External Debt and Economic Growth in Egypt

Adel El Mahdy[i] Neveen Toraeh[ii]

Rania Osama Mohamed[iii]

Abstract

This research was mainly conducted to investigate Egypt's external debt problem and its effect on economic growth, with a focus on the post-revolutionary period. The evolution of external debt structure and its indicators over the period (2000-2020) has been studied; also, the economic growth performance was analyzed simultaneously during the same period, which showed that Egypt's external debt has reached a critical point. The primary argument for external debt was to improve the macroeconomic environment to enhance economic growth. However, official data show that since 2016, external debt growth rates were much higher than economic growth, which has not been significant in the last decade. Egypt's external debt, on the other hand, has increased at an unprecedented rate when compared to pre-2011 levels.

[i] Professor of Economics, Faculty of Commerce & Business Administration – Helwan University.

[ii] Professor of Economics, Faculty of Commerce & Business Administration – Helwan University.

[iii] Assistant Lecturer in Economics Department, Faculty of Commerce & Business Administration –Helwan University.

1. Introduction

Egypt external debt increased to US$ 137.9 billion at end of June 2021, up by US$ 14.4 billion from the end of June 2020. According to CBE data, Egypt's debt stock to GDP was 34.5% at the end of June 2021, up from 15.9% in 2010. As per international standards, Egypt's debt remains manageable, but the situation reveals the economy to the risk of an external debt default if it keeps on growing at its present rates.

The **research problem** revolves in a serious burden of external debt on the Egyptian economy, as it increased dramatically since 2011, which is considered a heavy burden for economic growth, necessitating the need to discuss the relationship between external debt accumulation and its impact on economic growth.

The research is based on the **hypothesis** that, "Extensive relying on external debt as a source of finance may impede economic growth".

The **main objective** is to test the research hypothesis to investigate the relationship between external debt and economic growth in Egypt. To achieve this main objective the following **sub-objectives** will be targeted:

- Identifying and analyzing the structure of external debt in Egypt and the reasons for its accumulation at the present time, in order to measure the real burden of this accumulated debt.
- Formulating some effective policies in the management of external debt, with the specific aim of minimizing the debt burden and providing additional sources of finance.

The research **Methodology** will depend on the inductive approach, and whereas that the current search falls within the scope of applied studies related to external debt and economic growth in developing countries, the inductive approach is one of the best methodologies that can be relied on in this regard. In this regard, it would be relying on economic analysis to test the basic hypothesis of the study depending on foreign debt databases published by the World Bank. In selecting for further analysis of external debt and its relation to growth, debt ratios that indicate potential debt-related risks will be involved. Debt ratios are considered in conjunction with key economic and financial variables.

2. Literature review

External debt is the portion of a country's total debt that is obliged to creditors outside the country. Debtors include governments, corporations, and ordinary citizens, while creditors include international financial institutions, as well as governments and commercial banks. It is considered as one of the financing sources of capital formation in any economy (Sami, Kharusi & Mbah, Stella, 2018).

The impact of external public debt on economic growth has been a debatable issue since the beginning of the debt crisis in the 1980s. In this regard, theoretical and empirical studies attempt to analyze the impact of external public debt on economic growth to determine whether the rise in external debt shows positive or negative effects on the economic growth rate. In the theoretical and empirical literature, there is no unified explanation for the external debt economic growth relationship.

According to the debt cycle theory, the reasonable levels of external borrowing by a developing country are likely to

improve its economic growth, both by capital accumulation and productivity growth. Where, the developing countries in their early stages of the economic development process do not possess adequate stocks of capital due to the low level of savings, which reflects their low incomes, thus, the deficit in domestic savings should be supplemented by foreign resources. And as long as these countries use externally borrowed funds for productive investment and do not submit to macroeconomic instability and policies that distort economic incentives, or major negative economic shocks, growth should increase and allow debt to be paid in a timely manner (Catherine, Pattillo & Hélène Poirson, 2004).

Two-Gap Models are included in Post-Keynesian growth models for closed economies as presented by Harrod (1939) and Domar (1946). They attempted to identify the prerequisites for economic growth. These two prerequisites are internal, insufficient savings would almost certainly translate into investment; the gap between these two is called saving constraints (saving gap), to close this gap, foreign direct investment is required. Externally, insufficient foreign exchange due to the inability to export will result in a foreign exchange shortfall; the gap between these two is referred to as foreign exchange constraints (trade gap), which can be closed with foreign aid. The Harrod-Domar model provides a simple explanation of how debt augments the growth process. External debts can be used productively to reduce dual gaps. However, if the country does not employ its external debt for productive purposes, it may face dual gaps and debt servicing problems (Akande, Emmanuel, 2010). The debt overhang (excessive debt) hypothesis was developed by Krugman (1988), Sachs (1989), and Cohen (1992). This stated that beyond a particular

threshold, external public debt could restrict consumption and investment, and hence impede economic growth. The debt overhang hypothesis has two versions, narrow or traditional version and a broader version.

The narrow version, according to Krugman (1988), Sachs (1989), and Anyanwu (1994), supposes that the impact of the debt overhang occurs when investors anticipate an increase in the tax rate on returns to the capital for debt servicing, causing them to reduce their investment levels in order to avoid future tax increases. Neoclassical models presume that imposing taxes for interest payments reduces individuals' disposable income and thus taxpayer savings (John, Serieux & Yiagadeesen , Samy, 2001).

According to the broader approach, higher external debt increases the probability that the government will engage in inflationary financing and/or cause currency depreciation/devaluation due to excess demand for foreign currency resulting from debt servicing. A government' current administrative costs of debt rescheduling and uncertainties about future debt profiles could reduce the incentive to invest, resulting in lower investment and slower growth. However, it should be mentioned that the external debt burden can arise not only when a country accumulates a large amount of debt, but also when the country's circumstances change, making it hard to manage and discharge its debt stocks. Such scenarios may emerge owing to adverse economic shocks or weak economic policies, putting creditors' loan portfolios in danger. Creditors will panic, cashing out claims and withdrawing interest from possible new credits (Muhammad, Mustapha, 2016).

External debt service payments, according to Cohen (1993), Fosu (1996), Pattillo et al.,(2002), and Arnone et al.,(2005), can affect economic growth by a "crowding out effect", as limited resources are distributed among various alternatives uses, such as consumption, investment and transfers to pay outstanding debt. High debt service payments can directly crowd out investment by preventing a country from investing in productive areas. High public debt service increases the government's interest payment and budget deficit, decreasing public savings. This may crowd out private investment by increasing taxes and/or raising interest rates, lowering available funds for private investment (Aylin , Soydan&Serap, Bedir,2015).

3. Egypt's External Debt & Economic Growth Analysis

The following table shows the external debt stock developments, external debt indicators of Egypt over the period from 2000 to 2020 as well as the evolution of some macroeconomic indicators during the same period. Egypt's debt began to rise gradually during the first decade of the new millennium, reaching $ 36.8 billion in 2010, probably due to a slowdown in global growth caused by the 2008 global financial crisis. External debt increased from $35.2 billion in 2011 to $46.5 billion in 2013 in an environment marked by political turmoil during the Arab Spring. However, by 2014, the external debt had fallen to US$ 41.7 billion and, as a percentage of GDP, had dropped to 13.7 %, the lowest level during the entire study period, owing largely to increased grants and gifts to the Egyptian government from some Arab countries.

Table (1) Egypt's External Debt Evolution & Indicators (2000 - 2020)																					
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
External Debt (b$)	29.2	28.3	29.7	30.5	31.4	30.6	31.0	34.6	33.9	35.4	36.8	35.2	40.0	46.5	41.7	49.8	69.2	84.7	100.2	115.1	131.6
Long Term ED (b$)	25.0	26.0	27.3	28.4	29.5	28.7	29.1	32.1	30.9	31.4	32.2	30.8	32.0	42.3	37.1	44.2	53.4	66.2	80.6	90.7	99.3
Short Term ED (b$)	4.1	2.2	2.2	1.9	1.7	1.7	1.7	2.2	2.8	2.6	3.1	3.0	6.7	2.8	3.3	4.4	11.9	11.1	10.3	11.3	12.0
PPG, Official Creditors	23.8	23.1	25.1	26.7	27.9	25.5	26.3	28.8	27.9	28.5	28.0	27.2	28.4	35.7	33.1	37.9	47.5	52.8	56.0	57.6	62.6
PPG, Private Creditors	0.6	2.2	1.6	1.4	1.4	3.1	2.7	3.4	2.9	2.9	4.2	3.6	3.6	6.6	4.0	6.3	5.7	13.0	24.2	32.7	36.3
Debt Service (b$)	1.8	2.0	2.1	2.7	2.2	2.3	2.5	2.9	3.3	3.0	3.1	3.7	3.2	3.4	6.0	3.8	6.6	6.7	7.9	8.8	12.0
Short-term Debt/TED	14.0	7.8	7.2	6.1	5.5	5.4	5.5	6.5	8.4	7.2	8.6	8.6	16.6	6.1	8.0	8.9	17.3	13.1	10.3	9.8	9.1
External Debt \GDP	29	29.3	34.8	37.9	39.9	34.1	28.9	26.5	20.8	18.7	16.8	14.9	14.3	16.1	13.7	15.1	20.8	35.9	38.1	37	36.2
Reserves(%ED)	44.9	45.6	44.6	44.6	45.5	67.4	78.8	87.3	95.0	91.1	91.4	42.4	29.0	29.3	28.7	26.6	30.2	39.2	38.5	35.4	25.9
Short-term Debt/Reserve	31.3	17.1	16.2	13.7	12.0	8.0	7.0	7.4	8.8	7.9	9.4	20.3	57.3	20.7	27.7	33.3	57.3	33.5	26.8	27.7	35.1
Gov. external debt / TED	70.5	76.8	76.7	79.6	81.0	79.6	79.7	78.9	78.7	76.7	76.9	77.6	68.4	64.5	60.7	60.3	46.6	49.9	51.1	53.7	56.3
External debt% exports	156	161	173	147	115.9	95.1	79.1	72.5	58.6	77.6	74.5	74.3	82.0	103.4	88.1	131	203	194.3	190.7	210.9	323.7
Debt Service	9.8	12.3	13.3	12.1	10.8	9.4	8.5	6.9	4.6	6.2	5.5	5.7	6.3	6.3	7.4	12.7	14.6	19.7	28	25.5	36.1

%exports																				
Debt Ser/Current Receipts	9.2	9.8	11.1	10.1	9.2	7.9	7.3	4.3	5.3	4.5	4.5	4.5	4.6	5.5	6.3	8.5	12.3	17.4	18.2	17.0	22.5
External Debt/Capita US$	364	376	415	423	403	404	399	450	419	399	414	388	476	507	513.5	573	879	1013	1013	1140	1273
Some Macro Economic Indicators of Egypt (2000- 2020)																					
GDP %	6.4	3.5	2.4	3.2	4.1	4.5	6.8	7.1	7.2	4.7	5.1	1.8	2.2	2.2	2.9	4.0	4.2	4.3	5.3	5.6	3.6
CA/GDP	-1.0	-0.4	0.7	4.7	5.0	2.3	2.5	0.3	-0.9	-1.8	-2.1	-2.3	-2.5	-1.2	-1.9	-5.2	-6.2	-3.4	-3.1	-3.4	-3.9
Investment/GDP	19.6	18.3	18.0	16.9	16.9	18.0	18.7	20.9	22.4	19.2	19.5	17.1	16.0	14.2	13.6	14.3	15.0	15.3	16.7	18.2	13.8
Saving/GDP	12.9	13.4	13.6	14.3	15.6	15.7	17.1	16.3	16.8	12.6	14.3	13.0	8.1	7.9	5.2	5.8	5.5	1.8	6.2	10.0	6.2
Resources Gap %GDP	-6.6	-4.9	-4.4	-2.6	-1.4	-2.3	-1.6	-4.6	-5.6	-6.6	-5.2	-4.1	-7.9	-6.3	-8.4	-8.5	-9.6	-13.5	-10.5	-8.2	-7.6
Exports (%GDP)	16.2	17.5	18.3	21.8	28.2	30.3	29.9	30.2	33.0	25.0	21.3	20.6	16.4	17.0	14.2	13.2	10.3	15.8	18.9	17.5	13.2
Imports (%GDP)	22.8	22.3	22.7	24.4	29.6	32.6	31.6	34.8	38.6	31.6	26.6	24.7	24.3	23.4	22.7	21.7	19.9	29.3	29.4	25.7	20.8
Fiscal balance(%GDP)	-5.9	-9	-10	-8.2	-8.4	-9.2	-7.7	-7.5	-6.8	-7.9	-8.1	-9.9	-10.2	-12	-11.4	-12	-12.5	-10.6	-9.7	-8.1	-7.4
Foreign Reserves (b$)	13.1	12.9	13.2	13.6	14.3	20.6	24.5	30.2	34.2	32.3	33.6	14.9	11.6	13.6	12.0	13.3	20.9	33.2	38.6	40.7	34.1

Source: researcher based on data obtained from World Bank & Central Bank of Egypt

After 2014, a new political regime saw an increase in external debt as a result of a combination of a sharp decline in remittance, Suez Canal, tourism revenues, decline in exports and FDI. The Egyptian government attempted external borrowing from IMF and the World Bank. Following that, the external debt continued to rise, reaching nearly 131.6 billion dollars in 2020 (Mesbah , Fathy, 2021).

As illustrated in previous table, Egypt's external debt stock increased from US$29.2 billion in 2000 to US$131.6 billion in 2020, indicating that external debt stock increased slightly during the first decade of the new millennium, reaching $ 36.8 billion in 2010 compared to $ 29.2 billion in 2000. Egypt's external debt increased from $35.2 billion in 2011 to $46.5 billion in 2013 but then fell back to 41.7 billion dollars in 2014. Egypt's external debt increased significantly since 2016, and at high rates as a result of recent changes in both fiscal and monetary policies, as well as economic reforms associated with the implementation of the economic reform program since 2016, achieving about US$ 84.7 billion in 2017 and reaching US$131.6 billion at the end of 2020, an increase of about US$ 16.5 billion over 2019. PPG debt from official creditors increased from US$ 1.8 billion in 2000 to US$ 62.6 billion in 2020, while PPG debt from private creditors increased from US$ 0.6 billion in 2000 to US$ 36.3 billion in 2020. As a result, external debt service increased from US$ 1.8 billion to US$ 12 billion by the end of 2020, up from US$ 59.2 billion during the same period. The external debt indicators indicated an increasing trend, particularly in recent years, further after the currency floated, as this resulted in an increase in the cost of external debt and debt burden. The external debt to GDP ratio has increased rapidly since 2011, rising from 14.9 % in 2011 to 37% in 2019 and 36.2 % in 2020. This increase in external debt was reflected in external debt indicators, where the external

debt to export ratio increased to 323.7 % in 2020, up from 74.3 % in 2011, and external debt per capita increased to 1140 and 1273 US dollars, respectively, in 2019 and 2020. However, the increase was not limited to external debt stock. It also included an increase in debt service, which is usually measured as a percentage of total exports as an indicator of a country's economic capacity to meet its foreign obligations. This percentage has risen from a low of 6% in 2010 to 29.5 percent in 2020, the highest level since the early 1990s.

The ratio of short-term debt to total external debt is an important criterion for the safety of external debt, where "short-term debt is paid back within a year or less and bears more risks." During the period 2000-2020, the ratio of short-term debt to total external debt did not fall below 5.4 %in 2005. In 2019 and 2020, the ratio of short-term debt to external debt was 9.8 % and 9.1 %, respectively. Although the maximum value of this percentage did not exceed 17.3 % in 2016, the ratio of short-term debt to net international reserves was 57.3 % in the same year. While this figure has dropped to 26.8 % in 2018 and increased again to 35.1 % in 2020 compared to only 9.4 % in 2010, it is still much higher than pre-2011 levels, which may reflect the low creditworthiness of the Egyptian economy due to the high degree of competition for international reserves among debt repayment and meet the imports value obligations. It is also worth noting that the long-term debt as a percentage of total external debt did not fall below 83.7% between 2000 and 2020, and where that debt is compatible with financing productive projects (commodities and services) that generate returns that enable the repayment of loans alongside increasing the gross domestic product at the same time, this leads to a positive consideration of this indicator.

The new millennium's economic trends followed those of the previous decade. Economic growth slowed significantly in the

first half of the decade (2000-2005). Balance of payments troubles was exacerbated by a series of external shocks, including the East Asian crisis, dropping tourism revenues attributed to the insecurity generated by the September 11 attacks in 2001, and a downturn in global trade in 2001. Chronic currency shortages forced the government to announce pound devaluations between 2000 and 2003, until it suddenly announced in January 2003 the free float of the Egyptian currency, which, in addition to rising import prices, resulted in a significant increase in external debt, which reached 37.9 and 39.9 % of GDP in 2003 and 2004, respectively. In addition to rising inflation, a high unemployment rate, a widening fiscal deficit, and rising domestic debt. Over the same time period, the trade balance deteriorated as export performance showed no signs of improvement. One of the most notable indicators that depicted the situation in the first half of the decade was the fiscal deficit, which peaked at 10% of GDP in 2002, 8.2% in 2003, and total government debt reaching around 103 % of GDP. The debt structure differed, with domestic debt accounting for the majority of total debt (CBE & Ministry of Finance). For a period from 2004 to 2007, there was a visible improvement in both the budget deficit and external sector performance as revenues increased through the new tax law as revenues rose from 7.1 %of GDP in 2005 to 9 %in 2007, and the fiscal deficit decreased from 9.6 % to 7.5 %of GDP in 2007. Furthermore, as a result of further liberalization, the balance of payments position improved through capital inflows (Omneia, Helmy, 2008).

During 2004-2008, annual GDP growth averaged 6.4%. Domestic demand, particularly private consumption, is the primary driver of GDP growth, accounting for more than 70% of GDP. The GDP's high reliance on private consumption reflects unsustainable growth because it is based on consumer

spending rather than capital formation & investment. External shocks that occurred near the end of the decade had a negative impact on Egypt's economy. Annual GDP growth fell to 4.7% in 2009, down from 7.1% in 2007. The global financial crisis impacted the major sources of foreign currency, namely tourism revenues, Suez Canal receipts, and worker remittances, causing a visible deterioration in both the budget deficit and external sector performance. As a result, the current account deficit in 2009 was $4.3 billion, while the trade account deficit was $9.2 billion. Portfolio outflows totaled US$9.2 billion, resulting in a BOP deficit and a drop in foreign currency reserves to US$32.3 billion in 2009, down from US$ 34.2 billion in 2008. In 2009, the fiscal deficit was 7.9% of GDP, up from 6.8% in 2008 .After the Egyptian economy began to recover from the negative effects of the global financial crisis, and 2010 recorded an average growth rate of 5.6 %, the balance of payments recorded a surplus of US$ 3.3 billion, and foreign currency reserves increased to US$33.6 billion. The January 2011 revolution had a significant impact on the economy. The domestic economy contracted as a result of a slowdown in both domestic and external demand, as well as persisting disruptions in production activity. In 2011, for example, the annual rate of real GDP growth fell to 1.8%. In contrast, the year 2012 saw remarkable improvements in the political side, which led to some improvements in the Egyptian economy, with real GDP increasing by 2.2% in 2012 (Hebatalla, Emam, 2012). The annual GDP growth rate has witnessed a visible improvement reaching 4.0, 4.2, 4.3, 5.3 and 5.6 % in 2015,2016,2017,2018 and 2019 respectively compared to only 2.2 % in 2014. However, as shown in the table below, domestic demand, particularly private consumption is the primary driver of GDP growth. The GDP's high reliance on private consumption reflects unsustainable growth because it is based on consumer

spending rather than capital formation and investment. Except for 2018, real GDP growth was driven by an increase in the contributions of domestic demand (consumption and investment) that reached 3.5 %. The share of domestic demand was driven by the contribution of final consumption (government and private) that registered 1.1 %, as well as the contribution of capital formation that registered 2.4 %, reflecting the increase in investments.

Table (2) Growth Rates and Share of Demand Components in Real GDP Growth at Market Prices

		Share in growth rate		
Years	**GDP growth rate**	**consumption**	**Investment**	**Net external demand**
2014	2.2	4.1	0.2	-2.1
2015	4.0	3.0	1.2	-0.2
2016	4.2	4.2	1.6	-1.6
2017	4.3	3.8	1.8	-1.3
2018	5.3	1.1	2.4	1.8
2019	5.6	3.1	1.5	1.0

Source: The Central Bank of Egypt, Economic Review, several reports.

In terms of growth rates and external debt, Egypt achieved reasonable growth rates during 2000-2010, despite achieving modest growth rates at the beginning of the period; the Egyptian economy achieved high growth rates, recording 4.09, 4.47, and 6.84 % during 2004, 2005 and 2006 respectively. After that, the increases reached unprecedented levels, achieving 7.09, 7.16 percent in 2007 and 2008. Then, in 2009, it decreased to 4.67%. From this, it's noted that an increase in growth rates from 2.4% in 2002 to 4.1% in 2004 coincided with increases in external debt to GDP as recorded 29.2% in 2010 compared to 56.5% in 1998, investment to GDP increased also recorded 39.9% in 2004 compared to 29.3% in 2001. However, from 2004 to 2005, there was an upward trend in growth rates coinciding with decreases in external debt to GDP. During 2011-2014, the economy achieved modest growth rates, recording 1.76, 2.23, 2.19, and 2.21% respectively, indicated that the high debt levels were not reflected in high economic

growth. However, during 2015-2019, the Egyptian economy began to achieve reasonable growth rates, achieved 4.01%, 4.21%, 4.31%, 5.3% and 5.6% respectively. According to below, the variance in Egypt's external debt position appears to include its composition in terms of instruments, a difference that can be traced back to the fiscal year 2016. Both the ratio of rescheduled bilateral loans and the ratio of regular bilateral loans declined, while the share of loans from international institutions, deposits, bonds, and medium-term facilities for suppliers and buyers, and short-term debt increased. Despite the fact that diversification is beneficial, in the current situation, it implies the presence of types that may not be possible to be included in a plan or request to delay payment in accordance with what some countries and international financial institutions are now proposing. According to 2020 data, bilateral loans and loans from international institutions could be included in such a plan, accounting for 46% of the external debt. Deposits, on the other hand, can have their terms extended, and they account 11% of the external debt during the same time period. The rest of the debt types, particularly short-term debt, medium-term supplier facilities, and bonds, will require different treatment because they represent a commitment with non-sovereign entities; it will not be possible to refinance bonds through other bonds.

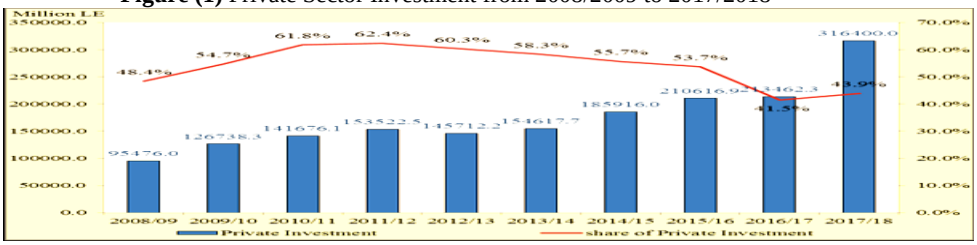
Table (3) Structure of External Debt According to Type of Debt (%), selected years.

	2008	2009	2010	2011	2016	2017	2019	2021
Rescheduled bilateral loans	46	45	37	37	9	5	3	2
Other bilateral loans	15	15	14	15	11	8	9	8
International and regional institutions	22	26	30	31	25	28	30	36
Buyers' and suppliers' facilities	2	1	1	1	6	8	10	9
Long-term deposits	0	0	0	0	29	23	16	11
Bonds	8	6	9	8	6	11	18	21
Short-term debt	7	7	9	8	13	16	10	10

Source: Central Bank of Egypt, Report on the External Position of the Egyptian Economy, various issues.

External borrowing was theoretically intended to support the stability of macroeconomic indicators. The CBE had already used a significant portion of its external debt to rebuild its foreign reserves, increasing them from $ 13 billion in 2015 to $ 40.7 billion by the end of 2018. This coincided with a relative stabilization of the pound-to-dollar exchange rate. The main justification for increasing external borrowing was to improve the macroeconomic environment to re-attract foreign capital in the form of investments. Official data show that external debt growth rates have been much higher than economic growth, which has not been significant in the last decade. In contrast, Egypt's external debt has increased at an unprecedented rate when compared to pre-2011 levels. The following graph illustrates the crowding out of the private sector. Although private sector investment has returned to positive growth since 2013/2014, reaching 316.4 L.E billion in 2017/2018, which is 3.3 times the amount in 2008/2009, the share of private investment has declined from 61.8 % of total investment in 2010/2011 to around 41.5 % in 2016/2017 and enhanced in 2017/2018 to reach 43.9% in 2017/2018.

Figure (1) Private Sector Investment from 2008/2009 to 2017/2018



Source: Ministry of Planning Monitoring and Administrative Reform.

4. Reasons behind External Debt Accumulation

According to the previous analysis, the following factors, resulting in the accumulation of external debt:

• The decline in exports and expansion of trade gap, as exports of goods and services as per cent of GDP recorded downward trend reached 10.3 % in 2016 compared to 20.6% in 2011then increase slightly to record 13.2%, the trade gap deficit increased

from 4.1 % of GDP to 8.2% and 7.6% in 2019 and 2020 respectively.

• Fiscal problems persisted, although the Ministry of Finance has taken many steps since 2004 to correct for structural fiscal problems and address the fiscal vulnerability, which reduced the fiscal deficit from 9.5 % of GDP in 2001 to 7.9 %of GDP in 2009, it increased again to 10.2 % of GDP in 2012 and 12 % of GDP in 2013 due to Egypt's public finance conditions came under significant pressure with the polity. As part of the economic reform program, the government initiated a remarkable fiscal adjustment, reducing the fiscal deficit from 12.5 % of GDP in 2016 to 8.1 and 7.4 % of GDP in 2019 and 2020, respectively.

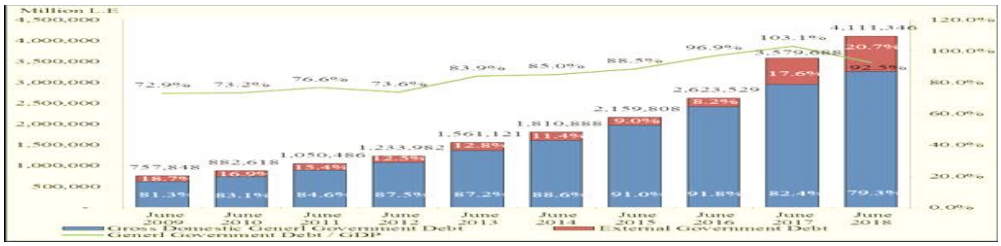
• The widening gap between savings and investment requires the supplementation of domestic savings with foreign resources in order to boost investment and increase the rate of economic growth.

• The reliance on external loans is seen as part of the increasing financial liquidity phenomenon in international financial institutions as a result of the global economic downturn, and as a result, foreign loans substitute investment inflows, making many developing countries, including Egypt, vulnerable to a debt crisis. For example, the International Monetary Fund has loaned US$57.43 billion to six Middle Eastern countries since 2011, in addition to the most recent loan of US$12 billion to Egypt (Martin, Khor, 2014).

• Ministry of Finance launched its Medium Term Debt Management Strategy, which was run for three fiscal years. The figure below illustrates the Ministry of Finance's actual intent to finance its needs from the external market. However, the rise in the share of external debt in the debt structure should not be explained solely by the rise in external governmental debt, as

another important factor that reinforced the effect was the floating of the Egyptian pound in 2016.

Figure (2) General Government Gross Debt from June 2009 to June 2018



Source: Mohammed ,Abdu,(2019)," Dealing with Egypt Public Debt Accumulation Problem", Business and Economic Research, working paper, ISSN 2162-4860, Vol. 9, No. 4,p.133

• The Egyptian pound fell in value after the country switched from a fixed exchange rate system to a floating exchange rate system in November 2016.

• Egypt's external debt has been steadily increasing since the signing of the IMF agreement in 2016. According to Central Bank data, total external debt increased from $ 26 billion in 2001 to $ 48 billion in 2015, and then jumped to $ 81 billion in 2017, reaching 92.6 and 105 billion in 2018 and 2019, respectively, as the Egyptian government's annual funding gap was estimated at $ 21 billion, of which Egypt provided $ 12 billion by borrowing from the IMF over the last three years.

• The disruptions caused by the COVID-19 pandemic, as Egypt's foreign reserves fell significantly caused by large capital outflows at the start of the COVID-19 crisis, in addition to the decline revenues. Egypt has obtained external financing, including a US$2.8 billion stopgap loan from the IMF's Rapid Financing Instrument, a US$5.2 billion Stand-by Arrangement, a US$5 billion sovereign Eurobond, a US$0.75 billion sovereign Green-bond, and US$2 billion loans from a UAE-led commercial bank consortium.

5. Egypt's External Debt Sustainability

According to IMF external DSA 2021, the level of external debt appears to be relatively low by international standards and is projected to fall in the medium term as the external position improves under economic reform policies to 25.9 % of GDP by 2025. The non-interest current account deficit is also expected to fall to 1.3 % of GDP in the medium term, down from 2.3 % in 2020 under the baseline scenario. Under each of the bound tests and the alternative scenario, For example, a significant depreciation or a persistently negative shock to the current account would increase the projected path of external debt. Under the 30% exchange rate shock, the level of external debt will rise to around 50% of GDP in 2022 but fall to around 33% of GDP in the medium term (IMF, 2021).

Despite the global outbreak of the COVID-19 and the S&P's expectations of a sharp decline in the Egyptian economy, Standard & Poor's maintained Egypt's credit rating at B with a stable outlook. This reveals the persistent confidence of international institutions, particularly credit rating agencies, in the Egyptian economy's stability and solidity, as well as its ability to positively handle the consequences of COVID-19 and overcome all external and internal subsequent shocks. Fitch also confirmed Egypt's B+ rating in July 2020, with a stable outlook. Egypt's recent track record of fiscal and economic reforms, improvements in macroeconomic stability and external finances, as well as policy commitment to advancing the reform program and the ready availability of fiscal and external financing in the face of the COVID-19 pandemic, all contribute to the rating. Fitch also stated that recent economic reforms have given Egypt some flexibility in dealing with the shock and ramifications of the pandemic (The Egyptian Cabinet, 2021).

Table (4) Egypt Long-term Sovereign Credit Ratings

	Pre-2016		**Post-2016**	
	Rating (outlook)	**Date**	**Rating (outlook)**	**Date**
Moody's	B3 (stable)	Apr 07, 2015	B2 (stable)	July ,2020

S&P	B- (stable)	Nov 13 ,2015	B (stable)	May, 2021
Fitch	B (stable)	Dec 19, 2014	B+ (stable)	Oct, 2021

Source: The Egyptian Cabinet, Information and Decision Support Center.

6. Egypt's current external position versus previous crises

The following table contains some economic indicators that describe Egypt's external financial position's readiness to the Corona crisis. The comparison made with the years preceding the Global Financial Crisis and the 2011 Revolution.

Table (5) External position of the Egyptian economy

	Global Financial Crisis		**2011 Revolution**		**COVID-19 crisis**		
	Before crisis 2007/2008	**After crisis 2008/2009**	**Before crisis 2009/2010**	**After crisis 2010/2011**	**Before crisis 2018/2019**	**After crisis 2019/2020**	**After crisis 2020/2021**
Net international reserves (b $)	34.2	31.3	33.6	14.9	44.3	38.2	40.6
reserves in months of imports	6.8	6.1	6.2	2.6	8	7.3	6.9
Balance of payments (b$)	5.4	-3.3	3.3	-9.7	-0.10	-8.6	1.9
Current account / GDP (%)	-0.9	-1.8	-2.1	-2.3	-3.4	-3.9	- 5.3
External public Debt/GDP	18.9	16.6	14.7	13.0	36.0	34.0	34.2
Net Bank Foreign Assets (b$)	23.1	14.7	16.1	17.8	2.2	-2.1	1.7
Debt Service / Exports (%)	4.6	6.2	5.5	5.7	25.5	36.1	35.4
Debt Service / Current Receipts(%)	5.3	4.5	4.5	4.5	17.0	22.5	20.5

Source: The Central Bank of Egypt, Report on the External Position of the Egyptian Economy, Various Issues.

According to the data in the previous table, it's noted that, despite the high level of net international reserves prior to the Corona crisis, recording US$44 billion at the end of 2019, and achieving US$38 billion by 2020 to slightly increase to 40.6 billion in 2021 compared to $34 billion prior to the global financial crisis and US$33 billion prior to the 2011 crisis. However, a higher level of reserves does not necessarily imply greater financial space at the moment, as higher external financing requirements, coupled with continued pressure on

current account receipts, may result in renewed pressure on foreign reserves. The Egyptian economy's transactions with the rest of the world resulted in an overall BOP deficit of US$ 8.6 billion in 2019/2020, compared to 0.102 billion the previous year, as the current account deficit has been almost stable compared to the previous year (the second half of which witnessed the negative repercussions of the COVID-19 pandemic). As a result, the current account deficit increased slightly. The noticeable improvement in the non-oil trade balance, as well as the increase in unrequited current transfers, helped to mitigate the impact of this shock on the Egyptian economy. On the other hand, the years prior to the global financial crisis and the 2011 crisis saw a balance-of-payments surplus, which aided in the relief of the crises when they took place. Banks' net foreign asset position at the end of the year prior to the Corona crisis (2018/2019) was lower than in previous comparable years. The overall analysis shows that Egypt's external debt and its service position is worse now than it was during the global financial crisis or even during the January 2011 Revolution.

7. Conclusion and Policy Recommendation

Rising external borrowing was a direct way out from the complex crises that the Egyptian economy faced after 2011. The main justification for increasing external borrowing was to improve the macroeconomic environment in order to re-attract foreign capital in the form of investments. However, official data show that since 2016, external debt growth rates have been much greater than FDI growth, which has not been significant in the last decade. Egypt's external debt, on the other hand, has risen in an unprecedented manner compared to pre-2011 levels, particularly during the last 20 years, which have been characterized by a lowering in external borrowing. As a

consequence, it is clear that the direct impact of the IMF agreement has been to facilitate access to more external loans, thus lenders have greater confidence in the Egyptian government. This primarily means that the risk of bankruptcy does not exist as long as borrowing to repay liabilities continues. However, the risk of falling into a "debt trap" would have long-term negative consequences for development. Accordingly, this study recommends reducing Egypt's external vulnerabilities by pursuing two complementary goals which are reducing overall reliance on external financing and shifting of external financing sources in favor of stable, growth-enhancing sources. In order to accomplish this, several policies must be implemented in order to deal with the growing stock of external debt while avoiding further debt accumulation. Policies can be proposed to describe how these goals can be met with available resources and how to deal with new loans that have begun with the existing amount of accumulated debt, suggested as follows:

- External debt restructuring targeted, this will potentially minimize interest payments and reduce the overall deficit; it can be accomplished through a variety of methods, such, the current pandemic crisis has induced international calls for debt forgiveness and debt restructuring for developing economies, which Egypt can capitalize on. Debt swaps can be organized, especially given the growing popularity of "debt-for-environment" swaps, in which debtors offer partial debt relief in exchange for forgiven debt payments being oriented to projects with significant environmental gains. Reducing the proportion of short-term debt and moving away from private debt, and then external debt structure is restricted to productive loans only, diversification external lending sources as criterion must be "the best conditions offered" and the government should pay more attention to

debt management and expenditure items, and try to direct them to productive uses.

- Rationalizing government spending and increasing tax revenue, capital expenditures on different investment projects can be replaced by effective public-private partnerships, in which the private sector can play its natural position. This measure is then predicted to have a lower contraction impact because total infrastructure spending may be maintained while the source of financing is switched from public funds to private investments. A predictable and progressive tax system is required for a successful and long-term increase in tax revenue. A simplified tax code will lower the barriers to entry for smaller businesses into the formal sector. Moreover, taxes on the digital economy, environmental taxes, and corrective taxes on health concerns like alcohol, tobacco, and sugary beverages and food could expand and strengthen tax revenue collection. Stimulating and encouraging remittances from Egyptians working abroad to flow through financial stability channels and be calculated within external liquidity, as remittances from Egyptians working abroad are assumed one of the most essential sources of foreign currency revenue after the Suez Canal and tourism revenues.
- Enabling environment for private investments, in addition to fiscal consolidation, institutional reforms are required to create an enabling business environment for the private sector. The government has made massive infrastructure investments in recent years, which has a positive impact on long-run productivity growth. This, however, can only be actually realized if the private sector acquires its role as the engine of growth and job creation. Reforms in investment environment should aim to eliminate all barriers to investment and create a suitable field for the private sector.

Customized policies are required to increase private investment (domestic and foreign) in manufacturing industries with export potential. Over time, this will lead to an increase in non-oil exports, which could be the driving force behind achieving a stable CA surplus.

- Targeting the trade balance to decrease the import bill and reform its structure, as it is the main source of financial instability, particularly due to distortions in its structure, which helps to stop the deterioration of foreign reserves; broadening the export revenue base (export diversification); improving the performance of technical education to improve productivity levels and reform the structure of Egyptian exports; and promoting industrialization to reduce import dependence.

Fiscal consolidation is a critical step in breaking the cycle that is worsening external vulnerabilities. A decrease in the overall government budget deficit will decrease the CA deficit and relieve pressure on the Bop. It also liberates the short-term interest rate as a monetary policy tool to reach its goal of delivering low and stable inflation rates. In order to improve the CA balance even further, measures to increase domestic private savings are also required. Finally, creating suitable business environment for the private sector is critical to attracting both domestic and foreign direct investments. It is also worth noting that fiscal consolidation is, in general, a contraction; however, the measures listed above are intended to reduce the contraction impact.

References

- Emam, H. (2012)," Monetary and Fiscal Policies in Egypt Post 25th January Revolution", LSE Middle East Centre, **Conference Paper**.
- Fathy, M. (2021),"The Asymmetric and Threshold Impact of External Debt on Economic Growth: new evidence from Egypt", Journal of Business and Socioeconomic Development Emerald, **Research Paper**, No, 2635-1374.
- IMF, (2021)," Consultation and Second Review under the Stand-By Arrangement", **Country Report** No. 21/163.pp.46-54.
- Kharusi,S & Stella,M (2018)," External Debt and Economic Growth: The Case of Emerging Economy ", Journal of Economic Integration, **working paper**, Vol.33 No.1.
- Khor, M (2014)," Resolving Debt Crises: How a Debt Resolution Mechanism Would Work", South Centre, **Policy Brief**, no. 16.
- Mustapha,M (2016)," Debt Overhang versus Crowding Out Effects: Understanding the Impact of External Debts on Capital Formation in Theory", International Journal of Economics and Financial Issues,**working paper,** Vol 6, Issues1.
- Omneia A. Helmy,(2008),"The Impact of Budget Deficit on Inflation in Egypt", ECES, **working paper**, No. 141.
- Pattillo, C& Poirson,H (2004)," What Are the Channels Through Which External Debt Affects Growth?", International Monetary Fund,**working paper**, WP/04/15.

- Serieux,J & Samy,Y (2001)," The Debt Service Burden and Growth: Evidence from Low Income Countries", World Institution for Development Economic Research ,working paper.
- Soydan, A & Bedir, S (2015)," External Debt and Economic Growth: New Evidence for an Old Debate", Journal of Business, Economics & Finance, **working paper**, Volume: 4 Issue: 3.
- The Egyptian Cabinet, (2021), Information and Decision Support Center.