Integrated national financing framework

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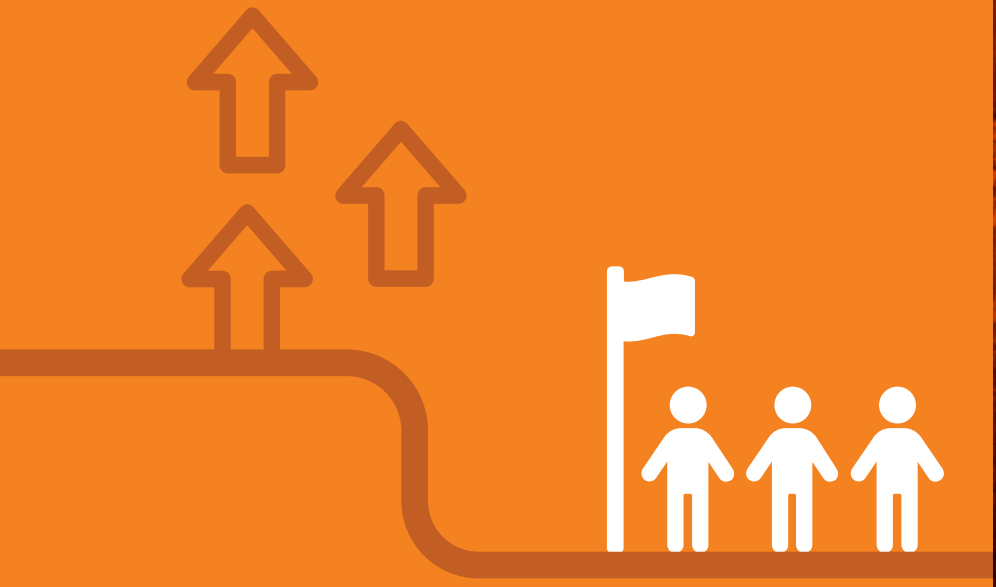

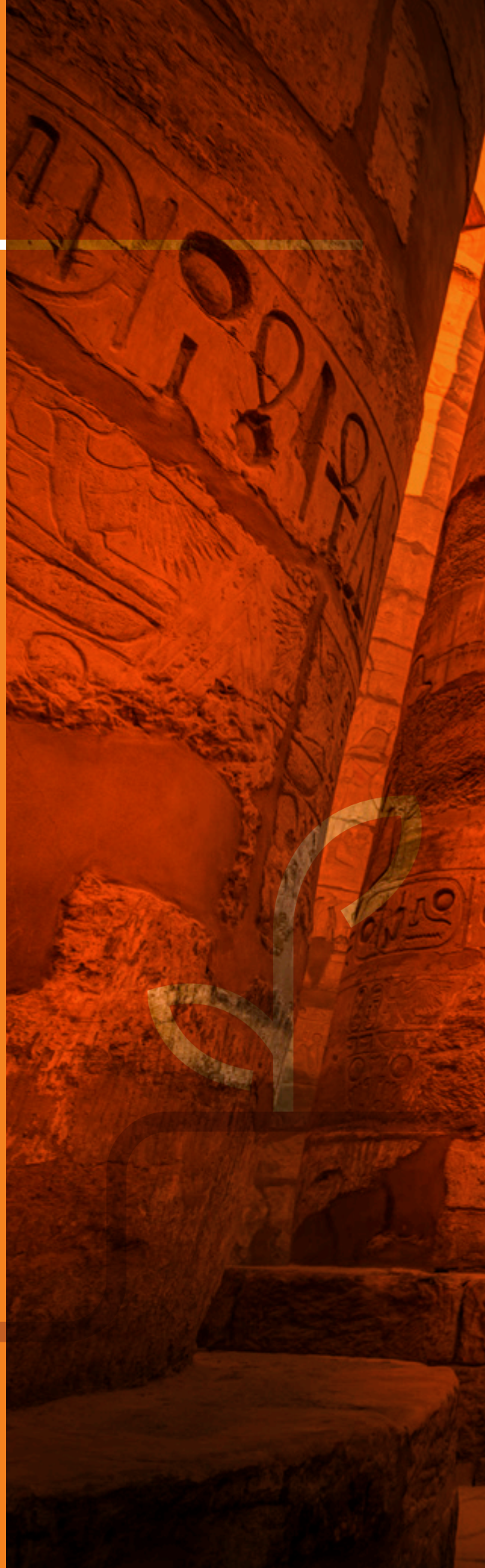

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Background

Achieving the SDGs at the country level depends largely on the ability to harness different sources of financing, whether private or public, through domestic or external flows. Countries with significant gaps in terms of achieving the SDGs are expected to simultaneously increase the volume of financial flows and enhance their diversity. Fortunately, countries are now facing a financing for development (FFD) landscape that is more diversified and therefore offers various financing opportunities. Nevertheless, it is also becoming clear that the global financing agenda for the SDGs will not be sufficient to meet the growing challenges. This is particularly true given the significant economic scarring from the COVID-19 pandemic and its medium- to long-term impact on indebtedness. As a result, countries must inevitably rely on home-grown solutions as 2030 approaches.

The objective of this chapter is to contribute to the development of an integrated national financing framework (INFF) for Egypt. The framework is useful in assessing the financing challenges and opportunities regarding the achievement of the SDGs, and it is being increasingly adopted by developing and emerging economies. It is fundamentally a tool to gauge the adequacy of the scale and mix of current FFD flow in terms of achieving the SDGs. The framework is composed of four building blocks: assessment, financing strategy, monitoring and governance. It also studies the role of government policies and institutional design in addressing financing challenges, which allows for the identification of gaps and missed opportunities. This information can be utilized to leverage new flows, scale up existing ones and change the mix of flows to deliver better outcomes. It is an integral component of a holistic, results-driven framework to measure progress towards the SDGs.

At the core of the INFF is the development finance assessment (DFA), which is considered the first building block. It provides a quantitative and qualitative assessment of the current flows and the ability of the Government's financing strategy to identify potential risks and highlight sustainability concerns. In other words, the DFA is the diagnostic component of the INFF. Based on the DFA, a more policy- and action-oriented assessment is undertaken to identify priority flows and discuss the options by which policy and institutional reforms can strengthen the existing financing framework. The DFA and subsequent policy assessment are undertaken in sections B and C, respectively, of this chapter. Section A provides a brief overview of the recent progress made by Egypt on various socioeconomic indicators with direct links to the SDGs and discusses the pillars of the country's long-term development strategy. Subsequent chapters in the report delve deeper into the assessment and diagnostics of each financial flow, with more specific policy assessments and recommendations.

While this chapter focuses on assessing the financing landscape in Egypt and provides potential policy solutions, it is worth emphasizing that a comprehensive INFF goes beyond the analytical framework. It requires government-led policymaking that articulates a clear financing strategy to match national developmental objectives, as well as institutionalization efforts that establish relevant mechanisms for coordination, monitoring and governance. In fact, in March 2021, the Government of Egypt, represented by the Ministry of Planning and Economic Development, signed a cooperation protocol with the Joint Sustainable Development Goals Fund to assess the financing needed to meet its developmental objectives.[2] In that respect, this chapter acts as a supportive analytical guide and will serve as a solid foundational base in establishing a comprehensive INFF for Egypt, together with the results of the United Nations Joint Fund Support Project for Integrated Financing for Sustainable Development Goals in Egypt and the Guiding Principles for Sustainable Finance,[3] recently published by CBE.

A. The integrated national financing framework in the context of national development objectives

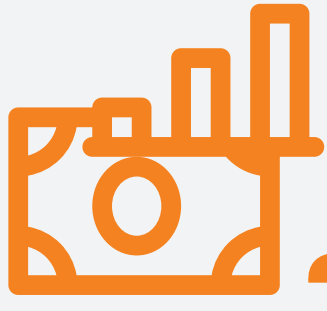
1. The socioeconomic-environmental context

The Egyptian economy enjoys a number of strengths that position it to make substantial progress towards the SDGs. The country has significant growth potential, given its diversified economy and industrial base, abundant labour and decent reservoir of natural resources, coupled with its enhanced infrastructure and strategic location. Furthermore, the Government has secured many bilateral and multilateral agreements on investment and trade, and recent policy reforms have attracted the attention of investors.

The economy enjoyed high growth rates from 2006 to 2020, with an average growth rate of 2.4 per cent in GDP per capita.[4] The period 2011–2016 witnessed a slowdown in growth; however, an expansionary fiscal policy stance helped to revive growth and generate employment for entrants to the labour force, an average of approximately 470,000 per year, according to the CAPMAS Labour Force Survey. Between 2005 and 2019, the economy witnessed increased diversification in its production base and an enhanced use of factors of production. In the previous five years, the economy also saw a significant upgrade in infrastructure, particularly in the energy sector, which currently enjoys excess capacity and an improved energy mix. The share of renewable energy production reached 8.8 per cent in 2018/19, up from 5 per cent in 2015. It is targeted to reach 20 per cent by 2022, as several large solar and wind energy projects go fully online.[5] The unemployment rate has fluctuated with the business cycle but has generally been on the decline since 2013. It remained in single digits during the pandemic, reaching 7.2 per cent in the fourth quarter of 2020.

Overall, growth was not inclusive, as evidenced by the increase in inequality and the persistent urban-rural development divide (Goal 10). With regard to the labour market, the female labour force participation rate remains extremely low, female youth unemployment (20–29 age group) remains exceptionally high and general policy frameworks are not gender sensitive (Goal 5). The economy's limited dynamism did not enable the creation of sustainable decent jobs in high productivity sectors, and informal employment has increased as a share of total employment over the past few years (Goal 8). In addition, decades of cheap non-renewable energy prices (Goal 7) have helped to create and sustain energy-intensive industries (e.g. steel, cement and fertilizers), in which Egypt does not necessarily have a competitive advantage. These industries also did not help to create decent jobs (Goal 8) at a rate that kept pace with growth in the population and the labour force (Goals 1 and 2). Furthermore, they did not contribute positively to the country's environmental progress (Goals 12 and 13).

The economy enjoyed high growth rates from 2006 to 2020



2.4%

average GDP per capita

In some measure, underlying structural challenges can account for the fact that some socioeconomic-environmental outcomes with direct relevance to the SDGs did not fare better with economic growth. First, the pace and direction of the structural transformation were not conducive to inclusive growth, as it was largely driven by an expansion in factors of production (labour and capital) rather than increases in productivity. Furthermore, the contribution of labour reallocation across sectors to overall productivity growth was negative over the period 2000–2010, indicating that more labour moved into low productivity sectors.[6] Currently, three sectors (agriculture, construction and public services) in which productivity is significantly below average employ approximately two thirds of the labour force.[7]

Second, there is a low rate of manufacturing value added per capita and little technological upgrading in industrial output (Goal 9). Manufacturing value added per capita currently stands at $480, compared to an average of $807.50 in lower-middle-income economies.[8] Non-oil manufacturing value added as a per cent of GDP dropped to 11.7 per cent in 2019/20 after witnessing marginal progress; it had increased from 12 per cent in 2015/16 to 12.7 per cent in 2017/18.[9] While it could be argued that Egypt shows symptoms of premature deindustrialization, the country's labour and natural resource endowments still offer strategic advantages that can be utilized with supporting policies. Limited efforts in technological upgrading are reflected in the meagre share that medium- and high-tech exports hold of the country's total exports.

Third, the Egyptian economy lags behind in trade openness, which stands at 43.3 per cent of GDP, compared to an average of 54.5 per cent in lower-middle-income economies.[10] There is broad consensus that trade openness offers a window of opportunity for making significant progress on many of the SDGs.[11] The low degree of economic openness in Egypt reflects protectionist tendencies that still persist in some sectors. Chapter 9 assesses the country's trade portfolio and policies in detail and discusses trade as a potential engine for growth.

The aforementioned structural impediments are not all a product of circumstance. Policy decisions over the previous decades have been a contributing factor. These structural challenges deepened over time as a result of rigidity and informality in labour markets, occasionally inconsistent macroeconomic policies, administrative pricing, lax competition policy frameworks, overly protective trade policies and a lack of sufficient financing for the private sector. In addition, Egypt could not adequately capitalize on opportunities offered by the ICT revolution and the growing importance of global value chains. Both were drivers of growth and development in other developing countries in the last 30 years.[12]

With enhanced policy frameworks, some of these structural impediments are currently being addressed. The first phase of the National Program for Economic and Social Reform (2016–2019) is credited with increasing growth and employment, containing inflation after the flotation of the exchange rate and making progress in fiscal consolidation. The upcoming second phase of the programme, announced by the Ministry of Planning and Economic Development in 2021, focuses on structural reforms to improve the business environment and boost competitiveness. It also focuses on manufacturing, ICT and agriculture, given their high potential for growth and added value, their relative weight in the GDP and their forward and backward linkages. These new policy frameworks are coupled with reforms in the tax collection system, with a view to broadening the tax base without increasing the tax burden by promoting digitization, removing inefficiencies and formalizing the informal economy.

Notwithstanding this ambitious policy agenda, further work is needed to unleash the necessary dynamism for inclusive and

sustainable growth and to ensure the optimal use of available resources. Higher productivity gains are necessary for the Egyptian economy to achieve the higher growth rates needed to meet socioeconomic challenges. Technological upgrading and an effective national innovation system are central to realizing these productivity gains.

2. Pillars of the long-term development strategy in Egypt

Egypt Vision 2030 is the national document outlining the sustainable development strategy along economic, social and environmental dimensions. The plan provides policies and programmes, along with indicators for monitoring, which align with achieving the SDGs.

Taking into account existing challenges and potential opportunities, the development strategy is centred on creating a path for inclusive growth to meet the needs of a growing population with a youth bulge, as Egypt completes its demographic transition. This requires addressing existing challenges such as upgrading the infrastructure, investing in affordable housing and mitigating the impact of water scarcity. In addition, to capitalize on the potential provided by a growing population, a national plan for overhauling the education system has been enacted.

Inclusive growth requires a stronger focus on the quality of growth to ensure that it is driven by productivity enhancements and positive structural transformation. As a result, education reform and targeted programmes for retraining and reskilling the labour force are a fundamental pillar in the country's long-term success in meeting the SDGs. Fostering innovation and technological upgrading both in production and exports is essential for making gains and achieving deeper global integration.

Also central to the achievement of this ambitious vision is collaboration among the Government, the private sector and civil society. Stakeholder engagement is crucial to the success of the development strategy. Accordingly, section C explores the integration of different types of financial flows from the Government, the private sector and civil society, in addition to donor support.

B. Development finance assessment

The DFA is an analytical mapping tool for studying financial flows in the economy with the intention of capturing trends, identifying gaps and highlighting sustainability concerns. It also identifies missed opportunities to leverage particular FFD flows and, therefore, forms an integral component of the INFF. The methodology is outlined in the UNDP Development Finance Assessment Guidebook.[13]

The DFA distinguishes financial flows along two dimensions: private versus public flows and domestic versus external flows, with public-private finance as a cross-cutting flow (table 5). Private flows comprise various forms of domestic and foreign private investment, as well as non-commercial private flows through non-governmental organizations (NGOs), philanthropy and remittances. On the other hand, public flows pertain to the Government's capacity to raise funds domestically through tax revenues and borrowing, in addition to external support provided through official development assistance (ODA), South-South cooperation and climate financing. It is worth noting that some of the categories of funding straddle the classification boundaries of table 5. For instance, NGO flows can be both domestic and external, and public borrowing can be from either domestic or foreign institutions.

Table 5. Types of financing for development flows

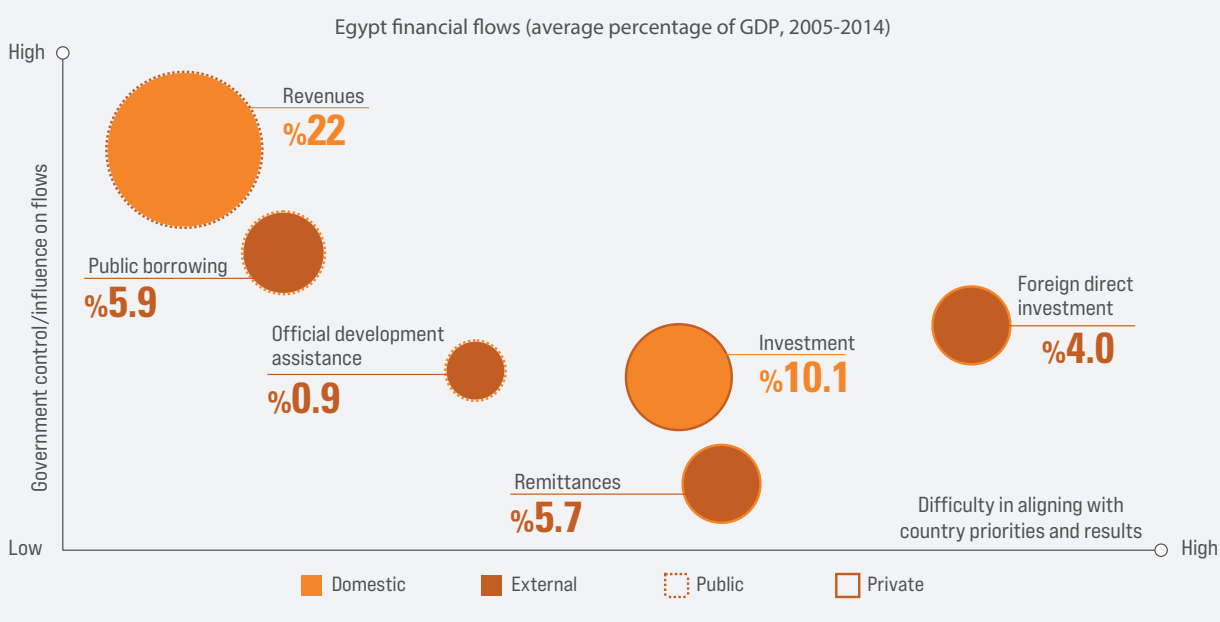
	Private		Public
Domestic	• Commercial: private investment, corporate bonds, credit to private sector. • Non-commercial: foundations and non-governmental organizations.	Public-private flows such as public-private partnerships and blended finance structures	• Government revenue (tax/non-tax) • Public entities' revenues • Public borrowing
External	• Commercial: foreign direct investment (FDI), portfolio investments. • Non-commercial: remittances.		• Official development assistance (grants and loans) • South-South cooperation • Climate finance

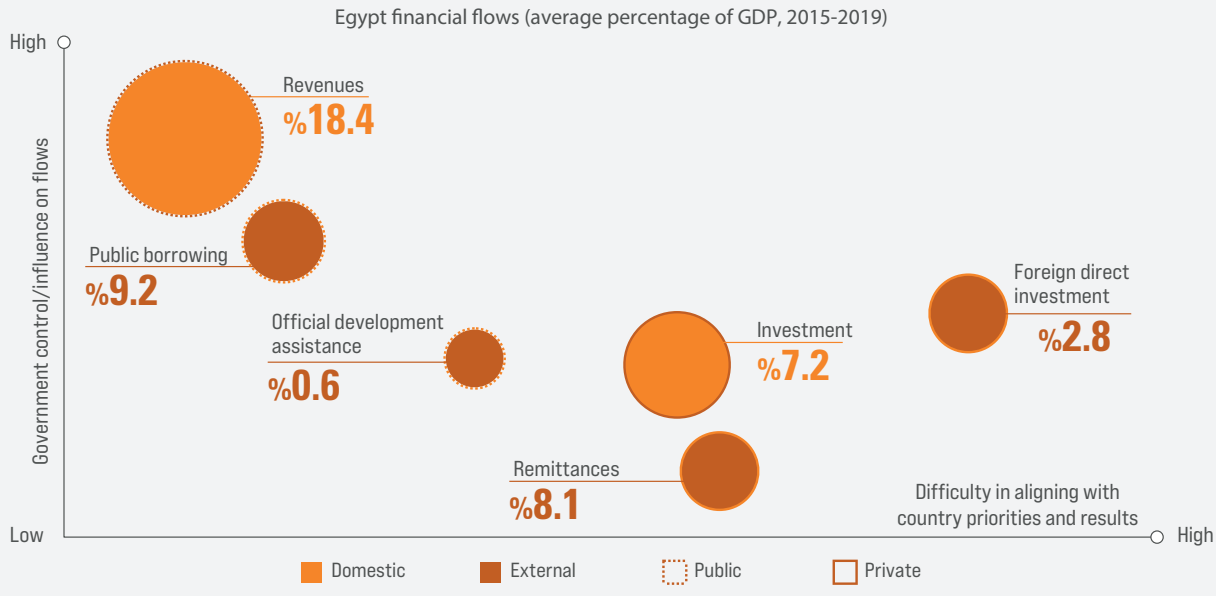
Source: Authors.

The focus of the DFA is to undertake a mapping of these flows to identify persistent gaps and missed opportunities. Figure 21 shows an initial mapping of some of these flows along three dimensions: (i) relative weight with respect to total FFD flows (bubble size in the chart), (ii) the Government's ability to control or influence these flows, and (iii) the ease with which these flows can be aligned to the country's development priorities.[14]

Figure 21 shows that government revenue and public borrowing are both under the control of government policy and can be deployed to spending programmes that are easily aligned with development objectives. This is in contrast to domestic private investment, remittance and FDI. During the periods 2005–2014 and 2015–2019, government revenue represented the main source of financing, although there was a significant drop during the latter period. While domestic private investment was the second largest source of financing during the period 2005–2014, it retreated to the fourth place in recent years, during which government borrowing and remittances increased in relative importance. Both FDI and ODA saw a decline from 2015 to 2019, compared to the earlier period.

Figure 21. Financing for development flows – mapping for Egypt





Source: Authors, using data from the Ministry of Finance of Egypt, the CBE and the World Bank World Development Indicators Database.

These flows are intricately linked to other economic developments, particularly in relation to the fiscal stance and the financing of trade and current account deficits. They also relate to the private sector's willingness and ability to channel investment flows into the economy, which partially depends on the existence and outlook of any internal and external macroeconomic imbalances, as well as the overall regulatory environment and institutional framework governing business investment. These interlinkages are further discussed in section D.

1. Mapping of financial flows for development

The development of domestic public flows related primarily to government tax and non-tax revenues is examined in relation to the overall fiscal policy stance in order to gauge the extent of reliance on public borrowing as a complementary resource to government revenues. Figure 22 shows that government revenues have stagnated in the range of 18 to 19 per cent of GDP since 2011, with tax revenue comprising over two thirds of total revenue. This range is distinctly lower than the average revenue over the period 2007–2010, which was 24 per cent of GDP. On the expenditure side, government spending witnessed an increase from 2012 to 2014 as a countercyclical measure to revive growth rates, which had plummeted since 2011. As a result, the government budget deficit increased to reach a high of 12.8 per cent in 2013. The fiscal stimulus helped to revive the economy but required an increase in public borrowing. As a result, domestic debt increased significantly, from 73.9 per cent in 2012 to 96.7 per cent in 2016, before retreating. Nevertheless, total debt was well on the rise due to an increased reliance on external borrowing since 2017.

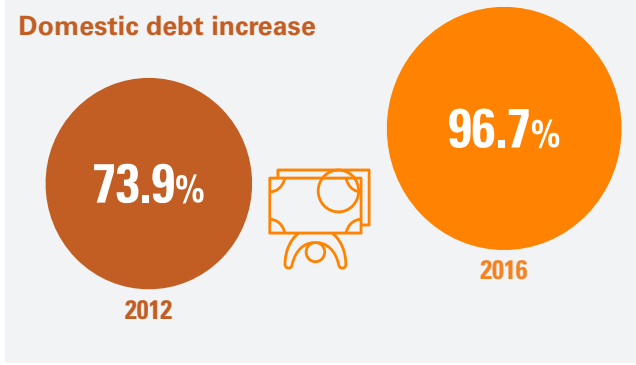
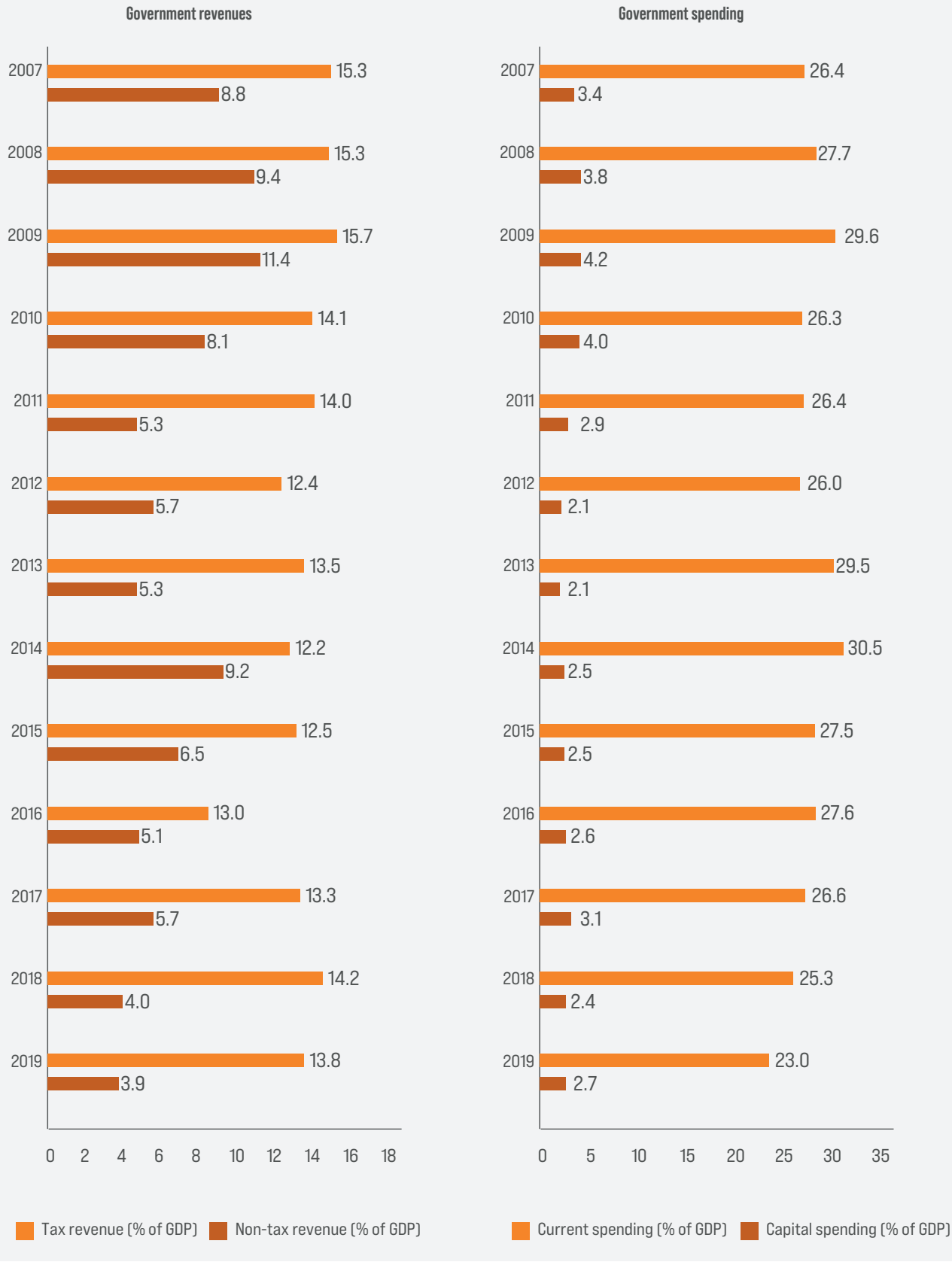
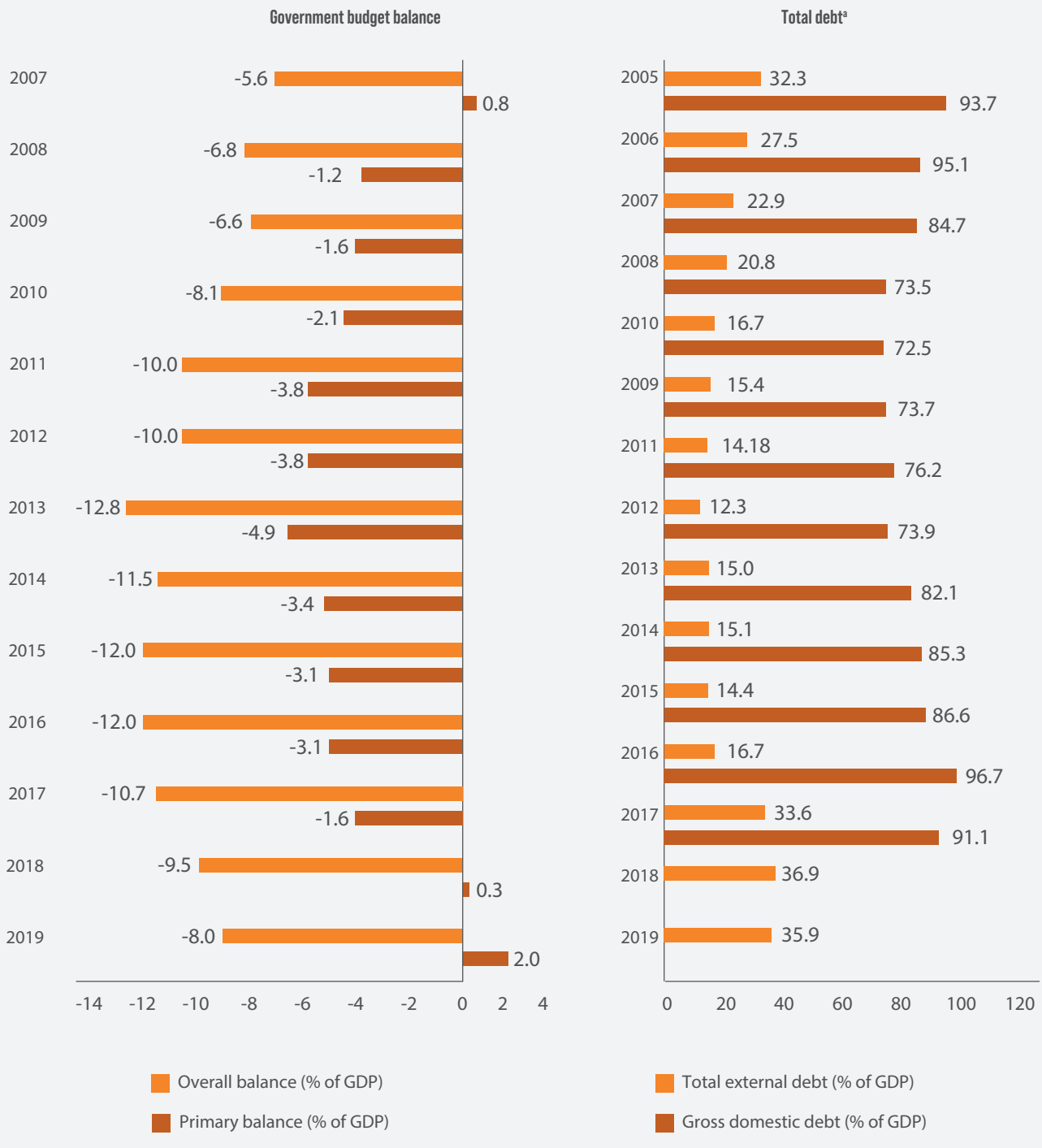


Figure 22. Domestic public flows and the fiscal policy stance





Source: Authors, using data from the Ministry of Finance of Egypt, the CBE and the World Bank World Development Indicators Database, accessed October 2020.

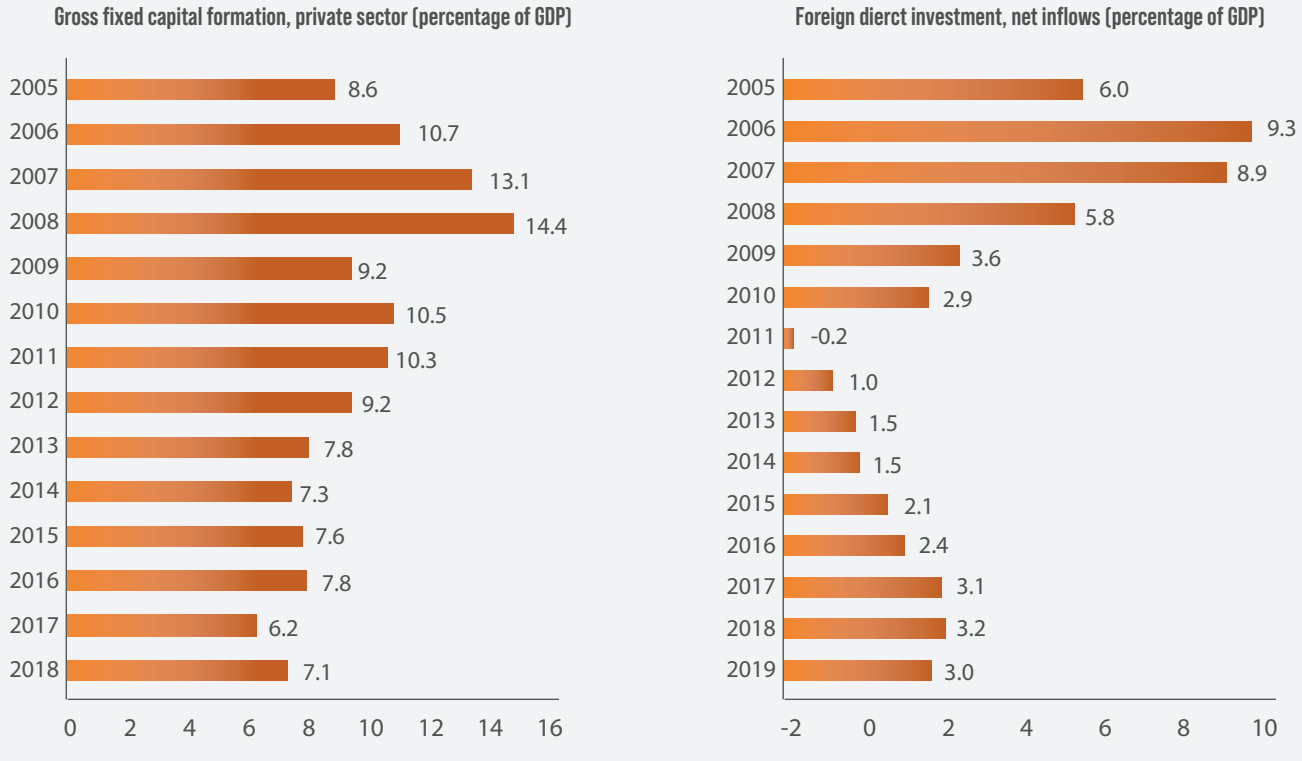
a Data for gross domestic debt was unavailable for 2018 and 2019.

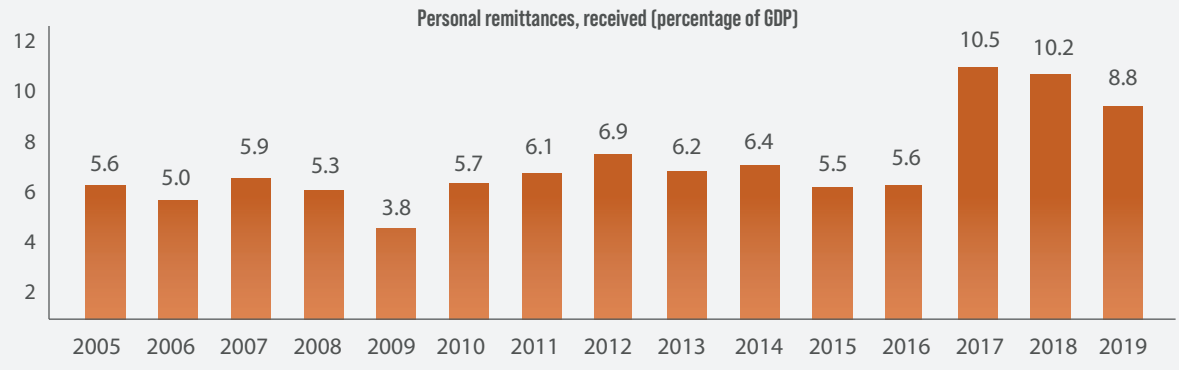
In 2016, amid significant pressure on the exchange rate, the Government signed an Extended Fund Facility with the IMF. It included an ambitious programme of economic reforms centred on two main pillars for macroeconomic policy: the flotation of the exchange rate and fiscal consolidation to achieve a primary surplus in the government budget. This resulted in a gradual decline in the overall deficit.

Concomitantly with the increase in the government budget deficit, domestic private flows in the form of private investments witnessed a notable retraction. As seen in figure 23, the decrease in private investment began in 2008 in the aftermath of the global financial crisis, followed by a partial rebound in 2009 and 2010. From 2011 to 2013, the decline in private investments accelerated, largely owing to the political turmoil in Egypt and the region. From 2014, domestic private investments have remained low, owing to a number of interconnected factors. It began with deteriorating domestic business activity due to a shortage of foreign exchange, coupled with increased uncertainty about the future of the exchange rate parity. After the flotation, and in response to a strong surge in inflation, CBE hiked interest rates by 7 per cent, which increased borrowing costs for businesses.

> From 2014, domestic private investments have remained low, owing to a number of interconnected factors.

Figure 23. Private sector flows





Source: Authors, using data from the CBE and the World Bank World Development Indicators Database, accessed October 2020.

External private flows in the form of FDI also declined sharply in 2011 and then began to recover gradually; however, FDI levels currently stand at approximately 3 per cent of GDP. This remains below the impressive levels achieved before the 2008 financial crisis, when it reached a record high of 9.3 per cent in 2006. Over the same period, particularly since 2017, remittances have come to play an increasingly important role as a flow of private funds. They made up an average of 9.8 per cent of GDP from 2017 to 2019.

It is instructive to study the mapping of financial flows with regard to the following key macroeconomic identity: S – I = CAB, where S and I denote domestic savings and investment, respectively, and CAB denotes the current account balance. This identity highlights the dynamics of investment flows in relation to domestic savings and their impact on national external accounts, which facilitates an assessment of external sustainability. To incorporate the fiscal stance into the analysis, the savings-investment (SI) balance can be further broken down as follows:

(Sp – Ip) + (Sg – Ig) = CAB

where (Sp – Ip) and (Sg – Ig) denote private and government SI balances, respectively.

As shown in figure 24, the government SI balance was consistently negative, increasing in line with the budget deficit from 2011. This development weighed heavily on the overall SI balance and the current account deficit. This was particularly the case during 2014/15 and 2015/16, which also saw a smaller surplus in the private SI balance. Egypt has been in this "twin deficits" predicament since 2007/08, with both the government budget and the current account recording large deficits. The current account deficit may also be reflective of other factors, such as demographic changes and trade developments.[15]

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3%
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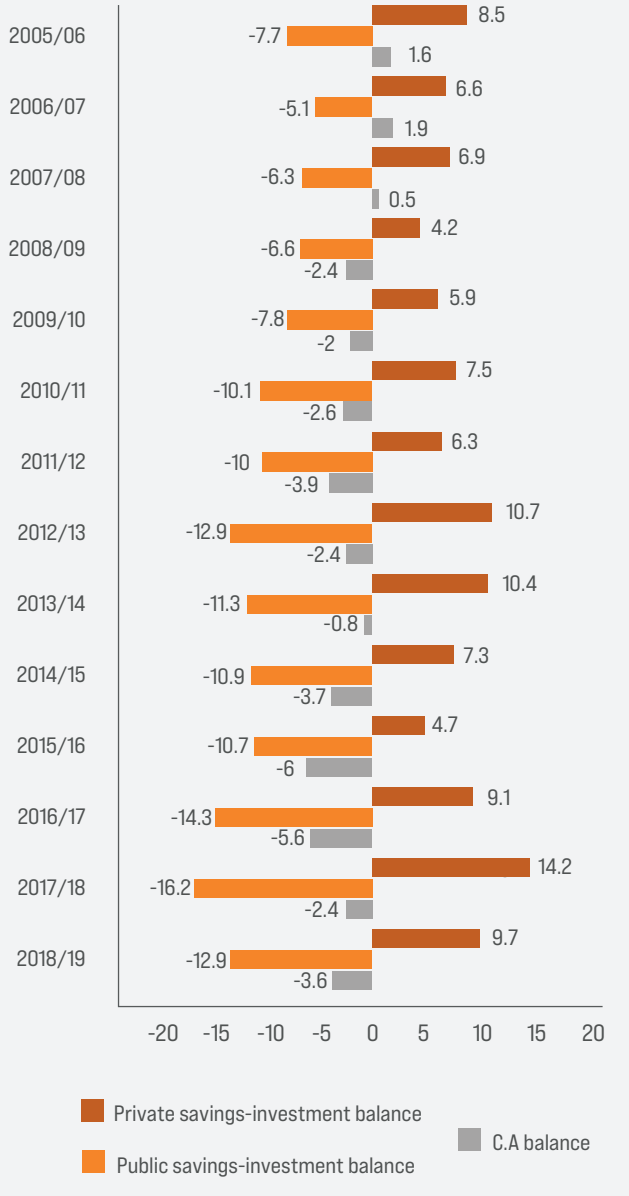
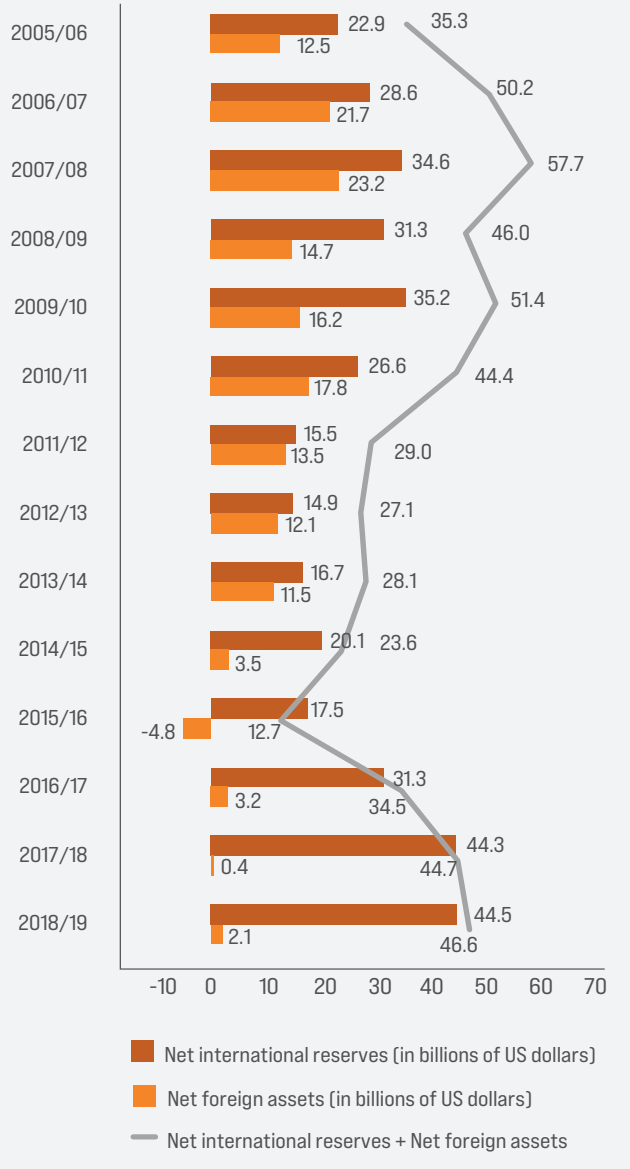
Figure 24. Emerging twin deficit dynamics



Source: Authors, based on IMF country reports for Egypt.

Figure 25. Net international reserves and net foreign assets of commercial banks



Source: Authors, based on the Central Bank of Egypt reports on the external position of the Egyptian economy (2005/06 to 2019/20).

The emergence of a persistent current account deficit since 2007/08 requires financing on the capital and financial account side of the balance of payments. During the period 2008–2010, the economy relied on FDI to close the bulk of the funding gap (figure 23). The remainder was financed by drawing down international reserves and the net foreign assets of the banking sector (figure 25). While the latter remain at low levels, CBE managed to shore up international reserves despite the persistent current account deficit by resorting to alternative means of financing, with increased reliance on portfolio inflows and external borrowing in recent years. The moderate increase in FDI since 2017 was not sufficient to finance the current account deficit induced by a large government SI gap.

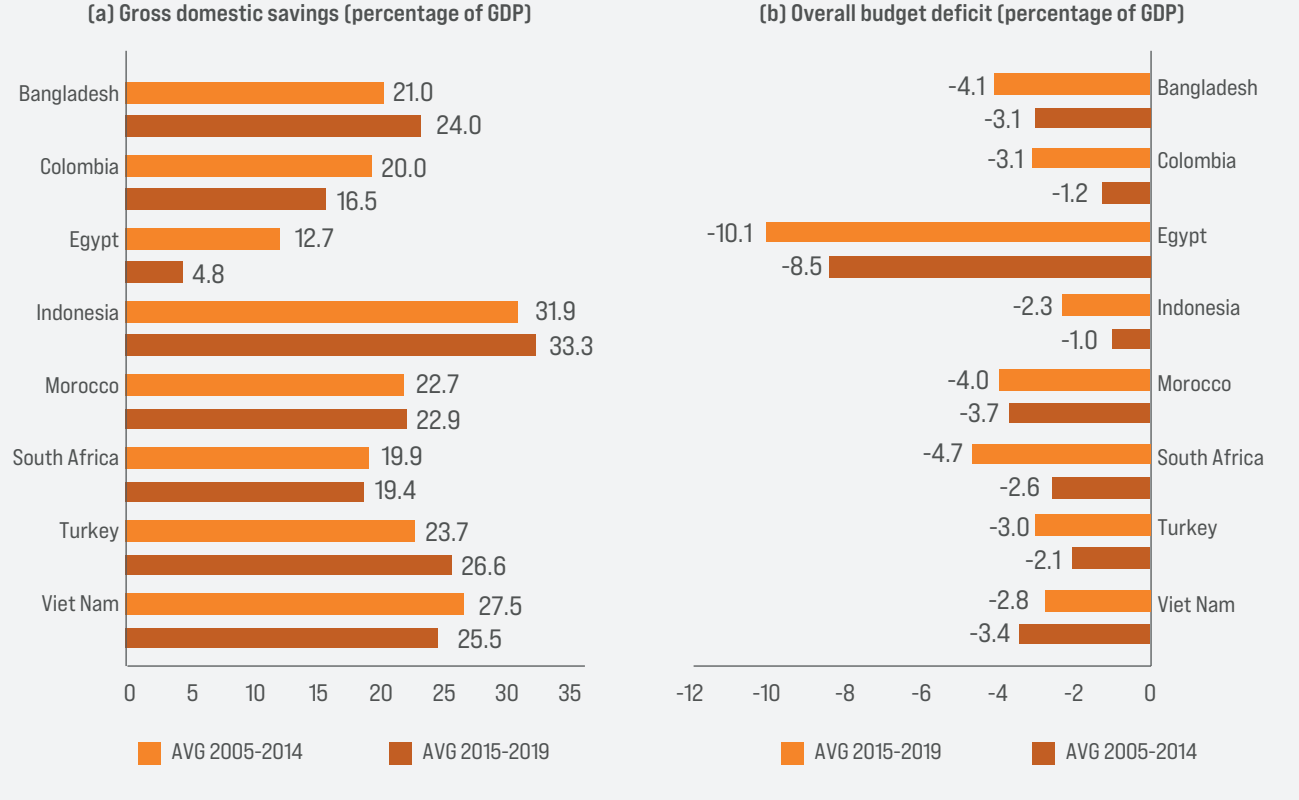
It is worth noting that while the COVID-19 pandemic caused considerable disruptions to the external environment, the pandemic itself did not create a new situation for Egypt but rather served to aggravate the macrofiscal challenges that the country was already attempting to overcome. Projections in section 4 elaborate on this point.

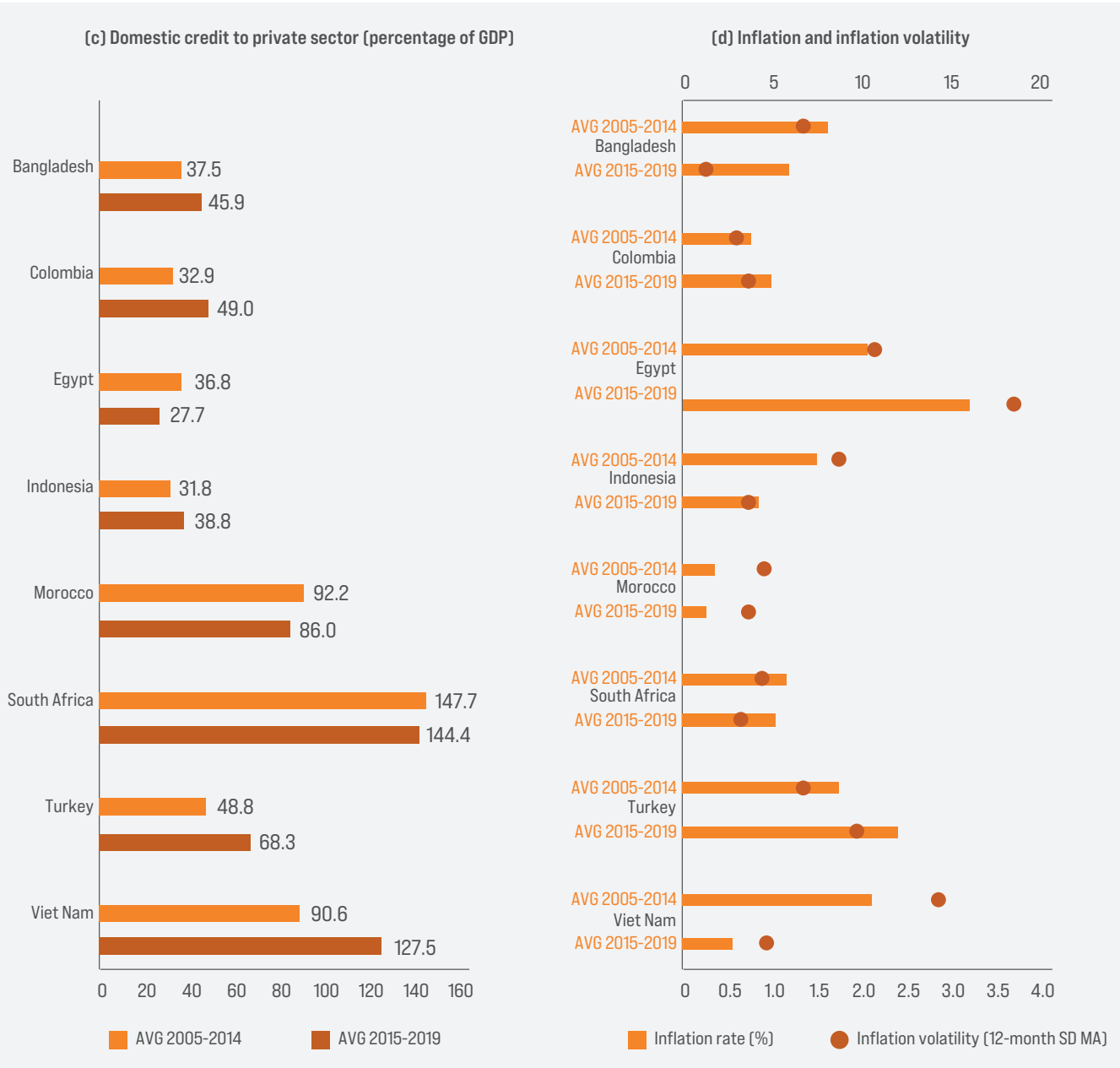
2. Identified shortfalls

To better understand the mapping of FFD flows, it is also instructive to understand national private and public flows in a comparative context, measuring them against peer economies that share similarities. The comparator group includes Bangladesh, Colombia, Indonesia, Morocco, South Africa, Turkey and Viet Nam.[16]

Figure 26 shows the comparative position of Egypt on economic indicators that have direct and indirect effects on FFD flows. The national gross domestic savings rate, at 4.8 per cent of GDP during the period 2015–2019, is quite low in comparison. It also witnessed a marked decline compared to the period 2005–2014. This largely reflects the increase in the fiscal deficit over the more recent period. Despite impressive fiscal consolidation efforts in recent years, Egypt still runs an excessive fiscal deficit, which averaged 10.1 per cent of GDP during the period 2015–2019. The deficit level is more than double that in comparators. With more historical perspective, the country's fiscal deficit was quite high during the period 2005–2014 as well. Even with zero fiscal deficit during these two periods, which would boost gross domestic savings by the magnitude of fiscal savings, the savings rate for Egypt would still appear modest in comparison, especially during the latter period. Helmy shows that household saving behaviour in Egypt depends on income distribution and the degree of access to financial services.[17]

Figure 26. Country comparison: savings, fiscal deficit, private sector credit and inflation





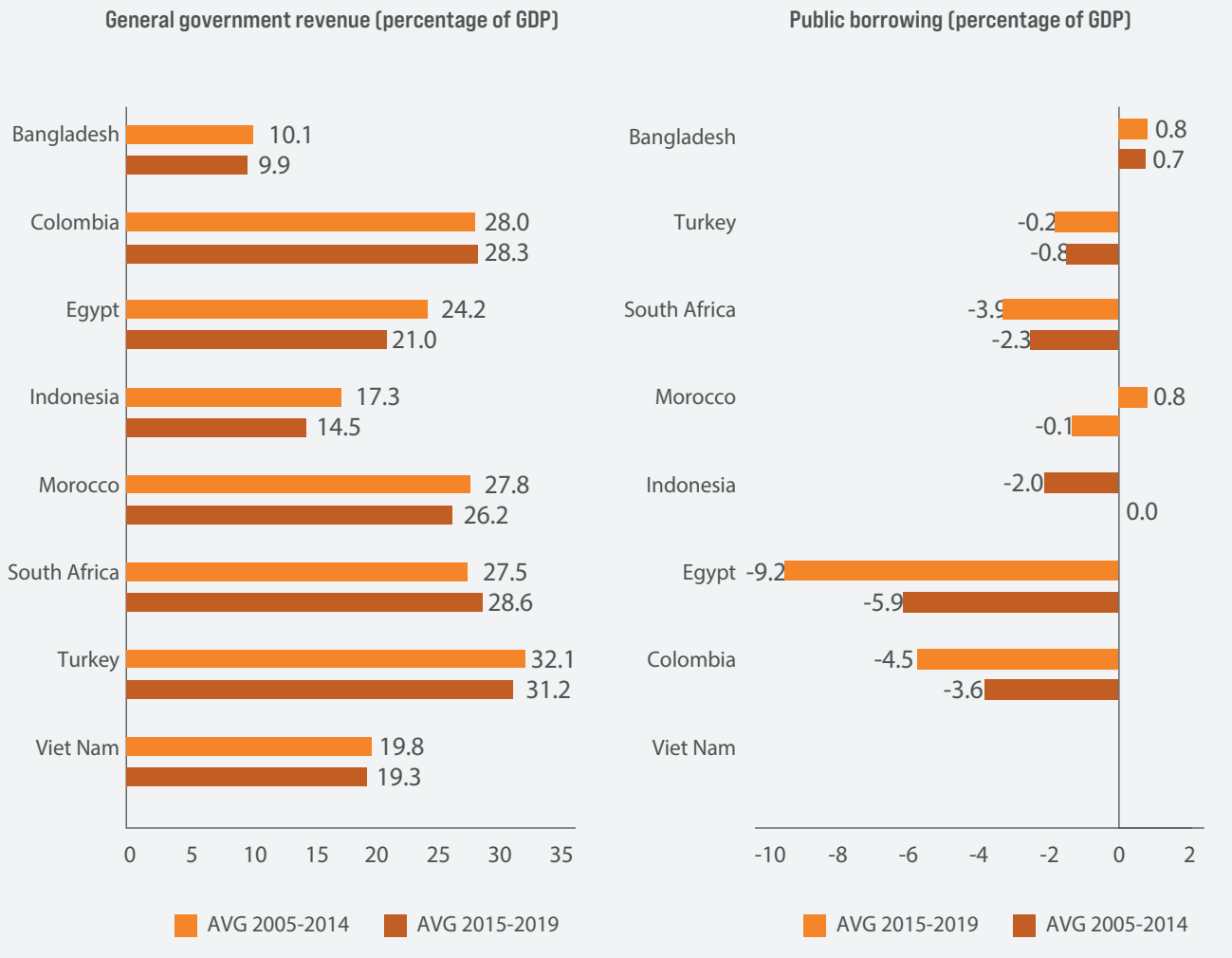
Source: Authors, based on the World Bank World Development Indicators Database, accessed October 2020.

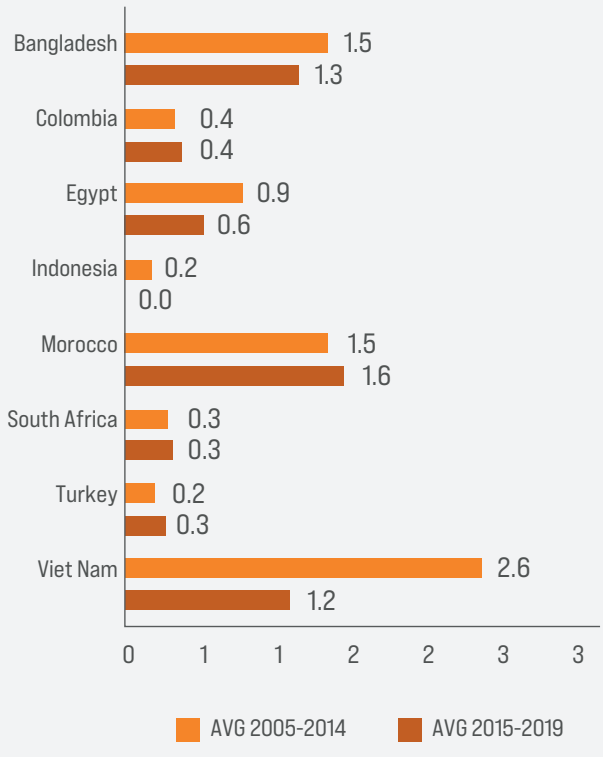
There was also a heavy reliance on the domestic banking sector to finance the deficit, which naturally decreased the pool of credit available to the private sector. While Egypt fared better on this indicator during 2005–2014, as is shown in figure 26 (c), access to credit deteriorated during the period 2015–2019, in line with the increase in the fiscal deficit. To a large extent, this underlies the decline in private sector investments (figure 23). High inflation has a detrimental effect on the investment rate and on growth in general.[18] Egypt witnessed elevated levels of inflation relative to its peers and a notable increase in inflation volatility for the period 2015–2019, primarily owing to a surge in inflation after the flotation of the exchange rate in late 2016. Periods of high inflation in Egypt were associated with increases in relative price variability and inflation uncertainty, both of which hurt long-term growth.[19] The most recent data show that CBE was

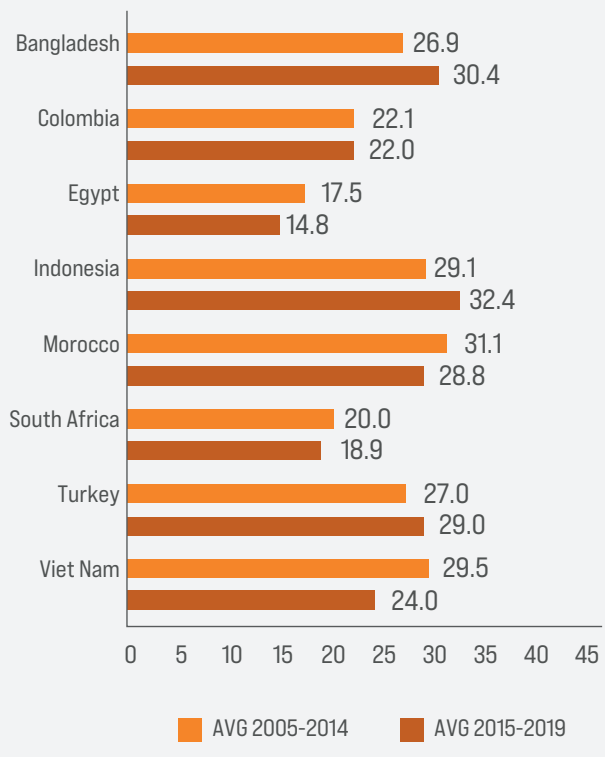
successful in curbing inflation, with headline rates holding steady at an average of only 5 per cent throughout 2020 and in the first nine months of 2021, which is particularly commendable given the pandemic challenges.

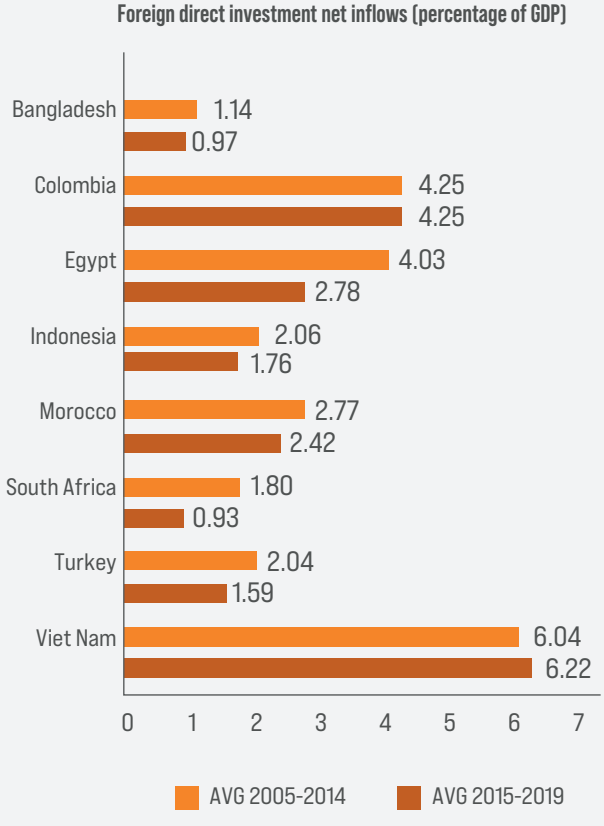
Figure 27 plots the comparative levels of the most significant FFD flows. Government revenue compares favourably to Bangladesh and Indonesia and is slightly higher than that of Viet Nam; however, it is lower than the other comparators by some margin. At the same time, the intensity of government spending exceeds that of comparators, resulting in higher fiscal deficits and elevated levels of public borrowing. As indicated earlier, private investments in Egypt are significantly lower than in comparator countries, partially as a result of the business environment, as discussed in section C.1. On the other hand, Egypt fares well in attracting FDI when compared to most comparators, except for Colombia and Viet Nam. Nevertheless, FDI inflows tend to be concentrated in the mining and real estate sectors, including oil and gas, which limits the potential for creating decent high productivity jobs.

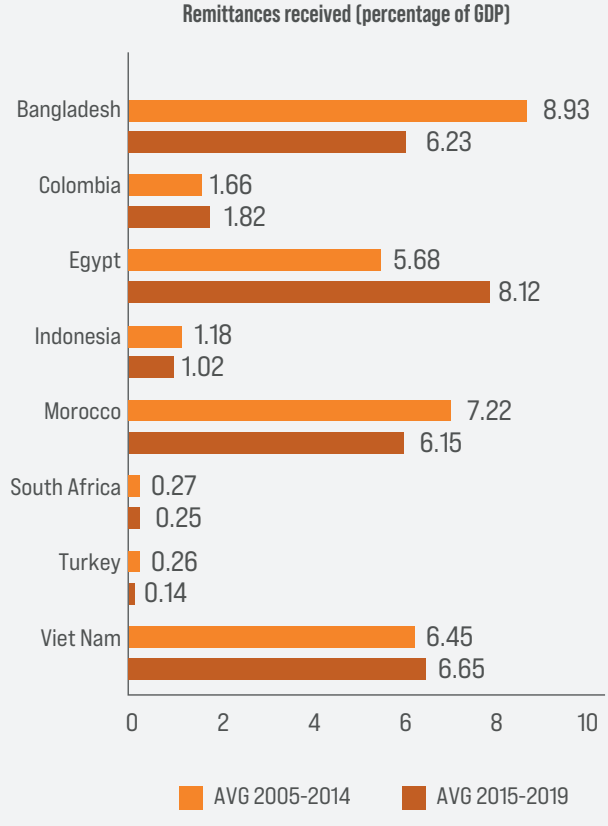
Figure 27. Country comparison: financial flows for development











Source: Authors, based on the World Bank World Development Indicators Database, accessed October 2020.

Remittances have historically played an important role as a private external flow in Egypt and constitute a significant source of foreign exchange receipts in the current account. In this respect, Egypt resembles Bangladesh, Morocco and Viet Nam. The importance of remittances increased during the period 2015–2019. It is conjectured that this increase was largely driven by the significant inflationary wave in 2017 (after the flotation of the exchange rate), which prompted Egyptian workers abroad to provide increased support to families and dependents as a cushion against inflation. ODA represented 0.6 per cent of GDP on average during the period 2015–2019, slightly lower than the 0.9 per cent recorded during the period 2005–2014. This places Egypt behind Bangladesh, Morocco and Viet Nam, but not significantly.

(a) The impact of identified gaps on the Sustainable Development Goals

Considering both the historical developments and the position of Egypt relative to its peers, a number of shortfalls can be identified. First, the twin deficit dynamic in recent years has increased reliance on foreign borrowing, since FDI and portfolio inflows were insufficient to finance the current account deficit. In particular, dependence on portfolio inflows as a source of foreign financing is problematic, given the tendency for sudden stops and reversals due to uncontrollable global factors. Not only does this create an external vulnerability, it also constitutes a weakness in the county's current FFD framework that needs to be addressed.

Second, on the fiscal side, government borrowing has increased as a result of low levels of government revenues. In addition, the current composition of government spending shows the majority of expenditures going to debt service (i.e. interest expense and repayment of principal). This leaves little room for spending on programmes with a direct impact on the SDGs, such as education, health, climate action and scientific research. The current achievement of a primary surplus in the fiscal accounts is praiseworthy, but it is not enough. Improvements on the revenue side are needed over the medium and long term. Chapter 4 discusses the country's government budget design and priorities at length.

Third, insufficient private investment by domestic and foreign investors stalls positive structural transformation in the economy and negatively affects the diffusion of modern technologies and the ability to integrate into global value chains. It also impacts the economy's dynamism and capacity to create decent high productivity jobs.

Fourth, the economy's increased reliance on remittances in recent years must also be revisited. While many developing countries rely on remittances as an important source of foreign financing, Egypt seems to have developed an excessive reliance during the period 2015–2019. It is also important to study the determinants of workers' remittance flows to Egypt and their sensitivity to factors beyond the country's control. For instance, it is important to project how remittance flows will be impacted by the secular decline in oil prices or recent changes in tax policy in some of the Gulf economies. The same applies to the potential impact of the COVID-19 shock on future remittances.

Remittances remained comparatively robust

8.1%
of GDP from 2015 to 2019

5.7%
of GDP from 2005 to 2014

Fifth, while there are no data on other sources of funding such as climate financing, philanthropy and South-South cooperation, their level is likely low in comparison to other FFD flows. Moving forward, it is important to leverage these sources to address some of the country's present challenges, such as water scarcity and the impact of climate change, and to enable the economy to bridge the gap in the respective SDGs.

3. Priority flows

In light of the previous discussion, the fiscal side is a good starting point for streamlining the composition of FFD flows and harnessing their potential to improve SDG outcomes. Enhancing the Government's capacity to raise tax revenue is key in this respect. This should be implemented with a view to enhancing revenue collection without increasing the tax burden, as well as possibly redistributing the tax burden across income strata by introducing more progressivity in the tax structure. Positive steps have already been taken in this direction with a new income tax law in 2020, which increases the tax exemption limit, reduces the tax burden for the majority of lower-income brackets and increases the tax rate on the highest bracket. In light of ongoing efforts to formalize the informal sector, this policy must balance advantages and disadvantages in order to incentivize informal establishments to join the formal sector. Another important element is to balance tax and non-tax sources of revenue and assess policy measures that help to increase private savings in the long term.

On the expenditure side, a two-pronged approach is needed. On the one hand, there is a need to rationalize some forms of spending. By increasing revenues and reducing expenditures, fiscal consolidation will reduce the budget deficit, which increases the overall level of national savings and avoids the current crowding out of the private sector. On the other hand, reduced government expenditures call for a reprioritization of spending, with the aim of expanding and strengthening social safety nets and enhancing the potential for future growth. The latter requires targeted spending programmes in health, education, infrastructure and innovation.

Increased fiscal consolidation provides the Government with sufficient fiscal space to address potential crisis situations that may have an abrupt negative impact on the SDGs. The COVID-19 crisis is one such example. The expected costs of climate change for Egypt are another important consideration. Furthermore, enhanced fiscal space reduces the cost of government borrowing (via a premium effect) by improving the path to public debt sustainability. Chapter 8 focuses on the country's debt sustainability and develops SDG-focused, scenario-based projections.

Another priority flow is that of private investment from both the domestic private sector and FDI. Increased fiscal consolidation creates more room for private sector growth. Reprioritized spending may also crowd in the private sector if a comprehensive public-private partnership approach is adopted. This provides more space for the private sector to participate and increases the availability of funds, since the lower budget deficit reduces the need for borrowing. In parallel, immediate and significant reforms in the business environment are needed to ensure that the private sector adequately participates in economic activity. A discussion of these reforms is presented in section 4.

One FFD flow holds particular promise in the case of Egypt: public-private partnerships in areas such as education, health and infrastructure. While there are currently no comprehensive data on existing partnership arrangements or projects in the pipeline, it remains relatively scant.

Lastly, climate finance is another nascent flow that Egypt can capitalize on to achieve the respective SDGs. It is expected to become a sizable flow internationally, with a number of donors and international financial institutions targeting green financing. At the same time, there is a strong

corporate drive towards environmental, social and governance investing, by which investment funds are allocated to companies and projects that are environmentally friendly and sustainable and promote good governance. Initial steps have already been taken. The Government of Egypt issued its first sovereign green bonds in September 2020, which will partly finance green projects on renewable energy and clean transport.[20]

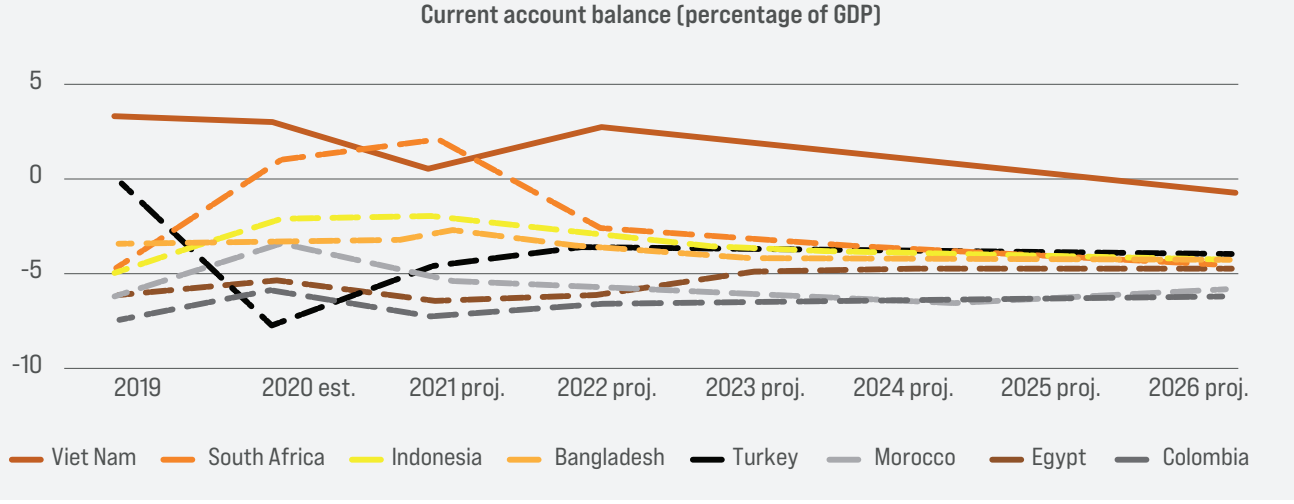
4. Projections for priority flows under a no-change scenario

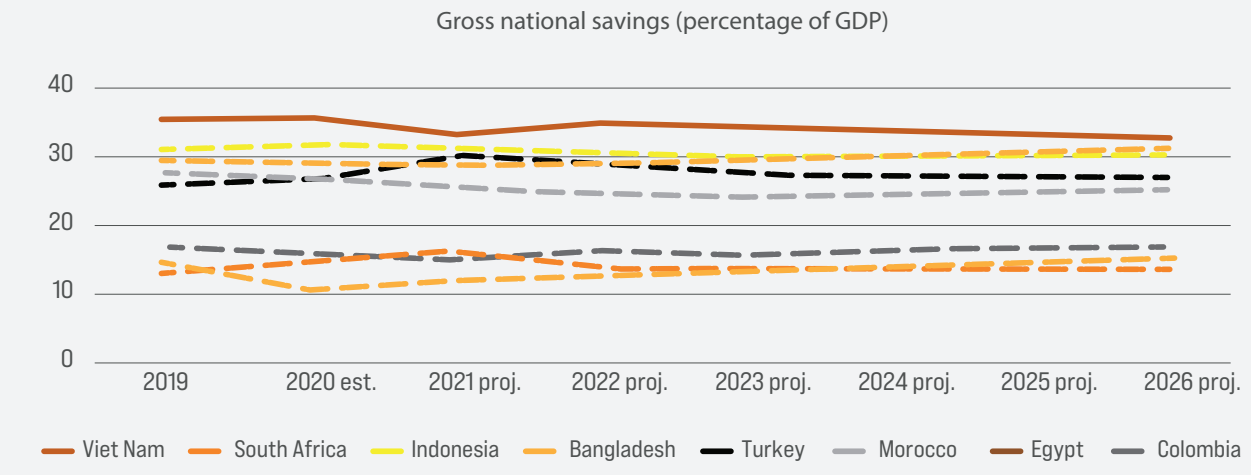
It is also important to consider the near-term outlook for Egypt with respect to some of the main FFD flows and the key macroeconomic variables influencing them. These include the current account balance, gross national savings, total investment and the evolution of debt. The assessment is conducted using the available IMF five-year projections from October 2021 for Egypt and its comparators. It is worth noting that these projections are drafted based on the plausible assumption that there are no fundamental policy changes or structural shifts in the economy under consideration. As shown in figure 28, the four tracked indicators display a favourable trend over the projection period. Given the growth projections for Egypt and the current stance

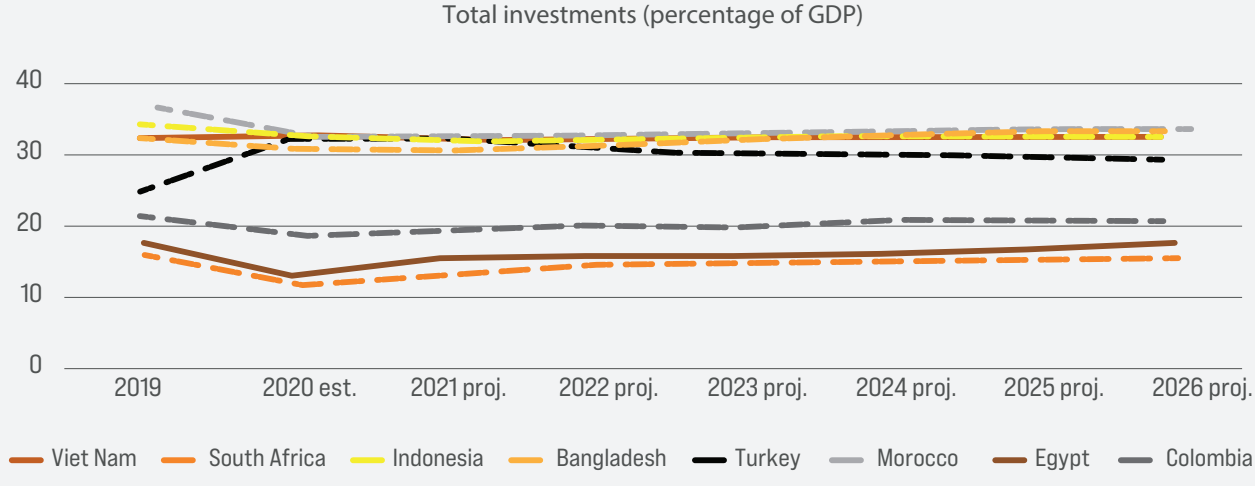
“The Government of Egypt issued its first sovereign green bonds in September 2020, which will partly finance green projects on renewable energy and clean transport.

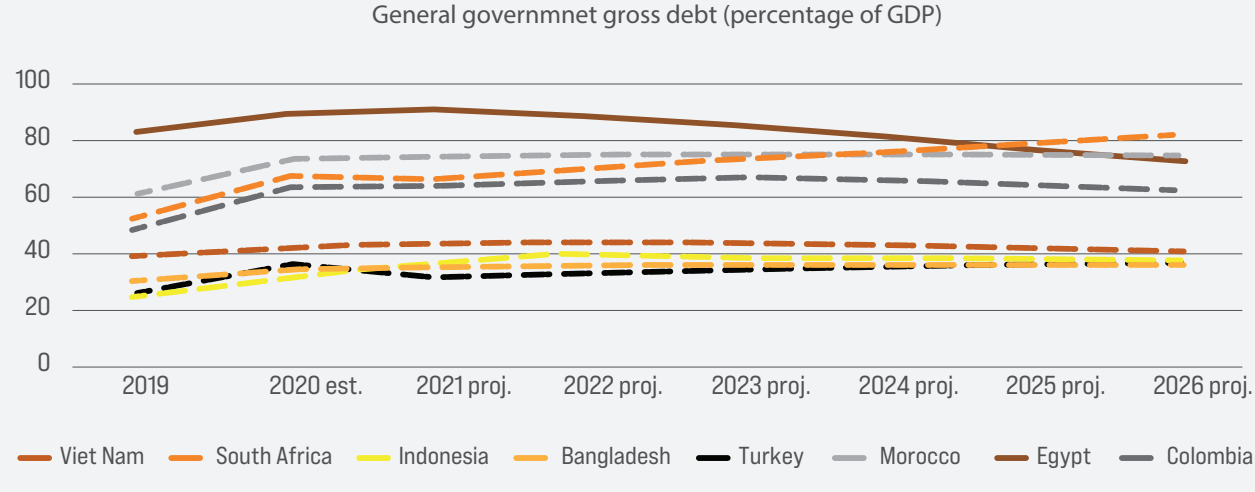
of fiscal consolidation, gross national savings are projected to rise slightly to reach 14.7 per cent of GDP in 2025. Nevertheless, it is worth noting that this is a downward revision from the IMF projections of October 2020, which had projected a savings rate of 19.1 per cent in 2025. Table 6 shows the revision of the projections for Egypt as the economic repercussions of the pandemic became clearer. Total investments are also projected to increase at a comparable pace, which stabilizes the current account deficit at 2.5 per cent of GDP by 2023 and beyond. Debt levels as a percentage of GDP are also expected to decline as a result of the primary surplus and favourable projections for the real interest rate in relation to GDP growth.

Figure 28. Country comparison – projections









Source: IMF, 2021. World Economic Outlook: Recovery During a Pandemic – Health Concerns, Supply Disruptions, and Price Pressures, October.

On the whole, the outlook points to improvement over the medium term; however, there are groundbreaking changes in the trends and overall compositions of FFD flows. As can also be seen in figure 28, the comparative position of Egypt improves only marginally. The country continues to lag behind in terms of both savings and investments, and its current account deficit and debt levels remain high in comparison to its peers. As a result, the no-policy-change scenario is likely to be unfavourable with respect to SDG outcomes.

Table 6. Egypt's revised projections

Percentage of GDP	October 2020 for 2025	October2021 for 2025
Total investments	21.780	17.28
Gross national savings	19.128	14.70
Current account deficit	2.651	2.58
General government gross debt	77.018	78.20

Source: IMF, 2021. World Economic Outlook: Recovery During a Pandemic – Health Concerns, Supply Disruptions, and Price Pressures, October. IMF, 2020. World Economic Outlook: A Long and Difficult Ascent, October.

C. Gap analysis and options for policy and institutional reforms

1. Gap analysis based on policy benchmark indicators

Significant FFD flows such as private domestic and foreign investment are sensitive to the policy environment and the institutional set-up in the host economy. The indicators in figure 29 show that Egypt has made considerable progress to close the gap with its peer group, although some areas still lag behind. With regard to the Ease of Doing Business scores in panel (a), there is room for improvement in three areas: enforcing contracts, trading across borders and paying taxes.[21] In terms of governance, as per the Worldwide Governance Indicators shown in panel (b), Egypt would benefit from further improvement in regulatory quality and voice and accountability. It is worth noting that Egypt and its peers have significant room for improvement relative to the frontier.

Figure 29. Gap analysis

Source: Authors, using data from the World Bank, the World Economic Forum and UNCTAD.

With regard to competitiveness indicators, such as the World Economic Forum Competitiveness Index in panel (c), Egypt made significant strides to close the gap with peer economies in areas such as infrastructure, institutions, financial market development and goods market efficiency. It still lags behind in higher education and training, labour market efficiency and technological readiness. One area deserving further attention is the macroeconomic environment. Nevertheless, it should be noted that the data in the chart are rather dated and there has been evidence of improvement on that front in subsequent years.

Chapter 6 elaborates further on the role of the business sector in FFD and the various challenges faced by businesses in Egypt, but the productive capacities indicators highlight the structural issues mentioned earlier in section B.2. The UNCTAD Productive Capacities Index, shown in panel (d), demonstrates that Egypt is comparatively close to its peer group averages but continues to lag behind the frontier considerably in a number of areas, including the accessibility and integration of ICTs, institutional and regulatory quality, and structural change (which refers to the movement of productive resources such as labour from low productivity to high productivity economic activities). Although Egypt also lags behind in transport, there will likely be some improvement moving forward; other transport infrastructure-related indicators have shown notable improvement since 2018, especially on road quality and connectivity.[22]

2. Gap analysis vis-à-vis national development objectives and spending priorities

In April 2018, the Government of Egypt asked the Parliament to ratify the official year-one plan of the four-year Medium-Term Sustainable Development Plan (2018/19 to 2021/22). Since then, the annual plans outline spending priorities for each fiscal year, broken down by sector and location, to meet the Government's medium-term development objectives. They include a brief on the expected macrofiscal balance for each year. The larger four-year plan included the broader development and financial targets for the year 2021/22. In inspecting both the four-year plan and the detailed annual plans, two key gap areas are continually problematic.

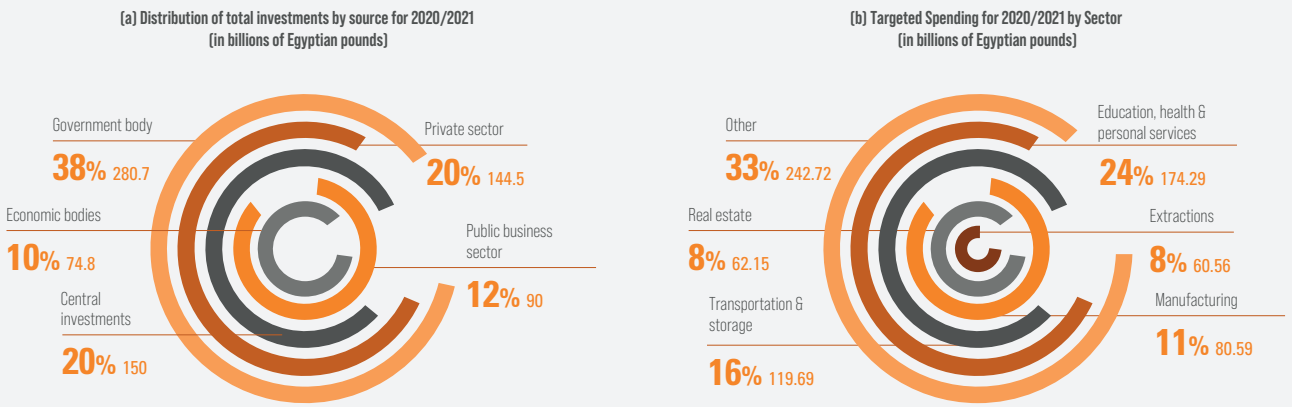
First, the four-year plan establishes ambitious fiscal and financial targets, even after considering setbacks as a result of the COVID-19 pandemic. These include a gross domestic savings rate of 22 per cent of GDP (the estimate for 2019/20 is 6.7 per cent), a domestic investment rate of almost 25 per cent (the estimate for 2019/20 is

> Reprioritized spending may crowd in the private sector if a comprehensive public-private partnership approach is adopted

14.1 per cent), a net FDI inflow of $14 billion (the actual amount for 2018/19 was $9 billion) and an overall budget deficit of less than 5 per cent. The plan does not explain the process by which these targets will be achieved.[23]

Conversely, the plan sets a meagre target for the private sector's contribution to total investment spending,[24] reaching 57.3 per cent by the last year of the four-year period. This contribution appears to decrease yearly. The target for private sector investment spending was set at 56 per cent and 54.6 per cent in 2018/19 and 2019/20, respectively, and reached a low of 19.5 per cent in 2020/21.[25] Figure 30 (a) shows the disproportionately high reliance on public investments, which is understandable to some extent, given the unusual burden that COVID-19 exerted on the private sector for the fiscal year 2020/21. Nevertheless, the relatively low contribution of the private sector seems to place a large burden on public flows, especially when considering that total revenues, which are the biggest source of public flows, have witnessed a decline over the past five years. Furthermore, priority spending sectors can easily allow for private sector contributions. For example, figure 30 (b) shows that after education, health care and personal services, priority spending for 2020/21 is in the transport and storage infrastructure sector. Even after factoring out the Suez Canal and other primarily public investments, private investments can still contribute more than the allocated 7.8 per cent,[26] whether in the form of public-private partnerships or other contracts.

Figure 30. Public spending and investment plan, 2020/21



Source: Ministry of Planning and Economic Development, Egypt (2020). Third Year Plan 2020/21 of the Medium-term Sustainable Development Plan 2018/19–2021/22.

Nevertheless, the plans could be transformed into comprehensive medium-term expenditure frameworks that utilize forecasting models to assess the availability of total resources and financial flows. The findings could then be translated into allocations for spending, allowing for improved linkages between national development commitments and funding and spending priorities.

D. Conclusion and policy recommendations

According to the UNDP Development Finance Assessment Guidebook 3.0, the process of operationalizing an INFF comprises three phases: inception, development and ongoing operations. With the DFA as the prime diagnostic tool, this chapter analyses various financial flows and presents broad recommendations based on identified gaps, with a view to supporting Egypt in the INFF inception phase. To that end, this chapter should not be read in isolation, as subsequent chapters in the report provide more detailed diagnostics on the key financial flows mentioned in table 5, focusing on their sustainability and connection to the SDGs. Government revenues are addressed in chapter 4, domestic and foreign commercial private investments in chapters 6 and 7, public borrowing in chapter 8 and external public flows in chapter 12.

Consequently, a road map for a comprehensive INFF for Egypt (i.e. the development phase) should be laid out utilizing the report in its entirety, along with further diagnostics as required. Creating this road map is first and foremost a government-led task that entails a dialogue with financing and governance partners and stakeholders. It also entails instituting monitoring and evaluation mechanisms that feed back into revisions of the road map to facilitate its operationalization.

Although challenging, it could be exceptionally useful to repeat the diagnostic exercise in this chapter on a governorate level. The trend to localize development is on the rise internationally. Several countries, including India, Thailand and the United Republic of Tanzania, have conducted the DFA on a subnational level. This practice is also on the rise in Egypt; recent published reports assess the state of

> The road map for the INFF is first and foremost a government-led task that entails a dialogue with financing and governance partners and stakeholders."

the SDGs in each governorate in an attempt to map localized development needs. An in-depth analysis can be found in chapter 11. This will then result in a stronger tool during the ongoing implementation of the INFF, which, alongside the monitoring and evaluation mechanisms, could help to ensure the efficacy of the INFF and a more equitable distribution of development.

Given the discussion presented in this chapter, the following policy recommendations can be proposed:

1. Reprioritize spending to adopt a comprehensive public-private partnership approach, especially in development priorities, such as education, health care and infrastructure, which could contribute to crowding in the private sector, provide more space for participation and increase the availability of funds.

2. Reduce the reliance on foreign borrowing and volatile external inflows such as portfolio investments to address the twin deficit dynamic. They constitute an external vulnerability and are subject to shocks, as observed globally during the pandemic.

3. Complete the INFF by activating its third and fourth building blocks (monitoring and review, and governance and coordination, respectively). They should be geared towards (i) reassessing national developmental objectives, (ii) increasing coherence across public and private financing policies, and (iii) improving collaboration among actors in each area of financing.

4. Continue the recent path of fiscal consolidation by (i) enhancing the capacity to raise tax revenue without increasing the tax burden, (ii) redirecting public spending to match developmental objectives without crowding out the private sector, and (iii) assessing policy measures that help increase private savings in the long run.

5. Leverage and provide data on other sources of funding, including climate financing, South-South cooperation and philanthropy, to assist in bridging the financing gap for specific SDG-related challenges such as the impact of climate change and water scarcity. A noteworthy first step in this direction for Egypt was the first issuance of sovereign green bonds in September 2020.

Endnotes

1. The views expressed herein are those of the author and should not be attributed to the International Monetary Fund, its Executive Board or management.
2. The United Nations Joint Fund Support Project for Integrated Financing for Sustainable Development Goals in Egypt will be developed in cooperation with United Nations agencies in Egypt, including UNDP, UNICEF, UN-Women, ILO and UNCTAD. It will focus on key sectors, namely social protection, health, education, water, sanitation and transport.
3. Published on 18 July 2021 and intended to be the foundational framework for sustainable finance in Egypt.
4. World Bank, 2021b.
5. According to the Egyptian New and Renewable Energy Authority.
6. Morsy and others, 2015.
7. These sectors naturally have low potential for technology absorption and diffusion and rarely attract high-skilled labour, contributing to their low productivity and expected growth.
8. Calculated from the World Bank 2019 World Development Indicators Database, accessed February 2021.
9. Ministry of Planning and Economic Development, Egypt, 2021.
10. Trade openness is gauged by the sum of exports and imports as a percentage of GDP. Calculated using trade data from the United Nations Comtrade Database.
11. While inconclusive, empirical evidence tends to suggest that economic openness has a positive impact on growth performance. The impact appears to differ with the degree of economic development (Kim and Lin, 2009) and may be non-linear and subject to threshold effects (Zahonogo, 2016).
12. Dahlman, 2007.
13. UNDP, 2020b.
14. While the size of each bubble accurately reflects the average annual flow for each category over the indicated period, its position is arbitrary and reflects a judgment concerning the extent of government control over the respective flows and the ease with which it can be aligned with development objectives. This has been guided by UNDP (UNDP, 2016).
15. Chinn and Prasad 2003; Devadas and Loayza 2018.
16. Peer economies have been chosen based on comparability in the following parameters: population, size and structure of the economy and per capita income levels. In addition, these economies do not have rich endowments of energy resources. It is worth noting that the majority of the countries are upper-middle-income economies, whereas Egypt is a lower-middle-income country. The rationale for comparison here is partly aspirational and aims to benchmark against high performing economies sharing the country's development trajectory.
17. Helmy, 2015.
18. Barro, 2013.
19. Noureldin, 2009.
20. Ministry of Planning and Economic Development, Egypt, 2021.
21. The authors are aware of the reservations surrounding potential data irregularities in the Doing Business report. It is therefore presented here as one of several international indicators for the purpose of benchmarking and should be interpreted with caution.
22. For example, see the subindices under the infrastructure pillar of the Global Competitiveness Index, such as road connection, quality of road and transport infrastructure.
23. Ministry of Planning and Economic Development, Egypt, 2018b, p. 72.
24. It is worth mentioning that the plans seem to indicate that all investment (i.e. capital) spending is considered development spending.
25. See the Ministry of Planning and Economic Development annual sustainable development plans, chapter 3.
26. Ministry of Planning and Economic Development, Egypt, 2020, p. 299.