POLICY VIEWPOINT

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Egypt's Global Competitiveness: Unlocking the 2006-07 Report

Policy Viewpoint reflects the stance of ECES on key policy issues in Egypt.

With the recent momentum in Egypt's economic reforms, it is important to look back in order to look forward. Taking stock of past reforms and determining where Egypt stands today in relation to other economies will undoubtedly help inform future reforms, and hence place the economy on a sustainable path of development. To this end, this edition of the *Policy Viewpoint* takes a closer look at the results of the new Global Competitiveness Report (GCR) to address questions such as how far Egypt has gone along the route covered by its comparators on the nine pillars of the Global Competitiveness Index (GCI) of the Report.[*] What are Egypt's main comparative (dis)advantages? And more broadly, are reform efforts in Egypt paying off adequately, and if not, why?

The crux of the analysis is that our reform efforts have not yet put us on an equal footing with other emerging economies as regards competitiveness. Besides the need to enhance macroeconomic stability in the economy, Egypt would do well to accelerate structural reforms especially as related to the financial sector and the regulatory environment. To keep pace with a rapidly changing world and overcome persistent problems in the economy would require a bolder approach to reform, while realizing that success will ultimately rest on the presence of a strong political will for reform. It also entails setting forth communication plans capable of effecting behavioral changes among the main stakeholders of the reform process.

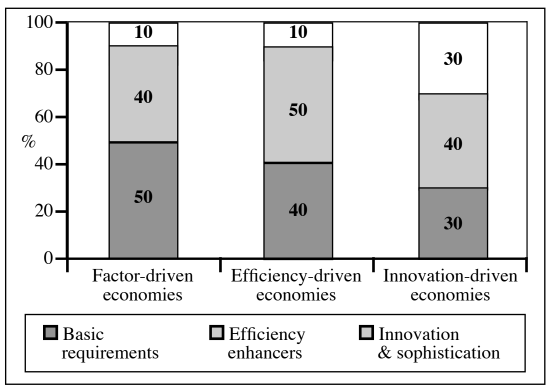
This edition of *Policy Viewpoint* starts with a brief review of the GCI and its main components. It then moves on to identify where Egypt stands on the nine competitiveness pillars of the GCI in relation to other emerging economies. It also discusses the factors responsible for observed outcomes and concludes with some broad proposals for reform.

[*] The nine pillars of the GCI are: institutions, infrastructure, health and primary education, macroeconomy, higher education and training, technological readiness, market efficiency, business sophistication, and innovation. It is noteworthy that the 2006/07 Global Competitiveness Report ranked Egypt at 63 out of 125 countries. The higher the rank the less competitive the country is.

What is the Global Competitiveness Index?

The 2006-07 edition of the Global Competitiveness Report adopted a new tool to assess countries' competitiveness: the GCI. The GCI captures a larger set of factors, policies and institutions that affect productivity and growth as compared to the Growth Competitiveness Index used by the Report since 2001. The selection of the nine pillars used in the construction of the GCI was based on the findings of theoretical and empirical research that proved their importance to competitiveness. These pillars were grouped into three sub-indices: the basic requirement index (comprising institutions, infrastructure, macroeconomy, and health and primary education), efficiency enhancers index (higher education and training, market efficiency, technological readiness) and the innovation index (business sophistication and innovation). In the construction of the GCI, the sub-indices were accorded different weights depending on countries' stages of development (Figure 1). The Report classifies Egypt as a factor-driven economy.[1]

Figure 1. Weights of GCI Sub-Indices According to Country's Stage of Development



Source: The Global Competitiveness Report 2006-07.

One-third of the variables used to construct the GCI comes from publicly available hard data and the rest from an executive opinion survey. Hard data lag behind a year or two. Macro data are for 2005. Data on health, education, and telecommunications sectors are for 2004. In other words, most recent developments in the economy are not reflected on country rankings, yet this applies to all countries.[2]

The survey provides an up-to-date measure of a nation's economic environment and its ability to achieve sustained growth. It gathers information on a broad range of variables for which hard data sources are scarce. The sample of respondents is representative of the different sectors of the economy, and it focuses on larger companies with some international experience that can visualize where their country relatively stands. Questions are set such that respondents answer on a 1-7 scale, one being the worst and 7 the best. Despite the inherent subjectivity in answering the survey questions, the GCI still offers a reliable and useful measure of competitiveness on comparative basis. It is reliable because the possibility of subjective responses applies to all countries and thus we can assume the effect on relative positions cancels out. It is also useful as it positions the economy in an international context and highlights the areas of reform that are most pressing.

In light of the above, this *Policy Viewpoint* proceeds to investigate how Egypt fares on the nine pillars of the index as compared to the other emerging economies and to identify Egypt's main comparative (dis)advantages.

Where does Egypt Stand?

The Global Competitiveness Report ranks Egypt at 63 among the 125 countries covered by the Report, which includes both developed and developing economies. It is less obvious, however, how we fare compared to the group of emerging economies—our main competitors. To visualize where Egypt stands on the different pillars of competitiveness and how far it has gone along the route covered by other emerging economies, Egypt's score on each pillar, Z, was normalized using the formula:

$$\acute{Z}_E = \frac{Z_E - min\ Z}{max\ Z - min\ Z}$$

where

$\acute{Z}_E$ = normalized Z for Egypt

Z_E = Egypt's value of variable Z

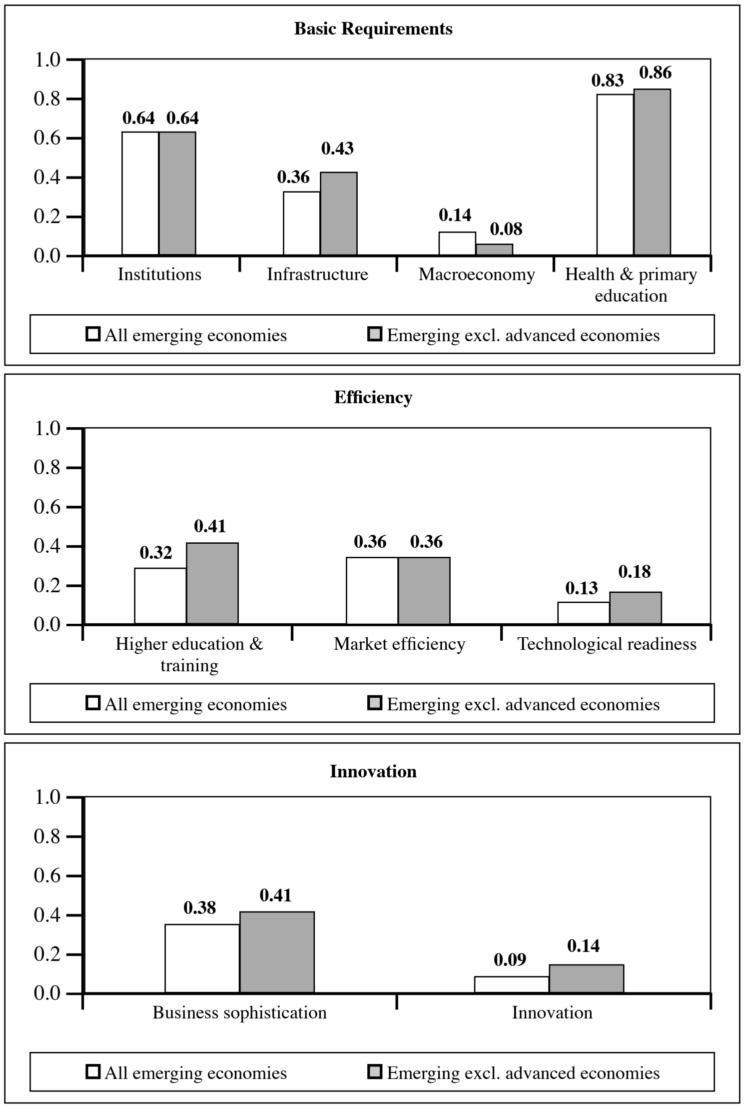
Min Z = min value of Z in the group of emerging economies

Max Z = max value of Z in the group of emerging economies

The normalized values are indicators of the distance Egypt covered (Z_E – min Z) from the total route it has to cover (max Z – min Z). If Egypt's value is at the minimum, the normalized value of the measure will be 0 and if it has attained the maximum value, the normalized value will be 1. The results are given in Figure 2. The figure compares Egypt to two groups of emerging economies. The first group is the whole set of emerging economies (26 countries) as included in the Morgan Stanley Emerging Markets Index as of 2006.[3] The second group excludes from the former: Brazil, Israel, Mexico, South Africa, Korea, and Taiwan, classified by FTSE[4] as advanced emerging economies.

Egypt performed relatively well on health and primary education and to a lesser extent on institutions. It lies at the low end as regards macroeconomy, innovation and technological readiness. As regards infrastructure, higher education and training, market efficiency and business sophistication, Egypt traveled about 30-40 percent of the way covered by other emerging economies. If advanced emerging economies are excluded, Egypt's relative position improves marginally on health and primary education, infrastructure, technological readiness, higher education and training, business sophistication and innovation, remains unchanged on institutions and market efficiency and deteriorates on the macroeconomy pillar of competitiveness.

Figure 2. Egypt's Normalized Values of the Nine Pillars of GCI



Source: Author's calculations.

The above gives a general view of where Egypt stands on the 9 pillars of competitiveness. While it is clear that the budget deficit and public debt are pulling us down on the macroeconomy pillar, our disadvantages on the other pillars is less obvious and this is discussed in detail in the next section.

What is Holding Egypt Back on Competitiveness?

To identify Egypt's comparative disadvantages, we rely on Egypt's ranking among the 26 emerging economies and the 125 countries of the GCR on the different components of the pillars of the GCI. Egypt's ranks are reported below in parentheses. Unless otherwise indicated, the first number refers to Egypt's ranking among the 26 emerging economies and the second to its ranking among the 125 countries of the GCR.

As mentioned above, high government deficit (26, 124) and public debt (24, 101) are our apparent disadvantages on the macroeconomy pillar. Other disadvantages include inflation (24, 109) and interest rate spread (19, 64). On the positive side is the real effective exchange rate. However, the continuation of this advantage into the future is questionable given our *de facto* fixed exchange rate and rising inflation in Egypt.

On public institutions, Egypt's main disadvantage relates to the extent of red tape measured as the percent of time spent by firms' management in dealing with government officials (26, 121), and the burden of compliance with government regulations (16, 73). Other disadvantages include the relatively high cost of terrorism (20, 102). Disadvantages of private institutions include the efficacy of corporate boards (18, 79) and the strength of auditing and reporting standards (19, 71). Of these disadvantages, only the cost of terrorism is temporary, others are of a more permanent nature and will continue to affect Egypt's competitiveness if they are not addressed.

On the human infrastructure of competitiveness, Egypt ranked very low on the quality of higher education (23, 104). Its position is relatively better on the quantity of primary education (8, 41) and secondary education (12, 55). On the extent of staff training, Egypt ranked very low (23, 83). As regards physical infrastructure, railways ranked first (47 among 126 countries), followed by air transport (56), and sea ports (61). Relative to the other emerging economies, Egypt's ranking on infrastructure was around average. This ranking is expected to change with the recent disruptions in the railway transport.

The market efficiency pillar of the GCI covers the three markets: goods, labor and financial markets. Egypt's main weaknesses as regards financial markets are the soundness of banks (20, 94), venture capital availability (22, 87) and access to loans (21, 81). The main labor market weaknesses are the tendency of talented people to leave the country to pursue opportunities in other countries (25, 110), the hiring and firing practices (20, 98), and the tendency to assign senior management to relatives rather than professionals (23, 88). Contrary to expectations, Egypt ranked relatively high on the flexibility of wage determination (2, 7), linking payment to productivity (10, 31), and private sector employment of women (6, 37). The main weakness in the goods market is competition (76 among 125) especially as regards the prevalence of trade barriers (25, 105). Despite the improvement in Egypt's score on the trade barriers variable, its relative rank remained unchanged.

On the sophistication of business operations, Egypt ranked low on the willingness to delegate authority in firms (24, 88), the extent and sophistication of marketing (26, 89), and production process sophistication (21, 73). Egypt's weakness on the microeconomic foundations of growth, firms, is also reflected in Egypt's low score on the Business Competitiveness Index, another index reported by the GCR. On this index, Egypt ranked 23 among the 26 emerging economies only before Russia, Venezuela and Morocco.

Finally, on the innovation pillar, Egypt ranked very low on company spending on research and development (26, 98), the quality of scientific research institutions (24, 95), and university/industry research collaboration (25, 94).

To sum up, Egypt's comparative disadvantages are closely related to its budget stance, bureaucracy, financial sector, quality of education, and underdeveloped business operations. However, Egypt is not new to these problems. The next section discusses why our disadvantages persist despite reforms.

Why are we Lagging Behind?

As previously shown, Egypt lags behind on the nine pillars of competitiveness, but with varying degrees. The bulk of this can be attributed to the nature of reforms adopted. First, economic reform has not been pursued with the same intensity since its inception in 1991. It slowed down at the end of the 1990s (until 2004), which eroded some of the early success in stabilizing the economy and prevented more progressive structural reforms. Second, reforms undertaken have not always been of the type that makes a "real" difference and when they are, they are not backed enough by effective communication plans.

The slowdown of economic reform in Egypt towards the end of the 1990s has been a key factor behind our lackluster performance on the macroeconomy and market efficiency pillars of competitiveness. With the loss of reform momentum, the economy witnessed deterioration in its stabilization indicators, especially as regards the fiscal stance. The fiscal deficit as a share of GDP reached a peak of 10.5 percent in 2002/03 after declining to less than 1 percent in 1997/98. Also, between 1997/98 and 2002/03 there was a rise in inflation (from 4.2 to 7.1 percent) and dollarization (from 17.9 to 19.9 percent of total liquidity) (Central Bank of Egypt; the Ministry of Trade and Industry; and the Ministry of Finance). The efficiency of goods and financial markets that is closely related to structural reforms has also been affected by stagnating reforms in trade and finance and by the slowdown of privatization.

Egypt's low performance on institutions, especially as related to the burden of compliance with government regulation and on business sector competitiveness is also a reflection of the inadequate nature of reforms. Over the past few years there have been attempts to reduce barriers to market entry and exit and to improve the tax system, but it is evident that improving the regulatory environment requires more than piecemeal reforms at different points in time. Also, the majority of firms in Egypt are still underdeveloped in their operations and strategies and their export readiness is very limited despite the multiple business support programs. These suggest the need for bolder reforms and international experience shows relevant examples in this regard. In the area of regulatory reforms, consider the deregulation experience of Korea, Mexico and the Czech Republic, which is based on assigning the responsibility of deregulation to a temporary national committee that is empowered to undertake the process. This approach is justifiable given the size and the sophistication of the work involved that ranges between acquiring knowledge of existing rules and regulations and of business environment constraints and mastering the ability to select and deal with those regulations that have the largest impact on transaction costs in the economy. As regards upgrading firms' operations in Egypt, the successful Asian experience with supporting subcontracting stands as a worthwhile example. The National Supplier Development Program (NSDP)[5] applied in Egypt to increase the efficiency of subcontractors could form the nucleus for a national program aimed at encouraging subcontracting in Egypt along the lines of the Asian experience.

Adopting best practices is, however, insufficient to achieve the desired leap-forward developments. Such reforms need to be supported by a communication strategy capable of rallying support for change. It is important that such strategy be formulated and implemented at an early stage of the reform program to determine the needs of beneficiaries and understand potential barriers to reform. The acquired information then feeds into the design of the reform programs. Well-designed communication plans to this effect can contribute significantly to the success of some currently applied reforms as educational decentralization, into which Egypt puts a lot of stock to improve the quality of education. This approach to educational reform proved useful in countries such as Argentina, Nicaragua, and the Philippines, but so far it has had an ambiguous effect on students' outcomes in Egypt (Nasser-Ghodsi 2006). Being at its early stages, educational decentralization in Egypt can benefit from communication with the main stakeholders to remove any cultural barriers to its success.

Looking ahead, reform efforts in Egypt need to be of a continuous nature to achieve their intended objectives. Absent continuity, even the most appropriate reforms will fall short of achieving their goals. It is also important to deal with persistent problems in the economy and address cultural and structural barriers to reform. A priority area for action is reforming public finances and reducing public debt, as there is no country experience that shows any potential for sustainable growth in the context of an unstable macroeconomy (WEF 2006-07). Additionally, developing a sound and responsive financial sector emerges as another priority area for higher growth and development as shown by the results of the regression analysis conducted for 81 countries of the GCR and the performance of Egypt relative to other countries. Alleviating the burden of compliance with government regulations is another priority for growth.[6] Both reforms will ultimately feed positively into the investment performance in Egypt.

In today's world, we have to run just to stay in place. To get ahead, we have to run faster than others and we have to act accordingly. What is needed is a strong political commitment as well as realization that any meaningful reform will involve costs for some in the short run, but significant gains for the economy in the medium and long runs.

References

Nasser-Ghodsi. 2006. What is the effect of educational decentralization on student outcomes in Egypt? An analysis of Egypt's education reform program. Thesis presented to Stanford University.

WEF (World Economic Forum). The Global Competitiveness Report 2006-07.

Endnotes

1 Countries are categorized into different stages of development according to per capita GDP. Countries with per capita GDP less than $2000 are at the factor-driven stage; from $3,000 to $9,000 are at the efficiency-driven stage and more than $17,000 are at the innovation-driven stage. Countries with per capita income outside these ranges are in transition.

2 According to the GCI, Egypt's budget deficit increased from -2.5 percent to -10.5 percent, which is inconsistent with official data. It seems that the report used different measures of the deficit for the two years: primary deficit for the 1st and overall deficit in the 2nd. However, this does not affect this year's score for this variable but negatively affects last year's score.

3 The whole set of emerging economies includes Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey, and Venezuela.

4 FTSE is an independent company owned by the Financial Times and the London Stock Exchange. Its sole business is to create and manage indices on an international scale.

5 NSDP is under the Industrial Modernization Program.

6 To set priorities for reform, GDP per capita growth of 81 countries of the GCR was regressed on population growth rate, the ratio of investment to GDP, initial GDP per capita, interest rate spread (as a proxy for the efficiency of the financial sector), burden of compliance with government regulations (a proxy for the efficiency of public institutions), and gross secondary enrollment rate (a proxy for the availability of educated labor force). These variables had the expected signs and were significant. Other variables were tried such as the level of local competition and the prevalence of trade barriers, but they turned to be insignificant. The dataset used is cross-sectional with each data point representing the average of 4 successive years (2002-2005) except for the gross secondary enrollment rate (1991) and initial GDP per capita (2002).

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