Chapter 15
The Future of Public Finances in Egypt

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ABSTRACT

Egypt, a country of 82 million people with a GDP of $272 billion, is arguably one of the most important countries in the Middle East. At this stage of its transition, the structure and level of public finances are more critical than ever. Like many countries, Egypt suffers from substantial non-compliance, which undermines the entire system of public finance, yet there has been relatively little focus on addressing this issue in Egypt. This chapter is focused on a review of the recent history of Egypt’s public finances and a unique experiment that aims to better understand the potential for political institutions to affect tax compliance at a time when those institutions are under development.

INTRODUCTION

Egypt, a country of 82 million people with a GDP of $272 billion, is the most populous and arguably one of the most influential countries in the Middle East. At this stage of its transition, the structure and level of its public finances are more critical than ever. Like many countries, Egypt suffers from substantial tax non-compliance, which undermines the entire system of public finance, yet there has been relatively little focus on addressing this issue in the country. This chapter is focused on a review of the recent history of Egypt’s public finances and a unique laboratory experimental study that aims to shed some light on the determinants of tax compliance behavior at a time when political institutions are under development making existing field data obsolete.

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The structure of public finances in Egypt is not unlike many countries—a combination of own-revenue sources including taxes, fees, and charges, and in addition, grants and loans. In general, the larger the share of own revenue sources in overall government revenue, the more sovereignty a country retains. Tax compliance directly affects the ability to raise own source revenues and this ability is critical to the long term fiscal sustainability of a country. Fiscal sustainability itself allows governments to engage in thoughtful long-term budgeting and planning which support the growth of nations.

The Arab Spring, which began in late 2010, called for new forms of representative governance in countries including Tunisia, Algeria, Yemen, Libya, and Egypt. Since 2011, Egypt witnessed the resignation of long-time ruler Mubarak, the election of President Morsi and the development of a new government. The ouster of Morsi in June 2013 continued the precarious political situation and increased concerns of the country’s ability to serve the needs of its population. Partially as a result of this tumultuous period (and some would say years leading up to the Arab Spring), the government’s budget is in a risky situation. In the financial statement of the Government of Egypt budget plan for the year 2014/15, tax revenues are estimated to reach 15.2 percent of GDP, a figure well below world averages of 35.6 percent in developed countries, 25.5 percent in emerging markets, and 22.8 percent in low-income countries (The Ministry of Finance, 2014) and the UN’s estimate of 20 percent to reach the millennium development goals. Gross domestic budget sector debt has grown from 68 percent in March of 2011 to 80 percent in March 2013 yielding deficits of 10.7 percent of GDP which is far above the planned deficit of 7.6 percent. Outstanding public (domestic and external) debt is staggering at a rate of approximately 100 percent of GDP (The Ministry of Finance, 2013).

Since 2011, various leaders in the country have attempted to engage in a policy discussion regarding the country’s public finances. The 2012/13 budget preparation circular in fact speaks to the social contract of government finances and the public. The two pillars referenced in the document call for transparency, accountability, and trust:

“Reconstruct trust and safety between citizens and government”

and

“Increase national income and economic growth...to assure a good life for citizens”

While tax compliance is a necessary component of strengthening and stabilizing Egypt’s finances, there is very little research that can be called on to assist policy makers in the country. A series of reforms have been called for to spur lasting economic growth and development. Those reforms include structurally reforming the tax administration, strengthening of the judicial system, better protection of property rights, and more effective action against growing corruption—much of which is aimed at creating a more transparent and efficient government that is accountable to the population.

In this chapter, we take a novel look at factors affecting tax compliance in Egypt. We first provide a review of the country’s fiscal structure and recent legislation focused on fiscal policy. We then turn to a discussion of determinants of tax compliance—one of the critical issues for solvency of government finance. In Egypt, there has been little study to date of the compliance issue. In addition, the political changes the country is experiencing (such as unprecedented political participation of citizens and the cherished initiated motion to withdraw confidence from the president) render previous field data inadequate. Therefore, we designed a laboratory experiment on tax compliance to test several hypothesis
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