EGYPT
2017

Angus DOWNIE / a.downie@afdb.org

www.africaneconomicoutlook.org

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- **The economic outlook for 2017 remains cautiously optimistic largely based on the government's ability to maintain the policy and structural reform agenda as well as successfully implement the sustainable development strategy.**
- **Assuming economic policy and structural reform implementation, growth is expected to accelerate as confidence returns and investment increases, although some domestic issues and global economic headwinds will remain challenges.**
- **Overall, Egypt can reverse the major and long-standing trend of low and non-inclusive growth along with weak employment prospects on the basis of the potential of the industrial and entrepreneurial sectors.**

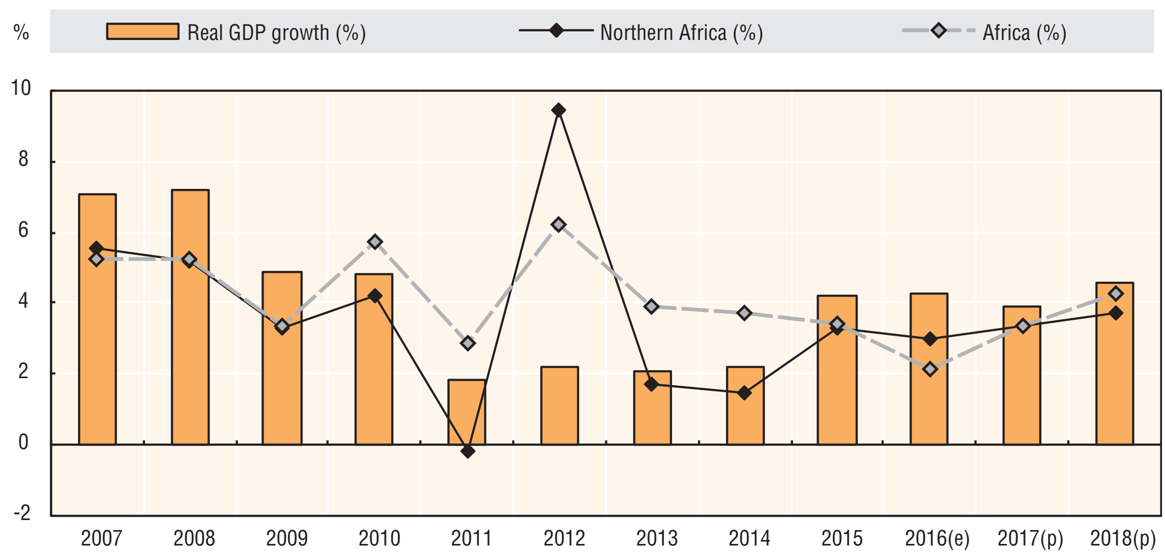
Overview

The formal "political roadmap" has been completed and attention is now focused on management of the reform programme and how this will support growth in 2017 and beyond. With foreign exchange now more readily available after the Central Bank of Egypt (CBE) liberalised the exchange rate in November 2016, the outlook for 2017 is more optimistic. Assuming reforms continue to be implemented, growth should pick up slightly because of positive developments in the gas, manufacturing and real estate sectors, alongside recovery in the tourism sector from recent security-related issues. However, managing to contain the large fiscal and current account deficits in an environment of high inflation will be a challenge in the remainder of 2017 and beyond.

Success in stabilising the economy and boosting growth will be demonstrated by lowering the fiscal deficit while: increasing pro-poor spending; managing price stability in a context of exchange-rate flexibility; increasing employment; enhancing the business environment; strengthening security; and improving social justice. Fiscal consolidation efforts will be continued through the 2017/18 budget supported by expenditure enhancements contained in the Civil Service Law (approved in early October 2016), and revenue strengthening provided via the introduction of the VAT law in mid-2016. Other revenue- and expenditure-management tools will also be utilised, such as the August 2016 tax disputes resolution law, and there will be further efforts to reduce energy subsidies with savings directed towards social safety nets. A new investment law is under discussion in parliament, which should help strengthen the business environment, support the private sector and boost employment. With the exchange rate now liberalised, the CBE will be able to strike a better balance between curbing inflationary pressures and boosting growth without simultaneously having to focus on keeping the exchange rate steady.

The economy is relatively well diversified but despite large-scale industrialisation, investment has not delivered a vibrant economy with high employment. The reforms are designed to help improve productivity and efficiency in order to boost employment and move away from the "informality trap". Yet increased industrialisation and entrepreneurship depends not only on a strong and supportive policy environment, but also on access to more natural resources, capital, improved technology and higher skilled labour.

Figure 1. **Real GDP growth**



Source: AfDB, Statistics Department AEO. Estimates (e); projections (p).

Table 1. **Macroeconomic indicators**

	2014/15	2015/16(e)	2016/17(p)	2017/18(p)
Real GDP growth	4.2	4.3	3.9	4.6
Real GDP per capital growth	2.0	2.2	1.8	2.5
CPI inflation	11.0	10.1	16.9	12.9
Budget balance % GDP	-11.4	-12.8	-11.5	-9.7
Current account % GDP	-3.7	-5.9	-5.2	-5.0

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Recent developments and prospects

Increased signs of recovery and a positive outlook started to take effect from the second half of 2016 with the implementation of reforms. The government's macroeconomic policy and structural reforms focus on fiscal consolidation, the energy sector and the business environment. Assuming reforms continue in 2017, real growth, according to the IMF, should be close to 4% in 2016/17. This raises hopes that more resilient and equitable growth, similar to that which averaged 5% in real terms during the decade leading up to 2011, can be delivered to all sectors of society. A lack of shared benefits from earlier growth was one of the main triggers of the 2011 revolution and shifting growth policies towards the development of labour-intensive industries is an important step to consolidate the limited gains to date.

Although growth slowed in 2015/16 (July-June) to 3.8% from 4.2% the year before (according to IMF data), largely due to investor caution caused by policy uncertainty, the situation appears to have been reversed in the first half of the new fiscal year (July-December of 2016). A series of reforms were approved by parliament to support stronger investor confidence: private investment increased 22% in 2015/16 year-on-year and is expected to be higher in 2016/17. This is mainly because the foreign-exchange supply constraint has been significantly reduced (but not eliminated) following the Central Bank of Egypt's (CBE) exchange-rate policy liberalisation in early November 2016.

The exchange-rate policy switch helped boost capital inflows – particularly portfolio inflows – which helped reverse net portfolio flows to zero from outflows of USD 1.1 billion in 2015/16 and USD 0.6 billion in 2014/15. Not only did debt-focused foreign investors increase their holdings of Treasury bills and bonds, but the Egyptian Stock Exchange benchmark EGX 30 index rose nearly 45% at the end of 2016 following liberalisation, reflecting strong foreign investor demand for undervalued stocks that were made more attractive by significant currency depreciation. There was also an increase in FDI to the hydrocarbons, mobile telecoms, manufacturing and financial services sectors following the Egypt Economic Development Conference (EEDC) held in March 2015, helping boost foreign reserves.

Despite the positive momentum surrounding the government's reform programme, weak growth and an expansionary fiscal policy are estimated to have resulted in the fiscal deficit (including grants) widening to 12% of GDP in 2015/16 from 11.5% the year before (according to IMF data). With fiscal consolidation well entrenched, the deficit is likely to narrow to around 10% of GDP in 2016/17 as reforms take hold, leading to increased public revenue resources and a rationalisation of expenditures, with savings directed towards social safety nets. However, because of a combination of slow growth, and revenue and spending pressures, the fiscal deficit is likely to remain elevated over the near term.

To finance the fiscal deficit, the government has relied extensively on domestic borrowing. Gross domestic debt increased from over 65% of GDP in 2011/12 to an estimated 87% in 2015/16 (according to IMF data). The increase in domestic public borrowing crowded out the private sector, contributing to a reduced appetite of the banks to finance private investment (particularly for small and medium-sized enterprises): growth in credit to the private sector is estimated to slow to around 8% in 2016/17 from over 14% the year before. With fiscal consolidation delivering the expected reduction in the fiscal deficit-financing requirement, domestic debt issuance will slow, allowing the domestic debt stock to fall to around 84% of GDP in 2016/17. Public-debt sustainability risks nonetheless remain significant, although they are offset by an ambitious fiscal adjustment plan and a supportive domestic investor base. External debt is expected to rise from around 12.5% of GDP in 2011/12 to 23% in 2016/17 (according to IMF data), boosted partly by external borrowing and eurobond issuance to help meet the financing gap. Nonetheless, the external debt stock will remain at a comfortable level over the next few years.

Following exchange-rate liberalisation, the CBE will be able to focus on striking a balance between curbing inflationary pressures and boosting growth without having to try to maintain exchange-rate stability. The focus on inflation is welcome, given that in 2016 headline inflation averaged 13.7%, up from 10.4% the year before (based on CBE data). Average annual inflation is expected to continue increasing to 18% (or possibly higher) in 2017. Headline inflation accelerated to 30.2% in February 2017 because of the exchange-rate effect, along with other structural bottlenecks and cyclical factors (such as supply-side weaknesses and the harvest season), which is a major challenge to manage in 2017. Rapidly accelerating inflation could disrupt the finely balanced reform programme. For this reason, the CBE will remain focused on tackling inflation throughout 2017, which could see the policy interest rate for overnight borrowing rise above the mid-March 2017 rate of 15.75%. Already, this rate is sapping growth by reducing credit to the private sector, so the pace of real growth is likely to slow if rates are raised further in 2017.

External-sector strains increased in 2015/16, reflected in widening of the current-account deficit to 5.5% of GDP from 3.7% the previous year (according to IMF data). Not only were exports down but import demand remained strong because of the value of the EGP against Egypt's main trading partners' currencies under the former pegged exchange rate. Security-related issues continued to undermine the tourism sector but remittances decreased only moderately, despite oil-price related economic uncertainties in the Gulf Cooperation Council member states where many Egyptians work. The external sector is likely to strengthen slightly in 2016/17, helped by the exchange-rate adjustment that should boost exports (of goods and services) while dampening demand for imports that are now much more expensive. Meanwhile, additional revenues from the new Suez Canal will help supplement foreign reserves, which are expected to rise to around USD 25 billion in 2017 (around four months of imports), up from USD 17 billion in 2016 (about three months' worth of imports).

Table 2. **GDP by sector (percentage of GDP at current prices)**

	2010/11	2015/16
Agriculture, forestry, fishing and hunting	14.5	12.1
of which fishing	...	...
Mining and quarrying	14.9	7.9
of which oil	14.5	6.6
Manufacturing	16.5	17.5
Electricity, gas and water	1.6	2.3
Construction	4.6	5.2
Wholesale and retail trade; Repair of vehicles; Household goods; Restaurants and hotels	14.7	16.4
of which hotels and restaurants	3.2	2.1
Transport, storage and communication	9.4	8.3
Finance, real estate and business services	9.7	15.1
Public administration and defence	10.2	10.1
Other services	3.9	5.1
Gross domestic product at basic prices / factor cost	**100**	**100**

Source: Data from domestic authorities.

Macroeconomic policy

Fiscal policy

The five-year fiscal consolidation plan (2013/14 to 2018/19) aims to cut the budget deficit to between 8% and 8.5% of GDP by 2018/19 by reducing expenditure and increasing revenues. Specifically, tax revenues are projected to rise due to the effect of introducing VAT in the summer of 2016, while expenditure will fall as subsidies are reduced and the public wage bill is contained. As part of these fiscal consolidation efforts, the government made progress towards widening the tax base and streamlining spending in 2015/16. However, progress was slower than expected, with the fiscal deficit narrowing only slightly to 12.2% of GDP from 12.6% the year before (according to IMF data).

The latest data for 2015/16 show a rise in total revenues due to stronger performance of tax receipts, which account for 68% of the total, driven by reforms adopted since the beginning of the current fiscal year (the authorities' decision to devalue the EGP by 13% in March 2016 was another factor in helping push up revenues). These reforms helped increase goods and services taxes by nearly 50%, compared to the year before, while taxes on income, capital gains and profits increased by 22% during the same period due to higher taxes on domestic salaries and increased taxation of industrial and commercial profits. Meanwhile, non-tax revenues (32% of the total) grew 26%, largely due to higher property-related revenues, which increased 55% reflecting the vibrant local real estate market.

Total expenditure in 2015/16 increased by 18% over the year, mainly due to higher domestic debt interest payments (28% of total expenditure), larger subsidy payments, grants and social benefits (27% of the total), and higher public wages/salaries (25% of the total). Adoption of fiscal reforms to reduce subsidies and increase revenues, plus reprioritising expenditure in favour of lower-income groups helped to prevent a worse outcome.

The 2016/17 budget aims to rebalance revenues and expenditure to narrow the fiscal deficit. Subsidies on petroleum products were reduced in November 2016 by an average of 40%, however, the simultaneous floating of the EGP resulted in subsidies' being increased by a large margin in EGP terms. Meanwhile, the government plans to increase revenues by applying new taxes following the introduction of VAT at a rate of 13% in 2016/17 (it will rise to 14% in the following year). Furthermore, the government aims to decrease public debt steadily, thereby lowering interest payments.

Table 3. **Public finances (percentage of GDP at current prices)**

	2007/08	2012/13	2013/14	2014/15	2015/16(e)	2016/17(p)	2017/18(p)
Total revenue and grants	**24.7**	**19.0**	**21.7**	**19.0**	**18.2**	**19.1**	**18.8**
Tax revenue	15.3	13.6	12.4	12.5	12.5	12.2	12.0
Oil revenues	0.2	0.3	4.6	1.0	0.1	1.3	1.1
Total expenditure and net lending (a)	**31.5**	**32.0**	**33.9**	**30.5**	**31.0**	**30.6**	**28.4**
Current expenditure	27.7	29.8	30.9	27.5	28.1	27.4	25.1
Excluding interest	22.1	21.8	22.6	19.6	19.3	18.5	17.5
Wages and salaries	7.0	7.8	8.5	8.1	7.9	7.3	6.5
Interest	5.6	8.0	8.2	7.9	8.7	8.9	7.6
Capital expenditure	3.8	2.1	2.5	2.5	2.6	2.7	2.9
Primary balance	**-1.2**	**-5.0**	**-3.9**	**-3.5**	**-4.1**	**-2.6**	**-2.0**
Overall balance	**-6.8**	**-13.0**	**-12.2**	**-11.4**	**-12.8**	**-11.5**	**-9.7**

Note: a. Only major items are reported.
Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Monetary policy

Following major external-sector pressures, the CBE shifted exchange-rate policy in early November 2016 from a peg to the US dollar to a floating regime, which had a pronounced effect on monetary policy. The exchange rate moved initially from EGP 8.85:USD under the peg to around EGP 16.5:USD, representing a depreciation of nearly 90% (in early 2017 the rate was around EGP 18.8:USD). The CBE had tried earlier to reduce external-sector pressures in March 2016 by devaluing the EGP 13%, but maintaining the peg to the US dollar. This was unsuccessful in creating supply-demand equilibrium, which led to the significant change in policy in November.

The overvalued exchange rate was one of the IMF's major concerns (along with fiscal laxity and a weak business environment) and its advice was that achieving a more competitively priced exchange rate was crucial to stabilising the economy and supporting economic recovery. The CBE's exchange-rate policy move has boosted confidence in the economy, particularly to private investors who have increased their interest and exposure to Egyptian assets. Around USD 1.5 billion in extra inflows was recorded by the CBE in the immediate two-week period following the policy shift, and the Egyptian stock market index rose to its highest level since 2008, reflecting strong foreign-investor interest in equities.

At the same time as the change in exchange-rate policy, the CBE also tightened monetary policy by raising rates 300 basis points to 15.75% for overnight lending and for 14.75% for overnight deposits. This brought the cumulative rate rise to 600 basis points as of late-March 2017 (the CBE's Monetary Policy Committee meeting held on 16 February 2017 held rates steady), underlining the CBE's tightening policy stance initially to support the EGP and then to address inflationary pressures. The interest-rate rise was a pre-emptive move to tackle the inflationary effect caused by currency weakening, which has raised the cost of imported goods and services.

The new exchange-rate regime will also help improve monetary policy effectiveness because inflation targeting through interest-rate setting will replace exchange-rate targeting – an important move in making monetary policy dominant when trying to tackle inflationary pressures. However, the overall weakness of the monetary policy transmission effect will remain in place, partly because the vast majority of Egyptians and many small, informal sector businesses do not hold bank accounts and are therefore relatively immune to changes in interest rates.

Economic co-operation, regional integration and trade

Strengthening regional integration with the rest of Africa remains work in progress. One of the main recent policy events was the government's Africa 2016: Business for Africa, Egypt Forum held in February 2016 that brought together political and business leaders to discuss enhancing pan-African trade and investment. The business climate and the role of the private sector were the main areas of talks. However, there have been only a limited number of investment deals confirmed following initial announcements made at the event.

The Tripartite Free Trade Area (TFTA) that was launched in June 2015 and brings together the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Southern African Development Community (SADC) has seen work continue behind the scenes in anticipation of the 2017 move to establish the free trade area. The TFTA has a combined population of 625 million people, representing 57% of Africa's population and a total GDP of USD 1.6 trillion (2013) equal to 58% of the continent's GDP.

Despite the above efforts, the current account deficit widened to 5.9% of GDP in 2015/16 from 3.7% the year before according to the most recent data from the IMF. The deterioration was driven by a weakening of exports and on-going strong import demand despite the shortage of foreign currency; a weakening of services exports, notably tourism caused by domestic insecurity, along with weak growth in Suez Canal receipts due to weak global trade; and a drop in remittances from Egyptians overseas to around USD 17 billion from USD 19 billion the year before. The current account deficit is likely to narrow to around 5.2% of GDP in 2016/17 largely as the trade balance strengthens, helped by the change in exchange rate policy.

Table 4. **Current account (percentage of GDP at current prices)**

	2007/08	2012/13	2013/14	2014/15	2015/16(e)	2016/17(p)	2017/18(p)
Trade balance	-14.2	-10.8	-11.3	-11.8	-11.3	-10.9	-10.9
Exports of goods (f.o.b.)	17.8	9.5	8.6	6.7	5.8	6.7	8.3
Imports of goods (f.o.b.)	32.0	20.2	20.0	18.5	17.1	17.6	19.1
Services	8.3	4.4	2.7	3.2	1.9	1.8	1.7
Factor income	0.8	-2.6	-2.4	-1.7	-1.3	-1.4	-1.5
Current transfers	5.7	6.8	10.1	6.6	4.9	5.3	5.7
Current account balance	**0.5**	**-2.2**	**-0.9**	**-3.7**	**-5.9**	**-5.2**	**-5.0**

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Debt policy

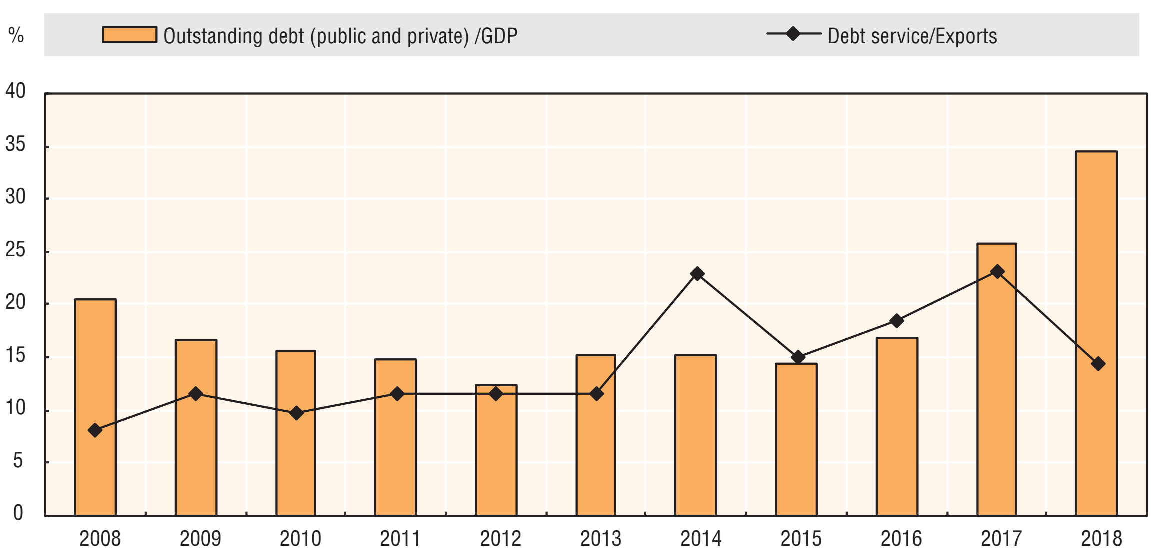
The government has continued to focus on debt consolidation and targets a reduction in the debt stock to around 85% of GDP by 2018/19, down from 96.7% in June 2016. The aim is to achieve this reduction at the same time as increasing spending on education (to 4% of total spending), health (3%), higher education (2%), and scientific research (1%) as mandated by the 2014 Constitution.

According to the finance ministry's Debt Management Unit, gross domestic debt increased to EGP 2 619 billion (96.7% of GDP) at end of June 2016, from EGP 2 116 billion (86.6% of GDP) 12 months earlier, largely the result of rising debt issuance to meet the higher public financial-borrowing requirement caused by the 2015/16 fiscal deficit. The size and dynamics of the domestic debt stock is partly responsible for Egypt's B rating from the major credit-rating agencies.

Reducing the domestic debt stock will be a key challenge for the government in 2016/17 and beyond. It will need to diversify sources of financing, lengthen debt maturities and reduce the cost of borrowing while aiming not to crowd out credit for the private sector. Total government debt service increased during July-May 2016/17 to EGP 370.7 billion from EGP 320.5 billion a year previously and needs to come down. The increase was mainly due to higher interest payments that jumped 36% during the same period to EGP 210 billion, reflecting the larger debt stock and higher interest rates compared to the year before.

By June 2016, external debt had increased more than 16% to USD 55.8 billion (18.1% of GDP) from USD 48 billion (14.8% of GDP) the previous year. However, the external debt stock is lower than Egypt's peer group of countries and suggests that additional external debt could be taken on. More than 87% of total external debt is medium- and long-term. The government's share of external debt (and of the external debt stock overall) has increased with the January 2017 issuance of USD 4 billion in eurobonds (with more issuance possible in 2017/18), which is part of the financing to be raised under the IMF's financial-support programme.

Figure 2. **Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)**



Source: IMF (WEO & Article IV).

Economic and political governance

Private sector

The government wants the private sector to play a more constructive role in the economy to increase employment and boost growth. This objective was set out in the March 2015 Egypt Economic Development Conference and forms part of the Vision 2030 development strategy launched at the same time. While Egypt's overall rank in the World Bank report *Doing Business 2017* improved 4 points over the year to 122 (out of 190 countries), reflecting improvements to starting a business, getting electricity, and protecting minority investors, challenges to businesses remain considerable. These range from the effort required to register property and trade across borders to getting credit. Other obstacles to doing business include corruption, non-conducive regulation, the infrastructure gap and a mismatch in skilled workforce, particularly among university graduates. A picture of similar difficulties emerges from the World Economic Forum's 2016-17 *Global Competitiveness Index* (Egypt has an unchanged rank of 115th out of 138 countries).

There is no lack of well-established laws and regulations in Egypt but there remains a need for provisions that can facilitate investment, reduce bureaucratic delays, and generally create a supportive policy environment to boost investment. The government's reform programme, which picked up speed in 2016, seeks to tackle these shortcomings by enhancing industrial licencing, supporting individual-owned companies, strengthening consumer protection, and deregulating the domestic gas sector. Meanwhile, a new draft investment law aims to simplify the business environment and standardise incentive schemes.

To attract investment, the president's investment council approved a number of measures in October 2016. These include an extended suspension of capital gains tax on shares (up for review in May 2017) and tax exemptions for producers in some strategic sectors, efforts to reduce bureaucratic barriers to investment, and the introduction of new legislation to settle tax disputes.

The government is also developing the electricity sector to bridge the power supply-demand gap, in order to make Egypt more attractive to investors. Part of the energy sector strategy aims to close the energy gap and promote energy efficiency and the renewable energy (RE) agenda. In order to attract private investment in RE, a feed-in-tariff (FiT) was approved and the gas law ratified by the parliament in late 2016, which opened up the gas sector to private investments. It also aims to manage electricity demand by reducing subsidies on energy. The annual second electricity price was introduced in summer 2016.

Financial sector

The CBE's exchange-rate policy change in early November 2016 will have a net positive effect on banks' loan portfolios via businesses' stronger export receipts. The banking system also remains relatively stable, despite increases in non-performing loans (NPL) in some of the smaller banks. The microfinance sector remains largely undeveloped. Around 450 microfinance institutions operate country-wide serving an estimated 1.2 million customers, compared to an estimated demand of 21 million people. However, the introduction in February 2017 of the National Payments Council should help boost the cashless economy and increase financial sector penetration.

Financial intermediation, measured by banks' loans-to-deposits ratio, increased slightly to 44.2% in September 2016, which is low by global standards and is little changed from previous years, reflecting the banks' preference for lending to large companies (public and privately owned) and to invest in government securities, which are perceived as low-risk but crowd out the private sector. Small and medium-sized enterprises (SMEs) are estimated to account for only 6% of total bank credit. Long-term bank financing remains limited to less than 10 years, reflecting the conservative risk nature of the banks, a limited pool of viable, long-term lending opportunities, and the lack of long-term government securities against which banks can lend. There is also a limited pool of investment opportunities, reflected in a low savings-to-investment ratio. The aim is to develop alternative investment opportunities and institutions that can absorb savings and, in turn, increase productive activities.

To date, only about 12% of Egyptians have a bank account. Egypt is still a cash-based economy because of a large proportion of the population who are too young to set up bank accounts, limited banking facilities outside major cities and low internet-banking penetration. However, mobile banking is growing in importance because of competition from four "mobile wallets". Moreover, Egypt is now the second largest credit- and debit-card issuance market in the Middle East, reflecting the large size of the population, compared to other regional countries. This is expected to rise following the government's recent collaboration with MasterCard to extend financial inclusion to 54 million citizens through the Digital National ID Programme, which will link national ID cards to the mobile payments system.

Public sector management, institutions and reforms

In order to address the dead hand of Egypt's bureaucracy, the government adopted a new strategy for administrative reform, which culminated in parliament approving the Civil Service law in October 2016. The reforms contained in the law seek to transform the public administration into an efficient and effective service characterised by professionalism, transparency, equality, accountability and responsiveness. Changes to benefits and allowances, pay structures and hiring practices that are in-line with global best practice are some of the main elements. Meanwhile, citizens applying for civil-service jobs will be assessed according to the rules set by the Central Agency for Organization and Administration (CAOA) and will be supervised by the Ministry of Administrative Reform.

Egypt's 2014 constitution gives absolute power to the Supreme Constitutional Court in choosing its members, making it the first constitutional court in the world with this kind of authority. It also gives numerous powers to the judiciary without giving any guarantee of the use of these powers. Although the Judicial Independence score in the World Economic Forum's (WEF) 2016-17 *Global Competitiveness Index* (GCI) has not changed from the year before (at 4.55), the rank has improved to 45th out of 140 compared to 63rd in 2011, which reflects legal-system improvements in the post-revolution environment.

The government has also taken steps to make reforms more transparent and accountable to the public such as by publishing the "citizen's budget" that summarises revenue collection and expenditure allocations each year, and the "citizen plan". The government is also making efforts to automate the public-sector payroll (around 50% complete as of late-2016), which will deliver cost savings, and strengthen Public Financial Management (PFM) following the establishment by the Minister of Finance of a PFM Improvement Unit that will work with line ministries to enhance public services and value for money.

Natural resources management and environment

While Egypt's contributions, in accordance with the UN Framework Convention on Climate Change, are focused on promoting resilience in water resources, agricultural security and coastal-zone master planning, environmental challenges remain significant and extend to air and water pollution, as well as soil contamination. The Ministry of State for Environmental Affairs and its executive arm, the Egyptian Environmental Affairs Agency, are responsible for the management of natural resources through national policies and projects. Their main aim is to preserve natural resources, biological diversity and the national heritage in relation to sustainable development.

Several initiatives are underway to halt the deterioration of the environment. The National Strategy of Sustainable Development (NSSD) identifies and selects mechanisms to support sustainable development practices. However, this strategy lacks legal and administrative enforcement leading to the continuance of poor environmental conditions and exposure to damaging pollutants countrywide. The annual mean of the concentration of particulate matter in downtown Cairo was 138 PM10 microns per cubic metre (ug/m3) by mid-2016, which puts the country 6th out of 91 countries with the most damaging air. The 2016 Environmental Performance Index rank for Egypt in 2016 is 104th out of 180 countries, reflecting sustained pressures on environmental resources, particularly water, as well as damage to biodiversity and habitat, with consequences for the population's health.

Political context

The first parliamentary session in January 2016 marked the final stage of the formal political transformation set out by the government in 2014 and a return to a more normal political environment. Domestic political events were largely focused on parliament's work of scrutinising draft legislation and the executive's reform agenda that picked up speed prior to the IMF's approval of USD 12 billion balance-of-payments support in November.

Efforts to strengthen bilateral relations with other countries in the region were undertaken in 2016. Meanwhile, Egypt will look to improve its relations with the new US administration and the European Union, as well as build on relations with Russia and China, helped by its membership of the UN Security Council (its term expires later in 2017).

Social context and human development

Building human resources

The 2014 constitution mandates that 10% of total GDP be allocated to spending on social sectors. The institutional capacity to reach this level is not yet in place, as exemplified by several reports from the World Health Organization (WHO), among others, highlighting the poor quality of public health services that limit health outcomes and negatively impact human capital formation by lowering the general health of the population. A similar situation exists in the education sector leading to low quality school and university graduates, with some estimates claiming that large parts of the population is functionally illiterate.

Egypt is trying to meet the increasing need for services from its growing population (growing over 2% per year) by efforts to extend free health-care and education services to all citizens. However, both the health and education systems are under strain from the demands of strong population growth, spending inefficiencies, high costs and structural bottlenecks. The pressure on free public health and education services is increasing, the equivalent private services are expensive, and the poorest are caught in a vicious circle. A contribution to addressing health-sector inefficiencies would be by extending universal health insurance coverage, currently limited to around half the population, to all Egyptians by 2030, although the system is skewed towards public-sector employees, which leaves the poor marginalised. In the education sector, public-private partnerships (PPP) are increasingly seen as an option but institutional capacity to implement PPPs is relatively weak.

According to recent FAO data, the availability of products on the Egyptian market from the major food groups has continued to increase, although access varies depending on socio-economic class, with the poorest seeing little absolute change in their diet, particularly in the rural areas of Upper Egypt. The results of recent nationwide nutrition surveys suggest that the nutritional status of young children has also improved. The main remaining problems are stunting among many pre-school children and obesity among young and older adults, both of which are due to poor diet.

Poverty reduction, social protection and labour

The contribution of welfare allocations to household incomes depends heavily on location, with rural Upper Egypt the major beneficiary because of persistently high poverty rates. According to the Social Safety Net (SSN) programme, there is huge pressure to maintain subsidies in response to rising food prices. As an alternative to subsidies, the government initiated a new cash transfer programme with the support of the World Bank in 2015. The programme, known as Takaful and Karama, is aimed at helping 1.5 million poor, elderly and disabled families through cash transfers. The government is reviewing and unifying the databases to improve targeting so that the programme ensures that children under 18 have access to education and health care. Based on the late-2016 evaluation, the programme is making good progress and has reached nearly 1.2 million beneficiaries.

The constitution earmarks funds for SSNs. Yet, institutional capacity for spending funds accurately is low and leakages to other uses occur. As a result, poverty in Egypt remains widespread and is even increasing under economic pressures. According to the 2015 income and household expenditure survey, 27.8% of the population is poor, compared to 26.3% in 2013. Rural Upper Egypt is the poorest region with 56.7% of its inhabitants considered poor, compared to 43% in 2008, while the majority of 18-29 year olds in Upper Egypt are classified as poor, highlighting not only immediate health and social problems but longer term issues that will continue to undermine growth prospects in 2017 and beyond. Nonetheless, in terms of providing accommodation for the poorest, the government has built 240 000 social housing units and aims to build 1 million units over the course of the next five years along with implementing a programme to raise the coverage of sanitation in rural areas from 15% to 40% by June 2018.

The labour market is weak, with insufficient quality in employed labour and unimpressive gains in productivity. With mediocre growth performance and strong population growth, employment has expanded only slowly, despite low female labour-force participation; this has been accompanied by a long trend of sub-optimal job quality. The growing informal sector provides 91% of the jobs for young people. Part of the government's response is contained in the Civil Service law, which simplifies pay, benefits and allowances structures; increases hiring and dismissal transparency; and professionalises the civil service. More needs to be done, however, to boost formal private-sector employment. Meanwhile, child labour is prohibited under the 2014 constitution; and legislation exists to protect employees against all forms of discrimination based on gender, language or religion. A paucity of recent, timely data makes it difficult to assess these issues.

Gender equality

According to the most recent WEF *Global Gender Gap Report*, Egypt sits at 132nd of 144 countries, indicating a very high level of gender inequality. A mixture of social attitudes and traditions continue to undermine women's equal access to education, employment and health care.

In the United Nations Development Programme's (UNDP) 2015 *Human Development Report*, Egypt ranks 131st out of 188 countries on the *Gender Inequality Index*. Gender disparities are heightened by poverty. Female illiteracy is approximately twice as high as it is among males. The situation for females in 2017 is unlikely to improve significantly.

Thematic analysis: Entrepreneurship and industrialisation in Egypt

Egypt's economy is relatively well diversified. However, the structure of the economy is tilted towards large public-sector enterprises, which reflects decades of centrally planned and driven economic policies. Indeed, the profusion of state-controlled agencies, authorities, committees, and councils reflects the strong presence of the state in the economy and economic decision-making. One result of this state of affairs has been the failure of gains from economic growth to become more widely felt. As a result, growth has not reduced poverty to any significant extent.

The Industrial Modernisation Centre, established by presidential decree in 2000, and the Federation of Egyptian Industries see Egypt's economic development based on the competitiveness and growth of the industrial sector. The four-year Industrial Development Strategy (IDS) launched in February 2016 by the Ministry of Industry and Trade is premised on Egypt's becoming a leading industrial economy in the MENA region and a main export hub for medium-technology manufactured products by 2025. The IDS has a 3-phases strategy to increase industrial exports and employment, enhance industrial efficiency and build innovation capacity.

The IDS strategy is built on several programmes. The legislative and procedural reform programme deals with the Industrial Licensing Law, the Industrial Development Authority's use of industrial lands, laws regulating tenders and supply to support small and medium-sized enterprises (SMEs), as well as the food safety law. It also addresses the legislative procedures concerning the One-Person Company Law and the development of entrepreneurship, SMEs, and micro enterprises, as well as the industrial development programme through which the ministry has offered land throughout the country for industrial development projects.

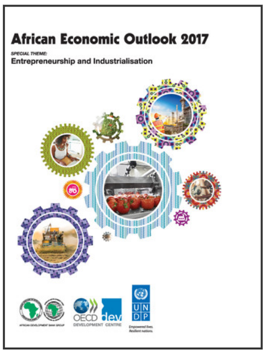
The government is finalising a new Investment law for the first quarter of 2017, which aims to make investing in Egypt more attractive by developing a one-stop-shop system aimed at encouraging more FDI. Reflecting these improvements, Egypt's rank in the World Bank report *Doing Business 2017* improved four places to 122nd out of 189 countries. This is still low, however, and reflects the various obstacles to businesses, entrepreneurs and investors that remain. These include excessive bureaucracy, cumbersome regulations and poor contract-enforcement mechanisms.

In 2016 the government, via the CBE, allocated EGP 200 billion over five years to national banks for on-lending to small SMEs at 5% and to larger SMEs at 7%, to be repaid over 5-7 years in a wider attempt to support commerce and industry. In addition, commercial banks have been directed by the Central Bank of Egypt to raise SME lending to 20% of their total loan books. The government has also established new industrial zones around the country and expanded some of the existing major industrial cities like Tenth of Ramadan and Sixth of October, near Cairo, and Borg El-Arab in Alexandria Governorate.

The development of more knowledge-intensive industries, exploitation of inter-firm linkages and the generation of higher quality labour skills form a relatively more recent focus of government and the private sector. The successful experience of other developing countries indicates that both the traditional industrial sector and the growth of knowledge-based industry have the potential to become important drivers of higher growth and employment while fostering Egypt's integration into the global economy. In a bid for greater global integration the government has announced the establishment of an Innovation Centre in Cairo's Smart Village to enable Egypt to become a world-class hub for ICT-based innovation and entrepreneurship. A recent ICT-sector strategy (2011-14) focused on innovation and entrepreneurship as its main pillar, with a new strategy carrying forward many of these aims. Innovation and entrepreneurship in ICT will be the basis of a national effort to increase competitiveness, create jobs and opportunities and to enhance Egypt's overall standard of living and quality of life.

Reflecting the efforts made since 2010, entrepreneurship has emerged as an area of interest for policy makers and government agencies, partly as a means of absorbing around 800 000 new labour-market entrants each year. However, from an entrepreneur's perspective, starting a new business in Egypt remains challenging (as highlighted in successive World Bank *Doing Business* reports) because of the difficulty of accessing low-cost credit and micro credit, navigating through the tax administration, dealing with the licencing and standards bureaucracy, facing insufficient mentoring support services, dealing with corruption, fraud and access to skilled labour, among other problems. After the 2011 revolution, entrepreneurs have struggled with these challenges, which has affected Egypt's ranking in the Global Entrepreneurship Monitor (GEM) report for 2015/16 – in general, most scores have deteriorated since the last report in 2012. This is not surprising, given the above obstacles and the uncertainty of regulations and polices during the 2011-16 transition period.

Despite the challenges, there have been some notable entrepreneurial successes. One is Wuzzuf, which is the region's largest job search platform in Egypt and MENA. It has processed more than 2 million job applications since it was launched in 2009. Moreover, it is the first Egyptian start-up to join the prestigious "500 Start-ups" accelerator in San Francisco, in 2014. Another success is InstaBug, which is a tool that helps mobile app developers test and improve their products by fixing bugs before submitting apps to online stores. In 2013, Instabug won the Massachusetts Institute of Technology's Enterprise Forum Arab Start-up Competition top prize of USD 50 000. Another successful start-up is Edfa3ly.com, which is the leading e-commerce platform in Egypt. It enables customers to buy products from other countries and ship them to their door. With these and other start-ups, some of which are supported by Cairo Angels (the largest angel investor and source of venture capital), Egypt has the potential to draw together its attributes of capital, ICT ingenuity, and labour resources to create successful new businesses that help the economy grow and generate increased employment, particularly for the youth that make up the majority of the population.



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