

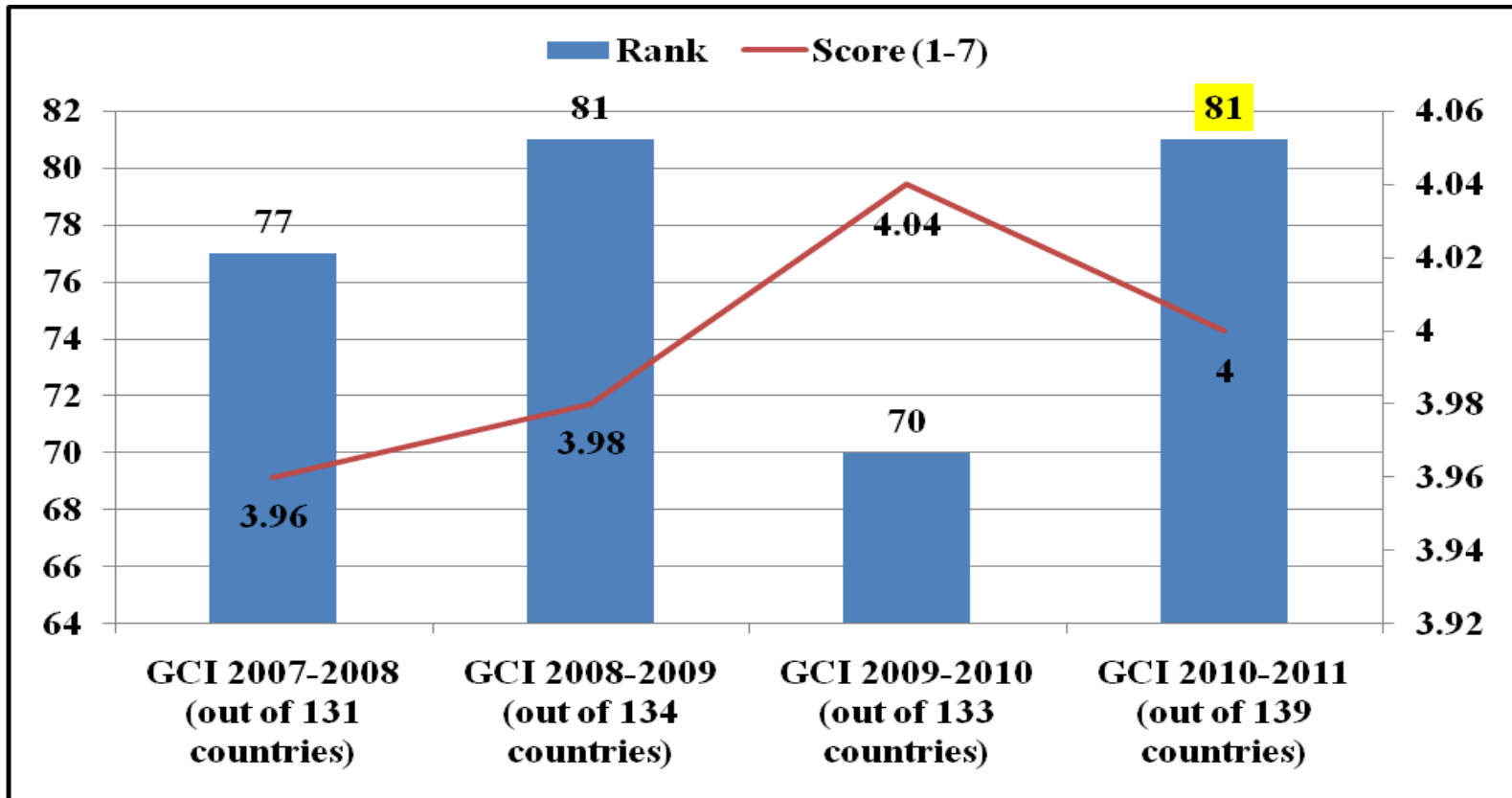
TOWARDS ENHANCING EGYPT'S COMPETITIVENESS IN THE GLOBAL ECONOMY

April 14, 2011

Contents

- Overview of Egypt's Competitiveness
- Where does Egypt have a competitive advantage?
- Areas where Egypt made progress
- Areas of weakness
- Recommendations for greater competitiveness

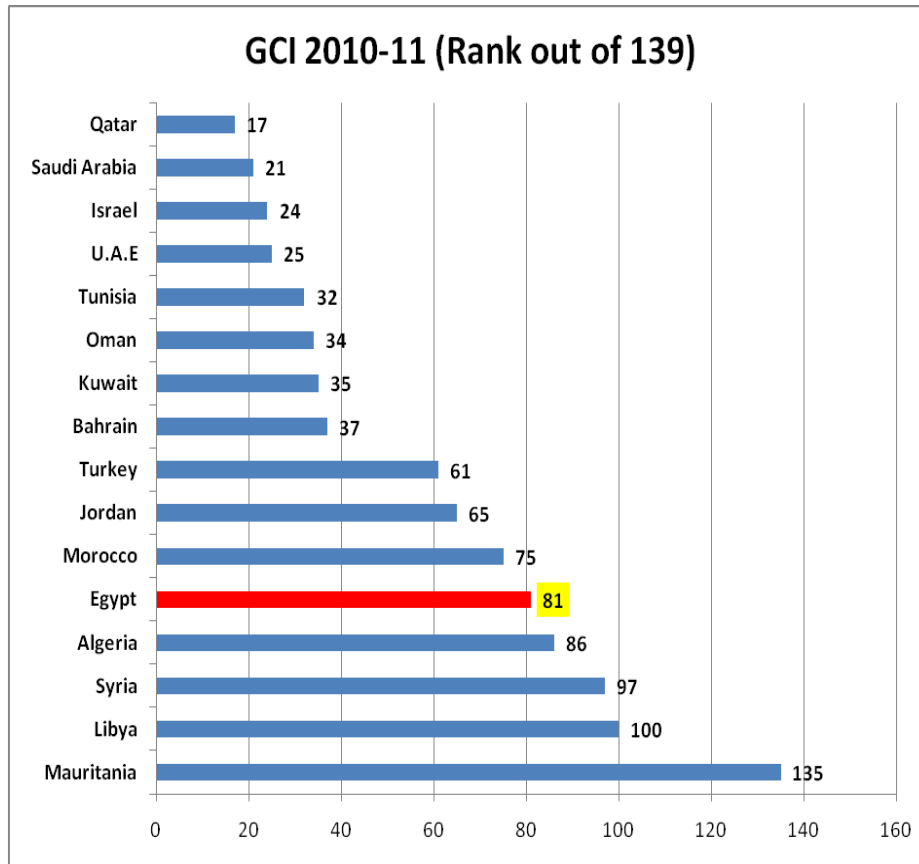
Egypt's Stance in The Global Competitiveness Index



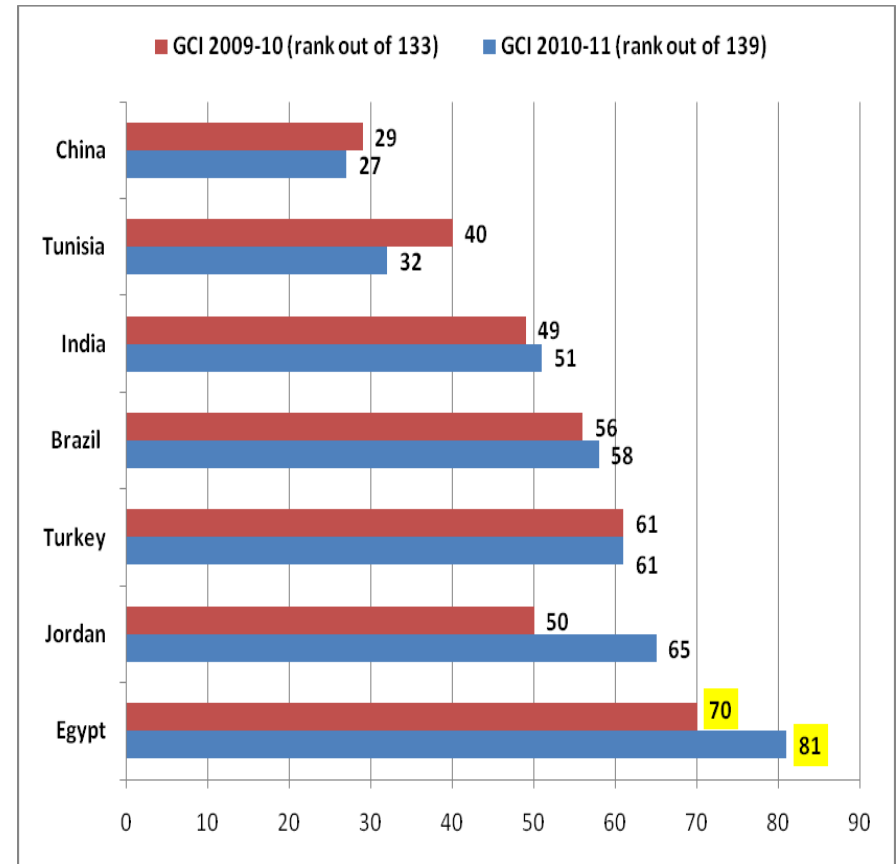
Source: WEF , Global Competiveness Reports, 2007-2010.

Egypt's Stance in The Global Competitiveness Index

Egypt Compared to MENA



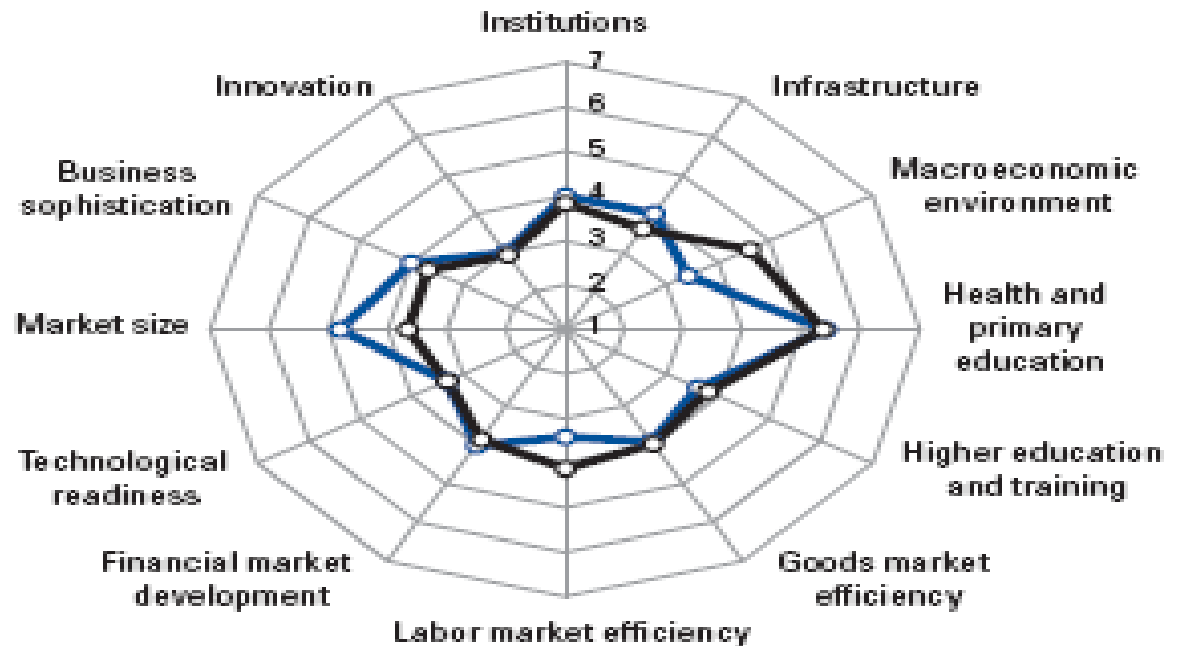
Egypt Compared to Select Countries



Egypt has a competitive advantage in:

- Market Size
- Infrastructure

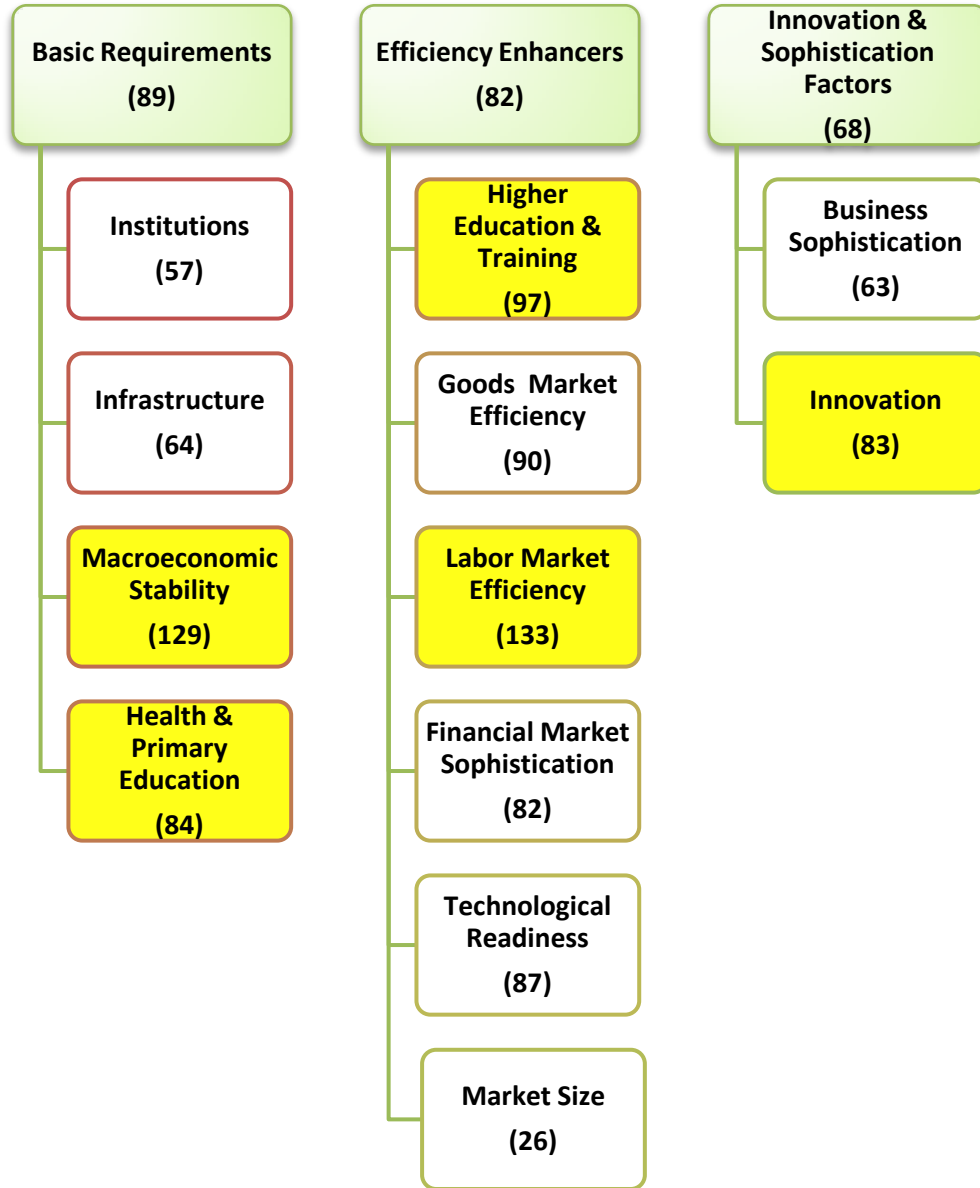
Stage of development



—●— Egypt —●— Economies in transition from 1 to 2

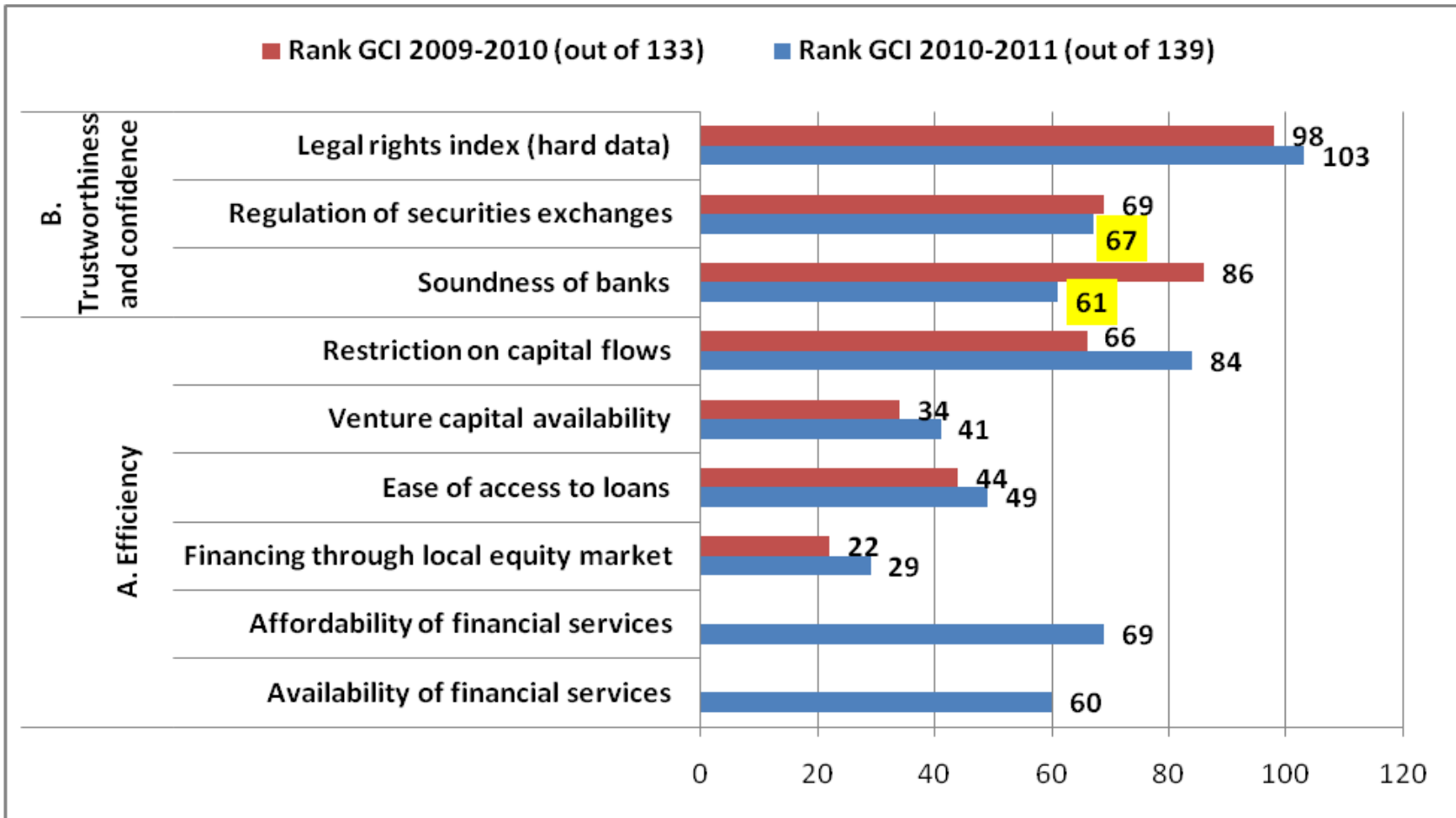
Egypt's rank on the 12 pillars GCI 2010-11

(Highest =1, Lowest= 139)



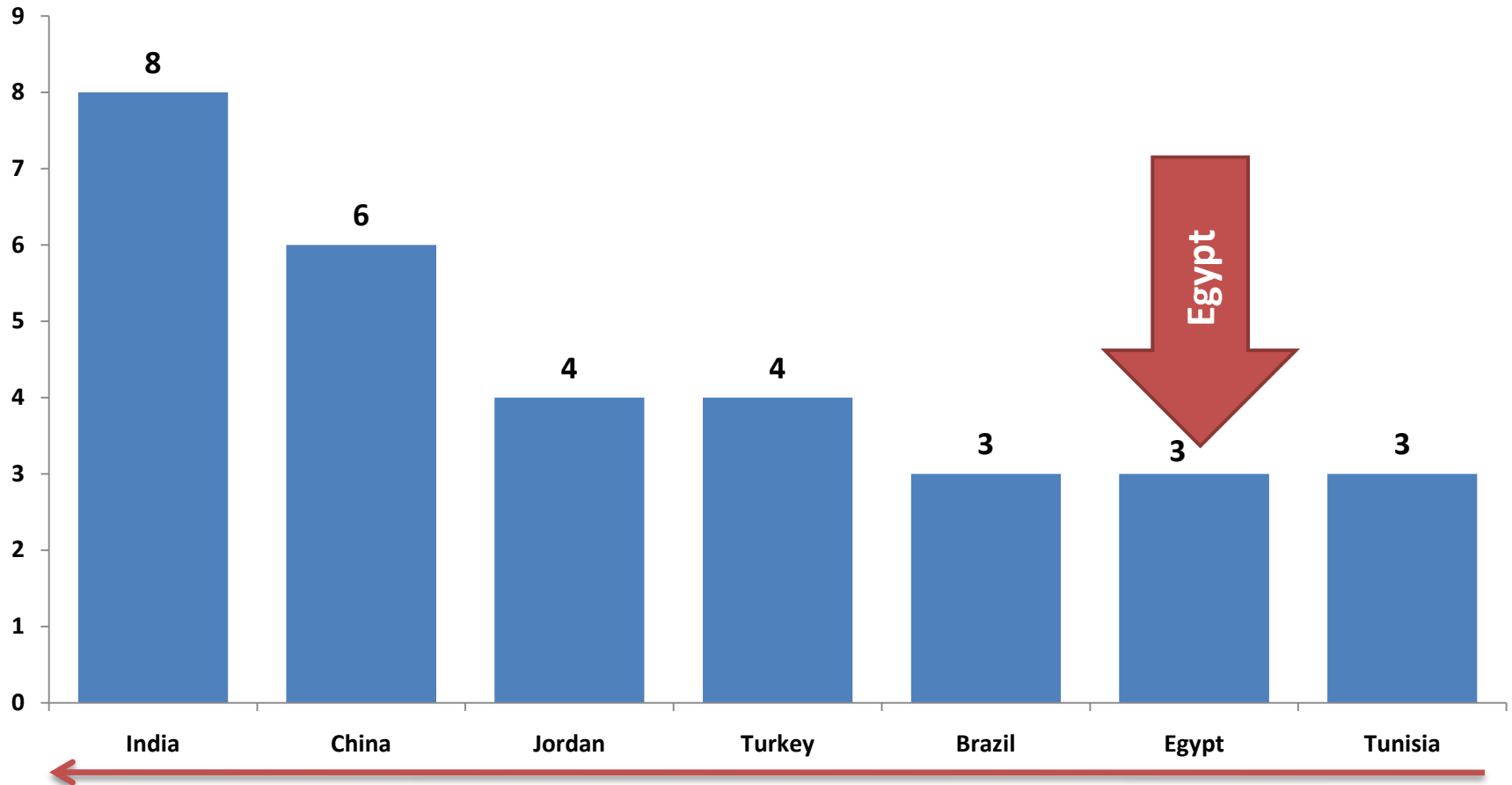
Where did Egypt Improve?

Financial Market Sophistication- Up 2 Places to be ranked 82nd



Egypt's score is very low suggesting the need for tougher enforcement of the rules of law

Legal rights index Score (0 - 10) *

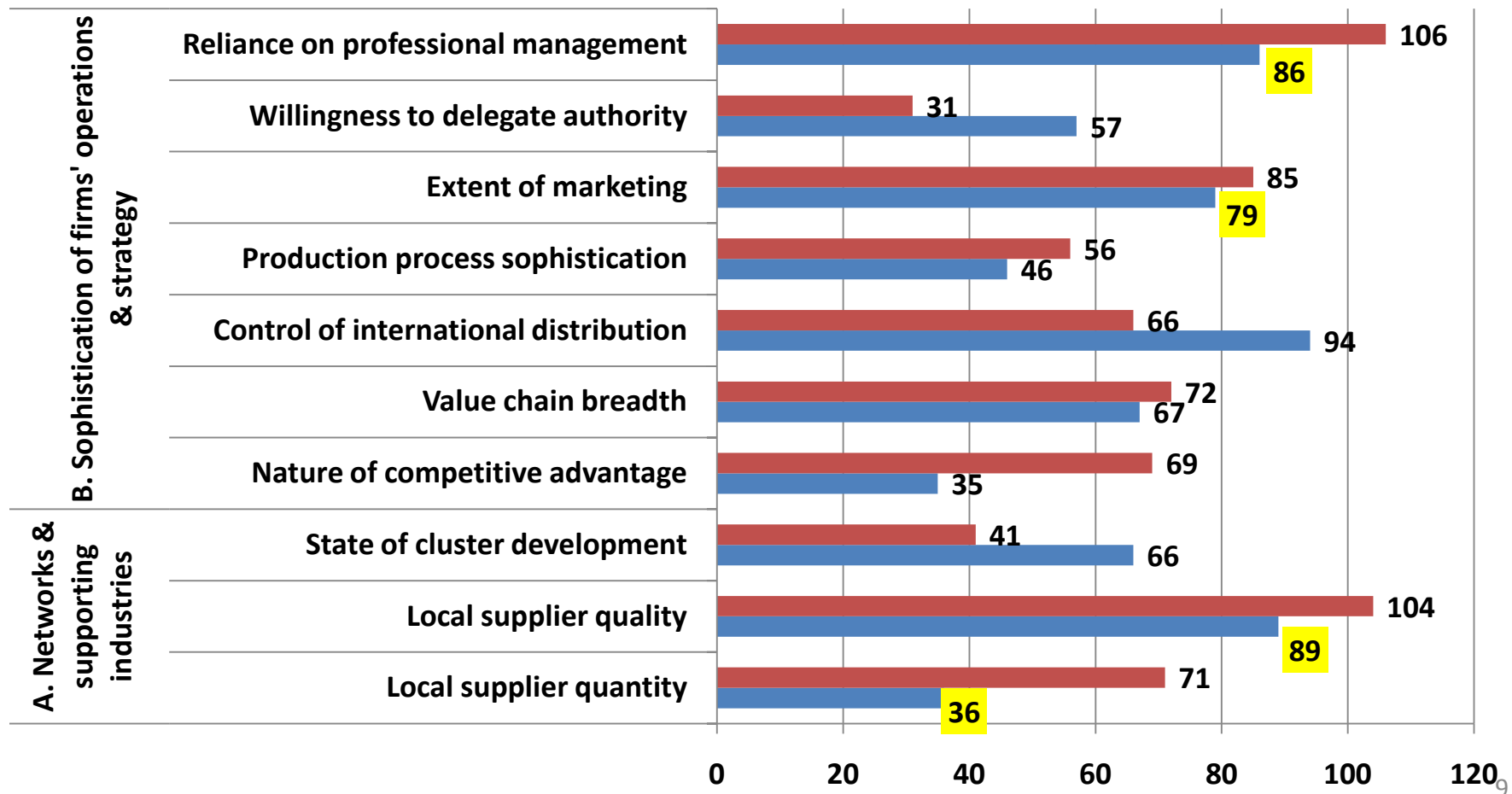


Where did Egypt Improve?

Business Sophistication- Up 9 Places to be ranked 63rd

■ Rank GCI 2009-2010 (out of 133)

■ Rank GCI 2010-2011 (out of 139)



Chronicle Weaknesses

Areas that put Egypt's competitiveness at stake:

Macroeconomic stability

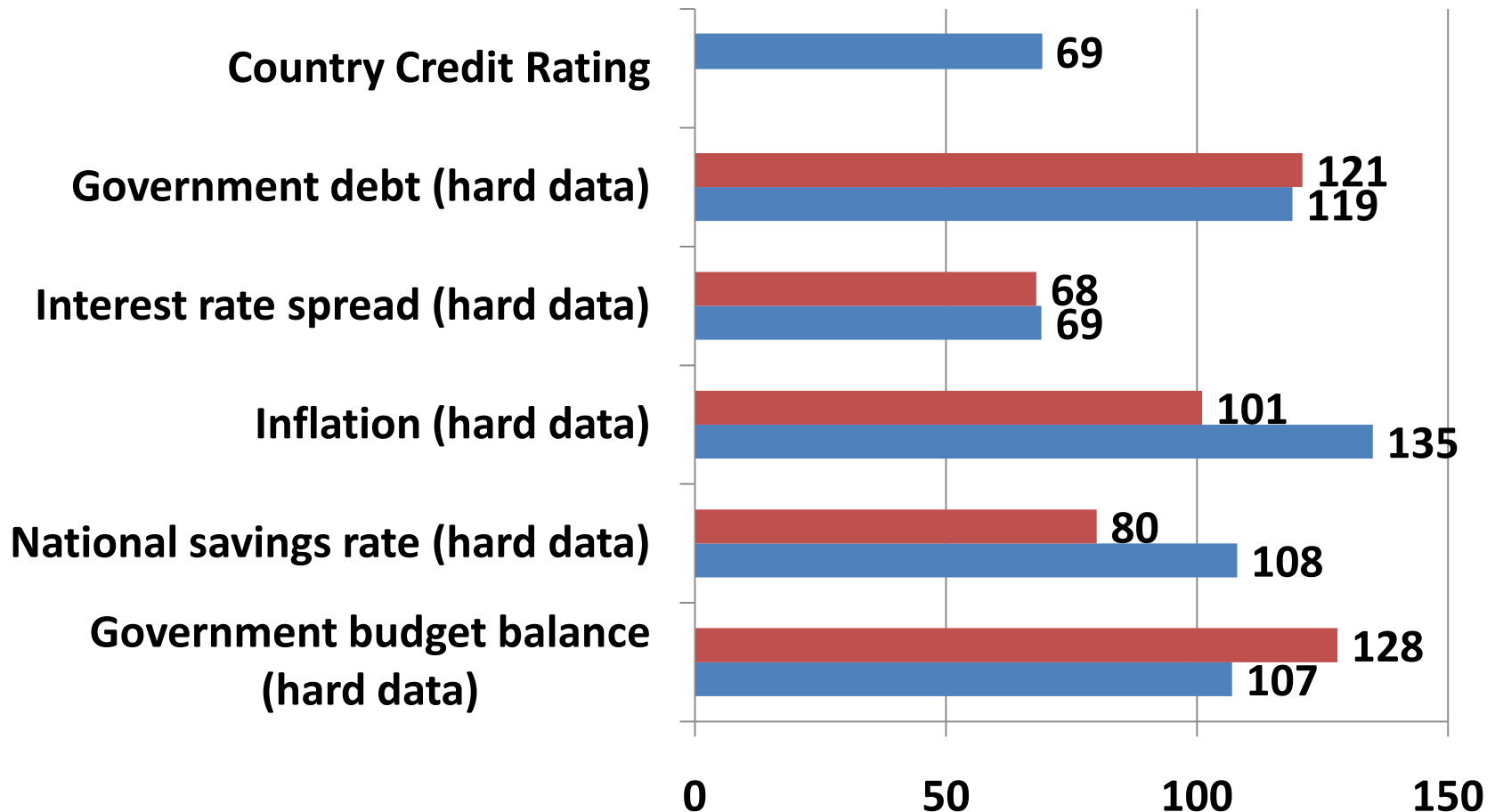
Human Capital Development

Innovation

Macroeconomic stability

Macroeconomic Stability

■ Rank GCI 2009-2010 (out of 133) ■ Rank GCI 2010-2011 (out of 139)



Macroeconomic Stability

	Govt. Budget balance as % of GDP (2009)	General Government gross debt as a % of GDP (2009)	National Savings rate as % of GDP (2009)	Inflation	Interest rate spread**	Country credit rating (score from 0-100)***
Brazil	-3.2	48	15	4.9	35.4	65.3
China	-2.2	16.9	52.3	-0.7	3.1	75.4
Egypt*	-6.6	80.1	16.9	16.2	5.5	51.4
2009/10	-8.2	73.2	14.1	11.6	5.1	NA
India	-4.6	73.1	37.5	10.9	5.2	62.2
Jordan	-11.8	64.4	30.7	-0.7	4.3	45.5
Turkey	-5.5	45.2	14.8	6.3	3.4	52.5
Tunisia	-2.9	53	26.9	3.7	2.9	59.2
Average	-5.3	54.4	27.1	5.8	8.5	58.8

*Egypt data for fiscal year 2008/09

** average interest rate spread between typical lending and deposit rates

*** Expert assessment of the probability of sovereign debt default on a 0-100 . (lowest) probability scale as of September 2009.

Recently, Several Agencies Downgraded Egypt's Rating

□ Moody's: On 31st of January 2011 it cut its rating on Egypt's sovereign debt by one grade from Ba1 → Ba2

✓“the government may damage its already weak finances by increasing social spending to calm mass protests”

✓“A background of rising inflationary pressures further complicates fiscal policy by threatening to increase the high level of budgetary expenditure on wages and subsidies”

✓“Given that around half of the government's expenditure is spent on subsidies and wages, there is clearly a risk that the public finances could deteriorate significantly”

Recently, Several Agencies Downgraded Egypt's Rating

□ **S&P – on 1st of February 2011, lowered Egypt's long-term foreign currency rating from BB+ → BB**

✓ “the rating actions reflect expectation that demonstrations will persist

□ **Fitch – on 29th of January 2011, cut the outlook for Egypt from Stable → Negative**

✓ Saying “the political turmoil would likely undermine the country's economic reform program”

Moody's and S&P Sovereign Rating: Large scope for improvement

Moody's Sovereign Rating

Country	Foreign Rating
China	Aaa3
Brazil	Baa3
Jordan	Baa3
Tunisia	Baa3
India	Ba1
Egypt	Ba2
Turkey	Ba2

Lower quality & Greater Risk

S&P Sovereign Rating

Country	Foreign Rating
China	AA-
Tunisia	BBB
Brazil	BBB-
India	BBB-
Egypt	BB
Jordan	BB
Turkey	BB

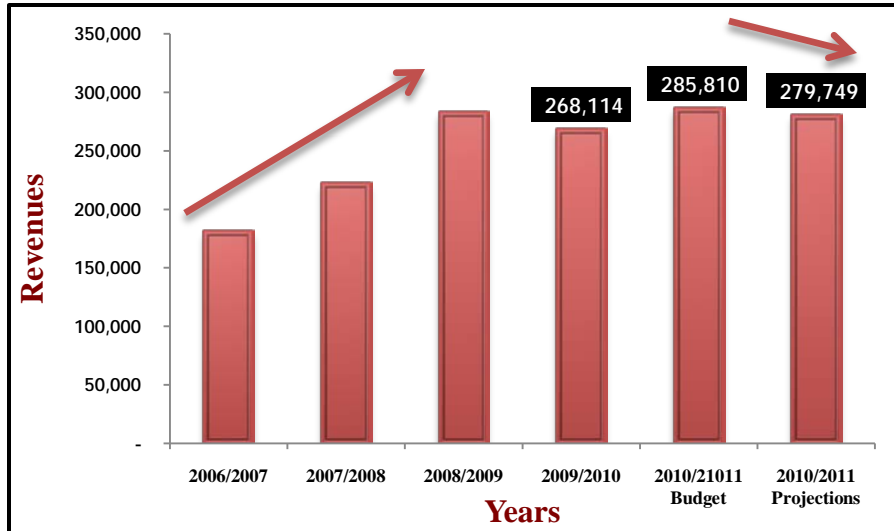
Lower capacity to meet financial commitments

Overall deficit is projected to widen significantly, compared to budget

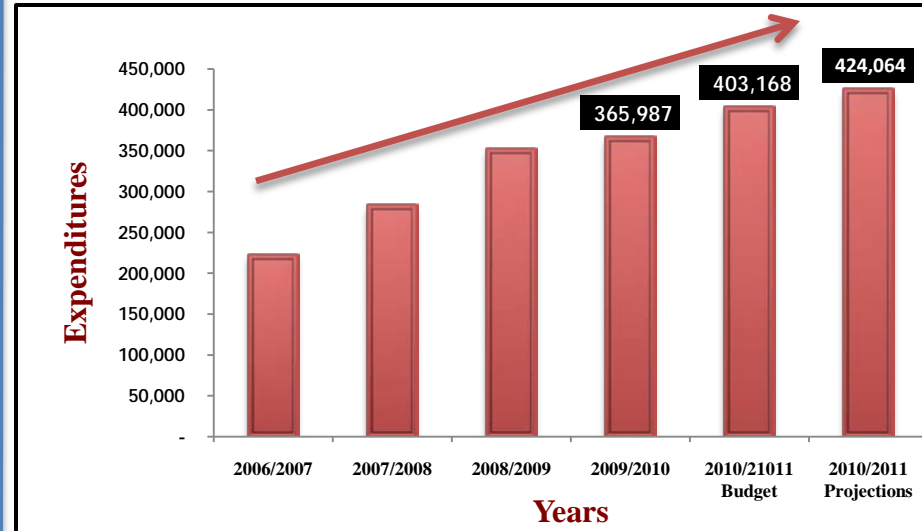
(LE Million)	2006/2007	2007/2008	2008/2009	2009/2010	2010/21011 Budget	2010/2011 Projections	Change	% Change
	Budget Sector	Budget Sector	Budget Sector	Budget Sector	Budget Sector	Budget Sector		
Total Revenues	180,215	221,404	282,505	268,114	285,810	279,749	(6,061)	-2.12%
Tax Revenues	114,326	137,195	163,222	170,494	200,424	194,363	(6,061)	-3.02%
% tax revenues	63%	62%	58%	63%	70%	69%	-1%	
Total Expenditures	222,029	282,290	351,500	365,987	403,168	424,064	20,896	5.18%
Wages and Salaries	52,153	62,839	76,147	85,369	95,309	109,605	14,296	15.00%
% wages and salaries	23%	22%	22%	23%	24%	26%	2%	
Subsidies, Grants and Social benefits	58,442	92,371	127,033	102,974	116,616	118,216	1,600	1.37%
Other expenditure (compensations for losses)							5,000	
Overall Fiscal Deficit	54,697	61,122	98,038	98,038	109,076	136,033	26,957	24.71%
Overall Deficit/GDP (%)	7.3%	6.8%	6.9%	8.1%	7.9%	10%	2%	17

Revenues are likely to shrink while spending has increased

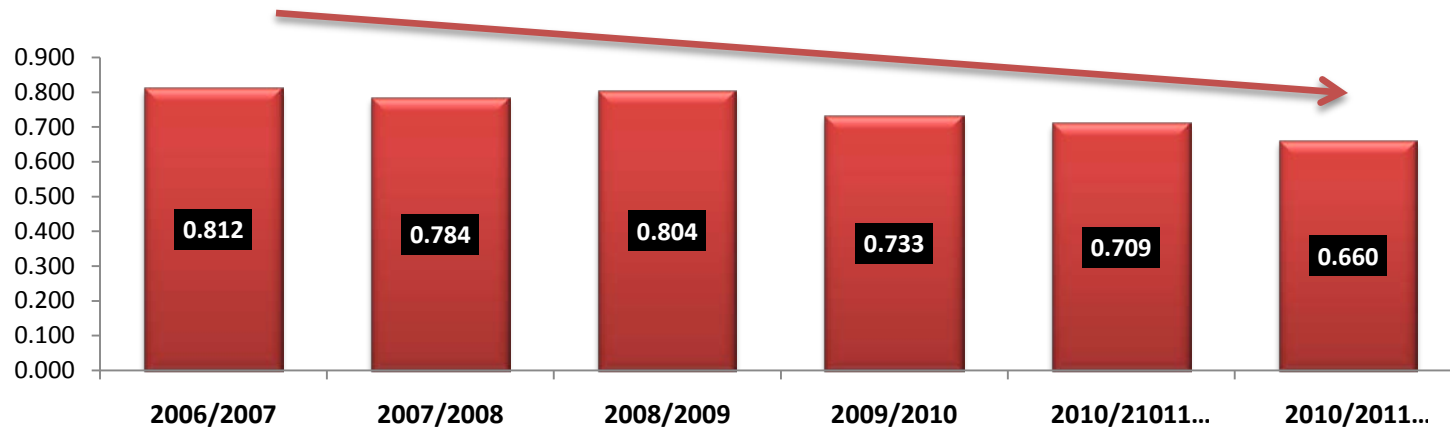
Revenues



Expenditures

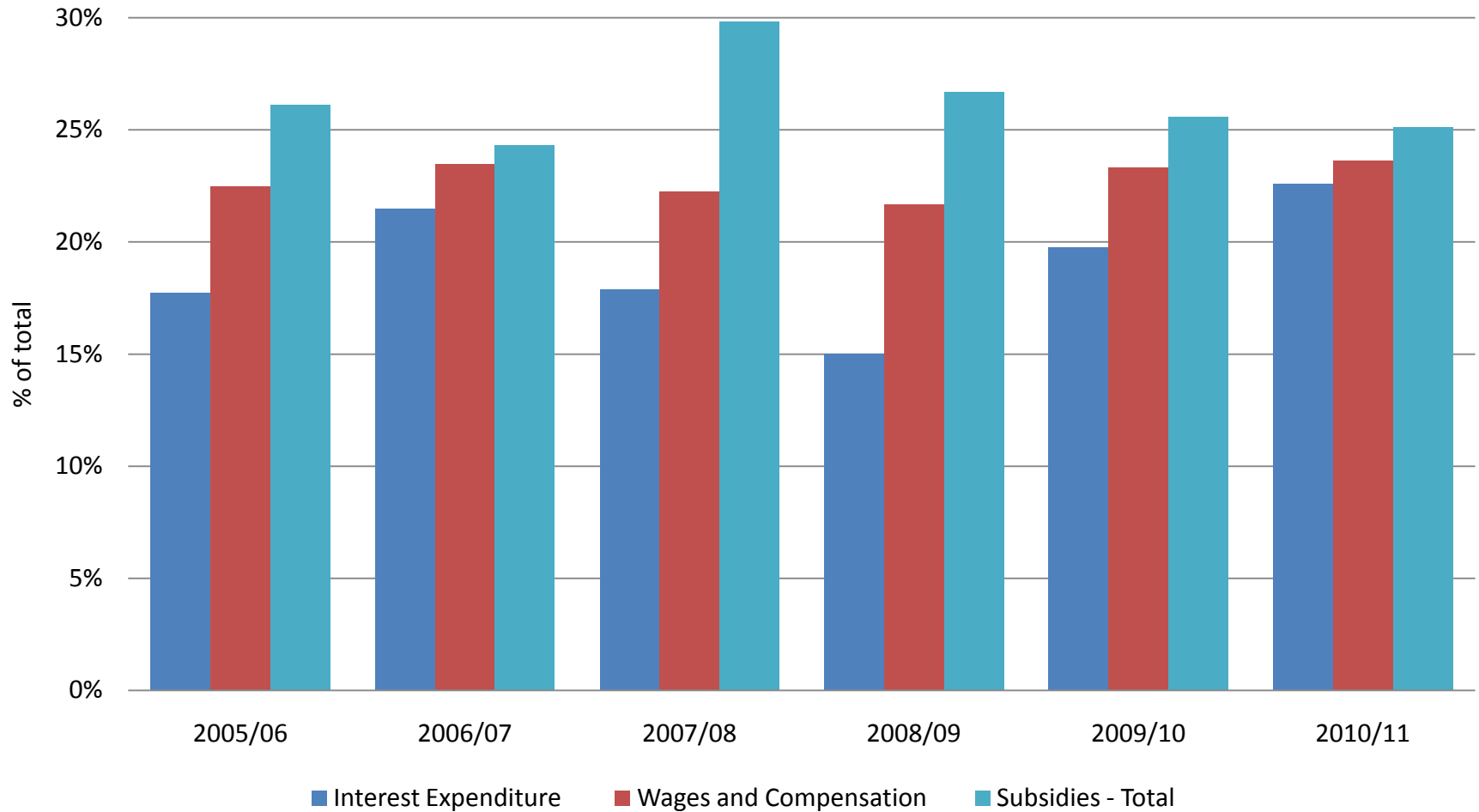


Revenues/Expenditures

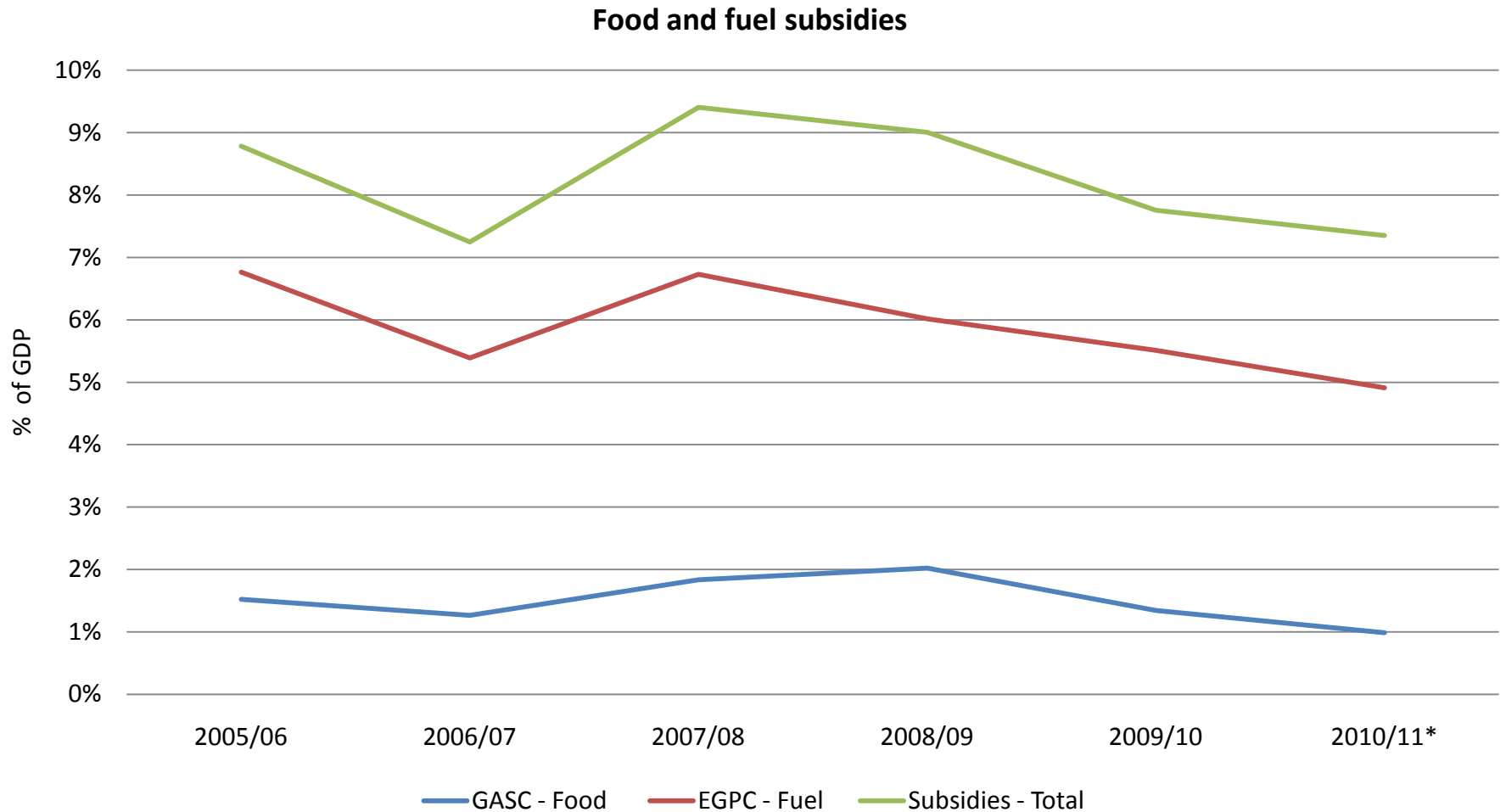


Expenditures on subsidies, wages and salaries, and interest payments have steadily grown, presenting nearly 75% of total spending

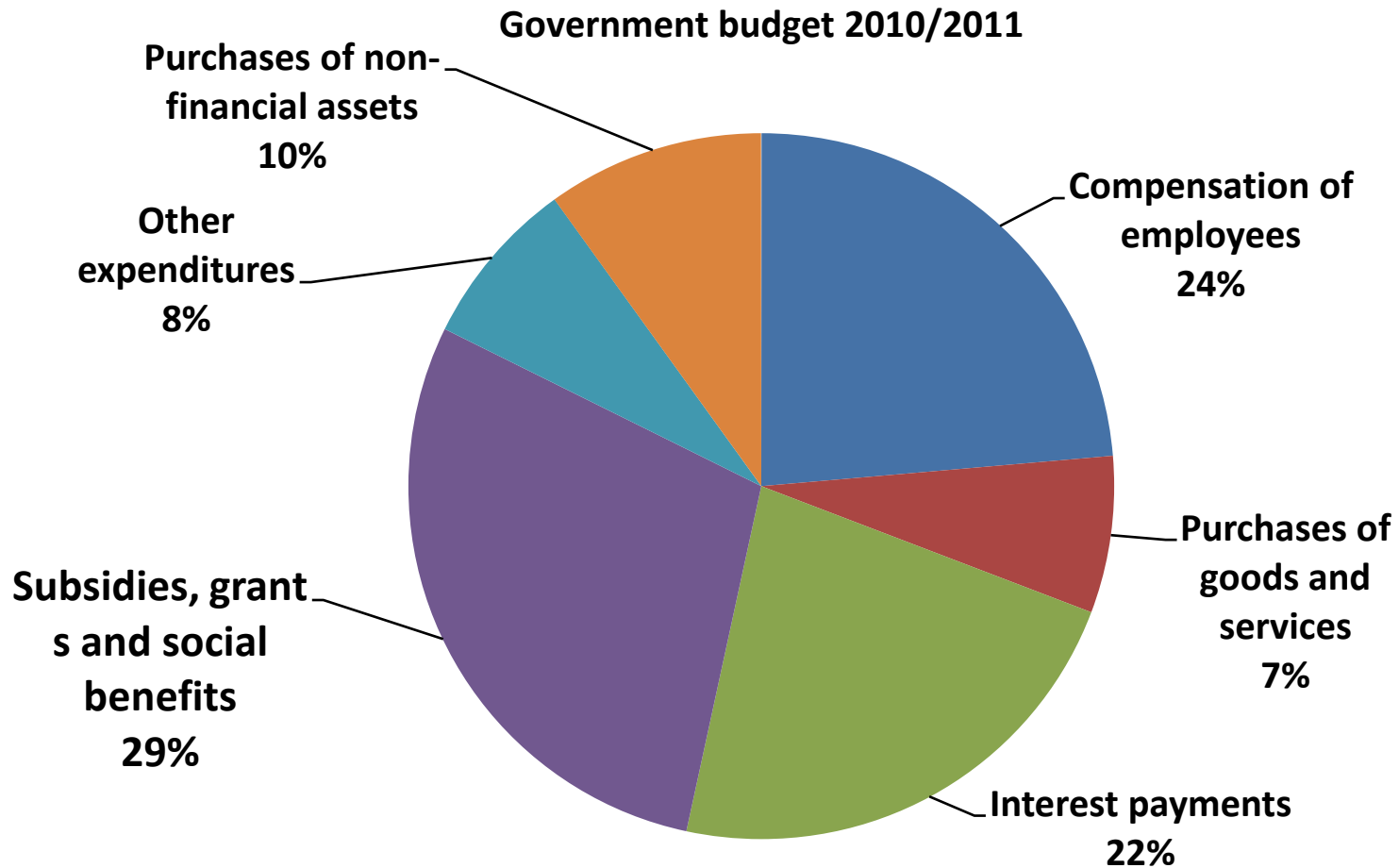
Components of government spending



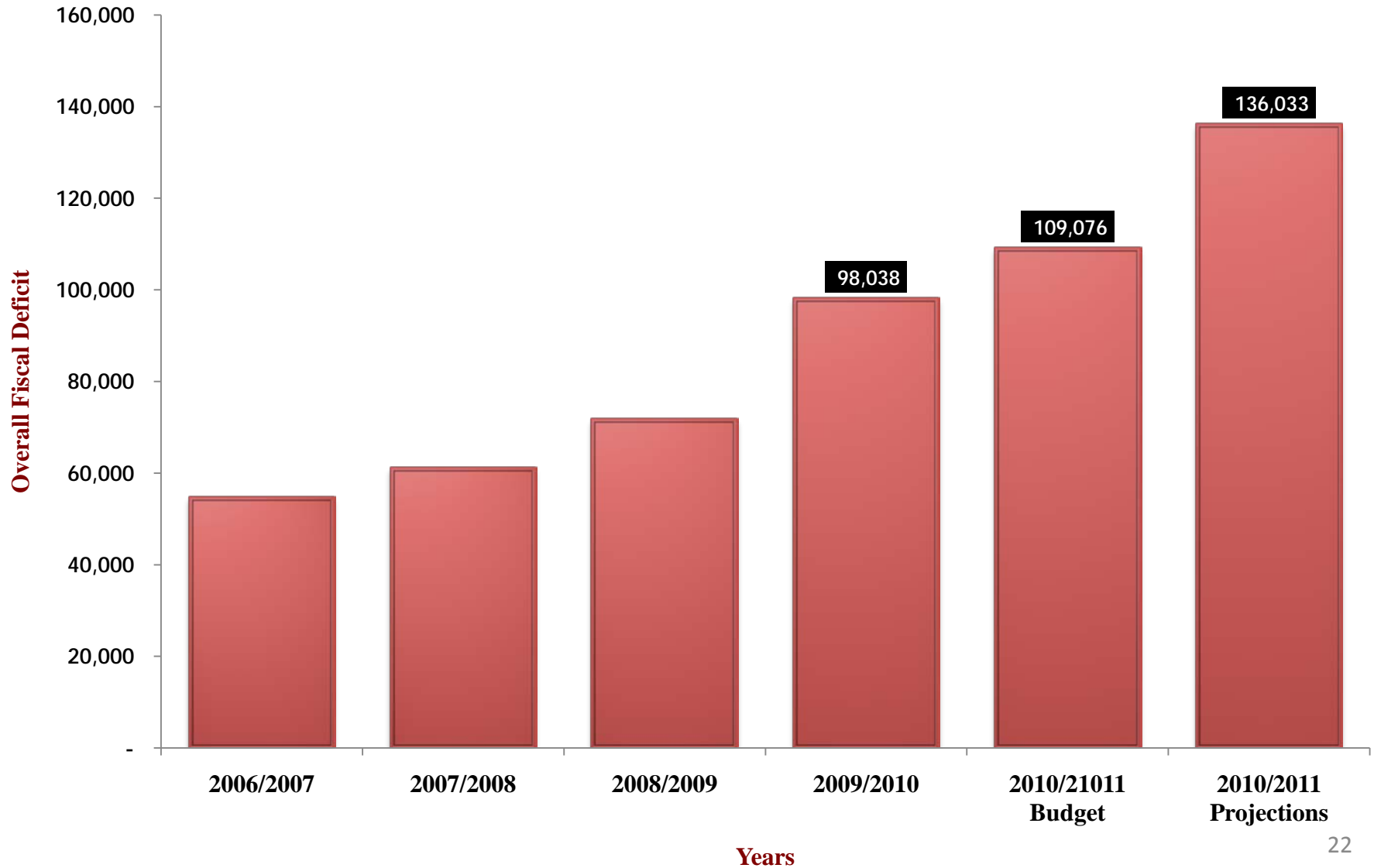
With projected increase in international food and fuel prices, subsidies may rebound to the high level in 2007/2008, exceeding nine percent of GDP



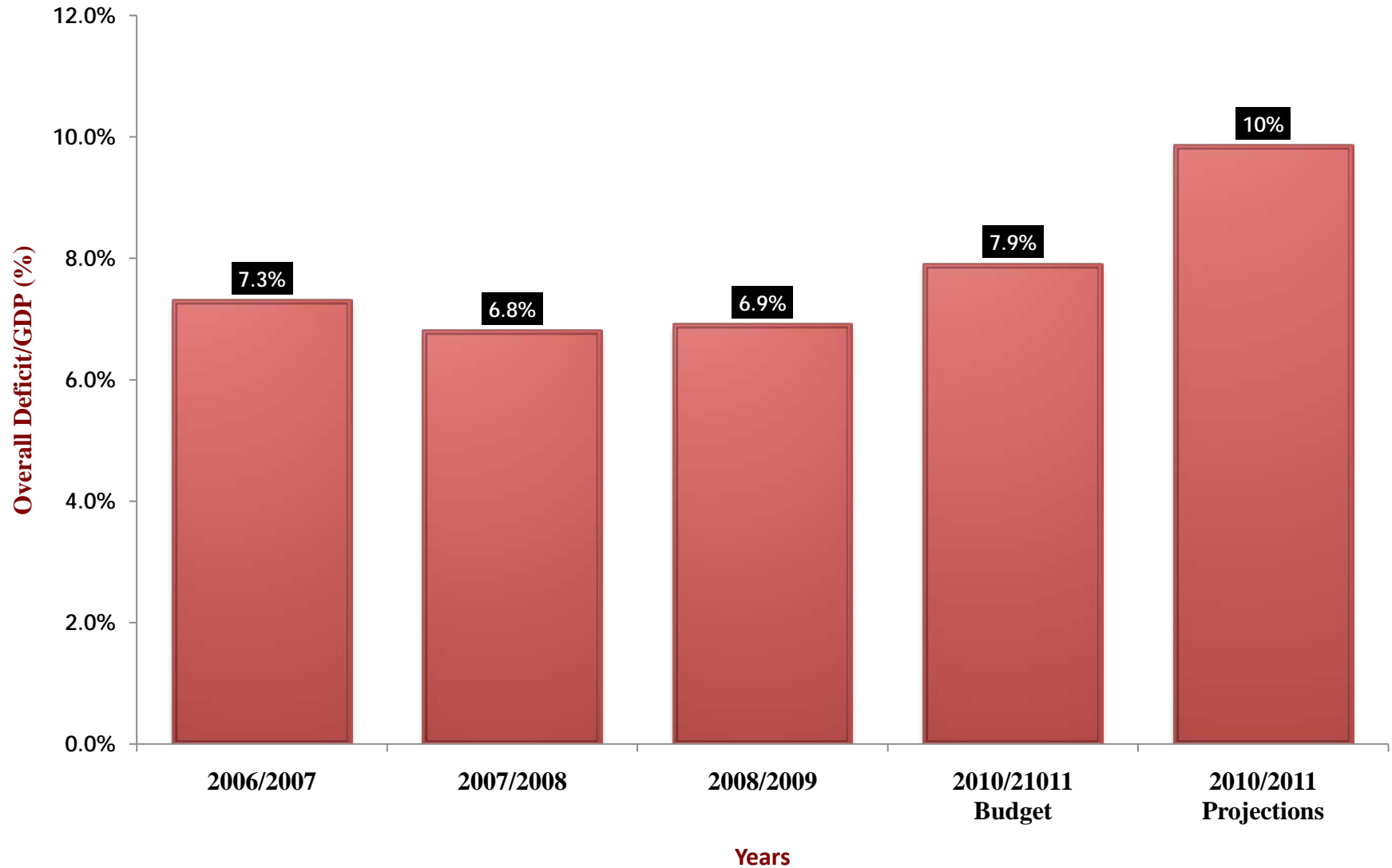
Current budget does nothing to address these fiscal concerns



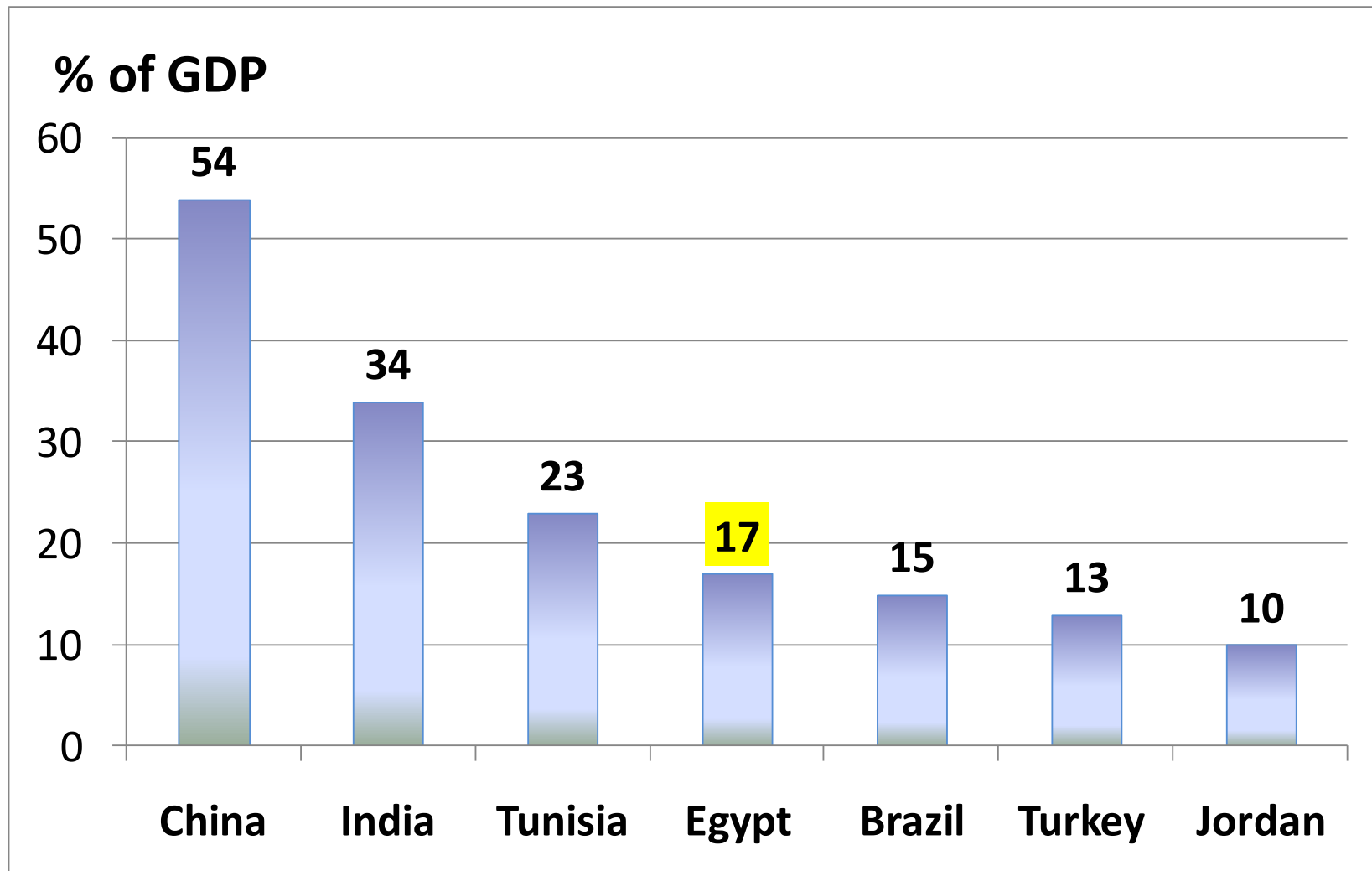
The fiscal deficit in 2010/11 could increase by nearly 25 percent



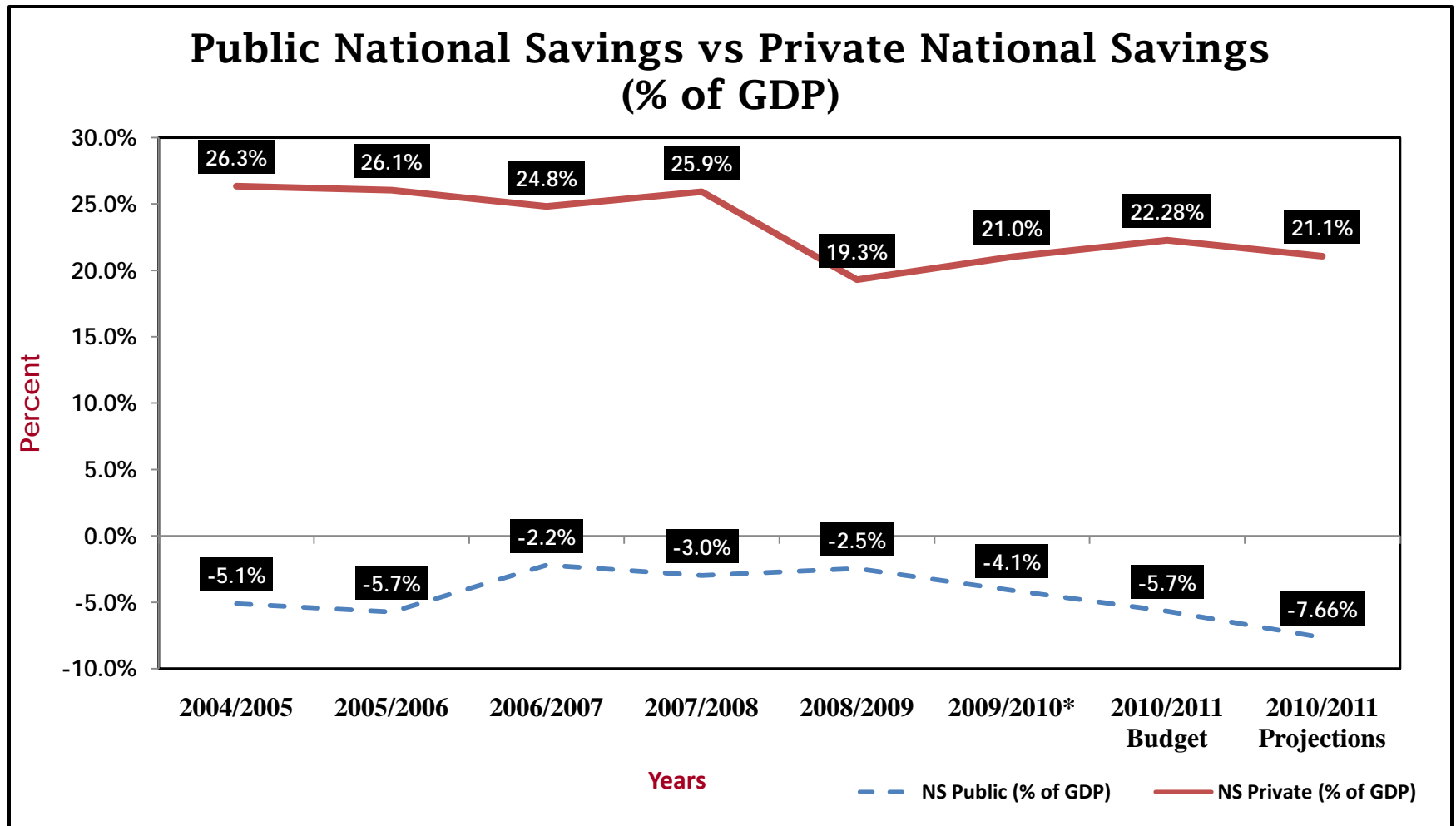
Hence, the deficit is projected to widen by nearly two percentage points, relative to GDP



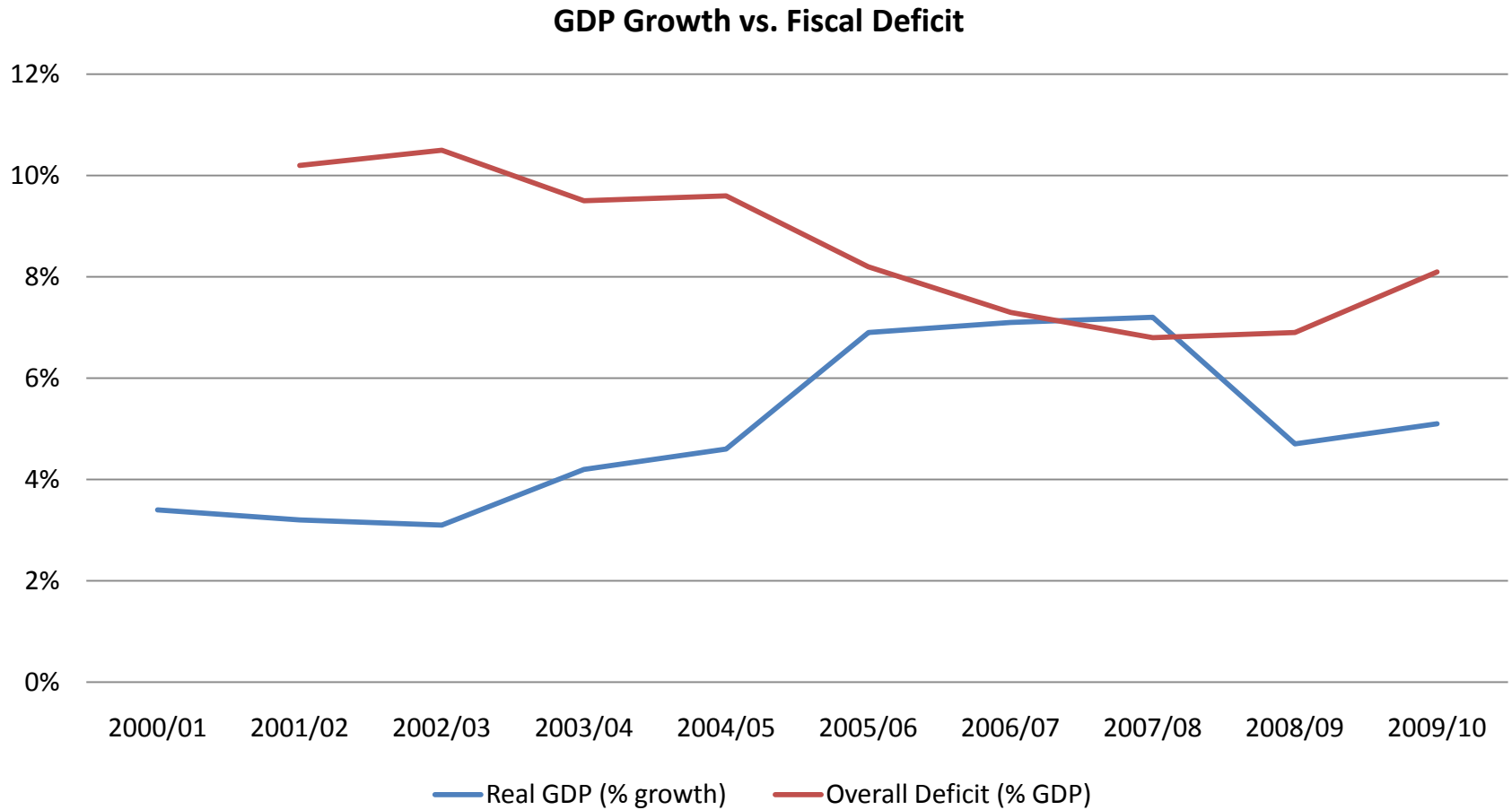
National savings as percentage to GDP is moderate



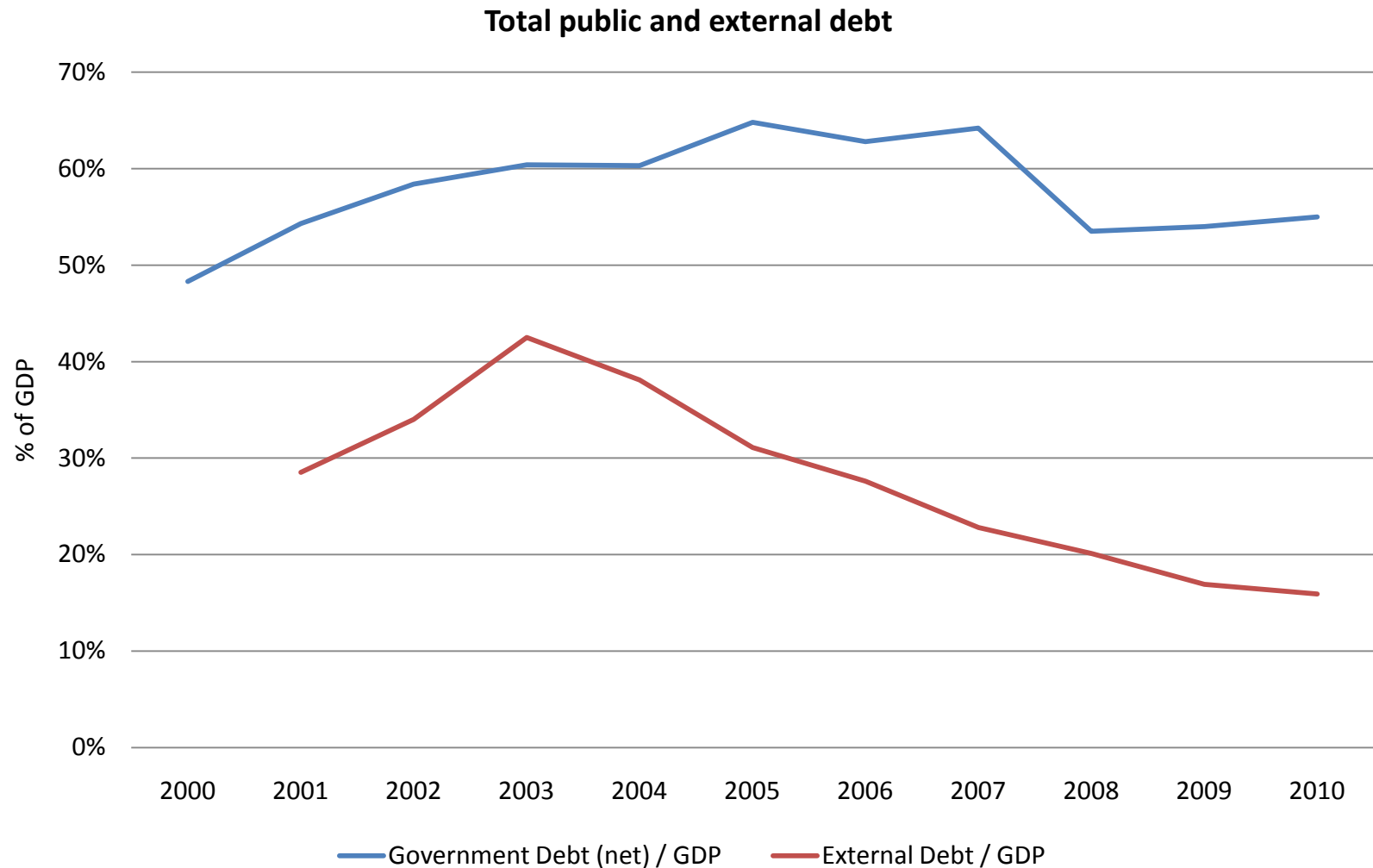
Private savings have been financing public dis-savings



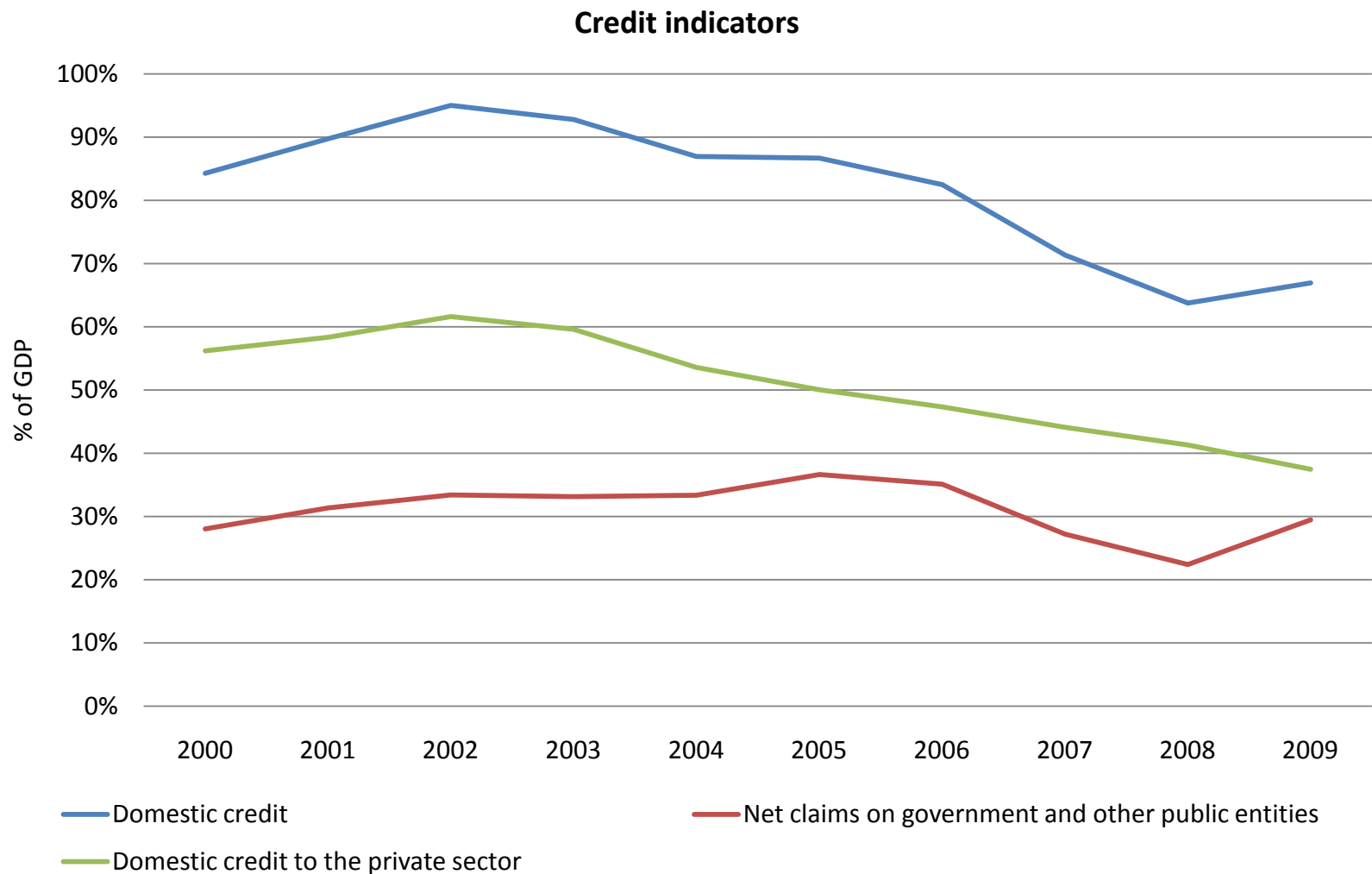
The deficit widened to provide a necessary stimulus during the downturn



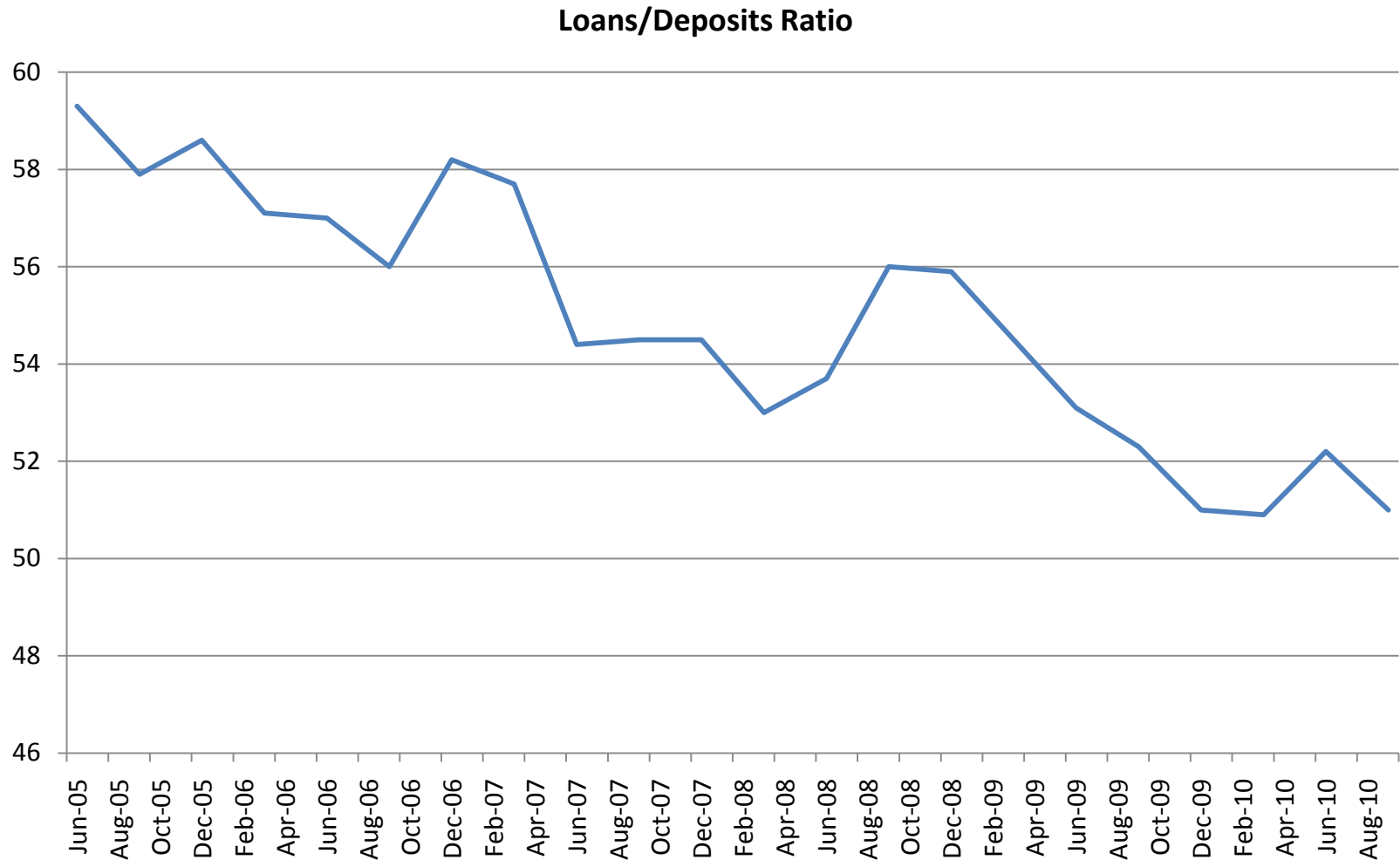
Wider fiscal deficit has contributed to a rising public debt ratio, although the external debt has been on a declining path



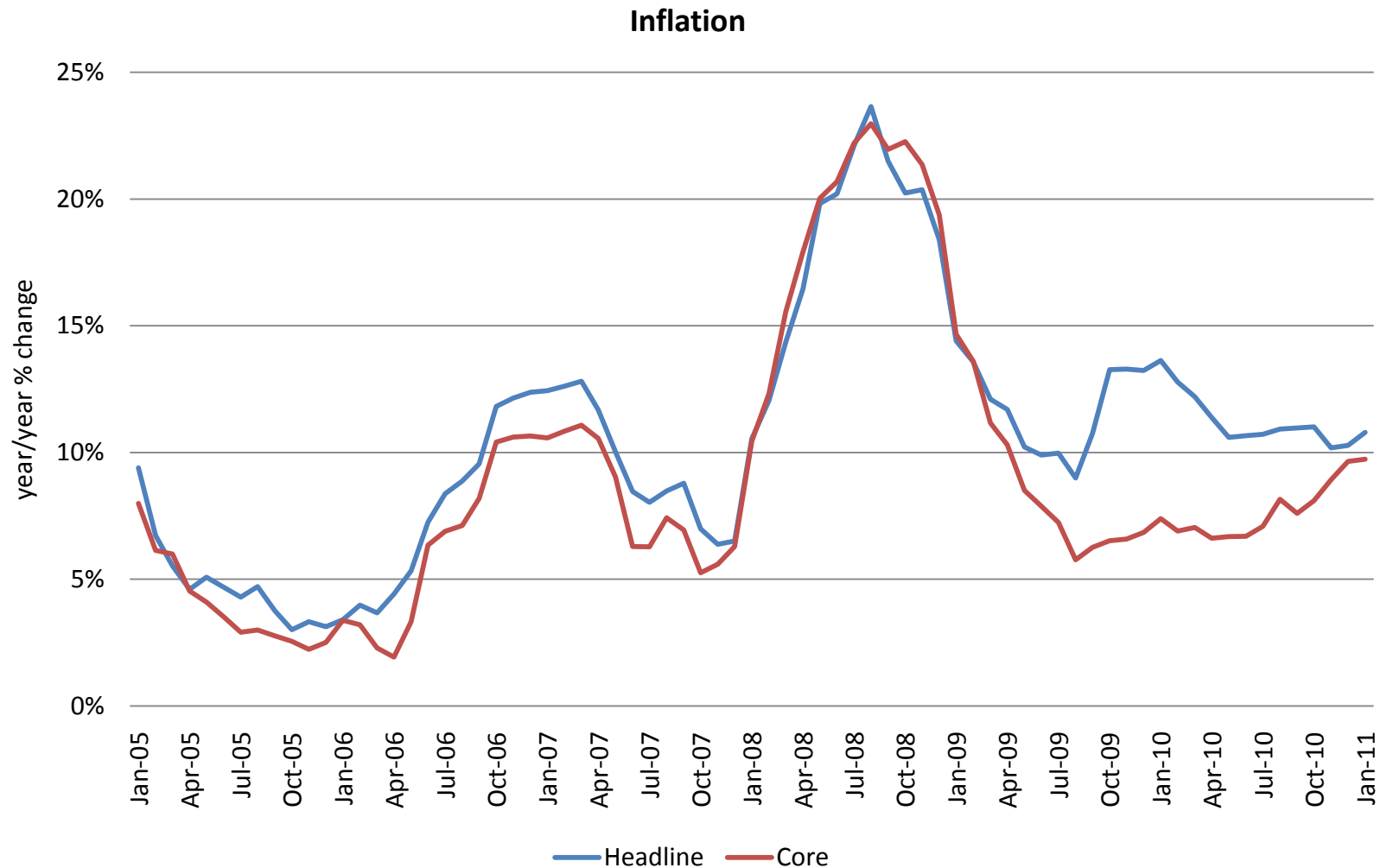
Slowing demand for private credit, coupled with a rebound in government credit



All this, despite ample liquidity in the banking system

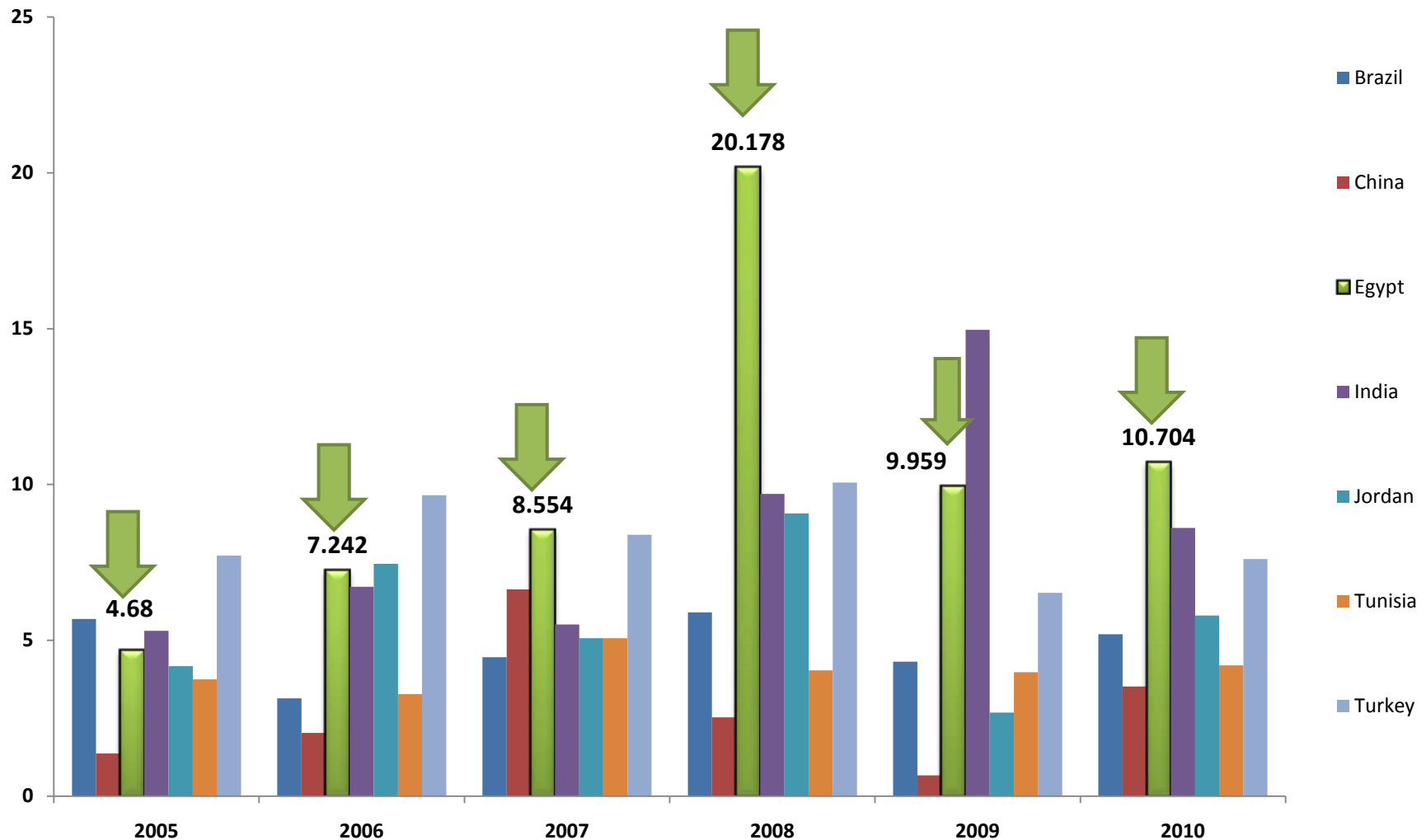


Core inflation accelerated in the first half of 2010/2011, owing to rising prices of rice, poultry, edible oils and fats



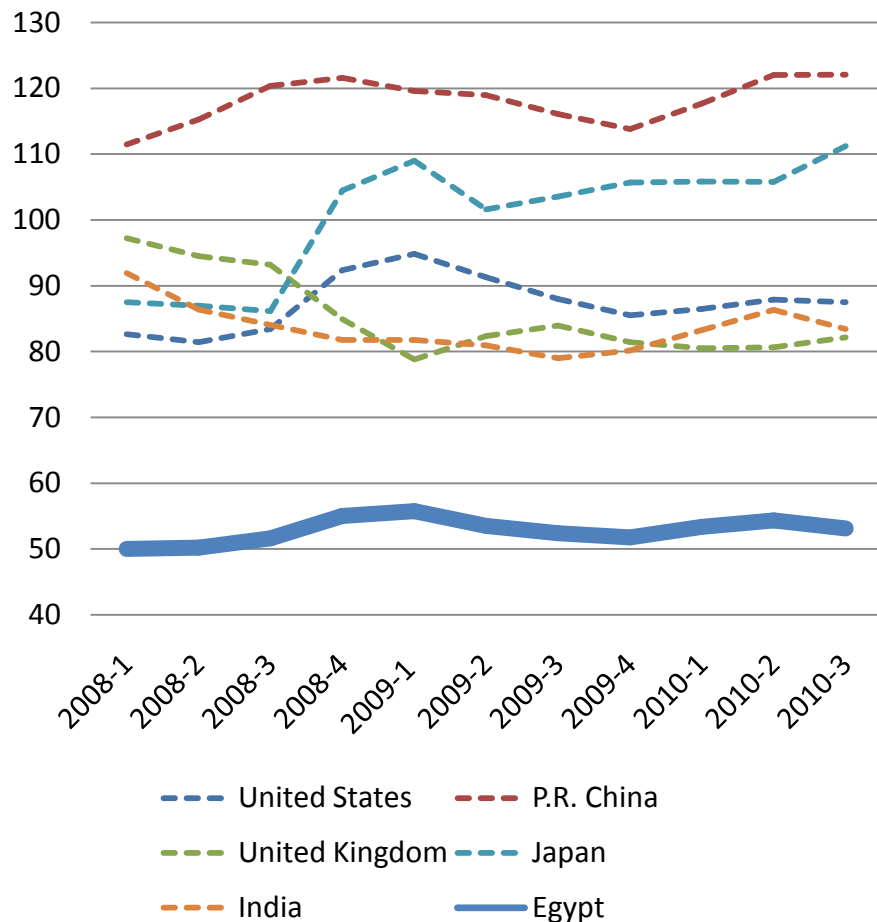
Inflation in Egypt has been persistently high, threatening competitiveness

Inflation, end of period consumer prices

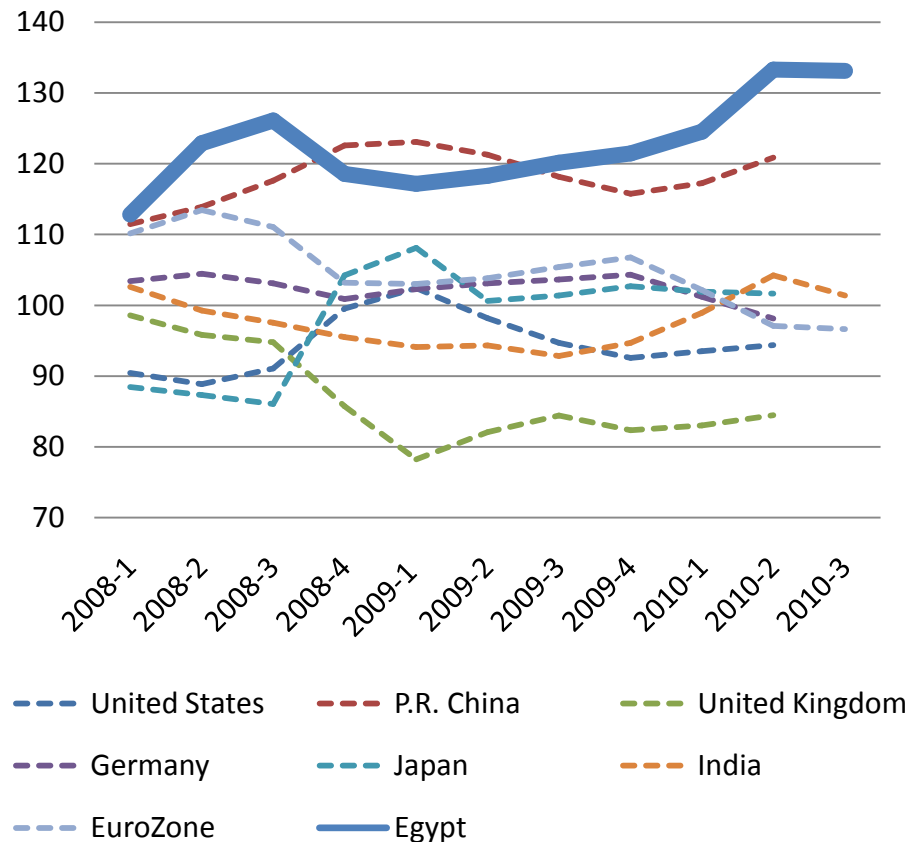


Efforts to preserve competitiveness are challenged by higher inflation, appreciating REER in Egypt

Nominal Effective Exchange Rate



Real Effective Exchange Rate




















Human Capital Development

Human Capital Development





- Health and Primary Education
- Higher Education and Training
- Labor Market Efficiency

Egypt's has low competitiveness in human capital development related indicators

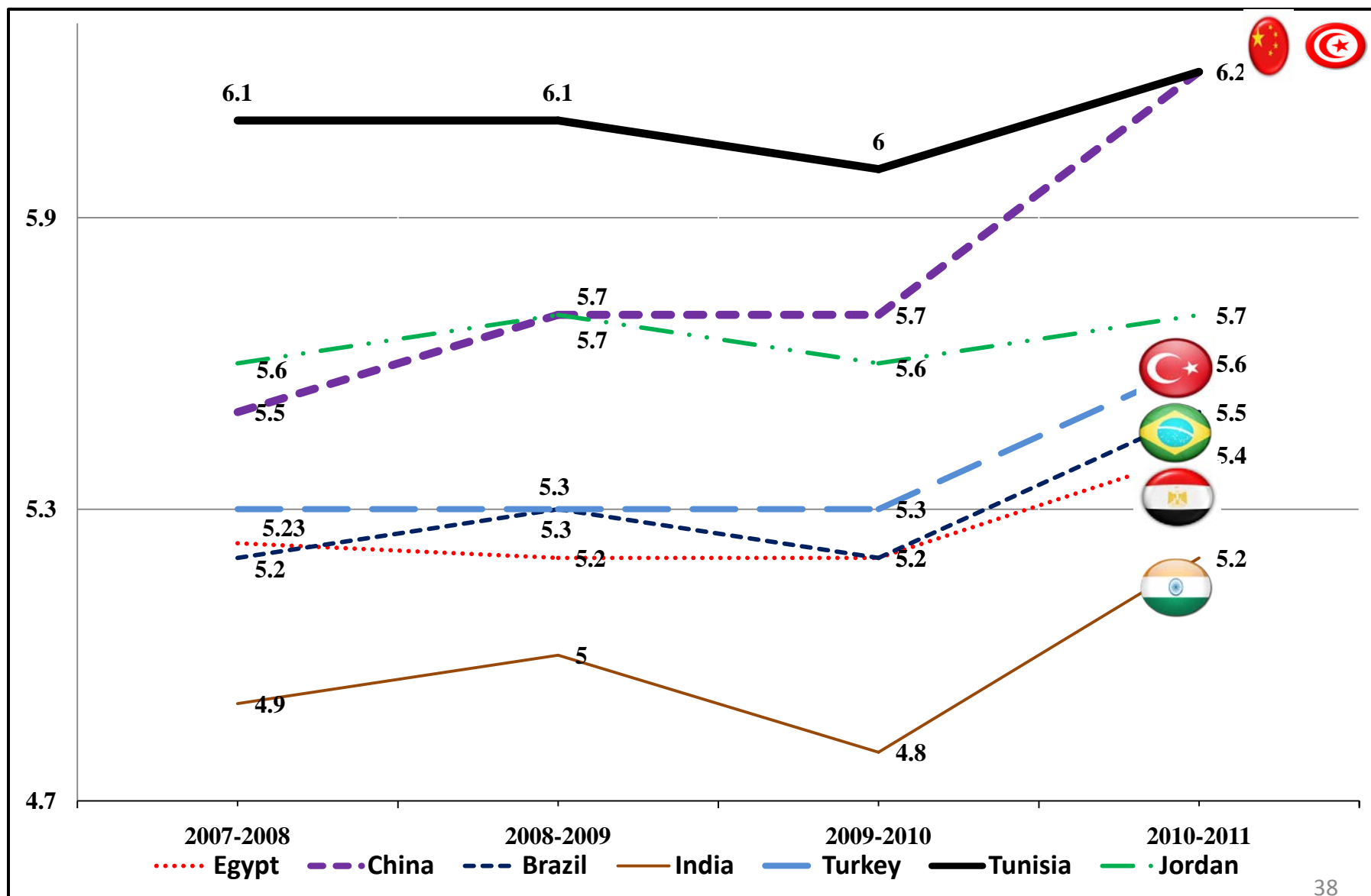
	GCI 2009-10 (out of 134 countries)	GCI 2010-11 (out of 139 countries)	
Health and primary education	84	91	
-Health	88	81	
-Primary Education	86	108	
Higher educational & training	88	97	
-quality of educational system	121	128	
-quality of math & science education	123	131	
-quality of management schools	124	125	
-internet access in schools	114	122	
	95	96	
On the job training	88	90	
-Extent of staff training	106	112	
Labor market efficiency	126	133	
<i>A-Labor market flexibility</i>	106	120	
-redundancy costs	121	128	
<i>B-Efficient use of talent</i>	130	132	
-Brain Drain	123	114	
-Female Participation in Labor force	127	130	

Education

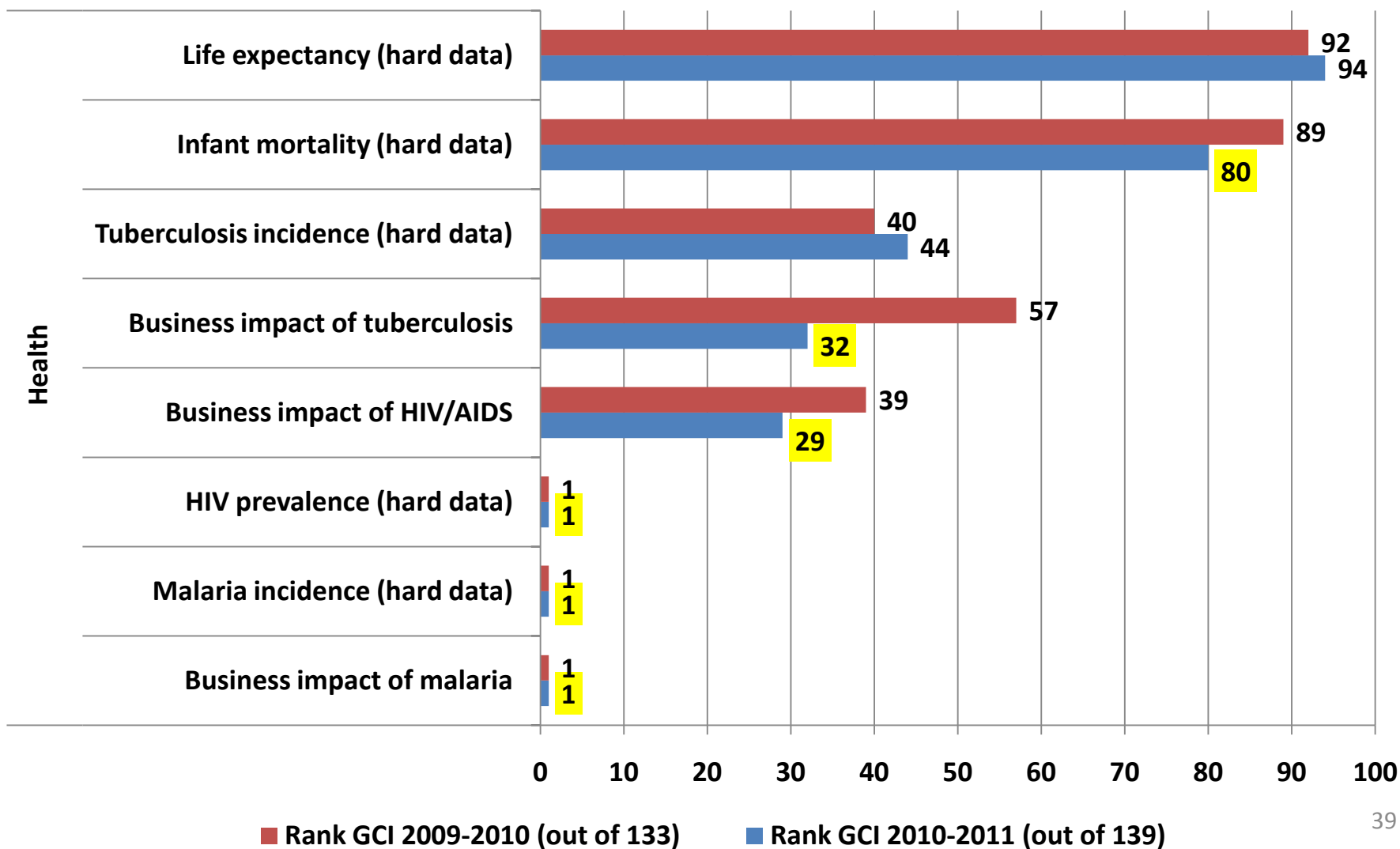
Overall ,Health &Primary Education have deteriorated

	GCI 2009-10 (out of 134)	GCI 2010-11 (out of 139)	
Health & primary education	84	91	
-Health	88	81	
-Primary Education	86	108	

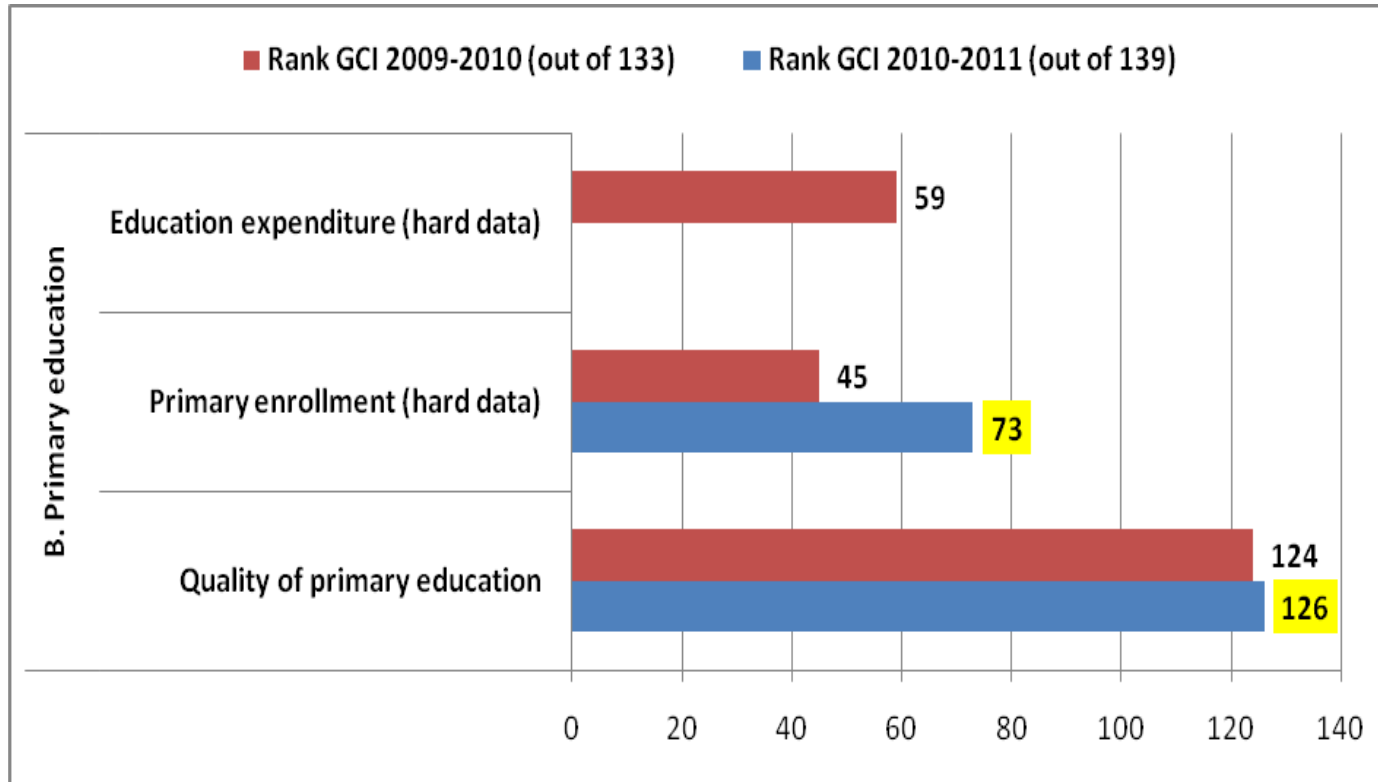
Egypt performs poorly relative to select comparators



Some health indicators are improving but Egypt Hepatitis C & B are major threats



Primary education enrollment is deteriorating and the quality of education is a major challenge



Primary Education Problems

- Outdated curriculum
- Low incentive environment
- Low pay for teachers & poor accountability
- High prevalence of private tutoring
- No adequate evaluation of outcomes

Reform of Primary Education is a prerequisite for greater competitiveness

- New curriculum using new technologies
- Better teachers pay
- Greater accountability
- More efficient expenditure
- Egypt should aim to become like Korea

Reform of Primary Education is a prerequisite for greater competitiveness

- Expenditure on education is slightly higher in Korea as compared to Egypt



- Yet, Korea ranked 1st in a survey of reading literacy among 15 years old, including ability to manage digital information

	Egypt	Korea, Rep
Public expenditure on education as percentage of GDP (2007)	3.8%	4.2%
Public expenditure on education as a percentage of total government expenditure (2007)	11.9%	15.5%

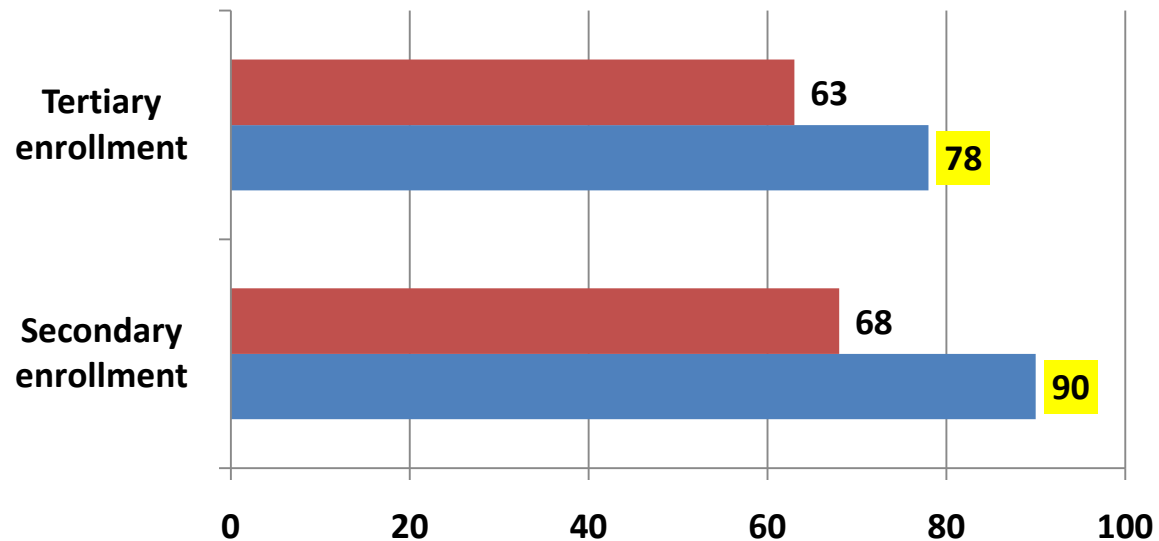
Perceptions on Higher Education quality & extent of staff Training are poor

	GCI 2009-10 (out of 134 countries)	GCI 2010-11 (out of 139 countries)	
Higher educational & training	88	97	↓
-quality of educational system	121	128	↓
-quality of math & science education	123	131	↓
-quality of management schools	124	125	↓
-Internet access in schools	114	122	↓
	95	96	↓
On the job training	88	90	↓
-Extent of staff training	106	112	↓

Egypt's youth is the country's greatest asset

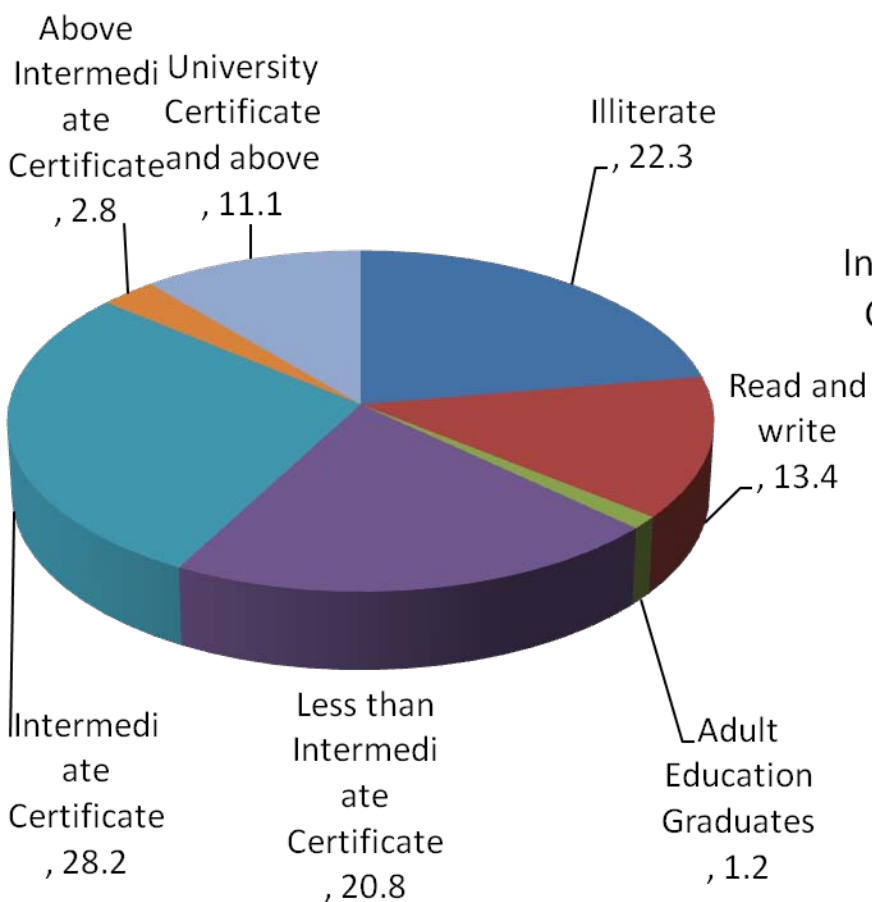
- 17.7 million are enrolled in basic education (prior to univ.)
- 28% of total students are enrolled at university and higher education
- Tertiary and Secondary enrollments rank are deteriorating

■ Rank GCI 2009-2010 (out of 133) ■ Rank GCI 2010-2011 (out of 139)

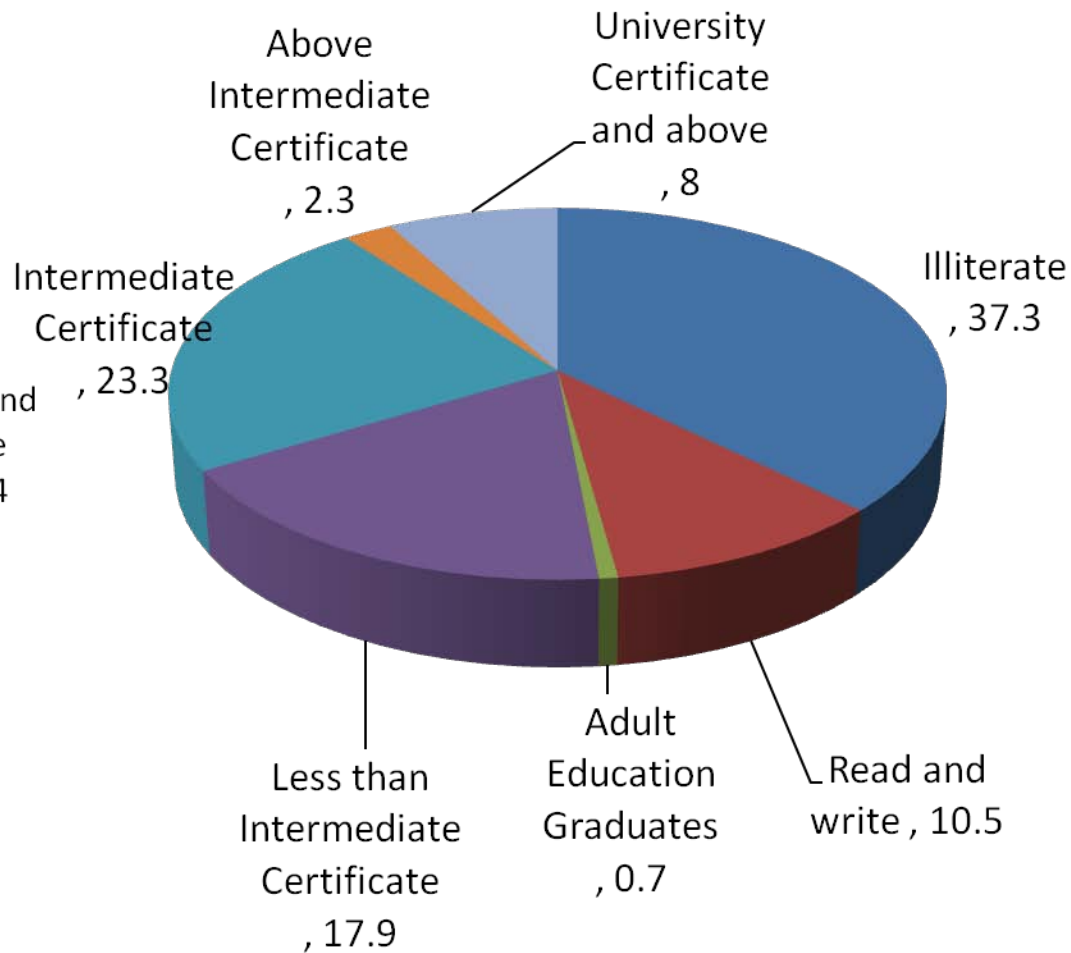


Males tend to be more educated than females

Males' distribution by educational level (%)

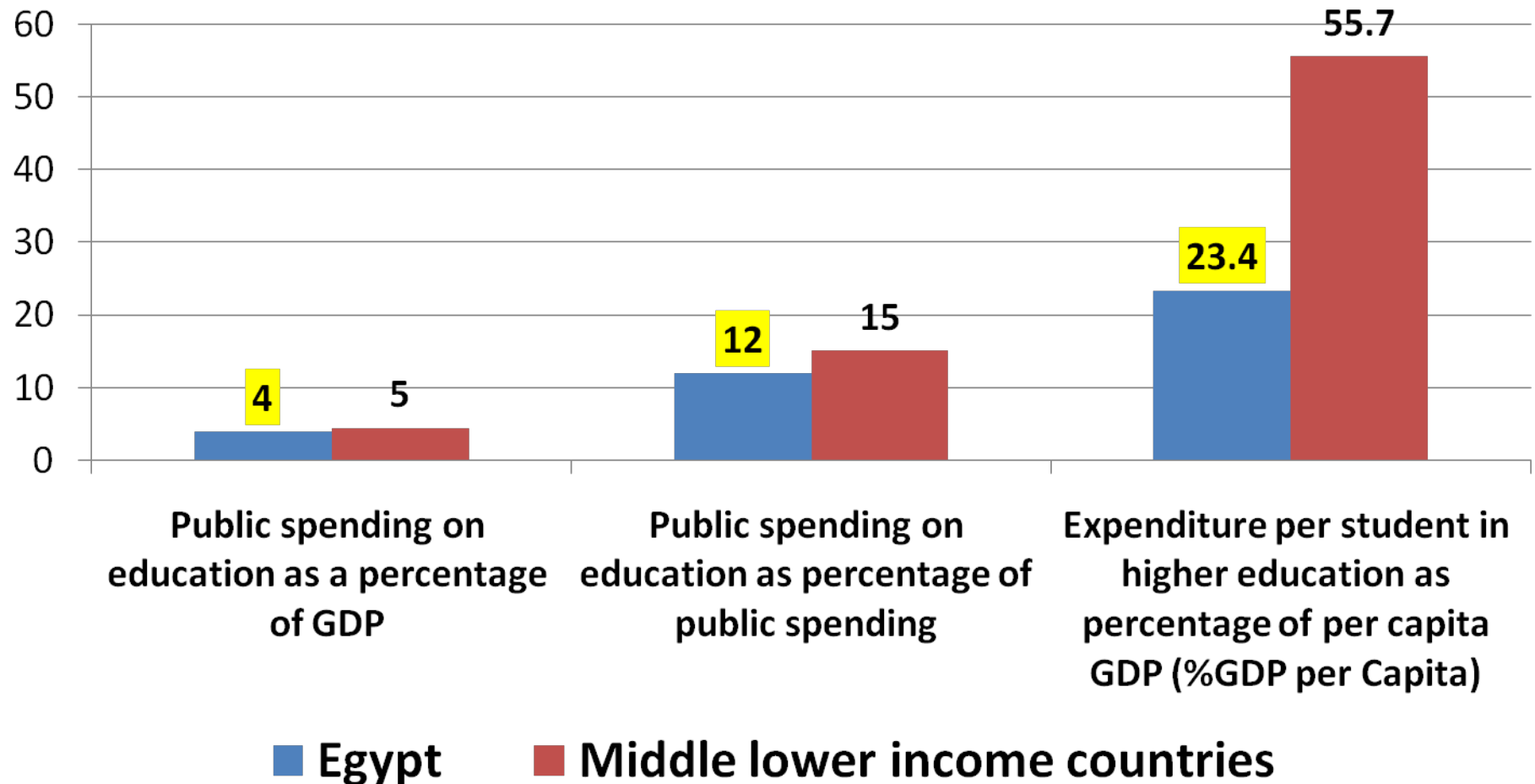


Females' distribution by educational level (%)



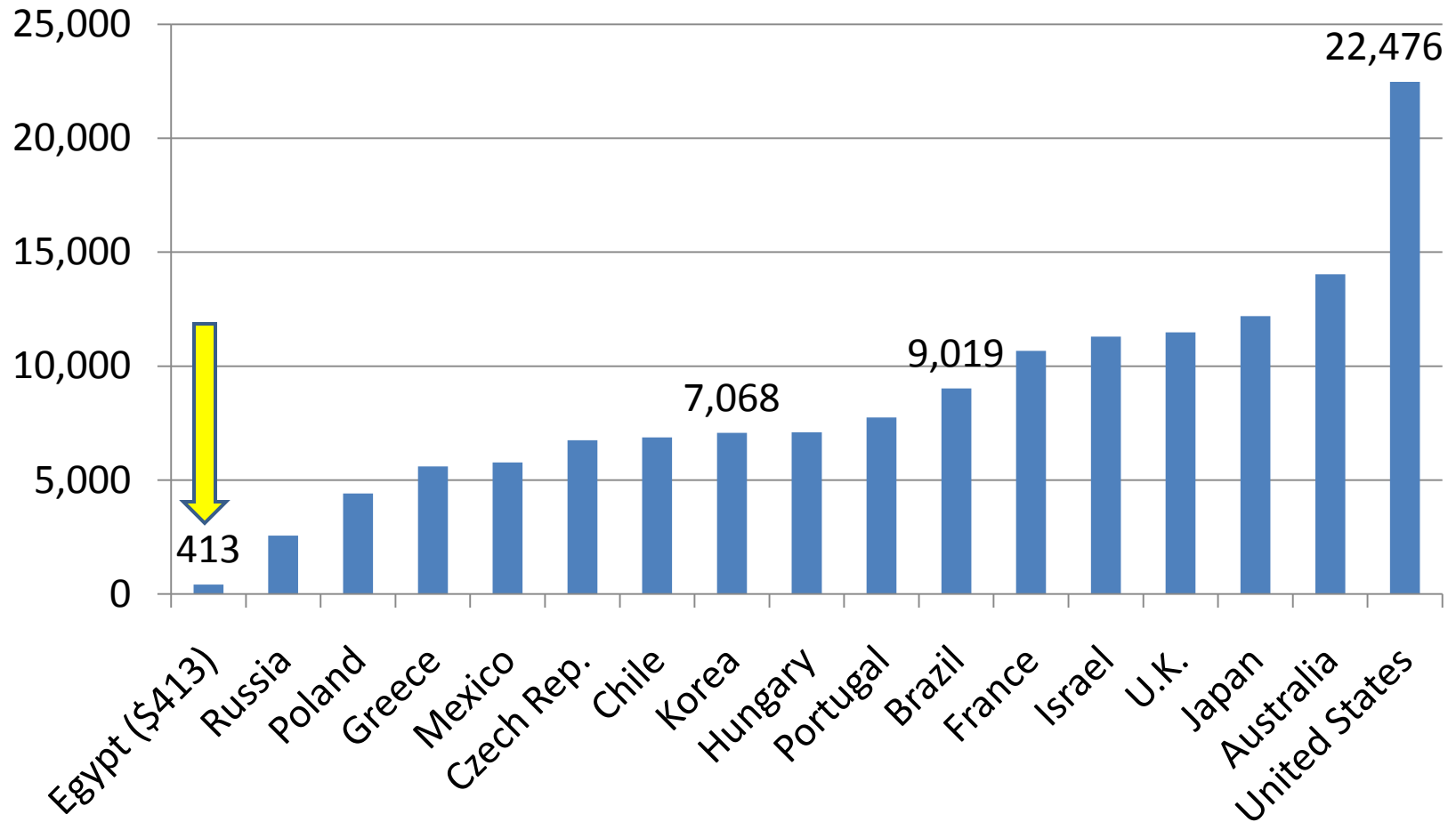
Greater & more efficient expenditure on higher education is a priority to better quality

Expenditure on education Egypt versus Middle lower income countries

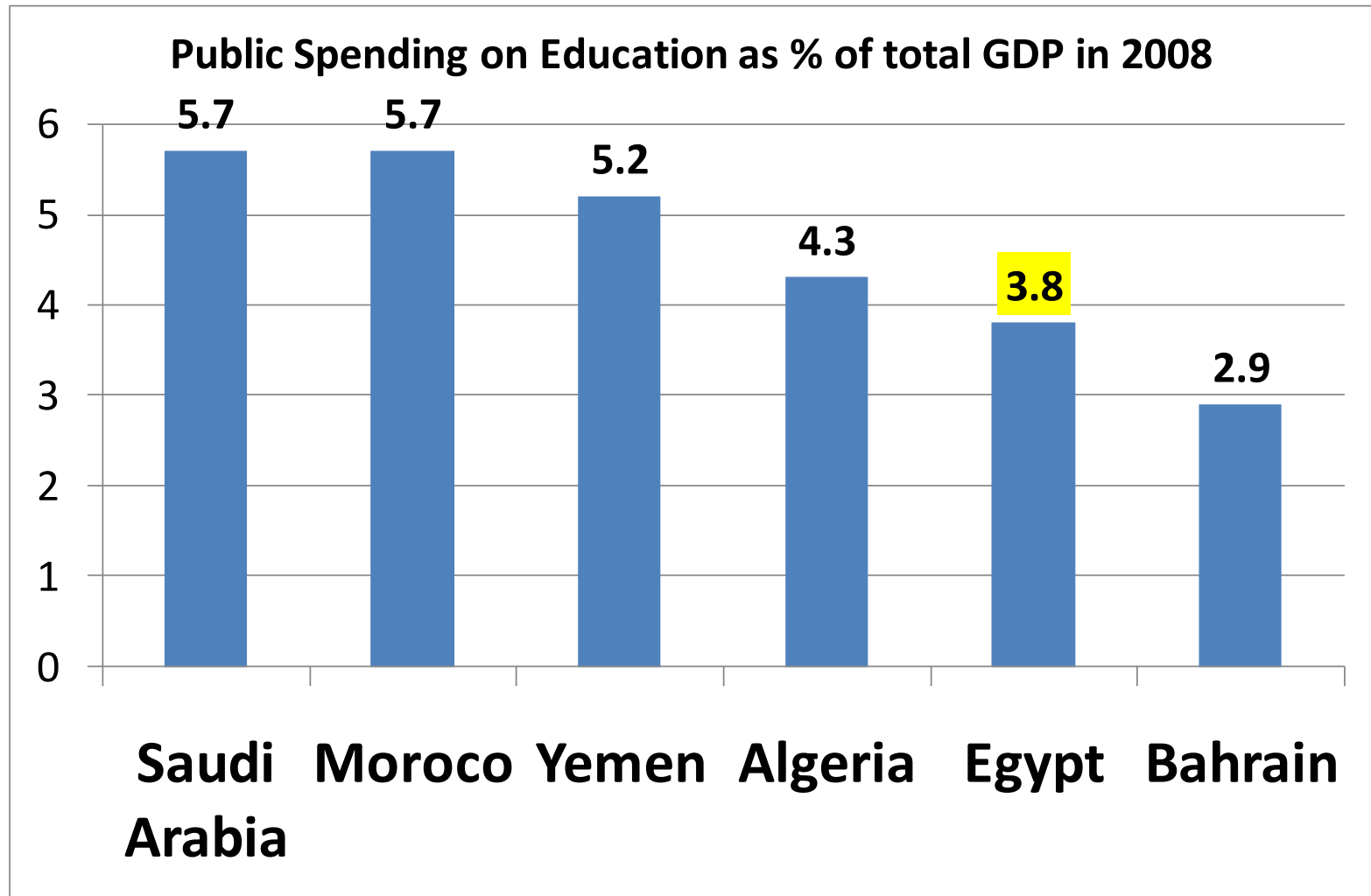


Higher Education Expenditure per student is low

University education: expenditure per student (2004 constant prices, \$USD).

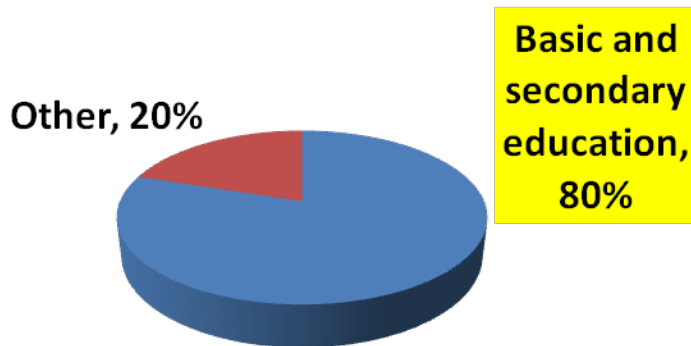


Greater & more efficient expenditure on higher education is a priority to better quality

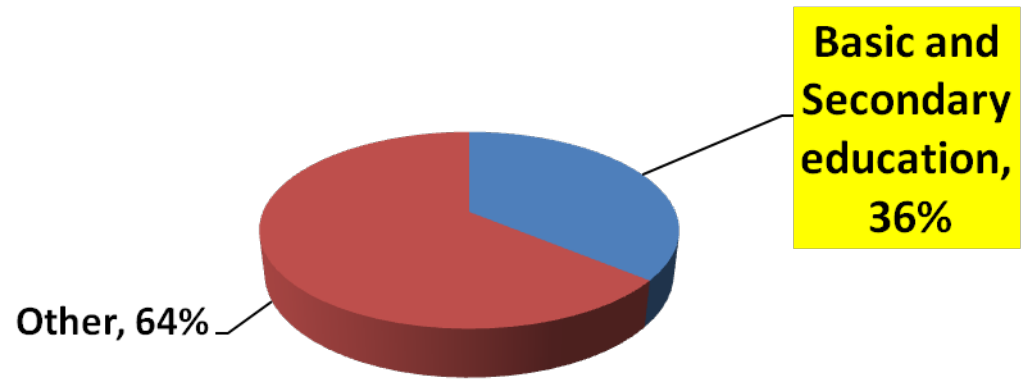


Unbalanced expenditures include

% of total enrollment



% of total education expenditure



- Two thirds of secondary students are in technical education. Yet, they get almost the same share of expenditure as those in the general stream.

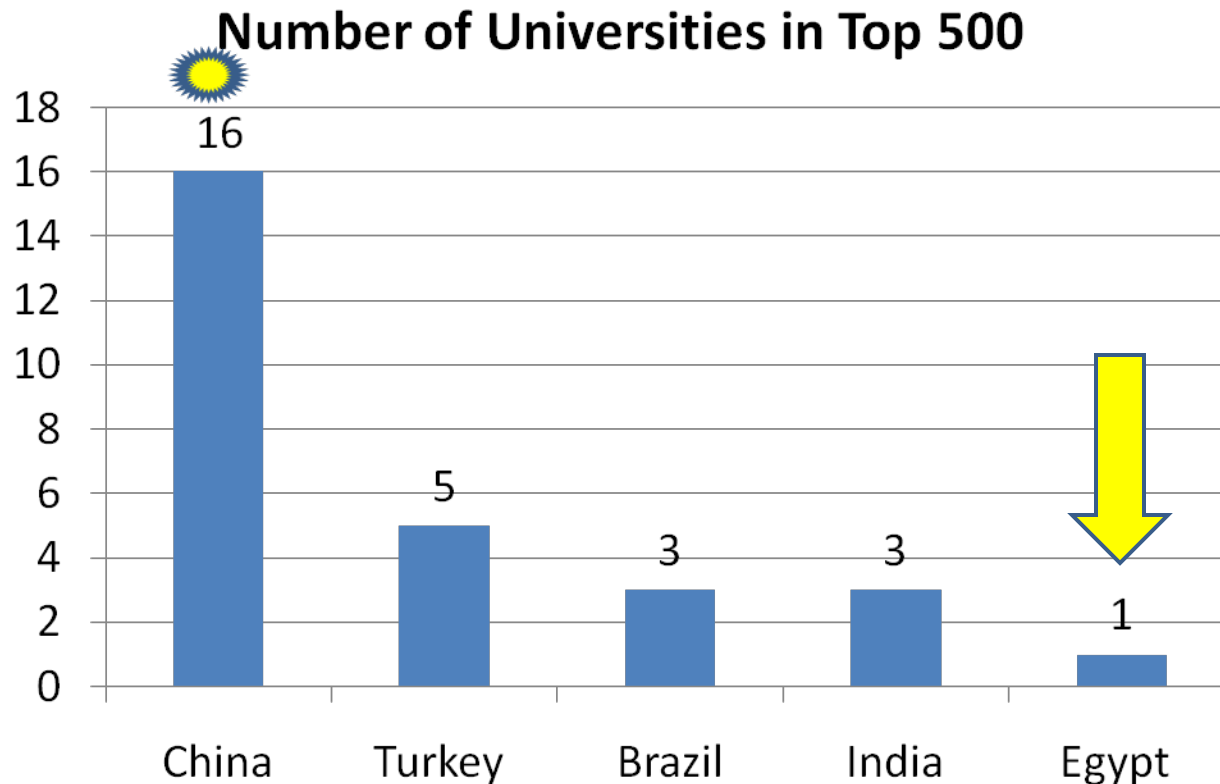
This affects the quality of technical educational outcomes negatively and leads to low educational return for that large segment.

Low expenditure on research and curricula

- 70% of total spending on higher education is directed towards salaries and wages, crowding out resources which are needed to upgrade research capabilities and curricula.
- Non academic staffs in universities absorb almost 50 percent of total spending. Thus, reducing resources for teachers' upgrade and leading to increased private tutoring.

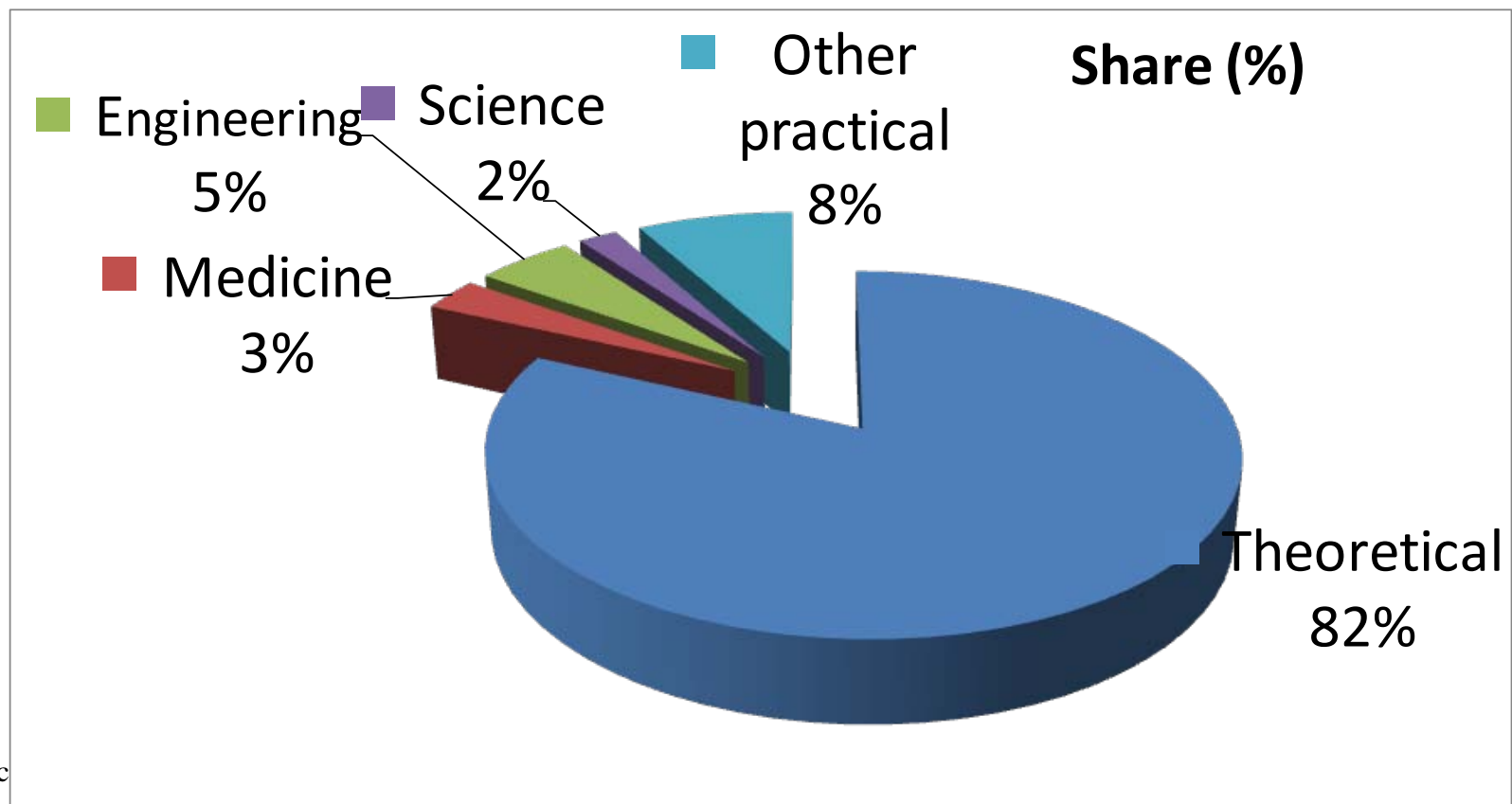
Low quality of education is confirmed by

- Egypt has only 1 university in the last 50 of the top 500 universities “Cairo University”.

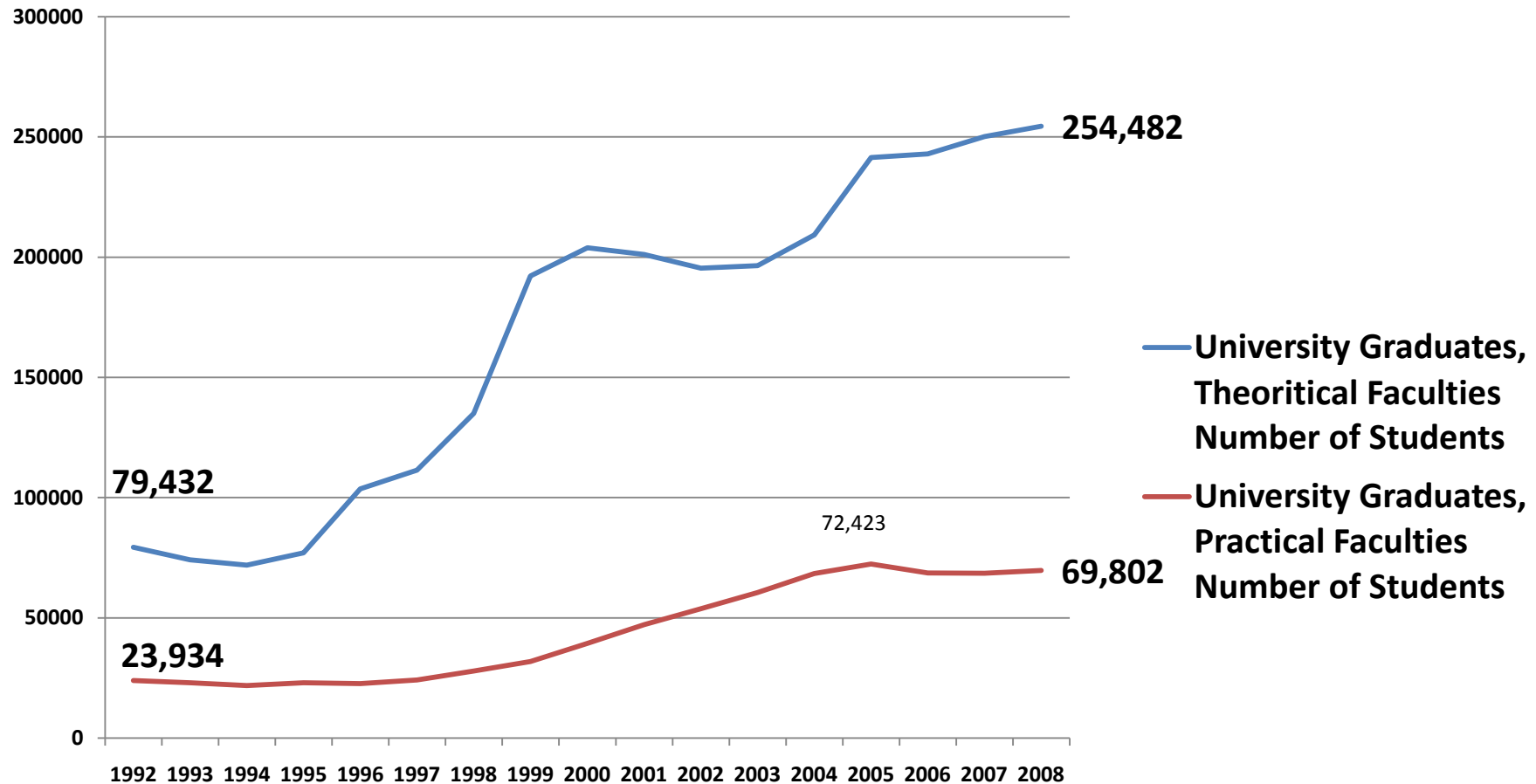


Egypt needs to raise learning outcomes in practical fields, highly needed for economic development

Only 18 % of Higher education graduates in 2005/06 are in practical fields



Number of graduates in theoretical faculties is growing at much faster rates than practical faculties



Return on education is low, leading to mismatch between education outcomes and labor market needs

Private rate of return* on education in Egypt 1995-2000.

	1995-1996	1999-2000
Basic education	-3.39	-0.11
Secondary	-0.67	2
University and above	7.1	8

The private rate of return on education: is the rate of discount that equates the present value of costs and benefits from investing in education.

Source: El Baradei, Mona (2003). "The Private Rate of Return to Education, Educational Inequalities and Poverty in Egypt". Research Papers Series, Economics Department, Faculty of Economics and Political Sciences. Cairo University.

The return for vocational secondary education is low and decreasing

	1988	1998	2006
Vocational secondary education	0.085	0.048	0.047

Source: Said, Mona (2006). "The Fall and Rise of Earnings and Inequality in Egypt: New Evidence from the ELMPS, 2006. Economic Research Forum. Cairo.

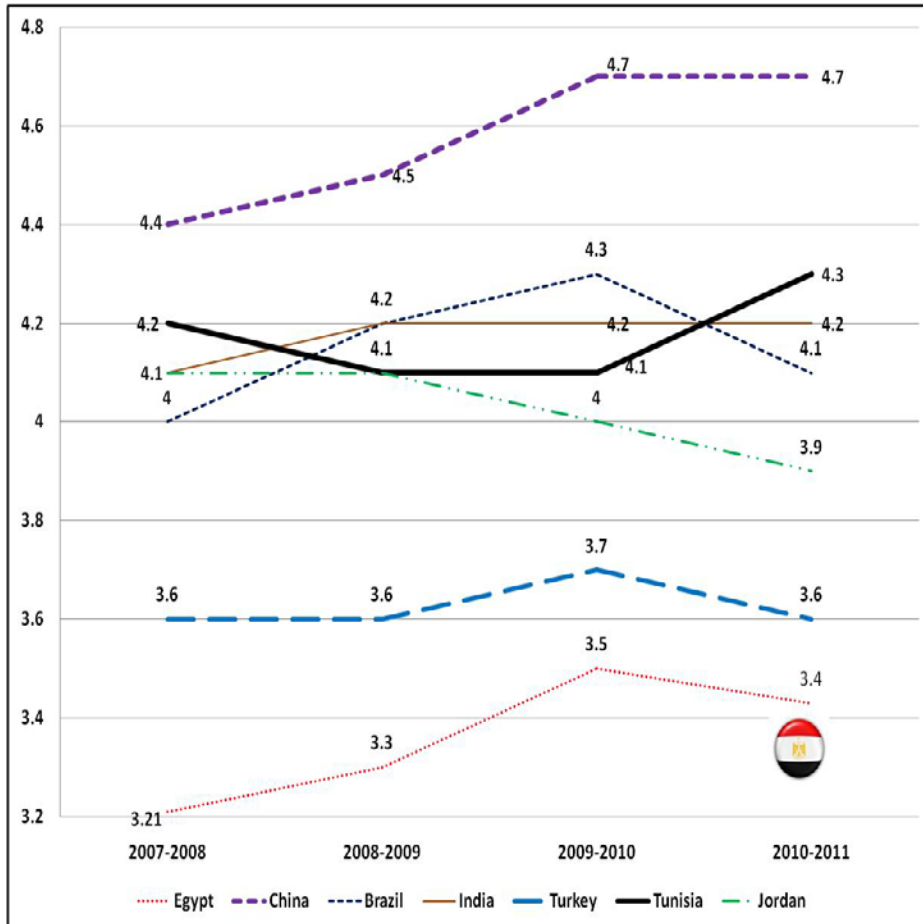
Labor Market Efficiency

Low female participation, brain drain & high costs of redundancy are major drawbacks

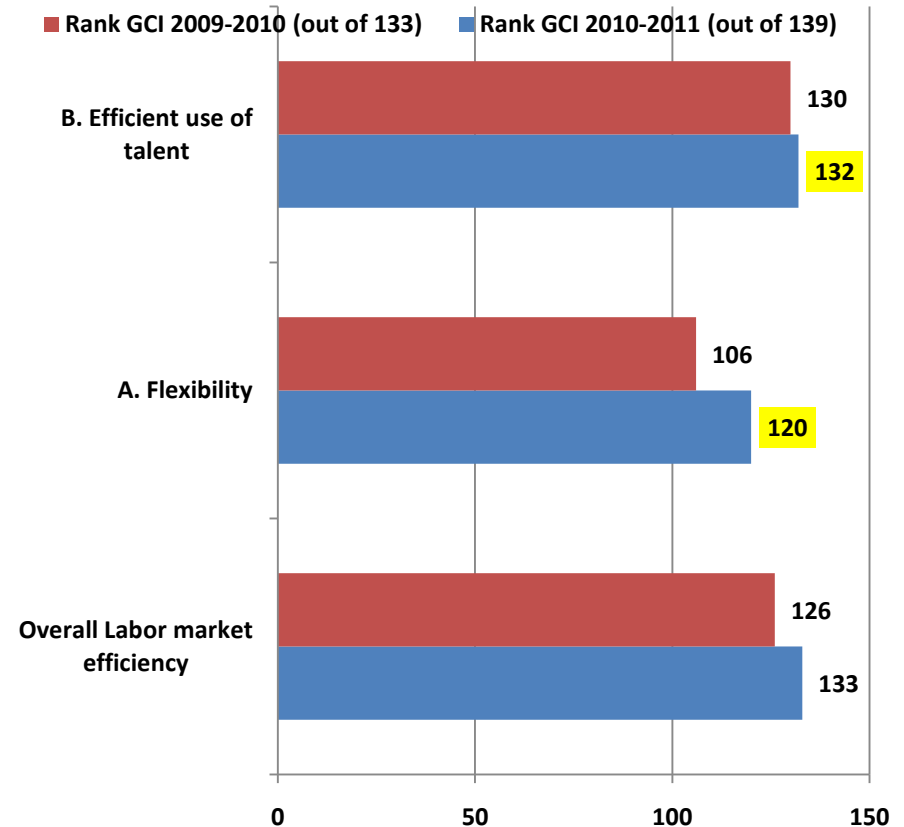
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<i>A-Labor market flexibility</i>	106	120	↓
-redundancy costs	121	128	↓
<i>B-Efficient use of talent</i>	130	132	↓
-Brain Drain	123	114	↑
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Labor Market Efficiency is very weak

Egypt compared to select countries

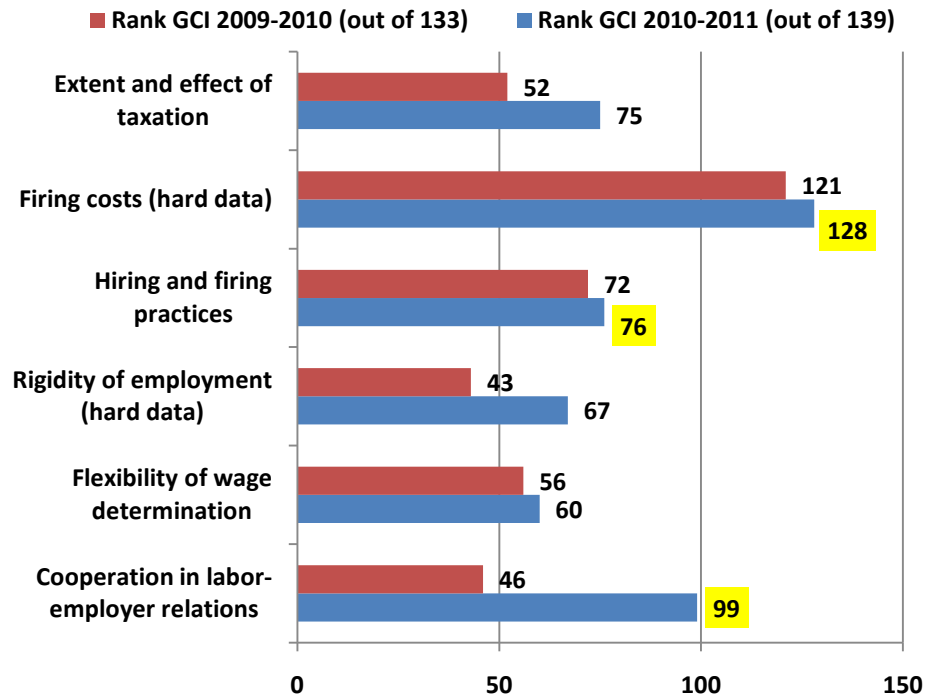


Labor Market & Sub-components

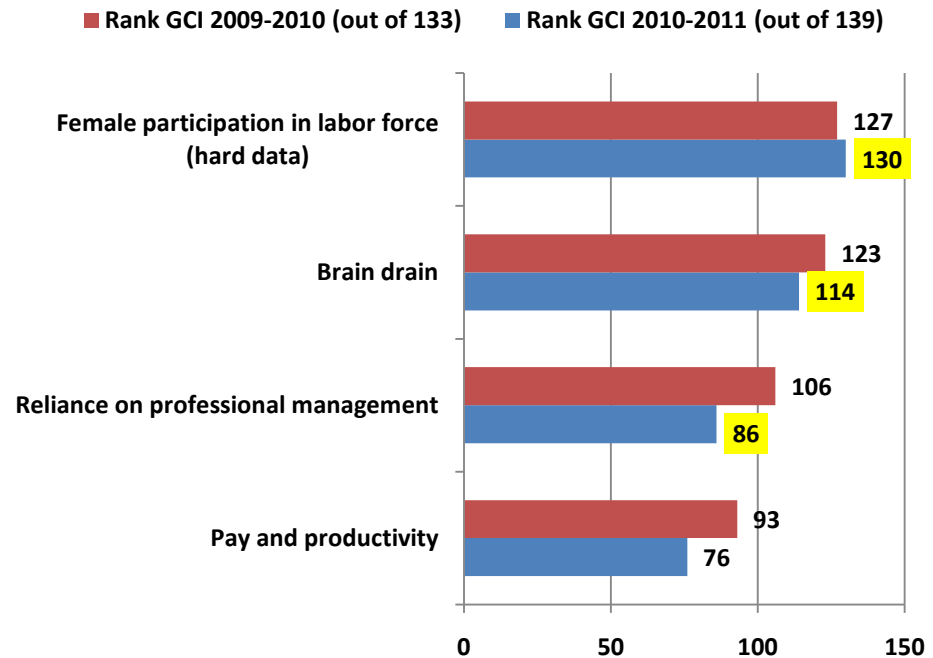


Firing costs, brain drain & low female participation are key challenges

Labor Market Flexibility



Efficient Use of Talent



Source: WEF, 2010

Reform of wages and addressing supply and demand gaps in the labor market are key to greater productivity and competitiveness

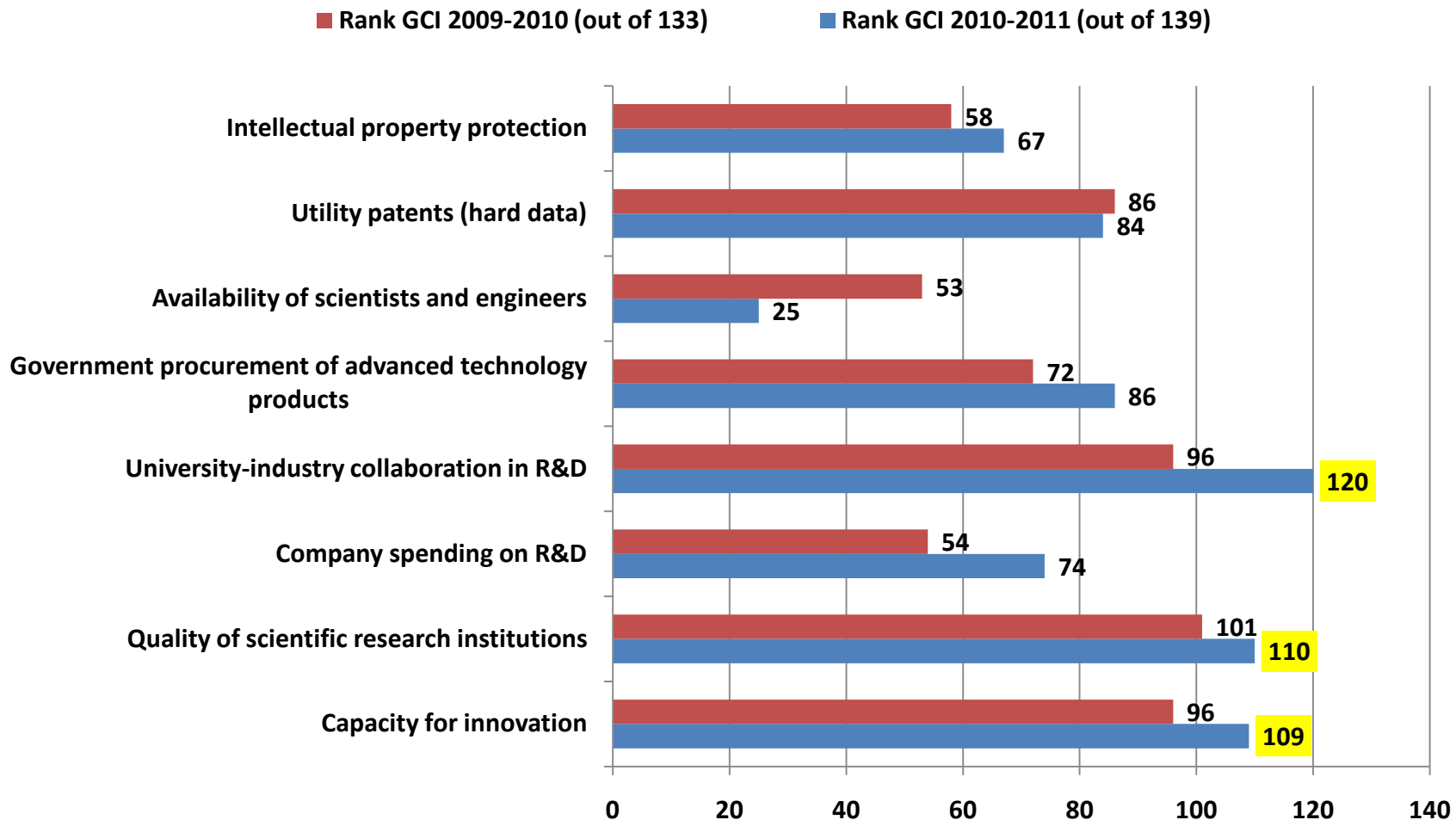
- The mismatch between education outcomes and labor market needs to be addressed
- Career counseling is essential
- Adjusting basic wages to be in line with minimum decent life is a prerequisite for greater productivity
- Vacancies should be given to those who deserve them not to family members



Innovation

Egypt suffers from Low R& D, poor university-industry collaboration and low quality of scientific institutions

Innovation Indicators



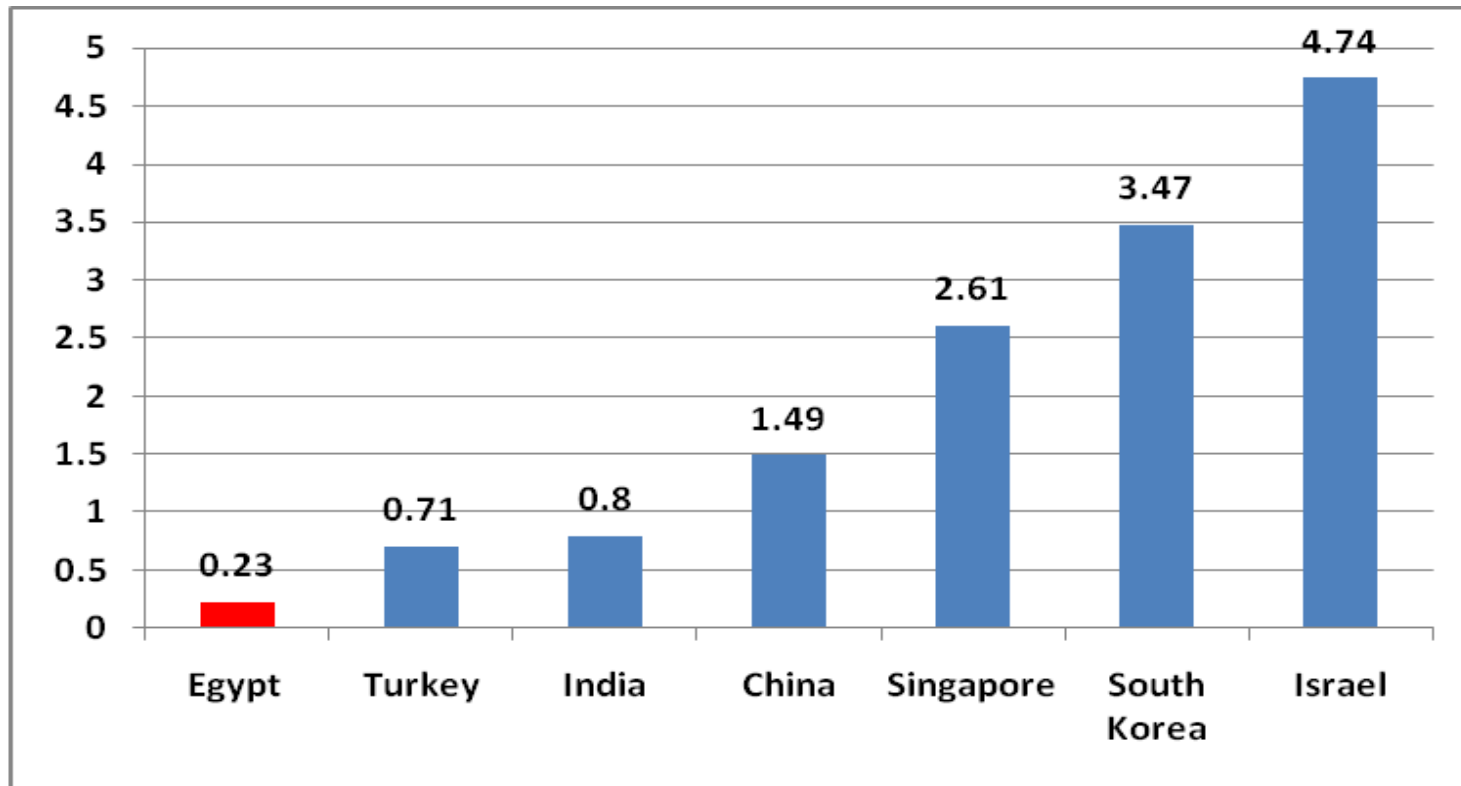
Egypt's rank poorly on several innovation indicators

Egypt's rank on a range of innovation measures

	Overall rank out of 139 countries	Capacity for Innovation	Quality of Scientific Research Institutions	Company Spending on R& D	University-Industry Collaboration in R& D	Government Procurement of Advanced Technology Products	Availability of Scientists and Engineers	Utility Patents per Million Population
Brazil	42	29	42	29	34	50	68	61
Turkey	67	55	89	62	82	62	44	70
Jordan	68	96	98	<u>116</u>	99	57	26	76
China	26	21	39	22	25	12	35	51
Tunisia	31	36	38	35	41	14	7	76
Egypt	83	109	110	<u>74</u>	120	86	25	84
India	39	33	30	37	58	76	15	59
South Korea	12	18	25	12	23	39	23	5
Singapore	9	17	11	8	6	2	10	11

Egypt's spending on R&D is very tiny

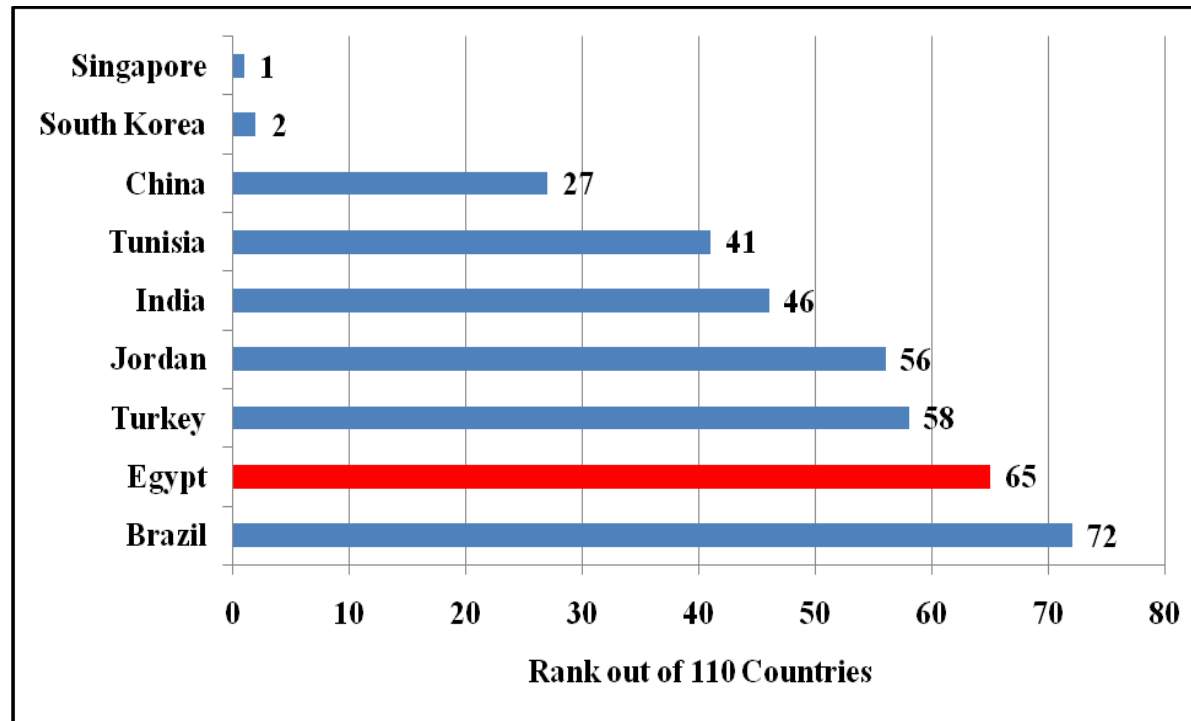
Spending on R&D as % of GDP in 2007



Source: World Bank Indicators, 2010.

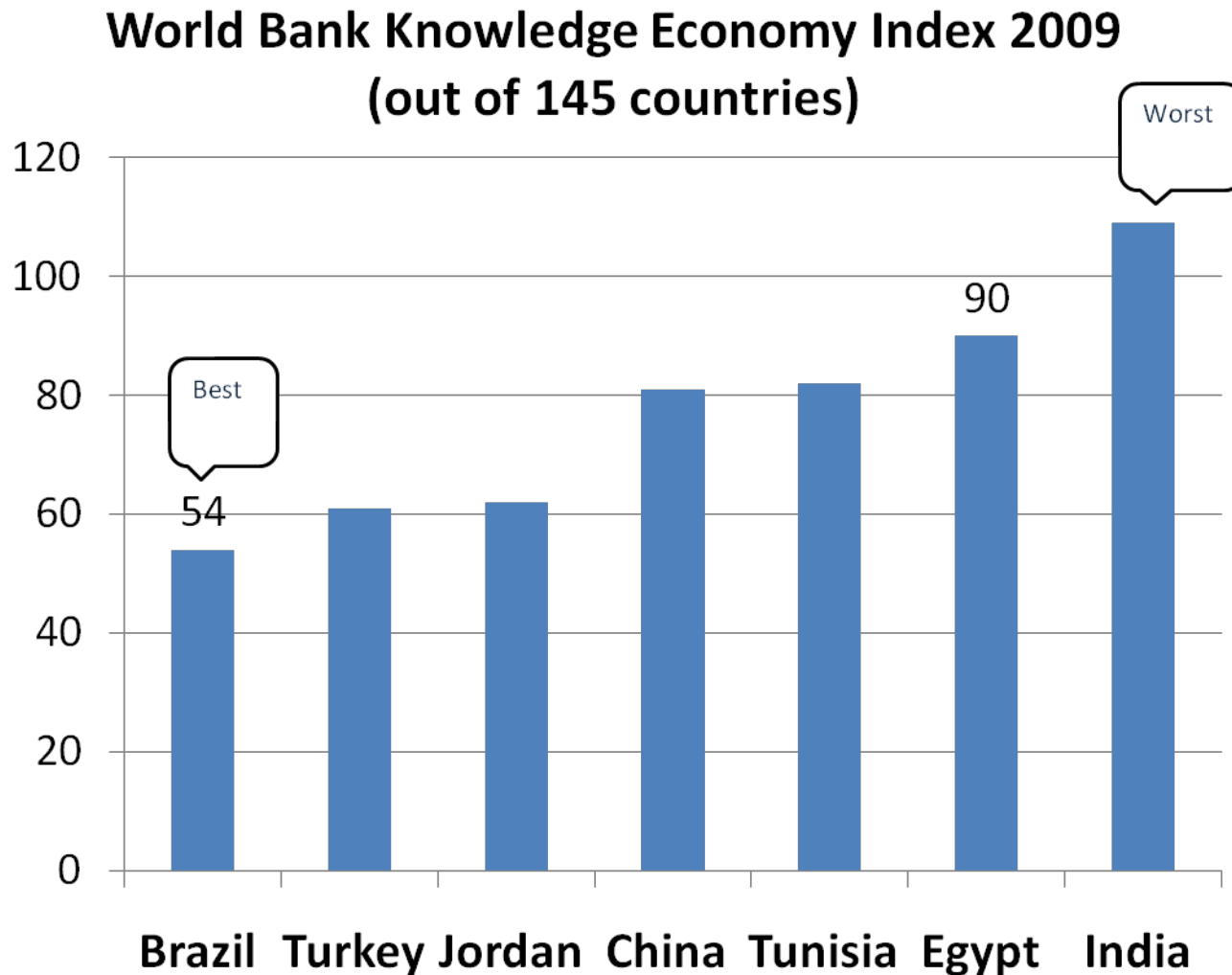
Egypt's low innovation capacity is confirmed by other international rankings

Egypt compared to select comparators in the Boston Global Innovation Index 2009



Source: BCG, 2009. The Innovation Imperative in Manufacturing.

Egypt's low innovation capacity is confirmed by other international rankings



Egypt needs to improve its innovation capacity by:

- Facilitating the registry of patents (could take up to 4 years)
- Greater expenditure on R& D
- Greater incentives for R& D such as tax relief programs
- Attracting back expatriate Egyptian Scientists
- Increasing collaboration between universities and R&D research centers
- Adopting a national strategy that promotes R&D

Way Forward:

Towards Egypt's Greater Competitiveness

- Widening fiscal deficit against declining revenues and increasing domestic borrowing, crowding out private sector activity at the risk of fewer jobs, and higher inflationary pressure.
- Fiscal consolidation is necessary to avail more resources for private sector activity and increase employment, while prioritizing fiscal spending to avail more production subsidies and capital spending.

Way Forward:

Towards Egypt's Greater Competitiveness

- Monetary policy should target inflation to increase competitiveness and preserve the growth momentum, including by aligning the exchange rate with underlying fundamentals.
- Facilitating credit flow to the private sector, particularly SMEs, should help mobilize employment growth.

Way Forward:

Towards Egypt's Greater Competitiveness

- Structural rigidity, inflexibility in the labor market and poor quality education are areas that need to be addressed.
- Social equity requires more jobs in the private sector and growing wages in line with productivity.

Way Forward:

Towards Egypt's Greater Competitiveness

- For Education reform, there is a need to increase spending and efficiency of spending.
- To correct the mismatch between education outcomes and labor market needs and close the gap between labor supply and demand.

Way Forward:

Towards Egypt's Greater Competitiveness

- Increase training, including for vocational graduates, and help coordinate the private sector needs with the supply of graduates.
- Increase incentives for research and innovation to improve quality and compete internationally.

Way Forward:

Towards Egypt's Greater Competitiveness

- Central to Egypt's success is the reform of wages and labor market policies to ensure greater productivity and competitiveness.
- Egypt should capitalize on its greatest asset "Human Capital" by raising the coverage and quality of education, health services and research and development institutions