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Amun Oracle
Report
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INTRODUCTION

USAID created the Amun Oracle in 1995 as a means of tracking progress of the Government of Egypt's (GOE) economic reform and structural adjustment programs that began in 1991. The name, Amun Oracle, is taken from the ancient Oracle of Siwa, which Alexander the Great visited before departing on his conquests.

This report is the tenth in a continuing series that utilizes scores and opinions garnered from questionnaires distributed to knowledgeable Egyptians in the business and academic communities twice each year, in January and July. The January report looks at both Egypt's progress during the previous six months and progress since the beginning of the current economic reform program that began in 1991. The July report looks only at progress during the preceding six months. An accompanying roundtable discussion takes place on each occasion. Panelists at the roundtable discuss the questionnaire and pertinent economic reform issues. The tenth roundtable discussed the proposed labor law, unemployment, and market liquidity and lack of credit for small and medium enterprises (SME).

Respondents to the questionnaires scored 24 policy areas. The areas cover three main categories: stabilization, structural adjustment, and social policies. Within the category of stabilization, there are six policy areas. Structural adjustment covers twelve policy areas while the social covers six policy areas. Scores can range from a positive rating of +10 to a negative rating of -10. A rating of + 10 means that the respondent believes the GOE has taken a significant step forward, that is, it has taken a significant positive policy initiative or improved implementation of existing policies in a significant way. A rating of -10 means that the respondent believes the GOE has taken a step backwards, that is, it has taken a significant negative policy initiative or implementation of existing policies has declined in a significant way. Respondents also offer predictions of key macroeconomic indicators, such as the inflation and exchange rates. Scores and projections appear in the annexes.

By their very nature scores and opinions are subjective. The respondents' perceptions of the behavior of domestic and international market place serve as proxy for the larger business community's opinion of GOE progress with economic reform. Opinions and recommendations from those directly affected by GOE policies can be a useful tool for evaluating policy initiatives.

I. SUMMARY

As in January 1999, respondents expressed concern about the GOE's monetary policy and management of the money supply. In the opinion of most respondents, an exchange rate regime that does not operate by market forces will continue to impede investment and growth. Also, restrictions on imports are not the answer to an overvalued currency and weak exports. Many respondents said recent GOE directives aggravated the foreign exchange situation. They also recommended that the banking sector be further liberalized and reformed to simulate investment in the larger economy. It was further noted that the GOE's expenditures are not sufficiently rationalized. There is a nagging concern that mega projects are overtly political and symbolic rather than sound investments. Education continues to receive the most attention as the respondents considered social policies. It is their overwhelming view that the education system needs revamping. For many respondents the system must be more attuned to the needs of the marketplace. This would stimulate growth, ameliorate unemployment and underemployment, and improve the standard of living.

In their review of key macroeconomic indicators, the respondents predict:

- a GDP growth rate of 5.3% and 5.6% for 1998 and 1999, respectively;
- inflation of 4.0% for both years;
- an exchange rate of LE 3.5 and LE 3.6 to the US dollar, respectively;
- a commercial lending rate of approximately 14% for both years;
- a fiscal deficit of 1.1% and 1.2%, respectively;
- an unemployment rate of approximately 9.0% for both years;
- a current account balance of -\$1.8 and -\$2.0 billion, respectively; and
- a trade gap of -\$11.9 and -\$11.7 billion, respectively.

II. SCORES FOR THE PREVIOUS SIX-MONTH PERIOD

- Eight policy areas were scored as **Minor Improvement**. They are: Overall Fiscal Policy, Overall Privatization and Public Enterprise Reform, Privatization, Exports, Overall Private Sector, Basic Education, Basic Health Services, and Reduction of Pollution.

- Thirteen policy areas were scored as **No Change**. They are: Fiscal Sector Policies, Interest Rate and Monetary Policy, Fiscal Deficit, Taxes, Expenditure, Public Enterprises, Economic Pricing Policies, Market Entry & Exit, Market Operations, Competitiveness, Social Safety Net,

Reduction of Poverty, and Administrative Bureaucratic Reforms.

- Three policy areas were scored as **Minor or Slight Movement Backwards**.

They are Foreign Exchange Market and Exchange Rate System, Overall Trade Policies, and Imports.

III. COMMENTS ON TWENTY-FOUR POLICY AREAS

Stabilization Policies

The Foreign Exchange and Market Rate System and Interest Rate and Monetary Policies: Questionnaire respondents believe the GOE is trying to support an exchange rate inconsistent with market forces and the end result will be the depletion of international reserves. They disagree with the GOE's move to limit imports as a strategy to protect those reserves. All agreed that the Egyptian pound is overvalued. One respondent said that denial does not solve economic problems and that blaming moneychangers is a weak argument.

Fiscal Policies: This policy category consists of four sub categories: overall fiscal policy, the fiscal deficit, taxes, and expenditure. Respondents attached considerable importance to expenditure restraint and strengthened tax administrative. The tax structure needs to be addressed and collections improved. One respondent commented that corporate taxes are high relative to other countries. In the category of expenditures, respondents note a slight reduction in the government budget, e.g., from limiting defense expenditure and canceling the 10% wage increase. On the other hand, many respondents are leery of GOE expenditure cuts when large sums are plowed into mega projects such as Toshka. "The fact that the GOE is applying austerity measures with one hand and pouring funds into Toshka with the other is alarming." Another respondent said the GOE must invest more rationally. "The focus should be on how to maximize returns and avoid symbolic projects."

Structural Adjustment Policies

Financial Sector Policies: Respondents feel the GOE is divided in the execution of policies guiding the financial sector. On the one hand, it wants to encourage savings and expand investment opportunities. On the other, the financial system remains uncompetitive and protected. Some respondents commented that there is a general loss of faith in the stock market. One criticized the GOE's and the Central Bank of Egypt's (CBE) overreaction to the recent crisis in the bond market. They

recommended that the GOE and CBE expand and liberalize the bond market, not overregulate it.

Privatization and Public Sector Reform: Respondents viewed the GOE's move to privatize electricity companies as positive. As an overall policy, however, privatization has been adversely affected by recent GOE restrictions on duty free shops. This decision, in the words of one respondent, "sheds doubt on the credibility of privatization." One respondent said that privatization of utilities is important, but there must be a proper regulatory framework in place. Without it Egypt runs the risk of converting a public monopoly into a private monopoly.

Economic Pricing: A number of respondents said that relative prices of commodities, both tradable and non-tradable, do not reflect their true economic costs. For example, energy prices remain rigid. Others suggested that increased competition would bring prices more in line with actual costs. Still, "most utilities are fully controlled by the GOE and thus monopolies exist and will continue at least for the next three to five years."

Foreign Trade Policies: One respondent commented that restrictions on trade financing imposed by the CBE have indirectly led to a step backwards. Respondents agree that restrictions on imports are not an effective way to deal with the issue of an overvalued currency. Respondents commented that credit facilities are non-existent as a way of supporting exports and financial institutions that support exports are of limited scope. Deregulation and reform are needed to help meet exporters needs. One respondent noted that "the GOE's difficult position in trade issues is acknowledged and that Egypt is not at this time well positioned to lift all trade barriers. Most export-oriented businesses are still lagging behind in international standards and are in need of more sustainable inputs of technology and management."

Private Sector Policies: Though respondents pointed out that while the private sector has received more attention from the GOE over the last few years, still no significant steps have been taken to reduce transaction costs incurred by the private sector. Most respondents felt that sudden and unpredictable government regulations, such as the selective ban on imports and the recent restrictions on duty free shops adversely affect investment and the private sector environment.

Social Policies

Social Safety Net: Opinions point to an overall sense that the social security system is in need of reform. The Social Fund for Development is a positive force, but needs to be enhanced. A

number of respondents commented that the recent NGO law will adversely affect Egypt's social safety net.

Provision of Basic Education: Respondents recommended that this area receive serious attention. The present education system is failing in its task to properly equip the future workforce. Lack of reform in the system aggravates underemployment and unemployment, and limits economic growth.

Provision of Basic Health Services: The present health insurance safety net is not adequate for the needs of the public. Respondents recommended deregulation of the health insurance sector as a solution within broader social insurance reform.

Poverty Reduction: This is an area that one respondent said is "in dire need of creativity as well as integration between Egos, government organizations and private industry."

Administrative and Bureaucratic Reforms: On the whole respondents sense little progress in this area. One respondent commented that "the GOE's level of tolerance for criticism in the areas of economic and technical issues has gone down. This is a step backwards. A healthy dialogue is crucial to reform and growth."

Reduction of Pollution: Respondents believe this area continues to move forward albeit slowly. One respondent said that the business community is taking pollution seriously now. Respondents are waiting for vehicle emission standards to be implemented and enforced. One respondent pointed out that many Egyptians might need financial assistance in order to bring their vehicles up to standard.

IV. SUMMATION OF AMUN ORACLE ROUNDTABLE

The proposed labor law, unemployment, liquidity in the market and access to credit for small and medium businesses, and improvement of domestic and international competition figured prominently in the topics discussed during this Amun Oracle roundtable.

If enacted, the labor law will have an important effect on foreign investment and privatized public sector companies, but not on the existing private sector. Panelists said established private sector businesses have accommodated themselves to the existing labor law. An example is the use of alternative contractual agreements to avoid hiring and firing problems.

A number of panelists said the proposed law should consider the rights not only of the employees, but also of the employer. They explained that much money and time is invested in training with no assurance that an employee trained in-house will remain at the firm long enough for the firm to recoup its investment. The need

for in-house training stems from what the panelists view as a deficient education system that does not adequately prepare graduates for productive employment.

Panelists expect social repercussions until the work culture adapts to the principles of a market economy. They expressed concern that the right to strike will be misunderstood and possibly abused by a labor force that is largely illiterate. Respondents believe implementation of the law will be the true test. A positive impact is foreseen only if the law is accompanied by a pertinent institutional framework.

Panelists see Egypt's employment problem as one of underemployment rather than unemployment. This they attribute to Egypt's sizable informal economy. One panelist said the GOE must take the initiative to allow this potentially powerful economic force to prosper and make it easier for it to be integrated into the formal sector. It was recommended that the GOE further liberalize the economy, remove unnecessary burdens on this sector, and not create a myriad of intimidating restrictions. This would alleviate employment problems, stimulate growth, and create security for more Egyptians. Another panelist put forth the idea that firms be exempted from the now mandatory government social insurance contributions. He reasoned that tax holidays have acted as an incentive for investment and this strategy might be equally beneficial. He added that taxes and social insurance are the most serious deterrents to the informal sector integrating into the formal sector.

Also discussed was the lack of liquidity in the market and credit problems facing SMEs. Panelists commented that the present liquidity crunch is a problem adversely affecting investment, the stock market, and the business climate as a whole. It was recommended that Egypt's insurance sector-- an untapped resource-- be privatized. This would free up a vast amount of money and spur investment and growth.

Regardless of the present liquidity crunch, panelists see no tangible initiative on the part of the GOE to improve the SME business environment, particularly their inability to access credit. It was recommended that a credit facility be established, possibly with social insurance funds. It was also recommended that a credit reference bureau be developed. Overall, the panelists believe that liberalization, not increased regulation, will have the most positive impact on SMEs. As one panelist said, "the beauty of SMEs is that they act on their own." The banking sector as a whole needs further liberalization and reform. One panelist put forward the view that private banks are restricted in what they can do in order to safeguard the position of public banks, and this has created a vicious circle. Establishment of more banks and bank branches would help the sector offer more competitive and improved services. Reform of

the loan approval process, lowering reserve requirements, development of innovative lending methods, lowering of interest rates and borrowing costs, more flexibility for banks to encourage commercial lending, more avenues for non-collateralized lending, development of niche banking, and improved credit analysis would all assist SMEs, improve the banking sector, and jump-start the economy as a whole. It was also recommended that streamlined procedures to register informal enterprises and property be established.

The lack of a mortgage law was also discussed. Panelists are concerned that the lack of such a law has left Egypt open to unnecessary risk. They believe a mortgage law would spread risk and dilute what many view as an impending housing/construction crisis.

The fourth policy issue, domestic competitiveness and the corresponding international competitiveness, was not discussed at the roundtable due to time constraints. Questionnaire responses, however, made a number of recommendations. Further liberalization of the economy was recommended. They also urged the GOE to move toward a realistic exchange rate, reduce tariffs on intermediate and capital goods, and reduce trade barriers and taxes on exports.

CONCLUSION

This Amun Oracle recommends that liberalization and reform of the banking sector be intensified and that the needs of SMEs, especially the many operating in the informal sector, be addressed. There is a strong recognition that SMEs, if given access to credit and relieved of many government bureaucratic and administrative barriers, will prosper and give strength to Egypt's overall economic well being. Their development would also serve to integrate the very large informal sector into the formal economy.

Annex 1

Scores for the Previous Six-Month Period January 1, 1999 - June 30, 1999

Scores reported are the averages tabulated after the highest and the lowest scores are removed.
The scoring scale for the six-month period is as follows:

+10	: at least one major or significant step forward
7 to 9	: an important step forward
4 to 6	: a modest step forward
1 to 3	: minor movement forward
0	: no change
-1 to -3	: minor or slight movement backwards
-4 to -6	: a modest step backwards
-7 to -9	: a serious step backwards
-10	: at least one major or significant step backwards

A. Stabilization Policies	January 1995	July 1995	January 1996	July 1996	January 1997	July 1997	January 1998	July 1998	January 1999	July 1999
1. Foreign Exchange Market and Exchange Rate System	2.0	1.4	1.7	1.0	1.0	0.3	3.0	2.5	-0.3	-3.4
2. Interest Rate & Monetary Policies	2.3	3.0	3.7	3.2	3.0	2.5	5.4	4.0	2.4	0.0
3. Fiscal Policy										
a. Overall	0.4	1.3	1.8	2.7	3.4	3.1	4.1	3.4	1.9	1.0
b. Fiscal Deficit	2.3	2.8	3.2	3.0	4.4	4.0	4.6	4.3	2.2	0.8
c. Taxes	0.5	0.6	0.3	2.0	3.4	2.4	2.1	1.9	0.6	0.7
d. Expenditure	0.5	0.6	0.4	1.0	1.6	1.3	2.7	2.8	1.6	0.7

B. Structural Adjustment Policies	January 1995	July 1995	January 1996	July 1996	January 1997	July 1997	January 1998	July 1998	January 1999	July 1999
1. Financial Sector Policies	3.1	2.6	1.9	2.8	3.3	3.4	2.8	3.3	1.7	0.3
2. Privatization and Public Enterprise Reform:										
a. Overall	3.0	2.6	0.8	2.8	3.3	3.5	3.8	3.2	2.2	1.1
b. Privatization	2.8	2.3	0.9	3.3	4.0	3.5	4.0	3.9	2.6	1.5
c. Public Enterprise	2.7	2.2	0.6	1.4	1.3	2.0	1.5	1.4	1.3	0.8
3. Economic Pricing Policies	1.6	2.3	2.9	2.8	3.1	3.1	4.2	4.0	1.9	0.8
4. Foreign Trade Policies										
a. Overall	1.6	1.2	1.0	1.5	2.2	3.4	3.7	3.5	1.3	-1.5
b. Exports	1.2	0.4	0.7	1.1	1.4	1.3	3.4	2.9	0.4	1.1
c. Imports	3.0	1.6	0.9	1.2	3.3	3.4	3.3	3.6	1.0	-2.8
5. Private Sector:										
a. Overall	0.8	0.8	1.4	2.0	2.4	2.4	3.6	3.4	2.3	1.1
b. Entry/Exit	1.0	0.3	0.3	1.6	1.7	1.6	3.5	3.0	1.6	0.8
c. Operations	1.0	0.1	0.1	1.4	3.0	1.6	2.8	2.9	1.0	0.7
d. Competitiveness	1.2	0.4	0.5	1.3	1.6	1.7	2.5	2.7	1.2	0.3
C. Social Policies										
1. Social Safety Net	1.0	0.1	0.0	0.3	0.6	1.5	2.5	2.4	1.8	0.9
2. Basic Education	1.0	0.4	0.7	0.3	0.8	0.9	1.0	1.6	0.7	1.7
3. Basic Health Services	1.0	0.0	0.0	0.2	0.7	1.0	0.8	1.7	1.1	1.5
4. Reduction of Poverty	0.2	-0.3	-0.9	-0.6	-0.8	0.0	0.3	1.0	0.7	0.7
5. Administrative/ Bureaucratic Reforms	0.0	-0.2	-0.4	1.6	1.5	1.0	1.2	0.8	0.8	0.6
6. Reduction of Pollution*	----	-1.0	-0.8	-0.3	0.3	0.3	2.1	2.7	1.9	3.0

* This policy was added in the July 95 survey.

Annex 2

PROJECTIONS FOR 1998/1999

Projections reported are the averages tabulated after the highest and the lowest scores are removed

Macroeconomic Variables	January 1995	July 1995	January 1996	July 1996	January 1997	July 1997	January 1998	July 1998	January 1999	July 1999
1. GDP Growth Rate (%)	2.6	2.6	2.8	2.6	4.7	5.0	5.0	5.1	5.3	5.3
2. Inflation (%)	11.0	10.5	8.9	8.8	7.2	7.2	5.9	6.1	3.8	4.0
3. Exchange Rate (US/LE)	3.8	3.6	3.5	3.4	3.4	3.4	3.4	3.4	3.6	3.5
4. Commercial Lending Rate	14.5	13.9	15.0	15.0	15.3	14.5	13.3	13.6	14.1	14.1
5. Fiscal Budget Deficit (% of GDP)	3.3	2.7	1.8	1.6	1.2	1.1	1.0	1.0	1.2	1.1
6. Unemployment Rate (% of Labor Force)	12.1	13.5	12.6	11.2	9.8	9.9	8.9	9.1	9.6	9.2
7. Current Account Balance* (\$ billions)	-----	-----	-----	-----	-0.2	-0.2	-0.6	-0.5	-2.2	-1.8
8. Trade Gap** (Merchandise Exports- Imports in \$billions)	-----	-7.9	-8.0	-7.8	-9.6	-10.0	-10.2	-9.9	-13.0	-11.9

* Current Account Balance was added in the January 97 survey.

** Trade Gap was added in the July 95 survey.

PROJECTIONS FOR 1999/2000

Macroeconomic Variables	AVERAGE	MEDIAN
1. Real GDP Growth Rate (%)	5.6	5.5
2. Inflation (%)	4.0	4.0
3. Exchange Rate (LE/US\$)	3.6	3.6
4. Commercial Lending Rate at End of Period (%)	14.2	14.0
5. Fiscal Budget Deficit (% of GDP)	1.2	1.4
6. Unemployment Rate (% of Labor Force)	9.0	9.0
7. Current Account Balance (\$ billions)	-2.0	-2.7
8. Trade Gap (Merchandise Exports-Imports in \$ billions)	-11.7	-11.5