the current state of play across the Compact's four pillars. This demand-driven assessment takes the form of a comprehensive **Stocktaking Report** for each ACT to be presented and discussed at a Deauville Partnership Senior Officials' Meeting. Under each of the pillars, these reports contain: (1) a *qualitative assessment of reform implementation* since 2011 (including both achievements and outstanding challenges); (2) an *indicator scoreboard* listing output and outcome indicators (with both baseline values and historic trends to allow comparison across ACTs but also improvement over time for each individual ACT); and (3) *policy recommendations* to serve as a basis for the Compact Implementation Plans through the identification and prioritisation of reforms.
- ***Phase 2 – Progress reporting:*** Building on each Stocktaking Report as a baseline assessment, the OECD will report annually on progress made by ACTs in the different dimensions of the Compact. This will be done through a brief Monitoring Report providing for each ACT: (a) a *description of achieved or ongoing reforms as well as emerging challenges*; (b) an *update on output and outcome indicators*; and, potentially, (c) a *thematic focus in one policy area covered by the Comp*act. Monitoring Reports will also be presented and discussed at Senior Officials' Meetings.

In parallel to both exercises above, ACTs will benefit from **capacity building** through the above peer-review exchanges, the involvement of government officials in the gathering and interpretation of relevant data and indexes, as well as specific capacity-building and knowledge-sharing meetings.

This Deauville Partnership tool will be complementary to, and aligned with, other instruments to support policy dialogue and reform implementation at the national level, including IMF programmes and budget support from IFIs and bilateral development partners.

Stocktaking Reports: Overall Approach and Methodology

Stocktaking Reports are prepared by the OECD in consultation with each relevant ACT and in cooperation with Deauville Partnership IFIs. Drafts are circulated to each ACT for fact checking and to IFIs for comments. Draft Reports will be submitted by the OECD to the G7 Presidency for inclusion in the agenda of a Senior Officials' Meeting. A peer review discussion will then take place with the participation of other ACTs, G7 countries, as well as partner countries.

Stocktaking Reports are concise and relatively high-level. They comprise qualitative and quantitative elements.

On the *qualitative* front, the Reports identify key developments, challenges and recommendations across the four pillars. While following the structure of the Compact, each report is adapted to the specific circumstances of each ACT, as the relative importance of policy priorities and pillars varies from country to country. Given the extensive analytical work undertaken by various partners in most ACTs, Stocktaking Reports build on existing research and analysis, including reports and other materials produced by the OECD, the Deauville Partnership IFIs and bilateral development agencies from G7 and partner countries. Each report contains a list of references used in the analysis.

On the *quantitative* front, each Report contains an indicator scorecard comprising 32 indicators (see **Annex III**). The scoreboard combines macroeconomic variables, composite indices, and other indicators. Indicators have been carefully selected based on three criteria: relevance, availability, and comparability. As a result, the scoreboard includes well-established indices typically used in the evaluation of structural reforms and public policies, and which are available for all four references ACTs (Egypt, Jordan, Morocco, and Tunisia) and updated periodically (on a yearly basis in most cases). In order to avoid comparability concerns, national statistics and other quantitative data are used in the qualitative assessment but are not part of the indicator scoreboard. Indicators cover both policy output and outcomes. In addition to values for ACTs, the scoreboard provides OECD averages and data from a set of comparator emerging economies from different regions (Malaysia, Mexico, Turkey and Romania) for benchmarking purposes. Depending on the indicator, baseline values will be 2010 or multi-year averages (e.g. 2000-2010).

The use of qualitative indicators is subject to important caveats. First, the indicator scoreboard is just part of the analysis and its results need to be analysed in combination with the qualitative assessment. Second, the Reports refrain from establishing a causal link between the implementation of specific reforms and the evolution of individual indicators. The indicator dashboard is thus used to provide an overall picture of the situation in each ACT and the evolution over time, not to measure the impact of a given reform. When available, data on the actual results of a given policy or reform are presented as part of the qualitative analysis.

Preparation of the Pilot Stocktaking Reports for Egypt

The preparation of the pilot Stocktaking Report for Egypt took place in three stages.

First, the OECD conducted a dialogue missions to Cairo (May 2016) to present the proposed methodology and consult with the authorities regarding the overall approach and scope of the Stocktaking Reports.

Second, fact-finding and data collection were completed through thorough desk research as well as field missions to Cairo, which took place in October/November 2016 and again in December 2017. Table 1, below, provides a list of stakeholders participating in this exercise.

Table 1: List of Co-ordinating institutions and stakeholders who participated in fact-finding missions

EGYPT
Co-ordinating institution: Ministry of Foreign Affairs
Other government stakeholders met: • Ministry of Finance • Ministry of Investment and International Co-operation • General Authority for Investment and Free Zones • Ministry of Planning, Monitoring and Administrative Reform • Ministry of Industry and Trade • Ministry of Social Solidarity • Central Bank of Egypt
Other stakeholders met: • World Bank • African Development Bank

Third, consultations with Egypt and other Stakeholders on the basis of an interim draft took place in February 2017. An executive summary of the report was then presented, reviewed and discussed at a Senior Officials' Meeting of the Deauville Partnership held in Paris on 30 March 2017. Following an updating exercise in 2017 and early 2018, the full version of the report was presented at a Senior Officials Meeting held in June 2018. The report was then finalised after integrating the comments received from Senior Officials.

Annex III. Compact for Economic Governance Indicator Scoreboard

Number	Pillar	Indicator	Type (Outcome / Policy)	Rationale	Source	Frequency and period of reference
1	Economic Policies for Inclusive, Sustainable Growth	**Real GDP growth (percent change)**	O	Basic macroeconomic framework (growth)	IMF World Economic Outlook databases	Annually (2000-2017)
2	Economic Policies for Inclusive, Sustainable Growth	**Inflation (percent change)**	O	Basic macroeconomic framework (price stability)	IMF World Economic Outlook databases	Annually (2000-2017)
3	Economic Policies for Inclusive, Sustainable Growth	**Labour productivity (GDP at PPP exchange rates per employed person; annual growth rate)**	O	Measuring efficiency with which inputs are used to produce goods and services; including absolute levels as well as y-o-y growth	Calculations based on ILO Key Indicators of the Labour Market database; OECD (for OECD average)	Annually (2000-2015)
4	Economic Policies for Inclusive, Sustainable Growth	**Employment-to-population ratio**	O	Basic macroeconomic framework (employment); Measuring share of employment for working age population	ILO Key Indicators of the Labour Market database; OECD (for OECD average)	Annually (2000-2016)
5	Economic Policies for Inclusive, Sustainable Growth	**Total investment/GDP**	O	Measuring gross fixed capital formation (public and private)	IMF World Economic Outlook databases	Annually (2000-2017)
6	Economic Policies for Inclusive, Sustainable Growth	**Current account balance/GDP**	O	Basic macroeconomic framework (current account)	IMF World Economic Outlook databases	Annually (2000-2017)
7	Economic Policies for Inclusive, Sustainable Growth	**General government gross debt/GDP**	O	Basic macroeconomic framework (fiscal); Measuring sustainability of government finances	IMF World Economic Outlook databases	Annually (2000-2017)
8	Economic Policies for Inclusive, Sustainable Growth	**(1) Gini coefficient and (2) poverty headcount ratio at $3.10 a day (2011 PPP) (% of population) (not available for Egypt)**	O	Measuring level of inequality in income distribution and poverty levels	World Bank World Development Indicators	Varying frequency; most recent data ranges between 2007-2012; poverty headcount data not available for Egypt
9	Economic Policies for Inclusive, Sustainable Growth	**CO2 emissions (kg per USD 1,000 of GDP)**	O	Measuring efficiency in terms of energy consumption/environmental sustainability of growth	International Energy Agency	Annually (2000-2013)

10	Economic Policies for Inclusive, Sustainable Growth	**Exports of goods and services/GDP (for all ACTs); TiVA (for Tunisia)**	O	Measuring openness to trade; TiVA can be used in countries where it is available (at present only Tunisia) to measure value addition, participation in GVCs	OECD Trade in Value Added; World Bank World Development Indicators	Annually (2000-2015); Latest TiVA data is from 2011
11	Public Sector Transparency and Efficiency	**Tax revenue/GDP**	O	Measuring resource mobilisation efforts	World Bank World Development Indicators, OECD (for OECD average)	Annually (2000-2014)
12	Public Sector Transparency and Efficiency	**Government expenditure in (1) compensation of employees; and (2) subsidies**	O	Showing relative importance of government expenditures in key dimensions (civil service, subsidies)	IMF Governance Finance Statistics	Annually (2000-2014)
13	Public Sector Transparency and Efficiency	**Transparency International Corruption Perception Index**	O	Widely used composite index measuring corruption perceptions as a proxy for governance standards	Transparency International	Annually (2009-2015)
14	Public Sector Transparency and Efficiency	**Global Open Data Index score**	P	Composite index measuring legal and technical openness of government data	Open Knowledge Open Data Index	Annually (2013-2015)
15	Public Sector Transparency and Efficiency	**Open Budget Index**	P	Composite index measuring transparency in central government budget formulation and execution	International Budget Partnership Open Budget Index	Biennially (2006-2015)
16	Public Sector Transparency and Efficiency	**Worldwide Governance Indicators for (1) Government Effectiveness; (2) Regulatory Quality; and (3) Rule of Law**	P	Composite index measuring key aspects of governance based on various data sources (surveys, international organisations, NGOs)	World Bank's Worldwide Governance Indicators	Annually (2010-2015)
17	Investment Climate and Private Sector Development	**(1) FDI inflows; (2) FDI stocks (% of GDP)**	O	Measuring trends and relative positions regarding foreign direct investment attraction	UNCTAD database	Annually (2000-2014)
18	Investment Climate and Private Sector Development	**New business density (new limited liability firms per 1,000 working-age people)**	O	Measuring LLC incorporations based on business registry data as a proxy for overall entrepreneurial activity/business creation	World Bank's Entrepreneurship Survey database	Annually (2010-2014); not available for Egypt

19	Investment Climate and Private Sector Development	**Domestic credit to private sector/GDP**	O	Measuring depth of credit market for private sector as a proxy for financial sector development	IMF International Financial Statistics	Annually (2010-2015)
20	Investment Climate and Private Sector Development	**Financial inclusion (% of adults with an account at a financial institution)**	O	Measuring financial inclusion amongst the adult population as a proxy for overall access (no comparable data exists for SMEs)	Global Financial Inclusion (Findex) Database	Every three years (2011, 2014)
21	Investment Climate and Private Sector Development	**Resident patent applications per 100 billion USD GDP (2011 PPP)**	O	Measuring patent production relative to the size of the economy as a proxy for innovative activity	WIPO Statistics Database	Annually (2010-2014)
22	Investment Climate and Private Sector Development	**Evaluation of key transition policies: (1) large and small-scale privatisation; (2) Governance and enterprise restructuring; (3) Price liberalisation; (4) Trade & Forex exchange system; and (5) Competition Policy**	P	Measuring progress in areas for a successful transition to a market economy, as evaluated by the EBRD's Chief Economist Office	European bank for Reconstruction and Development (ERBD) Transition Indicator Database	Annually (2012-2014)
23	Investment Climate and Private Sector Development	**FDI Regulatory Restrictiveness Index**	P	Measuring statutory restrictions to FDI across sectors as a proxy for the openness of the FDI policy framework	OECD FDI Regulatory Restrictiveness Index	Annually (2010-2015)
24	Investment Climate and Private Sector Development	**Global Entrepreneurship Monitor (Average National Expert Survey scores of entrepreneurial ecosystem and total early-stage entrepreneurial activity) (only for Tunisia, Egypt, Morocco)**	P/O	Measuring (a) the strength of the overall environment for entrepreneurship (including several key variables); and (b) actual entrepreneurial activity based on survey data	Global Entrepreneurship Monitor	Every 2/3 years for National Expert Survey (2010, 2012, 2015); only 2015 for adult population survey on entrepreneurial activity; GEM data not available for Jordan

25	Investment Climate and Private Sector Development	**World Bank Doing Business Distance to Frontier**	P	Measuring performance in World Bank Doing Business dimension as a proxy for the overall business regulatory environment; distance to frontier measures absolute performance over time	World Bank DB, distance to frontier	Annually (2010-2016)
26	Investment Climate and Private Sector Development	**Average trade facilitation performance**	P	Measuring the policy framework for trade facilitation	OECD Trade Facilitation Indicators	Every 2/3 years (only 2015 data is available for ACTs)
27	Investment Climate and Private Sector Development	**Logistics Performance Index (overall score)**	P	Measuring performance in trade logistics	World Bank Logistics Performance Index	Biennially (2007-2016)
28	Inclusive Decision-Making	**Youth unemployment rate**	O	Measuring youth labour market outcomes	ILO Key Indicators of the Labour Market database; OECD (for OECD average)	Annually (2000-2016)
29	Inclusive Decision-Making	**Gender labour participation gap**	O	Measuring gender labour market outcomes	ILO Key Indicators of the Labour Market database; OECD (for OECD average)	Annually (2000-2016)
30	Inclusive Decision-Making	**Worldwide Governance Indicator for Voice and Accountability**	P	Composite index measuring strength of voice & accountability mechanisms based on various data sources (surveys, international organisations, NGOs); used to evaluate mechanisms for public participation in policy-making	World Bank's Worldwide Governance Indicators	Annually (2010-2015)
31	Inclusive Decision-Making	**Proportion of parliamentary seats held by women**	P	Proxy for women participation in policy-making	Inter-Parliamentary Union, OECD Gender Data Portal	Annually (2010-2017)
32	Inclusive Decision-Making	**Commonwealth Youth Development Index indicator for political participation**	P/O	Composite index measuring different aspects of youth political engagement, including policy inputs (policy framework) and outcomes (voter education and youth voice)	Commonwealth Youth Development Index	Every 2-3 years (2013, 2016)

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