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European Commission
Directorate-General for Economic and Financial Affairs

Making Egypt's Post-COVID Growth Path More Sustainable

By Uwe Böwer

Abstract

Just when Egypt had achieved a hard-earned economic stabilisation and was on track towards more sustainable growth, COVID-19 threw the country back into stabilisation mode. Building on the economy's strengthened fundamentals, swift government intervention helped mitigate the pandemic's economic fallout, seeing the economy through the storm with resilience. However, Egypt's growth performance has increasingly relied on extractive industries and a large role of the state in the economy. Compared to emerging market peers, Egypt might not yet be fully exploiting its catching-up growth potential. Strong population growth amid low participation rates calls for a redoubling of efforts to make Egypt's post-COVID growth path more inclusive and sustainable, with the non-oil private sector at its core. Unleashing the private sector's potential for growth and job creation will require a more enabling environment for trade and investment by removing non-tariff barriers and creating a level playing field for investors, including vis-à-vis public and state-connected firms. Fast-tracking the twin transition towards a digital and greener economy would capitalise on the digitalisation push ushered in by the pandemic and help Egypt to reap its large opportunities for a green and sustainable recovery.

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1. From stabilisation towards sustainability, and back

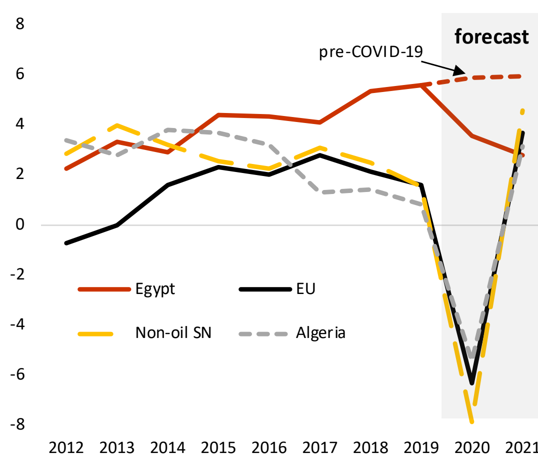
Egypt's successful economic stabilisation has been put to the test by the COVID-19 crisis. In response to a low-growth/high-debt situation with increasing balance-of-payments pressure in the mid-2010s, Egypt embarked on a comprehensive home-grown reform agenda in 2016. The International Monetary Fund (IMF) supported Egypt with an USD 12 billion financial assistance programme over three years. Thanks to bold macro policy measures including currency floatation, subsidy reforms and fiscal consolidation alongside a strengthened social safety net, real GDP growth gained momentum while the fiscal and current account deficits narrowed. Foreign exchange reserves recovered while consumer price inflation and unemployment declined. Just when the government was well on track to move the economy from stabilisation towards a more sustainable and inclusive growth path, the COVID-19 pandemic threw Egypt back into stabilisation mode.

The government responded swiftly to mitigate the pandemic's short-term fallout. While the initial fiscal stimulus worth 1.8% of GDP was not as large as in other countries, it was dispatched speedily and is being supplemented. The measures included expanding cash transfer social programmes, supporting irregular workers and offering low-interest loans for consumer goods. A new guarantee fund for mortgages was set up and tax relief for real estate and subsidised loans were made available to the industry and tourism sectors. Energy costs were lowered for all industrial sectors, partly counteracting the government's subsidy reform programme. The agricultural sector benefited from a tax moratorium. Support for exporters was also stepped up and capital gains taxes were postponed. The central bank slashed the policy rate pre-emptively and provided preferential financing for housing and natural gas-powered vehicles. It also suspended credit score blacklists and waived court cases for distressed clients. While these measures provided immediate relief and helped avoid a more severe economic setback, they run the risk of creating economic distortions and financial instability in the longer term and so should be wound down once the impact of the pandemic subsides.

Resilient growth but unequal employment

Growth has been dented, but less than elsewhere. Compared to the EU and to its regional peers, Egypt's real GDP growth profile has held up well, thanks in part to Egypt's more solid starting position. After expanding by 5.6% in fiscal year (FY) 2018/19, growth dropped to 3.6% in FY19/20, dragged down by a 1.7% year-on-year (yoy) contraction in the April-June quarter. A virtual standstill in tourism dealt a blow to services exports, in addition to declines in manufacturing, although lower imports limited the fallout. Investment dropped sharply while consumption continued to support growth, on the back of relatively light lockdown measures. During July-September, quarterly growth recovered to 0.7% yoy as the decline in investment and exports decelerated and tourism began a gradual recovery. Preliminary government indications point to growth accelerating to around 2% yoy in the October-December quarter. For FY20/21 as a whole, growth is expected at 2.8% (IMF 2021).[1]

Graph 1: **Real GDP Growth (%)**

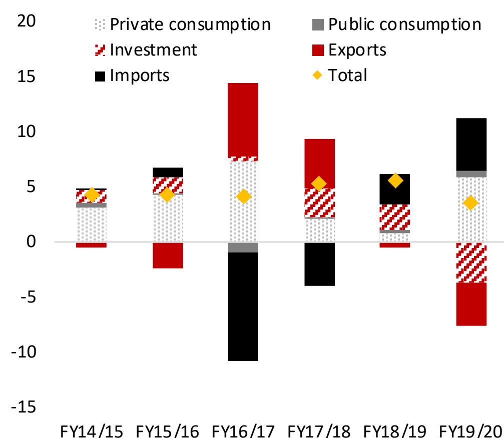


Note: Non-oil SN denotes the weighted average of non-oil and non-conflict Southern Neighbourhood countries Israel, Jordan, Lebanon, Morocco and Tunisia. For Egypt, years refer to fiscal years (July-June).

Sources: European Commission, IMF, World Bank.

[1] The fiscal year in Egypt runs from July to June.

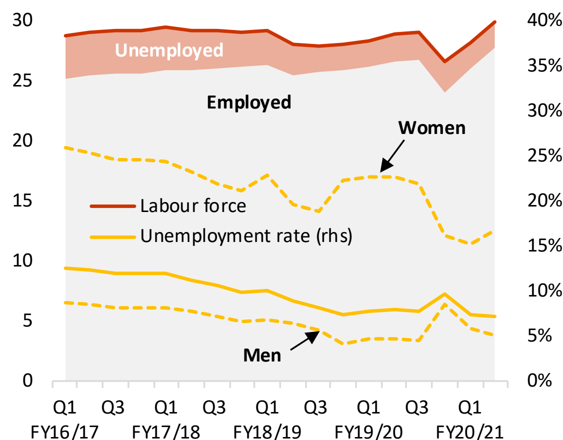
Graph 2: **Real GDP Components (Percentage points)**



Source: Central Agency for Public Mobilisation and Statistics (CAPMAS).

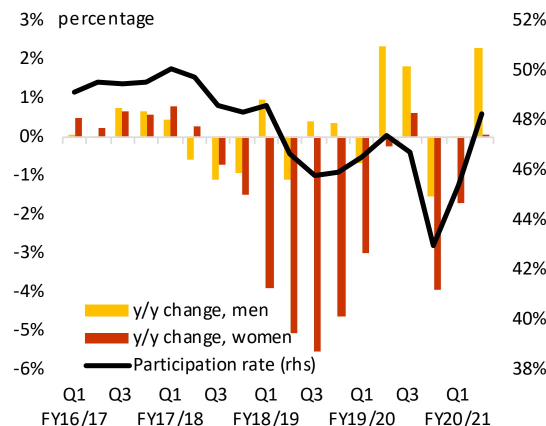
Falling unemployment masks striking gender disparities. The unemployment rate has declined steadily from 13.4% in 2013 to 7.2% at end-2020, after an uptick to 9.6% during the first COVID-19 wave in the April-June quarter. However, female unemployment has been markedly above its male counterpart. Labour participation rates have declined in recent years, as employment growth has not kept up with the pace of population growth. The fall in women's participation in the workforce has been particularly pronounced, suggesting that women have been bearing the brunt of the crisis while the recovery has largely been driven by a rise in employment among men.

Graph 3: Employment and Unemployment (Million persons)



Source: CAPMAS.

Graph 4: **Labour Force Participation**

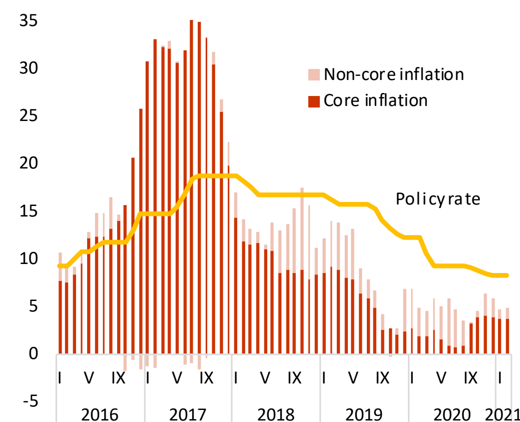


Source: CAPMAS.

Moderate inflation and a stable currency

Moderating inflation has allowed for lower policy rates. Consumer price inflation had spiked at 34% in mid-2017, following the floatation of the Egyptian pound and the successive reduction in blanket fuel subsidies. By 2020, inflation had come down to 5% on average and stood at 4.8% in February 2021. Reflecting the easing inflationary pressure, the Central Bank of Egypt (CBE) progressively cut the main policy rate from 18.8% in 2017 to 12.3% in February 2020. A pre-emptive rate cut of 300 basis points in March 2020 aimed at containing the economic fallout from COVID-19 was followed by further cuts to 8.3% by November 2020. In consultation with the IMF, the CBE adjusted its inflation target corridor from 9% (+/-3 percentage points) to 7% (+/-2 points). Room for further rate cuts could be limited by rising oil prices and higher US treasury yields.

Graph 5: **Inflation and Monetary Policy Rate (%)**

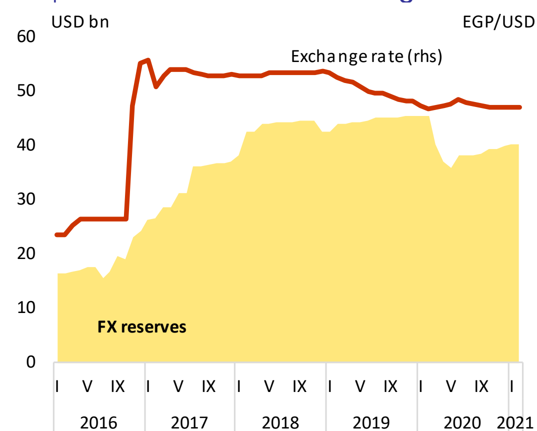


Source: Central Bank of Egypt (CBE).

Foreign exchange reserves have been replenished. During the 2016-19 IMF-supported programme, reserves grew from USD 16.5 billion to USD 45.4 billion, amounting to around 130% of the IMF's floating metric for reserve adequacy. However, reserves dropped by USD 9.5 billion between February and May 2020, mirroring significant foreign exchange (FX) interventions in an attempt to limit disorderly market conditions when the onset of the COVID-19 pandemic triggered widespread capital outflows across emerging markets. Fresh IMF support amounting to USD 8 billion helped reassure international investors and rebuild reserves, which reached USD 40.2 billion by February 2021.

The exchange rate has remained broadly stable since early 2020. Over 2019, the Egyptian pound appreciated by around 10% as the removal of a repatriation mechanism channelled capital flows back into the FX market. In 2020, the CBE's intervention prevented a marked depreciation. While the authorities declared their intention to allow market forces to drive the exchange rate and limit interventions to extraordinary circumstances, implicit stabilisation efforts, e.g. through state-owned banks by moral suasion, cannot be excluded.

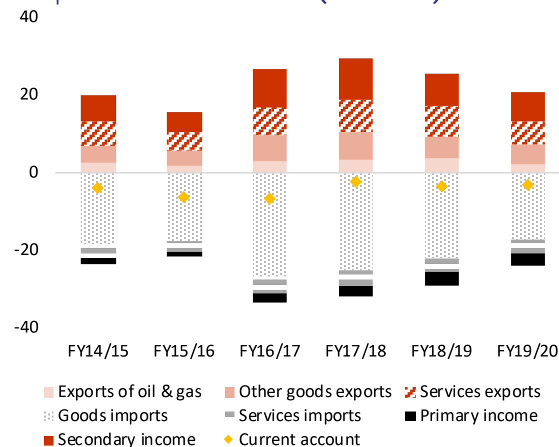
Graph 6: **FX Reserves and Exchange Rate**



Source: CBE.

Although the current account improved overall, COVID-19 has reversed its drivers. The current account deficit narrowed from 6.5% of GDP in FY16/17 to 3.1% in FY19/20. While the initial improvement had relied heavily on improved revenue from tourism and the oil & gas sector, COVID-19-related developments reversed this trend in FY19/20 when international travel come to a halt and oil prices slumped temporarily as global demand dropped. Remittances, which had been expected to soften during the COVID-19 crisis, have held up surprisingly well. However, temporary factors, due to the permanent return of workers from abroad and higher bank transfers caused by travel restrictions, could have played a role and might imply lower remittances in the future. Falling imports helped to keep the overall current account broadly stable in FY19/20 although a slower decline in imports and sluggish tourism revenues caused the current account deficit to deteriorate somewhat during the first quarter of FY20/21.

Graph 7: **Current Account (% of GDP)**



Sources: CBE, CAPMAS.

Fiscal stability amid high uncertainty

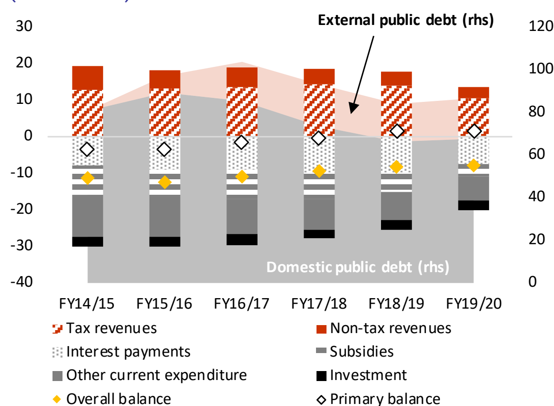
The fiscal deficit has remained stable during the pandemic so far. Egypt has managed to significantly reduce its overall deficit in recent years. Whereas in FY15/16 the overall deficit was as high as 12.5% of GDP, by FY18/19 it had fallen to 8.2% and Egypt recorded a primary surplus of 1.9% of GDP, thanks to IMF-supported subsidy reforms and other painful fiscal consolidation measures. While most measures affected the expenditure side, ongoing efforts to enhance fiscal revenue have yet to bear substantial fruit. In FY19/20, the overall balance even improved slightly to -7.9% while the primary surplus remained stable as extra stimulus spending and reduced revenues were compensated by lower expenditures for interest payments, energy subsidies and transfers to the social insurance fund. During July-January, revenues rose by 16.4% yoy, partly thanks to substantial dividends from public companies and one-off receipts of overdue taxes and outstanding penalties, which might not carry through

the entire fiscal year. Expenditure grew by 12.4% during the same period, including hefty increases in investment and social benefits that partly reflect the government's COVID-19 stimulus package.

The ongoing pandemic raises fiscal uncertainty. Crisis-related amendments and overdrafts will lift the fiscal deficit above budget plans and push back the envisioned fiscal consolidation. Additional spending is earmarked for extended economic support as well as beefed-up social safety, healthcare and education. While the overall budget planning appears generally robust, higher-than-expected infection rates could exert further spending pressure and weigh on revenues.

Public debt reduction will be delayed. Since its peak of 103% of GDP in FY16/17, public debt has been declining and reached 84% of GDP in FY18/19. Due to slower GDP growth and weaker than expected budget outcomes due to the COVID-19 crisis, debt rose again to 88% of GDP in FY19/20 and is projected to peak at 93% of GDP this fiscal year, before declining thereafter (IMF 2021). The external share in budget sector debt has increased gradually to 22%.

Graph 8: **Fiscal Balance and Public Debt** (% of GDP)



Sources: Ministry of Finance, IMF.

Structural reforms thwarted by COVID-19?

Progress on structural reforms has been uneven. While the IMF-supported reform programme agreed in 2016 focused primarily on macroeconomic stabilisation, it also featured a structural reform package to help move Egypt's economy towards a higher and more sustainable growth path. This included a new licensing law to facilitate industrial development by simplifying compliance procedures during the industrial licensing process. Moreover, a new investment law has contributed to business simplification and improved incentive schemes. The authorities also began tackling structural growth impediments in competition policy, industrial land allocation and governance of public corporations. However, some of these efforts have experienced delays and remained incomplete (IMF 2019). The regulatory environment remains burdensome and the strong role of the state continues to weigh on private businesses (IFC 2020).

The pandemic risks further delaying structural reforms. The COVID-19 shock shifted the government's focus back to macro stabilisation efforts. The renewed IMF programme includes a limited structural component to keep up momentum and further develop competition and governance reforms. Going forward, redoubled efforts will be needed to broaden and deepen the structural agenda to achieve more sustainable and inclusive growth (see section 3).

2. Egypt falls short of its growth potential

There is still upside potential for growth. Egypt's reform efforts have already yielded a tangible dividend, with solid real GDP growth prior to COVID-19 and a remarkable resilience during the pandemic so far. Nonetheless, comparisons with its peers suggest that Egypt might not yet be reaping its full potential as an emerging market economy. Egypt's rapid population growth calls for more inclusive economic growth to prevent welfare losses while higher participation rates are needed to unleash Egypt's largely untapped demographic dividend. In light of the large footprint of the state and the dominant position of oil & gas in Egypt's economy, strengthening the non-oil private sector could unleash additional economic momentum.

The case for stronger growth

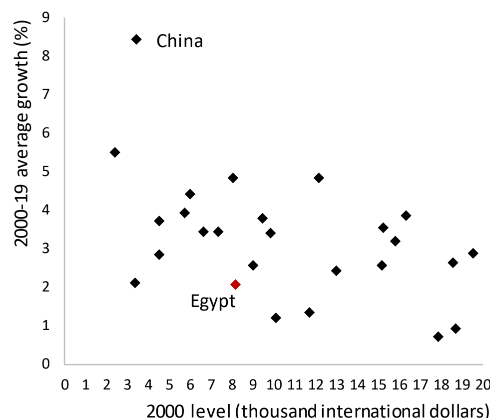
Egypt's catching-up convergence could be more dynamic. According to economic theory and international evidence, countries with weaker starting points tend to grow faster over time. A comparison of emerging market countries confirms a broadly negative relationship between initial per-

capita income and average per-capita growth over the last two decades, albeit less pronounced when disregarding China. Egypt is located at the lower fringe of the data cloud, suggesting that catching-up dynamics in per-capita terms have not yet fully unfolded.

Exports and investment have been below historical levels and peer country averages. Key growth drivers in emerging market economies include exports, domestic investment (defined as gross fixed capital formation) and foreign direct investment (FDI). Over the last decade, Egypt has largely undercut its own performance of the mid-to-late 2000s. Despite recent increases, Egypt remains below peer country averages in exports and domestic investment. Its level of FDI inflows stood exactly at the average of its peer countries in 2019. While the pandemic weighed on exports and investment around the world in 2020, Egypt's path to catching up likely remains long.

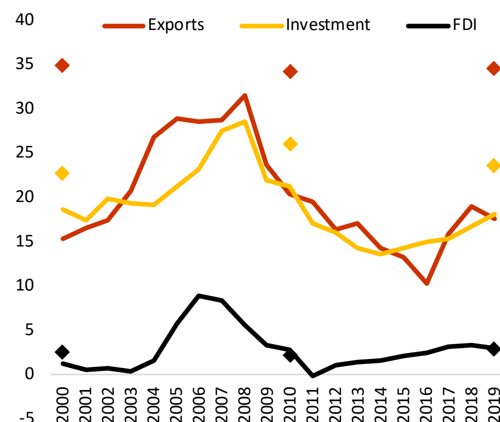
Low labour participation has inhibited a higher demographic dividend. Among middle-income peer countries, Egypt has experienced solid economic growth amid a fast-growing population. However, large parts of the working-age population have not been absorbed into the labour force, suggesting that economic growth remains below its potential. Indeed, growth accounting analysis has shown that capital and, to a lower extent, total factor productivity, have contributed to Egypt's growth while labour contributions have remained flat, despite strong population growth (El-Baz 2016). The unsustainable combination of high population growth and low labour participation creates the risk of social instability. The Egyptian statistical office estimates that economic growth would need to reach around three times the rate of population growth to preserve current living standards and ensure public health and education. Tapping the growth potential of Egypt's young and growing population will require human capital investments and educational reforms to reduce skill mismatches and build bridges for women and youth into the labour force, with the private sector at its core.

Graph 9: **Real GDP Convergence**
(Real GDP per capita, purchasing power parity)



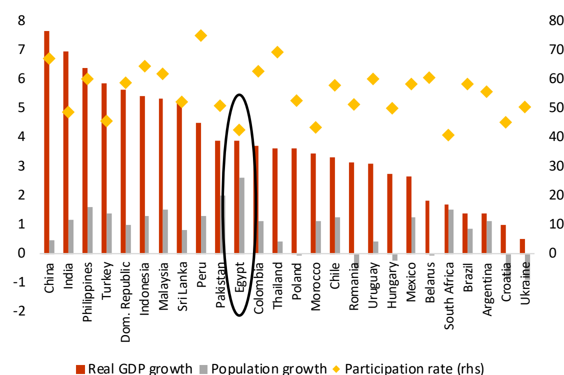
Note: Middle-income emerging-market countries (excluding oil producers) as classified by the IMF.
Source: IMF.

Graph 10: **Investment and Exports in Egypt and Peer Countries** (% of GDP)



Note: Diamonds denote simple averages of middle-income emerging market countries.
Sources: IMF, World Bank.

Graph 11: **Average real GDP growth, population growth and labour participation rates, 2010-19 (%)**

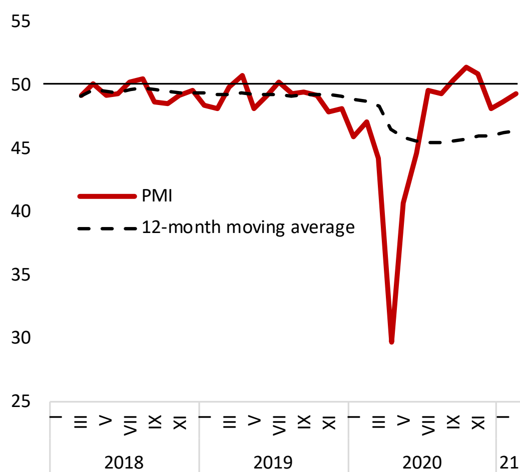


Note: Middle-income emerging-market countries.
Sources: IMF, ILO.

Growth potential beyond oil & gas

Non-oil private sector activity has been disproportionately sluggish. In a medium-term perspective, it is particularly worrisome that the non-oil private sector is struggling most. Even prior to the COVID-19 crisis, the purchasing managers' index (PMI) had largely lingered a whisker below the 50-point neutral threshold, in striking contrast to the buoyant performance of the economy as a whole.[2] While measurement issues and informal economy effects cannot be excluded, this development points to a significant decoupling of the non-oil private sector from real GDP growth, which has been strongly driven by public demand and extractive industries. Following the slump triggered by the first COVID-19 wave, the PMI has recovered and entered positive territory briefly before returning to contraction in December. Overall, the non-oil private sector appears to hold significant untapped growth potential for Egypt's economy.

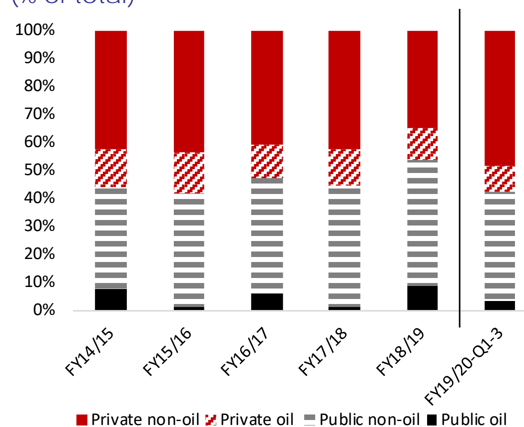
Graph 12: **Non-Oil Purchasing Managers' Index**



Note: The area below the 50-point line denotes compression. Source: IHS Markit.

Domestic investment in the non-oil private sector has been lagging behind. The share of the private sector in total domestic investment decreased to 46.4% by FY18/19, while the non-oil part accounted for 35%. According to intra-year data, the latter's share expanded during the first three quarters of FY19/20 to 48% although it is expected to be lower for the full fiscal year as public investment likely held up better during the COVID-19 crisis.

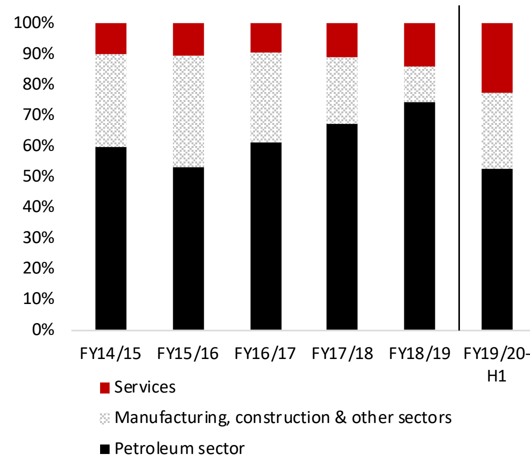
Graph 13: **Domestic Investment by Sector** (% of total)



Source: CBE.

The share of non-oil foreign direct investment has long been decreasing. In FY18/19, the petroleum sector accounted for as much as 74.3% of inbound FDI. The manufacturing and construction sectors' combined share of inbound FDI, by contrast, had fallen to just 11.5%, while services increased their share to 14.2%. The dominant position of the oil & gas sector in FDI highlights the unbalanced development among the sectors, which is to the detriment of more innovative and job-rich economic activity beyond oil & gas. In the first half of FY19/20, intra-year data point to a partial reversal. However, this might be temporary, due to the subsequent impact of the pandemic on services.

Graph 14: **Inward FDI by Sector** (% of total)

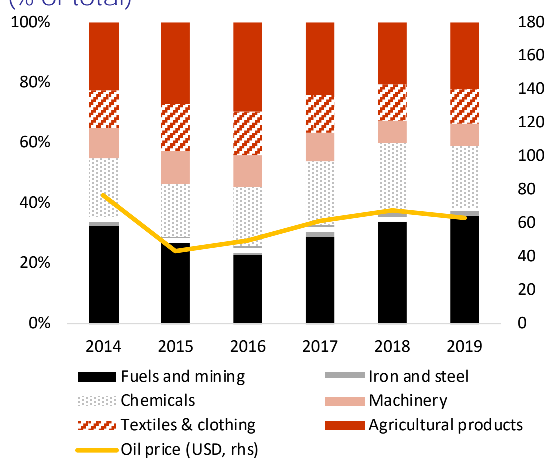


Source: CBE.

[2] The PMI encapsulates feedback from 400 private companies in the non-oil manufacturing, construction, wholesale, retail and service industries on new orders, output, employment, suppliers' delivery times and stocks of purchases. The reading above 50 indicates an overall increase or improvement over the previous month while values below 50 denote a contraction or deterioration.

The share of the non-oil sector in exports has also decreased. Fuels & mining exports have increased their share in total merchandise exports from 23% in 2016 to 36% in 2019, at the expense of agriculture, machinery and textiles. The rising share of extractive sectors is partly due to oil price developments between 2016 and 2019 and to the discovery and exploration of new gas fields in the Mediterranean. It does raise, however, the question of the comparative strength of other merchandise export sectors and the sustainability of Egypt's business model in light of global 'greening' trends.

Graph 15: **Merchandise Exports by Sector** (% of total)



Source: World Trade Organization.

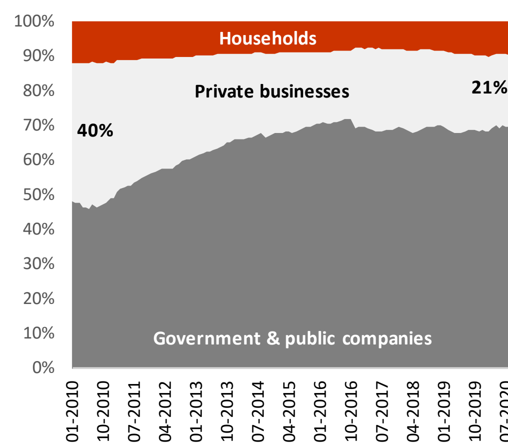
Growth potential beyond the public sector

Private firms must contend with the preponderant presence of the public sector in the economy. While strong public sector involvement can dampen volatility in a crisis, it can also limit the breathing space of private sector activity. While there is no comprehensive database of public companies in Egypt, government reports indicate that there are more than 400 state-owned enterprises, economic authorities, and companies linked to the armed forces. These entities operate in almost every economic sector, with an unusually high presence in subsectors in which the activity of public companies is typically low. They employ around 1.1 million Egyptians, equivalent to around 20% of public workers and 3% of total employment. Total assets amount to around 117% of GDP, mostly held by state-owned banks, utilities and energy companies (IFC 2020).

The distortive role of the state risks stifling private sector dynamics. Although private firms benefit as contractors and end users from large-scale public infrastructure projects, the strategic priorities, financial frameworks and practical implementation of these projects are not primarily market-driven but politically determined by state agencies (Sayigh 2021). This may distort the efficient allocation of resources and inhibit foreign investment and private sector development. The OECD/World Bank's assessment of Product Market Regulations Indicators shows Egypt at the restrictive end of peer countries, with state control and barriers to entrepreneurship as major weaknesses. Specifically, distortions stem from exemptions in competition, taxes and public procurement. The lack of separation between the state's roles as owner and regulator, and between commercial and non-commercial activities of public companies are additional obstacles for private investors (IFC 2020). Moreover, politically connected firms tend to reduce Egypt's long-term growth potential by substituting innovation with lobbying for privileges such as input subsidies, procurement contracts and preferential financing, effectively crowding out private sector activity (Francis et al. 2018).

Access to finance has tilted towards public actors. The share of private businesses in total domestic credit almost halved between 2010 and 2020, affecting primarily the industrial and service sectors. During the same period, the share of government, public economic entities and state-owned enterprises has expanded dramatically. During extended periods of uncertainty, banks have found it safer to lend to public rather than private actors. The share of private businesses in domestic credit has broadly stabilised since 2016, yet it remains far from earlier levels.

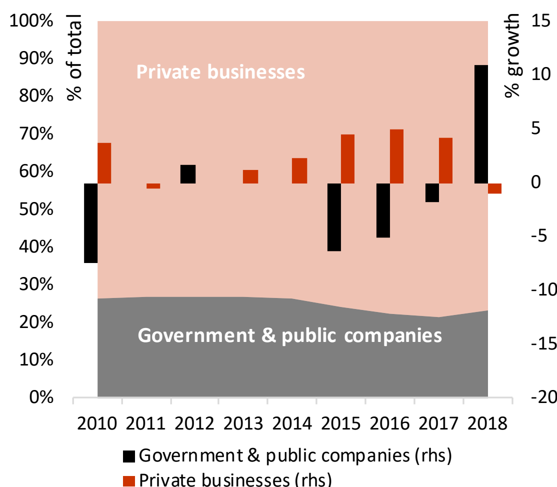
Graph 16: **Domestic Credit by Sector** (% of total)



Source: CBE.

Private sector employment will be key to meeting the demographic challenge. While the share of the private sector in total employment had been growing until 2017, the quality of those jobs had mostly been poor. The bulk of additional private sector jobs were created outside fixed establishments with low-skill profiles and little job security, and almost entirely by male employment (World Bank 2020c). As of 2018, employment in government and public companies has increased its share. While more recent data are not yet available, it can be assumed that the COVID-19 crisis has shifted the balance further towards government employment. The public sector's stabilising role in crises also extends to employment but an excessive focus on public employment could risk severe labour market mismatches in the future. More dynamic private sector employment and a better alignment between the educational system and labour market needs will be indispensable to meet the challenge of absorbing the large number of new entrants into the labour market each year.

Graph 17: **Employment by Sector**
(% of total and % growth)

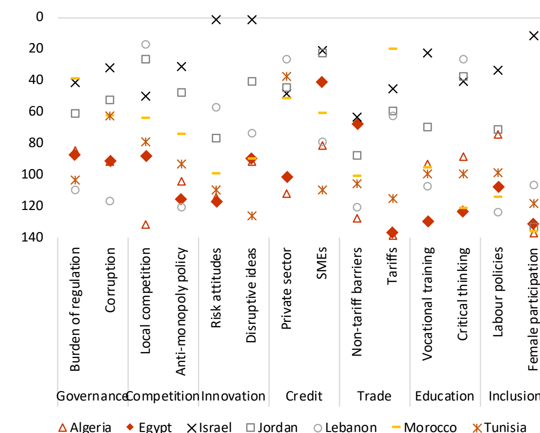


Source: CBE.

A subpar business environment weighs on private sector development. A cross-country comparison of the World Economic Forum's Global Competitiveness Indicators with regional peers shows Egypt in the lower ranks across several dimensions. Competition policy is a particularly sensitive issue given the large role of the state in the economy and the perceived lack of a level playing field. Innovation, trade, education and inclusion ratings also show room for improvement. In the World Bank's Doing Business ranking, Egypt has climbed 12 places since 2016, reaching a rank 114 out of 190 in 2020 thanks to improvements in starting a business, online tax payments, protection of minority investors and electricity supply. However, Egypt still ranks far behind regional peers including Morocco (53), Jordan (75) and Tunisia (78). Registering property, paying taxes, trading across borders and enforcing contracts remain among Egypt's prominent weaknesses.

Poor private sector productivity inhibits stronger potential growth. The economic transformation process in terms of within-sector productivity and reallocation of labour towards more productive sectors has been slow (World Bank 2020c). Employment shares have increased in sectors with low added value and declining productivity, inhibiting productive capacity and high-quality job creation in the economy. Raising total factor productivity by pursuing a deep reform agenda centring on the private sector could lift Egypt's growth potential beyond the contributions from capital and labour (IIF 2021).

Graph 18: **Business Environment Quality**
(Rank out of 140)



Source: World Bank Global Competitiveness Index 2018/19. Values for burden of regulation and competition pertain to 2017/18.

3. From COVID-19 to a more sustainable and inclusive growth model

The post-COVID-19 era offers the opportunity to build a stronger economy for all Egyptians. While current economic policy rightly focuses on combatting the fallout from COVID-19, strategic choices concerning medium-term structural reforms could set the course for putting Egypt's growth

model on a broader footing. The non-oil private sector will have to play a central role in this effort. Key elements include a more enabling regulatory environment for trade and investment and a strategic focus on the twin transitions towards a digital and greener economy. Taking strategic decisions for the post-pandemic era now could turn the COVID-19 crisis from a setback for structural transformation into an accelerator for change.

Trade & investment

Egypt could capitalise on post-pandemic reorientations in global value chains. Given the dominating positions of extractive industries and low-to-medium tech products, there is significant scope to improve Egypt's export profile and boost inward FDI. So far, Egypt has not reaped its full potential for integration in global value chains (EBRD 2020). Due to the disruptions caused by the pandemic, global investors have been rethinking their international production processes, considering a stronger emphasis on more regionalised value chains. With its strategic geographic location bridging Asia and Africa and its proximity to European markets, Egypt could position itself as an attractive partner for international firms seeking to strengthen their regional linkages, with strategic opportunities in the automotive, chemical and textile sectors (IFC 2020).

Removing trade barriers could be instrumental in boosting Egypt's competitiveness. While trade between Egypt and the EU in industrial and agricultural goods is largely liberalised, rising regulatory and non-tariff barriers create unnecessary hurdles. This includes import bans and restrictions, registration requirements for foreign companies, safeguard duties, discriminatory fees related to steel, as well as licensing and permit requirements for food imports. The growing trade in services, including tourism and transportation but also services linked to the growing oil & gas sectors, have yet to benefit from liberalisation. Although the authorities have made progress in reforming customs procedures, more could be done by automating the process, modernising inspections and streamlining customs services and storage royalties. Removing tariff and non-tariff measures, enforcing international trade commitments, enhancing transparency and addressing regulatory uncertainty would help Egypt's private sector to strengthen its export profile.

Competition policy needs to ensure a level playing field. Lack of competition features prominently among the key obstacles for doing business in Egypt. Ongoing efforts to reform competition policy legislation include regulating mergers and acquisitions under certain conditions and granting businesses the right to request opinions from the Egyptian Competition Authority (ECA). It will be important to ensure the ECA's operational and financial independence and to endow it with fining powers in order to establish a robust competition policy environment.

Investors would benefit from more clarity about the role of the state in the economy. Egypt's efforts to reduce the public sector's footprint in the economy by attracting private investment in public corporations has experienced setbacks due to unfavourable market conditions and internal resistance. A reform strategy for state-owned enterprises is in the making, including modernised legal, governance and operational frameworks. Ongoing amendments to the Public Enterprises Act aim at streamlining financial performance and forcing loss-making companies into liquidation. For foreign investors, it will be important to gain clarity on the state's economic activities. This would call for enhanced transparency and a clearly defined separation of the market vs. non-market activities of public corporations. Regulatory and operational functions should be unbundled, notably in the telecom and transport sectors (IFC 2020). Ideally, the authorities would articulate a coherent ownership policy and financial oversight framework in line with OECD guidance on state-owned enterprises (OECD 2015a).

A more enabling entrepreneurship ecosystem would improve the private sector's export capacity. The vast majority of Egypt's companies are micro, small and medium-sized enterprises (MSMEs), representing 91% of the total private-sector workforce. 97% of these companies have less than five employees, and only 1.1% operate in export markets (IFC 2020). The authorities have launched various support measures for MSMEs, including preferential lending facilities, partly supported by the European Investment Bank, as well as tax and customs incentives, land plots and training. Effective export promotion efforts could also help to make the most out of Egypt's entrepreneurial potential and put the economy's export base on a broader footing.

Digital transition

COVID-19 is already fast-tracking digitalisation. The pandemic has seen digital solutions surge globally, with Egypt no exception. Teleworking, e-schooling, online shopping and videoconferencing have forced employees, students, consumers, businesses and families alike to adapt to virtual environments at lightning speed. Internet usage in Egypt has increased markedly, notably the use of mobile applications and educational portals (Kamel 2020). This change in habits towards digital platforms will likely outlast the current crisis and offers opportunities for an accelerated digital transition.

High-speed digitalisation entails positive spillovers for the economic recovery. More wide-spread adoption of digital solutions can leverage efficiency gains across sectors, benefitting trade, retail, manufacturing, logistics and agriculture. The ongoing paradigm shift in digital absorption can pave the way for more innovative and creative attitudes, boosting entrepreneurship and start-ups. It can advance the efficiency and transparency of government services such as tax and customs administration, social safety and health care. Moreover, enhanced use of mobile banking can foster financial inclusion, using the very high mobile penetration rate of 99% to lower the share of unbanked adult Egyptians below its current level of 85%. Digital solutions – together with more childcare facilities – could also help to raise the low female labour participation rate by facilitating the combination of telework and childcare. Employment in rural areas could also benefit from enhanced use of teleworking and better connectedness.

Building on the immediate crisis response, strategic policies can lay the foundation for a lasting digital change. The government has put a number of financial measures in place to facilitate virtual work and learning during the pandemic, including enhanced payment flexibility for prepaid users, subsidies for monthly subscriptions, free cloud applications for companies and subsidised web access for professors and students (World Bank 2020a). To solidify the digital opportunities offered by the COVID-19 crisis, investment is needed in ICT infrastructure and in human capital, accompanied by an enabling regulatory framework. Increasing broadband capacities would help reduce congestion, notably at 'last mile' networks providing user access. Targeted training and upskilling efforts would endow students and employees with the skills to best adapt to the digital workplace. Digital services and e-commerce would benefit from a strong legislative environment to ensure good governance, data protection and contractual certainty. Putting the private sector at the heart of Egypt's digital transition would also imply a strengthened ecosystem for tech start-ups linked to innovation incubators in Egypt's universities.

Green transition

The COVID-19 crisis offers an opportunity to accelerate Egypt's green transition. As the pandemic has sent shockwaves through the global economy, investors are rethinking their value chains and governments are moving from short-term stimulus to strategic investment programmes to reboot their economies. Egypt's environmental vulnerabilities and green growth potential alike call for determined action to put the recovery on a green foundation.

As one of the countries most vulnerable to climate change, Egypt has a strong incentive to protect its natural capital. This is vital for both tourism and the livelihood of its own population, which is constrained to living in just 8% of the country's surface. Rising sea levels threaten the Mediterranean coast and the densely populated Nile delta. Water scarcity will exacerbate Egypt's existing dependence on water resources generated outside its territory (UNDP 2021). Air pollution in the Greater Cairo area, mainly due to transport and solid-waste burning, poses a significant environmental health issue, implying an estimated 1.4% of GDP loss via reduced labour productivity (World Bank 2021). Overall, North Africa appears to be among the most severely impacted regions in the world, mainly via agriculture, health and tourism effects (OECD 2015b).

The potential for greening the economy is huge. Egypt's geography offers enormous opportunity to exploit renewable energy sources, notably solar and wind. Existing projects include Benban, which upon completion will be the world's largest solar energy park, and the Gulf of Suez wind farm, both supported by European financial institutions. Egypt's ascendant natural gas industry can play the role of a transition fuel on the way to a low-carbon economy and could be a centrepiece of a future EU-

Mediterranean gas corridor. Further potential lies in enhanced energy efficiency, where Egypt and North African peers have room to catch up. The industry sector in particular offers large energy savings potential, alongside appliances, equipment and lighting (IEA 2020).

Effective implementation of Egypt's greening initiatives will be key. As a signatory to the Paris Agreement and supporter of the UN 2030 Agenda, Egypt is committed to combatting climate change and has launched its own development strategy, known as 'Vision 2030'. However, Egypt's nationally determined contributions often lack timelines and specific greenhouse gas emission targets. Existing policies include Egypt's recent fuel subsidy reforms, which will help incentivise energy efficiency, and the development of solar parks and wind farms aimed at raising the share of renewable energy. The Egypt Environmental Pollution Abatement Project and the Air & Climate Pollution Reduction Project provide incentives for fuel switching and aim to reduce pollution from the heavily polluting transport and solid waste management sectors (World Bank 2021). A successful green bond issuance in September 2020, the first of its kind from the region, sent a strong signal to international investors and should help to financing eligible green projects.

The EU's green transition could inspire and challenge Egypt. The European Green Deal, with its target of transforming the EU into a climate neutral economy by 2050, is the EU's signature strategy to combat climate change (see Box 1). It could serve as an inspiration to policy makers in Egypt and other partner countries in the EU's southern neighbourhood, but it could also challenge them to speed up their own green transitions and restructure away from carbon-heavy production. In an effort to combat global climate change and avoid carbon leakage from Europe to third countries, the EU is developing a carbon border adjustment mechanism. Through this tool, a higher carbon price would not only apply to production within the EU but also to imported goods, putting partner countries like Egypt under ambitious adjustment pressure.

Conclusion

Egypt has shown resilience in addressing the COVID-19 crisis. Building on the fruits of its pre-pandemic reforms, Egypt entered the COVID-19 shock in a relatively strong position. An immediate policy response has helped the economy to withstand the worst repercussions and maintain a positive, albeit easing, growth profile. Mitigating the fallout of the pandemic, however, has forced the authorities to re-focus their resources to short-term stabilisation policies, entailing a setback in Egypt's efforts to move on from stabilisation towards building a more sustainable and inclusive economy.

Forging a business-centred strategy would help Egypt to emerge stronger from the crisis. Building stronger foundations for Egypt's future growth potential will invariably have to involve a stronger role for non-oil private businesses. Investment, exports, employment and financing all mirror an excessive focus on oil & gas and on public sector involvement in the economy. Enhancing Egypt's catching-up potential will also help the country to meet its demographic challenge and catalyse a demographic dividend. Moving Egypt on a robust path towards more sustainable and inclusive growth calls for making the trade and investment environment more conducive to non-oil private sector development, capitalising on the pandemic's positive side effects in fast-tracking the digital transition, and pursuing the opportunities of greening the recovery.

Box 1: THE EXTERNAL DIMENSION OF THE EUROPEAN GREEN DEAL[1]

The European Green Deal is the EU's principal strategy to undertake an energy transition and combat global climate change. The overarching aim of the European Green Deal (EGD) is to turn the EU climate neutral by 2050. This policy priority is both a global environmental necessity and an economic opportunity for growth, innovation and jobs. The European Green Deal covers the main policy areas of clean energy, sustainable industry, building and renovation, a 'farm-to-fork' approach to agriculture, eliminating pollution, sustainable mobility and biodiversity. The Deal includes an investment plan to mobilise €1 trillion with strong private sector involvement over the next decade. The envisaged cost of action is very likely to compare favourably with the cost of inaction.

The European Green Deal also aims to incentivise a green transition in partner countries. The European Green Deal seeks to complement and operationalise the Paris Agreement and the UN 2030 Agenda for Sustainable Development in the EU. While the EU accounts for only 8% of global emissions, the Deal defines a set of internal policies that will also have an impact beyond the EU's borders and its immediate neighbourhood. To articulate its external dimension, the European Green Deal calls on the EU to conduct green diplomacy, to incentivise partner countries to adopt their own green frameworks, and to implement sound market mechanisms that support a green transition across borders. A carbon border adjustment mechanism is currently under development, which could act as a prospective market mechanism to prevent carbon leakage by applying a higher carbon price not only to production within the EU but also to the carbon content of imports from third countries.

The 'farm-to-fork' component offers opportunities for agricultural cooperation with partner countries. Moving the EU food system to a sustainable path offers environmental, social and health benefits, provides economic gains and ensures a sustainable recovery. The 'farm-to-fork' strategy aims to enhance both food production and supply by improving their carbon footprint, allowing for wider access to healthy and sustainable food options and achieving a circular economy. The EU plans to establish a legislative proposal for a sustainable food system by 2023, targeting a 50% reduction in the overall use of chemical pesticides by 2030, improving competition rules and advancing energy efficient modes of agriculture. These initiatives open up plenty of opportunities for cooperation with partner countries with large primary sectors, including Egypt.

The EU's neighbourhood cooperation policy actively supports the green transition in partner countries. The Neighbourhood, Development and International Cooperation Instrument (NDICI) allocates large parts of its budget to supporting climate targets, in line with the EU's key priorities, the United Nations' 2030 Agenda and the Paris Agreement. Building on geographical, thematic and rapid response financing components, the NDICI supports all EU external action. This activates tools in form of green investments, budget support, R&D and green budgeting to promote green transitions.

The energy sector is critical to accelerate the global energy transition, accounting for two thirds of worldwide greenhouse gas emissions. Aiming to secure energy security in the EU and improve its efficiency, the European Green Deal discourages investments into fossil-fuel-based infrastructure projects in third counties, unless they are in line with a committed climate neutrality pathway. In this vein, the EU scaled up its provisions of international climate finance and set up a Just Transition Mechanism to support those regions most affected by the energy transition.

[1] This box has benefitted from input by Samir Chouman.

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