



EGYPT INVESTMENT CLIMATE ASSESSMENT 2009: ACCELERATING PRIVATE ENTERPRISE-LED GROWTH – POLICY BRIEF

World Bank

This Investment Climate Assessment (ICA) is based in large part on a survey of Egyptian Enterprises requested by the Ministry of Investment to better understand the dynamics and diversity of the Egyptian private sector, as well as the overall impact of the Government's reform program. The intention of this assessment is to inform public policymakers of the current performance, costs and constraints facing the private sector to help guide the future agenda of reforms. Egypt's long-term vision of development includes the twin goals of achieving "high and sustainable growth and the alleviation of poverty and income disparity."¹ This is the crux of investment climate work – enhancing the role of the private sector in leading growth and creating employment, while enhancing the role of government in underpinning markets and assuring that vital services are provided.

The ICA began from a framework that suggests that reform is not an issue of policy alone. Rather, the private sector response to a Government's actions depend on a combination of the rules on the books, the way those rules are implemented, and the credibility of a government with investors.² Thus, the focus of the ICA is not only on the progress of policy reforms, but how they are experienced by firms.

ICA Methodology. The World Bank Investment Climate Assessments (ICAs) are based on large-scale enterprise surveys and complementary analytic work, providing a standardized way of measuring and comparing investment climate conditions in a country. Nearly 1200 firms were sampled and interviewed in the second half of 2008, ranging in size from ten to many thousands of employees, reflecting different subsectors, 23 governorates, domestic and foreign ownership, exporters and non-exporters, and other features of the Egyptian economy. In services, 544 firms in construction, tourism services, restaurants, and hotels were interviewed, also reflecting the underlying structure of each of these formal service sectors. For the first time in the 2008 survey, 500 enterprises, mostly microenterprises, were included from the informal sector.

The Competitiveness Challenge. The 2009 survey provided evidence of better performance in the Egyptian economy. Both the general survey and the manufacturing panel results clearly demonstrated substantial progress in labor and total factor productivity. Trends in sales, employment and investment were not as favorable but still positive.

¹ World Bank. *Egypt Country Assistance Strategy, Overview* (2005)

² World Bank MENA Region, *From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa* (Washington, 2009).

The survey revealed various constraints and barriers to competition, growth and operation. Investor perceptions critically shape their decisions about enterprise operation and investment. The questionnaire provided business executives' views on which factors matter most to their operation and growth. Over time, there has been steady progress in reducing the burden of taxes and tax administration identified by firms. 2008 priorities re-emphasized the need to reduce macroeconomic policy uncertainty, address informality, reduce regulatory policy uncertainty, deepen worker skills and reduce corruption.

	2004	2006	2008
1	Tax Rates	Macroeconomic Instability	Macroeconomic Instability
2	Macroeconomic Instability	Illegal/Informal Competition	Informal sector competition
3	Regulatory Policy Uncertainty	Corruption	Regulatory policy uncertainty
4	Tax Administration	Regulatory Policy Uncertainty	Worker Skills
5	Illegal/Informal Competition	Tax Rates	Corruption
6	Corruption	Cost of Financing	Tax Rates
7	Cost of Financing	Tax Administration	Cost of Financing

to investment and growth.

Corruption. is common in obtaining approvals and connections. Corruption associated with public procurement is reportedly getting more frequent and expensive: the percentage of firms that report an informal payment to an official is expected to obtain a government contract has increased significantly among the panel of manufacturing firms, from 9% in 2004 to 10% in 2006 to nearly 19% in the current survey.

Other Constraints to Competition. The ICA team encountered a view that competition was sometimes constrained by dominant firms or by unfairly advantaged "connected" individuals. Confidence in the judiciary to uphold property rights has actually increased over time in Egypt, yet the courts remain fundamentally backlogged and inefficient.

Informality and Business Entry. Competition from the informal sector has risen to be the second leading constraint identified as "major" or "very severe" by Egyptian enterprises. Informal competition reportedly includes informal operators who can undercut formal firms' costs by evading tax, labor, public health and safety, and trade regulations; formal operators who hide a portion of their activity "in the shadow" by evading some portion of their tax, labor or trade obligations or other rules; and competitors who package inferior goods under international brand names or otherwise violate trademarks, patents or copyrights.

From the point of view of formal participants in the economy, the coexistence of a large informal sector undermines fairness and rule of law, allowing others to compete with them on a lower cost basis. International evidence suggests that entrepreneurs in the informal sector weigh the costs and benefits of formalization; hence the size of the informal sector can be understood to respond to the imposition of taxes and regulations and the quality of public services (as well as the effectiveness of enforcement of laws against informality). The background of informal sector

entrepreneurs reveals a striking difference – their lower level of education. The workforce itself is also less educated. 33% of the informal manufacturing workforce did not complete primary school, compared to only 19% of the workforce among small formal manufacturing firms. In light of this evidence, the idea of the informal sector being the employer of last resort for the less educated has some credibility.

Informal firms regard themselves as severely constrained as do small formal manufacturing and service firms across a variety of obstacles, and in some cases find themselves more troubled than small service firms. In two dimensions they regard themselves as distinctly more constrained than either small manufacturers or small service firms – regarding the price of land and, more surprisingly, regarding tax administration. They are no less likely to view tax rates or business licenses and permits as constraining. At the same time, informal firms are distinctly less likely to find worker skills or regulatory policy uncertainty seriously constraining. The micro and small enterprises in the sample do not report themselves to be either unregulated or untaxed, but rather less regulated and less taxed. Thus, informality in Egypt may better be thought of as a continuum closely related to firm size.

Labor Markets and Worker Skills. Employment is a driving motivation for the Government's growth orientation. With a reported 650,000 young workers entering the labor market each year, it is critical to understand labor markets. As Egyptian firms move up the value chain and compete in increasingly globalized markets, they are finding the supply of skilled and educated workers more constraining. For the first time in the Egyptian enterprise surveys, firms identified worker skills and education among their top five constraints.

Access to Finance and the Challenges of Small Enterprises. Access to finance is a serious challenge in Egypt and a constraint to the pace of private-led growth. The low rate of financial intermediation in Egypt and the poor access to finance among small firms and microenterprises raises important concerns. Analysis of firm efficiency further suggests that many firms are constrained for working capital. The percentage of firms that have loans has dropped significantly from 17.4 percent in the 2004 ICA survey to 11.41 percent (all firms surveyed) in 2008 – one of the lowest rates of financial intermediation in the MENA region and among developing countries.

Upper Egypt – Differences and Similarities. The Government's Poverty Reduction Strategy Paper highlights the “strong regional dimension in that Upper Egypt is distinctly poorer than other parts of the country. The ICA used both the survey and qualitative interviews to understand what factors might be limiting private investment in the region. The survey does not suggest that firms that have already located in Upper Egypt are unduly burdened, although they are more likely to stress a few key factors as constraining. Firms in Upper Egypt place greater emphasis on the cost of financing, access to financing, tax administration, and infrastructure (transport, water and telecommunications).

Explaining Innovation. Innovation is a popular concept commonly associated with raising productivity. The investment climate survey evaluated certain innovative behaviors and associated practices. In general, besides firm size, innovation positively relates to competition, whether from foreign firms, informal firms, or having more domestic competitors.

Progress, Challenges and Implications for the Next Generation of Reforms. Over the last

five years, Egypt has progressed substantially in strengthening its investment climate. Yet competitiveness is an ongoing challenge, and other countries are strengthening their investment climates at the same time. The ICA notes that not only policies, but policy implementation and the very process of policymaking are appropriate targets for improvement. It identifies six principles to strengthen the reform process:

1. Better Information: "A strategy for dramatically improving the availability of both public decisions and economic information."
2. Better Dialogue: "Form a central policy dialogue that includes a broad representation of the business community, to meet regularly and pursue specific reform areas through working groups."
3. Better Planning: "Capacity needs to be built to strengthen planning, perhaps initially concentrated in the Prime Minister's office."
4. Better Procedures: Use systematic regulatory reform to make procedures clear, easy to comply with and less subject to discretion.
5. Stronger Institutions: "Egypt's ongoing reform of a few key agencies needs to be broadened to cover more agencies."
6. Accountability for Actions and Results: Benchmark and monitoring public services and regulatory activities, and holding agencies and individuals accountable for results.

Along with these principles, the ICA made a number of specific reform recommendations in each of the areas considered.