Egypt

key figures

• Land area, thousands of km^2	1 001
• Population, thousands (2004)	73 390
• GDP per capita, $ (2002/2003)	1 115
• Life expectancy (2000-2005)	68.8
• Illiteracy rate (2004)	41.5

African Economic Outlook 2004/2005

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Egypt

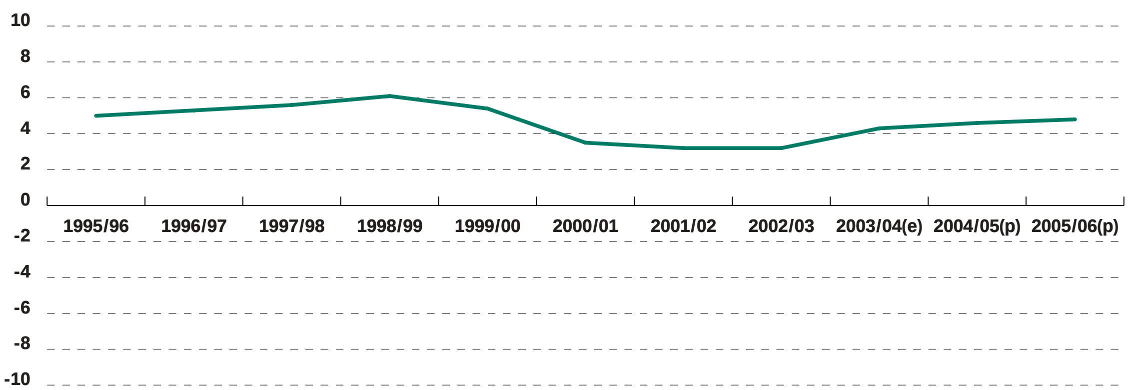
THE GROWTH OF THE EGYPTIAN ECONOMY, driven primarily by export revenue and improved external competitiveness, has revived since mid-2003, returning to rates identical to those of the 1990s, at close to 5 per cent. Exports have benefited from the 25 per cent depreciation of the national currency against the US dollar following the introduction in January 2003 of a partially floating exchange rate, and the current account showed a surplus of nearly $3.7 billion at the end of the 2003/04 fiscal year (1 July 2003-30 June 2004). This surplus, accompanied by a strict monetary policy, has also addressed the problem of availability of foreign exchange, which was holding back imports. The depreciation has, however, contributed substantially to the importation of inflation. The official inflation rate in 2003/04 was 8 per cent, but this depends on the calculation method used; it could in reality be in double figures.

Although the economy is sensitive to external shocks and regional insecurity, growth prospects are significant, particularly in the tourism and natural gas sectors. The Suez Canal is generating substantial profits, and demand for reconstruction in the Persian Gulf has revitalised the construction sector.

An ambitious programme of economic reforms is currently underway.

Structural reforms have made little progress in the last few years, but after the ministerial reshuffle of July 2004, the new cabinet set to work to advance trade and financial liberalisation and the economic and structural reform programme. In 2004, the

Figure 1 - Real GDP Growth

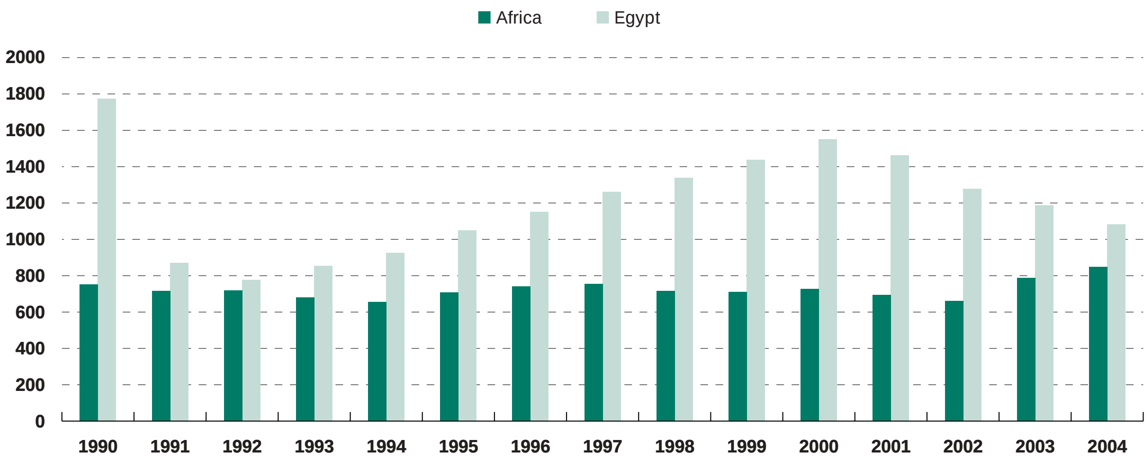


Source: Central Bank data; estimates (e) and projections (p) based on authors' calculations.

number of customs tariff rates was reduced from 27 to six and the average rate from 14.6 per cent to 9.1 per cent. In 2005, the banking sector is to undergo a major privatisation, restructuring and recapitalisation programme, along with the introduction of stricter prudential ratios. The 2005 presidential elections are expected to result in the re-election of the current president, who has been in office since 1981, but the Egyptian economy is currently in an important phase of transition from centralised economy to market economy.

The country's leaders will also need to tackle two major challenges. First, growth is insufficient to absorb the number of unemployed, and the official unemployment rate, which is rising steadily, exceeded 10 per cent in 2004 and is creating large pockets of poverty in certain governorates. Second, the budget

Figure 2 - GDP Per Capita in Egypt and in Africa (current $)



Source: IMF.

continues to show large deficits, generating a level of public debt which is starting to become problematic. In 2003/04, public debt totalled 98.7 per cent of GDP, as against 89.3 per cent the previous year.

Recent Economic Developments

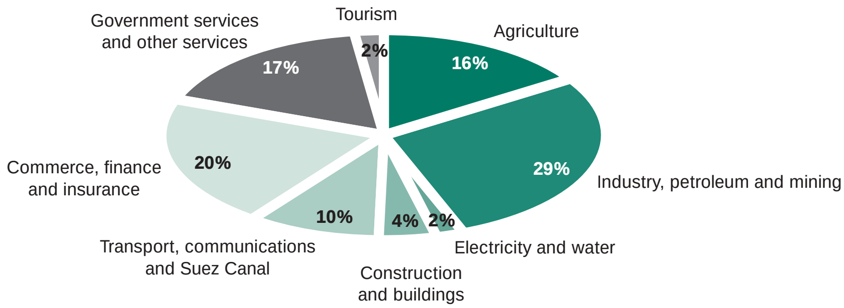
Real GDP grew 4.3 per cent in 2003/04, as against 3.2 per cent the preceding year, and is projected to rise 4.6 per cent in 2004/05 and 4.8 per cent in 2005/06, which would constitute the best performances since 1999/2000. Thus, with average annual population growth at 2 per cent, GDP per capita increased nearly 2 per cent in 2003/04 and should continue to improve.

Agriculture is still one of the pillars of the Egyptian economy, although its contribution to GDP has been diminishing steadily for several decades (it fell from 17 per cent in 1996/97 to 16 per cent in 2003/04), as has its contribution to employment. The agricultural sector recorded a real growth rate of 3.3 per cent in 2003/04. Egypt is unable to feed its population, however, and remains a major importer of food products, which represented 10.8 per cent of imports of 2003/04. With the aim of increasing agricultural output, the authorities have launched huge projects, such as the Toshka project, and plan to irrigate 540 000 hectares of arable land in the desert and the South Valley. There are also prospects for exports of fruit and vegetables to Europe, particularly during the winter months, under the terms of the association agreement which came into force in early 2004. Apart from food products, the Egyptians raise cotton, linen and flowers. Cotton production has fallen sharply in recent years, from 315 000 tonnes in 2001/02 to 190 000 tonnes in 2003/04. International prices, which rose substantially in late 2003 and early 2004, seem to have begun falling again.

In mid-November 2004, the locust invasion that had hit West Africa arrived in Egypt. For the first time in 50 years, the highly agricultural region around Alexandria was invaded by a swarm of insects covering a 60 km front along the Mediterranean coast. The extent of the damage has not been quantified, but it should be relatively limited and localised since the locusts soon left the country.

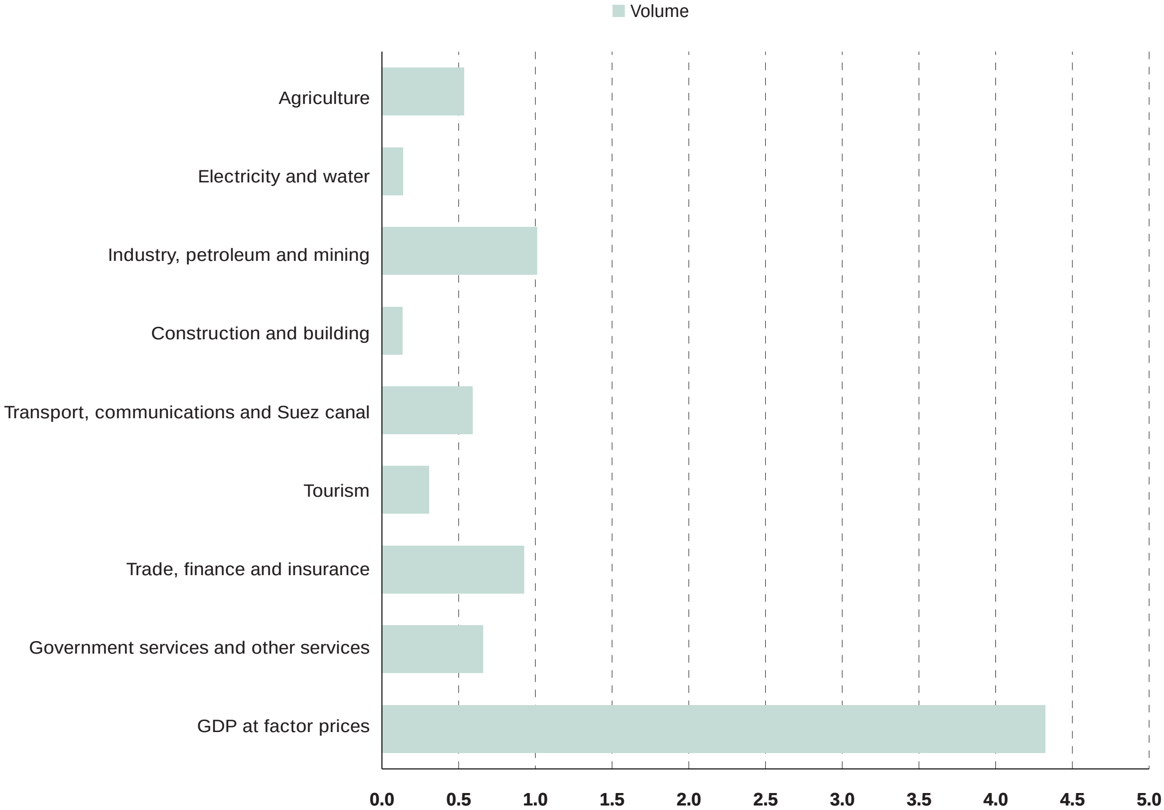
The oil and gas sectors account for about 9 per cent of GDP and one-third of exports of goods. They are very attractive for foreign investors. Reserves continue to be boosted by regular discoveries, and natural gas production is booming: it has increased 75 per cent over the last five years and totalled 3.3 billion cubic feet per day at the end of 2003/04. Proven gas reserves amount to 62 000 billion cubic feet and have increased three-fold in ten years. The first two liquefied natural gas (LNG) production plants were due to open in late 2004 and mid-2005, opening the way for exports of

Figure 3 - GDP by Sector in 2003/04 (percentage)



Source: Authors' estimates based on Central Bank data.

Figure 4 - Sectoral Contribution to GDP Growth in 2003/04 (percentage)



Source: Authors' estimates based on Central Bank data.

Egypt's natural gas. In contrast, oil production is declining. From more than 920 000 barrels per day in 1995, production fell to under 620 000 barrels per day in 2004. New discoveries have kept the amount of proven oil reserves stable since 2001 at slightly under 3 billion barrels.

The manufacturing sector, consisting mainly of food processing and textiles, generated 20 per cent of GDP and 14 per cent of employment in 2003/04. The construction sector has benefited from strong regional demand for reconstruction from the Persian Gulf countries and the devaluation of the Egyptian pound.

As a result, the sector's export revenue, overall output and prices have increased. Cement exports have soared from 67 000 tonnes in 2000/01 to more than 4.2 million tonnes today, whereas domestic demand for cement has remained relatively stable, rising from 25.5 to 26.4 million tonnes over the same period.

The services sector accounts for about half of Egypt's GDP. Its principal components, the Suez Canal and tourism, constitute a major source of foreign currency and an engine of economic growth. In 2003/04, despite regional insecurity, the number of tourists rose to over 6 million. Tourists spent nearly 53 million nights in the country and spent $4.6 billion. The upward trend continued with record-breaking revenues in the first half of 2004/05, and prospects for further growth are favourable even though the government has decided to increase taxation of tourism. Suez Canal revenue has continued to increase, from $2.31 billion in 2002/03 to $2.82 billion in 2003/04, partly owing to the deepening of the canal to allow supertankers to use it but also to the increase in military traffic in connection with the war in Iraq and to the depreciation of the US dollar.

The domestic savings ratio has increased since the 1990s, from 10.9 per cent in 1995/96 to 14.9 per cent in 2003/04, but it is still lower than the investment ratio, which stood at 16.7 per cent in 2003/04. Egypt is therefore heavily dependent on foreign savings to finance domestic investment, but the savings ratio is expected to increase sharply, to over 22 per cent, in 2004/05 and 2005/06.

The investment ratio has fallen regularly between 1989/99 and 2003/04, from close to 20 per cent of GDP to 16.7 per cent. The reforms undertaken by the government to create an investment-friendly environment should lift the ratio to 17.2 per cent of GDP in 2004/05 and 18.6 per cent in 2005/06.

Table 1 - Demand Composition (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04(e)	2004/05(p)	2005/06(p)
Gross capital formation	**16.9**	**18.3**	**18.3**	**17.1**	**16.7**	**17.2**	**18.6**
Public	5.6	5.1	4.5	4.6	4.8	4.8	5.1
Private	11.3	13.2	13.8	12.6	11.9	12.4	13.5
Consumption	**89.1**	**86.6**	**86.1**	**85.5**	**85.1**	**77.9**	**76.4**
Public	10.6	11.3	12.5	12.5	12.2	11.6	11.8
Private	78.5	75.3	73.6	73.0	72.9	66.3	64.7
External sector	**-6.0**	**-4.9**	**-4.4**	**-2.7**	**-1.8**	**4.9**	**5.0**
Exports	21.2	17.5	18.3	21.7	25.1	30.3	29.6
Imports	-27.2	-22.3	-22.7	-24.4	-26.8	-25.4	-24.6

Source: Central Bank data; estimates (e) and projections (p) based on authors' calculations.

The export ratio has been increasing since 1998/99. It improved markedly following the devaluation of the national currency in 2003/04 and is projected to be nearly 30 per cent of GDP during the next two years.

Macroeconomic Policies

Fiscal and Monetary Policy

The increases in the budget deficit and public debt have become alarming since 2000/01. Expenditure as a share of GDP increased slightly from 27 per cent in 2002/03 to 27.2 per cent in 2003/04 but should fall to 25.8 per cent in 2004/05 and 25.6 per cent in 2005/06. The government wants to improve the targeting of subsidies and social spending so as to provide benefits for the poorest groups without unduly straining the budget. Nearly 43 per cent of 2004/05 budget expenditure – E£76 billion – was social spending, of which E£9.1 billion was devoted to health and E£25.9 billion to education. Subsidies are on the increase, as their budget share nearly doubled from 2003/04 to 2004/05. This phenomenon is partly due

Table 2 - Public Finances[a] (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Total revenue and grants[b]	**27.1**	**21.2**	**20.8**	**20.8**	**21.2**	**20.3**	**19.9**
Tax revenue	17.0	14.3	13.7	14.4	14.8	14.0	13.7
Oil revenue	2.7	2.0	1.8	1.4	1.4	1.4	1.4
Total expenditure and net landing[b]	**28.4**	**26.8**	**26.7**	**27.0**	**27.2**	**25.8**	**25.6**
Current expenditure	22.8	22.5	22.6	22.9	23.3	21.9	21.6
Excluding interest	*15.6*	*16.7*	*16.5*	*16.5*	*16.5*	*15.7*	*15.9*
Wages and salaries	6.2	7.0	7.5	7.6	7.7	6.9	6.7
Interest	7.1	5.8	6.0	6.5	6.8	6.2	5.6
Capital expenditure	5.6	4.2	4.0	4.0	3.8	3.8	4.0
Primary balance	**5.8**	**0.3**	**0.2**	**0.3**	**0.9**	**0.7**	**-0.1**
Overall balance	**-1.3**	**-5.6**	**-5.9**	**-6.1**	**-6.0**	**-5.5**	**-5.7**

a. Fiscal year begins 1 July.
b. Only major items are reported.
Source: World Bank data; estimates (e) and projections (p) based on authors' calculations.

to the devaluation of the Egyptian pound, which makes imports more expensive, but also to the government's decision to add certain foodstuffs such as rice, beans, lentils and tea to the list of subsidised products. In 2004/05, direct subsidies were devoted in descending order to food products (E£11.6 billion), housing for the poorest (E£1.7 billion), pharmaceutical products and health insurance for university students (E£530 million), export development, public transport and farming. In addition, indirect subsidies on energy products (electricity, gas and diesel fuel) increased in 2004/05 to E£23.4 billion.

The budget also provides for investment totalling E£85 billion for huge infrastructure projects such as the Toshka Project, the Al Salam canal for the irrigation of the northern Sinai and the development of Port Said East. Investment spending has accounted for about 4 per cent of GDP for a number of years.

Revenue is set to fall regularly, from 21.2 per cent of GDP in 2003/04 to 20.3 per cent in 2004/05 and 19.9 per cent in 2005/06. The government has calculated that it will lose E£3.5 billion in trade taxes as a result of tariff reform and removals resulting from its association agreement with the EU, and plans to issue E£3 billion in Treasury bills in 2004/05 to make up some of the shortfall. It also receives transfers of profits from public enterprises (22.5 per cent of total budget revenue), from the Suez Canal (5.8 per cent) and from the state oil company (3.6 per cent). The September 2004 reform of household income tax and company tax will also reduce revenue. The highest tax rates have been lowered from 40 to 20 per cent for households and will be cut from 40 to 20 per cent and subsequently to 10 per cent for companies, except in the oil sector, where the rate will remain 40.55 per cent.

The recent rise in oil prices had no major impact on the budget, as the resulting increase in revenue was offset by an increase in subsidies. The impact was felt, however, in the form of price hikes for the main oil products and in the value of exports of crude oil and oil products, which increased by 25.6 per cent from 2002/03 to 2003/04.

The budget deficit remains large, at 6.1 per cent of GDP in 2002/03 and 6 per cent in 2003/04, partly because of the scale of subsidies on basic products and partly owing to the wage bill and debt service. The deficit should fall to 5.5 per cent in 2004/05 and 5.7 per cent in 2005/06. According to the document approved by the People's Assembly, the 2004/05 budget deficit, which is expected to amount to E£52.3 billion, should be financed largely by the issue of E£37.5 billion in Treasury bills and bonds, and by an increase in public sector demand for bank lending.

The expansionist budgetary policy of recent years was certainly appropriate in a context of economic slowdown. The deterioration in the budget deficit and the public debt, which amounted to 98.7 per cent of

GDP in 2003/04, is posing a threat to macroeconomic stability, however, and could have harmful repercussions on control of monetary policy.

The main objective of the Central Bank of Egypt (CBE) under its new governor is to stabilise inflation and the money supply. The CBE steadily tightened its monetary policy and substantially increased interest rates during the first half of 2004. For example, the inter-bank interest rate rose from 5.9 per cent in January 2004 to 10.75 per cent in December. The lending rate in December 2004 was 13.33 per cent and the borrowing rate 7.91 per cent.

The banking sector continues to be handicapped by the high level of doubtful loans, estimated at 20 to 30 per cent of total loans. Domestic credit increased only 9 per cent in 2003/04, but lending to the public sector rose more quickly than that to the private sector; the public sector share of total credit stood at 29.9 per cent, as against 26.7 per cent in 2002/03. The banks continue to be cautious and are wary of small private-sector entrepreneurs. The government is planning to carry out a major restructuring programme in 2005 and to impose stricter prudential ratios.

The national currency stabilised in relation to the dollar after the sharp devaluation which followed adoption of a partially floating exchange rate regime in January 2003. There are some remaining constraints on international transactions in Egyptian pounds. The shortage of foreign exchange, which was holding back trade, has nevertheless become less acute since early 2004, and the government has abolished the currency "requisitioning" it had been imposing on exporters since March 2003. This improvement was due to the government's tight monetary policy, combined with the current account surplus, and the gap between the official exchange rate (E£6.22 to the dollar in December 2004) and the black market rate has virtually disappeared. At the moment, currency reserves cover about 10 months of imports. Nevertheless, the inter-bank foreign exchange market records only small transactions, as banks keep their foreign currency for their customers. In March 2004, the level of dollarisation of the economy, as measured by foreign currency deposits as a percentage of total liquidity, stood at 28.4 per cent.

In August 2003, the government revised its method of calculating inflation based on the consumer price index to bring it closer to the wholesale price index. Use of the consumer price index leads to underestimation of price increases, since subsidies and price controls on basic products and housing protect consumers and the poorest groups against excessive price increases. The wholesale price index, in contrast, reflects not only the prices of imported goods and services but also the cost of living of the middle and upper classes. Depreciation of the Egyptian pound contributed to the importation of inflation, and wholesale prices increased 21.4 per cent between April 2003 and April 2004. Estimates of annual inflation in 2003/04 therefore range from 5.5 to 16 per cent, depending on the sources and calculation method used, compared to 4 per cent the previous year. Taking the average inflation rate to be 8.1 per cent in 2003/04, it should fall to 7.7 per cent in 2004/05 and 6.6 per cent in 2005/06.

External Position

The association agreement signed with the European Union in June 2001 came into force on 1 June 2004. During its first phase, the agreement gives Egyptian exporters free access to the European market for industrial goods, and for agricultural goods that do not compete with European production. In return, Egypt will progressively reduce the import tariffs applied to four categories of goods, over a period which varies according to the category: imports of raw materials and capital goods will be fully deregulated in 2007, those of semi-finished goods in 2010, those of consumer goods in 2013 and those of motor vehicles in 2016. The agreement also provides for the EU to supply aid totalling 615 million euros and loans totalling 1.1 billion euros for the restructuring of Egyptian industry. The EU is Egypt's principal trading partner, with a roughly one-third share of both exports and imports. The implementation of the association agreement should result in trade diversion and thus increase the share of trade with the EU.

Table 3 - Current Account (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04(e)	2004/05(p)	2005/06(p)
Trade balance	-14.3	-10.4	-8.9	-8.3	-10.0	-9.6	-9.7
Exports of goods (f.o.b.)	7.0	7.8	8.4	10.2	13.8	13.0	12.2
Imports of goods (f.o.b.)	-21.3	-18.2	-17.3	-18.5	-23.8	-22.6	-21.9
Services	7.9	5.0	4.3	6.3	10.2		
Factor income	0.8	1.2	0.3	-0.1	-0.3		
Current transfers	5.3	4.1	5.0	4.5	5.3		
Current account balance	**-0.3**	**0.0**	**0.7**	**2.4**	**5.1**		

Source: Central Bank data; estimates (e) and projections (p) based on authors' calculations.

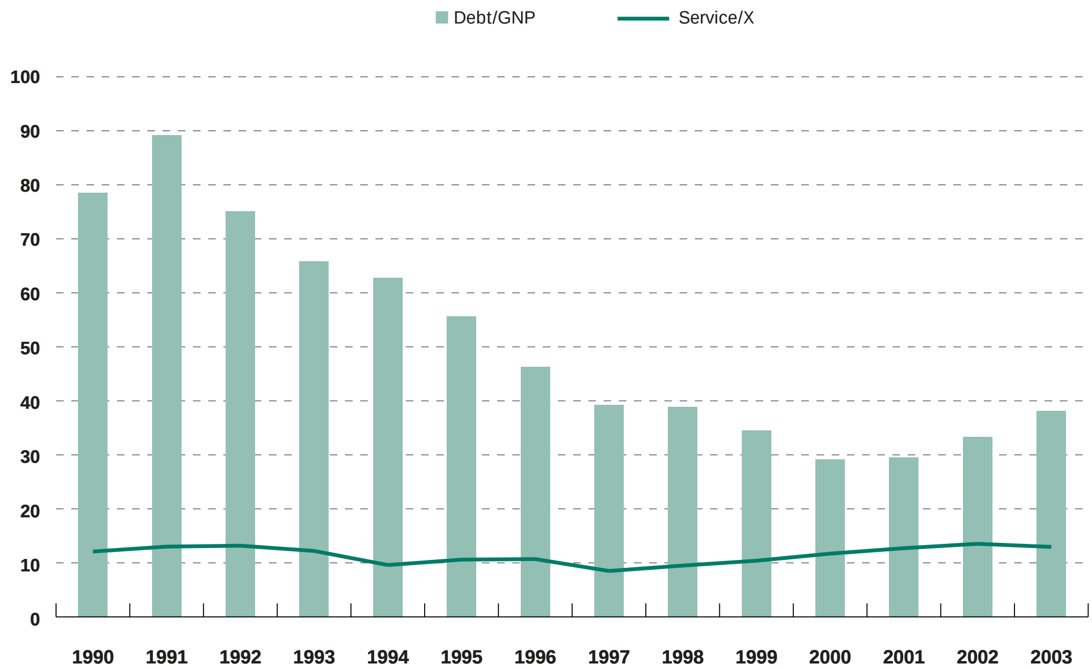
Egypt signed an agreement with the United States, its second biggest trading partner, in 1999. The Trade and Investment Framework Agreement (TIFA) provides a mechanism for the promotion of free trade between the two countries. The expiry of the Multi-fibre Agreement on 1 January 2005 and growing competition from Asian countries in the textile sector have obliged Egypt to revise its trade strategy with respect to the United States, since clothing and textiles are now subject to customs duties ranging from 10 to 39 per cent. As a result, Egypt signed an industrial and trading partnership with Israel in December 2004, which ensures free entry to the United States for Egyptian products produced in "qualified industrial zones" using 11.2 per cent of Israeli components. Egypt is also a member of the Greater Arab Free Trade Area (GAFTA) with the 11 countries of the Arab League, and has concluded a smaller-scale trade agreement with Tunisia, Morocco and Jordan under the terms of the Agadir Agreement, which should result in a free-trade area in 2005. Egypt has also belonged to the Common Market for Eastern and Southern Africa (COMESA) since 1998, but this market accounts for less than 2 per cent of its imports and exports.

In September 2004, a thorough reform of customs tariffs was undertaken to comply with Egypt's commitments to the World Trade Organisation. The number of rates came down from 27 to six and the rates on certain products were reduced, with the result that the average tariff rate applied to imports fell from 14.6 to 9.1 per cent. This reform constitutes progress towards trade liberalisation, although the General Organisation for Import and Export Controls (GOIEC), which is responsible for checking that imports meet international environmental and employment standards, could be used to re-establish a degree of protection in the form of non-tariff barriers.

Egypt's international trade in goods and services increased strongly in 2003/04, and the current account shows a surplus of more than $3.7 billion, representing 5.1 per cent of GDP, compared with 2.45 per cent the previous year. The trade balance shows a deficit of around 10 per cent of GDP, which should diminish in 2004/05 and 2005/06. In 2003/04, imports remained stable in volume terms, but their price in national currency increased significantly. In value terms, the principal imports are capital equipment such as machinery and electronic components, vegetables and chemical products. Exports showed strong growth as a result of the depreciation of the national currency, which restored price competitiveness, and the increase in world oil prices, which had a positive impact on export revenue. Exports of iron and cement doubled from 2002/03 to 2003/04 and gas exports could become a major foreign exchange earner from 2005 when production of liquid natural gas is due to get underway. Egypt has been exporting gas to Jordan via a new pipeline since 2003, and revenue is expected to rise. It should reach $200 million from 2005 and $1.3 billion from 2007/08.

The balance of services also benefited from the improvement in the country's competitiveness. Suez Canal revenue increased 22 per cent in relation to 2002/03 and revenue from tourism rose 40 per cent over the same period. As a percentage of GDP, services rose from 6.3 per cent in 2002/03 to 10.2 per cent in 2003/04.

Figure 5 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports)



Source: World Bank.

The capital account, however, continued to show a deficit of close to \$5 billion in 2003/04, nearly three times that observed in 2002/03 (\$1.7 billion). Net flows of foreign direct investment have fallen sharply, from \$1.2 billion in 2000/01 to just \$216 million in 2003/04. Foreign investors – especially European investors, which have substantially reduced their capital flows – were reluctant to invest in the country, principally because of regional security problems. At the same time, Egyptian banks made substantial investments abroad. The new fiscal incentives for investment aim to reverse this trend.

The low levels of debt service and external debt (most of which is concessionary and long-term debt) remain major advantages for the Egyptian economy. External debt stood at \$29.4 billion in March 2004. It is relatively stable in absolute value terms but is increasing as a percentage of GDP expressed in US dollars. Owing to the sharp depreciation of the Egyptian pound with respect to the dollar, the debt represented about 30 per cent of GDP in 2000 and 39.7 per cent in March 2004, although the dollar amounts were similar. Debt service is low at 12.1 per cent of exports of goods and services in 2004/05, up from 11.1 per cent in 2003/04.

Structural Issues

The new government has initiated a great many structural reforms, but some of them are progressing slowly and legislative bills dealing with such subjects as export promotion, financial markets and taxation have been delayed several times. A major challenge is the reform of the policy on subsidies, notably in energy. Prices of oil products (apart from benzene, which is used to bake bread) have risen recently following increases in world prices, but they remain below international prices and sometimes below production cost. For example, the price of diesel increased by 50 per cent in October 2004 but it sold at the pump for E£0.40 per litre, which is less than \$0.07. This policy of subsidisation is putting an increasing strain on the budget owing to the increase in domestic demand and the depreciation of the national currency. The Oil

Ministry estimates the implicit and explicit cost of these subsidies in 2003/04 at E£24 billion, or one-sixth of total public spending. Moreover, the steady rise in oil consumption since the 1990s is depriving the economy of part of the revenue from one of its principal export products. In 2003/04, Egyptians consumed 475 000 barrels per day, as against 460 000 the preceding year, and the figures are expected to increase as economic activity picks up. To conserve oil export revenue, the government has converted 63 per cent of its thermal power stations to gas. It has also announced that it will concede 14 000 square km of land to various foreign companies for exploration purposes. At the same time, it is trying to develop its natural gas export capacity by building gas pipelines. Egypt could become the world's sixth largest natural gas exporter by 2007.

Air and water pollution have become a major problem for the country, and environmentalists have warned the government against major development and irrigation projects. They are seriously concerned about water management – not management of Nile water resources *per se*, but of the way this water is allocated over the national territory and its polluted state.

The World Bank has approved a $335 million loan for the construction of new terminals at Cairo and Sharm El Sheik airports so as to keep up with growth in the tourist sector. The government has also launched a E£140 million project to modernise ports, streamline customs procedures and improve management of port data so as to reduce customs clearance time for goods. As regards road traffic, Egypt has a very high number of accidents due to the poor state of roads but also, and especially, to excessive speed and failure to comply with the rules of the road. In 2003, these factors caused the deaths of 8 000 people and left nearly 320 000 others injured.

The privatisation process has fallen well short of its initial objectives and of the 314 public sector companies targeted by law 203 in 1991. Since 2000, the process has been idling along, and in 2003/04 only nine of 35 planned privatisations were carried out, bringing in proceeds totalling E£114 million. Nevertheless, the state must eventually withdraw from certain key sectors to allow modernisation of production techniques, better resource allocation and improved competitiveness. The banking sector is particularly concerned because the "big four" public sector banks alone hold about half the sector's assets, although they also hold more than a third of doubtful loans. The new 2003 banking law increases the minimum initial capital required of commercial banks from E£100 million to E£500 million. This measure aims to consolidate the system through restructuring, liquidations and mergers, as the sector has too many banks and about 50 financial institutions showing very poor performance. Under the terms of the law, the CBE has put back the deadline for compliance with the new requirement to June 2005. It hopes that mergers and privatisations will reduce the number of financial institutions and raise the quality of financial services.

The Cairo and Alexandria Stock Exchange (CASE), has been posting good performance in the services sector since mid-2003. The Hermes Financial Index (HFI) more than doubled, from 738.5 points in July 2003 to 1 577.3 points in July 2004. At the latter date, market capitalisation stood at E£182 billion and the number of companies listed at 794, down from 1 151 in December 2002 following the introduction of new, stricter regulations that are closer to international standards. Just 20 companies, however, accounted for 45 per cent of all trading in July 2004. Foreign investors represented 24 per cent of trading and held a portfolio of stock worth about $400 million.

The mobile telephone and information technology sectors have been deregulated in recent years. Six and a half million Egyptians are now subscribers with one of the two providers of cellular phone service, Vodafone and MobiNil, compared with 4.3 million at the end of 2002. Telecom Egypt, the public sector company which has a monopoly of fixed lines, paid for a licence to set up a third mobile phone operator in 2002 but cancelled the project after failing to find a strategic foreign partner. Egypt has the lowest ADSL subscription charge for individual customers (transmission speed 256 kbps) in the Middle East at $24 per month, but only 3 per cent of the population had a computer in 2004. A 420 km fibre-optic cable now links Egypt and Sudan, and the information technology sector is showing average growth of 15 to 20 per cent a year.

The business climate seems to be improving, and important measures are being taken to stimulate the development of the private sector. The sector seems to have confidence in the new government and its pro-active business policy, although the powerful central bureaucracy is still an obstacle. The government has made very clear its determination to attract fresh investment and create jobs. The Ministry of Investment, established in July 2004, has replaced the former Ministry of Public Enterprise and taken charge of the privatisation programme. In April 2004, parliament adopted a law authorising the use of electronic signatures and set up an authority for the development of information technology. It also amended the law on investment incentives to add a fourth section offering new incentives, the most important of which is the conversion of the General Authority for Free Zones and Investment (GAFI) into a one-stop reception point for the facilitation of foreign investment projects. Recent laws on mortgages, the harmonisation of working conditions, competition and property rights also aim to improve the business environment.

In the small and medium-sized enterprise (SME) sector, the People's Assembly adopted a wide-ranging law in June 2004 for the development of micro-enterprises and small enterprises[1]. This policy is part of Small and Medium Enterprise Policies (SMEPol), a joint project of the Egyptian and Canadian governments. SMEPol was working on a national strategy to improve the competitiveness of SMEs, to be launched in the first quarter of 2005. The development of this sector is an integral part of the government's policy for fighting unemployment, which aims to create 550 000 new jobs per year through 2017. It is counting on small firms to create 350 000 jobs a year.

In 1998, the government identified 3 322 476 small businesses (fewer than 15 employees) and estimated that 38 763 new ones were started every year. The sectors which have the highest number of SMEs are industry, mining, commerce, finance and insurance. The most urbanised governorates (Cairo, Sharkia, Giza and Alexandria, i.e. the Nile Delta and Cairo areas) have the greatest number of small firms, and only 12 per cent of company heads are women. The SME sector accounts for 75 per cent of jobs, 80 per cent of GDP and 99 per cent of the non-agricultural private sector, but only 4 per cent of exports and 10 per cent of fixed capital formation. Eighty-four per cent of Egyptian SMEs operate in leased premises. The informal sector, representing 20 per cent of productive activity, consists of small activities like street stalls, which are very numerous, and manufacturing businesses that rarely have more than 10 to 15 employees. The recent depreciation of the national currency could have boosted their development, but SMEs do not have access to foreign markets. On the other hand, trade liberalisation has increased foreign competition in some sectors.

The law of June 2004 for the development of small and micro-enterprises offers such firms incentives and aids such as technical and financial assistance via the Social Fund for Development (SFD), 10 per cent of the land in industrial and tourist development zones and 10 per cent of public contracts. It also sets up a special SME unit in each of Egypt's 26 governorates so that firms can very quickly obtain a temporary licence and start trading. The long, tedious procedures for obtaining a full licence, which involve 32 steps, can be deferred. The law gives a particularly important role to the SFD, which now serves as the main co-ordinator between SMEs, ministries and foreign investors. First and foremost, it distributes the credits from donors. These funds, received initially at advantageous interest rates ranging from 1 to 4 per cent, are distributed to firms at an interest rate of 7 per cent, designed to cover administrative costs and risks, whereas the bank lending rate is currently 13 per cent. The SFD also provides the companies with various services such as feasibility studies and information

1. The June 2004 law defines micro-enterprises and small enterprises. The latter have capital ranging from E£50 000 to E£1 million and employ fewer than 50 people, whereas micro-enterprises have capital of less than E£50 000 and no more than five employees.

about marketing, risks, equipment and machinery suppliers, and so forth. For this purpose, it allocates about half of its resources to the Small Enterprise Development Organisation (SEDO). Lastly, the SFD is to set up funds in each of the governorates to help enterprises obtain loans and financing, as well as a fund to insure them against financial risk.

Apart from red tape and management problems, SMEs have great difficulty in obtaining loans. Financial institutions blame their lack of accounting systems and financial forecasting for this phenomenon. Only 6 per cent of bank loans are granted to SMEs. The figures from a SMEPol survey also indicate that 78 per cent of small firms have never applied to a bank for financing and that 92 per cent of those that have done so were refused. The figures are even higher for micro-enterprises.

One of the solutions for the small companies is micro-financing. In principle, lines of micro-credit are very substantial because donors (USAID, the International Finance Corporation, Environmental Quality International, the Canadian International Development Agency, the Islamic Development Bank, the Kuwaiti Fund, the European Union and others) are investing heavily in the financing of Egyptian businesses. NGOs, certain commercial banks, the SFD and the Credit Guarantee Company are very active in this field. Egypt is the regional leader where micro-financing is concerned. At the end of 2003, more than 250 000 customers, of whom about 46 per cent were women, had received micro-loans totalling $55 million, and demand remains strong, with the number of potential customers estimated at 2 to 3 million. Small entrepreneurs have two alternatives: to approach a not-for-profit NGO like the Alexandria Business Association

A Successful Micro-financing Programme run by the Alexandria Business Association (ABA)

ABA is a non-governmental micro-financing organisation whose success is nationally recognised. It grants loans very quickly – 72 hours for renewals, 14 days for first applications – to groups formed for the term of the loan, consisting on average of 100 borrowers headed by an ABA officer. The average amount lent is E£2 641 (about $425) at an interest rate of 18 per cent; 80 per cent of loans are earmarked for micro-enterprises and 20 per cent for vulnerable groups such as the unemployed and women. For loans up to E£3 000, the ABA requires only an identity card or family record book and a home lease or ownership deed.

The loan repayment rate stands at 99.2 per cent, and the number of new applicants is increasing at a rate of 140 per cent a year. The organisation has already covered its operating costs, two years ahead of schedule, and now operates in five governorates and has 28 subsidiaries. One of ABA's innovations has been the way its officers are paid. They receive a basic salary and bonuses based on the number of loans and repayment levels. The organisation also has a technical assistance centre and has contributed greatly to the economic development of the Alexandria area.

Two programmes have recently been launched to help "the poorest of the poor":

- In the Towards Self-Employment Programme, ABA has introduced micro-grants of E£200. This programme is open to the most vulnerable groups, woman and unemployed young people, so long as they have plans to undertake productive activity. The first payment is made on condition that the person works on the project eight hours a day for three months, and the second is made if the venture remains viable and the person available beyond that period. Seventy-four per cent of beneficiaries subsequently joined the micro-credit programme in 2003.
- The Blossoms of Micro-Enterprise Programme is designed for women who are household heads. It grants small loans of E£100-500 to groups of five members, as well as training on family matters such as hygiene, pollution and first aid. In 2003, 31 500 women benefited from this scheme.

(ABA) or to apply to a bank offering micro-financing services.

The funds distributed by donors are relayed by two large banks, the National Bank for Development (NBD) and the Banque du Caire. New banks regularly enter the micro-credit market, however. The Commercial International Bank (CIB) and Banque MISR made their appearance in September and October 2003 respectively, in partnership with North Africa Enterprise Development (NAED), and the Export Development Bank of Egypt (EDBE) joined them at the end of 2004 in partnership with the Private Enterprise Partnership for the Middle East and North Africa (PEP-MENA). The loans granted are generally for very small amounts (E£1 000-3 000), however, and interest rates are higher than market rates, at around 20 per cent.

The SMEPol now wants to address access to other sources of finance such as export financing, financial leasing and venture capital. Only one leasing firm, ORIX, finances SMEs without requiring a guarantee. Whereas other companies refuse to lend less than E£2 million, this sum is the maximum amount that ORIX will provide to its customers. SMEs also face problems of export financing and access to foreign markets. Several studies are in progress, notably with EDBE, which wants to set up export promotion units at a number of commercial banks. The idea is to have chambers of commerce act as intermediaries and guarantors for transactions between banks and SMEs.

Political and Social Context

A major ministerial reshuffle took place in July 2004, and several of the incoming ministers are regarded as belonging to a younger generation more open to change and reform. The new ministers were appointed to head the ministries most concerned by the reforms: the Ministry of Industry and Foreign Trade, Ministry of Finance and Ministry of Investment Development.

The president of the Arab Republic of Egypt has broad powers. He appoints first one or more vice-presidents, then the prime minister and the cabinet, and lastly the governors of the 26 provinces. A dozen opposition parties exist, but the party of the current president, the National Democratic Party, dominates both nationally and locally. In this situation, voter turnout for elections is generally low, ranging from 24.1 per cent in the last legislative elections to 42.4 per cent in district elections. The National Council for Human Rights recently called for an end to the state of emergency and an open political system, but the country's leaders favour stability and step-by-step change to avoid opening the door for the extremist parties.

The Egyptian president is chosen in two stages. His candidacy is first validated by a two-thirds majority of the National Assembly, which then submits its choice to plebiscite. President Hosni Mubarak, who has been in office for 24 years, could stand for a fifth term in May before a National Assembly dominated by his party. As candidates from other parties have no chance of being chosen, the opposition has united to call for amendment of the constitution so that the president can be elected by universal suffrage and his powers reduced.

Generally speaking, Egypt has made great progress in social affairs and poverty reduction. The government did not slacken its efforts in 2003/04, investing E£3.7 billion in the education sector and E£2.6 billion in health. Major regional disparities nevertheless remain.

Per capita income has fallen in US dollars at purchasing power parity owing to the sharp depreciation of the national currency. Nationally, GDP per capita was $3 793 in 2002, as against $4 878 in 2000. In the Port Said area, however, it stood at $8 287, compared with $2 245.30 in the Suhag region in Lower Egypt. In 2002, 20.4 per cent of the population was living below the poverty line, set at $1 per day at purchasing power parity. Lower Egypt is poorer than Upper Egypt. In the former area, 43.4 per cent of inhabitants either have no access to water or health care or are illiterate or unemployed, compared to 36.7 per cent in Upper Egypt. On the other hand, urban/rural disparities are greater in Upper Egypt, although the figures are tending to improve, in contrast to the rest of the country.

To eradicate poverty, the government is making cash transfers to the poorest, but their impact is not very great. These transfers represented 8.34 per cent of the income of the poorest (E£47 on average) and benefited 897 708 people in 2002.

Under the pressure of demographic growth, the job market sees 700 000 to 800 000 new entrants every year. This increases the unemployment rate, which rose from 9.9 per cent of the working population in 2003 to 10.7 per cent in 2004. The employment problem is particularly worrying for young graduates, increasing numbers of whom are failing to find a steady job on completing their education. In 2003, 14.4 per cent of unemployed people were university graduates. More than 23 per cent of women were unemployed in 2004, with the highest rates being found in urban areas. There are strong regional disparities: in the Aswan region, for example, 50.4 per cent of women are looking for work. Under-employment and work in the informal sector are estimated to account for one-third to one-half of GDP.

Life expectancy at birth has improved from 57.1 years on average in 1980 to 72.3 years for women and 67.5 years for men in 2003, as a result of a sharp drop in infant and maternal mortality rates, which have fallen by at least a third since 1980. The main diseases have been eradicated and the estimated prevalence of HIV/AIDS is very low, at less than 0.1 per cent of the adult population aged 15 to 49. The number of doctors, hospitals and beds per capita increased again in 2003/04 and, in line with the same trend, the percentage of the population with access to water and health care exceeded 90 per cent in 2003 for the entire country.

School enrolment rates in Egypt rose from 73 per cent in 1980 to 97 per cent in 2002 for primary education and from 50 to 85 per cent over the same period for secondary education. Considerable disparities remain, however. In 2003/04, more than 40 per cent of women were illiterate, compared with 17 per cent of men, but the figures for rural areas were even more alarming, at 85 per cent and 43 per cent respectively. The problem of educational quality is compounded by the shortage of teachers, especially at the primary level. In 2003/04, the average number of children per primary school class was over 40, a very high level. To deal with these problems, the education reform due in 2005 includes a number of basic proposals such as the establishment of an independent body to monitor the quality and level of education, the adoption of a decentralisation policy, an increase in the number of schools and the eradication of illiteracy among girls. This reform emphasises the quality of education and, to this end, sets much stricter standards for teacher recruitment.

The great majority of children – more than 85 per cent – are educated in the public school system. Others turn to the private providers (6.1 per cent) or to Al-Azhar (8.1 per cent), which is financed by public funds but run by a Koranic religious organisation.

