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SESSION 1: "HOW TO PACKAGE REFORM"

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Good morning. I am very pleased to be with you here today to share with you the developments in the Egyptian economy as far as the reform of the business environment is concerned.

I would like to thank Mr. Klein and Mr. Djankov for the kind invitation. I don't know if I should be saying that or not, but I was asked to tackle five questions about how do you sequence reforms and who are the main supporters for reform in the country and who are the main opponents of the reform, and the fourth question, how much have you learned from the reforms in other countries, and what indicators do you target to know your reforms are successful.

While the Bank has been nice enough to say that these are just

suggested questions to guide the structure of the presentation, someone is free to say something else, but I am going to be tackling these important questions in a way, and I have been always puzzled, personal level possibly, with this issue of sequencing of the reforms because if one checks the literature, one would be almost confronted with these interesting ideas.

You have three main markets, markets for trade of goods and services, a market for capital, and the third is for the labor, and then you have the domestic dimension, external dimension. If you need to do something right, you need to open all of these markets at once in a big push kind of approach of reform, and then every wise person will tell you, "Well, this is not really going to be doing the trick. Why don't you adopt a sort of a sequencing pattern of the reforms?" These suggestions normally come from the Bank and from the Fund.

My trouble with these suggestions from the Bank and the Fund, that we assume that you have done nothing during the years just waiting for the mission until it arrives and tells you, "Well, this is the right path, and you have to do this particular sequencing of reforms." Definitely all countries in their own ways, good or bad, they have tackled the reform with some partial approaches of reform, some comprehensive approaches with good and possibly bad intentions. So the issue of getting into sequencing as such may not really be the best way of dealing with the matter.

Then you have as well, as usual, the advice of the Bank and the

Fund that comes with all of these kinds of help warnings, that these are just suggestions, and you have to understand your innocent conditions and the reactions of different players of the markets and all of that, so we leave you then on your own with a particularly interesting disclaimer of whatever is going to be happening, especially if it is going to be a failure.

So what we are going to be doing then, given that we have freedom to do the action, is basically to adhere to the news of reforms through a comprehensive reform, just basically what we have been doing in Egypt since July 2004 until this moment and we are continuing.

We adopted what I can describe as a sort of an overwhelming approach of reform, that you have a good team led by a senior minister, our Minister of Finance who is joining us here, as the chief coordinator of the economy policy, and we just found that you cannot really have the luxury of waiting and starting with a reform, be it partial or not partial, and then go on with it. You have to tackle all of the areas of reform at once.

There were problems when we started in July 2004. There were problems in the trade front. There were problems in the financial sector. There were problems in the fiscal policy and the tax department, and there is a problem of the privatization program which was almost dead, if not dead and buried. So what we started to do is basically have all of these measures of reform tackled at once with good coordination through the Ministerial Economy Committee with good support from our Prime Minister because all

of these economic policies, as you know, would have an impact on other aspects of public policies, and we need it and we have it and we still have great political support from the president because all of these measures of reform that I am going to be sharing with you are very controversial in the short term by their very nature. They may take from your political capital or stock if you have any. So, in this case, you need this kind of a good political support from the leadership, and this could answer the other issue about who are going to be the supporters and the opponents of reform.

Generally before we get into this issue of supporters and opponents, in the short term you will not have many supporters as such. When you are going to be doing the privatization, liberalization, stabilization measures, you are not going to be seeing people marching in the streets saying something, "Well, I like privatization, I like fiscal reforms, and I like what you are doing in the banking reform front."

Even some of those that you may assume that they are going to be marching in your support from the private sector, some of the liberalization measures in the trade front, they are not going to be pleased with it because it is going to be reducing the protection that we enjoyed in the past. Privatization as well may not really be good news for many in the private sector who like to see some sort of a closed environment for their own businesses, and the media, even if you try your best to communicate and be transparent about what you are doing, if your media is being basically

educated and living in the past, whatever you are going to be doing in the liberalization front is not going to be praised, and some of the results, good results, are going to be attributed only to your good luck.

So here, the issue of continuity with the reforms are going to be waiting for some cheers of support. This, you are not going to be getting, and I think it is the custom, not just in Egypt, for those who are going to be winners of reform and good believers in God may go and thank God in silence. For those who are not going to be necessarily winners, the losers are going to be very much vocal about it and condemn everything and anything that you are going to be doing.

Then you get into that interesting question, are there any useful experiences that you can benefit from. Yes. Well, I think with what we are getting today from what is going wrong here and there, I think this is the best kind of publication that you can get from The World Bank and the IMF of what went wrong in it. So this is a nice interesting series of publications that you can go and get some good ideas from, what went wrong in East Asia as far as the financial reforms is concerned, what went wrong in almost every country in the world when it comes to the implementation of the privatization program.

So, if you try to avoid the mistakes, you are going to start doing nothing, I think. Whatever you are going to be doing then is basically trying to get some experience from the wrong examples, but we do have some

good examples to follow, and we are aiming high, so are looking for better examples to follow, especially coming from the OECD, but you can see as well some countries being mentioned frequently in the reforms in the business environment.

Singapore and Malaysia were quoted, Ireland and what they did in the reforms in the business environment. The cases of South Africa in public/private partnerships, mortgage finance reforms, for instance, in Mexico, and some other countries' experiences, especially in the Eastern European countries trying to catch up with the EU in the large form of the EU, especially the Czech Republic, Poland, and Hungary. All of these countries were good guides. Recently, we have been introduced to the two good examples of the reform of Canada and Holland in reforming their business environments.

What are the indicators of success? I think this is the last question before I get into -- this is an introduction -- the indicators.

Well, of course, one has to be a nice in the climatic -- of course, doing business report is our main guide to life, and we have to check it from time to time. There were some people in the past that got it wrong by aiming for a rank of 165 to be the best rank, but we are trying to fix it, to fix it now, and I am very pleased that some of the reforms are going to be definitely improving our ranking, but seriously, we are taking a variety of bench marks and indicators and will be sharing them with you now.

So what we did then is basically open all of these fronts of economic reforms, and we just took a stock of what is happening. We started actually with an investment climate assessment jointly with The World Bank, and we asked the business people what is going wrong, and we got 14 obstacles facing them to establish their businesses, dealing with the tax department, dealing with customs, problems related to access to land, access to finance, 14 big problems.

Meanwhile, the macroeconomic indicators were showing us very low real economic growth, at 3 percent, and if you are not an OECD country, you should be feeling the trouble if you are just growing at 3 percent. Increase rate was around 17 percent; unemployment rate, 10 percent. Fiscal deficit at the time was around 9.3 percent. Net international reserves, we lost one-third of our international reserves in a desperate move to defend the Egyptian pound. So we have to do something about it, that market in the form of change, and the foreign direct investment was less than 1 percent of GDP. This was basically the case in July 2004. So the luxury of sequencing and all of that wouldn't be -- and I am emphasizing here that this is not going to be doing the trick.

What we did starting a business, we established a one-stop shop that managed to reduce the number required to establish a firm and get it on the road from 34 working days to 72 hours, and this has been now one of the recognized success stories. There have been some interesting studies about

our own investment authority that encourages us to extend the idea beyond the establishment phase of the companies into extending it to the lifetime of the project.

So we are establishing now a free zone, investment free zones. Well, these are not free zones that are free from customs and free from taxes. These are going to be zones free from bureaucracy, free from corruption, free from incompetence. Basically, we are going to be having the same 32 agencies that are presented in our investment authority, responsible for dealing with all of the licenses and dealing on behalf of the investor with all of the government agencies, and this is being discussed and debated now in our parliament, and we are expecting that this is going to be fully operational by the beginning of this year.

We did something actually that is going to be, I hope, reflected in the Doing Business Report of this year. We reduced the minimum capital requirements for the firms from 50,000 pounds to 1,000 pounds. This is a 98-percent reduction. So we are trying to compete with the case of Georgia here. So 98 percent was basically the net reduction of the minimum capital requirements.

Property registration. We have an interesting case as well here because governments in the past have been proven that the people are always able to outsmart the governments because we have a property registration fee of 12 percent of the value of the property.

Then a government, 10 years ago, said, "Well, 12 percent is too much. Let's reduce it to 9 percent." The public said, "Well, 9 percent is too much. We are not going to be cooperating. We are not going to be registering." Then 6 percent and then 3 percent and nobody bothered to apply for a registration for the property, and then I think the government started to converge with the public in a way, and we have now a flat fee of a maximum of 2,000 Egyptian pounds. This is less than \$320, and this is the maximum for property registration coupled with administrative reforms. This is in the front of the part of the business and how we encourage business to be starting.

Then in paying taxes, I think we had a sort of a silent revolution by every spect of the tax reform we had from accord that is easy to read, that is going to be minimizing, if not eliminating, any possibility of corruption by leaving the tax to the interpreters, reducing the highest tax rate from 42 percent to 20 percent, having that as well on the personal income of maximum of 10, 15, and 20 percent. This has had a magnificent result. This is one of the most recognized reform measures that we have undertaken, and the tax returns increased from 1.5 million when we started the reforms in 2005 to 2.4 million last year, and I have been informed by the Minister of Finance, we are expecting 3.2 million of the tax returns for this fiscal year. So it seemed that the latter curve is very much in operation in the case of Egypt because tax returns do come as well with tax revenue. We established

as well a model of customs and tax center which is fully operational.

Customs reforms. Some of the members of The World Bank would remember failures of three missions coming to Egypt from 1999 until 2004 trying to reduce the tariff bands from 27 to 11. Failed. We were trying to reduce the effective tariff rates from 15 -- 14.6 percent to 10 percent. Failed.

What we did is basically reducing the number of bands from 27 to 6, without any cooperation with The World Bank here, and reduced the effective tariff rates from 14.6 percent in the first phase to 9 percent, and then we reduced that even further just a couple of months ago to less than 7 percent. So this is basically showing that another front is being opened, and that was coupled with some good reforms in the customs administration.

Improving the protection of investors, we established an institute of directors. This was with the help of The World Bank and the IFC, and we produced the first corporate governance manual in the language based on the OECD principles, including another manual for state-owned enterprises, again, based on the OECD.

We issued as well a competition law, and I have today a Competition Commission. We improved as well the issues related to protection of intellectual property rights. We improved transparency. We are adopting every possible international standard that we can, download, revise, and adopt effectively, and we are now adhering to the rules of the

game as far as the standards on loans of accounting and publishing a new budget system based on the GFSN 2001, rules modified and adopted. So this encourages us today to introduce the Information Disclosure Act of Egypt that is going to be discussed in the next parliamentary session, and this is not going to be just limited to the statistics. This is going to be treating information and data as one of the rights of the citizens.

Then at the same time, we tackled financial sector reforms, banking reforms. You can name every measure of the reform on this front, from the privatization of public states and joint venture banks to privatizing one of the publicly owned insurance companies, and this was promised in 1994 in one of the joint missions of the IMF and The World Bank. For 10 years, nothing happened, and now our government managed to do that big privatization of Bank of Alexandria. It is going to be followed by similar reforms in the insurance sector before the end of this calendar year, consolidation then of the banking sector, mergers and acquisitions in place, privatization, and reform of the regulatory structure and effectiveness of the regulation at the central bank level.

Something similar happened as well in the capital market, improving the instruments, the regulatory aspects of the market, introducing new pieces of the legislation based on the international standards, and here, the OECD should be recognized not just through the OECD main approach, but through some bilateral work that we managed to have during the last 2

years.

The market capitalization as a result of that increased in other things, including the development of the economy and the privatization program. It increased from 33 percent to close to 90 percent now.

Very quickly, we have a couple of minutes just to show you the indicators we are using. The story so far then that we have opened all of the fronts of the reform at once and through a comprehensive reform program, this helps us well politically for those who are opposing reforms. It is better that you are overwhelming them as well with your measures. If you do something that is going to be upsetting them in the privatization, they just disappeared, that something wrong is there, then you get the fiscal reforms taking its change, then a trade liberalization measure is taking place, a privatization of a bank. So, even if they are good in criticizing and trying to stop you, they don't really know how to catch you while you are doing it.

So this is an approach that could be good in a way in a country that has been living at least for 40 years in world interventionist policies of the state and considering any kind of liberalization of reform as at least something wrong that every minister in the government should be for.

The impact of these reforms, real economic growth increased from the averages of 3 percent, hitting 7 percent last year. We are expecting 7.2 to 7.3 percent of real economic growth this year. We are comfortable that this is going to be sustainable in the future because the breakdown of the

growth and the sectors responsible for growth are basically there, showing increases in the manufacturing side, the construction, real estate development, and one of the good aspects of the Egyptian economy, basically it is diversity, and it is not really relying on one sector. So we started to unleash one of the biggest issues of development in our economy. That is basically awaken every possible sector that would have good contribution to the reforms.

The monetary sector, I told you about this black market, and since the 23rd of April 2004, we have no problem whatsoever in the foreign exchange market. We don't use marketable exchange rates to be confusing every investor and even every normal citizen who likes to be with this market. We have seen some stability and convergence of overnight into bank rate, and as a result of capital inflows, FDI and portfolio investment net international reserves increased from \$14 billion to more than \$26 billion. This is more than 10 months of coverage of our inputs.

Annual inflation rate, this is one of the issues that we are working on now. There were a couple of supply-side shocks in the form of the revision of the image of prices and the impact of the Avian flu on the basket of food products, but through the discipline, we are introducing in the monetary policy, and what we are seeing today of improvement in our fiscal deficit, the government through the Ministry of Finance has promised a reduction of 1 percentage point since 2004, aiming to 3 to 4 percent of

budget deficit to GDP by the year 2009, and we are achieving that target in a year-to-year comparison.

Trade balance. Increases in exports, increases as well in imports, but this is very much attributed to the growth pattern we are starting to see. More intermediate goods and more primary goods are there on the import side, and we can see as well some increases, thanks to the competitiveness of particular industries in Egypt today, including food products being exported to different markets, the impact of the qualified industrial zones with the United States, and this is basically going to be continuing for a good deal of time.

Despite having a trade deficit, our current account is still seeing positive figures of around 2 percent of GDP. Actually, a country like Egypt should be seeing a current account deficit of around 2 to 3 percent. We are not aiming for that now, but if this is going to be happening, this should be good news in a way through an active capital account.

The banking sector, you can see here a few important developments, including the reduction of the number of operating banks from 57 to 38. Through the consolidation program, we are seeing some slight improvement in the domestic credit in the country, and this has been basically through increases in the Bank's activities to extending credit.

There is some positive development as well. You can see a decline in the share of the public sector in credit, and this is basically

because the public sector started to pay back its debt. This is one of the confusing things, how you are paying back debts and then the credit growth is defining, is it because of one of the confusing tricks in the banking sector. Even if you are not paying your debt and you are a public company, you are assumed to be performing your debt, and interest rates are going to be accounted for.

So, when you start to pay back your debt, it is going to be shown in negative credit growth. This is a bit confusing for those who are not familiar with some ways of managing banking systems that we are trying to get rid of. In any case, we are seeing the list of private banks and foreign banks are much better in the performance than the public banks, and we are doing something about it through the privatization and through the reforms in the public banks that are going to be remaining in the government hands for a while.

Unemployment rates is declining in a country that is producing 600,000 applicants for work every year. This is approximately the size of some neighboring countries who have to take care of that through high growth rates. Employment is being generated through the private sector. You can see now a generation of more than 600,000 compared to the government sector producing only 76 while it should be actually downsizing. So 76 is not good news. We need to have negative growth of jobs in the government sector.

The state-owned enterprises are showing us some profits. Some restructuring has been taking place. These are operational profits, not because of the privatization. What we are using the privatization proceeds for is basically paying back the debts and reduce the demand performing loans from 33 billion to less than 10 billion Egyptian pounds today, and we have a target to eliminate all of the non-performing loans by the end of the next fiscal year.

These are the sales proceeds. As I told you, it was almost nothing in 2003 and 2004. We managed to increase that, and we still have a few months. I think we can have something similar to the record year of last year by the privatization proceeds, and this is basically that we are interested in how we are using the sales proceeds and how we are channeling them. These are basically the different aspects of using the sales proceeds.

Capital markets have been increases of market capitalization from 33 percent, July 2004, to more than 90 percent in April 2007, despite the corrections in the markets that took place during the last 18 months or so, and we still see activities that should be recognized, especially in the acquisitions and the net portfolio investment turning from negative into positive, as you can see on the chart there.

The insurance sector, this is something that we are working on reforming. Before the end of this year, we are going to be seeing more private sector participation than what we are seeing today, especially in the

non-life business, and then mortgages, this is something that I am very pleased to see some good support from The World Bank in. We started from nothing to a billion Egyptian pounds, and we are expecting more than 2.5 billion before the end of this calendar year in mortgage finance.

The private sector, it seems happy by two measures. More established companies and more companies of the incumbent ones are reporting increases of 20 to 25 percent of expansions, and this is one of the main measures that we are using, FDI as a percentage of GDP, from 1 percent of GDP to 6.5 percent last fiscal year. This year, we are expecting the net FDI to be more than 8.5 percent of GDP, and this is going to be bringing Egypt from being number two in Africa, after South Africa last year, by the measure of the unfed to become number one for this year.

Private sector share in total investment increased from 47 percent when we started to 67 percent this year, expecting 72 percent next year, and this is another proof of what I am saying. The private sector in the purple bar and the bluish one of the public sector, the private sector is leading and is going to be continuing to do that through more reforms. It may upset some people in the short term, but we are asking for two things; first, that these reform measures are going to be having the required impact on the long term, and we bet on that. If not, we are seeking to be rewarded in heaven.

Thank you so much.