Egyptian National Competitiveness Council

The Egyptian Competitiveness Report 2004-2005

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EGYPTIAN NATIONAL COMPETITIVENESS COUNCIL

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2004-2005

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At the Egyptian National Competitiveness Council, leaders from business, academia, labor and government collaborate to increase awareness of competitiveness and its economic implications for industry.

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It is quite satisfying to join efforts in issuing a report that we know can provide valuable insights to those who work hard on the development of Egypt.

Hossam Badrawi	Helmy Abouleish
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WHAT THE ECONOMIC TEAM IS SAYING ABOUT THE EGYPTIAN COMPETITIVENESS REPORT 2004-2005

Minister of Finance Youssef Boutros-Ghali

The Egyptian Competitiveness Report 2004-2005 reviews key recent changes in the Egyptian economy, analyzing their implications for our skill requirements and international competitiveness. It takes a look at Egypt's economic performance during the past year: what drove recent economic growth and where economic performance has fallen short. It lays out to businesses and policymakers a whole spectrum of challenges and opportunities to enhancing Egypt's long-term competitive advantage.

The report makes bold statements about the significance of upgrading our infrastructure to improve the quality of education, science, technology, and training systems, and makes it clear that a culture of reform must be adopted to help Egypt keep up with global institutional changes. It also points to areas where Egypt has shown declining competitiveness and other areas where Egypt has managed to maintain its rankings but has been outperformed by peer countries in the developing world.

The Egyptian Competitiveness Report 2004-2005 raises many important questions for ongoing policy debates. How can we encourage partnerships between the state and firms that will help sustain what must become a relentless effort to catch up and stay competitive with other countries? How can we address long-term issues on competitiveness in order to match the dynamism of our emerging economy with regional and global economies? How can we promote a well-functioning market economy that encourages the development of institutions that ensure the sustainability of policies over generations of governments in order to keep up with other industrializing countries that are constantly changing the competitive landscape? How can we start to build on our unique advantages to avoid falling behind and, more importantly, go beyond trying to catch up?

Minister of Foreign Trade and Industry, Mr. Rachid Mohamed Rachid

In its second year, the Egyptian Competitiveness Report 2004-2005 continues to review, synthesize, interpret, and draw implications from the available evidence on the competitiveness of the Egyptian economy. The report uses indices developed by the World Economic Forum to analyze trends in Egypt's competitiveness ranking over the past several years. The 2004-2005 report asks that special attention be paid to the role of institutionalizing reforms in enhancing Egyptian competitiveness to help set the stage for the effective and sustainable implementation of strategies for growth and development.

A number of concerns pointed out in the report remind us that Egypt has the potential to do much more in order to catch up with rapid global advancements. Increases in competitiveness are brought about by taking advantage of a number of factors: (i) macroeconomic stability; (ii) good governance; and (iii) a sound institutional infrastructure.

However, Egypt cannot compete on the basis of price alone as a long-term competitive factor. Increasing productivity is the key to increasing the competitiveness of businesses in Egypt. This requires investing in human infrastructure to develop a more highly qualified, creative labor force that, despite the challenges, is a longer-term driver of competitiveness.

With particular reference to exports, the past few years saw favorable trends as exports grew at healthy rates. Our export promotion strategy aims at slowly shifting Egypt's export mix towards more dynamic and technologically intensive products and services. As our firms continue to compete in an ever-globalizing market, the government will continue to ensure the smooth functioning of the market economy.

The Egyptian Competitiveness Report 2004-2005 has once again brought important issues to the limelight and we hope it continues to measure the impact of reforms on Egyptian competitiveness and enriches the policy debate.

Minister of Investment, Dr. Mahmoud Mohieldin

The main thrust of the Egyptian Competitiveness Report 2004-2005 is on the importance of institutionalizing reforms to facilitate and ensure the sustainability of Egypt's international competitiveness. Asserting that sound macroeconomic and structural policies are needed to enable a highly competitive economy, the report calls for a coalition of government, businesses and stakeholders to foster long-lasting competitiveness.

The report addresses the crucial role of a highly skilled workforce not only in fostering economic and social welfare but also in helping institutionalize reforms. Skills formation has stimulated the creation of a highly skilled workforce in industrialized economies. This raises a key question: *What are the conditions under which Egypt can attain a high-skill economy in order to not only improve its international competitiveness in the short term but sustain it over the future generations*?

There is no simple or immediate solution. The economic, regulatory and policy environment mix should be directed to facilitate the links between economic strategies and the skills-creating areas in the economy such as education and training. A long-term strategy should be developed nationwide to match labor skills to market needs. As the links become embedded in the key social institutions of a highly skilled society (including schools and the manufacturing sector), there will be positive spillovers on the demand for cost-effective and high-quality Egyptian products.

Elements of this strategy should include the consensus and commitment of the government and other stakeholders to (i) upgrade skills; (ii) develop long-term entrepreneurial innovation rather than short-term cost-cutting approaches to productivity and competitiveness; and (iii) ensure the compliance of all stakeholders to this strategy.

The Egyptian Competitiveness Report 2004-2005 provides a helpful analysis of the drivers of international competitiveness. As a long-term partnership between all stakeholders in the Egyptian economy takes hold, it provides many promising ideas for improving Egypt's competitiveness.

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ACRONYMS

BSCI	Business Competitiveness Index
CBE	Central Bank of Egypt
EOS	Executive Opinion Survey
ENCC	Egyptian National Competitiveness Council
FDI	Foreign Direct Investment
GLCI	Global Competitiveness Index
GRCI	Growth Competitiveness Index
IMF	International Monetary Fund
MOF	Ministry of Finance
MFTI	Ministry of Foreign Trade and Industry
WEF	World Economic Forum

PREFACE

The Egyptian National Competitiveness Council (ENCC) tracks key indicators of Egypt's performance to measure the global competitiveness of the economy. The ENCC systematically monitors and analyzes domestic data on economic performance. It also makes use of indicators from the Growth Competitiveness Index (GRCI), the Business Competitiveness Index (BSCI) and the Global Competitiveness Index (GLCI), which are also used in the World Economic Forum's (WEF) Global Competitiveness Report. These indicators help detect emerging trouble spots in the economy. The result is a clearer picture of the drivers of competitiveness in our domestic economy. The ENCC then compiles the data and analysis in its annual report with the goal of providing direction to policymakers and leaders in the business sector. It is specifically designed to support leaders seeking positive changes in the nation's underlying infrastructure to develop a closer partnership between business and government.

How can the report decide whether the Egyptian economy is competitive[1] or not? We will examine three facets of competitiveness to answer that question:[2]

1. How well is Egypt performing compared to other countries?
2. How well has Egypt performed in international trade?
3. Are we doing the best we can?

Concerning the first question, *How well is Egypt performing compared to other countries,* the report finds that Egypt's rankings have mostly been slipping or staying the same. In the few cases where Egypt made progress, peer countries in the developing world have improved more rapidly.

As for the second question, *How well has Egypt performed in international trade,* our findings reveal that the macro-environment in Egypt has recently become better suited for improved access to the global markets. Changes at the macroeconomic level, particularly as measured by fiscal, trade and exchange rate trends, have led to an incentives system that is more conducive to an "exporter friendly" environment.

However, this is only part of the story. Eliminating distortions in the incentives system will make Egypt's exports more competitive in terms of cost. Egypt must also address how it can innovate in order to improve the quality of its products and the efficiency of the production process. While Egypt's macroeconomic indicators have seen a significant change in a short period of time, our analysis shows that Egypt is only in the early stages of building a culture of innovation and competitiveness.

The long answer to the third question, *Are we doing the best we can*, is that the new economic team appointed as part of the Cabinet shuffle in July 2004 has taken up a number of reform issues that were previously considered off limits. Privatization, tariff reductions and tax cuts are not only costly reforms, but have always been branded as politically sensitive. The new

[1] Please refer to Chapter 1 of last year's competitiveness report for an in-depth look at different definitions of competitiveness (http://www.encc.info). See Chapter 1 of this report for the operational definition used for the purpose of our study.
[2] Robert Lawrence (http://www.econlib.org.).

economic team, in particular, has shown that when it comes to economic transformation there are no taboos. Their activity and enthusiasm should serve as a model for the rest of the Cabinet.

Does this mean that the recent reforms have been driven by the individual efforts of only a handful of reform-minded members in the Cabinet? Are these reformers alone in developing a national strategy for reform? Will failure to institutionalize these reforms open us to the risk of policy reversals as governments and individuals change? Finally, how can we extend positive change throughout the government and encourage long-lasting change over successive governments?

These are tough questions that have no short answers.

Hossam Badrawi, Chairman

Egyptian National Competitiveness Council

EXECUTIVE SUMMARY

This is the second report issued by the Egyptian National Competitiveness Council (ENCC) examining the competitiveness of the Egyptian economy.[3] The Egyptian Competitiveness Report aims to become a regular and prominent benchmarking exercise that assesses developments in the status of Egyptian competitiveness based on the indices of the WEF's annual Global Competitiveness Report. Last year's Egyptian report discussed recent developments in the competitiveness of the economy, and concluded that Egypt's rank was slipping in many areas, both in absolute terms and relative to other developing countries. The report identified 11 issues related to Egypt's weakening competitiveness that required attention by the government. Egypt's 2005 Competitiveness Report continues to gauge developments in Egypt's international competitiveness status. Noting the implementation of a number of reforms in response to the challenges underlined in last year's report, which served to achieve an impressive turnaround in the economy in 2005, the report draws attention to a set of new challenges that need to be addressed in order to unlock untapped opportunities.

We are still in the process of developing and improving on the report. This year's report has undergone some restructuring. Chapter 1 gives a brief overview of the methodology developed by the World Economic Forum to build the various indices and sub-indices that are used to measure competitiveness. Using Egypt's ranking on these indices, Chapter 2 presents the key competitiveness indices and analyzes Egypt's performance over time and relative to peer countries in the developing world. It also provides an in-depth analysis of the sub-indices to identify the drivers behind Egypt's performance. Chapter 3 discusses the recent reform initiatives undertaken by the Cabinet's new economic team, comprised of the ministries of finance, foreign trade and industry, and investment. Chapter 4 presents the challenges and opportunities ahead.

A number of interesting conclusions emerge from the report. We find that Egypt's competitiveness ranking has continued to struggle in the past few years, and remains unfavorable relative to its peers. It's important to note that Egypt's low rankings in 2005 do not account for the reforms undertaken since the reshuffle of the Cabinet in July 2004. The Executive Opinion Survey was conducted in March 2004 and failed to capture executives' opinions about the recent economic changes.

In analyzing the impediments in Egypt's business environment, the Executive Opinion Survey[4] (EOS) indicated eight main constraints, ranked in order of significance. The constraints identified relate to (i) access to financing; (ii) tax regulations and tax rates; (iii) inefficient bureaucracy; (iv) policy instability; (v) foreign currency regulations; (vi) inflation; (vii) an inadequately educated workforce; and (viii) restrictive labor regulations. Notwithstanding the persistence of some of those impediments, their severity and ranking have changed markedly since the time of the survey in April 2005. New simplified tax regulations were issued in June

[3] The Egyptian Competitiveness Report 2003-2004 was issued in September 2004.

[4] The Executive Opinion Survey (EOS) is the main tool that translates perceptions about a country's economic environment into measurable and comparable indicators. These indicators enable the Growth Competitiveness Index (GRCI) to reveal the economic environment in a particular country, as well as the factors that affect its performance over a given time period. See Chapter 1 for more details.

2005, while tax rates were slashed by 50 percent, effective July 1. Foreign currency regulations such as surrender requirements were eliminated in December 2004, leading to a liquid foreign exchange market. This, in conjunction with the implementation of the foreign exchange interbank market, has served to bring together the official and parallel market rates for the US dollar and Egyptian pound, stabilizing the exchange market. As for inflation, both the consumer price index (CPI) and wholesale price index (WPI) have dropped by more than 50 percent[5] between October 2004 and March 2005. We hope that as the new economic measures start to bear fruit, the Executive Opinion Survey of March 2005 reflects improved business perceptions and that Egypt's rankings surge ahead in 2006.

Concerning the remaining five problems, either no action is being taken to resolve them, or the necessary reforms are being taken too slowly and too gradually for their impact to be felt. Many of the low rankings reflect a lack of reform initiative in these five areas ─ as well as other areas discussed in Chapter 4 ─ which threaten to undermine Egypt's competitiveness as long as the complacency lasts. The question that arises is *why did recent bold efforts manage to achieve rapid and perceptible changes in some areas, while initiatives to address other equally important concerns are either absent or have gone astray*?

The implications are worrisome: What framework guides the reform decisions of the Cabinet? Do the leaps taken in limited areas reflect the isolated endeavors of a few reform-minded cabinet members? If so, will these reforms collapse or lose momentum if this group of reformists retires or is replaced? Are individual attempts of reform at risk of being reversed on the whim of the policymakers in charge? How will these reforms be institutionalized so that their implementation reaches other ministries and ensures continued sustainability over successive governments?

We now turn to a brief summary of the chapters. Chapter 1, as stated earlier, discusses methodology. In Chapter 2, Egypt's international competitiveness rankings on the GRCI, BSCI and GLCI[6] are discussed. Egypt's overall GRCI ranking slipped from No. 58 in 2003 to No. 62 in 2004, partly due to the entry of three newcomers that ranked higher than Egypt (United Arab Emirates, Bahrain, and Cyprus) and also because of the improved competitiveness status of peer countries such as Morocco. On this front, the main weakness in Egypt's international competitiveness position pertains to the public institutions index, where Egypt's rank deteriorated markedly from No. 57 in 2003 to No. 70 in 2004. In the macroeconomic environment index, Egypt's rank stagnated, appearing at No. 57 compared to last year's rank of No. 56. While the appearance of several new countries on this year's index distorted the ranking, the important point is that Egypt is not improving and in some cases is falling behind. For instance, the country's credit rating fell by ten spots. On a positive note, Egypt's position in the technology transfer index improved by three ranks to No. 65 in 2004. This improvement, albeit slight, marks a positive perception among executives regarding the capacity of technological attainment in the country.

On the BSCI index, Egypt ranked 66th out of 104 countries on a global level compared to 58th out of 102 countries last year. The retreat in Egypt's position is traced back to a lower ranking on the two main components of the BSCI: the company operations and strategy index, and the quality of the national business environment index. This reflects a continuation of a declining trend in Egypt's international competitiveness on this front. Egypt's rank declined from

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[5] See Chapter 3 for more details.
[6] The definitions for these indices are available in Chapter 1.

No. 40 in 2001 to No. 58 in 2003, and finally to No. 66 in 2004. This is partly a reflection of investors' negative sentiment about the Egyptian economy prevalent at the time of the survey in March 2004. With a prolonged recession in the economy starting in 1998, coupled with an inadequate government response and the slow pace of institutional and structural reforms, Egypt's image in the past few years has seen an overall deterioration in the eyes of domestic and international investors. This negative perception was further heightened by significant improvements in the business environment in neighboring economies.

Regarding the GLCI index, Egypt occupied the 47th rank among 104 countries. This rank places Egypt well ahead of its position in both the GRCI and BSCI (No. 62 and No. 66 respectively); yet, it preserves almost the same ordering against its selected peers. The key driver behind Egypt's relatively good performance on this index is reflected by its No. 47 ranking on the "innovation enhancers" component.

Chapter 3 describes the main reform efforts undertaken to date. Economic growth picked up in 2004 after a period of slowdown, mainly due to favorable performance in the external sector. Macroeconomic policy remains geared towards reducing inflation and stabilizing the foreign exchange market, which seems to be paying off in terms of declining inflation rates and the disappearance of the foreign exchange parallel market. The recent appreciation of the Egyptian pound helped the Central Bank of Egypt (CBE) to increase its international reserves. On the fiscal front, the budget deficit (as a percentage of GDP) was contained at a level slightly below that of last year's; however, there has been a continued rise in the government and public sector debts, which is an alarming trend.

As for the external sector, Egypt's position remains robust with a current account surplus for six quarters in a row. Improvements in both oil and non-oil exports, as well as proceeds for services exports (namely tourism and the Suez Canal), have strengthened the current account. This contrasts the pattern in previous years when improvements in the current account stemmed primarily from a sharp decline in imports due to slackening economic activity. The capital account remains in deficit due to weak investment flows and a net increase in the acquisition of foreign assets by residents.

Overall improvements in the macroeconomic framework are reflected by the bullish performance of the stock market since July 2004; in addition, both Fitch and Standard and Poor's have upgraded Egypt's credit rating outlook from negative to stable.

On the institutional front, the CBE is currently working on developing a monetary policy framework that anchors inflation expectations under an inflation-targeting regime. In the short term, liquidity indicators (broad money (M2)) will be used as an intermediate target for controlling inflation outcomes, whereas, in the medium term, indirect market instruments will be used to control liquidity in the market.[7] The Central Bank of Egypt (CBE) has already established a Monetary Policy Unit to communicate the direction of short-term monetary policy to the market, which should help to lower inflation expectations. The CBE published its first and overdue monetary policy statement on June 2, 2005.[8]

[7] من أنظمة السياسة النقدية استهداف سعر الصرف الثابت، أو استهداف الإجماليات النقدية للسيولة مثل قاعدة النقود (M2)، أو استهداف معدلات التضخم (inflation targeting). Monetary policy regimes include exchange rate targeting, the targeting of monetary aggregates of liquidity such as M2, or inflation targeting.

[8] See www.cbe.org.eg.

In addition, more fiscal consolidation is underway along with the movement towards a more transparent budget-preparation process for fiscal year 2005/2006 based on internationally accepted standards defined by the International Monetary Fund (IMF).

The structural reforms taken under the direction of the new Cabinet were comprehensive and tapped into the backbone of the economy. This is unlike previous experiences with reform that were made in a conservative and piecemeal fashion. The most tangible changes were observed in the development of a comprehensive strategy for trade liberalization that comprised tariff adjustments, a rationalization of the tariff structure, the abolition of fees and surcharges, and the reduction of customs exemptions.

Tariff reform took place in parallel with the introduction of a new draft tax law that lowers tax rates on personal and corporate income, and unifies tax exemptions and related legislation. The law also provides for the phasing out of tax exemptions for newly established companies. The law is intended to encourage the voluntary submission of returns by taxpayers, the timely payment of taxes, and greater compliance of citizens to address the tax evasion issue.

The financial system is also being strengthened via structural reforms, bank mergers, and privatization of joint venture banks and one state-owned bank. Serious efforts are underway to solve the problem of non-performing loans in the banking sector. In addition, institutional reforms are underway to improve the supervisory power of the CBE over the banking system. On a different front, the privatization program has been reinvigorated after a period of stagnation — between July 2004 and March 2005, stakes were divested in 17 non-financial enterprises in addition to two financial institutions.

One of the areas long overdue for reform was the overhaul of agencies that deal with investment, which have only attracted modest levels of foreign direct investment (FDI). The Ministry of Investment was created and is currently taking the lead in preparing a comprehensive investment policy for Egypt in consultation with private sector stakeholders. A fundamental reorientation in the role of the General Authority for Investment and Free Zones (GAFI) is also underway to improve its efforts to promote and target FDI.

Chapter 4 concludes that although the initial reform effort has been impressive, a number of issues still pose challenges to improving the competitiveness of the Egyptian economy. Addressing such challenges is crucial to unleashing Egypt's growth potential. On top of these challenges comes the need for a comprehensive vision to fully meet the desires for a more competitive Egypt. Developing the vision must be a continuous process that engages all stakeholders and caters to the development needs of the country.

Next to vision formulation, good governance is key to managing the implementation process. Egypt, like many developing countries, faces the challenge of adopting a rules-based system of governance and enforcement. Current efforts in this regard include the establishment of the Egyptian Institute of Directors (EIOD), which assumes the role of promoting corporate governance in Egypt. To date, EIOD has not achieved tangible outcomes; however, it is projected to be a vehicle for the dissemination of international standards of corporate governance. Along the theme of good governance, the budget has been published according to the International Monetary Fund's Government Finance Statistics (GFS) standards, making the budget more transparent. However, the National Investment Bank (NIB) budget still needs to be integrated into the overall budget.

Also, there is a need for significant fiscal consolidation and complementary expenditure-reduction measures such as streamlining subsidies and controlling the government wage bill.

Fiscal consolidation assumes even greater importance in the face of recent tariff reductions and proposed tax cuts and social reforms, which will increase the budget deficit in the shorter term. In the medium term, another series of trade, tax and social reforms will help reinvigorate the business environment, give momentum to economic activity and, in turn, boost growth and job creation. But the key question revolves around the mechanism of financing the short-term costs of reform, which further strengthens the need for fiscal consolidation to avoid an explosion of public debt.

With regard to monetary policy, the Central Bank still needs to address the risk that expectations of higher inflation could become more deeply rooted. To avoid this risk, the Central Bank will need to develop a forward-looking policy approach in the immediate future that clearly communicates the direction of monetary policy using a nominal anchor. Moreover, the Central Bank must make periodic announcements about the direction of monetary policy. This would enhance the credibility of the Central Bank and the transparency of its operations, further strengthening the monetary policy framework.

As for the external sector, the diversification of exports, together with the recent appreciation of the pound, may constrain the demand for Egypt's merchandise exports. Lower export performance during the first half of fiscal year 2004/2005 and the robust growth in imports in response to lower tariffs could increase pressures on the trade deficit.

Pertaining to financial sector reform, the government faces a number of complex issues that need to be untangled carefully and immediately. This includes providing enough resources to restructure the banking sector without crowding out the private sector. Moreover, it is important to address the factors that impede the private sector from accessing banking sector finance. Also, the government needs to move fast on reducing the high levels of government borrowing that leave the private sector fighting for what's leftover.

Real estate investment still faces many problems that prevent the development of mortgage finance in Egypt. A mortgage finance debt market will help deepen the financial sector and boost the stagnant real estate sector. The report underscores several factors that deter the development of mortgage financing in Egypt.

One of the most critical issues on the reform agenda is the formulation of a strategic vision for the Egyptian industry. The Industrial Modernization Center (IMC) is currently in the process of formulating an industrialization strategy that builds on the existing industrial base, and also better utilization of Egypt's natural resource endowments, its large pool of human resources, as well as its strategic geographical location. The aim of the strategy is to strengthen the base of Egyptian manufactured exports and its visibility in international markets, increase domestic added value, and undertake technological upgrading of existing industrial activities by moving up the value chain. Implementation will be crucial to the success of this strategy as it hinges on instituting an effective public-private partnership to ensure the collaboration of all stakeholders.

Finally, human resource development still poses a major challenge that may very well impede Egypt's efforts to improve competitiveness. To address long-standing problems in the educational system, the Ministry of Higher Education is currently developing a plan for the reform of higher education and scientific research in Egypt with an associated action plan to achieve specified objectives. A parallel plan is in progress to overhaul scientific research institutions and establish solid coordination mechanisms with the private sector. Over the last three years, the ruling National Democratic Party (NDP) has introduced a complete set of reform policies in education, including preschool, school, vocational, and higher education at its annual conferences in September. The government has agreed to the proposed policies, with major developments in the following areas:

1. Decentralization of education planning, financing and management.
2. More societal participation with a clear vision of the private sector role to accommodate 20% of students.
3. The move towards improving the quality of education to guarantee that Egyptian graduates are more competitive, especially in the areas of vocational and higher education. These policies include a number of action plans that take effect over a specific time frame. The most important action plan, in our opinion, is publishing the standards of education at every level of education and the indicators needed to evaluate the performance of schools and universities, both institutionally and academically. The major recommendation was to establish an independent accreditation agency for education. However, delays in introducing that legislation constitute, in our opinion, an impediment confronting the reform of education towards a more competitive environment in the medium and long term.

Despite increasing enrollment rates at all levels, the overall quality of graduates of the education system is in decline. Furthermore, there is a continued mismatch with the demands of the private sector. The traditionally acclaimed comparative advantage of cheap labor in Egypt is being eroded by low levels of productivity. The overall weakness in the human resource base is seen as a barrier towards moving into technology- and skill-intensive activities that offer the best prospects for Egypt's integration into the global economy.

On a related front, the competitiveness edge of the female labor force should be further endorsed by empowerment of women at all levels to ensure their effective inclusion in productive activities. No reform can take place without increasing the competitiveness of women. The female gender constitutes 49 percent of the Egyptian society. Society cannot develop or compete with a high percentage of its labor force remaining uneducated and inactive. A high propensity to consume and not to produce places a burden on the rest of the population. Hence, women's participation in all domains of life ─ social, economic or political ─ is a necessity with the increasing importance of competitiveness for development. In order for Egyptian women to become active participants in Egypt's quest for global competitiveness, women's competitiveness needs to be enhanced. A special program should be developed with this objective in mind. Regular programs to increase the population or youth competitiveness may fail to address the special needs of women, especially in the remote and underprivileged areas of Egypt.

The UNDP 2004 Human Development Report (HDR) ranked Egypt low on the Gender Empowerment Measure (GEM). Egypt ranked 75th out of 78 countries. GEM relates to the participation of women in the political and professional life. There is a need to focus on the empowerment of women at all levels and to eliminate all forms of discrimination against them. In this context, the following measures need to be taken:

1. Initiate a socio-cultural movement to improve the perception of women as partners in societal development.
2. Take different measures that will ensure real equal access of females to all levels and sectors of education.
3. Provide health care services to women through means that they can easily access and use.
4. Ensure greater inclusion of women in the workforce at all levels and specializations.
5. Provide women with access to micro-financing of credit and loans.

6. Adopt affirmative action as a temporary program through allocating seats for women in different political local councils and Parliament.
7. Ensure that laws and regulations reflect the constitutional requirement of equal opportunity between men and women.

Concerning labor competitiveness, traditionally the low cost of labor was considered a comparative advantage for the Egyptian economy due to the abundance of its supply. Indeed, Egypt currently has one of the lowest levels of labor costs in manufacturing in the Middle East North Africa (MENA) region, reaching almost one-fourth of the MENA average. However, labor productivity is one of the lowest in the region as well. Thus, when linking labor costs with labor productivity (i.e. considering unit labor costs), Egypt's comparative advantage appears to be eroding as Egypt's unit labor costs are almost the same as the MENA average.

The implication of this weakness is double-sided. On one hand, it implies limited comparative advantage in labor-intensive activities that constitute a promising niche for addressing unemployment concerns. On the other, and more importantly, it indicates that domestic technological capabilities are not adequate to reap the benefits of the ICT revolution, which is currently the driver of global economic growth. This limits the ability to move towards technology and skills-intensive activities, which offer the best prospects for Egypt's integration into the global economy.

CHAPTER 1
METHODOLOGY

1.1 OPERATIONAL DEFINITION OF COMPETITIVENESS USED IN THE EGYPTIAN COMPETITIVENESS REPORT

In the Egyptian National Competitiveness Council's (ENCC) first report, *The Egyptian Competitiveness Report 2003-2004,* we introduced several definitions of competitiveness. However, our operational definition for competitiveness relied, and continues to rely, on Porter's definition of national competitiveness, which states that competitiveness is *"the set of institutions and economic policies supportive of high rates of economic growth in the medium term"* (Porter, Sachs and Warner, 2003).

♦ COMPETITIVENESS AND THE DETERMINANTS OF GROWTH

Positive growth rates help determine the welfare of a country's citizens. For high-income countries, positive growth rates bring about wage increases, bigger profits, more jobs and expanded business activities. For developing and low-income countries, positive growth rates help alleviate poverty as incomes rise and ensure higher quality human development, such as lower infant mortality rates, longer life expectancy, better education, etc.

Nevertheless, positive growth rates have still failed to materialize in many countries. According to Blanke, Paua and Sala-I-Martin (2004, p. 3), "Despite its enormous importance, the determinants of the growth rate of a country remain one of economics' biggest mysteries." Adam Smith wrote that specialization and the division of labor was the engine of growth. In the 19th century, Malthus and David Ricardo believed that the scarcity of natural resources constrained the growth potential of a nation because of the law of diminishing returns of land.

As these theories failed to provide a blueprint for growth, 20th century economists responded with alternative theories, proposing that investment in physical capital and infrastructure drove growth. The failure of the Soviet model and many of the developing countries that followed it — with assistance from the World Bank — later proved that investing in physical capital was not sufficient to put a country on a higher growth trajectory. In subsequent years, investing in human capital became en vogue in all developing countries, a trend which lasted for two decades. But again, economic growth remained elusive.

When all these theories failed miserably, technological progress became the next model heralded as the key determinant of growth. The question then shifted from "What determines the growth rate of GDP?" to "What determines the rate of technological progress?" The answer proved complex. No single indicator was found to account for growth in a country. Many answers were provided: openness, macroeconomic stability, in addition to other factors, but no single element could account for growth. This is because the process of economic growth is dynamic, complex and requires a great deal of coordination to make sure it functions properly.

In an attempt to capture as many of the factors involved in the complex growth process as possible, the World Economic Forum developed the Growth Competitiveness Index (GRCI) in

1979. The GRCI is updated every year as new data become available. Every year, economists gain new insights into the determinants of the process of economic growth. The GRCI index is then grouped with the results of the Executive Opinion Survey, which gauges the opinions of more than 7,500 business experts.

Thus, one of the principal objectives of the Global Competitiveness Report is "to evaluate the potential for the world's economies to attain sustained economic growth over the medium and long term" (Blanke, Paua & Sala-I-Martin, 2004, p. 4).

In the next section we discuss how competitiveness is measured using the GRCI and other indices, and how they are combined with the results of the Executive Opinion Survey.

1.2 MEASURING COMPETITIVENESS

Since 1979 the World Economic Forum (WEF) has strived to measure and evaluate the competitiveness of countries. It has focused on two approaches. The first is the Growth Competitiveness Index (GRCI) and the second is the Business Competitiveness Index (BSCI). 'Hard data' on the countries is used to construct these two indices in addition to the Executive Opinion Survey, which is conducted by the World Economic Forum.

1.2.1 The Executive Opinion Survey (EOS)

The Executive Opinion Survey (EOS) has been a key ingredient of the Growth Competitiveness Index. It is the main tool used to translate general perceptions about a country's economic environment into measurable and comparable indicators. These indicators allow the Growth Competitiveness Report to analyze the economic environment in a particular country, as well as the factors that affect its performance over a given time period, and have allowed it to become "a unique source of insight into the inner workings of a particular economy" (WEF, 2004, p. 167.).

The Executive Opinion Survey is conducted annually by the World Economic Forum during the first half of the year. Input for the survey comes from leading business executives and entrepreneurs. These businessmen provide their perceptions about the business environment in which they work, which is reflected by the results from a comprehensive and scientifically designed questionnaire. The questionnaire also asks them to identify key obstacles to economic growth.

The surveys are conducted by the World Economic Forum's partner institutes in the countries that participate in the Global Competitiveness Program (Egypt is a member of this program). These partner institutes conduct the surveys and ensure that the sample of respondents is representative of the economy being appraised. The World Economic Forum makes sure that the survey method used is consistent across countries.

1.2.2 Indices of Competitiveness

1.2.2.1 The Growth and Business Competitiveness Indices (GRCI and BSCI)

♦ *The Growth Competitiveness Index (GRCI)*

The main goal of the GRCI is to analyze the potential of the world's economies to achieve sustainable economic growth in the medium and long term. It refers to aggregate or macroeconomic determinants of productivity such as the set of institutions, policies and structures that impact on the growth potential of countries. It is the GRCI that captures the 'dynamic' or 'growth' determinants of productivity.

The GRCI is based on three main concepts:

- The first concept is the **process of economic growth**, which can be divided into three categories
    - Within the three categories (see Table 1.1 below), the importance of the determinants of economic competitiveness varies for core and non-core innovators. Core innovators will almost always have their macroeconomic fundamentals in place, and technological creativity is already the driver of their growth. In contrast, non-core innovators need to work to improve their macroeconomic conditions. The technology index thus weighs more heavily on core innovators than the index for public institutions or the macroeconomic environment. Non-core innovators are assigned equal weights between the three categories. Below is a more detailed table about the weight for the sub-indices within the categories.
- The second concept examines **innovation versus imitation**. The origin of technological sophistication may be different across countries. For 'core' countries, technological advancement is achieved mostly through innovation. For 'non-core' countries, technological improvement is achieved partly through innovation, partly through copying, and partly through the adoption of knowledge developed by a leading country in the field. Countries above the threshold of 15 patents per million people are identified as core. Innovator or core countries have a larger weight placed on innovation than non-core countries, but no weight is placed on adoption. By comparison, adoption of technology weighs positively on non-core countries.

  The main idea is that is that innovation is more important than adoption for core innovators than for non-core innovators. Technological adoption is captured by the technology transfer index.
- The third concept underlying the GRCI is that the **determinants of economic competitiveness vary for core and non-core countries**. (Again, see Table 1.1 for differences in weights among the three pillars for core and non-core countries). The explanatory power of the index improves if different weightings of the three pillars are introduced depending on the stage of development of a country.

Three pillars — the macroeconomic environment, the quality of public institutions, and technology — are combined to calculate the overall GRCI. The indices and sub-indices are calculated on the basis of both hard data and survey data. Survey responses are measured on a scale of 1–7. Hard data are collected from various sources. The formula for converting hard data into this scale is as follows:

$$\frac{\mathbf{6 * (country\ value - sample\ minimum)}}{\mathbf{(sample\ maximum - sample\ minimum)}} \mathbf{+ 1}$$

Table 1.1: Composition of Growth Competitiveness Index	Weights	
	Core	Non-core
	Countries	
o **The macroeconomic environment;**	**1/4**	**1/3**
▪ Macroeconomic stability sub-index [9]	1/2	
▪ Country credit rating	1/4	
▪ Government waste	1/4	
• *Extent of distortive government subsidies* • *Diversion of public funds* • *Public trust in the financial honesty of politicians*		
o **Public institutions index**	**1/4**	**1/3**
▪ Contracts and law sub-index	1/2	
▪ Corruption sub-index	1/2	
o **Technology index**[10]	**1/2**	**1/3**
▪ Innovation sub-index[11]	1/2	1/8
▪ Technology transfer sub-index	Zero	3/8
▪ Information and communication technology sub-index	1/2	1/2

♦ ***The Business Competitiveness Index (BSCI)***

The BSCI is constructed from indicators based on the results of the Executive Opinion Survey. It captures the determinants of the microeconomic components of productivity, including the 'static' or 'level' determinants of productivity.

The index attempts to measure indicators such as patenting rates, and internet and mobile phone penetration, but these data are unavailable for many countries. The survey alternatively captures the judgment of the respondents of the questionnaire.

The BSCI has two sub-indices:

- The sophistication of company operations and strategy
- The quality of the national business environment

1.2.2.2 The Global Competitiveness Index (GLCI, WEF, 2005)

The Global Competitiveness Index is a new measure of competitiveness that merges the GRCI and the BSCI. It is based on three key principles: productivity is complex, development takes place in three stages, and transition periods are required.

Principle 1: Productivity is complex, resting on 12 pillars of competitiveness:

[9] 5/7 macroeconomic stability hard data + 2/7 macroeconomic stability core data
[10] 1/3 ICT survey data + 2/3 ICT hard data
[11] 1/4 survey data + 3/4 hard data

1. Institutions
2. Physical infrastructure
3. Macro-stability
4. Security
5. Human capital
6. Market efficiency
7. Labor market efficiency
8. Financial market efficiency
9. Technological readiness
10. Openness and market size
11. Business sophistication
12. Innovation

Principle 2: Development takes place in three stages:[12]

1. *Factor-driven*: Firms compete in price. They take advantage of their cheap factors of production, while firms produce simple products and basic requirements.
2. *Efficiency-driven*: The quality of the products (not only prices) and the efficiency of the production process determine the productivity of firms. They have to access the best technologies even if they have to import them from abroad. They form the efficiency enhancers.
3. *Innovation-driven*: The country starts producing different and creative products, and practices the most advanced methods of production and organization. Businesses organize themselves in clusters in order to enjoy advanced and superior operations. They form the innovation and sophistication factors.

Countries in the first stage score low on innovation or business sophistication. Countries in the second stage should worry about performing well as they approach the third stage.

The Global Competitiveness Index is calculated as follows:

$\alpha1$ * basic requirements

$\alpha2$ * efficiency enhancers

$\alpha2$ * innovation factors

Where $\alpha1$, $\alpha2$, and $\alpha3$ are the weights that each sub-index gets in the overall index. The weight assigned depends on the stage of development of a country. The following table shows how the weights are assigned to the three stages of development.

[12] Please refer to ENCC (2004) for further details.

Weight	Basic requirements	Efficiency enhancers	Innovation and sophistication factors
Factor-driven stage	50%	40%	10%
Efficiency-driven stage	40%	50%	10%
Innovation-driven stage	30%	40%	30%

Principle 3: Transition periods are required

As economies develop, they move from one stage to another in a smooth fashion rather than abrupt jumps. The weights of the sub-indices change as a country develops. So, in addition to the countries in the three stages, there are countries that are categorized as being between stages one and two and two and three.

Countries in transition between the first and second stages have lost their ability to compete in low prices, and therefore slowly lose their competitiveness. They have not prepared themselves for the challenges that they will meet in the second stage.

We now turn to Chapter 2 to see the results of this year's 2005 GRCI, BSCI, and GLCI rankings for Egypt. The chapter analyzes Egypt's various rankings in the sub-indices, relative to last year and to other peer countries. Chapter 3 describes various issues relating to Egypt's competitiveness and recent economic performance. Finally, Chapter 4 looks at some of the important issues and challenges facing Egypt that have emerged during the past year.

CHAPTER 2
RECENT DEVELOPMENTS IN EGYPT'S COMPETITIVENESS STATUS: MOVING FROM RETREAT TO RECOVERY

Studying the development of a country's competitiveness is increasingly becoming a subject of interest not only among research groups and think tanks but also policymakers and representatives of civil society. This interest stems from the fact that changes in a country's international competitiveness have an impact on people's lives in the political, economic, and social realms. It is also deeply rooted in the emerging consensus that economies today are no longer operating in a 'vacuum,' but are becoming part of a global economy where international competitiveness, as it is broadly defined, is the key vehicle for growth and prosperity.

The growing interest in the evolving concept of competitiveness[13] is largely attributed to the proliferation of various studies, indicator scoreboards, and results of opinion surveys focusing on gauging the relative competitiveness of a group of countries. Interest in both the analysis contained in these studies as well as the design of scoreboards and surveys is the product of cutting-edge research by prominent scholars in this field. Furthermore, many of these studies have been carried out under the umbrella of renowned international institutions,[14] which has helped bring credibility to their results and caused policymakers to take them more seriously.

The aim of this chapter is to trace the recent developments in Egypt's competitiveness in relation to a group of selected comparators. The analysis relies exclusively on the competitiveness indices revealed in the recent World Competitiveness Report 2004-2005 (as well as earlier reports), as this remains the most comprehensive composite measuring the development of competitiveness. As indicated in the previous chapter, the competitiveness indices revealed in this report rely on both 'hard' (i.e. quantitative) indicators disseminated by national and international statistical authorities in addition to 'soft' (i.e. qualitative) indicators extracted from the annual Executive Opinion Survey. The use of other sources of data and information only serves to provide a broader picture of the factors behind the recent developments in Egypt's competitiveness ranking.

The chapter addresses the three indices used in the latest World Competitiveness Report (2004-2005). These indices are the Growth Competitiveness Index (GRCI), the Business Competitiveness Index (BSCI), and the newly introduced Global Competitiveness Index (GLCI), which is a new index designed to combine (and eventually replace) both the GRCI and BSCI. The Global Competitiveness Report offers a set of indicators that are basically drawn from the Executive Opinion Survey (EOS), which is conducted by the World Economic Forum; the data covers almost all aspects that shape the status of competitiveness in a group of economies.

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[13] A thorough coverage of the different concepts and definitions of competitiveness has been undertaken in last year's Egyptian Competitiveness Report (2003-2004).

[14] A non-exhaustive list includes the World Economic Forum, the World Bank, the United Nations Development Program, the United Nations Conference on Trade and Development, the United Nations Industrial Development Organization, the Heritage Foundation, etc. However, some of these organizations focus on specific policy issues that still fall under the overall umbrella of international competitiveness.

2.1 THE GROWTH COMPETITIVENESS INDEX (GRCI): HOW READY IS EGYPT TO CAPITALIZE ON ITS GROWTH POTENTIAL?

The GRCI captures the ability of the world economies to attain sustained economic growth over the medium and long term. The concept rests upon three pillars: macroeconomic environment, public institutions and technology.

Egypt's overall GRCI ranking declined from No. 58 in 2003 to No. 62 in 2004. The recoil is partly explained by the entry of three newcomers that appeared ahead of Egypt in the overall ranking: the United Arab Emirates (UAE) (No. 16), Bahrain (No. 28) and Cyprus (No. 38).[15] Two of these countries, the UAE and Bahrain, are regional comparators to Egypt that have put together an impressive record of reform in their business environment in recent years. On a positive note, this signifies that some MENA economies have started reaping the benefits of reform, which may offer an incentive that helps other MENA countries move forward. The reforms in the UAE have successfully transformed its image in the eyes of international investors from an oil-dependent economy to an economy with a growth potential that far exceeds countries such as Hong Kong, Chile, New Zealand, and Belgium.

During last year, most of the selected comparators witnessed a slight fallback (see Table 1 in Appendix 1) with a few exceptions: Morocco improved from No. 61 in 2003 to No. 56 in 2004, South Africa from No. 42 to No. 41, Indonesia from No. 72 to No. 69 and Chile, which

Box 2.1: Rationale for the Choice of Comparators

The choice of comparators depends mainly on whether they are neighboring economies with relatively similar resource endowments and economic structures and regional competitors that compete with Egypt for exports and FDI. International role models from the developing world that were able to solidify their international position are also included. The following explains the rationale behind the choice of specific comparators:

- Regional competitors with somewhat similar production structures and specialization in the same export groups (such as textiles and apparel, heavy industries, energy-intensive industries, etc.) are **Jordan**, **Morocco**, **Tunisia**, and **Turkey**. These countries are currently working on industrial modernization and have improved access to neighboring European and Arab markets, and thereby are key regional competitors.
- **Bahrain** and the **UAE** are emerging as regional hubs for FDI, especially in the services sector, and milestones in the improvement of the domestic business environment have placed them among leading countries in the different competitiveness indices among the MENA region.
- Among the successful international role models: **Brazil** enjoys a well diversified industrial base with strong competitive potential. **Chile** is a prime example of a country that has gradually diversified away from resource-based and primary exports. The **Czech Republic** is a successful model in the transition economies with a deep drive for regulatory reform and structural adjustment. **South Africa** is also an emerging source of competitive threats due to intensified competition with Egypt in some export markets as well as competition for FDI flowing into Africa.
- **Malaysia** is one of the leading Newly Industrialized Economies with proven global competitiveness in the past two decades. **Indonesia** is also an emerging Asian Tiger that is shifting gradually from the dependence on primary and resource-based exports into low-tech manufactures.

[15] Figures in parenthesis indicate rank in the GRCI in 2004.

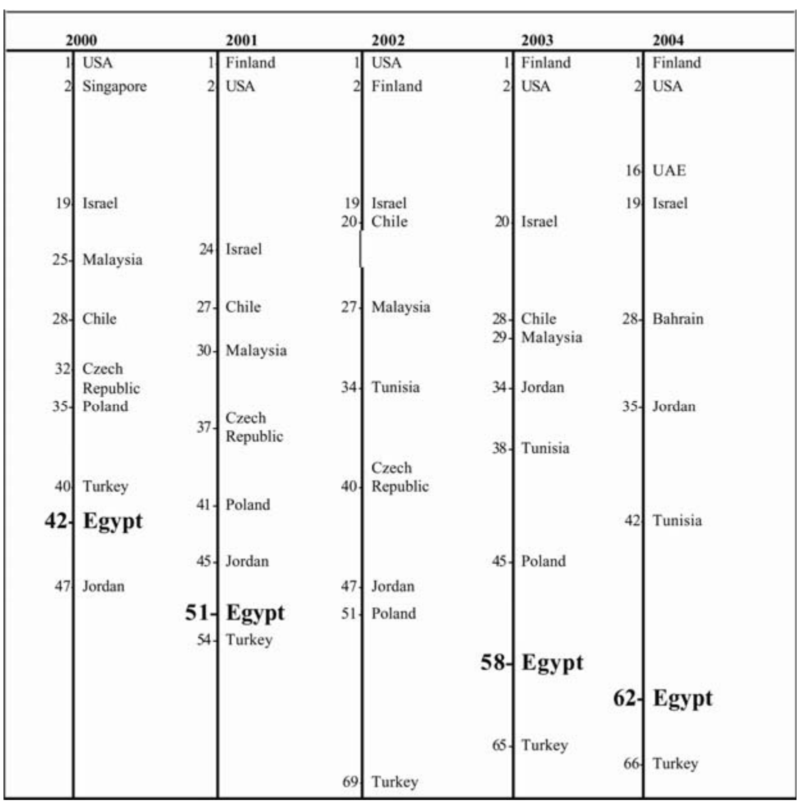
continued to leverage its competitiveness profile, jumped from No. 28 to No. 22. As it stands today, Chile surpasses not only some of the leading Asian Tigers, such as Korea and Thailand, but also important industrialized countries such as France, Ireland, and Spain (See Box 2.5).

Historically, as displayed in Figure 2.1 below, the deterioration in Egypt's rank in the GRCI reverses improvements witnessed since the start of 1999. In 2000, Egypt's rank was higher than most of its comparators, including Indonesia, Brazil, and Jordan, whereas in 2004 most comparators outranked Egypt — except for Turkey which ranked No. 66 in 2004 compared to No. 65 in 2003. Over the same period, countries like Jordan and Israel achieved steady progress, albeit they started from a higher position than Egypt in 1998.

Looking deeper at the components of the index, the main weakness in Egypt's international competitiveness position seems to pertain to the **public institutions** index, where Egypt's rank deteriorated markedly from No. 57 in 2003 to No. 70 in 2004. This reflects a deterioration in the perception on both sub-indices, contracts/law and corruption. During the same period, comparators such as Morocco, Brazil, Indonesia and South Africa were able to improve their relative ranking on this front. Despite the fact that some other comparators slipped back during the last year on this indicator, none has dropped by as many as 12 places, as in the case of Egypt.

Both components of the public institutions index, contracts/law and corruption, lost significant ground, amounting to 10 places in the former and 12 in the latter (from No. 47 to No. 57 and from No. 67 to No. 79 respectively). Under the contracts/law component, judicial independence retreated from No.59 to No. 98, whereas favoritism in decisions of government officials went from No. 26 to No. 55 under the corruption component.

Figure 2.1: Developments in Egypt's Position in the GRCI



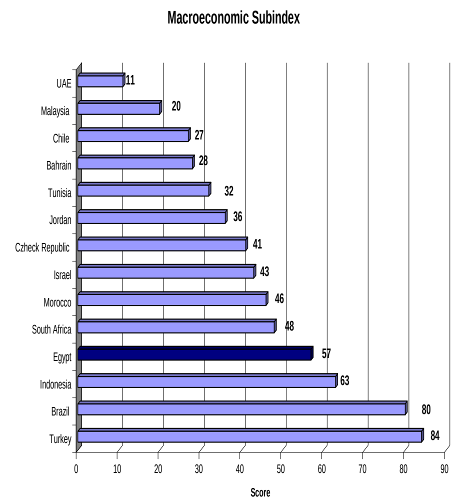
Source: World Economic Forum, Global Competitiveness Report 2004/2005.

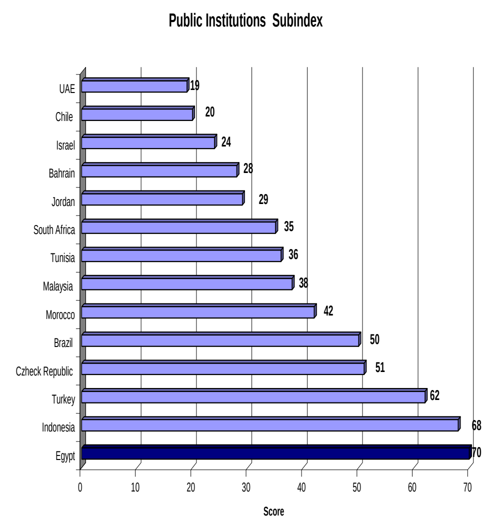
In the **macroeconomic environment** index, Egypt's ranking slid back slightly to No. 50 compared to No. 56 a year earlier, mainly because the country's credit rating sub-index fell 10 places. During the same period, the other two sub-indices (macroeconomic stability and government waste) each improved by four positions. However, the decline in the credit rating sub-index seemed to outweigh the improvement of the other two components. Best performers from the selected comparators on this front are the UAE (No. 11), Malaysia (No. 20), Chile (No. 27) and Bahrain (No. 28). The UAE ranked No. 2 among 104 countries with respect to minimizing government waste, whereas Tunisia was No. 4, Malaysia No 11 and Bahrain No. 12.

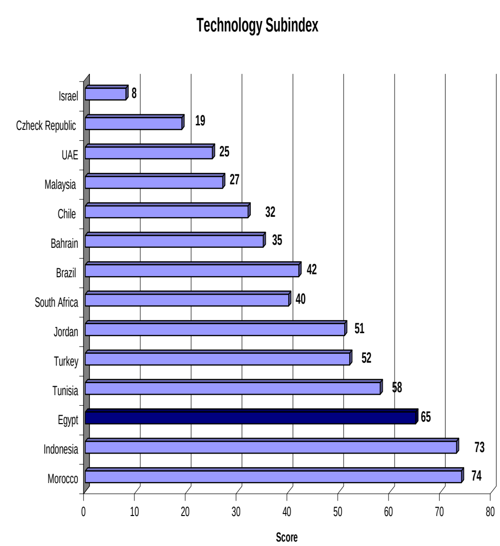
Also, on macroeconomic stability, some regional comparators scored very favorably on the international scene. Bahrain (No. 11), UAE (No. 12), and Jordan (No. 13) appeared high on international rankings. It is worth noting that the UAE ranked first on the survey with regard to recession expectations.

With regards to the **technology** index, Egypt's position improved by three ranks to No. 65 in 2004 compared to No. 68 in 2003 due to a notable improvement in the technology transfer sub-index, which jumped 12 ranks from No. 44 last year to the No. 32 this year. This indicator more or less captures the degree of technological spillover accruing from foreign sources (either through foreign direct investment or through licensing) as indicated by the respondents to the executive survey.

Figure 2.2: GRCI Sub- indexes for the selected countries







Box 2.2: Egypt's Readiness on the ICT Front

The Global Information Technology Report (GITR) is the result of ongoing efforts by the World Economic Forum to capture possible drivers of national competitiveness. The report aims at assessing the impact of recent developments in information and communication technology (ICT) on the competitiveness of various economies.

The Networked Readiness Index (NRI) is the flagship index developed to steer the analysis. The index measures the propensity for countries to exploit the opportunities offered by ICT and sets up a global comparison detailing the underlying factors for such aptitude. The concept rests on three fundamental pillars: the first captures aspects of the environment of a given nation for ICT development; the second looks at actual levels of networked readiness of individuals, businesses and governments; whereas the third traces actual levels of usage of ICT by these three groups.

Over the previous year, Egypt managed to improve eight ranks on the overall index. The table below shows Egypt's ranking on the different sub-indexes. For the environment sub-index, it was the only one to witness a decline on the sub-components. Egypt retreated seven ranks, basically due to its poor performance on the market and infrastructure environment sub-indexes.

Networked Readiness Index	Egypt	
	03-04	04-05
	65	**57**
Environment	***60***	***67***
Market Environment	49	65
Political and Regulatory Environment	66	64
Infrastructure Environment	65	75
Readiness	***71***	***63***
Individual Readiness	72	78
Business Readiness	60	81
Government Readiness	77	45
Usage	***63***	***51***
Individual Usage	77	75
Business Usage	72	56
Government Usage	44	26
Government success in ICT promotion, 2004	35	16
Government online services, 2003	44	47

On the other hand, the readiness and the usage indexes improved over the last year. The first jumped from No. 71 to No. 63. In this regard, the government readiness index recorded notable advancement, jumping to No. 45 from No. 77. The improvement of the whole readiness sub-index helped account for this dramatic change, given the deterioration of the other two components: individual readiness (No. 78 to No. 72) and business readiness (No. 60 to No. 81).

On the usage front, Egypt managed to jump from No. 63 to No. 51. Advancement took place across all sub-indexes. Most notably, in government usage Egypt moved from No. 44 to No. 26. A favorable government performance, both in readiness and usage, ostensibly reflected positively on the overall performance of Egypt.

Among the comparators, one can observe a similar performance as that detected in the Global Competitiveness Report. Chile still maintains the highest ranking among the Latin American countries, ranking 35th on a global scale, well ahead of its regional competitors: Brazil (No. 46), Mexico (No. 60) and Argentina (No. 76). South Africa and Tunisia maintained their leading placement among the 23 African countries included in the index, respectively ranked No. 34 and No. 31, up from their rankings of No. 37 and No. 40 the year before. United Arab Emirates (UAE) and Bahrain seized on their privileged positions (where they are both included in the index for the first time), respectively appearing at No. 23 and No. 33. As noted in the report, the UAE's first-rate performance seems to be the result of a successful government strategy in promoting ICT penetration and usage.

On the overall scale, Singapore was seeded, for the first time, the best in the world in exploiting global ICT developments. This is chiefly attributed to its exceptional performance with regard to the ability of individuals and the government to utilize the potential of ICT, as well as actual government usage of ICT. The report underscores again the tangible role played by the government in promoting ICT penetration and usage, together with the quality of the country's educational system and its proficient use of foreign technology.

By examining the sub-indices more closely, we can detect that a substantial part of the advancement stems from FDI and technology transfer.

This improvement in the technology index in Egypt, albeit slight, marks a positive perception among executives regarding the capacity for technological attainment in the economy. However, in a comparative context, some comparators made even more significant strides on this front. For instance, South Africa occupied 1st place compared to 3rd place last year in the technology transfer sub-index, where the UAE and Bahrain occupied 5th and 9th place. Increasing their attractiveness for FDI has arguably given these countries greater exposure to modern technology and organizational practices.

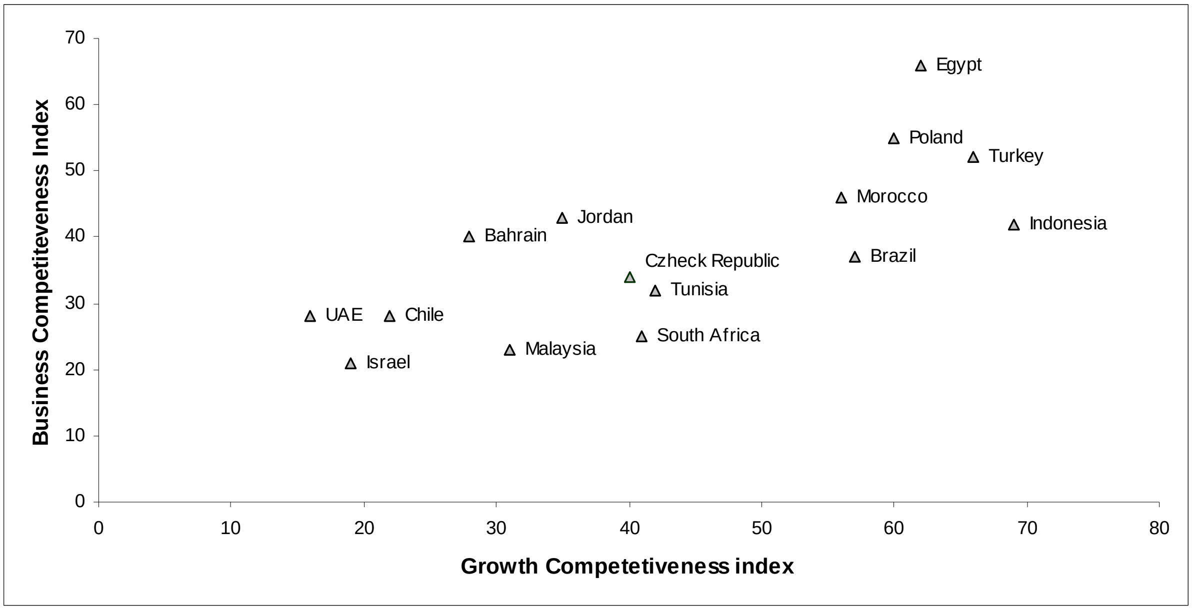
On the innovation sub-index, Egypt's position is favorable as it outranks all comparators except for Chile and the Czech Republic, and some international comparators such as Indonesia, Malaysia, and South Africa. Finally, the ICT sub-index is an area of concern as Egypt lagged behind most comparators, ranking No. 73 in 2004 compared to No. 69 in 2003. Regional comparators that ranked higher for digital infrastructure and ICT readiness include UAE (No. 33), Bahrain (No. 41), Turkey (No. 52), Jordan (No. 57) and Tunisia (No. 60).

As mentioned in Chapter 1, the technology transfer sub-index is only attached to non-core innovating countries as classified in the Global Competitiveness Report; it places additional weight to an aspect were such economies should have a competitive edge. Regarding Egypt, this implies that working more on improving the county's capacity to adopt technology, *inter alia*, will definitely help boost the country's competitiveness. This is not withstanding the innovation and ICT subcomponents. Egypt's track record has been rather modest, but is expected to pick up in the medium term in response to ongoing reforms in the ICT realm.

2.2 THE BUSINESS COMPETITIVENESS INDEX (BSCI): UNRAVELING THE MICRO-FOUNDATIONS OF COMPETITIVENESS

The BSCI is designed to capture the microeconomic elements of the competitiveness of the business environment and the factors conducive to increased productivity at the enterprise level. This year Egypt ranked 66th out of 104 countries on a global level compared to 58th out of 102 countries last year. This index also includes the newcomers that precede Egypt: the UAE (No. 28), Bahrain (No. 40) and Cyprus (No. 45). The retreat in Egypt's position can also be traced to its downgrading on the two main components of the BSCI: the company operations and strategy index, and the quality of the national business environment index. On the former, Egypt's rank slid back two places to occupy the 57th slot in 2004, whereas in the latter category Egypt's relative position retreated six spots to No. 68 in 2004.

Figure 2.3: Correlations among the BSCI and the GRCI (2004)

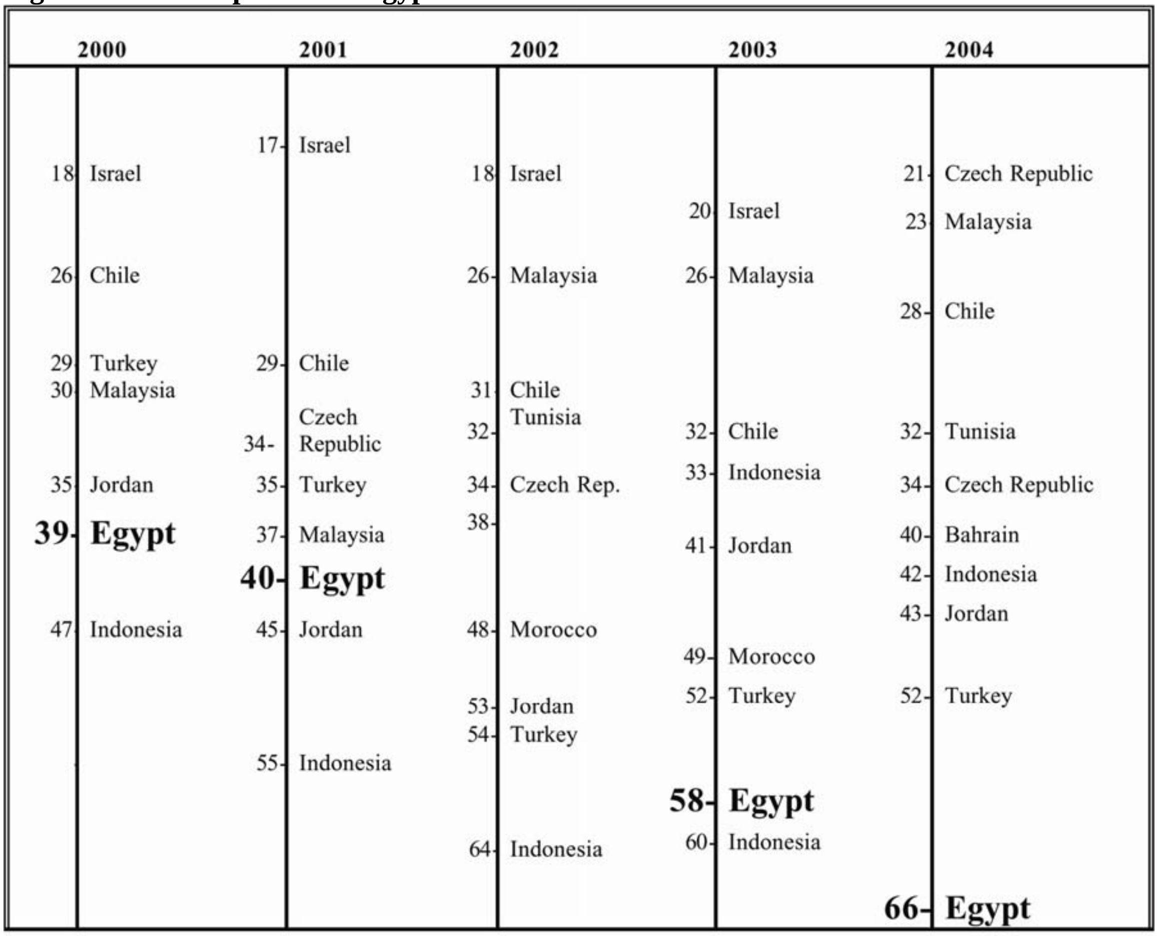


As shown in Figure 2.3, it has been observed as a pattern among the world's economies that rankings on both the BSCI and the GRCI reinforce each other. This finding suggests that to improve Egypt's growth potential, it is imperative to increase the competitiveness of all aspects of the domestic business environment. The figures appear to show that Egypt is lagging, implying that the pace of reform needs to accelerate if Egypt is to leapfrog from its current position to approach some leading regional comparators such as the UAE, Bahrain, Jordan, and Tunisia.

As shown in Figure 2.4 below, the developments over last year mark a declining trend in Egypt's international competitiveness. Egypt's rank fell from No. 40 in 2001 to No. 58 in 2003, and finally to No. 66 in 2004. As indicated earlier, most of the sub-indices under the BSCI are 'soft' indicators reflecting the perceptions of businessmen participating in the survey. With a prolonged recession in the economy starting in the late 1990s, an inadequate government response, and the slow pace of institutional and structural reforms, Egypt's image in the past few years has suffered in the opinion of domestic and international investors. Significant improvements in the business environment in neighboring economies reinforced this negative perception.

As such, there is anecdotal evidence that the government's recent reform package has helped turnaround the mood of investors. This is expected to be followed by a gradual improvement in Egypt's international competitiveness ranking, which will also be bolstered by the improvement in the macro-fundamentals as the economy reaps the benefits of past and ongoing reforms (see Box 2.6).

Figure 2.4: Developments in Egypt's Position in the BSCI



Source: World Economic Forum, Global Competitiveness Report 2004/2005.

Looking closer at the component indices of the BSCI, and in particular the **company operations and strategy index**, it appears that Egypt's downgrade owed to factors such as the capacity for innovation, company spending on R&D, breadth of international markets, and the nature of competitive advantage. Some of those concerns are acknowledged by observers of the Egyptian economy as there is a growing consensus that Egypt needs to enter niche markets for innovation-intensive products, endorse R&D activities at the company level, and foster the linkages between R&D institutions and private sector enterprises to leverage its competitiveness status. However, the concerns related to the nature of competitive advantage and breadth of international markets are likely to be softened by ongoing efforts to remove supply-side and administrative hurdles facing Egyptian exports, ongoing efforts to open new non-traditional markets for exports, and the removal of the anti-export bias brought on by a previously over-valued real exchange rate.

With regards to the **quality of the national business environment** index, Egypt's retreat has occurred due to a number of factors, including the following: (i) perceived decline in the quality of human capital skills coupled with the a deterioration in the quality of education;[16] (ii)

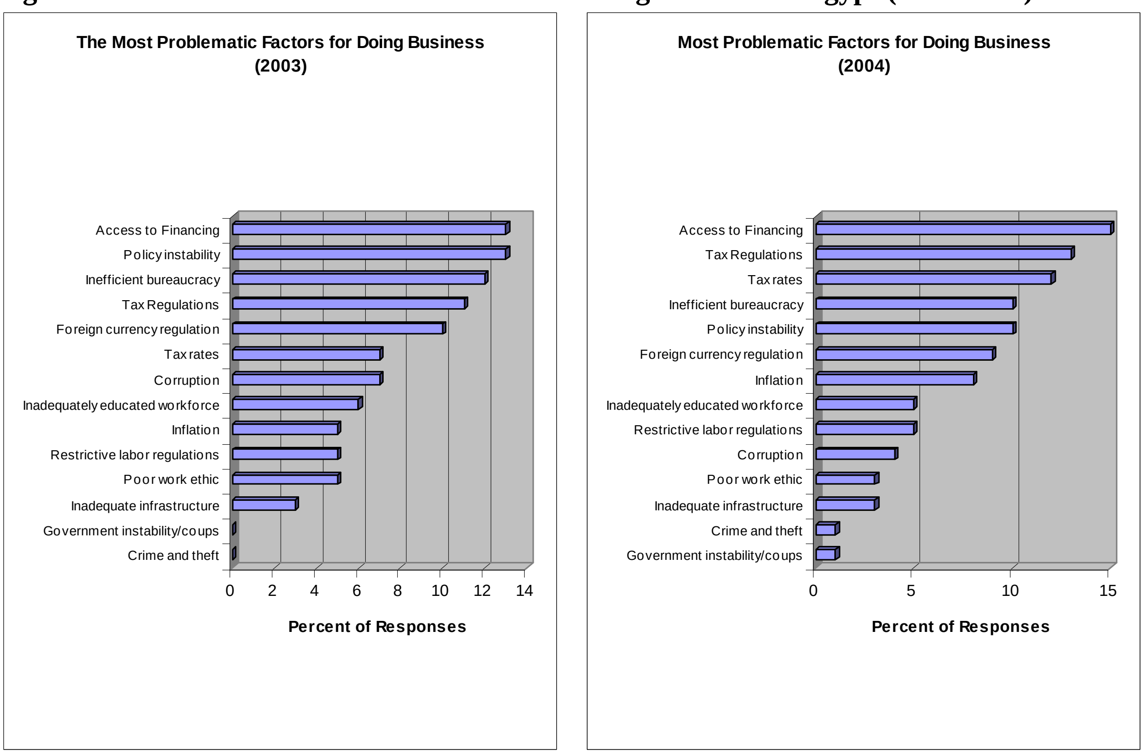
[16] Recently it has been documented that the availability of advanced technical skills in the national labor force is a key driver for successful industrial performance and overall improvements in international competitiveness.

concerns over the ability of capital markets to address the financing needs of the private sector; and (iii) the prevalence of factors that hinder domestic competition. Notwithstanding these concerns, there has also been an improvement in perceptions regarding some elements of the technology infrastructure, the extent and sophistication of supporting industries and services, as well as the overall incentive structure.

Figure 2.5 below lists the most problematic factors for doing business in Egypt, according to the results of the EOS. This list incorporates the responses of businessmen who were asked to select the five most problematic factors out of 14 factors. The bars in the figure show the responses weighted according to their ranking.

The results indicate that ***access to financing*** has topped the list for the past two years. The ***tax rate and tax regulations*** featured high on this year's list. Compared to last year, this problem seems to indicate mounting concerns raised by businessmen who are discouraged by a high corporate tax rate (based on international comparisons) and a burdening tax administration. However, a new tax law passed in June 2005 is expected to clear away some of these perceived obstacles in the near future.

Figure 2.5: The Most Problematic Factors for Doing Business in Egypt (2003-2004).



Source: World Economic Forum, Global Competitiveness Report 2004/2005

Also, ***inefficient bureaucracy*** has been a persistent problem identified by the list. In this regard, it is worth noting that one of the proposed solutions is the institution of e-government facilities. As indicated in the following chapter, a national project is underway that aims to make most government services available online for investors and the general public, which is expected to lower the burden of red tape. A more focused approach – also in the pipeline – entails the activation of the General Authority for Investment and Free Zones' (GAFI) one-stop-shop to

Box 2.3: Egypt's Ranking on the Environmental Sustainability Index

In recent years, various efforts have been made to develop indicators that quantify crucial concepts that have long been considered qualitative. Those concepts include governance, competitiveness and environmental issues. Such efforts were a result of ongoing demands imposed on policymakers to address the previous issues more rigorously. On the other hand, quantifying such concepts has revealed deficiencies and gaps in national policies, especially when international comparisons have pointed to the need for immediate action.

In that context, several indexes were established to trace environmental performance of countries around the globe. This fits perfectly with the emergence of environmental concerns as some of the most crucial variables considered in designing policies — to the extent that the environment receives as much attention now as growth and poverty.

Among the environmental indicators is the Environmental Sustainability Index (ESI), developed by Yale University. ESI benchmarks the ability of nations to protect the environment over the next several decades. It does so by integrating 76 datasets into 21 indicators of environmental sustainability, further grouped into five main categories: (i) environmental system, (ii) reducing environmental stresses, (iii) reducing human vulnerability, (iv) societal and institutional capacity to respond to environmental challenges, and (v) global stewardship.

The index is developed for 146 countries, among which Egypt ranked 115th. Regarding Egypt's scores on the sub-indexes, it scored a 40 on environmental systems, 41 on reducing stresses, 40 on reducing human vulnerability, 40 on social and institutional capacity, 54 on global stewardship. It's no surprise then that Egypt ranked among the last quartile of countries.

The low ranking of Egypt primarily owes to the following constraints:

Inadequate use of available resources and lack of public awareness: Egypt suffers from inadequate patterns of consumption, which results in a sustained drain on natural resources, be it water, soil, air, etc. This is chiefly attributed to the lack of awareness, both on the public and business levels, of the threats imposed by environmental damage.

Inadequate governance and public monitoring: Due to the preoccupation with economic and social problems, environmental issues did not feature high on the agenda of Egyptian policymaking. It was only in recent years, with the help of foreign donors, that resources had been allocated to environmental remediation. Moreover, it was not until 1994 that environmental laws were introduced in Egypt. On the other hand, there was no compensatory role detected on part of civil society organizations. Yet, it can be inferred that environmental awareness has been on the rise especially on the part of the government (in response to the mounting global attention to the problem) and the business side (in response to legal considerations constraining polluting industries).

Poor scientific and technological base: Most of the environmental solutions worldwide propose replacing old techniques with new cleaner technologies. Such techniques can be either be developed locally or imported through technology transfers from abroad. As such, the poor status of technological advancements within the Egyptian economy undermines the possibility of advancing solutions locally and suggests the need to capitalize on international resources (both financial and technical) made available for environmental purposes.

The argument above manifests the need for collaboration on a public-business-government front. Efforts should be directed towards raising public awareness and enforcing environmental laws. Collaboration from the business side can be shown by further commitment to clean industrial techniques. On the public front, civil society arrangements can help raise public awareness and curb inadequate consumption patterns.

cater to the needs of the business sector and curb time and monetary costs expended for establishing new businesses, not to mention day-to-day operations.

Policy instability has dropped to 5th place this year from last year's 2nd-place standing. Only 10 percent of respondents considered it a problem in 2004 compared to 13 percent in 2003. Respondents either believe recent policy reversals have staved off the possibility of instability or other problems have simply taken greater precedent. The tendency for unstable policies to undermine, to a great extent, the ability of businesses to plan ahead cannot be overlooked, as companies will ultimately associate higher risk to the business environment within a country. Thus, it is expected that the clear reformist approach adopted by the current government is likely to enhance the confidence of the investor community in the seriousness of commitment to reform.

Foreign currency regulation still features high on the list of impediments to business, occupying 5th place in 2003 and 6th place in 2004. This reflected the continued aftermath of the successive exchange rate devaluations and the short-term regulatory measures adopted to restore exchange rate stability. A major business concern has been decree 506, issued in March 2003, which forced companies to surrender of 75 percent of their export proceeds. The cancellation of the decree in December 2004 should help ease negative perceptions about foreign currency regulation in the 2006 Global Competitiveness Report.

Inflation occupies the 7th rank on the 2004 list, whereas it ranked 9th in the previous year. The percentage of respondents who considered it a problem increased by 3 percentage points this year, from 5 percent to 8 percent. However, it is important to note the temporary nature of this problem, which resurfaced after the successive devaluations of the pound. From 1997 to 2002, inflation development in Egypt has been very favorable, witnessing a continued erosion of inflation differential between Egypt and its main trading partners.[17] We already see that the temporary spike in inflation rates during 2003/2004 has subsided.

Inadequately educated workforce featured in the 8th spot for two years in a row. When speaking of raising the sophistication of company operations and strategy, the ability of the labor force to absorb and adopt innovative techniques is crucial. The low cost of labor is no longer sufficient to guarantee the attractiveness of an economy if productivity levels are low because the labor force lacks the basic skills demanded by modern business operations. The links between raising the quality of labor force and the quality of the educational and training system is of paramount importance in this respect.

Restrictive labor regulations received the same percent of responses in 2003 and 2004, with only a subtle variation in rank (from 10th to 9th). The inflexible hiring and firing rules do not only restrain entrepreneurs, but also deny workers the benefits of legal contracts by forcing them into jobs in the informal economy, where these rigid rules are ignored.

Other problems identified by the Executive Opinion Survey include corruption, poor work ethic, inadequate infrastructure, crime and theft and government instability. The first two are being addressed through a national strategy to promote transparency and fight corruption, which will be discussed later in Chapter 3. Upgrading the national infrastructure has long been a prime issue on the government's agenda, and there have been renewed efforts to engage the private sector in this regard. As for the problem of crime and theft and government instability, only 1 percent of the survey takers identified each of these as a problem in 2003, and these problems fell off the list after the 2004 survey.

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[17] Improvements from 1997 to 2002, however, created two other pressing problems: (i) a real exchange rate over-valuation, which created an anti-export bias and affected the international competitiveness of Egyptian exports; and (ii) a high real interest rate, which has reportedly been a deterring factor for accessing bank financing.

Box 2.4: The Corruption Perception Index

The Corruption Perception Index (CPI) was developed to capture the perception of experienced business people and country analysts, both residents and non residents, regarding the level of corruption within nations. The index is measured for 146 countries by 12 independent institutions worldwide building on the results of surveys conducted in respective countries. The surveys produced converging findings, validating the results as a powerful tool for the detection of corruption.

The index is developed based on estimates of the losses in productivity and capital inflows due to corruption. This is done by comparing each country with the best scoring country in the CPI, Finland, and multiplying the difference in the CPI score by 4 percent of GDP for the first indicator (loss in productivity) and 0.5 percent of GDP for the second indicator (loss in capital inflows). As such, these are only crude estimates that serve to highlight the negative impact of corruption on a country's productivity and its ability to attract FDI.

The table below shows the rankings of Egypt and the other comparators. Egypt ranked No. 77 together with Morocco and Turkey. The estimated productivity losses in the three countries amounted to 26 percent of GDP, whereas lost capital flows were around 3.2 percent of GDP. Within the 13 countries, Chile ranked the best (No. 20) followed by the UAE and Bahrain. Ranking at the bottom of the list was Indonesia, where the productivity loss is estimated to be 30.8 percent of GDP and loss of capital inflows stood at 3.8 percent.

Country	Rank*	Productivity Losses Due to Corruption (% of GDP)	Lost Capital Inflows Due to Corruption (% of GDP)
Chile	20	9.3	1.1
UAE	29	14.4	1.8
Bahrain	34	15.0	1.9
Jordan	37	18.9	2.3
Tunisia	39	19.0	2.3
Malaysia	39	18.7	2.3
S. Africa	44	20.5	2.6
Czech Rep.	51	21.9	2.7
Brazil	59	23.2	2.9
Egypt	**77**	**26.0**	**3.2**
Morocco	77	26.1	3.3
Turkey	77	26.0	3.3
Indonesia	133	30.8	3.8

Source: Passau University Press Release on Transparency International Website.
* Countries may have the same rank if they score equally on the Corruption Perceptions Index.

High levels of corruption are usually associated with low-income countries due to the lack of sufficient resources to fight corruption. Yet the surveys identify poor countries that were able to score rather well in the index, e.g. Chile, Botswana, Oman and Uruguay.

It is worth noting that the relative ranking of Egypt against its peers is not drastically different from a number of other competitiveness indexes, implying a close association between fighting corruption and its impact on leveraging a country's competitiveness status.

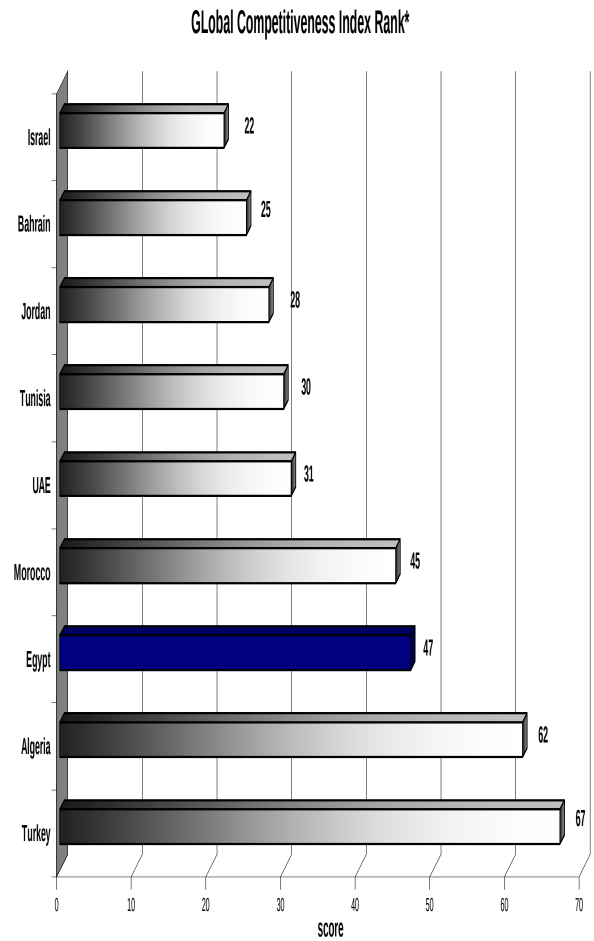
2.3 THE GLOBAL COMPETITIVENESS INDEX: EGYPT'S INTERNATIONAL COMPETITIVENESS IN A NEW LIGHT

The Global Competitiveness Index (GLCI) is a new indicator designed to combine (and eventually replace) the GRCI and the BSCI. The subcomponents of competitiveness are classified into **basic requirements**, **efficiency enhancers** and **innovation enhancers**. Different weights are assigned to each component according to the stage of development of each country.[18] Since this year is the first in the series, this section utilizes the GLCI to benchmark the stance of competitiveness of the Egyptian economy vis-à-vis others in the region.

As illustrated in Figure 2.6, Egypt occupies the 47th rank among 104 countries. This puts Egypt well ahead of its position in both the GRCI and BSCI (No. 62 and No. 66 respectively), given that all cover the same set of countries. Yet, it almost preserves the same ordering compared to the selected countries.

Before going into the analysis of subcomponents, it is worthwhile to look into the placement of each country on the spectrum of development. Egypt, Algeria, Bahrain and Morocco are considered to be in the 'factor-driven' stage, where more weight is given to the basic requirements. Tunisia is transitioning out of the 'factor-driven' stage to the 'efficiency-driven' stage, the latter of which includes Turkey. Israel is also transitioning into the 'innovation-driven' stage, where the UAE is currently the only country belonging to this group.

Figure 2.6: The GLCI of Selected Countries



* Higher ranks denotes lower competitiveness

[18] For further discussion of the composition of the index, please refer to Chapter 1.

Box 2.5: A Success Story of an Early Reformer: What Lessons Can Be Learned from the Chilean Experience?

With a twofold increase in GDP per capita over a twenty-year period, coupled with a 20% decrease in poverty within only a decade, the Chilean episode of reform is undeniably a success story despite some associated shortcomings. This is also manifest in a record on competitiveness that is way ahead of regional comparators; it outranks its closest regional competitors by more than 20 positions.

Significant reforms were initiated in 1984 after the severe crisis that hit the Latin American economies upon Mexico's announcement of default on external debt repayment, which created serious repercussions for Chile: accelerating inflation, GDP contraction, rising unemployment and accumulated foreign debt.

The need for reform was increasingly becoming a government priority. With regard to sequencing, according to Hernan Buc (minister of finance in Chile 1985-1959), the experience of reformers in Chile suggests that "it is necessary to proceed with all reforms at once and increase the pace in accordance with perceived prospects of success." Thus, the Chilean reform process can be seen as a comprehensive, far-reaching process that encompassed a broad range of aspects. It included reforms in the pensions and tax systems, the capital markets, trade liberalization, the functioning of the labor market, a momentous limitation of government intervention, and the privatization of state enterprises and social security.

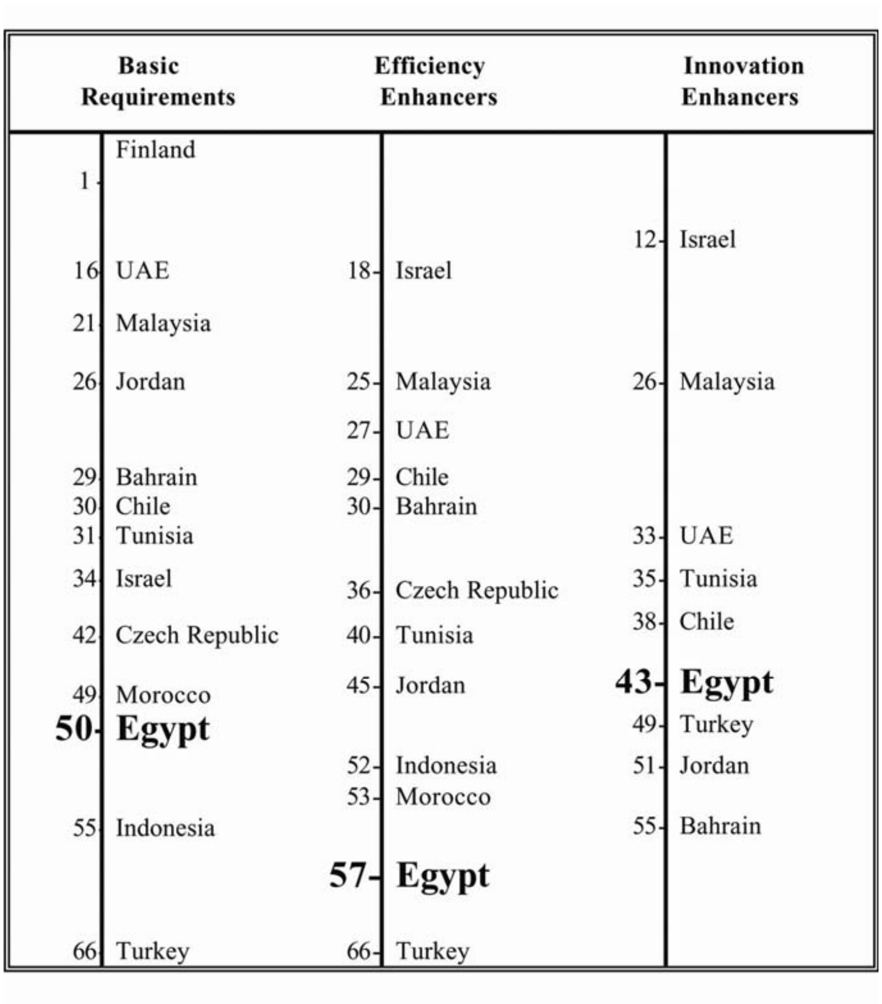
The following are key constituents of the Chilean recipe for success:

- ***Building consensus through promotion of transparency:*** The pillar of Chile's success has been the way successive governments were able to maintain public consensus. This was primarily a synthesis of high transparency and accountability together with the engagement of the government in consultations with different entities representing the private sector and civil society. This helped the public understand and endure the inimical effects of reform. The legitimacy of government has also been fortified by the tangible outcomes of the reform process embodied, for instance, in sustained growth and reduced poverty.
- ***Mobilizing domestic saving and enhancing financial markets:*** After the onset of the Latin American debt crises, chances to access foreign saving clearly withered. This meant that reform plans would have to rely on domestic savings. Consequently, corporate taxes were lowered, government spending was reduced and the Pension Fund Administrations (PFAs) played a special role by mobilizing substantial amounts of money to purchase shares in enterprises undergoing privatization.
- ***Instituting a solid macroeconomic framework:*** Chilean macroeconomic reforms are considered exemplary in many respects. First, the Chilean success rested on strict fiscal discipline, which was achieved by the effective isolation of the fiscal policy from surrounding political pressures. It served as a preset target of government balance, without making needless adjustment to cyclical ripples. Second, the central bank was guaranteed full independence and thus was able to bolster a credible monetary policy regime resting on inflation targeting. The outcomes were quite impressive, with inflation curtailed from 19.4 percent in 1990 to 1.3 percent in 2004.
- ***Promoting free trade***: Trade was seen to be a crucial element for the stimulation of competitiveness of various sectors of the Chilean Economy. Towards this end, several policies were adopted on the internal front (e.g. unifying the tariff rates and eliminating non-tariff barriers) and external front (concluding free trade agreements with Canada, USA, EU, Korea and European Free Trade Association). The liberal trade regime was also supported by strong institutional underpinnings.

Source: Global Competitiveness Report 2004-2005, Chapter 2.3.

From Figure 2.7 and Table 2.1, we see that Egypt appears at the bottom of the rankings compared to the selected countries in regards to **basic requirements**. Only Turkey, Brazil and Indonesia score lower. Basic requirements include institutions, infrastructures, macroeconomic stability, personal security and basic human capital. Within the basic requirements index, Egypt ranked the worst on the macroeconomic stability sub-index (No. 81), which places it among the bottom five within the sample of comparators. Egypt scored the highest on public institutions (No. 42), a rather favorable rank among the comparators. The country received modest scores on the other three sub-indexes: infrastructure, personal security and basic human capital. With reference to the last component (basic human capital), the forerunners among the comparator group were Israel, the Czech Republic and Chile.

Figure 2.7: The Composition of the Global Competitiveness Index (2004)



Source: World Economic Forum, Global Competitiveness Report 2004/2005.

Regarding **efficiency enhancers**, almost the same pattern holds, with Israel and the UAE leading and Egypt, Algeria and Turkey coming at the tail end of the group. Egypt ranked 40th in the openness/market size index, whereas it ranked 72nd in financial market efficiency; this is consistent with the sentiment that "access to credit" is the most problematic factor of doing business in Egypt, not to mention that this issue features high on the new reform agenda. It is worth noting that best performers within financial market efficiency were Israel (No. 16) and Chili (No. 19). On the other hand, two Arab countries performed particularly well in goods and labor market efficiency: the UAE and Bahrain. They were ranked 9th and 20th respectively in goods market efficiency; and 6th and 19th with respect to labor market efficiency.

For the **innovation enhancers** category, Egypt (No. 43) ranks tenth among its comparators. The highest achievers were Israel (No. 12) and Malaysia (No. 26). Within the sub-indexes rank, Egypt performed relatively well with regard to business sophistication (No. 34) in comparison to innovation (No. 56). Israel ranked 20th and 7th within the respective rankings.

Table 2.1: Rank of Selected Countries according to the GLCI (2004)

Global Competitiveness Index 2004 - 2005	Bahrain	Jordan	Tunisia	UAE	Morocco	Egypt	Algeria	Turkey	Malaysia	Chile	Indonesia	Czech Republic	South Africa	Brazil
	25	**28**	**30**	**31**	**45**	**47**	**62**	**67**	**23**	**29**	**48**	**38**	**36**	**49**
Basic Requirements	**29**	**26**	**31**	**16**	**49**	**50**	**48**	**66**	**21**	**30**	**55**	**42**	**46**	**67**
1. Institutions	25	31	24	21	40	42	70	71	19	29	51	72	27	55
2. Infrastructures	30	37	36	19	53	50	67	66	22	34	45	33	27	58
3. Macroeconomic stability	43	30	37	20	60	81	2	92	19	15	58	51	45	96
4. Personal Security	25	11	18	8	35	55	63	50	27	39	80	59	82	75
5a. Basic Human Capital	36	47	46	50	81	65	63	57	62	28	75	26	86	61
Efficiency Enhancers	**30**	**45**	**40**	**27**	**53**	**57**	**92**	**66**	**25**	**29**	**52**	**36**	**33**	**43**
5b. Advanced Human Capital	51	43	31	53	67	56	81	64	34	41	60	30	50	48
6. Good Market Efficiency	20	37	30	9	40	51	80	65	19	29	34	50	26	48
7. Labor Market Efficiency	19	38	32	6	28	44	76	70	10	26	74	27	61	52
8. Financial Market Efficiency	24	40	53	38	58	72	100	88	29	19	60	66	20	33
9. Technological Readiness	39	45	47	33	67	58	94	50	28	32	64	26	40	42
10. Openness/Market Size	68	56	51	41	48	40	92	42	26	25	25	34	59	28
Innovation Enhancers	**55**	**51**	**35**	**33**	**45**	**43**	**91**	**49**	**26**	**38**	**39**	**34**	**27**	**28**
11. Business Sophistication	48	62	36	28	40	34	93	41	30	32	44	38	29	27
12. Innovation	73	44	34	50	55	56	88	64	25	49	33	30	29	32

Source: World Economic Forum, Global Competitiveness Report 2004/2005.

2.4 Concluding Remarks: The Retreat in Competitiveness Masks Expectations of a Strong Rebound

The design of the competitiveness indices aims to reflect both the economic fundamentals as well as general investor perceptions of the economy. Economic fundamentals are reflected by 'hard' indicators such as country credit ratings, overall macroeconomic performance indicators (e.g. fiscal deficit, inflation, real effective exchange rate, interest rate spread, etc.), and also the physical and digital infrastructure (e.g. internet use, availability of telephone lines and personal computers, etc.).

On the other hand, the Executive Opinion Survey (EOS) gauges the general sentiment among investors and businessmen and women concerning competitiveness. Taken ever year, the EOS covers areas pertaining to the quality of public institutions, technological sophistication and potential, the sophistication of company operation and strategy, factor markets (infrastructure, human capital, technology, and capital markets), demand conditions, as well as the context for forming strategy and rivalry.

Box 2.6: The Government's New Reform Package

The newly appointed Cabinet has formulated a vision that is partial to the private sector's view of the most constraining factors in Egypt's business environment. The new reform package was built on four pillars:

- **Fiscal reform**: including reforming the tariff structure, introducing a new tax law to reduce income and corporate tax rates and improve the tax administration, and reforming the subsidy system.
- **Improving the investment environment**: including the launch of the Ministry of Investment, streamlining of all laws and decrees governing investment activities, evaluating the optimality of the current incentive scheme granted to investors, and improving efforts to attract FDI.
- **Financial sector reform**: including instituting operational mechanisms to solve the problem of non-performing loans, rationalizing the banking sector structure via bank mergers, improving bank management, and privatizing one state-owned bank and one state-owned insurance company.
- **Reinvigorating the privatization program**: including the restructuring and sale of public enterprises, and further engagement of the private sector in the provisions of public utilities.

The majority of the sub-indicators used in the composition of both indices are derived from the EOS, which is why investor sentiments and their general perceptions of a country's competitiveness status are key factors explaining the improvement/deterioration in a country's competitiveness. In the ensuing analysis, it appears that Egypt's rank has fallen back in both the GRCI and the BSCI, performing worse in the latter. Despite Egypt's retreat on some of the 'hard' indicators reflecting macro fundamentals, such as the worsening fiscal situation and the upsurge in inflation, the key factor behind Egypt's overall decline was due to the generally negative investor sentiment at the time the EOS was launched in March 2004.

During this time — as gauged by domestic and international surveys — both international and domestic businesspeople and investors felt that the government was not responsive enough to their pressing demands, and they started questioning the strength of the government's commitment to market-based reforms.

As we will see in the following chapter, the recent cabinet re-shuffle and the appointment of a new prime minister — Dr. Ahmed Nazif, previously Minister of Communications and Information Technology — has resulted in a clear reformist drive in the implementation and announcement of reforms long sought by the private sector. These changes have positively affected market sentiment. The departure from the old government's paradigm has been signaled by recurring official statements that recognize that increasing investment (both domestic and foreign) is the only way to achieve high and sustained growth rates to absorb the growing number of new entrants to the labor force.

The upshot of these reforms is expected to materialize soon and reflect positively on Egypt's rankings on international competitiveness indices. In the short-term, Egypt is likely to make some progress as a result of improvements in general market sentiments and investors' perceptions of the seriousness of the government's commitment to reform as it transitions to a market-based economy.

In the medium-term, it is expected that the fundamentals will also improve in what could possibly constitute a big push for Egypt's international competitiveness and a strong rebound in Egypt's regional position, as was the case in 1997 when Egypt not only outranked traditional regional competitors such as Jordan and Turkey but also today's rising stars such as India, Mexico, Poland, and South Africa.

For such short- and medium-term improvements to occur, it is imperative that the government continues with the instituted reform drive and deliver on the reform measures it has promised. It is also important to realize that the countries able to leapfrog were those that undertook comprehensive and far-reaching reforms at a reasonable pace.

Again, it's important to point out why the recent reforms are not captured in our analysis of Egypt's ranking in the competitiveness indices. They were all introduced after the Executive Opinion Survey was completed and, hence, their impact on market sentiment and business confidence is not measured by Egypt's most recent rankings. It remains to be seen whether Egypt's rankings on the various indices will show a measurable leap in next year's report.

The next chapter discusses in greater detail the economic policy shift brought on by the Cabinet's new economic team.

Box 2.7: Main Highlights of the Arab World Competitiveness Report 2005

In April 2005, the World Economic Forum released The Arab World Competitiveness Report 2005, the second systematic benchmarking exercise for competitiveness in the Arab world. The report attempts to benchmark the performance of Arab countries in a global context, identifying opportunities and threats facing the Arab countries in an ever-changing global era.

Despite disparities within constituent countries, the Arab world remains a region of distinct natural resource endowment that witnessed some of the highest investment rates in the world during the 1980s. Yet, international comparisons reveal the slow pace of integration of the Arab countries into the global economy as the region's share of global trade and capital flows falls short of its potential.

The report shows that a handful of Arab countries have occupied favorable competitive positions. Out of 12 Arab countries, Qatar ranked at the top of the list, followed by the UAE and Bahrain, showing that the small Gulf countries were able to supersede other larger economies (with greater populations and resource endowments).

Country	Overall Rank	Rankings Among the Sub-Components		
		Technology Index	Public Institutions Index	Macro-economic Environment Index
Qatar	**1**	2	1	1
UAE	**2**	1	3	2
Bahrain	**3**	3	4	4
Oman	**4**	9	2	3
Jordan	**5**	4	5	7
Tunisia	**6**	5	6	6
Saudi Arabia	**7**	6	8	5
Morocco	**8**	10	7	9
Egypt	**9**	7	10	10
Algeria	**10**	12	9	8
Lebanon	**11**	8	11	12
Yemen	**12**	11	12	11

Egypt ranked in ninth place, followed only by Algeria, Lebanon and Yemen (see above table). Egypt's rank is compatible with its overall position in the global ranking; its lagging position can be attributed to public institutions and macroeconomic deficiencies and a modest performance with regard to technological diffusion. Even within the technology index, Egypt is outpaced by other smaller economies such as Qatar, the UAE, Bahrain and Jordan. Egypt was highlighted as one of the countries still in need of deep-rooted reforms on many different fronts.

By gauging the views of several academics and intellectuals of the region, among others, the report has highlighted key challenges facing the region:

- **Improving macroeconomic management and deepening institutional reform.**

  Although a number of Arab countries have already attempted to embark on comprehensive economic and institutional reforms, their efforts have stalled for a number of reasons, including soft budget constraints, weakness of governance, reliance on oil, aid and strategic rents as well as a lack of accountability. Such flaws tend to surface whenever any discussions of competitiveness are involved.

- **Achieving better governance.**

  Governance issues were explored from different perspectives. Hence, key components for enhancing transparency in the Arab world were identified. This included accountability, pluralism, participation, the rule of law, the free flow of information, democracy, respect of human rights, gender equality and an educational environment that respects the innovative spirit of young people. The report underscored the special importance of revitalizing and mobilizing civil society, and enhancing public-private partnerships to develop a vision for change.

CHAPTER 3
WINDS OF CHANGE

In this chapter we discuss recent economic changes that have taken place since the new reformist government led by Dr. Nazif took office in July 2004. The Executive Opinion Survey conducted by the World Economic Forum was conducted in March 2004 and, hence, the results of the survey discussed in the previous chapter do not capture the robust and sharp change in the direction of economic policies during the past year. If we take into account the positive contribution of these reforms, we find that Egypt's economic outlook is palpably healthier compared to last year. Nevertheless, a number of challenges still lie ahead before Egypt can build a highly competitive, dynamic and private sector-led economy. These challenges are the subject of the next chapter.

The substantial progress attained to date covers the macro-economy; enhanced coherence, better governance, and consistency and stability in the domestic monetary/fiscal/trade mix; and accelerating structural reforms.

One limitation to measuring the impact of these changes is that the reporting does not address what has been accomplished with regard to each of the indices and sub-indices revealed in the World Competitiveness Report. Our team will continue to collect information on the sub-indices that haven't been handled this year, and next year's report will include analysis of Egypt's reform on a wider number of indices.

3.1 THE MACRO-ECONOMY

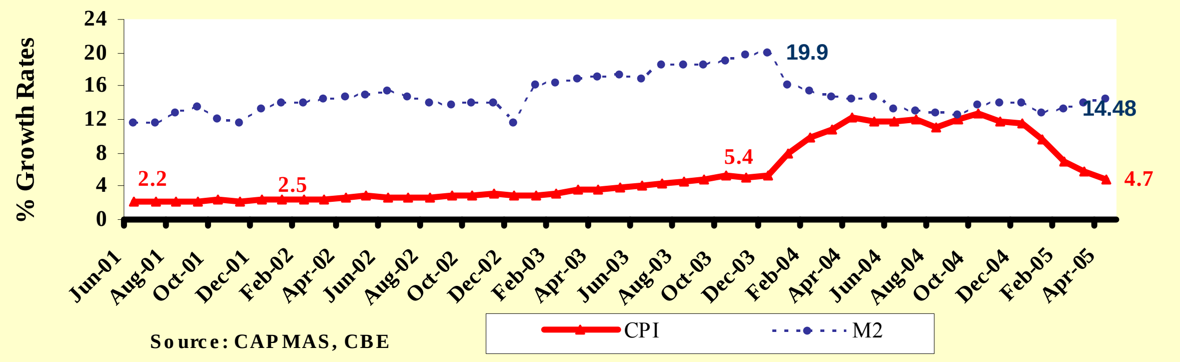
Economic policies took a new direction after the appointment of a reform-minded economic team in July 2004. Egypt's economy witnessed a turnaround during the past year as the economic team determinedly addressed important issues such as taxes, trade, monetary policy, and privatization. The economic team also launched plans for fiscal, budget and financial sector reforms

Following a period of slowdown that began in 2001, Egypt's economic growth rate strengthened to 4.3 percent in 2004. In the first half of fiscal year 2004/2005 real GDP growth rates reached 4.7 percent. The rebound in economic growth rates owed primarily to a strengthening of external demand and a moderate recovery in consumption. Growth in investment demand lagged behind and is expected to remain subdued in 2005. The strong recovery is expected to continue during the second half of the fiscal year (Ministry of Finance, December 2004).

An upturn in confidence is evidenced by a sustained bullish performance on the stock market since July 2004. Both Fitch and Standard and Poor's have upgraded Egypt's credit rating from negative to stable[19] (Press Releases by Fitch Ratings and Standard and Poor's).

[19] Egypt's credit rating is still one notch below investment grade.

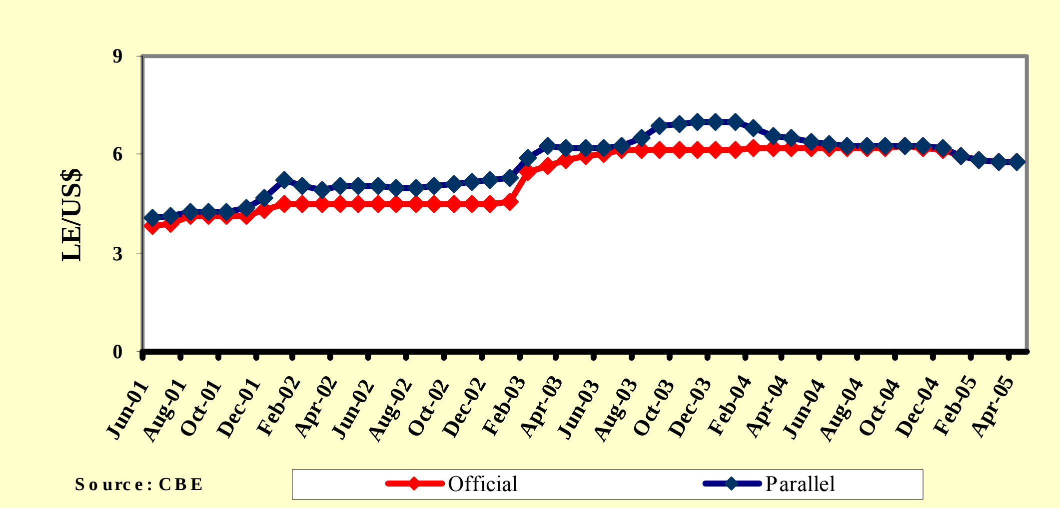
Figure 3.1: Percent Changes in the CPI and M2 (June 2001-April 2005)



Macroeconomic policy was geared towards reducing inflation and stabilizing the foreign exchange market. This has paid off in terms of substantially lower inflation rates in the third quarter of the 2004/2005 fiscal year. Inflationary pressures had reached a record high in October 2004 as the consumer price index (CPI) recorded a growth rate of 12.7 percent. More recently, these pressures showed signs of cooling as the CPI growth rate started to glide downward in November 2004, falling to 5.7 percent in March 2005 (see Figure 3.1).

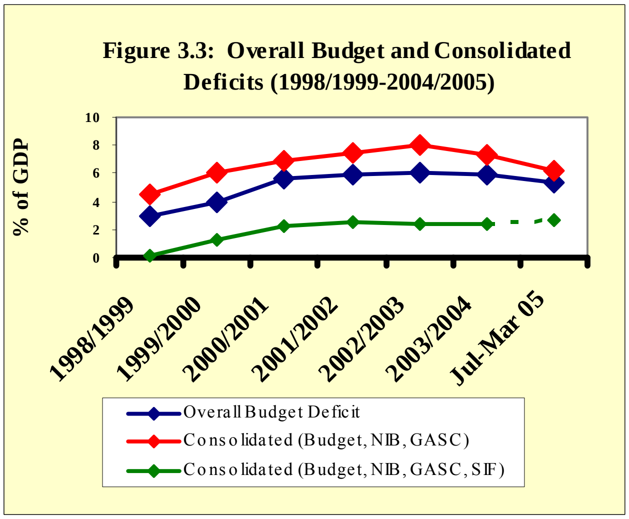
Monetary developments indicate that inflation will continue to subside. The Central Bank has contained last year's expansion of broad money growth (Figure 3.1), and tighter monetary policy has stabilized the exchange market. As a result, the official and parallel market rates converged in December 2004 (see Figure 3.2). The availability of foreign exchange improved by the end of the year following (i) the establishment of a formal interbank market for foreign exchange;[20] and (ii) the issuance of Prime Ministerial Decree No. 2059/2004 that canceled the surrender requirement of foreign exchange proceeds[21] (Ministry of Finance, March 2005). By the beginning of the new year, and in a liquid market, the exchange rate had moved to a market

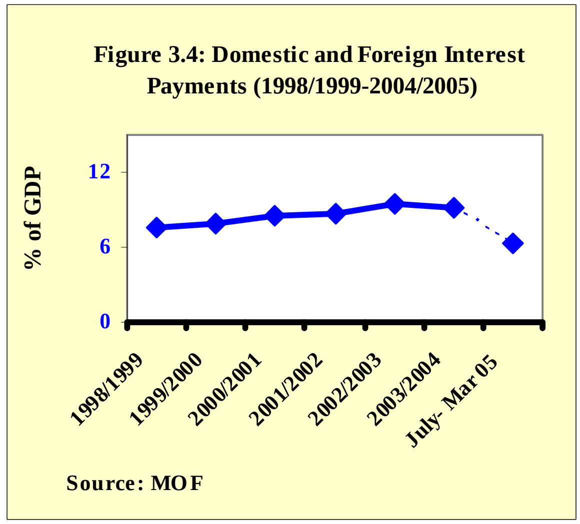
Figure 3.2: Official & Parallel Market Exchange Rates (June 2001- April 2005)



[20] The interbank market was a critical component of the market infrastructure for a successful float.

[21] أصدر السيد رئيس الوزراء تم إلغاء قرار رقم 2059 لعام 2004 بإلغاء قرار رقم 2003/506 الخاص بإلزام المصدرين بتوريد 75% من حصيلة وارداتهم بالعملة الأجنبية إلى البنك المركزي.



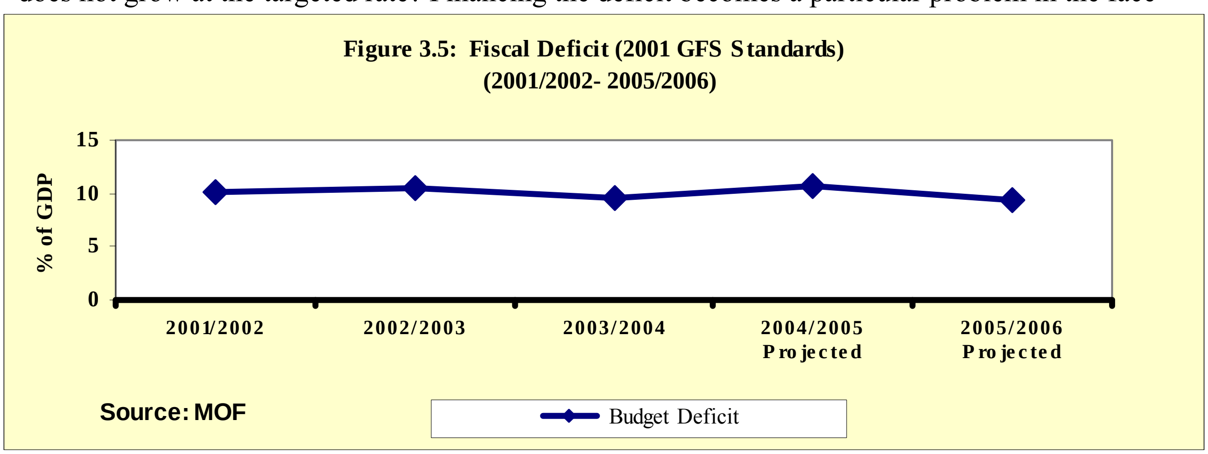


clearing level, and the Egyptian pound had appreciated by 44 piasters to 5.79 LE/$. Between December 2004 and March 2005, international reserves increased from $15.4 billion to more than $18.4 billion, supported by a large current account surplus (Central Bank of Egypt).

Budget deficits, however, have been growing for the past five years**. No actual data for the 2004/2005 budget was available at the time this report was published.[22] However, Minister of Finance Youssef Boutros-Ghali (MOF, May 2005, p. 30) recently announced the budget figures for 2003/2004 through 2005/2006 in accordance with the IMF's 2001 Government Finance Statistics standards. The numbers show an increase in the deficit of one percentage point of GDP in 2004/2005 compared to 2003/2004. This is understandable given the ambitious and costly reforms that the government is undertaking. The Ministry of Finance projects that the budget deficit will lose one percentage point in 2005/2006 as the economy becomes more dynamic in response to trade and tax reforms.**

While the budget deficit has witnessed a sizable increase in terms of absolute numbers,23 most if not all of the widening reflects the more transparent reclassification of the budget that made a number of expenditure items more explicit, including indirect subsidy figures. The Minister of Finance has announced that he intends to cut the budget deficit by 50 percent over a five-year period.

The question that remains is how long can Egypt sustain a large deficit if the economy does not grow at the targeted rate? Financing the deficit becomes a particular problem in the face



of the continued rapid rise in government and public sector debts. According to Jbili & Kramarenko (2003), Egypt has the second highest level of public debt in the region after

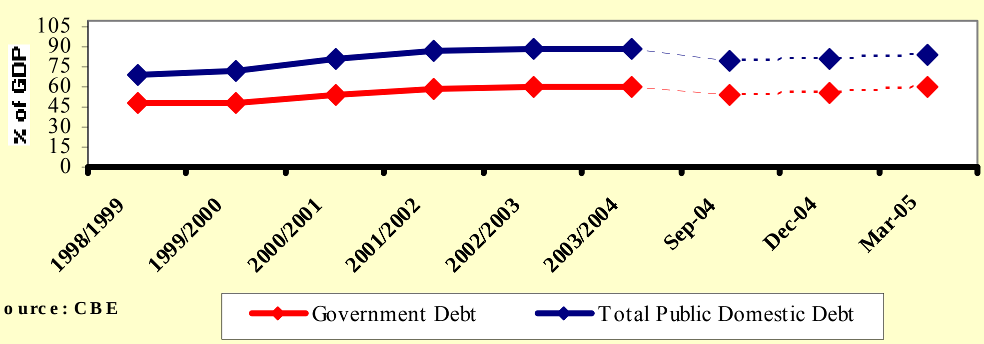
[22] Data for 3 quarters of 2004/2005 are available.
[23] According to the new GFS standards.

Lebanon. As a percent of GDP, government debt was 61.7 percent in June 2004 compared to 58.4 percent in June 2002. More recently, the government debt to GDP ratio started receding as economic growth rates accelerated. In December 2004 government debt fell to 57.3 percent of GDP. Similarly, total public debt climbed from 87 percent in June 2002 to 89 percent in June 2004, before falling to 81.6 percent in December 2004 as growth picked up (Figure 3.5). It remains to be seen whether this trend will continue. Significant fiscal consolidation would still be needed particularly in the face of recent tariff reductions and tax cuts that will most certainly impact the budget in the shorter term. In this context, the challenge of fiscal consolidation will be addressed in Chapter 4.

Egypt's external position remains robust. The current account surplus was 4.4 percent of GDP in 2004 and preliminary balance of payments data indicates that it is expected to be higher in 2005. The strength of the current account was driven by an improvement in both exports and the services account. The fall in the value of the pound made Egypt more competitive, and an even more attractive tourist destination, while regional developments have served to boost traffic in the Suez Canal. While the trade deficit rose by some $1.2 billion in 2002/2003, total exports proceeds saw more than a $2.2 billion increase, and imports payments increased by $3.5 billion. Merchandise exports alone rose by $1.5 billion.

This contrasts to the pattern of past years when the improvement in the current account stemmed from a sharp decline in imports rather than an improvement in exports of goods and services. During the four-year period between 1999/2000 and 2002/2003 imports payments fell by some $3.1 billion from $17.9 billion to $14.8 billion. The trade deficit also fell by some $4.9 billion. During the same period total exports proceeds increased by a mere $1.8 billion, and merchandize exports by $900 million.

Figure 3.6: Total Public Domestic and Government Debts (1998/1999-2004/2005)



Source: CBE

Table 3.1: The Share of Exports of Goods and Services in Current Account Receipts (1999/2000-2003/2004)

US$ billions	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
Current account receipts	**34.9**	**24.4**	**20.6**	**23.6**	**30.8**
Total exports	6.4	7.1	7.1	8.2	10.5
% of receipts	*27.2*	*29.1*	*34.5*	*34.8*	*34.0*
Oil exports	2.3	2.6	2.4	3.2	3.9
% of receipts	*9.7*	*10.8*	*11.5*	*13.4*	*12.7*
Merchandise exports	4.1	4.4	4.7	5.0	6.5
% of receipts	*17.5*	*18.0*	*23.0*	*21.2*	*21.3*
Services	5.6	5.6	3.9	5.0	7.3
% of receipts	*24*	*22.9*	*18.9*	*21.0*	*23.8*

Source: Ministry of Finance, March 2005.

While the increasing growth rate of imports in response to lower tariffs could increase pressures on the trade deficit, the services surplus should remain unaffected and should more than make up for any pressures on the trade balance, keeping the current account in surplus. This is because the recent appreciation of the pound should not have a significant impact on either tourism or Suez Canal receipts. European tourists represent the majority of tourists arriving in Egypt, and Egypt continues to benefit from a strong euro (Ministry of Finance, March 2005). Suez Canal earnings will actually benefit from higher oil prices. Hence, the diversity of foreign exchange income in the current account should provide protection against external shocks.[24]

Table 3.2: The Share of Exports of Goods and Services in Current Account Receipts Jul-December 2003/2004 – July-December 2004/2005

US$ billions	2003/2004	2004/2005
	July-December	**July-December**
Current account receipts	**14.8**	**19.9**
Total exports	4.5	6.4
% of receipts	*30.5*	*32.1*
Oil exports	1.7	2.5
% of receipts	*11.5*	*12.6*
Merchandise exports	2.8	3.9
% of receipts	*19.0*	*19.6*
Services	4.0	5.2
% of receipts	*26.7*	*26.1*

Source: Ministry of Finance, March 2005.

More impressive, we note that current account receipts are more diversified than before. The share of merchandise exports in current account receipts has increased from 17.5 percent in 1999/2000 to 21.3 percent in June 2004. While the share of oil exports has also increased, it remains below that of

[24] Fitch Ratings. January 2005. Arab Republic of Egypt: International Credit Update.

non-oil exports. Services account for 23.8 percent, and their share has fluctuated over the years due to their volatile nature.

The trend continues into 2004/2005. Data for the first half of the year shows that current accounts receipts are significantly higher compared to the same period last year. Oil exports rose to 12.6 percent following the recent escalation in oil prices. The share of merchandise exports, although higher than the corresponding period of last year, is less than the share of services. This is due to the appreciation of the pound since December 2004. Services (Suez Canal and tourism), which are not that sensitive to exchange rate fluctuations as noted earlier, are up to 26 percent of foreign currency receipts. It is still too early to judge the impact of recent trade and tax reforms on economic growth and activity, but it is expected that tariff and tax cuts will stimulate the business environment and manufacturing for exports.

Regarding the capital account, the deficit rose from $2.7 billion in June 2003 to $5 billion in 2004, reflecting weak investment flows and loss of confidence in government policies. The trend continued through the first quarter of 2005, which saw a capital account deficit of $2.2 billion. The second quarter, October-December 2004, saw a small surplus of $371 million, a testament to revived confidence in the economy.

The recent prudence in monetary policy is providing a stable environment for private sector activity. Private sector GDP grew by 4.3 percent in 2003/2004 compared to 3 percent a year earlier, and is projected to grow by 5.4 percent in June 2005. In contrast, growth in public sector GDP has been maintained at 2.9 percent since 2002. Growth in private sector credit, however, has declined from 9.5 percent in 2001 to 4.6 percent in 2004 (Ministry of Finance, March 2005). One reason is that the credit excesses of the late 1990s and the subsequent penalization of both failed businessmen and bank officials are hindering the recovery of private sector growth. A second reason relates to the high levels of government debt that are crowding out private investments.

Equally important, the Central Bank needs to be strengthened as an independent institution capable of preserving low and stable inflation, implementing the limits on financing of the budget stipulated in the recent banking legislation, and improving coordination with the Ministry of Finance (Oxford Analytica, December 2004). A new Commission has recently been formed to coordinate monetary and fiscal policies. A Monetary Policy Unit has been set at the CBE, and has recently issued the first of periodic announcements about the CBE's short-term monetary policy strategy.[25]

In the meantime, the Central Bank is working on developing a monetary policy framework that anchors inflation expectations. The ultimate goal of the Central Bank is to implement an inflation targeting monetary framework using indirect market instruments to control liquidity in the market. In the short term, broad money (M2) will be used as an intermediate target and nominal anchor.

3.2 Enhancing Governance/Transparency, Coherence, Consistency And Stability In The Domestic Monetary / Fiscal / Trade Mix

3.2.1 Governance/Transparency

The new Cabinet has adopted the flagship notions of transparency and good governance. These concepts are reflected in the overall paradigm of reform. Below is a brief overview of how

[25] See www.cbe.gov.eg

transparency and good governance form the cornerstone of the government's economic reform agenda.

3.2.1.1 Special Data Dissemination Standards (SDDS)

The SDDS was established by the IMF in 1996. It is intended to guide member countries in providing economic and financial data to the public. On January 31, 2005 Egypt subscribed to the IMF's Special Data Dissemination Standard (SDDS). This is a major step towards improving the reliability of Egypt's official statistics. It is also a testament to the new government's strong commitment to transparency and to implementing international best practices in statistics. These practices include the dissemination of timely and comprehensive statistics, thereby contributing to the pursuit of sound macroeconomic policies and the improved functioning of financial markets (Ministry of Finance, March 2005).

3.2.1.2 Transparency Reached by E-Government

The following section illustrates the Ministry of State for Administrative Development's (MSAD) role in creating a good governance environment. It explains how e-government solutions and services could be used to fight corruption.

E-government solutions and services are classified in three categories: Government to Government (G2G), Government to Business (G2B) and Government to Citizens (G2C).

For the G2G, services are clarified by the automation of the governmental offices project. This project's objective is to re-engineer the workflows of all the governmental services through all stages and converge it into one step that can be accessed through the e-government. This yields to better performance of employees, minimization of expenses and, in turn, less time and effort wasted by citizens seeking services.

For G2B, services aim to make the business procedures easier and efficient for all companies, investors, suppliers and exporters. This is done through some very important e-government services, such as:

- Taxation and customs services
- Electricity bills for businesses
- Licensing of new businesses
- Merging of two companies
- Filling in tax forms
- Inquiring about shipping charges and exchange rates

For G2C, today there are 590 inquiry services that provide citizens with information about documents and procedures for government services. In addition, over 50 services are now available that can reach customers wherever they are located.

3.2.2 Enhancing Coherence, Consistency and Stability in Monetary Policy

To pull the economy out of recession an expansionary fiscal policy was adopted to increase aggregate demand. In a small open economy with limited exchange rate flexibility and some capital mobility (which is the case in Egypt), fiscal policy is more effective in stimulating domestic demand or inflation, whereas monetary policy is more effective in addressing balance of payments problems (Wong, 2002.)

While the expansionary fiscal policy served the purpose of stimulating aggregate demand and reinvigorating economic activity, the rising fiscal deficit is not sustainable. With this in mind, the Ministry of Finance and the Central Bank must consider the appropriate mix of the fiscal, monetary and exchange rate policies that will deal with any rising macro-imbalances. Establishing a flexible exchange rate will allow monetary and fiscal policies to concentrate on addressing effects on production, domestic demand, prices, the budget, foreign assets and liabilities in the banking system. A fixed exchange rate policy will force the Central Bank to take into account the impact of monetary and fiscal policies on the exchange rate to the exclusion of other variables.

Moving to a more flexible exchange rate was thus necessary, albeit long overdue, to reinvigorate economic growth. Still, a few questions need to be answered: (i) how will the Monetary Authority ensure the continued implementation of an exchange rate policy that is supportive of the monetary/fiscal policy targets of production and growth, (ii) how will the Monetary Authority ensure that there is no policy reversal to a system with limited exchange rate flexibility (Wong, 2002).

Towards that end, the Central Bank of Egypt is currently developing a supporting institutional framework for monetary policy: a new banking law was introduced in 2003, and a committee to oversee the modernization of its monetary policy infrastructure was recently established. The recently created interbank foreign exchange market should facilitate greater liquidity of the market through the development of spot and forward markets for foreign exchange. The Central Bank is also working towards developing a monetary policy framework that effectively anchors inflation expectations in the context of a flexible exchange rate and a proactive interest rate policy. A Monetary Policy Unit has been established at the Central Bank to communicate the direction of monetary policy to the market using broad money as a nominal anchor in the short run and inflation targeting as the anchor in the medium term.

3.2.3 Enhancing Fiscal Transparency

Fiscal transparency is reflected in the issuance of a new tax law and the adoption of the IMF’s GFS standards for the Egyptian budget.

3.2.3.1 Taxes

The new tax law makes the Egyptian tax system more transparent for all taxpayers. Income tax brackets have streamlined into three categories only, at rates of 10, 15 and 20 percent. Avoidance of numerous taxes that yield limited revenue will facilitate tax assessment and discourage the impression of excessive taxation. Thus, the change is expected to yield a higher degree of participation among taxpayers. Additionally the tax law grants general amnesty for past tax evasion or other offences, and provides for many transitional provisions in order to encourage businesses in Egypt’s informal economy to legalize their status. The new law also introduces high deterrent penalties against tax fraud (Ministry of Finance, December 2004). Further details on tax reforms are illustrated in the next section.

3.2.3.2 The Budget

The Ministry of Finance recently announced that the 2005/2006 budget has been published according to the 2001 GFS standards, making the Egyptian budget comparable to other countries’ budgets. The budget legislation enacting the GFS standard was passed in June 2005.

Under the new standards, the budget deficit has been reported to increase to 10.3 percent because, for the first time, it includes all indirect subsidies. Recent announcements about pension reforms and increasing the efficiency of social spending will help enhance budget transparency.

The new legislation introduces many elements of transparency into the budget. The annual budget will be developed within a consistent medium-term macroeconomic framework. As a step towards transparency, a medium-term macro-fiscal strategy will be prepared along with an annual statement on progress towards the objectives in the strategy. The new legislation incorporates a section about the minimal amount of information required to conform to international standards of transparency. Other requirements concern periodic and regular publications on budget implementation to ensure that budget execution is in line with budget objectives.

Concerning the transparency of government expenditures, introducing performance budgeting and enhancing reporting and auditing procedures will help improve the quality of information on expenditures. This will allow the society and public to question the performance of spending units, thus establishing more control on the expenditure decisions of spending units (Ahmad et al., April 2005).

3.2.4 Enhancing Trade Transparency

Before the trade reforms of September 2004, the structure of customs had been complex and the rate schedule was ambiguous. This had led to disputes and delays in processing imports. As a first step towards greater transparency, distortions were eliminated as tariffs were cut. Tariff brackets were streamlined from 27 to only 6. The reductions in tariffs and the elimination of exemptions have served to rein in corruption through curtailing the discretionary assessments of imported goods. This helped eliminate the ambiguity accompanying the valuation procedures at the borders, resulting in further transparency and credibility of the system.

3.3 Public Debt

Moody's (2005) views the nature of the Egyptian local currency debt as partially reassuring, despite the continuous increase in debt levels, thanks to the following mitigating factors:

1. A mere 20 percent of the domestic debt is tradable.
2. Most of the debt carries medium- to long-term maturities.
3. About 80 percent of the debt is held by domestic public sector institutions, reducing refinancing risk.
4. The existence of a very large amount of deposits in the banking system at large provides some comfort.

3.4 Structural Reforms Gather Speed

To improve the incentives for private investment, the government has announced that it will accelerate the pace of a number of structural reforms directed towards reducing the role of the state, improving governance, and removing administrative barriers to market forces. Confidence in the economy is high as the new Cabinet has taken pains to avoid the typical rhetoric in favor of adopting a number of bold reforms. The reforms touched almost all areas of economic activity. A brief account of these reforms is presented below.

3.4.1 Continued and Accelerated Implementation of Trade Liberalization Policies

During the first few months after the new Cabinet took charge, several positive developments in the area of trade policy took place. The main intention was to further liberalize trade and open up the Egyptian economy to achieve the government's export promotion goals. Hence, a number of new initiatives were taken on in addition to corrective measures designed to deal with the so-called tariff distortions.

The first of these new initiatives was the adoption of a comprehensive trade liberalization strategy comprised of tariff adjustments, a rationalization of the tariff structure, the abolition of fees and surcharges, and the reduction of customs exemptions. Towards this end, tariffs were cut across the board, affecting almost all the tariff lines. The weighted average tariff fell from 14.6 percent to 9.1 percent and all surcharges and service fees were abolished. These recent changes are different from previous tariff reforms in two respects. First, they took into consideration the different stages of production, meaning that differences between tariffs on final products were higher than those on intermediates and, in turn, differences between tariffs on intermediates were higher than those on inputs. Meanwhile, most of the tariff distortions, where tariffs on inputs or intermediate products were higher than final goods, were corrected to reflect the rationale of having higher tariffs on final products. The differences between tariff levels were reduced, which helped to reduce tariff dispersion. The second difference related to tariff peaks. Tariffs on passenger cars (less than 1600 CC) were reduced by differing amounts.

Another new initiative was narrowing down the so-called tariff bands (or brackets) from 27 to only 6. Other customs reforms that serve to improve transparency include:

- Streamlining procedures to be on par with international standards and conventions (e.g., pre-arrival clearance).
- Introducing up-to-date techniques such as risk management and post audit.
- Expanding the electronic handling of documents.
- Streamlining customs procedures and minimizing discretionary exemptions and import controls.

A second round of reductions in December 2004 further lowered tariffs on inputs and intermediate goods by more than 50 percent (Ministry of Finance, December 2005).

3.4.2 Tax Reforms

Parliament passed a new tax law in June 2005 that overhauls personal and corporate income taxes. The new tax law makes the Egyptian tax system more transparent. It cuts personal and corporate income taxes and unifies tax exemptions and legislation. It introduces a 50 percent reduction in personal and corporate taxes to a maximum rate of 20 percent. (Ministry of Finance, December 2004).

The law also provides for phasing out tax exemptions for newly established companies. The law is intended to encourage the voluntary submission of returns by taxpayers, timely payment of taxes, and greater compliance of citizens who previously evaded taxes. A key element of the law is the introduction of self-assessment for taxpayers. The Tax Authority will also limit their inquiries to a sample of some 5 to 10 percent of all taxpayers, thus ending the long practice of discretionary assessments that only served to cultivate mistrust and tax evasion. Stiffer penalties will pose a greater disincentive against tax fraud (Ministry of Finance, March 2005).

3.4.3 Financial Sector Reforms

The Government has announced that it is strengthening the financial system through structural reforms, mergers and large-scale privatizations of joint venture banks and public enterprises. It has also announced an ambitious financial sector reform plan.

Concerning the divestiture of banks and state enterprises, it has announced the impending sale of one state-owned bank during 2005. Between July 2004 and March 2005 stakes divested in 17 non-financial enterprises and two financial institutions have brought in privatization proceeds of $2.35 billion, surpassing total proceeds in the last four years.

On the issue of overhauling the financial sector, the government has on more than one occasion announced that it has embarked on a financial sector reform plan that aims at increasing the role of the private sector in the economy through (i) strengthening the banking system by privatizing the smaller public sector banks and joint venture banks; (ii) restructuring public sector banks, including through recapitalization; (iii) resolving the problem of non-performing loans; (iv) privatizing insurance companies.

Achievements to date include mergers/sales of four joint venture banks. Another nine transactions are in the pipeline for implementation by the end of 2005. In preparation for its privatization, the Bank of Alexandria is currently being audited under the supervision of an international firm.

With assistance from the European Union, the Banking and Restructuring Unit at the Central Bank is in the process of assessing the risk profile of the portfolios of the three remaining public sector banks. This work is being complemented by efforts of the Non-Performing Loans Unit at the Central Bank to resolve bad loans as well as disputes between banks and borrowers.

3.4.4 Implementation of a Solid Regulatory Framework to Attract Foreign Direct Investment

The Egyptian Competitiveness Report 2003/2004 concluded with a set of recommendations to guide a solid government policy to attract foreign direct investment (FDI). Below is a short review of the progress achieved throughout the past year.

With regard to the first recommendation, which pertains to **articulating and advocating a national policy on FDI,** the newly created Ministry of Investment is currently taking the lead in preparing a comprehensive Investment Policy for Egypt in consultation with private sector investors and business associations. This investment policy will be published in due course after it's revised by the Ministerial Economic Committee and approved by the Cabinet. Also in line with those efforts, the Ministry of Investment has initiated a comprehensive Investment Climate Assessment (ICA), conducted by the World Bank, which is nearing completion.

The ICA will identify administrative barriers and all areas where reforms are needed to improve Egypt's business environment, along with providing recommendations on actions required, a detailed time plan, the priority of implementation, and the entities involved and responsible for timely implementation of these recommendations.

Anecdotally, it is worth noting that in a recent visit by representatives of UNCTAD, who were here to update Egypt's Investment Policy Review (IPR) from 1999 the mission recognized the sizable progress the Egyptian government has made in the fulfillment of most of the recommendations made by UNCTAD in their last IPR. Although GAFI is still in the process of establishing the one-stop-shop for simplifying the administrative burden on investors, the UNCTAD mission was pleased with GAFI's progress thus far.

With respect to **revising the incentive policy**, the new tax law under discussion will abolish investment incentives, which proved to be a drain on the government's budget and did little to move Egypt up on the priority list of investors, who tend to prefer other factors such as a stable macroeconomic framework and a growing economy. However, it's worth mentioning that the fourth chapter of the Investment Law No. 8, which has been approved by the Cabinet, sets the option for the Cabinet to provide other forms of incentives than tax incentives to attract large multinational corporations. These measures will be more apparent in due course.

Concerning the **establishment of an Investment Promotion Agency (IPA)** the Minister of Investment replaced GAFI's previous management with an experienced private sector-oriented management. A new chairman for GAFI has been appointed along with three vice chairmen, a consultant to the chairman (responsible for policy advocacy, one-stop shop facilitation, and aftercare services to existing and potential investors), a new Board of Trustees and a new Board of Directors. Almost all are private sector representatives and businessmen.

GAFI, with the help of multilateral institutions and specialized FDI consultants, is currently devising the IPA organization, governance structure and job descriptions. It is also working on the development of a general Investment Promotion Strategy and a detailed institutional business plan and budget. In this framework, GAFI is devising an overall location benchmarking for Egypt, sector benchmarking, and sector and investor targeting strategy. It is in the process of developing and implementing a market intelligence and proactive promotion program in addition to a policy advocacy program.

As part of the overall plan, special emphasis is given to investor-oriented services comprised of the following: a) investor facilitation and servicing program, b) investor aftercare program, c) comprehensive information system to provide investors with all relevant information on the country and the potential sectors, d) an investment map of Egypt that will give accurate and relevant information on all geographical areas and governorates in Egypt, e) an investor tracking system to follow-up on all investments from initial contact through to investment realization and beyond, f) a huge coordinating partnership network to be established across both the public and private sectors at the national and local levels to service investors, g) company site visit program to Egypt involving airport-to-airport service for major investors, h) sector studies that outline investment opportunities, i) matchmaking through identification of potential local partners and promoting joint ventures, strategic alliances, subcontracting, licensing, franchising arrangements, j) infrastructure and property solutions that are quick and easy to set up. It is worth noting that all proposed programs will be associated with intensive staff training.

Following that, a professional promotion and servicing program will be implemented by competent, newly hired staff, and professional promotional materials will be developed, such as the IPA corporate image, country brochure, country video/DVD, sector brochures, press kits, information packets, presentations, and promotional stands. The implementation of a national communications and awareness campaign is in progress. Additionally, an international communications and country branding campaign and promotion activities in target sectors and target markets will take place coupled with professional investor servicing and facilitation activities that are being identified and planned as part of the overall strategy.

Moreover, promotion executives will assist in developing ties between the MNCs and local firms in Egypt, with the assistance of specialized consultants, by identifying the existing linkages and outlining the factors behind their promotion or preclusion. They will also take on a number of other activities such as developing programs to be implemented by the government to promote clusters and deepen industrial linkages, as well as setting measures to be undertaken by government institutions, NGOs, and foreign companies to create and deepen linkages in subcontracting local suppliers, transferring technology from foreign affiliates, training, and information sharing. Finally promotion executives will be responsible for cooperating and coordinating with all technical assistance activities that are provided by other donor programs as these technical assistance activities represent an ideal supplier development program for foreign companies seeking to subcontract parts of their supply chain.

3.4.5 Promotion of Technology Transfer and Innovation to Enhance Competitiveness

The Egyptian Ministry of Foreign Trade and Industry (MFTI) has set up a strategy to improve the ability of SMEs to bridge the gap between their current technological status and the national and international technological base, and to help them adapt technological innovations specific to their needs. The strategy has been set according to the vision of the Egyptian Ministry of Foreign Trade and Industry to transform the Egyptian industry and export sectors to knowledge-based, high value-added, sustainable and competitive sectors.

The strategy also aims at facilitating SMEs’ access to technological development sources through appropriate channels, specifically through a network of Technology Transfer and Innovation Centers (TTIC) that stimulate, transfer and diffuse new technologies and innovations. The network acts as a catalyst to provide the technological needs necessary to upgrade the Egyptian industry and export sectors and raise its competitiveness. Technology Transfer Centers are either sectoral centers, sub-sectoral centers, or horizontal centers. The selection criteria for the sectors as well as the horizontal centers are based on the potential for growth, potential for export, apparent or latent demand, interest of stakeholders and emerging technologies.

TTICs provide a wide portfolio of services including quality management, advanced human resources development, technical assistance, technology transfer, environment and social management, R&D and innovation. They currently consist of eight vertical (sectoral) and two horizontal centers.

3.5 Concluding Remarks

The Egyptian government has taken on many decisive and aggressive reforms that are homegrown. These measures are aimed at reducing the role of the government in productive activities and supporting private sector growth, with to the goal of enhancing the competitiveness of the economy. The recent progress in implementing critical reforms contrasts favorably to the lackluster performance of recent years. Areas of reforms include tariffs and customs, income tax, monetary and external policies, fiscal policies and structural policies. Performance to date has been encouraging, and the government seems committed to restructuring the financial system, privatizing state-owned companies, modernizing fiscal accounts and continuing to strengthen monetary policy. Keeping up the momentum will be crucial for sustainable growth and increased competitiveness.

However, significant challenges remain. Foreign and domestic private investment needs to be increased to enable the economy to absorb the large pool of young workers entering the labor market. The government still needs to strengthen budget execution, and formulate a comprehensive strategy to consolidate the budget and reduce domestic debt. A modern monetary framework for monetary policy has yet to be developed to ensure price stability. All these challenges and others will be addressed in the next chapter.

CHAPTER 4

THE ROAD AHEAD: THE GOVERNMENT AND BUSINESS SECTOR'S WORKING PARTNERSHIP FOR INCREASING COMPETITIVENESS

4.1 WINDOWS OF OPPORTUNITY

In Chapter 3 we concluded that Egyptian policymakers, for the first time in many years, have made significant leaps in implementing a wide range of bold and comprehensive reforms. These reforms touched on many of the "drivers of change" pointed out in last year's competitiveness report (Egyptian National Competitiveness Council, 2004, p. 41) and should help Egypt regain some lost ground in the field of competitiveness. As determined in the last chapter, the reforms already underway have managed to revive confidence in the economy — as reflected by a buoyant stock market, higher growth rates, lower inflation, and a stronger and stable pound.

While the reforms of the past nine months have been impressive, to say the least, a number of challenges remain. Overcoming these challenges will be crucial to building a competitive economy and harnessing the Egyptian economy's growth and private investment potential.

The following section examines a number of windows of opportunity the government is seeking to unlock in an effort to turn "tomorrow's gains into today's competitiveness" (ENCC, 2004, p. 41). The ambitious work to date may have softened the potential impact of these future opportunities. Regardless, the faster these opportunities are pursued, the greater support they will bring to developing the private sector and promoting sustainable growth of a dynamic economy.

4.2 DEVELOPING A HOLISTIC VISION FOR LASTING COMPETITIVENESS – AN UPDATE

In the 2003-2004 Competitiveness Report, ENCC presented strategic challenges that stand in the way of the Egyptian economy's competitiveness. On top of the list came the need to develop a comprehensive vision to serve as the model for a more competitive Egypt. This vision should be the inspiration, guidance and source of alignment for all those striving to achieve this goal, be it governmental bodies, members of the civil society, or any other stakeholders. As reforms start to unfold, it is clear that progress requires some short-term pains to achieve long-term gains. Thus, it's of great importance to articulate a vision that is embraced by the majority of stakeholders in order to increase their tolerance and support for the ongoing — and deeply encouraging — waves of reform. Another important aspect of this vision is the need to engage all stakeholders in this process by increasing their sense of ownership. This vision should define the role of each individual and institution in working to achieve this model state.

Developing a vision requires the participation of all stakeholders in a constructive manner. Awareness of the importance and timeliness of the challenges at hand is imperative. It is encouraging and worth noting that we are witnessing the birth of a national debate in these areas, catalyzed by the many initiatives currently being developed between the government, political parties, academia and civil society. As this process matures we believe that these seemingly disparate voices urging reform will eventually come together.

4.3 GOOD GOVERNANCE

Corporate governance is a complex concept based on four principles: accountability, transparency, fairness and responsibility. The way these four elements mix defines the governance structure of an entity. The economic crises in East Asia in the late 1990s demonstrated that macroeconomic problems become worse when there is a systemic failure of corporate governance stemming from a weak legal and regulatory system combined with inconsistent accounting and auditing, poor bank practices and thin and unregulated capital markets (World Bank Group, 1999).

Egypt, like many developing countries, faces two challenges. The first is giving up economic governance arrangements that are not based on the rule of law in favor of a rule-based system. The second is enforcing the new system. Enforcement is the most pressing issue and the more challenging of the two tasks (Grant, 2004).

4.3.1 The Institute of Directors

As part of the effort to promote corporate governance practices in Egypt, then Minister of Foreign Trade Youssef Boutros-Ghali established the Egyptian Institute of Directors (EIOD) by issuing Decree No. 675 in 2003. The Cabinet reshuffle of July 2004 brought the EIOD under the purview of the nascent Ministry of Investment.

To date, the EIOD has not delivered on some of its key tasks, which cover the following areas:

- Issuing a code of corporate governance.
- Promoting high professional standards for boards and directors' conduct, practice, and performance.
- Providing accreditation for company directors.
- Conducting seminars and workshops on various topics, including shareholder rights and disclosure/transparency and financial reporting.
- Publishing newsletters and providing research, advisory and consulting services to:
    - improve compliance with laws and regulations;
    - raise awareness of the benefits of good corporate governance;
    - promote and facilitate the exchange of experiences about the application and development of the principles of corporate governance, including coordination with related government policies and legal principles.
- Developing an Egyptian code of corporate governance.

EIOD has the potential to unleash many opportunities by becoming a vehicle that spreads international standards of corporate governance — such as rules by the Organisation for Economic Co-operation and Development (OECD)[26] — rather than re-inventing the wheel. The importance of this reform measure cannot be stressed enough, given the ambitious financial sector restructuring plan that the government is about to undertake. Complying with international

[26] The OECD corporate governance standards may be found at the following link: http://www.oecd.org/document/49/0,2340,en_2649_34813_31530865_1_1_1_1,00.html.

standards of corporate governance will force banks to follow sound banking and auditing practices, and to avoid the recurrence of past financial problems.

4.3.2 Fiscal Transparency

The Ministry of Finance recently announced that the 2005/2006 budget has been published according to the International Monetary Fund's 2001 Government Finance Statistics (GFS) standards, making the budget more transparent (see Chapter 2). However, the National Investment Bank's (NIB) budget still needs to be integrated into the general budget.

Pension reforms and other efforts to increase the efficiency of social spending must be accelerated to further enhance transparency. The consolidated budget includes the operating budgets of (i) the General Authority for the Supply of Commodities (GASC); (ii) the National Investment Bank (NIB), which finances public investment projects, borrowing from the Social Insurance Funds (SIF), and lending to the government and to the Economic Authorities; and (iii) the two SIFs (government and private and public business sector employees). Although demographic trends are heavily tilted towards the very young, the pension system was structured in such a way that it is highly complex and ambiguous. Social security resources amount to LE 15 billion annually (which is transferred to the NIB), but the government has to pay out LE 21 billion in pensions. This is because the government has covered the cost of living increases in pensions and benefits for many years without increasing contributions. Rather than subsidizing the SIFs by LE 6 billion directly, the government is mandated by law to take only LE 6 billion from the SIFs, which essentially means it has to contribute the other LE 15 billion to the pensioners. More astonishing, the remaining LE9 billion is borrowed at high interest rates from the NIB and used up in non-revenue generating infrastructure projects.[27] Thus, the pension system as a whole is in deficit. Moreover, it is complex, opaque, not conducive to fiscal consolidation and public debt streamlining, and in dire need of reform.

4.4 FISCAL CONSOLIDATION

The fiscal deterioration in recent years mostly reflects revenue weaknesses created by a slowdown in growth. It also reflects higher interest payments on public debt as the government has increased its non-inflationary financing of the budget (Ministry of Finance, March 2005). Interest payments, defense and wage and salaries represent about two-thirds of total spending. As a result, public debt continued to increase (Moody's, 2005) without showing any signs of slowing down in 2004 (Ministry of Finance, March 2005).

The budget deficit for 2004/2005 is one percentage point higher than last year (Ministry of Finance, May 2005), pointing to the need for greater fiscal consolidation. Efforts to reclassify the budget according to international standards and improve treasury cash management and public expenditures will not be sufficient in either lowering government spending or borrowing. These efforts will have to be complemented by streamlining subsidies, controlling the government wage bill, and other cuts. Another important expenditure control measure must include bringing investment expenditures of the NIB under the control of the Ministry of Finance. This would help control the cost of off-budget outlays, serving to reduce government borrowing and placing public debt on a declining path.

[27] Hisham Tawfik, advisor to the minister of finance on pension reform

Fiscal consolidation assumes even greater importance in the face of recent tariff reductions and proposed tax cuts and social reforms, which will most certainly have a negative impact on the budget in the shorter term. Initially, the tariff reductions are expected to lower customs revenues. Indeed, customs duties have already seen a 16 percent decline during the first half of 2004/2005 (Ministry of Finance, March, 2005, p. 30). Similarly, tax cuts will cause a shortfall in tax revenues, estimated at between LE 3.2 to 3.5 billion (Ministry of Finance, December, 2004, p. 28).

In the medium run, however, greater openness to trade, tax cuts and tax administration simplifications will undoubtedly place Egypt on a more robust growth trajectory. These reform measures should act as a catalyst in stimulating the economy. Concerning recent trade reforms, customs revenues are expected to increase as import volumes pick up in response to lower tariffs. The reduction in tariffs and streamlining of customs procedures will help enhance Egypt's competitiveness in the global market. Even if customs revenues fall, they should be offset by increased tax revenues as Egypt becomes more of an export-led economy. The reduced costs of importing essential raw materials and intermediate and capital goods will also stimulate growth. This is because lower customs duties will reduce the cost of investment and consumption, supporting domestic investment, production and stronger growth.

With respect to the new tax code and the ongoing transformation of tax administration, the Ministry of Finance anticipates that the proposed rate reductions and administrative changes will fuel economic growth in the medium term. The drop in tax receipts will be more than recouped by a widening tax base and "taxable capacity." Higher profits for businesses will encourage faster economic growth, thus expanding the tax base and ultimately increasing tax revenues. This should partially make up for the shortfall in tax revenues. The planned transformation of the tax authority includes greater automation, which will lead to a less discretionary application of the rules and potentially raise additional income even as the effective tax burden is reduced.

Economic activity will be further reinforced in response to the rapid pace of current reforms and increased confidence in government policy. GDP growth rates should increase by 1.5-2 percentage points, giving rise to at least LE 10 billion in additional tax revenues[28] (MOF, May 2005). Also, the reduction in tax rates is likely to discourage tax evasion and improve tax compliance, thus covering a large part of the loss in tax receipts. Finally, the budget will be bolstered by complementary efforts by the Ministry of Finance to rationalize expenditures (Ministry of Finance, March 2005).

Another fiscal burden relates to implementing the government's social agenda to mitigate the effects of the numerous policy reforms on the disadvantaged and impoverished groups. The government has announced a social development program that includes an enhanced social safety net. This program will also carry an inevitable short-term fiscal cost, adding to the challenges of fiscal consolidation.

All in all, these trade, tax and social reforms will in the medium term help reinvigorate the business community, giving momentum to the domestic industry and, hence, supplying the needed push for growth and job opportunities (Ministry of Finance, March 2005). More immediately, however, the key question the government must address is how the economy will

[28] Not limited to income tax. Includes sales tax and all tax receipts.

finance the short-term costs of the new reforms. The answer should further strengthen the argument for substantial fiscal consolidation.

4.5 PUBLIC DEBT

According to Fitch Ratings (December, 2004), "Egypt's debt dynamics benefit from strong nominal GDP growth…so the government can incur a slightly higher deficit without jeopardizing the debt/GDP ratio." In addition, privatization proceeds could provide supplementary budget support in the immediate term.

Regarding strong growth rates, output growth is still low. GDP growth rates still remain below the 6 percent growth rate required to absorb the expanding labor force. Furthermore, privatization needs to be accelerated if its proceeds are to be used in writing off public debt. It is encouraging, however, that under a reclassified budget, privatization receipts are recorded as a financing item (below the line) used primarily to reduce the stock of public debt.

As discussed in Section 4.2.2, it would be simpler, more cost effective and conducive to public debt reduction if the government directly subsidized the SIFs by LE 6 billion, and save the high interest paid on borrowing the LE 9 billion from the SIF deposits at the NIB.

We also saw in Section 4.3 that the streamlining of off-budget outlays would help reduce public debt. Reforming the government securities market, building an upward sloping yield curve and establishing the conditions for efficient primary and secondary market trading would also help reduce domestic debt servicing. In addition to the basic microstructure required to activate the government securities market, the current interest/exchange rate policy mix is not conducive to the development of an efficient domestic debt market. This will be one of the topics highlighted in our next report.

4.6 MONETARY POLICY

Inflation rates dropped sharply during the third quarter of 2004-2005 as a result of the improved performance of monetary policy. Nevertheless, the Central Bank needs to address the risk that high inflation expectations could become more deeply rooted. To avoid this risk, the Central Bank needs to develop a forward-looking policy in the immediate future that clearly communicates the direction of monetary policy using a nominal anchor. In the immediate term broad money supply (M2) could serve as this anchor, whereas inflation targeting would be the proper nominal anchor for the medium term. Using broad money initially would provide guidance to the market and help anchor inflation expectations until the main pillars of the monetary policy infrastructure have been developed for the medium term.

The Central Bank established a Monetary Policy Unit to communicate the direction of monetary policy to the market. The Unit has recently published a long overdue monetary policy statement that communicates the Central Bank's short-term monetary policy strategy to date. Like all central banks, the Central Bank of Egypt must make periodic announcements about the direction of monetary policy. This would enhance its credibility and the transparency of its operations, further strengthening the monetary policy framework.

While the Central Bank advances in the medium term towards an inflation targeting framework (a more advanced nominal anchor), reliable price statistics should be developed. The Whole Sale Price Index (WPI) responded to the exchange rate depreciation much earlier than the

Consumer Price Index (CPI), showing that the CPI series (which contains subsidized foods) was an unreliable measure of inflation. With an imperfect measure of inflation, the Central Bank will not be able to establish its credibility or transparency, which will hamper its ability to communicate the direction of its monetary policy.

4.7 External Sector

The OECD's Economic Outlook No. 77 (May, 2005) states that growth prospects differ greatly across the OECD and the world economy, ranging from high growth rates in Asia to projections of a "soft landing" in the United States and weak and uncertain prospects in Europe. The IMF's World Economic Outlook (April 2005, p. xi) discusses some worrying global trends, citing "the continuing divergent patterns of growth. Both the euro area and Japan are growing more slowly than the other major regions of the world. This has not helped global current imbalances, which are continuing to widen."

This divergence, together with the recent appreciation of the pound, may constrain the demand for Egypt's merchandise exports. In Chapter 3 we already saw warning signals of lower export performance during the first half of 2004/2005. At the same time, the robust growth in imports in response to lower tariffs could increase pressures on the trade deficit.

4.8 Strengthening the Role of the Private Sector in the Economy

Private sector credit has recently been growing at rates as low as 4 percent per year. This meager performance owes to a number of complex and intertwining factors that need the government's urgent attention.

First, there is a high ratio of non-performing loans in the banking sector, which has acted to crowd out the private sector. We saw in the previous chapter that the government is embarking on an ambitious financial sector reform program that aims at increasing the participation of the private sector in the economy through rehabilitating the financial sector, including resolving the problem of non-performing loans. While the cost of the proposed financial restructuring and strengthening plan could be enormous, the implementation of the plan is inevitable in order to achieve high, private sector-led economic growth rates. The question that emerges is how the government will finance its aggressive financial sector reform plan? The restructuring of the banking system will consume significant public resources that could amount to 1.5 percent of GDP over the next five years (Moody's, 2005).

Second, there is a reciprocal lack of trust between creditors (the banks), debtors/defaulters and the government. This trinity has made private sector access to finance almost impossible. The credit excesses of the late 1990s followed by an economic slowdown led to a near standstill in lending and borrowing activities. Perhaps even worse, borrowers defaulted on billions of pounds in credit, which generated a draconian response from the government. Severe imprisonment penalties were imposed on defaulters and bank officials alike. Reviving trust between all parties must be an immediate priority if the private sector is going to take on a greater role in the resurrection of economic activity.

Finally, the government needs to move quickly to reduce public debt in order to generate more private investment, which is currently being depressed by the high levels of government borrowing.

4.9 REAL ESTATE INVESTMENT

Real estate investment has many problems that are preventing the development of mortgage finance in Egypt. The development of a mortgage finance debt market will help deepen the financial sector and kick up activity on the real estate market. Below is a list of the main problems facing the development of mortgage finance:

- The New Urban Communities Authority (NUCA) lacks the funds to complete many of the projects it undertakes in a timely way.
- To generate funds, NUCA overestimates property prices, which has led to a recession in real estate investments and activities.
- Because of unrealistically high land prices, real estate developers refrain from building for the middle class.
- The NUCA decision to permit the use of ground floors in residential areas as administrative offices caused a slump in the commercial and administrative zones, which are costly in comparison.[29]
- The multiplicity of the regulatory bodies of NUCA complicates its activities and puts huge pressures on the decision makers.
- The documents and steps needed to extract a license for any new building include 29 items. This creates an atmosphere that drives up construction costs, wastes time, encourages corruption and impedes the development of real estate projects.
- In imposing penalties, the buildings law does not distinguish between negligence and corruption.
- Because of the many rules and regulations and the lack of transparency, real estate developers are rarely familiar with all these rules, making them vulnerable to unintentional violations or extortion.
- Unregistered properties represent as much as 72 percent of total real estate assets. This percentage provides housing for some 90 percent of Egyptians, creating a huge collection of informal or "dead" capital, estimated at about six times the savings and deposits in the commercial banks. The implications of this phenomenon are as follows:
    - Because some 72 percent of Egypt's real estate is not registered, these assets are not included in the financial system. Only owners that have registered property can provide it as collateral to banks or obtain mortgage finance.
    - Registration problems include:
        - The lack of a registration culture.
        - The long duration of the registration procedures, and the opacity of these procedures.
        - The high costs of the registration.
- Because of a lack of funding and high interest rates, the mortgage finance fund cannot guarantee subsidized loans for low-income groups.
- The steps of registering a piece of land are very complicated and very detailed.

[29] In these areas investors have to bear higher costs, such as land or utility prices

- Without a geographic and digital database dealing with land ownership in Egypt, it is difficult to prove land ownership most of the time.
- The lack of an insurance system to protect against the risks of loan defaults.
- Slow judicial procedures do not enable creditors to seize property when debtors default, which tends to keep land out of the financing system.

4.10 INDUSTRY COMPETITIVENESS: A STRATEGY FOR INTEGRATING INTO THE GLOBAL ECONOMY

Enhancing industrial competitiveness was identified in the 2003/2004 Egyptian Competitiveness Report as one of the potential opportunities to boost the overall competitiveness of the Egyptian economy. The report underscored the need for an integrated methodology for the evaluation and management of industry growth and competitiveness through encouraging industry clusters and developing comprehensive industry assessment models.

Thus, it is important to put forward an industrialization strategy that would help improve Egypt's industrial performance. In this regard, the Industrial Modernization Centre (IMC) is in the process of formulating an industrial development strategy to revitalize an Egyptian manufacturing industry geared towards full integration into the global economy as a competitive player.

The overall objective is to strengthen the base of Egyptian manufactured exports and its visibility in international markets, increase domestic added value, and undertake technological upgrading of existing industrial activities by moving up the value chain. This could be achieved by building on the existing industrial base, and also through better utilization of Egypt's natural resource endowments, its large pool of human resources, and strategic geographic location.

The success of this strategy hinges upon the successful collaboration between the government and the private sector in what constitutes an effective public-private partnership. Thus, the challenge remains on the implementation side where the institutional setup must encourage collaboration among all stakeholders. The long-term nature of such strategies require the existence of effective coordination mechanisms between the government and the private sector, a clear definition of roles and responsibilities, as well as continuous monitoring and evaluation by the relevant government bodies.

4.11 HUMAN RESOURCES COMPETITIVENESS

4.11.1 Higher Education and Pre-University Education Reforms

The National Democratic Party has successively proposed a complete set of policies for education reform, starting at its annual conference in 2002, with action plans and a clear time frame of implementation. These policies have been taken up by the new government, and the Ministry of Higher Education has presented a plan to implement the new policy. Several elements were specified as the plan's main objectives, including establishing centers of excellence and scientific and technological incubators and parks, ensuring flexibility and mobility of faculty and students within the higher education system, enhancing collaboration between international education and research institutions, improving research capabilities and linking scientific research to development needs to the labor market, as well as promoting and encouraging life-long learning. The plan for higher education reform has been accompanied by another that handles scientific research. The plan will begin with a study of the 143 research centers and institutes in Egypt that report to almost 22 ministries with recommendations on how to coordinate the efforts of these centers. It is worth noting that though the percentage of national income allocated to scientific research increased from 0.3 percent of GDP in 1981/1982 to 0.9 percent in 2005, this percentage is very low when compared to the amount of money most countries spend on scientific research. As for the scientific research labor force (scientists and PhD holders) Egypt ranks higher than most other developing countries (Egypt has 1100 scientist for every million of its citizens while the average number in developing countries is 800 for every million). However, Egypt still falls well below the average of developed countries, which is 3300 for every million citizens.

Building on the argument above, the Ministry of Scientific Research has established a number of objectives for the scientific research reform plan. The objectives include establishing a fund to support scientific research and encouraging contributions by the private sector to scientific research. Currently, the private sector's contribution stands at only 10 percent — a presidential decree to establish such a fund has already been prepared. The plan has stressed the need for encouraging innovation through protecting intellectual property rights, providing incentives for innovation and linking research to implementation in developmental projects, and reviewing current legislation and modifying it in a way to facilitate scientific innovation. Plans to network research centers on a national level will help maximize the returns of a scientific research system.

Establishing a quality assurance system is the most important element of reform, which requires a paradigm shift. Work to bring Egypt's education up to international standards is envisioned through the establishment of the first national accreditation agency for education in Egypt. The vision is to have this agency act as a neutral and independent body from the providers of education services, which are mainly the public schools and universities. However, the delay in establishing the national accreditation agency has slowed the implementation of reform and impeded efforts to improve the quality of education and increase the competitiveness of schools. The reform policies also indicate the need to move towards more academic and financial flexibility in public higher education institutes, which we believe is still lacking. Regarding scientific research reform, Egypt has to change the philosophy of public ownership of scientific research centers, and allow all these centers to acquire funding through winning competitive research project bids. National research priorities have to be set clearly, and an announcement concerning the restructuring of the research academy and its budget to serve the new vision is expected soon. Along with such efforts, the Ministry of Education has also come up with a plan to reform pre-university education following persistent proposals by the NDP since 2002. The main elements of the plan are highlighted in Box 4.1.

4.11.2 Women's Competitiveness

Competitiveness, by definition, entails the capacity of generating high levels of performance and productivity. Considering that women form 49 percent of Egyptian society, it's crucial to utilize their untapped resources through empowerment and equal opportunities. This requires enhancing women's competitiveness abilities. A special program has to be developed with this objective in mind, as regular programs aiming to increase society's competitiveness in general may fail to address the special needs of women, especially in the remote underprivileged areas of Egypt.

The UNDP Human Development Report (HDP) of 2004 ranked Egypt low on the Gender Empowerment Measure (GEM). Egypt ranked 75th out of 78 countries. GEM relates to participation of women in political and professional life. An analysis of the ranking showed that the percentage of parliamentary seats held by women in Egypt is 3.6 percent, the percentage of female legislators and senior officials is 9 percent, female professionals represent 30 percent of the workforce, and the ratio of female to male income is 38 percent.

The report also highlights the fact that while Egyptian women have full constitutional rights, these rights are still considered stronger on paper due to the lack of awareness on the part of women, on one hand, and lack of support by the different concerned entities, including the family, on the other. Moreover, we have to take into consideration that unemployment is the most pressing problem in Arab societies, not to mention that globalization has increased competitiveness pressures in general and further limited economic opportunities for women.

Box 4.1: Action Plan for the Implementation of Higher Education Reform

The Ministry of Higher Education and Scientific Research has put forward an action plan to embark on the reform of higher education in Egypt. The plan is comprised of the following elements:

1. Increasing the student intake capacity of the higher education system. This is to be achieved through developing a master plan for institutional expansion based on demographic and economic needs (end of 2005), reviewing the legislation governing all universities and higher education institutes (end of 2005), transforming university branches to independent universities (2005-2007), introducing new academic programs (2005-7), establishing a distance-learning university (first phase 2006/7), establishing technological colleges (four colleges between 2005-7), establishing a non-profit civil society university (first phase 2006), reviewing the legislation of private universities and criteria for licensing them (2005).
2. Establishing quality assurance systems and performance-based governance within institutions of higher education and establishing the National Agency for Quality Assurance and Accreditation as an independent agency. Quality assurance will be supported by a special fund authorized by the president (decree already issued) and through programs of self-assessment and centers of quality assurance in different colleges (some are already established).
3. Maximizing the use of ICT to the benefit of academia, research and administration. This will be achieved through improving the Egyptian Universities Network (EUN) infrastructure (2005-6), introducing e-management to higher education institutions (2005-7), integrating e-learning in different disciplines (10 percent of the curricula 2006-7) and cooperating with the Ministry of Communication and Information Technology to integrate internet service in universities and research centers (current).
4. Improving the performance of graduate studies and scientific research programs. This is planned to take place through adopting the credit hour system (2006/7), establishing a fund to support scientific research (current) and establishing an institution for academic publishing and translation (2006)
5. Enhancing performance of the faculty and the administration of higher education. This should be implemented through programs that are starting to train academic leadership on modern management systems and to prepare young faculty through a one-year program to pursue their graduate studies abroad. Also, a review of the academic compensation system is in place.
6. Enhancing student activities and updating the regulations (student constitution is currently being revised).

There is a need to focus on empowering women at all levels and eliminating all forms of discrimination, which should eventually help increase and sharpen their ability to compete through the following:

Culture

- Initiating a socio-cultural movement to improve the perception of women as partners in societal development.
- Building alliances with traditionally influential groups (mainly religious institutions) to organize an awareness campaign of women's rights and entitlements based on religious doctrine, which has a considerable effect on societal attitudes.
- Maximizing the use of media to handle the misperceptions associated with the role of women in the family and in society, portraying them as equals with the goal of increasing their self-worth and confidence.

Education

- Expanding 'girl-friendly' schools to ensure the education of young girls in remote areas of Egypt.
- Reforming Egyptian school curricula to project a positive image of women and discouraging discrimination against girls.
- Providing girls access to education at all levels.
- Training educators to be gender sensitive in the classroom, with a more inclusive approach to the role of women.
- Investing in distance learning to allow flexibility for girls and women to pursue their school and university studies, especially in remote areas.
- Ensuring equal opportunity to female students to apply and be selected to education missions abroad.
- Encouraging scholarships — public and private — that are allocated to women to support their studies.
- Pushing for literacy among women who are beyond school age.

Health

- Establishing a culture of caring for the health and well-being of women, especially in rural and remote areas.
- Increasing awareness about health care among the younger generation, especially females.
- Providing health care services to women through means that they can easily access and use.
- Increasing awareness about the importance of birth control as a way to protect women's health.
- Advocating the right of women to determine the number of children she can afford to deliver — free from family pressures.

Economy

Unemployment rates reach nearly 15 percent in the Middle East and North Africa, which have a disproportionate effect on youth and women in the region. Moreover, structural reform policies aimed at downsizing public sector jobs have negatively affected women's job opportunities. In addition, many private sector companies do not opt for employing women due to their dual roles and responsibilities. Consequently, the preference to employ men over women has become a growing, though unconstitutional, phenomenon among different entities. Meanwhile, Arab women's participation in the labor force is the lowest worldwide, failing to exceed 26 percent of actual employment. However, this figure does not reflect the wide scope of women's involvement in the informal sector.

On the other hand, it has been proven that a diverse workforce, including the greater inclusion of women, helps produce products and services that meet new and different market niches. This diversity is becoming a key strategy for financial survival and competitiveness.

The following measures need to be taken in providing women with better economic opportunities:

- Unifying employment criteria applied to women and men, subject to the rules of transparency.
- Working to make financial, physical and business infrastructure more female-friendly.
- Providing women with access to micro financing to set up small- and medium-sized businesses.
- Extending small loans with preferential terms to small projects owned by women.
- Encouraging women to join consumer societies, as they represent almost 80 percent of families' purchasing decisions.
- Allowing tax incentives for businesses that hire women.
- Investing in infrastructure to support women at work and at home.
- Providing different levels of vocational training for women in different fields.

Politics

- Raising awareness of the importance of women's participation in politics for the benefit of a diverse representation of society.
- Initiating campaigns to issue identity cards for women.
- Encouraging parties to nominate women candidates for different levels of elections.
- Adopting affirmative action temporarily by guaranteeing a quota for women in representing different local political councils and parliament.
- Encouraging institutions that advance gender equality, such as the National Council for Women.
- Empowering women in decision-making positions.

Legislation

- Ensuring that all laws and regulations reflect the constitutional requirement of equal opportunity between men and women.
- Reviewing labor, social security and financial laws to eliminate any discriminatory provisions against women.
- Facilitating the enactment of laws that enable women to work and receive fair treatment at work.

- Amending family laws to eliminate unconstitutional discrimination, such as the need for authorization to travel or to open a bank account for children.
- Reviewing and modifying custody laws to give women an equal role in the family.
- Including the perspective of women in enacting new laws, and considering any adverse aspect the law may have on women in particular.
- Linking laws to implementation, especially laws that protect women but are rarely enforced.

4.11.3 Labor Force Competitiveness

Human resource development still poses a major challenge for the competitiveness of the Egyptian economy. In today's global economy, the intensity of knowledge- and innovation-based activities is becoming evermore visible, and those with a proven capacity to innovate and develop new technologies stand out as global leaders. In this regard, the weakness of the human resource base in Egypt may very well impede Egypt's efforts to become more competitive.

Despite a notable improvement in previous decades in the enrollment rates at the primary, secondary and tertiary levels, the overall quality of graduates has been on the retreat. Quality improvements in education have not kept up with achievements in quantity. In addition, there is a continued mismatch between the outputs of the education system and the demands of the private sector, which further compounds the problem of the employability of the labor force. Some segments in the labor market witness shortages because of this mismatch.

Traditionally, the low cost of labor — due to abundance of supply — has been considered a comparative advantage for the Egyptian economy. In fact, Egypt currently has one of the lowest levels of labor costs in manufacturing in the MENA region, reaching almost one-fourth of the MENA average. However, labor productivity is one of the lowest in the region as well. Thus, when linking labor costs with labor productivity (i.e. considering unit labor costs) Egypt's comparative advantage appears relatively eroded — unit labor costs are almost the same as the MENA average. The implication of this weakness has two sides: on the one hand, it implies limited comparative advantage in labor-intensive activities that constitute the most promising areas for addressing unemployment concerns; on the other, and more importantly, it indicates that domestic technological capabilities are not adequate to reap the benefits of the ICT revolution, which is currently the driver of global economic growth. Thus, Egypt's ability to move towards technology- and skill-intensive activities that offer the best prospects for integration into the global economy have been impaired.

4.12 Concluding Remarks

In this report we attempted to gauge developments in Egypt's international competitiveness status. Noting that the implementation of a number of reforms to address the challenges underlined in last year's report helped turnaround the economy in 2005, the report draws attention to a set of other challenges that need to be addressed in order to unlock additional windows of opportunity.

A number of interesting conclusions emerge from the report. We find that Egypt's competitiveness ranking continues to slip or stagnate relative to past years as Egypt's peers have made impressive strides. On a positive note, Egypt's low rankings on the 2005 indices do not reflect the reforms adopted since the new Cabinet took over in July 2004. Since the Executive Opinion Survey was conducted in March 2004, it did not capture executives' opinions in response to the recent economic changes.

In analyzing the impediments in Egypt's business environment, the Executive Opinion Survey (EOS) indicated eight main constraints, ranked in order of significance. The constraints identified relate to (i) access to financing; (ii) tax regulations and tax rates; (iii) inefficient bureaucracy; (iv) policy instability; (v) foreign currency regulations; (vi) inflation; (vii) an inadequately educated workforce; and (viii) restrictive labor regulations. Notwithstanding the persistence of some of those impediments, their severity and ranking have changed markedly since the time of the survey in March 2005. New simplified tax regulations were issued in June 2005, while tax rates were slashed by 50 percent, effective July 1. Foreign currency regulations, such as surrender requirements, were eliminated in December 2004, leading to a liquid foreign exchange market. This, in conjunction with the implementation of the foreign exchange interbank market, has served to bring together the official and parallel market US$/LE rates to stabilize the exchange market. As for inflation, both the CPI and WPI inflation rates have dropped by more than 50 percent. We hope that as the new economic measures start to bear fruit the Executive Opinion Survey of March 2005, which will be released in next year's report, reflects improved business perceptions and propels Egypt up the rankings.

Concerning the remaining five problems, either no action is being taken towards their resolution or the necessary reforms are being taken too slowly and too gradually for their impact to be felt. Many of the low rankings reflect a lack of reform initiative in these five areas — as well as other areas discussed in Chapter 4 — which will continue to undermine Egypt's competitiveness as long as the complacency lasts. The question that arises is *why have the recent reform efforts managed to achieve rapid and perceptible changes in some areas, while initiatives to address other equally important concerns have either been absent or gone astray*? The implications are worrisome: What framework guides the reform decisions of the Cabinet? Do the leaps made in a few areas reflect the piecemeal endeavors of a handful of reform-minded cabinet members? If so, will these reforms collapse or lose momentum when this group of reformists moves on? Do individual attempts at reform risk reversal at the whim of the policymakers who happen to be in charge? How will these reforms be institutionalized to extend implementation across other ministries and ensure continued sustainability over successive governments?

At the very least, the economic team appointed in July 2004 has shown us that the pursuit of reform is not equivalent to chasing after a myth. Progress may not be out of reach after all.

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CHAPTER 1

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APPENDIX 2: BIOGRAPHIES

Prof. Hossam Badrawi M.D; M P

Prof. Hossam Badrawi is a professor of OB/GYN at the Cairo University Medical School. He has done his graduate studies in the United States at Wayne State University in Detroit, Michigan, Northwestern University in Chicago, Illinois, and Boston University in Boston, Massachusetts. His academic activities include publishing more than 120 research papers and contributing to eight textbooks in his field of specialty, obstetrics and gynecology.

Beside his academic work, he is an elected member of the Egyptian Parliament and chairs the Committee for Education and Scientific Research. He has a clear vision for education reform in Egypt and works actively to promote his ideas.

Dr. Badrawi led the Committee of Education and Scientific Research in the last four years to become one of the most active and productive committees in the Egyptian Parliament. He also chaired the Joint Committee of the Parliament for the Intellectual Property Rights legislation in Egypt, and is considered the father of the law.

Dr. Badrawi has played a major role in pushing for new policies in the areas of education and health, and is a member of the policy secretariat of the Egypt's ruling National Democratic Party.

He was picked in January 2004 to become a member of the newly developed Supreme Council for Human Rights in Egypt, which was established as part of a wave of reforms moving Egypt closer towards democracy. Also, he has been chosen as chairman of the Egyptian National Competitiveness Council.

Dr. Badrawi is a leader in the private health care sector, with a vision for health care financing, management and provision. He started the first managed care company in Egypt in 1989 and, before that, a private health care institution, the Nile Badrawi Hospital, in 1982, which is considered one of the largest private hospitals in Egypt.

Besides the family business he leads, Dr. Badrawi is an active person in civil society. He is the founder, chairman, and member of a number of leading NGOs in Egypt. He is also an advocate for youth, women and children, actively promoting their role in society.

Dr. Badrawi's experience in civil work, non-governmental organizations, and in business as a part of a well-rooted family that has been a magnet for investment — especially in service fields — gives him a unique political, academic and private sector vision.

Mr. Alaa Hashim

After graduating from the American University in Cairo with a degree in mathematics, Mr. Alaa Hashim joined one of Egypt's largest Export manufacturing firms. MAC Carpets is a world leader in custom-printed mats and rugs, exporting its products to more than 100 countries worldwide, and is one of Egypt's leading export firms. He started his career at MAC Carpets as an international marketing manager and currently serves on its board and is the company's chief operating officer.

Alaa Hashim is a founding member of the NDP's business secretariat, sitting on its executive committee and also heading up its industry task force. He is also a founding member of the Egyptian National Competitive Council (ENCC) and sits on its executive committee. He is a board member of the Industrial Modernization Program (IMP), which is chaired by the minister of foreign trade and industry, and is a member of its National Quality Plan (NQP) task force. He is an active member in the Egyptian Junior Business Association (EJB), where he is coordinating an initiative titled "In pursuit of a Vision for Egypt." He is currently running for a seat on the association's board. He is an active member of the American Chamber of Commerce in Egypt (AmCham), serving as a member of its industry committee.

Mr. Shafik Gabr

Mr. Shafik Gabr is chairman and managing director of the Artoc Group for Investment and Development, a multi-disciplined holding company with affiliates and subsidiaries that operate in diverse fields, including investment, aerospace, automotive, communications, consumer products, infrastructure projects (i.e. water, airport terminals and power), steel fabrication, real estate, publishing, technology transfer, trade and engineered equipment. Artoc's headquarters and the bulk of its activity are located in Egypt. Artoc also maintains operations in the United States and the Czech Republic

Mr. Gabr is also chairman and a founding member of Egypt's International Economic Forum, Chairman of the Arab Business Council (ABC) and chairman of the Common Market of East & South Africa (COMESA) Business Council. Mr. Gabr also serves on the Egypt-US Presidents' Council and the Council of the World Economic Forum (Geneva), and is a member of the Council of 100 Leaders, the Executive Board of the International Chamber of Commerce (Paris), the Board of the Egyptian Center for Economic Studies (Cairo), the Conference Board (International Counselor), Prince of Wales Business Leaders Forum, and World Bank's Council of Advisors for the MENA Region.

Mr.Gabr also serves as a director on the board of several corporations in Egypt including the Holding Company for Metallurgical Industries, which supervises 17 major state-owned industries. Furthermore, Mr. Gabr was a founder of the American Chamber of Commerce in Egypt in 1982 and served as its first Egyptian President from 1995 until 1997. He is also a member of the Egyptian Businessmen's Association (EBA) after serving on its board from 1996 to 1998.

Mr. Gabr received his bachelor's degree in economics and management from the American University in Cairo (AUC) and a master's degree in economics from the University of London.

Dr. Iman El-Kaffass

Dr. Iman El-Kaffass is the associate dean and director of the Equal Opportunity and Student Leadership Development Program at the American University in Cairo, Egypt. She is founder and chair of the board of the Egyptian Association for Education and Development (EAED), a non-governmental organization working in the field of promoting education reform, human and societal development in Egypt. Dr. El-Kaffass is member of the Supreme Policies Council/the Policies Secretariat of the National Democratic Party. She is also member of the Parliamentarian Committee of the Party and executive board member of its Education and Scientific Research Committee. Furthermore, she is member of the education committee of the National Specialized Councils of Egypt.

Dr. El-Kaffass is an advisor to the minister of education and to the minister of higher education and scientific research. She is also a member of the following national committees: the National Supreme Committee for Pre-University Education Reform, the National Committee for Higher Education and Scientific Research Reform and the National Committee on Higher Education Quality Assurance. She has recently been appointed by Egypt's Prime Minister as a member of the Technical Committee for the Cabinet of Ministers' Team on Human Development. The Team on Human Development is formed of 12 cabinet ministers whose responsibilities directly impact human development in Egypt.

Dr. El-Kaffass holds a PhD in Higher Education Administration from Bowling Green State University, Ohio, in the US, with a specialization in organizational assessment and development. She holds a master's degree in public administration with a specialization in organizational development and a bachelor's degree in political science with a specialization in political sociology from the American University in Cairo. Her research and professional affiliations are mainly in the areas of education, human development, human rights and equal opportunity.

Mr. Seifallah Fahmy

Mr. Seifallah Fahmy is the President of the Almona Company, which specializes in providing marketing advice and in-country service support contracting for companies seeking to promote and sell their products and services in Egypt. Almona offers these services to companies such as Raytheon, Honeywell and Perceptronics. Almona is also teamed up with Booz Allen Hamilton to provide installation, training and technical support for a nationwide material management logistics system. Almona also provides communication solutions and consultancy services.

The company represents Intermec, the worldwide leader in barcode and RFID mobile solutions, and automates data collection and data handling from one end of the supply chain to the other. Almona also provides consultancy services to multinational communication solution vendors, such as 3Com, a worldwide leader in providing communication solutions.

Mr. Fahmy received his bachelor's degree in business administration from the University of South Carolina. He has been a partner in the Delta Clothing Company (Mix & Match) since 1984.

He is a member of the National Democratic Party Business Sector Secretariat, a founding member and current treasurer of Egypt's International Economic Forum, a founding member of the Arab Business Council, chairman of the Competitiveness Task Force of the Arab Business Council, secretary general of the Egyptian National Competitiveness Council, and chairman-elect of the Young Presidents Organization (YPO) Middle East and North Africa region.

Mr. Fahmy obtained a full academic tennis scholarship at the University of South Carolina (USC) and was awarded "Sportsman of The Year" by USC in 1981. He played on the professional tennis circuit throughout his tennis career. He was secretary general of the Egyptian Tennis Federation from 1994 to 1996; and served as vice president of the African Tennis Confederation (ATC) and president of the North African Zone of the ATC over the same period. In 1999, he won the BMW Egyptian World Amateur International Golf Cup.

Dr. Taher Samir Helmy

Dr. Taher Helmy is president of the American Chamber of Commerce in Egypt. In May 1975, he joined the international law firm of Baker & McKenzie and was elected full partner of the firm in 1981. Baker & McKenzie is the largest international law firm in the world with over 69 offices and over 3000 lawyers worldwide. Dr. Helmy has practiced law for more than nine years in the U.S., and four years in Saudi Arabia and Egypt since 1987. He is co-founder of Baker & McKenzie's offices in Riyadh, Kingdom of Saudi Arabia and Cairo, Egypt.

Dr. Helmy is the founder and member of the board of British Egyptian Businessmen Association (BEBA), a member of the National Production Council and one of the founders of the Future Generation Foundation.

Dr. Helmy received his bachelor's degree in 1971 and his doctorate in 1974 from St. Louis University in the United States. He was admitted before the Illinois Supreme Court in 1975, and admitted before the Federal Courts of the United States in 1975. In 1979, he became the first Arab lawyer to be admitted before the US Supreme Court. He became licensed to practice in Saudi Arabia in 1979, and he was admitted before the Egyptian Court of Appeals in 1983 and the Egyptian Supreme Court in 2000.

Dr Helmy is a member of the Illinois Bar Association, the Chicago Bar Association and the Egyptian Bar Association. He is the founder and chairman of the Egyptian Center for Economic Studies, the first independent private sector economic think tank in Egypt. Additionally, he is the founder and member of the Board of Trustees of the British Egyptian Foundation for Children in Need, a charity established in England to help children in Egypt, and founder and former member of the Executive Board of Egypt's International Economic Forum. He is a former member of the US-Egypt Presidents' Council.

Dr. Helmy also serves as a member of the Policies Council and Economic Committee of the National Democratic Party.

Mr. Helmy Abouleish

Mr. Helmy Abouleish is CEO of the SEKEM Group of Companies. The group is comprised of six companies, ATOS, CONYTEX, HATOR, ISIS, LIBRA, SEKEM, which cover the fields of biodynamic agriculture, phyto-pharmaceuticals, organic textiles and organic fast moving consumer goods.

A graduate of the Faculty of Commerce, Cairo University and Faculty of Business Administration at the American University in Cairo, he was closely involved in the establishment of all parts of the SEKEM Initiative, which promotes social and cultural development, and has specialized in finding modern approaches and novel solutions to questions on the global economy and competitiveness.

He is founder or cofounder of various organizations, including the Egyptian National Competitiveness Council (ENCC), the International Association for Partnership (IAP), the Egyptian Biodynamic Association (EBDA), Society for Cultural Development (SCD), and the Centre for Organic Agriculture in Egypt (COAE). Mr. Abouleish has worked in various positions within the SEKEM organization, and organized the first IFOAM Conference on Organic Cotton in Cairo in 1993 and AGROBIO'96. He represented SEKEM at the meeting of the World Economic Forum 2004 and various regional events of the WEF.

He is chairman of the Egyptian Junior Business Association (EJB), the Organic Agriculture Committee in the Agricultural Commodity Council, the executive director of the Industrial Modernization Program (IMC), and a board member of the Chamber of Food Industries, Egyptian Exports Developing Centre, , the Institute of Cultural Affairs – Egypt (ICA), the Agriculture Commodity Council (ACC), the German Arab Chamber of Industry & Commerce (GACIC), the General Authority for Free-Zones and Investment (GAFI), and the Business

Council of the NDP. He is a member of the steering committee of the Agricultural Exports' Traceability project, general coordinator for the Commodity Councils, as well as a member of the selecting panel of the Ashoka Foundation in Egypt. He also is an active member of several organizations including the International Demeter Organization (IDO), and the International Federation of Organic Agricultural Movements (IFOAM), Young Presidents' Organization (YPO), Arab Business Council (ABC), and the International Association of Partnership (IAP).

Under his stewardship of its commercial arm, the SEKEM initiative received the "Right Livelihood Award 2003" for sustainable development, which is better known as the "Alternative Nobel Prize, and became a member of the Schwab Foundation for outstanding Social Entrepreneurs.

Eng. Nehad Bahig Ragab

Eng. Nehad Bahig Ragab is chairman of the SIAC Industrial Construction and Engineering Company, which was founded in 1986 and is part of the NR Group. Under his guidance over the past 19 years, SIAC has become one of the leading companies in the field of construction and engineering in the region. Eng. Ragab also chairs other significant companies, including Drake & Scull, Steel-Tec. and Al Mostakbal.

Eng. Ragab also holds significant titles as chairman of the CEC (Construction Exporting Council), which is described as a "think tank for Egypt's construction sector to operate successfully outside Egypt." He is a member of the Business Secretariat at the National Democratic Party. Also, he is a member of the board of directors for Bauer, Egypt and GSDC. As a model businessman, Eng. Ragab contributes to his community as an active member at various associations, including the Egyptian Junior Businessmen Association (where he was nominated chairman from 2002 to 2004), Egyptian National Competitiveness Council, Arab Business Council, BEBA, EBA, AmCham, EEEF, ELBA, the German-Arab Chamber of Commerce (AHK), and Egypt's International Economic Forum.

Mr. Aladdin Saba

Mr. Aladdin Saba is founder of Beltone Financial, an investment banking firm that was established in 2002. Beltone Financial operates in the fields of asset management and investment banking through its subsidiaries and affiliates, Beltone Asset Management, Beltone Investment Banking and BMG Financial Advisors. Beltone Financial's subsidiaries and affiliates span the region with a presence in Egypt and Saudi Arabia.

Mr. Saba is the co-founder of Hermes Financial, which grew to become one of the leading investment banking institutions in Egypt. In 1996 Hermes Financial merged with the Egyptian Financial Group to form EFG-Hermes, where Saba assumed the role of managing director of asset management and served as a member of the Executive Committee of EFG-Hermes until February 2002.

In 1991, Mr. Saba co-founded the Kidder Peabody Middle East regional office in Cairo where he was co-manager and was involved primarily in corporate finance activities, including privatizations.

As vice president and senior portfolio manager at Kidder, Peabody & Co. in New York he managed institutional portfolios as well as a mutual fund utilizing quantitative investment strategies that he devised. He was also responsible for NOVA, an investment consulting service provided by Kidder, Peabody.

Prior to joining Kidder Peabody in 1987, Mr. Saba served as an associate pension consultant, analyzing and evaluating quantitative investment techniques and investment managers at Evaluation Associates Inc.

Mr. Saba holds master's degree in business administration from the Wharton School in the United States (1986), and another master's degree in science and engineering from the University of Pennsylvania (1983), also in the US. He also holds a bachelor's degree in biomedical engineering, graduating from Cairo University in 1981.

Mr. Saba is a board member of multiple financial organizations, including the National Bank of Egypt, and international investment funds. For three consecutive years, he has been a member of the Board of Directors of The Cairo and Alexandria Stock Exchange. Mr. Saba is a founding member of the Egyptian Investment Management Association and the Egyptian Capital Markets Association. He sits on the board of Egypt's International Economic Forum. He is also a board member of various corporations including industrial, environmental and tourism real estate development companies. He is a member of the AmCham, BEBA, and the EBA, where he is the head of the Stock Exchange Committee.

Ms. Amina Ghanem

Ms. Amina Ghanem is currently an advisor to the Minister of Finance, His Excellency, Dr. Youssef Boutros-Ghali. Mrs. Ghanem has worked with Minister Boutros-Ghali since 1990 in his various capacities as advisor to the Prime Minister, Minister of State, Minister of State for International Cooperation, Minister of Economy, Minister of Economy and Foreign Trade, and Minister of Foreign Trade. She has worked closely with Mr. Boutros-Ghali on Egypt's macroeconomic stabilization and structural adjustment program since 1991. Mrs. Ghanem is also a member of the technical secretariat of the ministerial economic committee, and a member of the Steering Committee for the IMF's Middle East Technical Assistance Center. She prepares periodic written and statistical analyses of the macro-economy. She has participated in the Trade and Investment Framework Agreement (TIFA) discussions held between the Egyptian and US governments.

She has written a number of articles in the Worldlink magazine and has contributed to a number of Euromoney Yearbooks on Egypt. Past positions include head of the Sovereign Ratings Department at the Ministry of Foreign Trade, coordinator for the Economic Reforms Monitoring Team and coordinator for the Assistance for Trade Reform Project. Her pre-government experience is diverse and includes banking experience abroad and teaching at the American University in Cairo.

Mrs. Ghanem has finished her PhD coursework and is currently writing her dissertation. She holds a master's degree in economics from Cairo University; a master's degree in teaching English as a foreign language from the American University in Cairo (AUC); a diploma in teaching English as a foreign language for non-native teachers of English from the Royal Society of Arts in London; and a bachelor's degree in economics from AUC.

Dr. Ahmed Farouk Ghoneim

Dr. Ahmed Ghoneim is currently an assistant professor at the Faculty of Economic and Political Science, Cairo University. He is a research associate at the Economic Research Forum for Arab Countries, Iran and Turkey (ERF). He works as a consultant to several international organizations, including the World Bank, the World Intellectual Property Organization (WIPO), the United Nation Development Program (UNDP) and Economic and Social Commission for Western Asia (ESCWA). He holds a PhD in economics and his special interest in research mainly includes trade policy, regional trade integration, the multilateral trading system, the World Trade Organization, and the economics of intellectual property rights. He has held many different policy-oriented positions, including advisor to the minister of industry on foreign trade issues and international agreements and advisor to the minister of foreign trade on foreign trade issues.

Mr. Diaa Noureldin

Mr. Noureldin is currently senior economist at the Economic Research Forum, a non-government, not-for-profit regional research network with economic research activities in the Middle East and North Africa Region. He is also a lecturer of econometrics at the American University in Cairo. Previously, he worked at the macroeconomic and banking policies division in the office of the minister of economy and foreign trade. Besides academic undertakings, Mr. Noureldin is involved in technical policy advice with a number of government bodies in Egypt, including the Industrial Modernization Center (IMC) and the General Authority for Investment and Free Zones (GAFI). He has also worked as consultant to a number of international organizations, including the UN Industrial Development Organization (UNIDO) and the UN Conference on Trade and Development (UNCTAD). His prime areas of specialty are macroeconomics, trade and foreign direct investment policies, and industrial development.

Dr. Heba Nassar

Dr. Heba Nassar is professor of economics and vice dean for community development at Cairo University’s Faculty of Economics and Political Science.

She has been the director of the Center for Economic and Financial Research and Studies (CEFRS) since 1999 and is also a research professor at the Social Research Center of the American University, advisor to the Economic Committee of the Parliament, member of the Board of the Holding Company of Electricity, member of the Economic Committee of the National Council for Women and of the National Democratic Party, a member of the Permanent Scientific Committee for Promotion of Associate Professors in Economics in Egypt, a member of the National Specialized Councils and a member of the Arab Alliance of Women. She is also a fellow of the Economic Research Forum and was chosen as a member in the Steering Committee of the Research Alliance for Development (World Bank Paris) in 2004.

During her professional years she worked as a consultant to several national, foreign and international organizations, such as the International Labour Organization (ILO), UNIDO, International Organization for Migration (IMO), World Bank, World Health Organization (WHO), United Nations Population Fund (UNFPA), National Council for Women, UNCTAD, GTZ (German Technical Cooperation) and ESCWA. She has presented several publications and papers at academic conferences in different areas, mainly focusing on human resource development, poverty, social protection, migration, economic adjustment, the labor market, health and population policies as well as the economics of Arab states. She was responsible for several country reports for different international and governmental agencies.

Dr. Samir Radwan

A graduate from the Universities of Cairo (B.Sc., Economics, 1963) and London (M.Sc., Economics of Underdeveloped Countries, 1967 and Ph.D., Economics, 1973), Dr. Radwan specializes in development economics with a particular emphasis on employment policies, labor markets and poverty.

A former lecturer at the Faculty of Economics, Cairo University (1963-65) and the Institute of Economics and Statistics, Oxford, and member of St. Anthony's College, Oxford (1970-76), he worked with the International Labour Organization from 1976 to 2003.

Following his retirement from the ILO, Dr. Radwan was appointed managing director of the Economic Research Forum for Arab Countries, Iran and Turkey. Previously he served as advisor to the director-general on development policies and counselor on Arab countries at the International Labour Office, Geneva, Switzerland, and the director of the Development and Technical Cooperation Department (1994-96) and the Development Policies Department (1996-99). He worked at the ILO from 1979 to 2003.

A member of the Bruntland Commission's panel on "Food Security, Agriculture, Forestry and Environment," Mr. Radwan has led and participated in several policy advisory missions on employment to developing and transition economies, and has acted as a consultant to numerous international organizations (e.g. UNDP, World Bank, UN Food and Agricultural Organization, Organisation for Economic Co-operation and Development, Arab Labour Organization) and is a member of several professional societies concerned with employment and development questions. Dr. Radwan was a visiting professor at the Faculty of Economics and Political Sciences, Cairo University, and the American University of Cairo, and was advisor to the Prime Minister of Egypt for the development of a National Employment Program (2000-2001).

He has published extensively on human resource development, labor markets, rural development, industrialization, and African and Arab economies. His publications include: Capital Formation in Egyptian Industry and Agriculture (Oxford, 1974); Agrarian Reform and Rural Poverty (ILO, 1977); the Industrialization of Egypt (with Robert Mabro, OUP, 1974); Employment Opportunities and Equity in Egypt (with Bent Hansen, ILO, 1982); Agrarian Policies and Poverty in Africa (with D. Ghai, ILO, 1983); Agrarian Systems (co-ed. Macmillan, 1979); Towards Full Employment (Cairo, 1997); Employment and Development (in honor of Hans Singer, Macmillan, 1998); Globalization: Losers and Gainers, AUC Fifth Research Conference (Cairo, 1998); Decent Work as a Development Agenda: An International Perspective (Geneva, April 2002); and Employment and Unemployment in Egypt: Conventional Problems, Unconventional Remedies, ECES (Cairo, August 2002).

EGYPTIAN NATIONAL COMPETITIVENESS COUNCIL

THE EGYPTIAN COMPETITIVENESS REPORT

2004-2005

THE EGYPTIAN COMPETITIVENESS REPORT 2004 -2005

THE EGYPTIAN NATIONAL COMPETITIVENESS COUNCIL

At the Egyptian National Competitiveness Council, leaders from business, academia, labor and government collaborate to increase awareness of competitiveness and its economic implications for industry.

MISSION STATEMENT

The mission of the Egyptian National Competitiveness Council is to spur efforts to improve the competitiveness of Egypt and to incite the public opinion and the business sector to give priority to such efforts in all domains.

EXECUTIVE COMMITTEE

Hossam Badrawi	Member of Parliament, Chair of Education Committee	Chair
Helmy Abouleish	Managing Director of Sekem Group	Vice Chair
Seifallah Fahmy	Chair, Al Mona	General Secretary
Aladdin Saba	Chair, Beltone	Treasurer
Shafik Gabr	Chair, Artoc	
Alaa Hashim	Chief Operating Officer, MAC	
Taher Helmy	Managing Partner of Helmy, Hamza & Partners (Baker & McKenzie)	
Iman El Kaffass	Associate Dean and Director Equal Opportunity and Student Leadership Development Program, AUC	
Nehad Ragab	Chair, Siac	

TECHNICAL COMMITTEE

Helmy Abouleish

Hossam Badrawi

Iman El Kaffass

Amina Ghanem

Ahmed Ghoneim

Alaa Hashim

Diaa Nour

Heba Nassar

Samir Radwan

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We would like to express our sincere gratitude and appreciation to all those who contributed to the issuance of this report .

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We want to particularly thank the authors of the different chapters: Amina Ghanem, Diaa Noureldin, Iman El-Kaffass and Ahmad Ghoneim.

We are grateful to those who contributed thoughts and expertise through the discussions of the report, and the review of its multiple drafts: Samir Radwan, Iman El Kaffass, Ahmed Ghoneim, Alaa Hashem, Heba Nassar and Hassan Abdallah.

The Egyptian Competitiveness Council would like to thank the World Economic Forum for making available analysis and research.

The Council would also like to extend its gratitude to all those who assisted in the completion of this report: Omniya Ramadan, Hazem Mahmoud, Sobhy El Saadany and Georg Michel.

We would finally wish to thank the designer of the report cover and the Publication Department for producing the report in its final shape.

It is quite satisfying to join efforts in issuing a report that we know can provide valuable insights to those who work hard on the development of Egypt.

Hossam Badrawi
Chair

Helmy Abouleish
Vice Chair

WHAT THE ECONOMIC TEAM IS SAYING ABOUT THE EGYPTIAN COMPETITIVENESS REPORT 2004-2005

Minister of Finance Youssef Boutros-Ghali

The Egyptian Competitiveness Report 2004-2005 reviews key recent changes in the Egyptian economy, analyzing their implications for our skill requirements and international competitiveness. It takes a look at Egypt's economic performance during the past year: what drove recent economic growth and where economic performance has fallen short. It lays out to businesses and policymakers a whole spectrum of challenges and opportunities to enhancing Egypt's long-term competitive advantage.

The report makes bold statements about the significance of upgrading our infrastructure to improve the quality of education, science, technology, and training systems, and makes it clear that a culture of reform must be adopted to help Egypt keep up with global institutional changes. It also points to areas where Egypt has shown declining competitiveness and other areas where Egypt has managed to maintain its rankings but has been outperformed by peer countries in the developing world.

The Egyptian Competitiveness Report 2004-2005 raises many important questions for ongoing policy debates. How can we encourage partnerships between the state and firms that will help sustain what must become a relentless effort to catch up and stay competitive with other countries? How can we address long-term issues on competitiveness in order to match the dynamism of our emerging economy with regional and global economies? How can we promote a well-functioning market economy that encourages the development of institutions that ensure the sustainability of policies over generations of governments in order to keep up with other industrializing countries that are constantly changing the competitive landscape? How can we start to build on our unique advantages to avoid falling behind and, more importantly, go beyond trying to catch up?

Minister of Foreign Trade and Industry, Mr. Rachid Mohamed Rachid

In its second year, the Egyptian Competitiveness Report 2004-2005 continues to review, synthesize, interpret, and draw implications from the available evidence on the competitiveness of the Egyptian economy. The report uses indices developed by the World Economic Forum to analyze trends in Egypt's competitiveness ranking over the past several years. The 2004-2005 report asks that special attention be paid to the role of institutionalizing reforms in enhancing Egyptian competitiveness to help set the stage for the effective and sustainable implementation of strategies for growth and development.

A number of concerns pointed out in the report remind us that Egypt has the potential to do much more in order to catch up with rapid global advancements. Increases in competitiveness are brought about by taking advantage of a number of factors: (i) macroeconomic stability; (ii) good governance; and (iii) a sound institutional infrastructure.

However, Egypt cannot compete on the basis of price alone as a long-term competitive factor. Increasing productivity is the key to increasing the competitiveness of businesses in Egypt. This requires investing in human infrastructure to develop a more highly qualified, creative labor force that, despite the challenges, is a longer-term driver of competitiveness.

With particular reference to exports, the past few years saw favorable trends as exports grew at healthy rates. Our export promotion strategy aims at slowly shifting Egypt's export mix towards more dynamic and technologically intensive products and services. As our firms continue to compete in an ever-globalizing market, the government will continue to ensure the smooth functioning of the market economy.

The Egyptian Competitiveness Report 2004-2005 has once again brought important issues to the limelight and we hope it continues to measure the impact of reforms on Egyptian competitiveness and enriches the policy debate.

Minister of Investment, Dr. Mahmoud Mohieldin

The main thrust of the Egyptian Competitiveness Report 2004-2005 is on the importance of institutionalizing reforms to facilitate and ensure the sustainability of Egypt's international competitiveness. Asserting that sound macroeconomic and structural policies are needed to enable a highly competitive economy, the report calls for a coalition of government, businesses and stakeholders to foster long-lasting competitiveness.

The report addresses the crucial role of a highly skilled workforce not only in fostering economic and social welfare but also in helping institutionalize reforms. Skills formation has stimulated the creation of a highly skilled workforce in industrialized economies. This raises a key question: *What are the conditions under which Egypt can attain a high-skill economy in order to not only improve its international competitiveness in the short term but sustain it over the future generations*?

There is no simple or immediate solution. The economic, regulatory and policy environment mix should be directed to facilitate the links between economic strategies and the skills-creating areas in the economy such as education and training. A long-term strategy should be developed nationwide to match labor skills to market needs. As the links become embedded in the key social institutions of a highly skilled society (including schools and the manufacturing sector), there will be positive spillovers on the demand for cost-effective and high-quality Egyptian products.

Elements of this strategy should include the consensus and commitment of the government and other stakeholders to (i) upgrade skills; (ii) develop long-term entrepreneurial innovation rather than short-term cost-cutting approaches to productivity and competitiveness; and (iii) ensure the compliance of all stakeholders to this strategy.

The Egyptian Competitiveness Report 2004-2005 provides a helpful analysis of the drivers of international competitiveness. As a long-term partnership between all stakeholders in the Egyptian economy takes hold, it provides many promising ideas for improving Egypt's competitiveness.

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ACRONYMS

BSCI	Business Competitiveness Index
CBE	Central Bank of Egypt
EOS	Executive Opinion Survey
ENCC	Egyptian National Competitiveness Council
FDI	Foreign Direct Investment
GLCI	Global Competitiveness Index
GRCI	Growth Competitiveness Index
IMF	International Monetary Fund
MOF	Ministry of Finance
MFTI	Ministry of Foreign Trade and Industry
WEF	World Economic Forum

PREFACE

The Egyptian National Competitiveness Council (ENCC) tracks key indicators of Egypt's performance to measure the global competitiveness of the economy. The ENCC systematically monitors and analyzes domestic data on economic performance. It also makes use of indicators from the Growth Competitiveness Index (GRCI), the Business Competitiveness Index (BSCI) and the Global Competitiveness Index (GLCI), which are also used in the World Economic Forum's (WEF) Global Competitiveness Report. These indicators help detect emerging trouble spots in the economy. The result is a clearer picture of the drivers of competitiveness in our domestic economy. The ENCC then compiles the data and analysis in its annual report with the goal of providing direction to policymakers and leaders in the business sector. It is specifically designed to support leaders seeking positive changes in the nation's underlying infrastructure to develop a closer partnership between business and government.

How can the report decide whether the Egyptian economy is competitive[1] or not? We will examine three facets of competitiveness to answer that question:[2]

1. How well is Egypt performing compared to other countries?
2. How well has Egypt performed in international trade?
3. Are we doing the best we can?

Concerning the first question, *How well is Egypt performing compared to other countries,* the report finds that Egypt's rankings have mostly been slipping or staying the same. In the few cases where Egypt made progress, peer countries in the developing world have improved more rapidly.

As for the second question, *How well has Egypt performed in international trade,* our findings reveal that the macro-environment in Egypt has recently become better suited for improved access to the global markets. Changes at the macroeconomic level, particularly as measured by fiscal, trade and exchange rate trends, have led to an incentives system that is more conducive to an "exporter friendly" environment.

However, this is only part of the story. Eliminating distortions in the incentives system will make Egypt's exports more competitive in terms of cost. Egypt must also address how it can innovate in order to improve the quality of its products and the efficiency of the production process. While Egypt's macroeconomic indicators have seen a significant change in a short period of time, our analysis shows that Egypt is only in the early stages of building a culture of innovation and competitiveness.

The long answer to the third question, *Are we doing the best we can*, is that the new economic team appointed as part of the Cabinet shuffle in July 2004 has taken up a number of reform issues that were previously considered off limits. Privatization, tariff reductions and tax cuts are not only costly reforms, but have always been branded as politically sensitive. The new

[1] Please refer to Chapter 1 of last year's competitiveness report for an in-depth look at different definitions of competitiveness (http://www.encc.info). See Chapter 1 of this report for the operational definition used for the purpose of our study.

[2] Robert Lawrence (http://www.econlib.org.).

economic team, in particular, has shown that when it comes to economic transformation there are no taboos. Their activity and enthusiasm should serve as a model for the rest of the Cabinet.

Does this mean that the recent reforms have been driven by the individual efforts of only a handful of reform-minded members in the Cabinet? Are these reformers alone in developing a national strategy for reform? Will failure to institutionalize these reforms open us to the risk of policy reversals as governments and individuals change? Finally, how can we extend positive change throughout the government and encourage long-lasting change over successive governments?

These are tough questions that have no short answers.

Hossam Badrawi, Chairman

Egyptian National Competitiveness Council

EXECUTIVE SUMMARY

This is the second report issued by the Egyptian National Competitiveness Council (ENCC) examining the competitiveness of the Egyptian economy.[1] The Egyptian Competitiveness Report aims to become a regular and prominent benchmarking exercise that assesses developments in the status of Egyptian competitiveness based on the indices of the WEF's annual Global Competitiveness Report. Last year's Egyptian report discussed recent developments in the competitiveness of the economy, and concluded that Egypt's rank was slipping in many areas, both in absolute terms and relative to other developing countries. The report identified 11 issues related to Egypt's weakening competitiveness that required attention by the government. Egypt's 2005 Competitiveness Report continues to gauge developments in Egypt's international competitiveness status. Noting the implementation of a number of reforms in response to the challenges underlined in last year's report, which served to achieve an impressive turnaround in the economy in 2005, the report draws attention to a set of new challenges that need to be addressed in order to unlock untapped opportunities.

We are still in the process of developing and improving on the report. This year's report has undergone some restructuring. Chapter 1 gives a brief overview of the methodology developed by the World Economic Forum to build the various indices and sub-indices that are used to measure competitiveness. Using Egypt's ranking on these indices, Chapter 2 presents the key competitiveness indices and analyzes Egypt's performance over time and relative to peer countries in the developing world. It also provides an in-depth analysis of the sub-indices to identify the drivers behind Egypt's performance. Chapter 3 discusses the recent reform initiatives undertaken by the Cabinet's new economic team, comprised of the ministries of finance, foreign trade and industry, and investment. Chapter 4 presents the challenges and opportunities ahead.

A number of interesting conclusions emerge from the report. We find that Egypt's competitiveness ranking has continued to struggle in the past few years, and remains unfavorable relative to its peers. It's important to note that Egypt's low rankings in 2005 do not account for the reforms undertaken since the reshuffle of the Cabinet in July 2004. The Executive Opinion Survey was conducted in March 2004 and failed to capture executives' opinions about the recent economic changes.

In analyzing the impediments in Egypt's business environment, the Executive Opinion Survey[2] (EOS) indicated eight main constraints, ranked in order of significance. The constraints identified relate to (i) access to financing; (ii) tax regulations and tax rates; (iii) inefficient bureaucracy; (iv) policy instability; (v) foreign currency regulations; (vi) inflation; (vii) an inadequately educated workforce; and (viii) restrictive labor regulations. Notwithstanding the persistence of some of those impediments, their severity and ranking have changed markedly since the time of the survey in April 2005. New simplified tax regulations were issued in June

[1] The Egyptian Competitiveness Report 2003-2004 was issued in September 2004.

[2] The Executive Opinion Survey (EOS) is the main tool that translates perceptions about a country's economic environment into measurable and comparable indicators. These indicators enable the Growth Competitiveness Index (GRCI) to reveal the economic environment in a particular country, as well as the factors that affect its performance over a given time period. See Chapter 1 for more details.

2005, while tax rates were slashed by 50 percent, effective July 1. Foreign currency regulations such as surrender requirements were eliminated in December 2004, leading to a liquid foreign exchange market. This, in conjunction with the implementation of the foreign exchange interbank market, has served to bring together the official and parallel market rates for the US dollar and Egyptian pound, stabilizing the exchange market. As for inflation, both the consumer price index (CPI) and wholesale price index (WPI) have dropped by more than 50 percent[3] between October 2004 and March 2005. We hope that as the new economic measures start to bear fruit, the Executive Opinion Survey of March 2005 reflects improved business perceptions and that Egypt's rankings surge ahead in 2006.

Concerning the remaining five problems, either no action is being taken to resolve them, or the necessary reforms are being taken too slowly and too gradually for their impact to be felt. Many of the low rankings reflect a lack of reform initiative in these five areas ─ as well as other areas discussed in Chapter 4 ─ which threaten to undermine Egypt's competitiveness as long as the complacency lasts. The question that arises is *why did recent bold efforts manage to achieve rapid and perceptible changes in some areas, while initiatives to address other equally important concerns are either absent or have gone astray*?

The implications are worrisome: What framework guides the reform decisions of the Cabinet? Do the leaps taken in limited areas reflect the isolated endeavors of a few reform-minded cabinet members? If so, will these reforms collapse or lose momentum if this group of reformists retires or is replaced? Are individual attempts of reform at risk of being reversed on the whim of the policymakers in charge? How will these reforms be institutionalized so that their implementation reaches other ministries and ensures continued sustainability over successive governments?

We now turn to a brief summary of the chapters. Chapter 1, as stated earlier, discusses methodology. In Chapter 2, Egypt's international competitiveness rankings on the GRCI, BSCI and GLCI[4] are discussed. Egypt's overall GRCI ranking slipped from No. 58 in 2003 to No. 62 in 2004, partly due to the entry of three newcomers that ranked higher than Egypt (United Arab Emirates, Bahrain, and Cyprus) and also because of the improved competitiveness status of peer countries such as Morocco. On this front, the main weakness in Egypt's international competitiveness position pertains to the public institutions index, where Egypt's rank deteriorated markedly from No. 57 in 2003 to No. 70 in 2004. In the macroeconomic environment index, Egypt's rank stagnated, appearing at No. 57 compared to last year's rank of No. 56. While the appearance of several new countries on this year's index distorted the ranking, the important point is that Egypt is not improving and in some cases is falling behind. For instance, the country's credit rating fell by ten spots. On a positive note, Egypt's position in the technology transfer index improved by three ranks to No. 65 in 2004. This improvement, albeit slight, marks a positive perception among executives regarding the capacity of technological attainment in the country.

On the BSCI index, Egypt ranked 66th out of 104 countries on a global level compared to 58th out of 102 countries last year. The retreat in Egypt's position is traced back to a lower ranking on the two main components of the BSCI: the company operations and strategy index, and the quality of the national business environment index. This reflects a continuation of a declining trend in Egypt's international competitiveness on this front. Egypt's rank declined from

[3] See Chapter 3 for more details.
[4] The definitions for these indices are available in Chapter 1.

No. 40 in 2001 to No. 58 in 2003, and finally to No. 66 in 2004. This is partly a reflection of investors' negative sentiment about the Egyptian economy prevalent at the time of the survey in March 2004. With a prolonged recession in the economy starting in 1998, coupled with an inadequate government response and the slow pace of institutional and structural reforms, Egypt's image in the past few years has seen an overall deterioration in the eyes of domestic and international investors. This negative perception was further heightened by significant improvements in the business environment in neighboring economies.

Regarding the GLCI index, Egypt occupied the 47th rank among 104 countries. This rank places Egypt well ahead of its position in both the GRCI and BSCI (No. 62 and No. 66 respectively); yet, it preserves almost the same ordering against its selected peers. The key driver behind Egypt's relatively good performance on this index is reflected by its No. 47 ranking on the "innovation enhancers" component.

Chapter 3 describes the main reform efforts undertaken to date. Economic growth picked up in 2004 after a period of slowdown, mainly due to favorable performance in the external sector. Macroeconomic policy remains geared towards reducing inflation and stabilizing the foreign exchange market, which seems to be paying off in terms of declining inflation rates and the disappearance of the foreign exchange parallel market. The recent appreciation of the Egyptian pound helped the Central Bank of Egypt (CBE) to increase its international reserves. On the fiscal front, the budget deficit (as a percentage of GDP) was contained at a level slightly below that of last year's; however, there has been a continued rise in the government and public sector debts, which is an alarming trend.

As for the external sector, Egypt's position remains robust with a current account surplus for six quarters in a row. Improvements in both oil and non-oil exports, as well as proceeds for services exports (namely tourism and the Suez Canal), have strengthened the current account. This contrasts the pattern in previous years when improvements in the current account stemmed primarily from a sharp decline in imports due to slackening economic activity. The capital account remains in deficit due to weak investment flows and a net increase in the acquisition of foreign assets by residents.

Overall improvements in the macroeconomic framework are reflected by the bullish performance of the stock market since July 2004; in addition, both Fitch and Standard and Poor's have upgraded Egypt's credit rating outlook from negative to stable.

On the institutional front, the CBE is currently working on developing a monetary policy framework that anchors inflation expectations under an inflation-targeting regime. In the short term, liquidity indicators (broad money (M2)) will be used as an intermediate target for controlling inflation outcomes, whereas, in the medium term, indirect market instruments will be used to control liquidity in the market.[5] The Central Bank of Egypt (CBE) has already established a Monetary Policy Unit to communicate the direction of short-term monetary policy to the market, which should help to lower inflation expectations. The CBE published its first and overdue monetary policy statement on June 2, 2005.[6]

[5] من أنظمة السياسة النقدية استهداف سعر الصرف الثابت، أو استهداف الإجماليات النقدية للسيولة مثل قاعدة النقود (M2)، أو استهداف معدلات التضخم (inflation targeting).
Monetary policy regimes include exchange rate targeting, the targeting of monetary aggregates of liquidity such as M2, or inflation targeting.

[6] See www.cbe.org.eg.

In addition, more fiscal consolidation is underway along with the movement towards a more transparent budget-preparation process for fiscal year 2005/2006 based on internationally accepted standards defined by the International Monetary Fund (IMF).

The structural reforms taken under the direction of the new Cabinet were comprehensive and tapped into the backbone of the economy. This is unlike previous experiences with reform that were made in a conservative and piecemeal fashion. The most tangible changes were observed in the development of a comprehensive strategy for trade liberalization that comprised tariff adjustments, a rationalization of the tariff structure, the abolition of fees and surcharges, and the reduction of customs exemptions.

Tariff reform took place in parallel with the introduction of a new draft tax law that lowers tax rates on personal and corporate income, and unifies tax exemptions and related legislation. The law also provides for the phasing out of tax exemptions for newly established companies. The law is intended to encourage the voluntary submission of returns by taxpayers, the timely payment of taxes, and greater compliance of citizens to address the tax evasion issue.

The financial system is also being strengthened via structural reforms, bank mergers, and privatization of joint venture banks and one state-owned bank. Serious efforts are underway to solve the problem of non-performing loans in the banking sector. In addition, institutional reforms are underway to improve the supervisory power of the CBE over the banking system. On a different front, the privatization program has been reinvigorated after a period of stagnation — between July 2004 and March 2005, stakes were divested in 17 non-financial enterprises in addition to two financial institutions.

One of the areas long overdue for reform was the overhaul of agencies that deal with investment, which have only attracted modest levels of foreign direct investment (FDI). The Ministry of Investment was created and is currently taking the lead in preparing a comprehensive investment policy for Egypt in consultation with private sector stakeholders. A fundamental reorientation in the role of the General Authority for Investment and Free Zones (GAFI) is also underway to improve its efforts to promote and target FDI.

Chapter 4 concludes that although the initial reform effort has been impressive, a number of issues still pose challenges to improving the competitiveness of the Egyptian economy. Addressing such challenges is crucial to unleashing Egypt's growth potential. On top of these challenges comes the need for a comprehensive vision to fully meet the desires for a more competitive Egypt. Developing the vision must be a continuous process that engages all stakeholders and caters to the development needs of the country.

Next to vision formulation, good governance is key to managing the implementation process. Egypt, like many developing countries, faces the challenge of adopting a rules-based system of governance and enforcement. Current efforts in this regard include the establishment of the Egyptian Institute of Directors (EIOD), which assumes the role of promoting corporate governance in Egypt. To date, EIOD has not achieved tangible outcomes; however, it is projected to be a vehicle for the dissemination of international standards of corporate governance. Along the theme of good governance, the budget has been published according to the International Monetary Fund's Government Finance Statistics (GFS) standards, making the budget more transparent. However, the National Investment Bank (NIB) budget still needs to be integrated into the overall budget.

Also, there is a need for significant fiscal consolidation and complementary expenditure-reduction measures such as streamlining subsidies and controlling the government wage bill.

Fiscal consolidation assumes even greater importance in the face of recent tariff reductions and proposed tax cuts and social reforms, which will increase the budget deficit in the shorter term. In the medium term, another series of trade, tax and social reforms will help reinvigorate the business environment, give momentum to economic activity and, in turn, boost growth and job creation. But the key question revolves around the mechanism of financing the short-term costs of reform, which further strengthens the need for fiscal consolidation to avoid an explosion of public debt.

With regard to monetary policy, the Central Bank still needs to address the risk that expectations of higher inflation could become more deeply rooted. To avoid this risk, the Central Bank will need to develop a forward-looking policy approach in the immediate future that clearly communicates the direction of monetary policy using a nominal anchor. Moreover, the Central Bank must make periodic announcements about the direction of monetary policy. This would enhance the credibility of the Central Bank and the transparency of its operations, further strengthening the monetary policy framework.

As for the external sector, the diversification of exports, together with the recent appreciation of the pound, may constrain the demand for Egypt’s merchandise exports. Lower export performance during the first half of fiscal year 2004/2005 and the robust growth in imports in response to lower tariffs could increase pressures on the trade deficit.

Pertaining to financial sector reform, the government faces a number of complex issues that need to be untangled carefully and immediately. This includes providing enough resources to restructure the banking sector without crowding out the private sector. Moreover, it is important to address the factors that impede the private sector from accessing banking sector finance. Also, the government needs to move fast on reducing the high levels of government borrowing that leave the private sector fighting for what’s leftover.

Real estate investment still faces many problems that prevent the development of mortgage finance in Egypt. A mortgage finance debt market will help deepen the financial sector and boost the stagnant real estate sector. The report underscores several factors that deter the development of mortgage financing in Egypt.

One of the most critical issues on the reform agenda is the formulation of a strategic vision for the Egyptian industry. The Industrial Modernization Center (IMC) is currently in the process of formulating an industrialization strategy that builds on the existing industrial base, and also better utilization of Egypt’s natural resource endowments, its large pool of human resources, as well as its strategic geographical location. The aim of the strategy is to strengthen the base of Egyptian manufactured exports and its visibility in international markets, increase domestic added value, and undertake technological upgrading of existing industrial activities by moving up the value chain. Implementation will be crucial to the success of this strategy as it hinges on instituting an effective public-private partnership to ensure the collaboration of all stakeholders.

Finally, human resource development still poses a major challenge that may very well impede Egypt’s efforts to improve competitiveness. To address long-standing problems in the educational system, the Ministry of Higher Education is currently developing a plan for the reform of higher education and scientific research in Egypt with an associated action plan to achieve specified objectives. A parallel plan is in progress to overhaul scientific research institutions and establish solid coordination mechanisms with the private sector. Over the last three years, the ruling National Democratic Party (NDP) has introduced a complete set of reform policies in education, including preschool, school, vocational, and higher education at its annual conferences in September. The government has agreed to the proposed policies, with major developments in the following areas:

1. Decentralization of education planning, financing and management.

2. More societal participation with a clear vision of the private sector role to accommodate 20% of students.

3. The move towards improving the quality of education to guarantee that Egyptian graduates are more competitive, especially in the areas of vocational and higher education. These policies include a number of action plans that take effect over a specific time frame. The most important action plan, in our opinion, is publishing the standards of education at every level of education and the indicators needed to evaluate the performance of schools and universities, both institutionally and academically. The major recommendation was to establish an independent accreditation agency for education. However, delays in introducing that legislation constitute, in our opinion, an impediment confronting the reform of education towards a more competitive environment in the medium and long term.

Despite increasing enrollment rates at all levels, the overall quality of graduates of the education system is in decline. Furthermore, there is a continued mismatch with the demands of the private sector. The traditionally acclaimed comparative advantage of cheap labor in Egypt is being eroded by low levels of productivity. The overall weakness in the human resource base is seen as a barrier towards moving into technology- and skill-intensive activities that offer the best prospects for Egypt's integration into the global economy.

On a related front, the competitiveness edge of the female labor force should be further endorsed by empowerment of women at all levels to ensure their effective inclusion in productive activities. No reform can take place without increasing the competitiveness of women. The female gender constitutes 49 percent of the Egyptian society. Society cannot develop or compete with a high percentage of its labor force remaining uneducated and inactive. A high propensity to consume and not to produce places a burden on the rest of the population. Hence, women's participation in all domains of life — social, economic or political — is a necessity with the increasing importance of competitiveness for development. In order for Egyptian women to become active participants in Egypt's quest for global competitiveness, women's competitiveness needs to be enhanced. A special program should be developed with this objective in mind. Regular programs to increase the population or youth competitiveness may fail to address the special needs of women, especially in the remote and underprivileged areas of Egypt.

The UNDP 2004 Human Development Report (HDR) ranked Egypt low on the Gender Empowerment Measure (GEM). Egypt ranked 75th out of 78 countries. GEM relates to the participation of women in the political and professional life. There is a need to focus on the empowerment of women at all levels and to eliminate all forms of discrimination against them. In this context, the following measures need to be taken:

1. Initiate a socio-cultural movement to improve the perception of women as partners in societal development.
2. Take different measures that will ensure real equal access of females to all levels and sectors of education.
3. Provide health care services to women through means that they can easily access and use.
4. Ensure greater inclusion of women in the workforce at all levels and specializations.
5. Provide women with access to micro-financing of credit and loans.

6. Adopt affirmative action as a temporary program through allocating seats for women in different political local councils and Parliament.
7. Ensure that laws and regulations reflect the constitutional requirement of equal opportunity between men and women.

Concerning labor competitiveness, traditionally the low cost of labor was considered a comparative advantage for the Egyptian economy due to the abundance of its supply. Indeed, Egypt currently has one of the lowest levels of labor costs in manufacturing in the Middle East North Africa (MENA) region, reaching almost one-fourth of the MENA average. However, labor productivity is one of the lowest in the region as well. Thus, when linking labor costs with labor productivity (i.e. considering unit labor costs), Egypt's comparative advantage appears to be eroding as Egypt's unit labor costs are almost the same as the MENA average.

The implication of this weakness is double-sided. On one hand, it implies limited comparative advantage in labor-intensive activities that constitute a promising niche for addressing unemployment concerns. On the other, and more importantly, it indicates that domestic technological capabilities are not adequate to reap the benefits of the ICT revolution, which is currently the driver of global economic growth. This limits the ability to move towards technology and skills-intensive activities, which offer the best prospects for Egypt's integration into the global economy.

CHAPTER 1
METHODOLOGY

1.1 OPERATIONAL DEFINITION OF COMPETITIVENESS USED IN THE EGYPTIAN COMPETITIVENESS REPORT

In the Egyptian National Competitiveness Council's (ENCC) first report, *The Egyptian Competitiveness Report 2003-2004,* we introduced several definitions of competitiveness. However, our operational definition for competitiveness relied, and continues to rely, on Porter's definition of national competitiveness, which states that competitiveness is *"the set of institutions and economic policies supportive of high rates of economic growth in the medium term"* (Porter, Sachs and Warner, 2003).

♦ COMPETITIVENESS AND THE DETERMINANTS OF GROWTH

Positive growth rates help determine the welfare of a country's citizens. For high-income countries, positive growth rates bring about wage increases, bigger profits, more jobs and expanded business activities. For developing and low-income countries, positive growth rates help alleviate poverty as incomes rise and ensure higher quality human development, such as lower infant mortality rates, longer life expectancy, better education, etc.

Nevertheless, positive growth rates have still failed to materialize in many countries. According to Blanke, Paua and Sala-I-Martin (2004, p. 3), "Despite its enormous importance, the determinants of the growth rate of a country remain one of economics' biggest mysteries." Adam Smith wrote that specialization and the division of labor was the engine of growth. In the 19th century, Malthus and David Ricardo believed that the scarcity of natural resources constrained the growth potential of a nation because of the law of diminishing returns of land.

As these theories failed to provide a blueprint for growth, 20th century economists responded with alternative theories, proposing that investment in physical capital and infrastructure drove growth. The failure of the Soviet model and many of the developing countries that followed it — with assistance from the World Bank — later proved that investing in physical capital was not sufficient to put a country on a higher growth trajectory. In subsequent years, investing in human capital became en vogue in all developing countries, a trend which lasted for two decades. But again, economic growth remained elusive.

When all these theories failed miserably, technological progress became the next model heralded as the key determinant of growth. The question then shifted from "What determines the growth rate of GDP?" to "What determines the rate of technological progress?" The answer proved complex. No single indicator was found to account for growth in a country. Many answers were provided: openness, macroeconomic stability, in addition to other factors, but no single element could account for growth. This is because the process of economic growth is dynamic, complex and requires a great deal of coordination to make sure it functions properly.

In an attempt to capture as many of the factors involved in the complex growth process as possible, the World Economic Forum developed the Growth Competitiveness Index (GRCI) in

1979. The GRCI is updated every year as new data become available. Every year, economists gain new insights into the determinants of the process of economic growth. The GRCI index is then grouped with the results of the Executive Opinion Survey, which gauges the opinions of more than 7,500 business experts.

Thus, one of the principal objectives of the Global Competitiveness Report is "to evaluate the potential for the world's economies to attain sustained economic growth over the medium and long term" (Blanke, Paua & Sala-I-Martin, 2004, p. 4).

In the next section we discuss how competitiveness is measured using the GRCI and other indices, and how they are combined with the results of the Executive Opinion Survey.

1.2 MEASURING COMPETITIVENESS

Since 1979 the World Economic Forum (WEF) has strived to measure and evaluate the competitiveness of countries. It has focused on two approaches. The first is the Growth Competitiveness Index (GRCI) and the second is the Business Competitiveness Index (BSCI). 'Hard data' on the countries is used to construct these two indices in addition to the Executive Opinion Survey, which is conducted by the World Economic Forum.

1.2.1 The Executive Opinion Survey (EOS)

The Executive Opinion Survey (EOS) has been a key ingredient of the Growth Competitiveness Index. It is the main tool used to translate general perceptions about a country's economic environment into measurable and comparable indicators. These indicators allow the Growth Competitiveness Report to analyze the economic environment in a particular country, as well as the factors that affect its performance over a given time period, and have allowed it to become "a unique source of insight into the inner workings of a particular economy" (WEF, 2004, p. 167.).

The Executive Opinion Survey is conducted annually by the World Economic Forum during the first half of the year. Input for the survey comes from leading business executives and entrepreneurs. These businessmen provide their perceptions about the business environment in which they work, which is reflected by the results from a comprehensive and scientifically designed questionnaire. The questionnaire also asks them to identify key obstacles to economic growth.

The surveys are conducted by the World Economic Forum's partner institutes in the countries that participate in the Global Competitiveness Program (Egypt is a member of this program). These partner institutes conduct the surveys and ensure that the sample of respondents is representative of the economy being appraised. The World Economic Forum makes sure that the survey method used is consistent across countries.

1.2.2 Indices of Competitiveness

1.2.2.1 The Growth and Business Competitiveness Indices (GRCI and BSCI)

♦ *The Growth Competitiveness Index (GRCI)*

The main goal of the GRCI is to analyze the potential of the world's economies to achieve sustainable economic growth in the medium and long term. It refers to aggregate or macroeconomic determinants of productivity such as the set of institutions, policies and structures that impact on the growth potential of countries. It is the GRCI that captures the ‘dynamic’ or ‘growth’ determinants of productivity.

The GRCI is based on three main concepts:

- The first concept is the **process of economic growth**, which can be divided into three categories
  - Within the three categories (see Table 1.1 below), the importance of the determinants of economic competitiveness varies for core and non-core innovators. Core innovators will almost always have their macroeconomic fundamentals in place, and technological creativity is already the driver of their growth. In contrast, non-core innovators need to work to improve their macroeconomic conditions. The technology index thus weighs more heavily on core innovators than the index for public institutions or the macroeconomic environment. Non-core innovators are assigned equal weights between the three categories. Below is a more detailed table about the weight for the sub-indices within the categories.
- The second concept examines **innovation versus imitation**. The origin of technological sophistication may be different across countries. For ‘core’ countries, technological advancement is achieved mostly through innovation. For ‘non-core’ countries, technological improvement is achieved partly through innovation, partly through copying, and partly through the adoption of knowledge developed by a leading country in the field. Countries above the threshold of 15 patents per million people are identified as core. Innovator or core countries have a larger weight placed on innovation than non-core countries, but no weight is placed on adoption. By comparison, adoption of technology weighs positively on non-core countries.

  The main idea is that is that innovation is more important than adoption for core innovators than for non-core innovators. Technological adoption is captured by the technology transfer index.
- The third concept underlying the GRCI is that the **determinants of economic competitiveness vary for core and non-core countries**. (Again, see Table 1.1 for differences in weights among the three pillars for core and non-core countries). The explanatory power of the index improves if different weightings of the three pillars are introduced depending on the stage of development of a country.

Three pillars — the macroeconomic environment, the quality of public institutions, and technology — are combined to calculate the overall GRCI. The indices and sub-indices are calculated on the basis of both hard data and survey data. Survey responses are measured on a scale of 1–7. Hard data are collected from various sources. The formula for converting hard data into this scale is as follows:

$$\frac{\textbf{6 * (country value – sample minimum)}}{\textbf{(sample maximum – sample minimum)}} \textbf{ + 1}$$

Table 1.1: Composition of Growth Competitiveness Index	Weights	
	Core	Non-core
	Countries	
o **The macroeconomic environment;**	**1/4**	**1/3**
▪ Macroeconomic stability sub-index [7]	1/2	
▪ Country credit rating	1/4	
▪ Government waste	1/4	
• *Extent of distortive government subsidies* • *Diversion of public funds* • *Public trust in the financial honesty of politicians*		
o **Public institutions index**	**1/4**	**1/3**
▪ Contracts and law sub-index	1/2	
▪ Corruption sub-index	1/2	
o **Technology index**[8]	**1/2**	**1/3**
▪ Innovation sub-index[9]	1/2	1/8
▪ Technology transfer sub-index	Zero	3/8
▪ Information and communication technology sub-index	1/2	1/2

♦ ***The Business Competitiveness Index (BSCI)***

The BSCI is constructed from indicators based on the results of the Executive Opinion Survey. It captures the determinants of the microeconomic components of productivity, including the 'static' or 'level' determinants of productivity.

The index attempts to measure indicators such as patenting rates, and internet and mobile phone penetration, but these data are unavailable for many countries. The survey alternatively captures the judgment of the respondents of the questionnaire.

The BSCI has two sub-indices:

- The sophistication of company operations and strategy
- The quality of the national business environment

1.2.2.2 The Global Competitiveness Index (GLCI, WEF, 2005)

The Global Competitiveness Index is a new measure of competitiveness that merges the GRCI and the BSCI. It is based on three key principles: productivity is complex, development takes place in three stages, and transition periods are required.

Principle 1: Productivity is complex, resting on 12 pillars of competitiveness:

[7] 5/7 macroeconomic stability hard data + 2/7 macroeconomic stability core data
[8] 1/3 ICT survey data + 2/3 ICT hard data
[9] 1/4 survey data + 3/4 hard data

1. Institutions
2. Physical infrastructure
3. Macro-stability
4. Security
5. Human capital
6. Market efficiency
7. Labor market efficiency
8. Financial market efficiency
9. Technological readiness
10. Openness and market size
11. Business sophistication
12. Innovation

Principle 2: Development takes place in three stages:[10]

1. *Factor-driven*: Firms compete in price. They take advantage of their cheap factors of production, while firms produce simple products and basic requirements.

2. *Efficiency-driven*: The quality of the products (not only prices) and the efficiency of the production process determine the productivity of firms. They have to access the best technologies even if they have to import them from abroad. They form the efficiency enhancers.

3. *Innovation-driven*: The country starts producing different and creative products, and practices the most advanced methods of production and organization. Businesses organize themselves in clusters in order to enjoy advanced and superior operations. They form the innovation and sophistication factors.

Countries in the first stage score low on innovation or business sophistication. Countries in the second stage should worry about performing well as they approach the third stage.

The Global Competitiveness Index is calculated as follows:

$\alpha 1$ * basic requirements

$\alpha 2$ * efficiency enhancers

$\alpha 2$ * innovation factors

Where $\alpha 1$, $\alpha 2$, and $\alpha 3$ are the weights that each sub-index gets in the overall index. The weight assigned depends on the stage of development of a country. The following table shows how the weights are assigned to the three stages of development.

[10] Please refer to ENCC (2004) for further details.

Weight	Basic requirements	Efficiency enhancers	Innovation and sophistication factors
Factor-driven stage	50%	40%	10%
Efficiency-driven stage	40%	50%	10%
Innovation-driven stage	30%	40%	30%

Principle 3: Transition periods are required

As economies develop, they move from one stage to another in a smooth fashion rather than abrupt jumps. The weights of the sub-indices change as a country develops. So, in addition to the countries in the three stages, there are countries that are categorized as being between stages one and two and two and three.

Countries in transition between the first and second stages have lost their ability to compete in low prices, and therefore slowly lose their competitiveness. They have not prepared themselves for the challenges that they will meet in the second stage.

We now turn to Chapter 2 to see the results of this year's 2005 GRCI, BSCI, and GLCI rankings for Egypt. The chapter analyzes Egypt's various rankings in the sub-indices, relative to last year and to other peer countries. Chapter 3 describes various issues relating to Egypt's competitiveness and recent economic performance. Finally, Chapter 4 looks at some of the important issues and challenges facing Egypt that have emerged during the past year.

CHAPTER 2

RECENT DEVELOPMENTS IN EGYPT'S COMPETITIVENESS STATUS: MOVING FROM RETREAT TO RECOVERY

Studying the development of a country's competitiveness is increasingly becoming a subject of interest not only among research groups and think tanks but also policymakers and representatives of civil society. This interest stems from the fact that changes in a country's international competitiveness have an impact on people's lives in the political, economic, and social realms. It is also deeply rooted in the emerging consensus that economies today are no longer operating in a 'vacuum,' but are becoming part of a global economy where international competitiveness, as it is broadly defined, is the key vehicle for growth and prosperity.

The growing interest in the evolving concept of competitiveness[11] is largely attributed to the proliferation of various studies, indicator scoreboards, and results of opinion surveys focusing on gauging the relative competitiveness of a group of countries. Interest in both the analysis contained in these studies as well as the design of scoreboards and surveys is the product of cutting-edge research by prominent scholars in this field. Furthermore, many of these studies have been carried out under the umbrella of renowned international institutions,[12] which has helped bring credibility to their results and caused policymakers to take them more seriously.

The aim of this chapter is to trace the recent developments in Egypt's competitiveness in relation to a group of selected comparators. The analysis relies exclusively on the competitiveness indices revealed in the recent World Competitiveness Report 2004-2005 (as well as earlier reports), as this remains the most comprehensive composite measuring the development of competitiveness. As indicated in the previous chapter, the competitiveness indices revealed in this report rely on both 'hard' (i.e. quantitative) indicators disseminated by national and international statistical authorities in addition to 'soft' (i.e. qualitative) indicators extracted from the annual Executive Opinion Survey. The use of other sources of data and information only serves to provide a broader picture of the factors behind the recent developments in Egypt's competitiveness ranking.

The chapter addresses the three indices used in the latest World Competitiveness Report (2004-2005). These indices are the Growth Competitiveness Index (GRCI), the Business Competitiveness Index (BSCI), and the newly introduced Global Competitiveness Index (GLCI), which is a new index designed to combine (and eventually replace) both the GRCI and BSCI. The Global Competitiveness Report offers a set of indicators that are basically drawn from the Executive Opinion Survey (EOS), which is conducted by the World Economic Forum; the data covers almost all aspects that shape the status of competitiveness in a group of economies.

[11] A thorough coverage of the different concepts and definitions of competitiveness has been undertaken in last year's Egyptian Competitiveness Report (2003-2004).

[12] A non-exhaustive list includes the World Economic Forum, the World Bank, the United Nations Development Program, the United Nations Conference on Trade and Development, the United Nations Industrial Development Organization, the Heritage Foundation, etc. However, some of these organizations focus on specific policy issues that still fall under the overall umbrella of international competitiveness.

2.1 THE GROWTH COMPETITIVENESS INDEX (GRCI): HOW READY IS EGYPT TO CAPITALIZE ON ITS GROWTH POTENTIAL?

The GRCI captures the ability of the world economies to attain sustained economic growth over the medium and long term. The concept rests upon three pillars: macroeconomic environment, public institutions and technology.

Egypt's overall GRCI ranking declined from No. 58 in 2003 to No. 62 in 2004. The recoil is partly explained by the entry of three newcomers that appeared ahead of Egypt in the overall ranking: the United Arab Emirates (UAE) (No. 16), Bahrain (No. 28) and Cyprus (No. 38).[13] Two of these countries, the UAE and Bahrain, are regional comparators to Egypt that have put together an impressive record of reform in their business environment in recent years. On a positive note, this signifies that some MENA economies have started reaping the benefits of reform, which may offer an incentive that helps other MENA countries move forward. The reforms in the UAE have successfully transformed its image in the eyes of international investors from an oil-dependent economy to an economy with a growth potential that far exceeds countries such as Hong Kong, Chile, New Zealand, and Belgium.

During last year, most of the selected comparators witnessed a slight fallback (see Table 1 in Appendix 1) with a few exceptions: Morocco improved from No. 61 in 2003 to No. 56 in 2004, South Africa from No. 42 to No. 41, Indonesia from No. 72 to No. 69 and Chile, which

Box 2.1: Rationale for the Choice of Comparators

The choice of comparators depends mainly on whether they are neighboring economies with relatively similar resource endowments and economic structures and regional competitors that compete with Egypt for exports and FDI. International role models from the developing world that were able to solidify their international position are also included. The following explains the rationale behind the choice of specific comparators:

- Regional competitors with somewhat similar production structures and specialization in the same export groups (such as textiles and apparel, heavy industries, energy-intensive industries, etc.) are **Jordan**, **Morocco**, **Tunisia**, and **Turkey**. These countries are currently working on industrial modernization and have improved access to neighboring European and Arab markets, and thereby are key regional competitors.
- **Bahrain** and the **UAE** are emerging as regional hubs for FDI, especially in the services sector, and milestones in the improvement of the domestic business environment have placed them among leading countries in the different competitiveness indices among the MENA region.
- Among the successful international role models: **Brazil** enjoys a well diversified industrial base with strong competitive potential. **Chile** is a prime example of a country that has gradually diversified away from resource-based and primary exports. The **Czech Republic** is a successful model in the transition economies with a deep drive for regulatory reform and structural adjustment. **South Africa** is also an emerging source of competitive threats due to intensified competition with Egypt in some export markets as well as competition for FDI flowing into Africa.
- **Malaysia** is one of the leading Newly Industrialized Economies with proven global competitiveness in the past two decades. **Indonesia** is also an emerging Asian Tiger that is shifting gradually from the dependence on primary and resource-based exports into low-tech manufactures.

[13] Figures in parenthesis indicate rank in the GRCI in 2004.

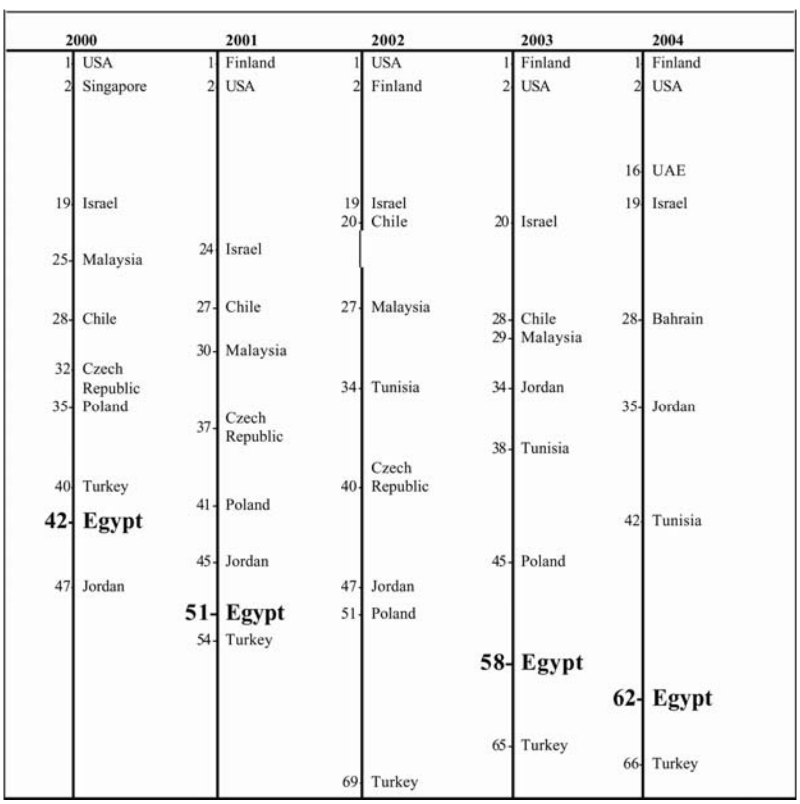
continued to leverage its competitiveness profile, jumped from No. 28 to No. 22. As it stands today, Chile surpasses not only some of the leading Asian Tigers, such as Korea and Thailand, but also important industrialized countries such as France, Ireland, and Spain (See Box 2.5).

Historically, as displayed in Figure 2.1 below, the deterioration in Egypt's rank in the GRCI reverses improvements witnessed since the start of 1999. In 2000, Egypt's rank was higher than most of its comparators, including Indonesia, Brazil, and Jordan, whereas in 2004 most comparators outranked Egypt — except for Turkey which ranked No. 66 in 2004 compared to No. 65 in 2003. Over the same period, countries like Jordan and Israel achieved steady progress, albeit they started from a higher position than Egypt in 1998.

Looking deeper at the components of the index, the main weakness in Egypt's international competitiveness position seems to pertain to the **public institutions** index, where Egypt's rank deteriorated markedly from No. 57 in 2003 to No. 70 in 2004. This reflects a deterioration in the perception on both sub-indices, contracts/law and corruption. During the same period, comparators such as Morocco, Brazil, Indonesia and South Africa were able to improve their relative ranking on this front. Despite the fact that some other comparators slipped back during the last year on this indicator, none has dropped by as many as 12 places, as in the case of Egypt.

Both components of the public institutions index, contracts/law and corruption, lost significant ground, amounting to 10 places in the former and 12 in the latter (from No. 47 to No. 57 and from No. 67 to No. 79 respectively). Under the contracts/law component, judicial independence retreated from No.59 to No. 98, whereas favoritism in decisions of government officials went from No. 26 to No. 55 under the corruption component.

Figure 2.1: Developments in Egypt's Position in the GRCI



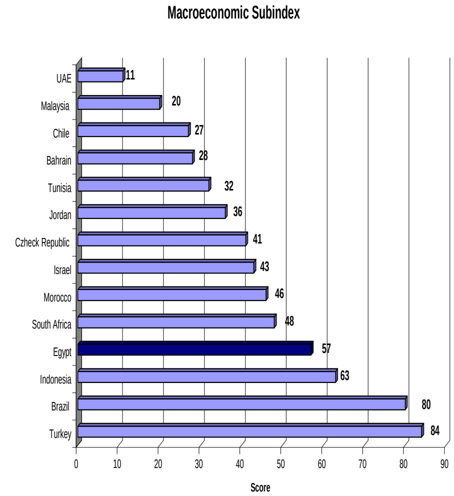
Source: World Economic Forum, Global Competitiveness Report 2004/2005.

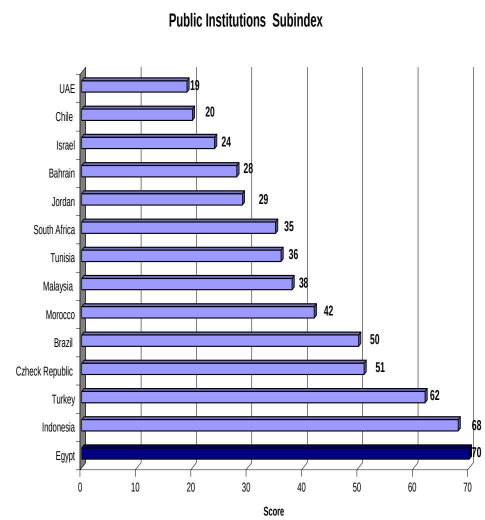
In the **macroeconomic environment** index, Egypt's ranking slid back slightly to No. 50 compared to No. 56 a year earlier, mainly because the country's credit rating sub-index fell 10 places. During the same period, the other two sub-indices (macroeconomic stability and government waste) each improved by four positions. However, the decline in the credit rating sub-index seemed to outweigh the improvement of the other two components. Best performers from the selected comparators on this front are the UAE (No. 11), Malaysia (No. 20), Chile (No. 27) and Bahrain (No. 28). The UAE ranked No. 2 among 104 countries with respect to minimizing government waste, whereas Tunisia was No. 4, Malaysia No 11 and Bahrain No. 12.

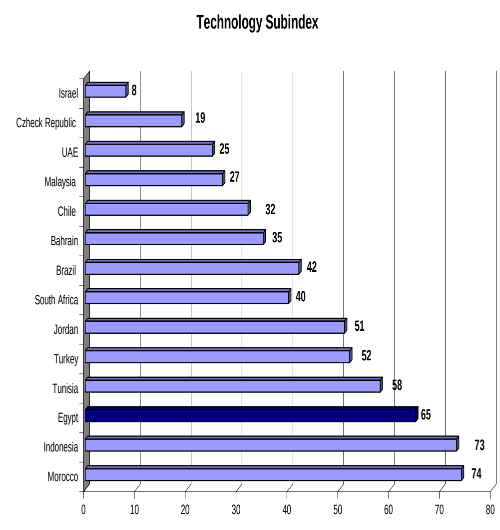
Also, on macroeconomic stability, some regional comparators scored very favorably on the international scene. Bahrain (No. 11), UAE (No. 12), and Jordan (No. 13) appeared high on international rankings. It is worth noting that the UAE ranked first on the survey with regard to recession expectations.

With regards to the **technology** index, Egypt's position improved by three ranks to No. 65 in 2004 compared to No. 68 in 2003 due to a notable improvement in the technology transfer sub-index, which jumped 12 ranks from No. 44 last year to the No. 32 this year. This indicator more or less captures the degree of technological spillover accruing from foreign sources (either through foreign direct investment or through licensing) as indicated by the respondents to the executive survey.

Figure 2.2: GRCI Sub- indexes for the selected countries







Box 2.2: Egypt's Readiness on the ICT Front

The Global Information Technology Report (GITR) is the result of ongoing efforts by the World Economic Forum to capture possible drivers of national competitiveness. The report aims at assessing the impact of recent developments in information and communication technology (ICT) on the competitiveness of various economies.

The Networked Readiness Index (NRI) is the flagship index developed to steer the analysis. The index measures the propensity for countries to exploit the opportunities offered by ICT and sets up a global comparison detailing the underlying factors for such aptitude. The concept rests on three fundamental pillars: the first captures aspects of the environment of a given nation for ICT development; the second looks at actual levels of networked readiness of individuals, businesses and governments; whereas the third traces actual levels of usage of ICT by these three groups.

Over the previous year, Egypt managed to improve eight ranks on the overall index. The table below shows Egypt's ranking on the different sub-indexes. For the environment sub-index, it was the only one to witness a decline on the sub-components. Egypt retreated seven ranks, basically due to its poor performance on the market and infrastructure environment sub-indexes.

Networked Readiness Index	Egypt	
	03-04	04-05
	65	**57**
Environment	***60***	***67***
Market Environment	49	65
Political and Regulatory Environment	66	64
Infrastructure Environment	65	75
Readiness	***71***	***63***
Individual Readiness	72	78
Business Readiness	60	81
Government Readiness	77	45
Usage	***63***	***51***
Individual Usage	77	75
Business Usage	72	56
Government Usage	44	26
Government success in ICT promotion, 2004	35	16
Government online services, 2003	44	47

On the other hand, the readiness and the usage indexes improved over the last year. The first jumped from No. 71 to No. 63. In this regard, the government readiness index recorded notable advancement, jumping to No. 45 from No. 77. The improvement of the whole readiness sub-index helped account for this dramatic change, given the deterioration of the other two components: individual readiness (No. 78 to No. 72) and business readiness (No. 60 to No. 81).

On the usage front, Egypt managed to jump from No. 63 to No. 51. Advancement took place across all sub-indexes. Most notably, in government usage Egypt moved from No. 44 to No. 26. A favorable government performance, both in readiness and usage, ostensibly reflected positively on the overall performance of Egypt.

Among the comparators, one can observe a similar performance as that detected in the Global Competitiveness Report. Chile still maintains the highest ranking among the Latin American countries, ranking 35th on a global scale, well ahead of its regional competitors: Brazil (No. 46), Mexico (No. 60) and Argentina (No. 76). South Africa and Tunisia maintained their leading placement among the 23 African countries included in the index, respectively ranked No. 34 and No. 31, up from their rankings of No. 37 and No. 40 the year before. United Arab Emirates (UAE) and Bahrain seized on their privileged positions (where they are both included in the index for the first time), respectively appearing at No. 23 and No. 33. As noted in the report, the UAE's first-rate performance seems to be the result of a successful government strategy in promoting ICT penetration and usage.

On the overall scale, Singapore was seeded, for the first time, the best in the world in exploiting global ICT developments. This is chiefly attributed to its exceptional performance with regard to the ability of individuals and the government to utilize the potential of ICT, as well as actual government usage of ICT. The report underscores again the tangible role played by the government in promoting ICT penetration and usage, together with the quality of the country's educational system and its proficient use of foreign technology.

By examining the sub-indices more closely, we can detect that a substantial part of the advancement stems from FDI and technology transfer.

This improvement in the technology index in Egypt, albeit slight, marks a positive perception among executives regarding the capacity for technological attainment in the economy. However, in a comparative context, some comparators made even more significant strides on this front. For instance, South Africa occupied 1st place compared to 3rd place last year in the technology transfer sub-index, where the UAE and Bahrain occupied 5th and 9th place. Increasing their attractiveness for FDI has arguably given these countries greater exposure to modern technology and organizational practices.

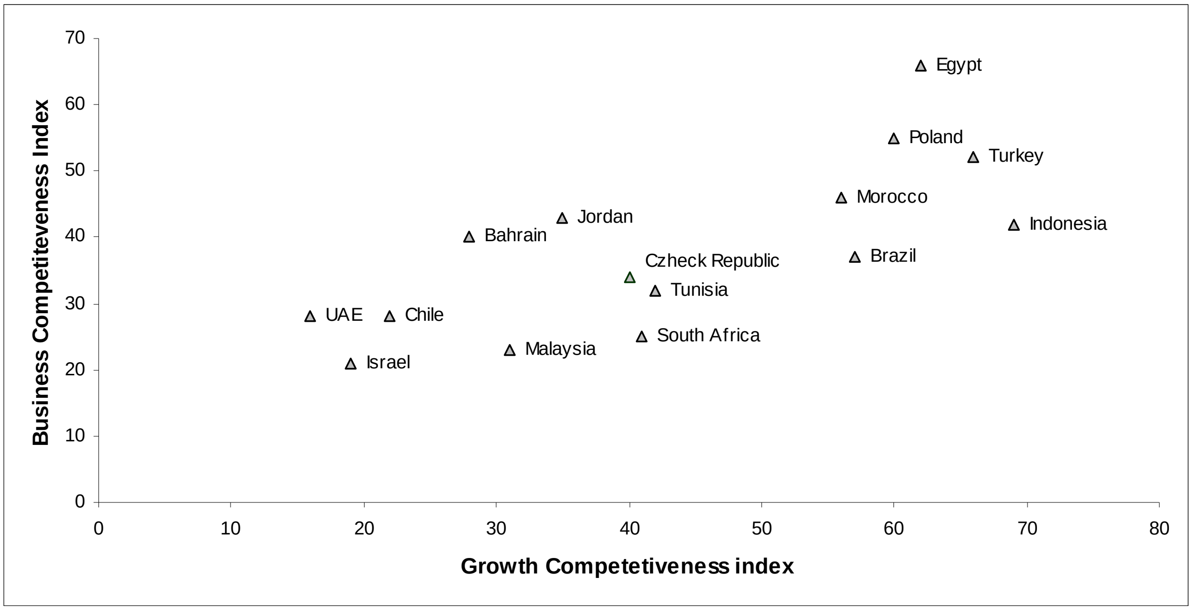
On the innovation sub-index, Egypt's position is favorable as it outranks all comparators except for Chile and the Czech Republic, and some international comparators such as Indonesia, Malaysia, and South Africa. Finally, the ICT sub-index is an area of concern as Egypt lagged behind most comparators, ranking No. 73 in 2004 compared to No. 69 in 2003. Regional comparators that ranked higher for digital infrastructure and ICT readiness include UAE (No. 33), Bahrain (No. 41), Turkey (No. 52), Jordan (No. 57) and Tunisia (No. 60).

As mentioned in Chapter 1, the technology transfer sub-index is only attached to non-core innovating countries as classified in the Global Competitiveness Report; it places additional weight to an aspect were such economies should have a competitive edge. Regarding Egypt, this implies that working more on improving the county's capacity to adopt technology, *inter alia*, will definitely help boost the country's competitiveness. This is not withstanding the innovation and ICT subcomponents. Egypt's track record has been rather modest, but is expected to pick up in the medium term in response to ongoing reforms in the ICT realm.

2.2 THE BUSINESS COMPETITIVENESS INDEX (BSCI): UNRAVELING THE MICRO-FOUNDATIONS OF COMPETITIVENESS

The BSCI is designed to capture the microeconomic elements of the competitiveness of the business environment and the factors conducive to increased productivity at the enterprise level. This year Egypt ranked 66th out of 104 countries on a global level compared to 58th out of 102 countries last year. This index also includes the newcomers that precede Egypt: the UAE (No. 28), Bahrain (No. 40) and Cyprus (No. 45). The retreat in Egypt's position can also be traced to its downgrading on the two main components of the BSCI: the company operations and strategy index, and the quality of the national business environment index. On the former, Egypt's rank slid back two places to occupy the 57th slot in 2004, whereas in the latter category Egypt's relative position retreated six spots to No. 68 in 2004.

Figure 2.3: Correlations among the BSCI and the GRCI (2004)



As shown in Figure 2.3, it has been observed as a pattern among the world's economies that rankings on both the BSCI and the GRCI reinforce each other. This finding suggests that to improve Egypt's growth potential, it is imperative to increase the competitiveness of all aspects of the domestic business environment. The figures appear to show that Egypt is lagging, implying that the pace of reform needs to accelerate if Egypt is to leapfrog from its current position to approach some leading regional comparators such as the UAE, Bahrain, Jordan, and Tunisia.

As shown in Figure 2.4 below, the developments over last year mark a declining trend in Egypt's international competitiveness. Egypt's rank fell from No. 40 in 2001 to No. 58 in 2003, and finally to No. 66 in 2004. As indicated earlier, most of the sub-indices under the BSCI are 'soft' indicators reflecting the perceptions of businessmen participating in the survey. With a prolonged recession in the economy starting in the late 1990s, an inadequate government response, and the slow pace of institutional and structural reforms, Egypt's image in the past few years has suffered in the opinion of domestic and international investors. Significant improvements in the business environment in neighboring economies reinforced this negative perception.

As such, there is anecdotal evidence that the government's recent reform package has helped turnaround the mood of investors. This is expected to be followed by a gradual improvement in Egypt's international competitiveness ranking, which will also be bolstered by the improvement in the macro-fundamentals as the economy reaps the benefits of past and ongoing reforms (see Box 2.6).

Figure 2.4: Developments in Egypt's Position in the BSCI

2000	2001	2002	2003	2004
18 Israel	17 Israel	18 Israel	20 Israel	21 Czech Republic
26 Chile	29 Chile	26 Malaysia	26 Malaysia	23 Malaysia
29 Turkey	34 Czech Republic	31 Chile	32 Chile	28 Chile
30 Malaysia	35 Turkey	32 Tunisia	33 Indonesia	32 Tunisia
35 Jordan	37 Malaysia	34 Czech Rep.	41 Jordan	34 Czech Republic
39 Egypt	**40 Egypt**	38	49 Morocco	40 Bahrain
47 Indonesia	45 Jordan	48 Morocco	52 Turkey	42 Indonesia
	55 Indonesia	53 Jordan	**58 Egypt**	43 Jordan
		54 Turkey	60 Indonesia	52 Turkey
		64 Indonesia		**66 Egypt**

Source: World Economic Forum, Global Competitiveness Report 2004/2005.

Looking closer at the component indices of the BSCI, and in particular the **company operations and strategy index**, it appears that Egypt's downgrade owed to factors such as the capacity for innovation, company spending on R&D, breadth of international markets, and the nature of competitive advantage. Some of those concerns are acknowledged by observers of the Egyptian economy as there is a growing consensus that Egypt needs to enter niche markets for innovation-intensive products, endorse R&D activities at the company level, and foster the linkages between R&D institutions and private sector enterprises to leverage its competitiveness status. However, the concerns related to the nature of competitive advantage and breadth of international markets are likely to be softened by ongoing efforts to remove supply-side and administrative hurdles facing Egyptian exports, ongoing efforts to open new non-traditional markets for exports, and the removal of the anti-export bias brought on by a previously over-valued real exchange rate.

With regards to the **quality of the national business environment** index, Egypt's retreat has occurred due to a number of factors, including the following: (i) perceived decline in the quality of human capital skills coupled with the a deterioration in the quality of education;[14] (ii)

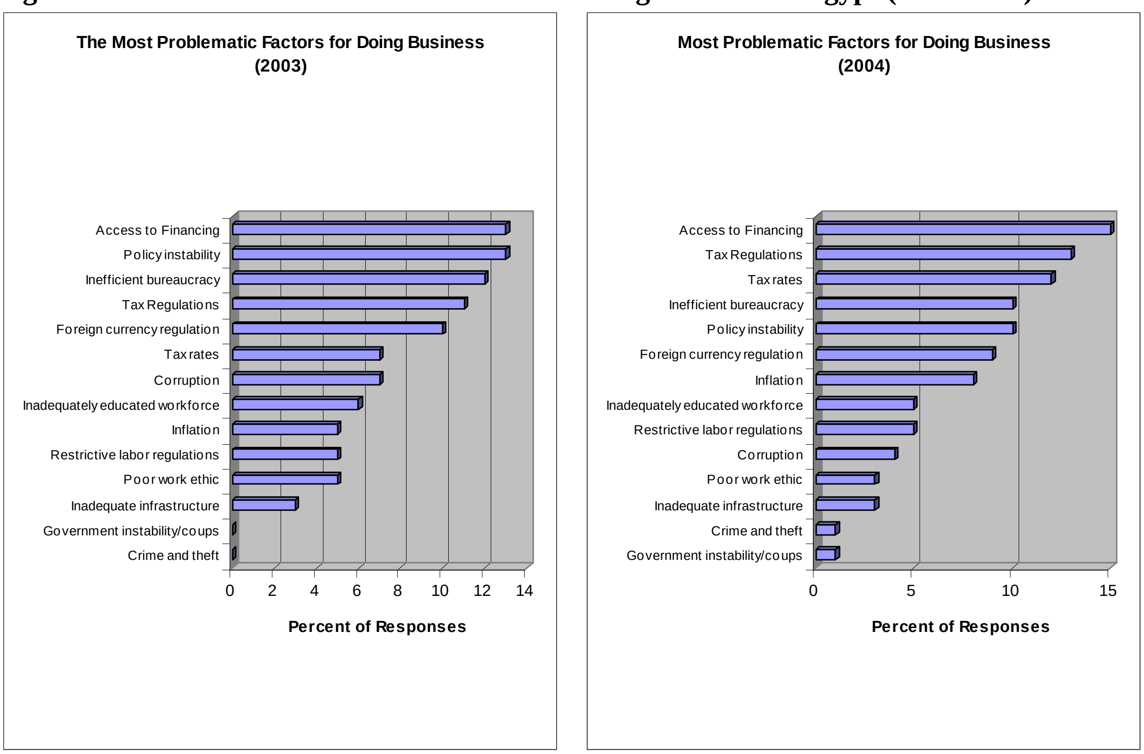
[14] Recently it has been documented that the availability of advanced technical skills in the national labor force is a key driver for successful industrial performance and overall improvements in international competitiveness.

concerns over the ability of capital markets to address the financing needs of the private sector; and (iii) the prevalence of factors that hinder domestic competition. Notwithstanding these concerns, there has also been an improvement in perceptions regarding some elements of the technology infrastructure, the extent and sophistication of supporting industries and services, as well as the overall incentive structure.

Figure 2.5 below lists the most problematic factors for doing business in Egypt, according to the results of the EOS. This list incorporates the responses of businessmen who were asked to select the five most problematic factors out of 14 factors. The bars in the figure show the responses weighted according to their ranking.

The results indicate that ***access to financing*** has topped the list for the past two years. The ***tax rate and tax regulations*** featured high on this year's list. Compared to last year, this problem seems to indicate mounting concerns raised by businessmen who are discouraged by a high corporate tax rate (based on international comparisons) and a burdening tax administration. However, a new tax law passed in June 2005 is expected to clear away some of these perceived obstacles in the near future.

Figure 2.5: The Most Problematic Factors for Doing Business in Egypt (2003-2004).



Source: World Economic Forum, Global Competitiveness Report 2004/2005

Also, ***inefficient bureaucracy*** has been a persistent problem identified by the list. In this regard, it is worth noting that one of the proposed solutions is the institution of e-government facilities. As indicated in the following chapter, a national project is underway that aims to make most government services available online for investors and the general public, which is expected to lower the burden of red tape. A more focused approach – also in the pipeline – entails the activation of the General Authority for Investment and Free Zones' (GAFI) one-stop-shop to

Box 2.3: Egypt's Ranking on the Environmental Sustainability Index

In recent years, various efforts have been made to develop indicators that quantify crucial concepts that have long been considered qualitative. Those concepts include governance, competitiveness and environmental issues. Such efforts were a result of ongoing demands imposed on policymakers to address the previous issues more rigorously. On the other hand, quantifying such concepts has revealed deficiencies and gaps in national policies, especially when international comparisons have pointed to the need for immediate action.

In that context, several indexes were established to trace environmental performance of countries around the globe. This fits perfectly with the emergence of environmental concerns as some of the most crucial variables considered in designing policies — to the extent that the environment receives as much attention now as growth and poverty.

Among the environmental indicators is the Environmental Sustainability Index (ESI), developed by Yale University. ESI benchmarks the ability of nations to protect the environment over the next several decades. It does so by integrating 76 datasets into 21 indicators of environmental sustainability, further grouped into five main categories: (i) environmental system, (ii) reducing environmental stresses, (iii) reducing human vulnerability, (iv) societal and institutional capacity to respond to environmental challenges, and (v) global stewardship.

The index is developed for 146 countries, among which Egypt ranked 115th. Regarding Egypt's scores on the sub-indexes, it scored a 40 on environmental systems, 41 on reducing stresses, 40 on reducing human vulnerability, 40 on social and institutional capacity, 54 on global stewardship. It's no surprise then that Egypt ranked among the last quartile of countries.

The low ranking of Egypt primarily owes to the following constraints:

Inadequate use of available resources and lack of public awareness: Egypt suffers from inadequate patterns of consumption, which results in a sustained drain on natural resources, be it water, soil, air, etc. This is chiefly attributed to the lack of awareness, both on the public and business levels, of the threats imposed by environmental damage.

Inadequate governance and public monitoring: Due to the preoccupation with economic and social problems, environmental issues did not feature high on the agenda of Egyptian policymaking. It was only in recent years, with the help of foreign donors, that resources had been allocated to environmental remediation. Moreover, it was not until 1994 that environmental laws were introduced in Egypt. On the other hand, there was no compensatory role detected on part of civil society organizations. Yet, it can be inferred that environmental awareness has been on the rise especially on the part of the government (in response to the mounting global attention to the problem) and the business side (in response to legal considerations constraining polluting industries).

Poor scientific and technological base: Most of the environmental solutions worldwide propose replacing old techniques with new cleaner technologies. Such techniques can be either be developed locally or imported through technology transfers from abroad. As such, the poor status of technological advancements within the Egyptian economy undermines the possibility of advancing solutions locally and suggests the need to capitalize on international resources (both financial and technical) made available for environmental purposes.

The argument above manifests the need for collaboration on a public-business-government front. Efforts should be directed towards raising public awareness and enforcing environmental laws. Collaboration from the business side can be shown by further commitment to clean industrial techniques. On the public front, civil society arrangements can help raise public awareness and curb inadequate consumption patterns.

cater to the needs of the business sector and curb time and monetary costs expended for establishing new businesses, not to mention day-to-day operations.

Policy instability has dropped to 5th place this year from last year's 2nd-place standing. Only 10 percent of respondents considered it a problem in 2004 compared to 13 percent in 2003. Respondents either believe recent policy reversals have staved off the possibility of instability or other problems have simply taken greater precedent. The tendency for unstable policies to undermine, to a great extent, the ability of businesses to plan ahead cannot be overlooked, as companies will ultimately associate higher risk to the business environment within a country. Thus, it is expected that the clear reformist approach adopted by the current government is likely to enhance the confidence of the investor community in the seriousness of commitment to reform.

Foreign currency regulation still features high on the list of impediments to business, occupying 5th place in 2003 and 6th place in 2004. This reflected the continued aftermath of the successive exchange rate devaluations and the short-term regulatory measures adopted to restore exchange rate stability. A major business concern has been decree 506, issued in March 2003, which forced companies to surrender of 75 percent of their export proceeds. The cancellation of the decree in December 2004 should help ease negative perceptions about foreign currency regulation in the 2006 Global Competitiveness Report.

Inflation occupies the 7th rank on the 2004 list, whereas it ranked 9th in the previous year. The percentage of respondents who considered it a problem increased by 3 percentage points this year, from 5 percent to 8 percent. However, it is important to note the temporary nature of this problem, which resurfaced after the successive devaluations of the pound. From 1997 to 2002, inflation development in Egypt has been very favorable, witnessing a continued erosion of inflation differential between Egypt and its main trading partners.[15] We already see that the temporary spike in inflation rates during 2003/2004 has subsided.

Inadequately educated workforce featured in the 8th spot for two years in a row. When speaking of raising the sophistication of company operations and strategy, the ability of the labor force to absorb and adopt innovative techniques is crucial. The low cost of labor is no longer sufficient to guarantee the attractiveness of an economy if productivity levels are low because the labor force lacks the basic skills demanded by modern business operations. The links between raising the quality of labor force and the quality of the educational and training system is of paramount importance in this respect.

Restrictive labor regulations received the same percent of responses in 2003 and 2004, with only a subtle variation in rank (from 10th to 9th). The inflexible hiring and firing rules do not only restrain entrepreneurs, but also deny workers the benefits of legal contracts by forcing them into jobs in the informal economy, where these rigid rules are ignored.

Other problems identified by the Executive Opinion Survey include corruption, poor work ethic, inadequate infrastructure, crime and theft and government instability. The first two are being addressed through a national strategy to promote transparency and fight corruption, which will be discussed later in Chapter 3. Upgrading the national infrastructure has long been a prime issue on the government's agenda, and there have been renewed efforts to engage the private sector in this regard. As for the problem of crime and theft and government instability, only 1 percent of the survey takers identified each of these as a problem in 2003, and these problems fell off the list after the 2004 survey.

[15] Improvements from 1997 to 2002, however, created two other pressing problems: (i) a real exchange rate over-valuation, which created an anti-export bias and affected the international competitiveness of Egyptian exports; and (ii) a high real interest rate, which has reportedly been a deterring factor for accessing bank financing.

Box 2.4: The Corruption Perception Index

The Corruption Perception Index (CPI) was developed to capture the perception of experienced business people and country analysts, both residents and non residents, regarding the level of corruption within nations. The index is measured for 146 countries by 12 independent institutions worldwide building on the results of surveys conducted in respective countries. The surveys produced converging findings, validating the results as a powerful tool for the detection of corruption.

The index is developed based on estimates of the losses in productivity and capital inflows due to corruption. This is done by comparing each country with the best scoring country in the CPI, Finland, and multiplying the difference in the CPI score by 4 percent of GDP for the first indicator (loss in productivity) and 0.5 percent of GDP for the second indicator (loss in capital inflows). As such, these are only crude estimates that serve to highlight the negative impact of corruption on a country's productivity and its ability to attract FDI.

The table below shows the rankings of Egypt and the other comparators. Egypt ranked No. 77 together with Morocco and Turkey. The estimated productivity losses in the three countries amounted to 26 percent of GDP, whereas lost capital flows were around 3.2 percent of GDP. Within the 13 countries, Chile ranked the best (No. 20) followed by the UAE and Bahrain. Ranking at the bottom of the list was Indonesia, where the productivity loss is estimated to be 30.8 percent of GDP and loss of capital inflows stood at 3.8 percent.

Country	Rank*	Productivity Losses Due to Corruption (% of GDP)	Lost Capital Inflows Due to Corruption (% of GDP)
Chile	20	9.3	1.1
UAE	29	14.4	1.8
Bahrain	34	15.0	1.9
Jordan	37	18.9	2.3
Tunisia	39	19.0	2.3
Malaysia	39	18.7	2.3
S. Africa	44	20.5	2.6
Czech Rep.	51	21.9	2.7
Brazil	59	23.2	2.9
Egypt	**77**	**26.0**	**3.2**
Morocco	77	26.1	3.3
Turkey	77	26.0	3.3
Indonesia	133	30.8	3.8

Source: Passau University Press Release on Transparency International Website.
* Countries may have the same rank if they score equally on the Corruption Perceptions Index.

High levels of corruption are usually associated with low-income countries due to the lack of sufficient resources to fight corruption. Yet the surveys identify poor countries that were able to score rather well in the index, e.g. Chile, Botswana, Oman and Uruguay.

It is worth noting that the relative ranking of Egypt against its peers is not drastically different from a number of other competitiveness indexes, implying a close association between fighting corruption and its impact on leveraging a country's competitiveness status.

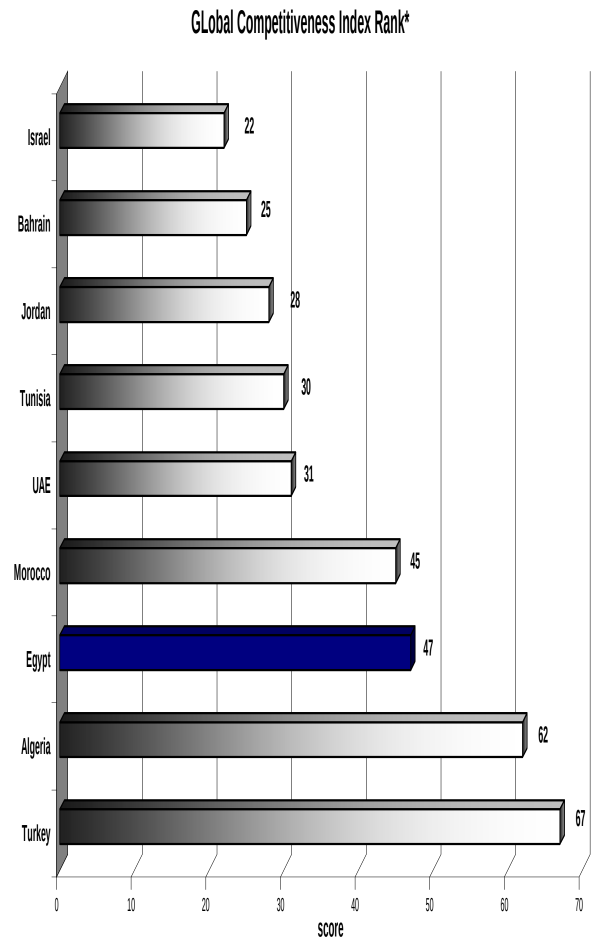
2.3 THE GLOBAL COMPETITIVENESS INDEX: EGYPT'S INTERNATIONAL COMPETITIVENESS IN A NEW LIGHT

The Global Competitiveness Index (GLCI) is a new indicator designed to combine (and eventually replace) the GRCI and the BSCI. The subcomponents of competitiveness are classified into **basic requirements**, **efficiency enhancers** and **innovation enhancers**. Different weights are assigned to each component according to the stage of development of each country.[16] Since this year is the first in the series, this section utilizes the GLCI to benchmark the stance of competitiveness of the Egyptian economy vis-à-vis others in the region.

As illustrated in Figure 2.6, Egypt occupies the 47th rank among 104 countries. This puts Egypt well ahead of its position in both the GRCI and BSCI (No. 62 and No. 66 respectively), given that all cover the same set of countries. Yet, it almost preserves the same ordering compared to the selected countries.

Before going into the analysis of subcomponents, it is worthwhile to look into the placement of each country on the spectrum of development. Egypt, Algeria, Bahrain and Morocco are considered to be in the 'factor-driven' stage, where more weight is given to the basic requirements. Tunisia is transitioning out of the 'factor-driven' stage to the 'efficiency-driven' stage, the latter of which includes Turkey. Israel is also transitioning into the 'innovation-driven' stage, where the UAE is currently the only country belonging to this group.

Figure 2.6: The GLCI of Selected Countries



* Higher ranks denotes lower competitiveness

[16] For further discussion of the composition of the index, please refer to Chapter 1.

Box 2.5: A Success Story of an Early Reformer: What Lessons Can Be Learned from the Chilean Experience?

With a twofold increase in GDP per capita over a twenty-year period, coupled with a 20% decrease in poverty within only a decade, the Chilean episode of reform is undeniably a success story despite some associated shortcomings. This is also manifest in a record on competitiveness that is way ahead of regional comparators; it outranks its closest regional competitors by more than 20 positions.

Significant reforms were initiated in 1984 after the severe crisis that hit the Latin American economies upon Mexico's announcement of default on external debt repayment, which created serious repercussions for Chile: accelerating inflation, GDP contraction, rising unemployment and accumulated foreign debt.

The need for reform was increasingly becoming a government priority. With regard to sequencing, according to Hernan Buc (minister of finance in Chile 1985-1959), the experience of reformers in Chile suggests that "it is necessary to proceed with all reforms at once and increase the pace in accordance with perceived prospects of success." Thus, the Chilean reform process can be seen as a comprehensive, far-reaching process that encompassed a broad range of aspects. It included reforms in the pensions and tax systems, the capital markets, trade liberalization, the functioning of the labor market, a momentous limitation of government intervention, and the privatization of state enterprises and social security.

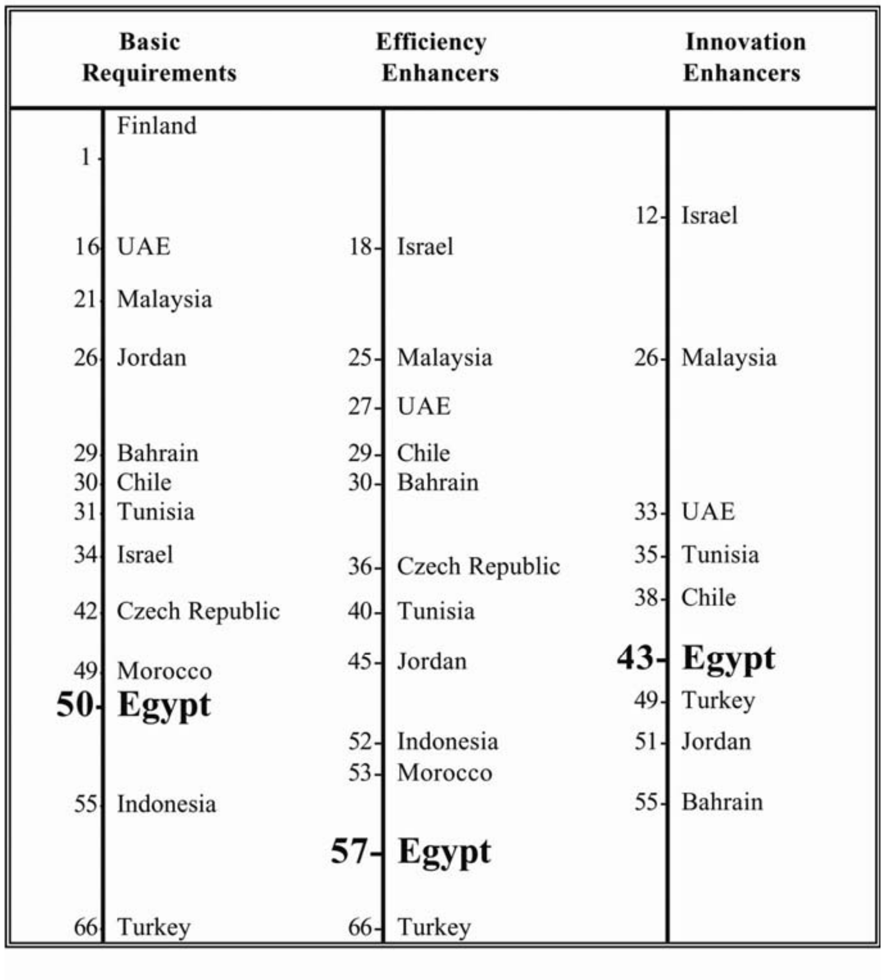
The following are key constituents of the Chilean recipe for success:

- ***Building consensus through promotion of transparency:*** The pillar of Chile's success has been the way successive governments were able to maintain public consensus. This was primarily a synthesis of high transparency and accountability together with the engagement of the government in consultations with different entities representing the private sector and civil society. This helped the public understand and endure the inimical effects of reform. The legitimacy of government has also been fortified by the tangible outcomes of the reform process embodied, for instance, in sustained growth and reduced poverty.
- ***Mobilizing domestic saving and enhancing financial markets:*** After the onset of the Latin American debt crises, chances to access foreign saving clearly withered. This meant that reform plans would have to rely on domestic savings. Consequently, corporate taxes were lowered, government spending was reduced and the Pension Fund Administrations (PFAs) played a special role by mobilizing substantial amounts of money to purchase shares in enterprises undergoing privatization.
- ***Instituting a solid macroeconomic framework:*** Chilean macroeconomic reforms are considered exemplary in many respects. First, the Chilean success rested on strict fiscal discipline, which was achieved by the effective isolation of the fiscal policy from surrounding political pressures. It served as a preset target of government balance, without making needless adjustment to cyclical ripples. Second, the central bank was guaranteed full independence and thus was able to bolster a credible monetary policy regime resting on inflation targeting. The outcomes were quite impressive, with inflation curtailed from 19.4 percent in 1990 to 1.3 percent in 2004.
- ***Promoting free trade***: Trade was seen to be a crucial element for the stimulation of competitiveness of various sectors of the Chilean Economy. Towards this end, several policies were adopted on the internal front (e.g. unifying the tariff rates and eliminating non-tariff barriers) and external front (concluding free trade agreements with Canada, USA, EU, Korea and European Free Trade Association). The liberal trade regime was also supported by strong institutional underpinnings.

Source: Global Competitiveness Report 2004-2005, Chapter 2.3.

From Figure 2.7 and Table 2.1, we see that Egypt appears at the bottom of the rankings compared to the selected countries in regards to **basic requirements**. Only Turkey, Brazil and Indonesia score lower. Basic requirements include institutions, infrastructures, macroeconomic stability, personal security and basic human capital. Within the basic requirements index, Egypt ranked the worst on the macroeconomic stability sub-index (No. 81), which places it among the bottom five within the sample of comparators. Egypt scored the highest on public institutions (No. 42), a rather favorable rank among the comparators. The country received modest scores on the other three sub-indexes: infrastructure, personal security and basic human capital. With reference to the last component (basic human capital), the forerunners among the comparator group were Israel, the Czech Republic and Chile.

Figure 2.7: The Composition of the Global Competitiveness Index (2004)



Source: World Economic Forum, Global Competitiveness Report 2004/2005.

Regarding **efficiency enhancers**, almost the same pattern holds, with Israel and the UAE leading and Egypt, Algeria and Turkey coming at the tail end of the group. Egypt ranked 40^{th} in the openness/market size index, whereas it ranked 72^{nd} in financial market efficiency; this is consistent with the sentiment that "access to credit" is the most problematic factor of doing business in Egypt, not to mention that this issue features high on the new reform agenda. It is worth noting that best performers within financial market efficiency were Israel (No. 16) and Chili (No. 19). On the other hand, two Arab countries performed particularly well in goods and labor market efficiency: the UAE and Bahrain. They were ranked 9^{th} and 20^{th} respectively in goods market efficiency; and 6^{th} and 19^{th} with respect to labor market efficiency.

For the **innovation enhancers** category, Egypt (No. 43) ranks tenth among its comparators. The highest achievers were Israel (No. 12) and Malaysia (No. 26). Within the sub-indexes rank, Egypt performed relatively well with regard to business sophistication (No. 34) in comparison to innovation (No. 56). Israel ranked 20^{th} and 7^{th} within the respective rankings.

Table 2.1: Rank of Selected Countries according to the GLCI (2004)

Global Competitiveness Index 2004 - 2005	Bahrain	Jordan	Tunisia	UAE	Morocco	Egypt	Algeria	Turkey	Malaysia	Chile	Indonesia	Czech Republic	South Africa	Brazil
	25	**28**	**30**	**31**	**45**	**47**	**62**	**67**	**23**	**29**	**48**	**38**	**36**	**49**
Basic Requirements	**29**	**26**	**31**	**16**	**49**	**50**	**48**	**66**	**21**	**30**	**55**	**42**	**46**	**67**
1. Institutions	25	31	24	21	40	42	70	71	19	29	51	72	27	55
2. Infrastructures	30	37	36	19	53	50	67	66	22	34	45	33	27	58
3. Macroeconomic stability	43	30	37	20	60	81	2	92	19	15	58	51	45	96
4. Personal Security	25	11	18	8	35	55	63	50	27	39	80	59	82	75
5a. Basic Human Capital	36	47	46	50	81	65	63	57	62	28	75	26	86	61
Efficiency Enhancers	**30**	**45**	**40**	**27**	**53**	**57**	**92**	**66**	**25**	**29**	**52**	**36**	**33**	**43**
5b. Advanced Human Capital	51	43	31	53	67	56	81	64	34	41	60	30	50	48
6. Good Market Efficiency	20	37	30	9	40	51	80	65	19	29	34	50	26	48
7. Labor Market Efficiency	19	38	32	6	28	44	76	70	10	26	74	27	61	52
8. Financial Market Efficiency	24	40	53	38	58	72	100	88	29	19	60	66	20	33
9. Technological Readiness	39	45	47	33	67	58	94	50	28	32	64	26	40	42
10. Openness/Market Size	68	56	51	41	48	40	92	42	26	25	25	34	59	28
Innovation Enhancers	**55**	**51**	**35**	**33**	**45**	**43**	**91**	**49**	**26**	**38**	**39**	**34**	**27**	**28**
11. Business Sophistication	48	62	36	28	40	34	93	41	30	32	44	38	29	27
12. Innovation	73	44	34	50	55	56	88	64	25	49	33	30	29	32

Source: World Economic Forum, Global Competitiveness Report 2004/2005.

2.4 Concluding Remarks: The Retreat in Competitiveness Masks Expectations of a Strong Rebound

The design of the competitiveness indices aims to reflect both the economic fundamentals as well as general investor perceptions of the economy. Economic fundamentals are reflected by ‘hard’ indicators such as country credit ratings, overall macroeconomic performance indicators (e.g. fiscal deficit, inflation, real effective exchange rate, interest rate spread, etc.), and also the physical and digital infrastructure (e.g. internet use, availability of telephone lines and personal computers, etc.).

On the other hand, the Executive Opinion Survey (EOS) gauges the general sentiment among investors and businessmen and women concerning competitiveness. Taken ever year, the EOS covers areas pertaining to the quality of public institutions, technological sophistication and potential, the sophistication of company operation and strategy, factor markets (infrastructure, human capital, technology, and capital markets), demand conditions, as well as the context for forming strategy and rivalry.

Box 2.6: The Government's New Reform Package

The newly appointed Cabinet has formulated a vision that is partial to the private sector's view of the most constraining factors in Egypt's business environment. The new reform package was built on four pillars:

- **Fiscal reform**: including reforming the tariff structure, introducing a new tax law to reduce income and corporate tax rates and improve the tax administration, and reforming the subsidy system.
- **Improving the investment environment**: including the launch of the Ministry of Investment, streamlining of all laws and decrees governing investment activities, evaluating the optimality of the current incentive scheme granted to investors, and improving efforts to attract FDI.
- **Financial sector reform**: including instituting operational mechanisms to solve the problem of non-performing loans, rationalizing the banking sector structure via bank mergers, improving bank management, and privatizing one state-owned bank and one state-owned insurance company.
- **Reinvigorating the privatization program**: including the restructuring and sale of public enterprises, and further engagement of the private sector in the provisions of public utilities.

The majority of the sub-indicators used in the composition of both indices are derived from the EOS, which is why investor sentiments and their general perceptions of a country's competitiveness status are key factors explaining the improvement/deterioration in a country's competitiveness. In the ensuing analysis, it appears that Egypt's rank has fallen back in both the GRCI and the BSCI, performing worse in the latter. Despite Egypt's retreat on some of the 'hard' indicators reflecting macro fundamentals, such as the worsening fiscal situation and the upsurge in inflation, the key factor behind Egypt's overall decline was due to the generally negative investor sentiment at the time the EOS was launched in March 2004.

During this time — as gauged by domestic and international surveys — both international and domestic businesspeople and investors felt that the government was not responsive enough to their pressing demands, and they started questioning the strength of the government's commitment to market-based reforms.

As we will see in the following chapter, the recent cabinet re-shuffle and the appointment of a new prime minister — Dr. Ahmed Nazif, previously Minister of Communications and Information Technology — has resulted in a clear reformist drive in the implementation and announcement of reforms long sought by the private sector. These changes have positively affected market sentiment. The departure from the old government's paradigm has been signaled by recurring official statements that recognize that increasing investment (both domestic and foreign) is the only way to achieve high and sustained growth rates to absorb the growing number of new entrants to the labor force.

The upshot of these reforms is expected to materialize soon and reflect positively on Egypt's rankings on international competitiveness indices. In the short-term, Egypt is likely to make some progress as a result of improvements in general market sentiments and investors' perceptions of the seriousness of the government's commitment to reform as it transitions to a market-based economy.

In the medium-term, it is expected that the fundamentals will also improve in what could possibly constitute a big push for Egypt's international competitiveness and a strong rebound in Egypt's regional position, as was the case in 1997 when Egypt not only outranked traditional regional competitors such as Jordan and Turkey but also today's rising stars such as India, Mexico, Poland, and South Africa.

For such short- and medium-term improvements to occur, it is imperative that the government continues with the instituted reform drive and deliver on the reform measures it has promised. It is also important to realize that the countries able to leapfrog were those that undertook comprehensive and far-reaching reforms at a reasonable pace.

Again, it's important to point out why the recent reforms are not captured in our analysis of Egypt's ranking in the competitiveness indices. They were all introduced after the Executive Opinion Survey was completed and, hence, their impact on market sentiment and business confidence is not measured by Egypt's most recent rankings. It remains to be seen whether Egypt's rankings on the various indices will show a measurable leap in next year's report.

The next chapter discusses in greater detail the economic policy shift brought on by the Cabinet's new economic team.

Box 2.7: Main Highlights of the Arab World Competitiveness Report 2005

In April 2005, the World Economic Forum released The Arab World Competitiveness Report 2005, the second systematic benchmarking exercise for competitiveness in the Arab world. The report attempts to benchmark the performance of Arab countries in a global context, identifying opportunities and threats facing the Arab countries in an ever-changing global era.

Despite disparities within constituent countries, the Arab world remains a region of distinct natural resource endowment that witnessed some of the highest investment rates in the world during the 1980s. Yet, international comparisons reveal the slow pace of integration of the Arab countries into the global economy as the region's share of global trade and capital flows falls short of its potential.

The report shows that a handful of Arab countries have occupied favorable competitive positions. Out of 12 Arab countries, Qatar ranked at the top of the list, followed by the UAE and Bahrain, showing that the small Gulf countries were able to supersede other larger economies (with greater populations and resource endowments).

Country	Overall Rank	Rankings Among the Sub-Components		
		Technology Index	**Public Institutions Index**	**Macro-economic Environment Index**
Qatar	**1**	2	1	1
UAE	**2**	1	3	2
Bahrain	**3**	3	4	4
Oman	**4**	9	2	3
Jordan	**5**	4	5	7
Tunisia	**6**	5	6	6
Saudi Arabia	**7**	6	8	5
Morocco	**8**	10	7	9
Egypt	**9**	7	10	10
Algeria	**10**	12	9	8
Lebanon	**11**	8	11	12
Yemen	**12**	11	12	11

Egypt ranked in ninth place, followed only by Algeria, Lebanon and Yemen (see above table). Egypt's rank is compatible with its overall position in the global ranking; its lagging position can be attributed to public institutions and macroeconomic deficiencies and a modest performance with regard to technological diffusion. Even within the technology index, Egypt is outpaced by other smaller economies such as Qatar, the UAE, Bahrain and Jordan. Egypt was highlighted as one of the countries still in need of deep-rooted reforms on many different fronts.

By gauging the views of several academics and intellectuals of the region, among others, the report has highlighted key challenges facing the region:

- **Improving macroeconomic management and deepening institutional reform.**

  Although a number of Arab countries have already attempted to embark on comprehensive economic and institutional reforms, their efforts have stalled for a number of reasons, including soft budget constraints, weakness of governance, reliance on oil, aid and strategic rents as well as a lack of accountability. Such flaws tend to surface whenever any discussions of competitiveness are involved.

- **Achieving better governance.**

  Governance issues were explored from different perspectives. Hence, key components for enhancing transparency in the Arab world were identified. This included accountability, pluralism, participation, the rule of law, the free flow of information, democracy, respect of human rights, gender equality and an educational environment that respects the innovative spirit of young people. The report underscored the special importance of revitalizing and mobilizing civil society, and enhancing public-private partnerships to develop a vision for change.

CHAPTER 3
WINDS OF CHANGE

In this chapter we discuss recent economic changes that have taken place since the new reformist government led by Dr. Nazif took office in July 2004. The Executive Opinion Survey conducted by the World Economic Forum was conducted in March 2004 and, hence, the results of the survey discussed in the previous chapter do not capture the robust and sharp change in the direction of economic policies during the past year. If we take into account the positive contribution of these reforms, we find that Egypt's economic outlook is palpably healthier compared to last year. Nevertheless, a number of challenges still lie ahead before Egypt can build a highly competitive, dynamic and private sector-led economy. These challenges are the subject of the next chapter.

The substantial progress attained to date covers the macro-economy; enhanced coherence, better governance, and consistency and stability in the domestic monetary/fiscal/trade mix; and accelerating structural reforms.

One limitation to measuring the impact of these changes is that the reporting does not address what has been accomplished with regard to each of the indices and sub-indices revealed in the World Competitiveness Report. Our team will continue to collect information on the sub-indices that haven't been handled this year, and next year's report will include analysis of Egypt's reform on a wider number of indices.

3.1 THE MACRO-ECONOMY

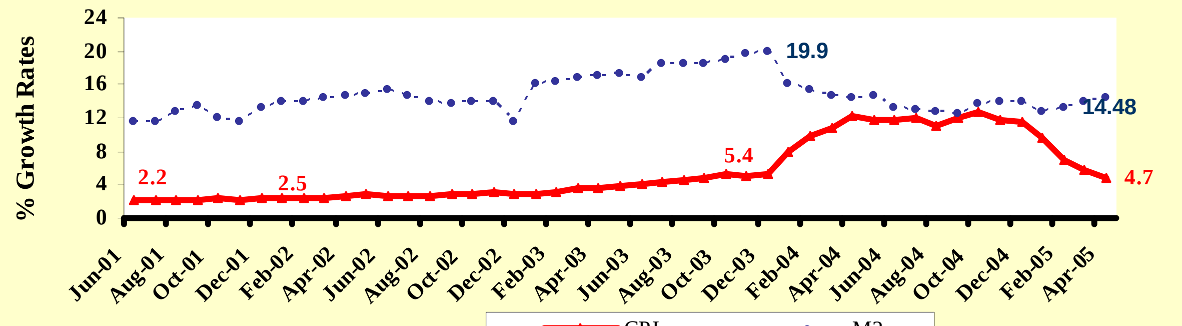
Economic policies took a new direction after the appointment of a reform-minded economic team in July 2004. Egypt's economy witnessed a turnaround during the past year as the economic team determinedly addressed important issues such as taxes, trade, monetary policy, and privatization. The economic team also launched plans for fiscal, budget and financial sector reforms

Following a period of slowdown that began in 2001, Egypt's economic growth rate strengthened to 4.3 percent in 2004. In the first half of fiscal year 2004/2005 real GDP growth rates reached 4.7 percent. The rebound in economic growth rates owed primarily to a strengthening of external demand and a moderate recovery in consumption. Growth in investment demand lagged behind and is expected to remain subdued in 2005. The strong recovery is expected to continue during the second half of the fiscal year (Ministry of Finance, December 2004).

An upturn in confidence is evidenced by a sustained bullish performance on the stock market since July 2004. Both Fitch and Standard and Poor's have upgraded Egypt's credit rating from negative to stable[17] (Press Releases by Fitch Ratings and Standard and Poor's).

[17] Egypt's credit rating is still one notch below investment grade.

Figure 3.1: Percent Changes in the CPI and M2 (June 2001-April 2005)

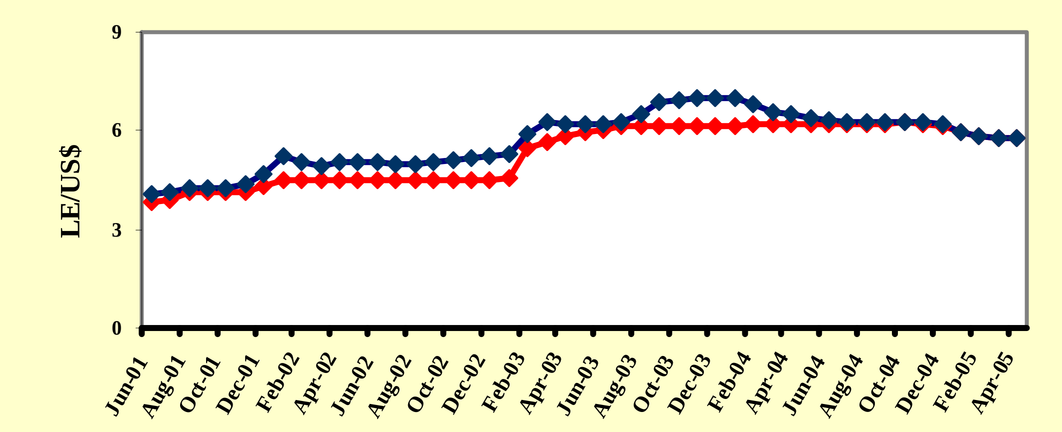


Source: CAPMAS, CBE

Macroeconomic policy was geared towards reducing inflation and stabilizing the foreign exchange market. This has paid off in terms of substantially lower inflation rates in the third quarter of the 2004/2005 fiscal year. Inflationary pressures had reached a record high in October 2004 as the consumer price index (CPI) recorded a growth rate of 12.7 percent. More recently, these pressures showed signs of cooling as the CPI growth rate started to glide downward in November 2004, falling to 5.7 percent in March 2005 (see Figure 3.1).

Monetary developments indicate that inflation will continue to subside. The Central Bank has contained last year's expansion of broad money growth (Figure 3.1), and tighter monetary policy has stabilized the exchange market. As a result, the official and parallel market rates converged in December 2004 (see Figure 3.2). The availability of foreign exchange improved by the end of the year following (i) the establishment of a formal interbank market for foreign exchange;[18] and (ii) the issuance of Prime Ministerial Decree No. 2059/2004 that canceled the surrender requirement of foreign exchange proceeds[19] (Ministry of Finance, March 2005). By the beginning of the new year, and in a liquid market, the exchange rate had moved to a market

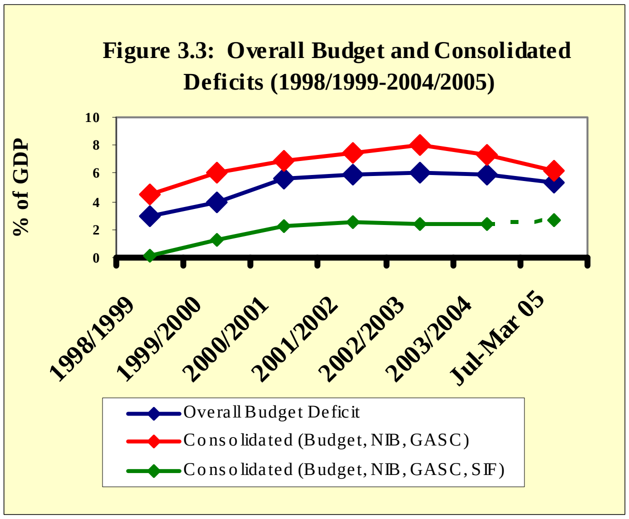
Figure 3.2: Official & Parallel Market Exchange Rates (June 2001- April 2005)

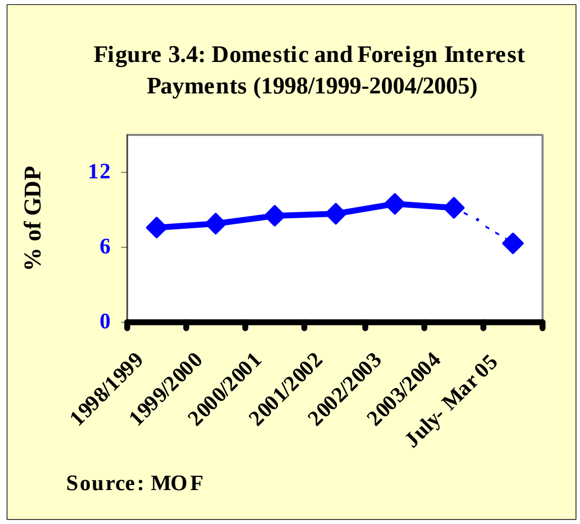


Source: CBE

[18] The interbank market was a critical component of the market infrastructure for a successful float.

[19] أصدر السيد رئيس الوزراء تم إلغاء قرار رقم 2059 لعام 2004 بإلغاء قرار رقم 2003/506 الخاص بإلزام المصدرين بتوريد 75% من حصيلة وارداتهم بالعملة الأجنبية إلى البنك المركزي.



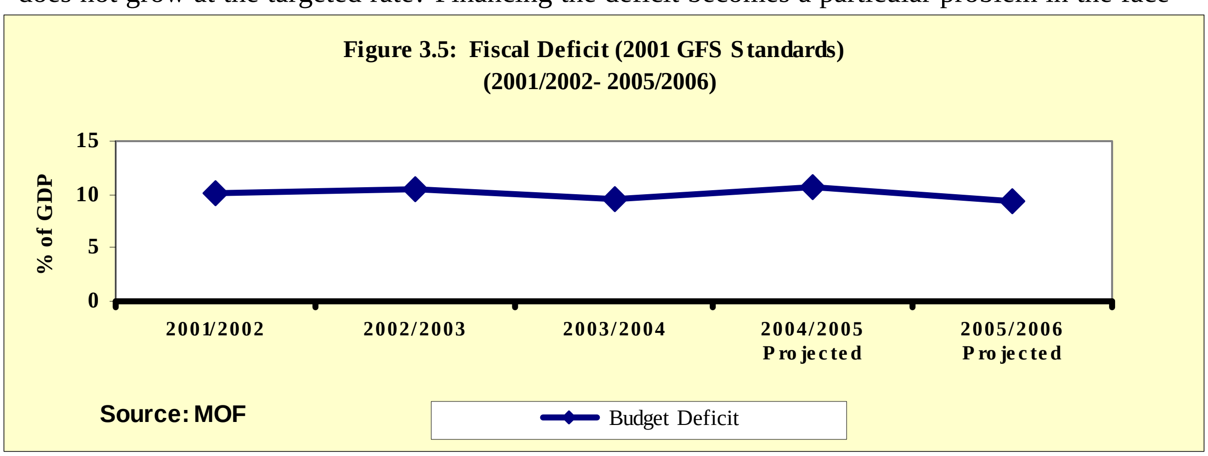


clearing level, and the Egyptian pound had appreciated by 44 piasters to 5.79 LE/$. Between December 2004 and March 2005, international reserves increased from $15.4 billion to more than $18.4 billion, supported by a large current account surplus (Central Bank of Egypt).

Budget deficits, however, have been growing for the past five years. No actual data for the 2004/2005 budget was available at the time this report was published.[20] However, Minister of Finance Youssef Boutros-Ghali (MOF, May 2005, p. 30) recently announced the budget figures for 2003/2004 through 2005/2006 in accordance with the IMF's 2001 Government Finance Statistics standards. The numbers show an increase in the deficit of one percentage point of GDP in 2004/2005 compared to 2003/2004. This is understandable given the ambitious and costly reforms that the government is undertaking. The Ministry of Finance projects that the budget deficit will lose one percentage point in 2005/2006 as the economy becomes more dynamic in response to trade and tax reforms.

While the budget deficit has witnessed a sizable increase in terms of absolute numbers,21 most if not all of the widening reflects the more transparent reclassification of the budget that made a number of expenditure items more explicit, including indirect subsidy figures. The Minister of Finance has announced that he intends to cut the budget deficit by 50 percent over a five-year period.

The question that remains is how long can Egypt sustain a large deficit if the economy does not grow at the targeted rate? Financing the deficit becomes a particular problem in the face



[20] Data for 3 quarters of 2004/2005 are available.
[21] According to the new GFS standards.

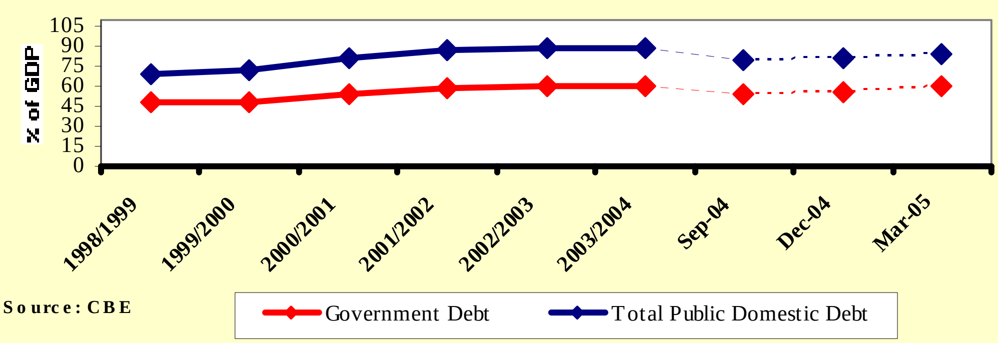
Chapter 3: Winds of Change

of the continued rapid rise in government and public sector debts. According to Jbili & Kramarenko (2003), Egypt has the second highest level of public debt in the region after Lebanon. As a percent of GDP, government debt was 61.7 percent in June 2004 compared to 58.4 percent in June 2002. More recently, the government debt to GDP ratio started receding as economic growth rates accelerated. In December 2004 government debt fell to 57.3 percent of GDP. Similarly, total public debt climbed from 87 percent in June 2002 to 89 percent in June 2004, before falling to 81.6 percent in December 2004 as growth picked up (Figure 3.5). It remains to be seen whether this trend will continue. Significant fiscal consolidation would still be needed particularly in the face of recent tariff reductions and tax cuts that will most certainly impact the budget in the shorter term. In this context, the challenge of fiscal consolidation will be addressed in Chapter 4.

Egypt's external position remains robust. The current account surplus was 4.4 percent of GDP in 2004 and preliminary balance of payments data indicates that it is expected to be higher in 2005. The strength of the current account was driven by an improvement in both exports and the services account. The fall in the value of the pound made Egypt more competitive, and an even more attractive tourist destination, while regional developments have served to boost traffic in the Suez Canal. While the trade deficit rose by some $1.2 billion in 2002/2003, total exports proceeds saw more than a $2.2 billion increase, and imports payments increased by $3.5 billion. Merchandise exports alone rose by $1.5 billion.

This contrasts to the pattern of past years when the improvement in the current account stemmed from a sharp decline in imports rather than an improvement in exports of goods and services. During the four-year period between 1999/2000 and 2002/2003 imports payments fell by some $3.1 billion from $17.9 billion to $14.8 billion. The trade deficit also fell by some $4.9 billion. During the same period total exports proceeds increased by a mere $1.8 billion, and merchandize exports by $900 million.

Figure 3.6: Total Public Domestic and Government Debts (1998/1999-2004/2005)



Source: CBE

Table 3.1: The Share of Exports of Goods and Services in Current Account Receipts (1999/2000-2003/2004)

US$ billions	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
Current account receipts	**34.9**	**24.4**	**20.6**	**23.6**	**30.8**
Total exports	6.4	7.1	7.1	8.2	10.5
% of receipts	*27.2*	*29.1*	*34.5*	*34.8*	*34.0*
Oil exports	2.3	2.6	2.4	3.2	3.9
% of receipts	*9.7*	*10.8*	*11.5*	*13.4*	*12.7*
Merchandise exports	4.1	4.4	4.7	5.0	6.5
% of receipts	*17.5*	*18.0*	*23.0*	*21.2*	*21.3*
Services	5.6	5.6	3.9	5.0	7.3
% of receipts	*24*	*22.9*	*18.9*	*21.0*	*23.8*

Source: Ministry of Finance, March 2005.

While the increasing growth rate of imports in response to lower tariffs could increase pressures on the trade deficit, the services surplus should remain unaffected and should more than make up for any pressures on the trade balance, keeping the current account in surplus. This is because the recent appreciation of the pound should not have a significant impact on either tourism or Suez Canal receipts. European tourists represent the majority of tourists arriving in Egypt, and Egypt continues to benefit from a strong euro (Ministry of Finance, March 2005). Suez Canal earnings will actually benefit from higher oil prices. Hence, the diversity of foreign exchange income in the current account should provide protection against external shocks.[22]

Table 3.2: The Share of Exports of Goods and Services in Current Account Receipts Jul-December 2003/2004 – July-December 2004/2005

US$ billions	**2003/2004**	**2004/2005**
	July-December	**July-December**
Current account receipts	**14.8**	**19.9**
Total exports	4.5	6.4
% of receipts	*30.5*	*32.1*
Oil exports	1.7	2.5
% of receipts	*11.5*	*12.6*
Merchandise exports	2.8	3.9
% of receipts	*19.0*	*19.6*
Services	4.0	5.2
% of receipts	*26.7*	*26.1*

Source: Ministry of Finance, March 2005.

[22] Fitch Ratings. January 2005. Arab Republic of Egypt: International Credit Update.

More impressive, we note that current account receipts are more diversified than before. The share of merchandise exports in current account receipts has increased from 17.5 percent in 1999/2000 to 21.3 percent in June 2004. While the share of oil exports has also increased, it remains below that of non-oil exports. Services account for 23.8 percent, and their share has fluctuated over the years due to their volatile nature.

The trend continues into 2004/2005. Data for the first half of the year shows that current accounts receipts are significantly higher compared to the same period last year. Oil exports rose to 12.6 percent following the recent escalation in oil prices. The share of merchandise exports, although higher than the corresponding period of last year, is less than the share of services. This is due to the appreciation of the pound since December 2004. Services (Suez Canal and tourism), which are not that sensitive to exchange rate fluctuations as noted earlier, are up to 26 percent of foreign currency receipts. It is still too early to judge the impact of recent trade and tax reforms on economic growth and activity, but it is expected that tariff and tax cuts will stimulate the business environment and manufacturing for exports.

Regarding the capital account, the deficit rose from $2.7 billion in June 2003 to $5 billion in 2004, reflecting weak investment flows and loss of confidence in government policies. The trend continued through the first quarter of 2005, which saw a capital account deficit of $2.2 billion. The second quarter, October-December 2004, saw a small surplus of $371 million, a testament to revived confidence in the economy.

The recent prudence in monetary policy is providing a stable environment for private sector activity. Private sector GDP grew by 4.3 percent in 2003/2004 compared to 3 percent a year earlier, and is projected to grow by 5.4 percent in June 2005. In contrast, growth in public sector GDP has been maintained at 2.9 percent since 2002. Growth in private sector credit, however, has declined from 9.5 percent in 2001 to 4.6 percent in 2004 (Ministry of Finance, March 2005). One reason is that the credit excesses of the late 1990s and the subsequent penalization of both failed businessmen and bank officials are hindering the recovery of private sector growth. A second reason relates to the high levels of government debt that are crowding out private investments.

Equally important, the Central Bank needs to be strengthened as an independent institution capable of preserving low and stable inflation, implementing the limits on financing of the budget stipulated in the recent banking legislation, and improving coordination with the Ministry of Finance (Oxford Analytica, December 2004). A new Commission has recently been formed to coordinate monetary and fiscal policies. A Monetary Policy Unit has been set at the CBE, and has recently issued the first of periodic announcements about the CBE's short-term monetary policy strategy.[23]

In the meantime, the Central Bank is working on developing a monetary policy framework that anchors inflation expectations. The ultimate goal of the Central Bank is to implement an inflation targeting monetary framework using indirect market instruments to control liquidity in the market. In the short term, broad money (M2) will be used as an intermediate target and nominal anchor.

[23] See www.cbe.gov.eg

3.2 ENHANCING GOVERNANCE/TRANSPARENCY, COHERENCE, CONSISTENCY AND STABILITY IN THE DOMESTIC MONETARY / FISCAL / TRADE MIX

3.2.1 Governance/Transparency

The new Cabinet has adopted the flagship notions of transparency and good governance. These concepts are reflected in the overall paradigm of reform. Below is a brief overview of how transparency and good governance form the cornerstone of the government's economic reform agenda.

3.2.1.1 Special Data Dissemination Standards (SDDS)

The SDDS was established by the IMF in 1996. It is intended to guide member countries in providing economic and financial data to the public. On January 31, 2005 Egypt subscribed to the IMF's Special Data Dissemination Standard (SDDS). This is a major step towards improving the reliability of Egypt's official statistics. It is also a testament to the new government's strong commitment to transparency and to implementing international best practices in statistics. These practices include the dissemination of timely and comprehensive statistics, thereby contributing to the pursuit of sound macroeconomic policies and the improved functioning of financial markets (Ministry of Finance, March 2005).

3.2.1.2 Transparency Reached by E-Government

The following section illustrates the Ministry of State for Administrative Development's (MSAD) role in creating a good governance environment. It explains how e-government solutions and services could be used to fight corruption.

E-government solutions and services are classified in three categories: Government to Government (G2G), Government to Business (G2B) and Government to Citizens (G2C).

For the G2G, services are clarified by the automation of the governmental offices project. This project's objective is to re-engineer the workflows of all the governmental services through all stages and converge it into one step that can be accessed through the e-government. This yields to better performance of employees, minimization of expenses and, in turn, less time and effort wasted by citizens seeking services.

For G2B, services aim to make the business procedures easier and efficient for all companies, investors, suppliers and exporters. This is done through some very important e-government services, such as:

- Taxation and customs services
- Electricity bills for businesses
- Licensing of new businesses
- Merging of two companies
- Filling in tax forms
- Inquiring about shipping charges and exchange rates

For G2C, today there are 590 inquiry services that provide citizens with information about documents and procedures for government services. In addition, over 50 services are now available that can reach customers wherever they are located.

3.2.2 Enhancing Coherence, Consistency and Stability in Monetary Policy

To pull the economy out of recession an expansionary fiscal policy was adopted to increase aggregate demand. In a small open economy with limited exchange rate flexibility and some capital mobility (which is the case in Egypt), fiscal policy is more effective in stimulating domestic demand or inflation, whereas monetary policy is more effective in addressing balance of payments problems (Wong, 2002.)

While the expansionary fiscal policy served the purpose of stimulating aggregate demand and reinvigorating economic activity, the rising fiscal deficit is not sustainable. With this in mind, the Ministry of Finance and the Central Bank must consider the appropriate mix of the fiscal, monetary and exchange rate policies that will deal with any rising macro-imbalances. Establishing a flexible exchange rate will allow monetary and fiscal policies to concentrate on addressing effects on production, domestic demand, prices, the budget, foreign assets and liabilities in the banking system. A fixed exchange rate policy will force the Central Bank to take into account the impact of monetary and fiscal policies on the exchange rate to the exclusion of other variables.

Moving to a more flexible exchange rate was thus necessary, albeit long overdue, to reinvigorate economic growth. Still, a few questions need to be answered: (i) how will the Monetary Authority ensure the continued implementation of an exchange rate policy that is supportive of the monetary/fiscal policy targets of production and growth, (ii) how will the Monetary Authority ensure that there is no policy reversal to a system with limited exchange rate flexibility (Wong, 2002).

Towards that end, the Central Bank of Egypt is currently developing a supporting institutional framework for monetary policy: a new banking law was introduced in 2003, and a committee to oversee the modernization of its monetary policy infrastructure was recently established. The recently created interbank foreign exchange market should facilitate greater liquidity of the market through the development of spot and forward markets for foreign exchange. The Central Bank is also working towards developing a monetary policy framework that effectively anchors inflation expectations in the context of a flexible exchange rate and a proactive interest rate policy. A Monetary Policy Unit has been established at the Central Bank to communicate the direction of monetary policy to the market using broad money as a nominal anchor in the short run and inflation targeting as the anchor in the medium term.

3.2.3 Enhancing Fiscal Transparency

Fiscal transparency is reflected in the issuance of a new tax law and the adoption of the IMF's GFS standards for the Egyptian budget.

3.2.3.1 Taxes

The new tax law makes the Egyptian tax system more transparent for all taxpayers. Income tax brackets have streamlined into three categories only, at rates of 10, 15 and 20 percent. Avoidance of numerous taxes that yield limited revenue will facilitate tax assessment and discourage the impression of excessive taxation. Thus, the change is expected to yield a higher degree of participation among taxpayers. Additionally the tax law grants general amnesty for past tax evasion or other offences, and provides for many transitional provisions in order to encourage businesses in Egypt's informal economy to legalize their status. The new law also introduces high deterrent penalties against tax fraud (Ministry of Finance, December 2004). Further details on tax reforms are illustrated in the next section.

3.2.3.2 The Budget

The Ministry of Finance recently announced that the 2005/2006 budget has been published according to the 2001 GFS standards, making the Egyptian budget comparable to other countries' budgets. The budget legislation enacting the GFS standard was passed in June 2005. Under the new standards, the budget deficit has been reported to increase to 10.3 percent because, for the first time, it includes all indirect subsidies. Recent announcements about pension reforms and increasing the efficiency of social spending will help enhance budget transparency.

The new legislation introduces many elements of transparency into the budget. The annual budget will be developed within a consistent medium-term macroeconomic framework. As a step towards transparency, a medium-term macro-fiscal strategy will be prepared along with an annual statement on progress towards the objectives in the strategy. The new legislation incorporates a section about the minimal amount of information required to conform to international standards of transparency. Other requirements concern periodic and regular publications on budget implementation to ensure that budget execution is in line with budget objectives.

Concerning the transparency of government expenditures, introducing performance budgeting and enhancing reporting and auditing procedures will help improve the quality of information on expenditures. This will allow the society and public to question the performance of spending units, thus establishing more control on the expenditure decisions of spending units (Ahmad et al., April 2005).

3.2.4 Enhancing Trade Transparency

Before the trade reforms of September 2004, the structure of customs had been complex and the rate schedule was ambiguous. This had led to disputes and delays in processing imports. As a first step towards greater transparency, distortions were eliminated as tariffs were cut. Tariff brackets were streamlined from 27 to only 6. The reductions in tariffs and the elimination of exemptions have served to rein in corruption through curtailing the discretionary assessments of imported goods. This helped eliminate the ambiguity accompanying the valuation procedures at the borders, resulting in further transparency and credibility of the system.

3.3 PUBLIC DEBT

Moody's (2005) views the nature of the Egyptian local currency debt as partially reassuring, despite the continuous increase in debt levels, thanks to the following mitigating factors:

1. A mere 20 percent of the domestic debt is tradable.
2. Most of the debt carries medium- to long-term maturities.

3. About 80 percent of the debt is held by domestic public sector institutions, reducing refinancing risk.
4. The existence of a very large amount of deposits in the banking system at large provides some comfort.

3.4 STRUCTURAL REFORMS GATHER SPEED

To improve the incentives for private investment, the government has announced that it will accelerate the pace of a number of structural reforms directed towards reducing the role of the state, improving governance, and removing administrative barriers to market forces. Confidence in the economy is high as the new Cabinet has taken pains to avoid the typical rhetoric in favor of adopting a number of bold reforms. The reforms touched almost all areas of economic activity. A brief account of these reforms is presented below.

3.4.1 Continued and Accelerated Implementation of Trade Liberalization Policies

During the first few months after the new Cabinet took charge, several positive developments in the area of trade policy took place. The main intention was to further liberalize trade and open up the Egyptian economy to achieve the government's export promotion goals. Hence, a number of new initiatives were taken on in addition to corrective measures designed to deal with the so-called tariff distortions.

The first of these new initiatives was the adoption of a comprehensive trade liberalization strategy comprised of tariff adjustments, a rationalization of the tariff structure, the abolition of fees and surcharges, and the reduction of customs exemptions. Towards this end, tariffs were cut across the board, affecting almost all the tariff lines. The weighted average tariff fell from 14.6 percent to 9.1 percent and all surcharges and service fees were abolished. These recent changes are different from previous tariff reforms in two respects. First, they took into consideration the different stages of production, meaning that differences between tariffs on final products were higher than those on intermediates and, in turn, differences between tariffs on intermediates were higher than those on inputs. Meanwhile, most of the tariff distortions, where tariffs on inputs or intermediate products were higher than final goods, were corrected to reflect the rationale of having higher tariffs on final products. The differences between tariff levels were reduced, which helped to reduce tariff dispersion. The second difference related to tariff peaks. Tariffs on passenger cars (less than 1600 CC) were reduced by differing amounts.

Another new initiative was narrowing down the so-called tariff bands (or brackets) from 27 to only 6. Other customs reforms that serve to improve transparency include:

- Streamlining procedures to be on par with international standards and conventions (e.g., pre-arrival clearance).
- Introducing up-to-date techniques such as risk management and post audit.
- Expanding the electronic handling of documents.
- Streamlining customs procedures and minimizing discretionary exemptions and import controls.

A second round of reductions in December 2004 further lowered tariffs on inputs and intermediate goods by more than 50 percent (Ministry of Finance, December 2005).

3.4.2 Tax Reforms

Parliament passed a new tax law in June 2005 that overhauls personal and corporate income taxes. The new tax law makes the Egyptian tax system more transparent. It cuts personal and corporate income taxes and unifies tax exemptions and legislation. It introduces a 50 percent reduction in personal and corporate taxes to a maximum rate of 20 percent. (Ministry of Finance, December 2004).

The law also provides for phasing out tax exemptions for newly established companies. The law is intended to encourage the voluntary submission of returns by taxpayers, timely payment of taxes, and greater compliance of citizens who previously evaded taxes. A key element of the law is the introduction of self-assessment for taxpayers. The Tax Authority will also limit their inquiries to a sample of some 5 to 10 percent of all taxpayers, thus ending the long practice of discretionary assessments that only served to cultivate mistrust and tax evasion. Stiffer penalties will pose a greater disincentive against tax fraud (Ministry of Finance, March 2005).

3.4.3 Financial Sector Reforms

The Government has announced that it is strengthening the financial system through structural reforms, mergers and large-scale privatizations of joint venture banks and public enterprises. It has also announced an ambitious financial sector reform plan.

Concerning the divestiture of banks and state enterprises, it has announced the impending sale of one state-owned bank during 2005. Between July 2004 and March 2005 stakes divested in 17 non-financial enterprises and two financial institutions have brought in privatization proceeds of $2.35 billion, surpassing total proceeds in the last four years.

On the issue of overhauling the financial sector, the government has on more than one occasion announced that it has embarked on a financial sector reform plan that aims at increasing the role of the private sector in the economy through (i) strengthening the banking system by privatizing the smaller public sector banks and joint venture banks; (ii) restructuring public sector banks, including through recapitalization; (iii) resolving the problem of non-performing loans; (iv) privatizing insurance companies.

Achievements to date include mergers/sales of four joint venture banks. Another nine transactions are in the pipeline for implementation by the end of 2005. In preparation for its privatization, the Bank of Alexandria is currently being audited under the supervision of an international firm.

With assistance from the European Union, the Banking and Restructuring Unit at the Central Bank is in the process of assessing the risk profile of the portfolios of the three remaining public sector banks. This work is being complemented by efforts of the Non-Performing Loans Unit at the Central Bank to resolve bad loans as well as disputes between banks and borrowers.

3.4.4 Implementation of a Solid Regulatory Framework to Attract Foreign Direct Investment

The Egyptian Competitiveness Report 2003/2004 concluded with a set of recommendations to guide a solid government policy to attract foreign direct investment (FDI). Below is a short review of the progress achieved throughout the past year.

With regard to the first recommendation, which pertains to **articulating and advocating a national policy on FDI,** the newly created Ministry of Investment is currently taking the lead in preparing a comprehensive Investment Policy for Egypt in consultation with private sector investors and business associations. This investment policy will be published in due course after it's revised by the Ministerial Economic Committee and approved by the Cabinet. Also in line with those efforts, the Ministry of Investment has initiated a comprehensive Investment Climate Assessment (ICA), conducted by the World Bank, which is nearing completion.

The ICA will identify administrative barriers and all areas where reforms are needed to improve Egypt's business environment, along with providing recommendations on actions required, a detailed time plan, the priority of implementation, and the entities involved and responsible for timely implementation of these recommendations.

Anecdotally, it is worth noting that in a recent visit by representatives of UNCTAD, who were here to update Egypt's Investment Policy Review (IPR) from 1999 the mission recognized the sizable progress the Egyptian government has made in the fulfillment of most of the recommendations made by UNCTAD in their last IPR. Although GAFI is still in the process of establishing the one-stop-shop for simplifying the administrative burden on investors, the UNCTAD mission was pleased with GAFI's progress thus far.

With respect to **revising the incentive policy**, the new tax law under discussion will abolish investment incentives, which proved to be a drain on the government's budget and did little to move Egypt up on the priority list of investors, who tend to prefer other factors such as a stable macroeconomic framework and a growing economy. However, it's worth mentioning that the fourth chapter of the Investment Law No. 8, which has been approved by the Cabinet, sets the option for the Cabinet to provide other forms of incentives than tax incentives to attract large multinational corporations. These measures will be more apparent in due course.

Concerning the **establishment of an Investment Promotion Agency (IPA)** the Minister of Investment replaced GAFI's previous management with an experienced private sector-oriented management. A new chairman for GAFI has been appointed along with three vice chairmen, a consultant to the chairman (responsible for policy advocacy, one-stop shop facilitation, and aftercare services to existing and potential investors), a new Board of Trustees and a new Board of Directors. Almost all are private sector representatives and businessmen.

GAFI, with the help of multilateral institutions and specialized FDI consultants, is currently devising the IPA organization, governance structure and job descriptions. It is also working on the development of a general Investment Promotion Strategy and a detailed institutional business plan and budget. In this framework, GAFI is devising an overall location benchmarking for Egypt, sector benchmarking, and sector and investor targeting strategy. It is in the process of developing and implementing a market intelligence and proactive promotion program in addition to a policy advocacy program.

As part of the overall plan, special emphasis is given to investor-oriented services comprised of the following: a) investor facilitation and servicing program, b) investor aftercare program, c) comprehensive information system to provide investors with all relevant information on the country and the potential sectors, d) an investment map of Egypt that will give accurate and relevant information on all geographical areas and governorates in Egypt, e) an investor tracking system to follow-up on all investments from initial contact through to investment realization and beyond, f) a huge coordinating partnership network to be established across both the public and private sectors at the national and local levels to service investors, g) company site visit program to Egypt involving airport-to-airport service for major investors, h) sector studies that outline investment opportunities, i) matchmaking through identification of potential local partners and promoting joint ventures, strategic alliances, subcontracting, licensing, franchising arrangements, j) infrastructure and property solutions that are quick and easy to set up. It is worth noting that all proposed programs will be associated with intensive staff training.

Following that, a professional promotion and servicing program will be implemented by competent, newly hired staff, and professional promotional materials will be developed, such as the IPA corporate image, country brochure, country video/DVD, sector brochures, press kits, information packets, presentations, and promotional stands. The implementation of a national communications and awareness campaign is in progress. Additionally, an international communications and country branding campaign and promotion activities in target sectors and target markets will take place coupled with professional investor servicing and facilitation activities that are being identified and planned as part of the overall strategy.

Moreover, promotion executives will assist in developing ties between the MNCs and local firms in Egypt, with the assistance of specialized consultants, by identifying the existing linkages and outlining the factors behind their promotion or preclusion. They will also take on a number of other activities such as developing programs to be implemented by the government to promote clusters and deepen industrial linkages, as well as setting measures to be undertaken by government institutions, NGOs, and foreign companies to create and deepen linkages in subcontracting local suppliers, transferring technology from foreign affiliates, training, and information sharing. Finally promotion executives will be responsible for cooperating and coordinating with all technical assistance activities that are provided by other donor programs as these technical assistance activities represent an ideal supplier development program for foreign companies seeking to subcontract parts of their supply chain.

3.4.5 Promotion of Technology Transfer and Innovation to Enhance Competitiveness

The Egyptian Ministry of Foreign Trade and Industry (MFTI) has set up a strategy to improve the ability of SMEs to bridge the gap between their current technological status and the national and international technological base, and to help them adapt technological innovations specific to their needs. The strategy has been set according to the vision of the Egyptian Ministry of Foreign Trade and Industry to transform the Egyptian industry and export sectors to knowledge-based, high value-added, sustainable and competitive sectors.

The strategy also aims at facilitating SMEs' access to technological development sources through appropriate channels, specifically through a network of Technology Transfer and Innovation Centers (TTIC) that stimulate, transfer and diffuse new technologies and innovations. The network acts as a catalyst to provide the technological needs necessary to upgrade the Egyptian industry and export sectors and raise its competitiveness. Technology Transfer Centers are either sectoral centers, sub-sectoral centers, or horizontal centers. The selection criteria for the sectors as well as the horizontal centers are based on the potential for growth, potential for export, apparent or latent demand, interest of stakeholders and emerging technologies.

TTICs provide a wide portfolio of services including quality management, advanced human resources development, technical assistance, technology transfer, environment and social management, R&D and innovation. They currently consist of eight vertical (sectoral) and two horizontal centers.

3.5 CONCLUDING REMARKS

The Egyptian government has taken on many decisive and aggressive reforms that are homegrown. These measures are aimed at reducing the role of the government in productive activities and supporting private sector growth, with to the goal of enhancing the competitiveness of the economy. The recent progress in implementing critical reforms contrasts favorably to the lackluster performance of recent years. Areas of reforms include tariffs and customs, income tax, monetary and external policies, fiscal policies and structural policies. Performance to date has been encouraging, and the government seems committed to restructuring the financial system, privatizing state-owned companies, modernizing fiscal accounts and continuing to strengthen monetary policy. Keeping up the momentum will be crucial for sustainable growth and increased competitiveness.

However, significant challenges remain. Foreign and domestic private investment needs to be increased to enable the economy to absorb the large pool of young workers entering the labor market. The government still needs to strengthen budget execution, and formulate a comprehensive strategy to consolidate the budget and reduce domestic debt. A modern monetary framework for monetary policy has yet to be developed to ensure price stability. All these challenges and others will be addressed in the next chapter.

CHAPTER 4
THE ROAD AHEAD: THE GOVERNMENT AND BUSINESS SECTOR'S WORKING PARTNERSHIP FOR INCREASING COMPETITIVENESS

4.1 WINDOWS OF OPPORTUNITY

In Chapter 3 we concluded that Egyptian policymakers, for the first time in many years, have made significant leaps in implementing a wide range of bold and comprehensive reforms. These reforms touched on many of the "drivers of change" pointed out in last year's competitiveness report (Egyptian National Competitiveness Council, 2004, p. 41) and should help Egypt regain some lost ground in the field of competitiveness. As determined in the last chapter, the reforms already underway have managed to revive confidence in the economy — as reflected by a buoyant stock market, higher growth rates, lower inflation, and a stronger and stable pound.

While the reforms of the past nine months have been impressive, to say the least, a number of challenges remain. Overcoming these challenges will be crucial to building a competitive economy and harnessing the Egyptian economy's growth and private investment potential.

The following section examines a number of windows of opportunity the government is seeking to unlock in an effort to turn "tomorrow's gains into today's competitiveness" (ENCC, 2004, p. 41). The ambitious work to date may have softened the potential impact of these future opportunities. Regardless, the faster these opportunities are pursued, the greater support they will bring to developing the private sector and promoting sustainable growth of a dynamic economy.

4.2 DEVELOPING A HOLISTIC VISION FOR LASTING COMPETITIVENESS – AN UPDATE

In the 2003-2004 Competitiveness Report, ENCC presented strategic challenges that stand in the way of the Egyptian economy's competitiveness. On top of the list came the need to develop a comprehensive vision to serve as the model for a more competitive Egypt. This vision should be the inspiration, guidance and source of alignment for all those striving to achieve this goal, be it governmental bodies, members of the civil society, or any other stakeholders. As reforms start to unfold, it is clear that progress requires some short-term pains to achieve long-term gains. Thus, it's of great importance to articulate a vision that is embraced by the majority of stakeholders in order to increase their tolerance and support for the ongoing — and deeply encouraging — waves of reform. Another important aspect of this vision is the need to engage all stakeholders in this process by increasing their sense of ownership. This vision should define the role of each individual and institution in working to achieve this model state.

Developing a vision requires the participation of all stakeholders in a constructive manner. Awareness of the importance and timeliness of the challenges at hand is imperative. It is encouraging and worth noting that we are witnessing the birth of a national debate in these areas, catalyzed by the many initiatives currently being developed between the government, political parties, academia and civil society. As this process matures we believe that these seemingly disparate voices urging reform will eventually come together.

4.3 Good Governance

Corporate governance is a complex concept based on four principles: accountability, transparency, fairness and responsibility. The way these four elements mix defines the governance structure of an entity. The economic crises in East Asia in the late 1990s demonstrated that macroeconomic problems become worse when there is a systemic failure of corporate governance stemming from a weak legal and regulatory system combined with inconsistent accounting and auditing, poor bank practices and thin and unregulated capital markets (World Bank Group, 1999).

Egypt, like many developing countries, faces two challenges. The first is giving up economic governance arrangements that are not based on the rule of law in favor of a rule-based system. The second is enforcing the new system. Enforcement is the most pressing issue and the more challenging of the two tasks (Grant, 2004).

4.3.1 The Institute of Directors

As part of the effort to promote corporate governance practices in Egypt, then Minister of Foreign Trade Youssef Boutros-Ghali established the Egyptian Institute of Directors (EIOD) by issuing Decree No. 675 in 2003. The Cabinet reshuffle of July 2004 brought the EIOD under the purview of the nascent Ministry of Investment.

To date, the EIOD has not delivered on some of its key tasks, which cover the following areas:

- Issuing a code of corporate governance.
- Promoting high professional standards for boards and directors' conduct, practice, and performance.
- Providing accreditation for company directors.
- Conducting seminars and workshops on various topics, including shareholder rights and disclosure/transparency and financial reporting.
- Publishing newsletters and providing research, advisory and consulting services to:
    - improve compliance with laws and regulations;
    - raise awareness of the benefits of good corporate governance;
    - promote and facilitate the exchange of experiences about the application and development of the principles of corporate governance, including coordination with related government policies and legal principles.
- Developing an Egyptian code of corporate governance.

EIOD has the potential to unleash many opportunities by becoming a vehicle that spreads international standards of corporate governance — such as rules by the Organisation for Economic Co-operation and Development (OECD)[24] — rather than re-inventing the wheel. The importance of this reform measure cannot be stressed enough, given the ambitious financial sector restructuring plan that the government is about to undertake. Complying with international

[24] The OECD corporate governance standards may be found at the following link: http://www.oecd.org/document/49/0,2340,en_2649_34813_31530865_1_1_1_1,00.html.

standards of corporate governance will force banks to follow sound banking and auditing practices, and to avoid the recurrence of past financial problems.

4.3.2 Fiscal Transparency

The Ministry of Finance recently announced that the 2005/2006 budget has been published according to the International Monetary Fund's 2001 Government Finance Statistics (GFS) standards, making the budget more transparent (see Chapter 2). However, the National Investment Bank's (NIB) budget still needs to be integrated into the general budget.

Pension reforms and other efforts to increase the efficiency of social spending must be accelerated to further enhance transparency. The consolidated budget includes the operating budgets of (i) the General Authority for the Supply of Commodities (GASC); (ii) the National Investment Bank (NIB), which finances public investment projects, borrowing from the Social Insurance Funds (SIF), and lending to the government and to the Economic Authorities; and (iii) the two SIFs (government and private and public business sector employees). Although demographic trends are heavily tilted towards the very young, the pension system was structured in such a way that it is highly complex and ambiguous. Social security resources amount to LE 15 billion annually (which is transferred to the NIB), but the government has to pay out LE 21 billion in pensions. This is because the government has covered the cost of living increases in pensions and benefits for many years without increasing contributions. Rather than subsidizing the SIFs by LE 6 billion directly, the government is mandated by law to take only LE 6 billion from the SIFs, which essentially means it has to contribute the other LE 15 billion to the pensioners. More astonishing, the remaining LE9 billion is borrowed at high interest rates from the NIB and used up in non-revenue generating infrastructure projects.[25] Thus, the pension system as a whole is in deficit. Moreover, it is complex, opaque, not conducive to fiscal consolidation and public debt streamlining, and in dire need of reform.

4.4 FISCAL CONSOLIDATION

The fiscal deterioration in recent years mostly reflects revenue weaknesses created by a slowdown in growth. It also reflects higher interest payments on public debt as the government has increased its non-inflationary financing of the budget (Ministry of Finance, March 2005). Interest payments, defense and wage and salaries represent about two-thirds of total spending. As a result, public debt continued to increase (Moody's, 2005) without showing any signs of slowing down in 2004 (Ministry of Finance, March 2005).

The budget deficit for 2004/2005 is one percentage point higher than last year (Ministry of Finance, May 2005), pointing to the need for greater fiscal consolidation. Efforts to reclassify the budget according to international standards and improve treasury cash management and public expenditures will not be sufficient in either lowering government spending or borrowing. These efforts will have to be complemented by streamlining subsidies, controlling the government wage bill, and other cuts. Another important expenditure control measure must include bringing investment expenditures of the NIB under the control of the Ministry of Finance. This would help control the cost of off-budget outlays, serving to reduce government borrowing and placing public debt on a declining path.

[25] Hisham Tawfik, advisor to the minister of finance on pension reform

Fiscal consolidation assumes even greater importance in the face of recent tariff reductions and proposed tax cuts and social reforms, which will most certainly have a negative impact on the budget in the shorter term. Initially, the tariff reductions are expected to lower customs revenues. Indeed, customs duties have already seen a 16 percent decline during the first half of 2004/2005 (Ministry of Finance, March, 2005, p. 30). Similarly, tax cuts will cause a shortfall in tax revenues, estimated at between LE 3.2 to 3.5 billion (Ministry of Finance, December, 2004, p. 28).

In the medium run, however, greater openness to trade, tax cuts and tax administration simplifications will undoubtedly place Egypt on a more robust growth trajectory. These reform measures should act as a catalyst in stimulating the economy. Concerning recent trade reforms, customs revenues are expected to increase as import volumes pick up in response to lower tariffs. The reduction in tariffs and streamlining of customs procedures will help enhance Egypt's competitiveness in the global market. Even if customs revenues fall, they should be offset by increased tax revenues as Egypt becomes more of an export-led economy. The reduced costs of importing essential raw materials and intermediate and capital goods will also stimulate growth. This is because lower customs duties will reduce the cost of investment and consumption, supporting domestic investment, production and stronger growth.

With respect to the new tax code and the ongoing transformation of tax administration, the Ministry of Finance anticipates that the proposed rate reductions and administrative changes will fuel economic growth in the medium term. The drop in tax receipts will be more than recouped by a widening tax base and "taxable capacity." Higher profits for businesses will encourage faster economic growth, thus expanding the tax base and ultimately increasing tax revenues. This should partially make up for the shortfall in tax revenues. The planned transformation of the tax authority includes greater automation, which will lead to a less discretionary application of the rules and potentially raise additional income even as the effective tax burden is reduced.

Economic activity will be further reinforced in response to the rapid pace of current reforms and increased confidence in government policy. GDP growth rates should increase by 1.5-2 percentage points, giving rise to at least LE 10 billion in additional tax revenues[26] (MOF, May 2005). Also, the reduction in tax rates is likely to discourage tax evasion and improve tax compliance, thus covering a large part of the loss in tax receipts. Finally, the budget will be bolstered by complementary efforts by the Ministry of Finance to rationalize expenditures (Ministry of Finance, March 2005).

Another fiscal burden relates to implementing the government's social agenda to mitigate the effects of the numerous policy reforms on the disadvantaged and impoverished groups. The government has announced a social development program that includes an enhanced social safety net. This program will also carry an inevitable short-term fiscal cost, adding to the challenges of fiscal consolidation.

All in all, these trade, tax and social reforms will in the medium term help reinvigorate the business community, giving momentum to the domestic industry and, hence, supplying the needed push for growth and job opportunities (Ministry of Finance, March 2005). More immediately, however, the key question the government must address is how the economy will

[26] Not limited to income tax. Includes sales tax and all tax receipts.

finance the short-term costs of the new reforms. The answer should further strengthen the argument for substantial fiscal consolidation.

4.5 PUBLIC DEBT

According to Fitch Ratings (December, 2004), "Egypt's debt dynamics benefit from strong nominal GDP growth…so the government can incur a slightly higher deficit without jeopardizing the debt/GDP ratio." In addition, privatization proceeds could provide supplementary budget support in the immediate term.

Regarding strong growth rates, output growth is still low. GDP growth rates still remain below the 6 percent growth rate required to absorb the expanding labor force. Furthermore, privatization needs to be accelerated if its proceeds are to be used in writing off public debt. It is encouraging, however, that under a reclassified budget, privatization receipts are recorded as a financing item (below the line) used primarily to reduce the stock of public debt.

As discussed in Section 4.2.2, it would be simpler, more cost effective and conducive to public debt reduction if the government directly subsidized the SIFs by LE 6 billion, and save the high interest paid on borrowing the LE 9 billion from the SIF deposits at the NIB.

We also saw in Section 4.3 that the streamlining of off-budget outlays would help reduce public debt. Reforming the government securities market, building an upward sloping yield curve and establishing the conditions for efficient primary and secondary market trading would also help reduce domestic debt servicing. In addition to the basic microstructure required to activate the government securities market, the current interest/exchange rate policy mix is not conducive to the development of an efficient domestic debt market. This will be one of the topics highlighted in our next report.

4.6 MONETARY POLICY

Inflation rates dropped sharply during the third quarter of 2004-2005 as a result of the improved performance of monetary policy. Nevertheless, the Central Bank needs to address the risk that high inflation expectations could become more deeply rooted. To avoid this risk, the Central Bank needs to develop a forward-looking policy in the immediate future that clearly communicates the direction of monetary policy using a nominal anchor. In the immediate term broad money supply (M2) could serve as this anchor, whereas inflation targeting would be the proper nominal anchor for the medium term. Using broad money initially would provide guidance to the market and help anchor inflation expectations until the main pillars of the monetary policy infrastructure have been developed for the medium term.

The Central Bank established a Monetary Policy Unit to communicate the direction of monetary policy to the market. The Unit has recently published a long overdue monetary policy statement that communicates the Central Bank's short-term monetary policy strategy to date. Like all central banks, the Central Bank of Egypt must make periodic announcements about the direction of monetary policy. This would enhance its credibility and the transparency of its operations, further strengthening the monetary policy framework.

While the Central Bank advances in the medium term towards an inflation targeting framework (a more advanced nominal anchor), reliable price statistics should be developed. The Whole Sale Price Index (WPI) responded to the exchange rate depreciation much earlier than the

Consumer Price Index (CPI), showing that the CPI series (which contains subsidized foods) was an unreliable measure of inflation. With an imperfect measure of inflation, the Central Bank will not be able to establish its credibility or transparency, which will hamper its ability to communicate the direction of its monetary policy.

4.7 External Sector

The OECD's Economic Outlook No. 77 (May, 2005) states that growth prospects differ greatly across the OECD and the world economy, ranging from high growth rates in Asia to projections of a "soft landing" in the United States and weak and uncertain prospects in Europe. The IMF's World Economic Outlook (April 2005, p. xi) discusses some worrying global trends, citing "the continuing divergent patterns of growth. Both the euro area and Japan are growing more slowly than the other major regions of the world. This has not helped global current imbalances, which are continuing to widen."

This divergence, together with the recent appreciation of the pound, may constrain the demand for Egypt's merchandise exports. In Chapter 3 we already saw warning signals of lower export performance during the first half of 2004/2005. At the same time, the robust growth in imports in response to lower tariffs could increase pressures on the trade deficit.

4.8 Strengthening the Role of the Private Sector in the Economy

Private sector credit has recently been growing at rates as low as 4 percent per year. This meager performance owes to a number of complex and intertwining factors that need the government's urgent attention.

First, there is a high ratio of non-performing loans in the banking sector, which has acted to crowd out the private sector. We saw in the previous chapter that the government is embarking on an ambitious financial sector reform program that aims at increasing the participation of the private sector in the economy through rehabilitating the financial sector, including resolving the problem of non-performing loans. While the cost of the proposed financial restructuring and strengthening plan could be enormous, the implementation of the plan is inevitable in order to achieve high, private sector-led economic growth rates. The question that emerges is how the government will finance its aggressive financial sector reform plan? The restructuring of the banking system will consume significant public resources that could amount to 1.5 percent of GDP over the next five years (Moody's, 2005).

Second, there is a reciprocal lack of trust between creditors (the banks), debtors/defaulters and the government. This trinity has made private sector access to finance almost impossible. The credit excesses of the late 1990s followed by an economic slowdown led to a near standstill in lending and borrowing activities. Perhaps even worse, borrowers defaulted on billions of pounds in credit, which generated a draconian response from the government. Severe imprisonment penalties were imposed on defaulters and bank officials alike. Reviving trust between all parties must be an immediate priority if the private sector is going to take on a greater role in the resurrection of economic activity.

Finally, the government needs to move quickly to reduce public debt in order to generate more private investment, which is currently being depressed by the high levels of government borrowing.

4.9 REAL ESTATE INVESTMENT

Real estate investment has many problems that are preventing the development of mortgage finance in Egypt. The development of a mortgage finance debt market will help deepen the financial sector and kick up activity on the real estate market. Below is a list of the main problems facing the development of mortgage finance:

- The New Urban Communities Authority (NUCA) lacks the funds to complete many of the projects it undertakes in a timely way.
- To generate funds, NUCA overestimates property prices, which has led to a recession in real estate investments and activities.
- Because of unrealistically high land prices, real estate developers refrain from building for the middle class.
- The NUCA decision to permit the use of ground floors in residential areas as administrative offices caused a slump in the commercial and administrative zones, which are costly in comparison.[27]
- The multiplicity of the regulatory bodies of NUCA complicates its activities and puts huge pressures on the decision makers.
- The documents and steps needed to extract a license for any new building include 29 items. This creates an atmosphere that drives up construction costs, wastes time, encourages corruption and impedes the development of real estate projects.
- In imposing penalties, the buildings law does not distinguish between negligence and corruption.
- Because of the many rules and regulations and the lack of transparency, real estate developers are rarely familiar with all these rules, making them vulnerable to unintentional violations or extortion.
- Unregistered properties represent as much as 72 percent of total real estate assets. This percentage provides housing for some 90 percent of Egyptians, creating a huge collection of informal or “dead” capital, estimated at about six times the savings and deposits in the commercial banks. The implications of this phenomenon are as follows:
    - Because some 72 percent of Egypt’s real estate is not registered, these assets are not included in the financial system. Only owners that have registered property can provide it as collateral to banks or obtain mortgage finance.
    - Registration problems include:
        - The lack of a registration culture.
        - The long duration of the registration procedures, and the opacity of these procedures.
        - The high costs of the registration.
- Because of a lack of funding and high interest rates, the mortgage finance fund cannot guarantee subsidized loans for low-income groups.
- The steps of registering a piece of land are very complicated and very detailed.

[27] In these areas investors have to bear higher costs, such as land or utility prices

- Without a geographic and digital database dealing with land ownership in Egypt, it is difficult to prove land ownership most of the time.
- The lack of an insurance system to protect against the risks of loan defaults.
- Slow judicial procedures do not enable creditors to seize property when debtors default, which tends to keep land out of the financing system.

4.10 INDUSTRY COMPETITIVENESS: A STRATEGY FOR INTEGRATING INTO THE GLOBAL ECONOMY

Enhancing industrial competitiveness was identified in the 2003/2004 Egyptian Competitiveness Report as one of the potential opportunities to boost the overall competitiveness of the Egyptian economy. The report underscored the need for an integrated methodology for the evaluation and management of industry growth and competitiveness through encouraging industry clusters and developing comprehensive industry assessment models.

Thus, it is important to put forward an industrialization strategy that would help improve Egypt's industrial performance. In this regard, the Industrial Modernization Centre (IMC) is in the process of formulating an industrial development strategy to revitalize an Egyptian manufacturing industry geared towards full integration into the global economy as a competitive player.

The overall objective is to strengthen the base of Egyptian manufactured exports and its visibility in international markets, increase domestic added value, and undertake technological upgrading of existing industrial activities by moving up the value chain. This could be achieved by building on the existing industrial base, and also through better utilization of Egypt's natural resource endowments, its large pool of human resources, and strategic geographic location.

The success of this strategy hinges upon the successful collaboration between the government and the private sector in what constitutes an effective public-private partnership. Thus, the challenge remains on the implementation side where the institutional setup must encourage collaboration among all stakeholders. The long-term nature of such strategies require the existence of effective coordination mechanisms between the government and the private sector, a clear definition of roles and responsibilities, as well as continuous monitoring and evaluation by the relevant government bodies.

4.11 HUMAN RESOURCES COMPETITIVENESS

4.11.1 Higher Education and Pre-University Education Reforms

The National Democratic Party has successively proposed a complete set of policies for education reform, starting at its annual conference in 2002, with action plans and a clear time frame of implementation. These policies have been taken up by the new government, and the Ministry of Higher Education has presented a plan to implement the new policy. Several elements were specified as the plan's main objectives, including establishing centers of excellence and scientific and technological incubators and parks, ensuring flexibility and mobility of faculty and students within the higher education system, enhancing collaboration between international education and research institutions, improving research capabilities and linking scientific research to development needs to the labor market, as well as promoting and encouraging life-long learning. The plan for higher education reform has been accompanied by another that handles scientific research. The plan will begin with a study of the 143 research centers and institutes in Egypt that report to almost 22 ministries with recommendations on how to coordinate the efforts of these centers. It is worth noting that though the percentage of national income allocated to scientific research increased from 0.3 percent of GDP in 1981/1982 to 0.9 percent in 2005, this percentage is very low when compared to the amount of money most countries spend on scientific research. As for the scientific research labor force (scientists and PhD holders) Egypt ranks higher than most other developing countries (Egypt has 1100 scientist for every million of its citizens while the average number in developing countries is 800 for every million). However, Egypt still falls well below the average of developed countries, which is 3300 for every million citizens.

Building on the argument above, the Ministry of Scientific Research has established a number of objectives for the scientific research reform plan. The objectives include establishing a fund to support scientific research and encouraging contributions by the private sector to scientific research. Currently, the private sector's contribution stands at only 10 percent — a presidential decree to establish such a fund has already been prepared. The plan has stressed the need for encouraging innovation through protecting intellectual property rights, providing incentives for innovation and linking research to implementation in developmental projects, and reviewing current legislation and modifying it in a way to facilitate scientific innovation. Plans to network research centers on a national level will help maximize the returns of a scientific research system.

Establishing a quality assurance system is the most important element of reform, which requires a paradigm shift. Work to bring Egypt's education up to international standards is envisioned through the establishment of the first national accreditation agency for education in Egypt. The vision is to have this agency act as a neutral and independent body from the providers of education services, which are mainly the public schools and universities. However, the delay in establishing the national accreditation agency has slowed the implementation of reform and impeded efforts to improve the quality of education and increase the competitiveness of schools. The reform policies also indicate the need to move towards more academic and financial flexibility in public higher education institutes, which we believe is still lacking. Regarding scientific research reform, Egypt has to change the philosophy of public ownership of scientific research centers, and allow all these centers to acquire funding through winning competitive research project bids. National research priorities have to be set clearly, and an announcement concerning the restructuring of the research academy and its budget to serve the new vision is expected soon. Along with such efforts, the Ministry of Education has also come up with a plan to reform pre-university education following persistent proposals by the NDP since 2002. The main elements of the plan are highlighted in Box 4.1.

4.11.2 Women's Competitiveness

Competitiveness, by definition, entails the capacity of generating high levels of performance and productivity. Considering that women form 49 percent of Egyptian society, it's crucial to utilize their untapped resources through empowerment and equal opportunities. This requires enhancing women's competitiveness abilities. A special program has to be developed with this objective in mind, as regular programs aiming to increase society's competitiveness in general may fail to address the special needs of women, especially in the remote underprivileged areas of Egypt.

The UNDP Human Development Report (HDP) of 2004 ranked Egypt low on the Gender Empowerment Measure (GEM). Egypt ranked 75th out of 78 countries. GEM relates to participation of women in political and professional life. An analysis of the ranking showed that the percentage of parliamentary seats held by women in Egypt is 3.6 percent, the percentage of female legislators and senior officials is 9 percent, female professionals represent 30 percent of the workforce, and the ratio of female to male income is 38 percent.

The report also highlights the fact that while Egyptian women have full constitutional rights, these rights are still considered stronger on paper due to the lack of awareness on the part of women, on one hand, and lack of support by the different concerned entities, including the family, on the other. Moreover, we have to take into consideration that unemployment is the most pressing problem in Arab societies, not to mention that globalization has increased competitiveness pressures in general and further limited economic opportunities for women.

Box 4.1: Action Plan for the Implementation of Higher Education Reform

The Ministry of Higher Education and Scientific Research has put forward an action plan to embark on the reform of higher education in Egypt. The plan is comprised of the following elements:

1. Increasing the student intake capacity of the higher education system. This is to be achieved through developing a master plan for institutional expansion based on demographic and economic needs (end of 2005), reviewing the legislation governing all universities and higher education institutes (end of 2005), transforming university branches to independent universities (2005-2007), introducing new academic programs (2005-7), establishing a distance-learning university (first phase 2006/7), establishing technological colleges (four colleges between 2005-7), establishing a non-profit civil society university (first phase 2006), reviewing the legislation of private universities and criteria for licensing them (2005).
2. Establishing quality assurance systems and performance-based governance within institutions of higher education and establishing the National Agency for Quality Assurance and Accreditation as an independent agency. Quality assurance will be supported by a special fund authorized by the president (decree already issued) and through programs of self-assessment and centers of quality assurance in different colleges (some are already established).
3. Maximizing the use of ICT to the benefit of academia, research and administration. This will be achieved through improving the Egyptian Universities Network (EUN) infrastructure (2005-6), introducing e-management to higher education institutions (2005-7), integrating e-learning in different disciplines (10 percent of the curricula 2006-7) and cooperating with the Ministry of Communication and Information Technology to integrate internet service in universities and research centers (current).
4. Improving the performance of graduate studies and scientific research programs. This is planned to take place through adopting the credit hour system (2006/7), establishing a fund to support scientific research (current) and establishing an institution for academic publishing and translation (2006)
5. Enhancing performance of the faculty and the administration of higher education. This should be implemented through programs that are starting to train academic leadership on modern management systems and to prepare young faculty through a one-year program to pursue their graduate studies abroad. Also, a review of the academic compensation system is in place.
6. Enhancing student activities and updating the regulations (student constitution is currently being revised).

There is a need to focus on empowering women at all levels and eliminating all forms of discrimination, which should eventually help increase and sharpen their ability to compete through the following:

Culture

- Initiating a socio-cultural movement to improve the perception of women as partners in societal development.
- Building alliances with traditionally influential groups (mainly religious institutions) to organize an awareness campaign of women's rights and entitlements based on religious doctrine, which has a considerable effect on societal attitudes.
- Maximizing the use of media to handle the misperceptions associated with the role of women in the family and in society, portraying them as equals with the goal of increasing their self-worth and confidence.

Education

- Expanding 'girl-friendly' schools to ensure the education of young girls in remote areas of Egypt.
- Reforming Egyptian school curricula to project a positive image of women and discouraging discrimination against girls.
- Providing girls access to education at all levels.
- Training educators to be gender sensitive in the classroom, with a more inclusive approach to the role of women.
- Investing in distance learning to allow flexibility for girls and women to pursue their school and university studies, especially in remote areas.
- Ensuring equal opportunity to female students to apply and be selected to education missions abroad.
- Encouraging scholarships — public and private — that are allocated to women to support their studies.
- Pushing for literacy among women who are beyond school age.

Health

- Establishing a culture of caring for the health and well-being of women, especially in rural and remote areas.
- Increasing awareness about health care among the younger generation, especially females.
- Providing health care services to women through means that they can easily access and use.
- Increasing awareness about the importance of birth control as a way to protect women's health.
- Advocating the right of women to determine the number of children she can afford to deliver — free from family pressures.

Economy

Unemployment rates reach nearly 15 percent in the Middle East and North Africa, which have a disproportionate effect on youth and women in the region. Moreover, structural reform policies aimed at downsizing public sector jobs have negatively affected women's job opportunities. In addition, many private sector companies do not opt for employing women due to their dual roles and responsibilities. Consequently, the preference to employ men over women has become a growing, though unconstitutional, phenomenon among different entities. Meanwhile, Arab women's participation in the labor force is the lowest worldwide, failing to exceed 26 percent of actual employment. However, this figure does not reflect the wide scope of women's involvement in the informal sector.

On the other hand, it has been proven that a diverse workforce, including the greater inclusion of women, helps produce products and services that meet new and different market niches. This diversity is becoming a key strategy for financial survival and competitiveness.

The following measures need to be taken in providing women with better economic opportunities:

- Unifying employment criteria applied to women and men, subject to the rules of transparency.
- Working to make financial, physical and business infrastructure more female-friendly.
- Providing women with access to micro financing to set up small- and medium-sized businesses.
- Extending small loans with preferential terms to small projects owned by women.
- Encouraging women to join consumer societies, as they represent almost 80 percent of families' purchasing decisions.
- Allowing tax incentives for businesses that hire women.
- Investing in infrastructure to support women at work and at home.
- Providing different levels of vocational training for women in different fields.

Politics

- Raising awareness of the importance of women's participation in politics for the benefit of a diverse representation of society.
- Initiating campaigns to issue identity cards for women.
- Encouraging parties to nominate women candidates for different levels of elections.
- Adopting affirmative action temporarily by guaranteeing a quota for women in representing different local political councils and parliament.
- Encouraging institutions that advance gender equality, such as the National Council for Women.
- Empowering women in decision-making positions.

Legislation

- Ensuring that all laws and regulations reflect the constitutional requirement of equal opportunity between men and women.
- Reviewing labor, social security and financial laws to eliminate any discriminatory provisions against women.
- Facilitating the enactment of laws that enable women to work and receive fair treatment at work.

- Amending family laws to eliminate unconstitutional discrimination, such as the need for authorization to travel or to open a bank account for children.
- Reviewing and modifying custody laws to give women an equal role in the family.
- Including the perspective of women in enacting new laws, and considering any adverse aspect the law may have on women in particular.
- Linking laws to implementation, especially laws that protect women but are rarely enforced.

4.11.3 Labor Force Competitiveness

Human resource development still poses a major challenge for the competitiveness of the Egyptian economy. In today's global economy, the intensity of knowledge- and innovation-based activities is becoming evermore visible, and those with a proven capacity to innovate and develop new technologies stand out as global leaders. In this regard, the weakness of the human resource base in Egypt may very well impede Egypt's efforts to become more competitive.

Despite a notable improvement in previous decades in the enrollment rates at the primary, secondary and tertiary levels, the overall quality of graduates has been on the retreat. Quality improvements in education have not kept up with achievements in quantity. In addition, there is a continued mismatch between the outputs of the education system and the demands of the private sector, which further compounds the problem of the employability of the labor force. Some segments in the labor market witness shortages because of this mismatch.

Traditionally, the low cost of labor — due to abundance of supply — has been considered a comparative advantage for the Egyptian economy. In fact, Egypt currently has one of the lowest levels of labor costs in manufacturing in the MENA region, reaching almost one-fourth of the MENA average. However, labor productivity is one of the lowest in the region as well. Thus, when linking labor costs with labor productivity (i.e. considering unit labor costs) Egypt's comparative advantage appears relatively eroded — unit labor costs are almost the same as the MENA average. The implication of this weakness has two sides: on the one hand, it implies limited comparative advantage in labor-intensive activities that constitute the most promising areas for addressing unemployment concerns; on the other, and more importantly, it indicates that domestic technological capabilities are not adequate to reap the benefits of the ICT revolution, which is currently the driver of global economic growth. Thus, Egypt's ability to move towards technology- and skill-intensive activities that offer the best prospects for integration into the global economy have been impaired.

4.12 Concluding Remarks

In this report we attempted to gauge developments in Egypt's international competitiveness status. Noting that the implementation of a number of reforms to address the challenges underlined in last year's report helped turnaround the economy in 2005, the report draws attention to a set of other challenges that need to be addressed in order to unlock additional windows of opportunity.

A number of interesting conclusions emerge from the report. We find that Egypt's competitiveness ranking continues to slip or stagnate relative to past years as Egypt's peers have made impressive strides. On a positive note, Egypt's low rankings on the 2005 indices do not reflect the reforms adopted since the new Cabinet took over in July 2004. Since the Executive Opinion Survey was conducted in March 2004, it did not capture executives' opinions in response to the recent economic changes.

In analyzing the impediments in Egypt's business environment, the Executive Opinion Survey (EOS) indicated eight main constraints, ranked in order of significance. The constraints identified relate to (i) access to financing; (ii) tax regulations and tax rates; (iii) inefficient bureaucracy; (iv) policy instability; (v) foreign currency regulations; (vi) inflation; (vii) an inadequately educated workforce; and (viii) restrictive labor regulations. Notwithstanding the persistence of some of those impediments, their severity and ranking have changed markedly since the time of the survey in March 2005. New simplified tax regulations were issued in June 2005, while tax rates were slashed by 50 percent, effective July 1. Foreign currency regulations, such as surrender requirements, were eliminated in December 2004, leading to a liquid foreign exchange market. This, in conjunction with the implementation of the foreign exchange interbank market, has served to bring together the official and parallel market US$/LE rates to stabilize the exchange market. As for inflation, both the CPI and WPI inflation rates have dropped by more than 50 percent. We hope that as the new economic measures start to bear fruit the Executive Opinion Survey of March 2005, which will be released in next year's report, reflects improved business perceptions and propels Egypt up the rankings.

Concerning the remaining five problems, either no action is being taken towards their resolution or the necessary reforms are being taken too slowly and too gradually for their impact to be felt. Many of the low rankings reflect a lack of reform initiative in these five areas — as well as other areas discussed in Chapter 4 — which will continue to undermine Egypt's competitiveness as long as the complacency lasts. The question that arises is *why have the recent reform efforts managed to achieve rapid and perceptible changes in some areas, while initiatives to address other equally important concerns have either been absent or gone astray*? The implications are worrisome: What framework guides the reform decisions of the Cabinet? Do the leaps made in a few areas reflect the piecemeal endeavors of a handful of reform-minded cabinet members? If so, will these reforms collapse or lose momentum when this group of reformists moves on? Do individual attempts at reform risk reversal at the whim of the policymakers who happen to be in charge? How will these reforms be institutionalized to extend implementation across other ministries and ensure continued sustainability over successive governments?

At the very least, the economic team appointed in July 2004 has shown us that the pursuit of reform is not equivalent to chasing after a myth. Progress may not be out of reach after all.

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Table 1.2

Growth Competitiveness Index	Egypt		Jordan		Morocco		Tunisia		Turkey		Bahrain		UAE		Brazil		Chile		Czech		South Africa		Indonesia		Malaysia		Israel	
	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03
	62	58	35	34	56	61	42	38	66	65	28	--	16	--	57	54	22	28	40	39	41	42	69	72	31	29	19	20
Technology index	*65*	*68*	*51*	*48*	*74*	*71*	*58*	*57*	*52*	*54*	*35*	*--*	*25*	*--*	*42*	*35*	*32*	*31*	*19*	*21*	*40*	*40*	*73*	*78*	*27*	*20*	*8*	*9*
Innovation subindex	**38**	**39**	**47**	**47**	**77**	**71**	**50**	**50**	**56**	**68**	**53**	**--**	**66**	**--**	**59**	**60**	**32**	**35**	**19**	**45**	**40**	**58**	**73**	**65**	**41**	**41**	**6**	**6**
(S) 3.01 Technological readiness*	52	52	38	44	71	64	34	42	54	59	31	--	12	--	36	40	23	29	41	38	32	39	57	54	28	22	1	4
(S) 3.02 Firm-Level Technology Absorption	37	71	46	48	74	43	24	23	29	54	43	--	13	--	33	40	31	24	42	42	28	28	85	96	41	41	6	4
(S) 3.06 Company Spending on Research and Development	72	52	65	65	66	38	37	33	76	74	88	--	45	--	31	26	46	49	35	42	24	21	28	35	23	25	7	7
(S) 3.08 University/ Industry Research Collaboration	58	54	47	59	55	53	32	31	62	67	69	--	65	--	28	29	44	44	29	34	19	21	27	28	15	26	12	9
(H) 3.17 Utility Patents	71	64	66	57	75	72	79	62	53	56	79	--	79	--	46	48	47	45	30	30	32	31	74	9	34	34	4	6
(H) 4.22 Tertiary Enrollment	37	37	49	48	80	73	62	57	58	66	54	--	76	--	67	62	38	38	47	45	71	65	74	69	50	50	23	22
ICT subindex	**73**	**69**	**57**	**46**	**75**	**71**	**60**	**59**	**52**	**51**	**41**	**--**	**33**	**--**	**45**	**43**	**38**	**36**	**28**	**30**	**50**	**44**	**74**	**74**	**35**	**32**	**20**	**21**
(S) 3.12 Internet access in schools	63	42	40	41	58	73	37	33	67	55	30	--	24	--	50	40	33	36	26	29	68	50	45	52	28	37	23	15
(S) 3.13 Quality of competition in the ISP sector	29	33	23	19	70	74	52	60	58	54	98	--	102	--	13	26	15	13	27	47	45	50	44	69	34	36	12	7
(S) 3.14 Government prioritization of ICT	13	42	17	11	62	63	12	5	79	90	25	--	3	--	54	66	39	33	59	62	41	35	65	8	23	2	27	58
(S) 3.15 Government success in ICT promotion	16	35	9	8	36	32	3	3	81	87	35	--	2	--	52	38	48	41	75	77	51	34	33	69	8	2	21	21
(S) 3.16 Laws relating to ICT	63	63	35	38	50	57	32	19	77	86	34	--	25	--	41	37	28	30	38	35	20	24	37	48	16	7	31	21
(H) 3.18 Cellular telephones per 100 inhabitants, 2003	80	74	62	52	61	53	65	77	45	42	36	--	26	--	46	54	43	37	30	8	48	46	74	76	34	39	7	3
(H) 3.19 Internet users per 10,000 inhabitants, 2003	73	74	56	54	80	78	62	55	58	51	32	--	33	--	57	47	37	32	34	31	60	52	74	67	24	26	31	27
(H) 3.20 Internet hosts per 10,000 inhabitants, 2003	92	86	74	62	87	79	94	88	49	5	59	--	39	--	35	40	40	42	25	24	47	44	79	73	51	48	17	25
(H) 5.08 Telephone lines per 100 inhabitants, 2003	64	61	69	59	85	80	66	60	42	38	44	--	40	--	52	49	53	48	34	32	71	65	86	81	59	52	26	25
(H) 3.21 Personal computers per 100 inhabitants,2003	76	74	66	61	77	75	63	65	60	57	32	--	40	--	53	47	41	36	33	35	54	48	83	80	38	34	26	24
Technology transfer subindex	**32**	**44**	**22**	**28**	**50**	**40**	**27**	**31**	**30**	**39**	**9**	**--**	**5**	**--**	**17**	**2**	**14**	**18**	**7**	**5**	**1**	**3**	**53**	**63**	**6**	**1**	**--**	**--**
(S) 3.04 FDI and Technology Transfer	44	57	62	65	69	41	64	50	58	80	36	--	27	--	42	10	15	18	6	17	22	26	82	85	11	2	41	53
(S) 3.03 Prevalence of foreign technology licensing	58	64	18	13	77	69	30	29	33	23	14	--	9	--	24	7	37	30	21	21	2	4	71	81	16	4	40	20

* The values of 2003 pertains to "Technological Sophistication" index

Table 1.2 (Continued)

Growth Competitiveness Index	Egypt		Jordan		Morocco		Tunisia		Turkey		Bahrain		UAE		Brazil		Chile		Czech		South Africa		Indonesia		Malaysia		Israel	
	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03	04	03
	62	**58**	**35**	**34**	**56**	**61**	**42**	**38**	**66**	**65**	**28**	**--**	**16**	**--**	**57**	**54**	**22**	**28**	**40**	**39**	**41**	**42**	**69**	**72**	**31**	**29**	**19**	**20**
Public Institution index	*70*	*57*	*29*	*20*	*42*	*68*	*36*	*32*	*62*	*63*	*28*	*--*	*19*	*--*	*50*	*53*	*20*	*19*	*51*	*47*	*35*	*43*	*68*	*76*	*38*	*34*	*24*	*15*
Contracts and law subindex	57	47	23	15	40	55	28	22	63	52	30	--	22	--	53	57	27	29	52	61	36	40	59	65	33	28	26	19
6.01 Judicial Independence	98	59	43	23	47	71	38	3	60	57	46	--	30	--	51	52	37	38	45	46	15	15	58	67	31	41	20	2
6.03 Property Rights	40	58	28	16	44	56	30	28	70	66	24	--	42	--	47	44	31	19	71	72	21	31	67	73	32	17	26	29
6.10 Favoritism in Decisions of Government Officials	55	26	22	22	31	56	16	11	68	61	35	--	17	--	47	51	19	32	64	68	37	45	24	33	30	3	52	53
6.18 Organized Crime	32	45	5	6	31	47	26	21	54	42	12	--	7	--	76	51	23	25	65	62	78	81	81	70	41	3	18	11
Corruption subindex	79	67	36	33	59	85	46	42	64	69	26	--	16	--	45	56	15	13	49	41	40	48	73	88	44	39	22	14
6.21 Irregular Payments in Exports & Imports	62	54	30	28	53	82	44	37	79	83	32	--	18	--	46	56	10	8	55	41	42	48	75	81	47	49	20	11
6.22 Irregular Payments in public utilities	93	84	38	35	53	75	51	47	64	67	30	--	19	--	44	50	11	15	49	39	52	61	70	88	56	43	22	11
6.23 Irregular Payments in Tax Collection	74	66	41	35	70	85	51	48	58	58	9	--	5	--	55	60	19	17	56	45	30	41	76	82	39	27	27	20
Macroeconomic Environment index	*57*	*56*	*36*	*42*	*46*	*43*	*32*	*32*	*84*	*82*	*28*	*--*	*11*	*--*	*80*	*75*	*27*	*35*	*41*	*39*	*48*	*40*	*63*	*64*	*20*	*27*	*43*	*44*
Macroeconomic stability subindex	59	63	13	39	25	37	37	31	91	94	11	--	12	--	97	88	18	28	30	27	87	41	68	65	8	11	42	77
(S) 2.01 Recession Expectations	86	61	47	44	43	41	57	38	36	43	17	--	1	--	51	31	12	42	60	35	45	9	25	52	3	36	64	100
(S) 2.07 Access to Credit	66	78	31	42	65	27	53	29	58	79	27	--	68	--	41	70	15	37	85	26	6	28	70	59	37	35	11	66
(H) 2.22 Government Surplus/Deficit 2003	87	73	10	84	64	35	38	40	101	99	23	--	100	--	80	87	25	25	90	61	35	32	39	34	76	67	83	56
(H) 2.23 National Savings Rate, 2003	40	73	16	14	37	24	49	30	60	36	70	--	6	--	56	75	55	55	51	40	82	71	65	67	8	11	83	66
(H) 2.25 Inflation, 2003	52	40	34	20	17	44	42	47	99	100	11	--	44	--	93	80	44	40	7	20	75	84	77	87	15	20	13	71
(H) 2.24 Real effective Exchange Rate, 2003	2	61	31	81	54	50	46	34	99	73	22	--	28	--	32	3	21	27	52	85	103	4	90	20	23	29	27	46
(H) 2.26 Interest Rate Spread, 2003	51	35	58	56	73	69	58	46	81	91	63	--	41	--	101	100	21	30	33	27	49	45	60	13	23	8	35	29
Government waste variable	41	45	27	18	50	44	4	11	87	75	12	--	2	--	72	52	23	36	81	71	18	37	25	42	11	25	46	19
6.06 Wastefulness of government spending	41	–	27	18	50	44	4	11	87	75	12	--	2	--	72	52	23	36	81	71	18	37	25	42	11	25	46	19
Country credit rating	63	53	66	59	55	50	50	45	68	63	46	--	33	--	60	62	30	31	32	32	45	40	72	80	36	35	43	39