*Chapter 5*

# Conclusion

*Egypt has made impressive strides with regard to improving its business environment in recent years. So far, much of the government's reform effort has focused on improving the macro-economic framework. This is the case with regard to policies such as banking sector reform, income-tax reform, improving the monetary policy framework, opening up the capital account and allowing free and unhindered capital transfers, and the lowering of average weighted tariffs.*

*Despite these improvements, Egypt still does not fulfill its potential as a high-growth economy, or to become the prime investment location warranted by its geographical position. Foreign investment still accounts for less than one-third of all investment, and FDI inflows fell between mid-2008 and end-2009. The competition for global investment is fierce and a country such as Egypt should no longer count on low costs to attract investors. To attract high value-added investors, a better overall investment climate is needed. This chapter presents the conclusions to the Business Climate Development Strategy findings for Egypt and finishes by inviting the Egyptian government to pursue its reform efforts in order to achieve its growth objectives.*

## 1. Egypt has made progress on business climate reform which has translated into economic growth

Egypt has made impressive strides with regard to improving its business environment in recent years under the reform impetus of the pro-business government which came to power in mid-2004. The progress is reflected in the fact that Egypt has consistently been in the World Bank's *Doing Business* list of "Top Reformers" over the past five years.

So far, much of Egypt's reform effort has focused on improving the macro-economic and overall structural framework of the economy. This is the case with regard to policies such as the first phase of banking sector reform, income-tax reform, improving the monetary policy framework, opening up the capital account and allowing free and unhindered capital transfers, and the lowering of average weighted tariffs for imports.

In addition, efforts have been put into improving the investment climate in particular, through the implementation of reforms at the micro level. These have been helped through having a dedicated Ministry of Investment and incorporating the General Authority for Investment (GAFI) into the ministry. This has enabled GAFI to become a one-stop shop and gradually improve Egypt's appeal to foreign investors. Other reforms and policies have been implemented in areas as diverse as privatisation and public-private partnerships, new phytosanitary rules, consumer protection, measures to improve corporate governance, steps to tidy up and reduce Egypt's reams of red tape, the modernisation of tax administration, initiating infrastructure improvements, and starting to address the issue of access for finance for small and medium-sized enterprises (SMEs).

As a result of the government's sustained efforts, GDP growth rose steadily between 2004 and 2008, averaging 7% a year in the three years preceding the international financial crisis. Tax receipts increased and compliance started to rise. The general government budget deficit narrowed and public debt was reduced (although the government's counter-cyclical fiscal policy has meant that the deficit has widened again since the onset of the financial crisis). Foreign direct investment (FDI) rose to USD 13.2 billion in fiscal year 2007/08, the year preceding the global recession. Foreign-exchange reserves rose significantly in step with larger inflows of FDI and rising receipts from tourism and transit through the Suez Canal.

All told, the progress since the economic reforms were launched in 2004 has been impressive and tangible benefits can be observed in Egypt's improved economic performance and rising FDI flows. The improved macro-economic climate did enable Egypt to broadly escape the most crippling effects of the global recession: the economy slowed, but did not contract, with real GDP growth remaining around the 5%-mark, and domestic banks have retained ample liquidity. Since the onset of the crisis, however, inward investment has been affected by the squeeze on credit in international financial markets and rising global competition for investment. This is one of the reasons why Egypt needs to pursue its reform programme.

## 2. More and further-reaching reforms are needed at the micro-economic level in order for Egypt to maximise its potential as an investment location

Despite these improvements, Egypt still does not fulfil its potential as a high-growth economy, or to become the prime investment location warranted by its geographical position at the crossroads between Europe, Africa and Asia. Foreign investment still accounts for less than one-third of all investment, and FDI inflows fell between mid-2008 and end-2009. The competition for global investment is fierce and a country such as Egypt should no longer count on low costs to attract investors. This is especially true if investment is also sought to help upgrade local skills and achieve improvements in know-how through transfers of skills and technology. To attract high value-added investors, a better overall investment climate is needed.

The in-depth assessment of the Egyptian business climate, carried out under the Business Climate Development Strategy (BCDS) process by the MENA-OECD Investment Programme has revealed several areas where more progress is needed in order to maximise Egypt's potential as a prime business location. Many of these findings are related to the business climate in general, and therefore are relevant to domestic and foreign businesses alike. The Egyptian government now – more than ever – needs to focus its energy on maintaining the reform momentum.

The BCDS findings and recommendations have been structured around 12 policy dimensions and a number of "cross-cutting" findings, common to most of the dimensions assessed. In general stakeholders report an absence of predictability and transparency in policy making. This is made worse by the fact that existing rules are not always evenly applied, and by a general lack of institutional enforcement capacities. This has led to a degree of scepticism towards the government's reform programme among investors, both domestic and foreign.

The problem of non-predictability is made worse by the pervasiveness of the informal sector. The presence of a large informal sector prevents competition policy from achieving full impact, undercuts domestic regulatory work and hinders effective tax collection. Linked to this are continued difficulties with achieving full market openness and access. Quasi-monopolies continue to operate in domestic product markets, including for construction materials, and technical barriers to market entry remain high, preventing competition policies from being effective, especially in the retail sector. The provision of professional services still remains closed to non-Egyptians. The absence of genuine competition in domestic markets is reflected in a still-high inflation rate which continues to hover around 10%. The government needs to push forward the enforcement of its recently enacted competition policy framework. The new Egyptian Competition Authority has yielded mixed results: more clarity and consistency in its rulings would be beneficial. In addition, remaining non-tariff and technical barriers to trade should be progressively listed to ensure full competition in Egypt's domestic product markets, especially, but not exclusively, for foreign retailers.

Moreover, the individual BCDS findings reveal that investors are still struggling to navigate the Egyptian investment landscape: local and foreign investors continue to feel a need for improvement at the operational level of doing business. Among some of the key findings and recommendations, we can mention:

Obtaining licences, permits, and gaining access to land remain significant obstacles, as does the provision of infrastructure for businesses. Clearer and simpler licensing rules are still needed and bureaucracy is still overwhelming at the local level. Pushing forward with the government's programme to streamline regulation (ERRADA) would be a positive step in this direction. Moreover, business inspections continue to pose problems owing to their high number and arbitrary nature. Each such interaction between government and the private sector bears costs to the firm in terms of regulatory compliance and uncertainty. Petty corruption (and grand, too) continues to hamper the smooth conduct of business. Sudden policy reversals and haphazard, uneven application of the laws at the local level continue to underpin deep scepticism with regard to the effectiveness of government reform. An inadequate legal framework in some cases cannot cope with the needs of modern finance. The creation of the new economic courts is an important step in the right direction, but to fully mitigate the inadequacies in the system, they need to be given the proper means. Their work is still hampered by the fact that judges have not been trained in the complex issues in modern international business. A dedicated training budget should be allocated to the judges in order to help speed up the process.

Small-and-medium sized companies still face difficulties in obtaining the necessary financing; while many small entrepreneurs and the population at large lack the necessary skills to use the measures already in place to help small businesses. There is an acute lack of financial literacy and general skills needed to run a business which in turn make banks reluctant to lend. Some of these issues may be addressed through more focused work by the new SME units that are being created by GAFI (see below). SME units should also help companies file tax returns and offer positive incentives to companies if they register and leave the informal economy.

Human capital is underused, and hiring is hampered by significant skills mismatches in many sectors. The human capital issue remains a significant problem with regard to the overall quality of Egypt's business climate. Even so, fast results could be obtained through better-targeted vocational and on-the-job training programmes. In many of these areas, targeted training programmes and workshops to build capacity would assist the government in overcoming some of the obstacles. Other efforts would aim at enhancing the government's outreach abilities; this is especially needed with respect to communicating its policies efficiently.

Generally speaking, much progress could be achieved by better co-ordination between ministries (interministerial co-ordination) and between line ministries and agencies or local government. There is a strong need for the government to improve its communication – both with stakeholders directly affected by policies and with the population and the business community at large.

Finally, there is still scope to improve Egypt's investment promotion strategy and framework. A detailed analysis of Egypt's most competitive sectors, focusing on key competitive advantages and employment opportunities would help focus and target investment promotion efforts, especially with regard to selecting potential private investors (countries and/or individual investors). This could be helped by spinning off the Investment Promotion function of the General Authority for Investment (GAFI), which also has regulatory functions and serves as company registry, in addition to allocating investment. A dedicated Investment Promotion Agency would significantly improve Egypt's investment promotion efforts and help serve as a focal point for potential investors. The investment promotion efforts should also be linked to an overall improvement of the newly created Investment Zones. The services on offer should be improved, and their development should be specifically geared to the creation of competitive clusters in order to attract high-value added investments. This would also have positive ramifications for the local economy through involving small and medium sized enterprises in the supply chain.

What stands out most of all from the BCDS exercise is the importance of continuing the work already set in motion. Stakeholders still complain about the business climate, but most agree that improvements, although insufficient, have been tangible and measurable. The BCDS findings and recommendations aim to offer support to the government in its drive to address these concerns and to achieve better targeted reforms.

## 3. The next phase of the BCDS focuses on defining policy priorities and on project implementation

Having concluded the first phase of the BCDS – the main findings of which have been discussed in the previous chapters – the next phase of the process consists of drawing out the policy priorities from the numerous recommendations that have emerged and making these recommendations operational through targeted projects. The most important recommendations will be formulated as project proposals to include objectives, concrete action steps, a timeline and a budget.

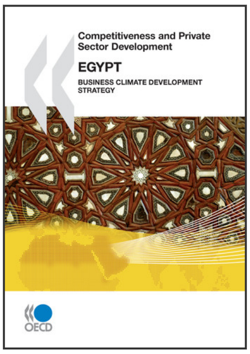
To this effect a series of workshops have already been held in Cairo, where the recommendations were presented to, and discussed by, stakeholders from both the public and private sectors, including international donors and private investors. The results of these consultations have already been incorporated into the recommendations presented here. They have also helped the BCDS team draw out the priorities for each of the 12 dimensions covered by the BCDS.

In light of the fact that the exercise has been going on since the beginning of 2009 and that there has been continuous dialogue between the MENA-OECD Investment Programme and the Egyptian government, some of these recommendations have already been taken on board and implementation has begun. This is the case with regard to the nine holding companies that control the remaining state-owned companies. It was recommended that the holding companies be gathered into a single entity. This entity is currently being formed and will become operational during 2011 once the relevant law has been passed.

Improving access to finance for SMEs is another point. The BCDS suggested the creation of one-stop outlets to better focus the delivery of services to SMEs at the local level, outside of Cairo. Early in 2010, GAFI set up an SME Unit and is now working on rolling out local "one-stop shops" for SMEs in Egypt's 29 governorates. A programme to train the staff for these SME outlets is currently being implemented with the help of the Canadian International Development Agency (CIDA).

The BCDS team recommends that an Inter-governmental Committee be formed to oversee the implementation of key business-climate projects where they impact several ministries or government agencies. For instance, the Moroccan government, which has conducted a BCDS process in parallel with the one in Egypt, has set up a National Business Environment Committee to oversee the implementation of cross-cutting recommendations. In Egypt, such a committee could be formed in the Office of the Prime Minister, or under the auspices of the Ministry of Investment which already oversees investment policies.

In Egypt, this first experience of the BCDS has been an exciting and challenging task. The MENA-OECD Investment Programme is grateful for having taken part in the work done by the Egyptian government as it seeks to push forward with its reform programme in a difficult national and international economic context. It is vital that the reform momentum does not stop now. The international financial crisis and increasing global competition for investment mean that a government needs to seize the opportunities offered to reform their domestic business climates and ensure they remain on the map. The post-crisis global market is likely to be a very different place from the 2008 heydays of fast growth and easy money. By maintaining its business climate reform programme, Egypt will give itself a better chance to become a high-growth economy and thereby ensure a better future for its large, young population.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