Egypt is carrying on its economic reforms program to stabilize the macroeconomic environment, create more jobs, improve the competitiveness of its economy and achieve high levels of sustainable and inclusive growth. To that end, the Government has adopted bold reforms in a number of areas which are considered as key to restore confidence in the economy; namely achieving progress on fiscal consolidation efforts, eliminating foreign exchange distortions, encouraging domestic and foreign investment and increasing the private sector contribution to growth and job creation. Given the inflationary pressures, expected in the short-term, of some of these reforms measures, the Government is scaling up and expanding its social programs to meet the pressing needs and protect the most vulnerable groups in the society.

This follows a first wave of reforms started in 2014 to address the vulnerabilities the country has been facing during the political transition. In FY 2014/15, the Government undertook bold fiscal consolidation measures; partially streamlining energy subsidies and introducing revenue-enhancement measures. But the difficult domestic and regional environment and volatile commodity prices in FY 15/16 have taken a toll on confidence and investment and weighed on economic growth.

The Government has launched an ambitious economic and social reforms program this year. Most notably, the Central Bank of Egypt (CBE) has introduced a flexible exchange rate regime in early November 2016, which will play a critical role in preserving competitiveness and serve as an important buffer to external shocks. Fiscal reforms include the issuance of new laws on Value Added Tax (VAT) and Tax Dispute Settlement as important steps to expand the tax-base, improve the business environment and increase public revenues. On the expenditures side, gradual increases in electricity tariffs and recent increases in the price of fuel products will help control government spending and shift towards a better targeted subsidies system. At the same time, a new civil service law was approved and is expected to improve efficiency and transparency of the civil service administration. In its effort to enhance transparency and accountability, the Ministry of Finance is establishing an internal audit function to oversee controls over public resource use and implement key public financial management reforms. Further steps are being taken to enhance the business environment including the issuance of the single-person company law, an ambitious Initial Public Offering (IPO) program for state-owned companies, and the establishment of a Supreme Investment Council to enable domestic and foreign private investment and promote SMEs growth.
The economic and social reforms program strives to create a dynamic economy by addressing macroeconomic imbalances, enhancing productivity and competitiveness and unleashing the growth potential. To achieve this ambitious goal, the Government’s reform program rests on three fundamental principles. First, restoring macroeconomic stability and fiscal sustainability which are key to boost confidence, free up public resources and redirect them towards social and growth enhancing spending. Second, creating a more dynamic and commercially oriented energy sector to meet the growing demand, improving service delivery and attracting private investment to support economic activity. Third, improving the business climate in which the private sector operates, enhancing the regulatory environment and fostering competition. The overarching approach is to strike a balance between progressing on important structural reforms while ensuring that the generated growth is truly inclusive, sustainable and the benefits are being reaped by the entire society. Particular attention is also given to ensuring the continuity of the economic reforms program in an efficient and effective manner. These reforms have signaled the Government’s commitment to take difficult decisions to address structural imbalances.

Advancing Fiscal Consolidation

Fiscal consolidation plans are carried out to narrow the deficit and put public debt on a downward path while creating room for much needed social spending, and increase the government’s ability to shift resources towards productive uses. This includes further investment in infrastructure, in increased spending on social protection programs, as well as in human capital including spending on health, education and research and development.

Despite efforts to control public spending, lower revenues have contributed to a widened fiscal deficit, reaching 12.2 percent in FY16 up from 11.5 percent in the previous year. The recent introduction of the VAT law to replace the generalized sales tax (GST) is an important step in the right direction, as it is expected to widen the tax base and generate an increase in public revenues of around 0.6 percent of GDP in FY17. The Ministry of Finance will be soon issuing the executive regulations of the Law, which provides important guidance on the implementation of the VAT including the process and workings of an effective credit and refund mechanism. In addition, the adoption of the law on Tax Dispute Settlement (Law No. 79 of 2016) will help clearing the backlog of the GST tax disputes. This set of reforms follow previous reforms of tax policy adopted as per law No. 96 of 2015, issued on August 20, 2015, unifying the corporate income tax rate, to widen the tax base and create a fairer and more equitable system. Taken together, these measures are expected to increase non-sovereign corporate income tax and sales/VAT on goods and services as a percent of GDP from 5.4 percent in FY15 to about 6.7 percent in FY18.
On the expenditures side, gradual increases in electricity tariffs (the most recent being an average of 34 percent in August 2016) and the increased fuel prices across different fuel products from 30 to almost 90 percent are positive steps towards attaining fiscal consolidation. In addition, the Government is committed to contain the wages bill which has become a pressing issue in light of the considerable increase in the wage bill post-2011. Building on previous efforts, the Government is continuing its plans to delink the variable portion of employees’ salaries from the basic salary component and contain further increases in bonuses and rewards to all government employees. These steps are complemented by the progress achieved with regards to the automation of wages and salaries payments for all Government employees, with more than 50 percent of the wage bill currently automated. As a result, the ratio of central government’s wages and salaries bill to nominal GDP is expected to decline to 7.4 percent of GDP by FY18 from 8.2 percent in FY15.

The Government will continue to pursue its key debt management objectives over the medium-term, focusing on further lengthening the average maturity of the debt profile, diversifying sources of financing, and reducing the average cost. The Government is committed to publishing an annual updated Medium-term Debt Management strategy, in addition to establishing a Public Finance Management Improvement Unit in charge of internal auditing, monitoring fiscal risks of Economic Authorities and SOEs including their contingent liabilities and enhancing Government accounting and financial control.

Together, all these efforts are expected to reduce the budget deficit by a little more than 2 percentage points of GDP, bringing it down to around 10 percent of GDP in FY17. It is worthy to note that despite such fiscal consolidation efforts, the Government continues to scale up expenditure on infrastructure (investments), as well as on social programs in FY 2016/17. The medium-term fiscal program is designed to minimize the contractionary effect of the consolidation by saving on inefficient spending, channeling part of the saved resources towards more productive uses and in addition to that, crowding in the private sector and enabling it to drive growth and job creation.

**Ensuring Sustainable Energy Supply**

The performance of Egypt’s energy sector, long considered as an engine of growth, has become increasingly compromised in recent years. Declining oil and gas production despite rapidly growing demand for subsidized energy products meant that Egypt became a net importer of oil since 2009 and a net importer of gas since 2015. Domestic energy supply became financially and environmentally unsustainable, leading to an escalating subsidy bill, power outages, shortfalls in gas supply to industry, accumulating arrears to international oil companies and rapidly growing pollutant emissions. The energy sector’s contribution to GDP growth fell from +0.8% in FY09 to -0.9% in FY14, turning the sector from a net contributor to a net drain on the budget (net fiscal burden reached EGP 54 bn).

The Government is following a two-pronged strategy to restore and improve the sector’s performance. In the short term, the Government procured emergency generation capacity and
floating natural gas import terminals to restore stable supply. In the medium to long-term, the Government is pursuing a wide-ranging set of structural reforms, which aim to improve sector governance and restore secure supplies of cost-effective and clean energy. These reforms were laid out in the White Paper “Energizing Egypt” presented at the Egypt Economic Conference in March 2015. Major measures include pricing reforms (upstream and downstream) to restore financial sustainability of the sector and attract new upstream investment; new sector legislation in the electricity and gas sectors, opening them up to wholesale and retail competition; and a renewable energy feed-in tariff to attract private sector investment in renewable energy.

The Government’s energy sector reforms are already yielding important results. New gas field discoveries include the largest gas field in the Mediterranean (‘Zohr’, with 30 Tcf of gas resources). The capacity deficit in the power sector (the gap between peak supply and peak demand) has been closed, eliminating power cuts in the summer of 2016. The energy subsidy bill subsequently fell from 6.6 percent of GDP in FY 2013/14 to 3.1 percent of GDP in 2015/16 (of which 1.1 percent of GDP was for electricity and 2.0 percent of GDP for fuels). As a result, the budgetary allocation in FY 2015/16 for health and education exceeded energy subsidies for the first time in many years.

Energy subsidy reforms. The Government is committed to continue implementing its ambitious reform program in the energy sector. In August 2016, the third scheduled electricity tariff increase was implemented, raising tariffs by an average of 33 percent. Further tariff increases are planned for FY18 and FY19. To ensure that energy subsidy reductions stay on track reaching 1.5 percent of GDP in FY18 and 0.6 percent in FY19, the Supreme Energy Council—a sub-committee of the Cabinet bringing together the Ministers of Finance, Petroleum and Mineral Resources, and Electricity and Renewable Energy—adopted in October 2016 a policy to undertake annual adjustments of energy prices consistent with passing through unanticipated changes in the cost of energy, so as to achieve the subsidy ceilings set in the Medium-Term Fiscal Framework 2016-2019. The policy would be implemented starting from FY18.

Electricity governance reforms. With the adoption of the Electricity Law No. 87 of 2015, the electricity sector has embarked on a process of market liberalization to encourage private sector investment in both conventional and renewable energy. The new law also strengthened the powers of the electricity regulator, EgyptERA, providing a stronger voice for consumer participation in its governance structure. The executive regulations of the new Electricity Law No.87/2015 have been issued and provide a detailed framework for tariff-setting, energy efficiency, and sector organization; expected to enhance the financial sustainability of the sector. The Executive Regulations also provide clear guidelines for energy efficiency actions expected from large consumers in excess of 500 kW. By Fy18, EgyptERA would disclose the electricity tariff methodology and operationalize the supply code, transmission tariff and market rules.

Gas sector governance reforms. The government is pursuing substantial market-oriented reforms in the gas sector, which has thus far been solely governed by the state-owned EGAS, with no regulatory agency. The new gas law, which was recently submitted to parliament, envisages the creation of an independent transmission system operator to provide non-discriminatory third
party access to gas networks, and mandates the creation of a new independent gas regulator. The regulator will be responsible for the development of the gas transmission codes, gas transmission tariff, entrance of new shippers and licensing of alternative suppliers apart from EGAS and EGPC. It will also be key in overseeing the gas sector and providing consumer protection. Furthermore, as an important complement to the legal and regulatory reforms, efforts are underway to modernize the management and governance of the sector. To spearhead this process, the Ministry of Petroleum and Mineral Resources recently established a Policy and Strategy Unit with a clear mandate for modernization and has staffed its key positions already. By FY18, the gas regulator would publish a separate gas transmission tariff, transmission code, market rules, approval procedure and operationalize a dedicated web portal with all regulations and rules. The governance reforms and the pricing reforms cited above are expected to increase domestic gas production from 4,020 MMScf/day in FY 2015/16 to 4,700 MMScf/day by FY 2017/18.

Private sector participation. Egypt strives to become a regional leader in renewable energy. With the issuance of the Renewable Energy Law No. 203 of 2014, a policy framework has been set in place to reach the target of 20 percent of energy through renewable sources by 2022. This has been followed by a transparent process of issuing regulations for Feed in Tariff, and an award of interim licenses. In September 2016, the Prime Minister overhauled the feed-in tariff program (by issuing a second phase Feed-in-Tariff Decree); addressing the concerns raised by investors previously (related to arbitration and currency conversion), as well as lowering the tariff level for solar energy to US$0.084 per kWh for solar projects (20-50 MW scale), given the declining market benchmark. The new FIT round is expected to achieve financial closure of private sector-owned renewable energy projects from 0 MW (October 2015) to 1,500 MW (end of FY18). Finally, the Ministry of Electricity and Renewable Energy is operationalizing the ‘Energy Efficiency Unit’ established since 2014, where the head of the unit was appointed on June 16, 2015. The unit is set up at the ministerial level, and is complemented with energy efficiency units in all distribution companies and a dedicated team in EgyptERA with an institutional mechanism for coordination between different entities within the sector as well as energy efficiency applications across other sectors, like transport and municipalities. Such institutional measures on energy efficiency are expected to have a further positive impact on the environment.

Improving the Business Environment

The Government is committed to further improve the domestic investment environment as part of its broader macroeconomic strategy prioritizing private investment-led growth. To this end, it has engaged in active and wide-ranging process of legal and regulatory reforms in order to cut the red tape and streamline procedures for doing business, to foster transparency, and to ensure a level playing field.

In order to further improve the investment regime and its transparency, particularly for MSMEs, the Law on Single-Person Company has been approved by the cabinet and submitted to
Parliament. The new law will improve the business environment for small enterprises and facilitate entry. This reform is an extension of the Government’s previous efforts to enhance investor rights, protections, and incentives under the Investor Guarantees and Incentives Law revised in 2015. The Single-Person Company Law will allow sole proprietors to register as companies, with all the provisions under the Company Law, as well as grant sole proprietors access to a number of the guarantees and incentives under the Law of Investment Guarantees and Incentives. This action will contribute to equalizing the treatment of small and large investors under the law, giving small businesses greater security and a better chance to grow. Having a registered company status will afford many small businesses - currently either unregistered or registered as sole owners with no liability protections - to better access to finance, markets, and legal protections. The implementation of the Single-Person Company Law is expected to result in an increase in business entry, particularly small businesses, as measured by the number of Single Person Companies registered, from zero in FY15 to at least 500 in FY18.

The Government has also made further progress to reform the industrial license regime. Following the issuance of the Prime Minister Decree 2807 of 2015 on the reform of industrial licensing, the Industrial Licensing Reform Committee was formed and led by the Minister of Trade and Industry with the mandate to develop the Industrial Licensing Reform Implementation Plan, within the reform framework set by the decree. Recommendations on the direction of the reform led to the preparation not only of an implementation plan, but went further to produce a framework law—now approved by Cabinet and submitted to Parliament—to reform the industrial licensing regime with executive regulations currently under preparation. The Law includes a key reform which would simplify industrial licensing requirements for industrial firms with low environmental and social risks using a “licensing by notification only” process. This would represent a major simplification of the process for a majority of industrial firms that would not be subject to the full process anymore, but only to a notification procedure. This reform is expected to affect the vast majority of firms, in particular MSMEs, most of which would fall into the low-risk category and would allow industrial firms with low environmental and social risks to use a notification procedure, to be reduced to no more than 7 days by end FY18. At the same time, the simplification of the licensing process for all industrial firms is expected to be reduced from 634 days in FY15 to 160 days by end of FY18.

To foster competition, the Government is working on ensuring that Egyptian markets are more dynamic and open. To that end, efforts are carried out to prevent anticompetitive behavior, and to strengthen the institutional independence of the Egyptian Competition Authority (ECA). This is likely to generate a competitive business environment, create incentives for entrepreneurship and foster innovation.

Improving competition and the ease of doing business are key priorities for the Government. This entails a thorough review of business procedures in Egypt including those with regard to
access to land, issuance of permits and licenses, inspection procedures, customs clearance, tax payments and compliance, and other sector-specific regulations. Accordingly, and as a first step, the Government has prioritized the review of the process of industrial licensing, whereby a committee of ministers has been formed to propose a roadmap for complete overhaul of the industrial licensing process by the middle of 2016.

Moreover, and in order to foster the Government’s efforts towards SMEs, a coordination body is being proposed by the Ministry of Trade and Industry to facilitate access to different services including technical assistance, technology transfer and access to finance through compiling the different bodies working in these domains under one umbrella.

**Social protection**

As Egypt progresses with its economic reforms program, the Government is taking important steps to mitigate potential adverse impacts expected in the short-term on the most vulnerable groups in the society. As proved by Egypt’s recent history, such mitigation measures are critical to the success of the reforms program, preventing reversibility of implemented reforms and ensuring societal buy-in.

Given the inflationary pressures generated by price hikes, the program has an integrated plan to increase spending on social protection, by scaling up and expanding the coverage of its social safety nets. In fact, significant changes to the Social Safety Nets (SSN) include the following:

- Gradually expanding cash transfer programs (Takaful and Karama) to reach 1.7 million households (7.3 million beneficiaries) by June 2017 and to 2 million households (8-9 million beneficiaries) across Egypt by FY19.

- Expanding the food subsidy program with efficiency improvements. The semi-cash transfer scheme (also known as ration cards) replaces the old four commodity system. It offers every individual a monthly allowance to be spent on over forty commodities widely used by Egyptian households. This allowance, which started at LE 15 per beneficiary in 2014/2015 was increased to LE 18 per beneficiary in 2015/2016, and has been further raised to LE 21 per card in November 2016, at a cost of LE 5 billion. The targeting of the program will be enhanced to ensure its efficiency and equity.

- Ensuring social protection of the poorest and the vulnerable groups.

- An ongoing initiative to establish a Unified National Registry (UNR) with technical assistance from the World Bank will support different SSN programs and facilitate coordinated targeting and delivery of social services.
New legislations are submitted to the Parliament on social insurance and pension, disability and child protection laws.

The expected outcome of all these policies, programs and projects is two-fold: to ensure long-term sustainability by correcting the country’s macroeconomic imbalances, and to create a dynamic, competitive and private sector-led new platform for inclusive growth.

Sincerely,

Sahar Nasr
Minister of International Cooperation