UPDATE ON STRATEGIC ECONOMIC AND LEGISLATION REFORMS IN EGYPT

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ECES Committed To Shaping Egypt’s Economic Future

The Egyptian Center for Economic Studies is an independent Egyptian think tank that promotes sound public and private policymaking through high quality, innovative research and informed public debate, committed to prosperity, social equity, open society and global integration.

About the Reform Bulletin

In light of the ongoing reform momentum and the high frequency legislative activity in Egypt, ECES is issuing its Reform Bulletin. The Bulletin provides an overview of recent economic reform measures, and newly issued and pending acts of economic and financial legislation. The Reform Bulletin will monitor progress in economic policy measures aiming at the identification of challenges, risks and policy gaps. In this regard, literature on economic and regulatory reform best practices has been reviewed for policy assessment. The bulletin builds its overview on official sources, such as ministries and authorities for implemented measures, and on the Official Journal for issued laws and acts. In addition, the Sub-Committee on Economic and Business Legislation, within the Supreme Committee for Legislative Reform, has been contacted for the validation of pipeline laws. This edition presents policy measures and legislations issued since May 1st, 2015 till August 31st, 2015.

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I. Introduction

This issue of the Reform Bulletin comes at the start of the fiscal year 2015/2016, the second in the five-year fiscal consolidation plan. This represents an opportunity to provide a recap of the results of the first year of the plan as well as shed light on the challenges that emerged. Measures undertaken previously have resulted in improved economic fundamentals: growth rate and sectoral performance, balance of payments and business sentiment. Preliminary figures show that growth rate during the first three quarters of FY 2014/2015 reached about 4.7 percent compared to 1.6 percent during the same period of the preceding year. Growth was driven by six key sectors, on the top of which was the non-oil manufacturing sector with 18.4 growth rate contributing 2.7 percentage points (PPT) to GDP growth compared to 0.3 PPT in H1-FY 13/14. As follows, these sectors were tourism, construction, general government sector, wholesale and retail trade, and agricultural sector.

The tourism sector witnessed a growth of 52.7 percent, contributing to overall growth by 1.2 PPT in H1-FY 14/15 compared to negative 1 PPT in FY 13/14. The number of tourists has shown an upward trend since July 2014. During April, May and June 2015, the number of tourists increased by 7.4 percent, 16.5 percent and 4.3 percent respectively, compared to the corresponding months in 2014. The number of tourist nights increased during the same months by 25.1 percent, 17.5 percent and 13.7 percent, respectively. Construction, general government, wholesale and retail, and agricultural sectors recorded real growth rates of 9.5 percent, 3.8 percent, 3.4 percent and 2.9 percent respectively in H1-FY14/15 compared to H1-FY13/14. Together, the above-mentioned six sectors constituted 61 percent of total real GDP during H1-FY14/15. On the other hand, natural gas extraction declined by 12.5 percent during the same period, representing a negative contribution to overall growth by 1 PPT.

On the fiscal front, tax receipts increased in the period July-May 14/15 by almost 22.5 percent compared to the same period in the previous year. This was driven by a 14.2 percent increase in income tax revenues, a 34.8 percent increase in sales tax revenue and a 30 percent increase in international trade tax revenue. Tax revenue improvement could be attributed to: the increase in receipts following the repayment of the last year tax arrears settlement with the petroleum companies, the recovery of tourism sector pushing the receipts of sales taxes, in addition to the better collection efficiency of the real estate tax. Meanwhile, the budget deficit registered a relatively high level of 10.8 percent of GDP during July-May 14/15 compared to 9.5 percent during the same period of the previous year. Higher budget deficit could be a result of lower non-tax revenues such as external grants. If the exceptional grants were to be excluded from both fiscal years, the budget deficit would have decreased by 1 PPT during the period under review.
Concerning Egypt’s transactions with the external world, the overall balance of payments registered a surplus of US$3.7 billion in FY 14/15 compared to US$1.5 billion in the previous year. The capital and financial account recorded a net inflow of US$17.6 billion thanks to the rise in both foreign direct investment, and deposits from some GCC countries. Meanwhile, the current account deficit went up to US$12 billion from US$2.7 billion due to a 15.5 percent decline in merchandise exports and a 1.1 percent increase in non-oil imports.\(^4\)

The gradual economic recovery, economic reform measures undertaken in 2014 along with the improving political stability resulted in a positively revised outlook by the international rating agencies. In May 2015, Standard and Poor’s Rating Services revised its outlook on the Egyptian economy to "positive" from "stable" reflecting a possibility to raise the long-term rating over the next 12 months. It affirmed the ‘B-/B’ long/short-term foreign and local currency sovereign credit rating. In June 2015, Fitch Rating Agency confirmed its outlook on Egypt with a ‘B’, and a stable outlook on long-term foreign and local currency Issuer Default Ratings (IDR).

Regarding business sentiment, the ECES Business Barometer reveals an optimistic outlook for business with the start of the new fiscal year and high expectations for economic recovery. On the other hand, the identified major constraints were political instability, dealing with government agencies and tax rates.\(^5\) In this regard, the call for parliamentary elections and expected formation of the legislative body by the end of 2015 would help alleviate business concerns regarding political instability.

During the last four months, economic legislative activity aimed at pursuing the previously taken measures by issuing the executive regulations of the issued and amended laws and meeting the current needs. The following section will give an overview of the latest economic measures and legislations by policy area as follows: (1) Macro Policy, (2) Business Environment, (3) Financial Sector, (4) Energy and Mining.

### II. Measures and Legislations by Policy Area

1. Macro Policy

   - **Monetary Policy:** The Monetary Policy Committee (MPC) of the Central Bank (CBE) decided in late July 2015 to keep the overnight deposit rate, overnight interest rate, and the rate of the CBE’s main operation unchanged at 8.75 percent, 9.75 percent and 9.25 percent, respectively. The discount rate was also kept unchanged at 9.25 percent. This decision was taken in light of the decline in monthly headline CPI inflation by 0.7 percent in June compared to an increase of 1.19 percent in May. Accordingly, the annual inflation rate decelerated to 11.39 percent in June from 13.11 percent in May.\(^6\) The MPC adopted the above-
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mentioned interest rates since January 2015 after a 50 basis point cut in light of lower inflationary pressures due to the drop in international oil prices. Previously, the rates were raised by 100 basis points in July 2014 to curb inflation after partial energy subsidy removal.\(^7\)

For the **exchange rate** policy, the pound was allowed to depreciate against the dollar for the second time in 2015 in July to reach EGP 7.73, which represents a depreciation of 8 percent since July 2014. In addition, the CBE announced on 9 June 2015 that it will cover fifty percent of foreign investors’ **pending backlog** for profit repatriation. Moreover, US$1.5 billion worth of Eurobonds were issued successfully during the same month at the rate of 5.875 percent with a 10-year maturity.

- **Economic and Social Development Plan:** The Government of Egypt (GoE) targets a growth rate of 5 percent in the FY 2015/2016. In this vein, the **new state budget** issued by Decree-Law No.32/2015\(^8\) targets curbing the deficit and the debt at rates below 10 percent and 90 percent of GDP, respectively to boost credit availability to the private sector and decrease its cost.

Additionally, the budget plan gives special consideration to **social spending** (subsidy, health and education), which is expected to constitute 50 percent of total public expenditures—representing an 11.4 percent growth compared to the previous year. Social programs comprise conditional cash transfers, social pension and insurance, social housing and slums development.\(^9\)

**2. Business Environment**

- **Investment Law:** The **executive regulations of the new investment** law No.17/2015 were issued by Decree-Law No.1820/2015\(^10\). The regulations specify activities covered by the law, start-up procedures and permits, tax exemptions, and investment services provided. Also, the executive regulations tackle the **temporary operating permits** that could be given before the final license. Accordingly, the Ministry of Industry, Trade and SMEs (MoTI) issued decree No.461/2015\(^11\) allowing the General Authority for Industrial Development to give firms, except those working in food and pharmaceutical industries, a six-month operating permit, renewable once, till the fulfillment of all requirements. The permit is to be issued within five working days from the date of request submission.

- **Taxes and Customs:** **Income tax** law No.91/2005 and Decree-Law No.44/2014 were amended by Decree-Law No.96/2015\(^12\). The amendment boosted the
amount of earnings exempted from taxation from EGP 5,000 to EGP 6,500. The 22.5 percent tax rate ceiling was imposed as well as tax rate unification for all corporations even those located in special economic zones. Also, the amendment suspended the capital gains tax for two years and ended the 3-year sunset clause tax rate of 5 percent on corporates and individuals earning more than one million pounds annually.

The executive regulations of the Customs Law were amended by Decree-Law No.256/2015\textsuperscript{13} to allow for electronic submission of some documents. This comes as a step in customs system restructuring plan, which includes new customs law, streamlining procedures and measures to decrease time consumed and transaction cost, in addition to combating smuggling.\textsuperscript{14}

In this vein, the MoTI issued decree No.606/2015\textsuperscript{15} to cease rice exportation staring September 2015 with exception of a certain type of rice and permits issued before the decree. Several representatives of the business community oppose this ban.

- **Property Rights Protection:** Law on Intellectual Property Rights Protection No.82/2002 was amended by Decree-Law No.26/2015\textsuperscript{16} The amendment aimed at putting a legal framework for protection of new varieties of plants. Such amendment comes in line with WTO Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPs" or the "TRIPs Agreement") and Egypt's agreement with the Euro-Mediterranean in Luxemburg in 2001.

- **Suez Canal Economic Zone:** A number of laws have been amended in connection with the strategic plan for the Suez Canal Zone development. The main one is the law of Special Economic Zones No.83/2002 amended by Decree-Law No.27/2015\textsuperscript{17} to guarantee the autonomy of the general authority of the zone and its governance. Moreover, the amended law stated the cancellation of tax incentives to come in line with the tax rate unification stated by the amended income tax law. Accordingly, the Suez Canal Special Economic Zone has been established by Decree No.330/2015\textsuperscript{18} to include the Zone of North West Gulf of Suez. Moreover, Sinai Development Law No.14/2012 was amended by Decree-Law No.95/2015 to extend the period of land usufruction from 30 to 50 years and boost the maximum period up to 75 rather than 50 years. Also the amendment stated exemptions—to be granted by a presidential decree—for the required percentage of Egyptian shareholders in companies holding lands in Sinai. The regional development strategy of the Suez Canal Zone aims at transforming the area into a world-class global logistics hub and industrial processing center.\textsuperscript{19}
3. Financial Sector

- **Capital Market:** As mentioned above, the capital gains tax has been suspended for two years by Decree-Law No.96/2015. The executive regulations of the capital market law were amended by Decree No.45/2015 introducing fair shares pricing based on studies prepared by the concerned company, allowing private placement and issuing criteria for convertible bonds. Also, intra-day trading has been organized by Decree No.74/2015 to allow for the sale of stocks after T+1 period (following day) rather than T+2. The decree mandated the Egyptian Stock Market Authority to establish a monitoring framework for this mechanism to guarantee market stability and investors interest.

- **Microfinance:** The newly issued Microfinance Law No.141/2014 does not stipulate the requirement of executive regulations, but it delegated EFSA’s Board of Directors to issue the necessary detailed decisions. In this regard, EFSA’s Board of Trustees issued Decrees No.1/2015 concerning licensing requirements for NGOs to provide microfinance products, No.2/2015 concerning the timing of the final permission of microfinancing by NGOs and No.289/2015 concerning the preparation and disclosure of the NGOs financial statements.

- **Mortgage Finance:** Real-estate appraisal code has been issued by Decree No.39/2015 to put unified criteria for property valuation. The licensing requirements for mortgage finance were issued by decree No.64/2015 stating that the required legal form is shareholding company, with paid-in capital not be less than EGP 50 million in case of mortgage and EGP 250 million for remortgage. Capital adequacy rate was defined as a minimum rate of 10 percent according to decree No.77/2015.

4. Energy and Mining

- **Electricity:** New Electricity Law has been issued by Decree-Law No.87/2015 which aims at “raising the performance efficiency and service level of the companies operating in the field of production, transmission, distribution and sale of electricity. For this purpose, it intends to hold free and legitimate competition, to create appropriate atmosphere that attracts investments to the electricity sector in order to cope with the increasing demand for electric power and to assert the principles of transparency, antimonopoly and anti-favoritism.” Also, the new electricity tariff for FY 2015/2016 was issued by Decree
No.2259/2015,\textsuperscript{27} where households consuming less than 200 kWh/month not to be affected by the tariff increase.

- **Mining**: The *executive regulations of the new Mining Law* were issued by Decree No.1657/2015. The regulations stated the licensing requirements for exploitation processes, the formation of the committee for monitoring and follow-up, and special rules for mines exploitation. Also, there has been a specific regulation issued for minerals sale procedures issued by decree No.1966/2015.\textsuperscript{28}

- **Nuclear**: A regulation has been issued by the Nuclear and Radiological Supervisory Board by Decree No.1/2014 \textsuperscript{29} to formulate the regulations required for undertaking nuclear works with regard to records, reporting, investigation and transportation of nuclear materials in line with the international standards set by the International Atomic Agency.
III. Key Policy Messages and Concluding Remarks

Measures undertaken during the period covered by this Reform Bulletin indicate a sustained pace of economic and legislative reform. Reform measures since 2014, especially energy subsidy removal, exchange rate adjustments and monetary policies, resulted in significant economic recovery combined with contained inflation rates. A general observation could be made with respect to the orientation of the recent economic and legislative reform activity. It is clear that central to the reform agenda is an intent to reinforce the government’s focus on the New Suez Canal Zone and its logistical hub.

Scheduling the parliamentary elections was well received by the business community. In addition, the persistence of the GoE to complete the civil service reform reflects a real political will to fight corruption and increase the efficiency of the public bureaucracy.

Measures taken such as cotton subsidy removal and the later reversal of that decision, cotton importation ban and its cancellation, and the more recent controversial rice exportation ban ushered in more cautious reform planning with more advanced impact analysis by government.

Anticipated lower global oil prices will decrease the pressure on budget deficit and allow more time for efficient preparation for fuel smart card introduction to ensure better targeting.

The GoE should take into consideration the latest international developments and revise its external policy accordingly. China’s slower economic growth and shift towards a consumption-led economy represents export opportunities for emerging markets, including Egypt. For Egypt to compete, it should apply a more flexible exchange rate policy, contain inflation and raise the quality of production and services.
Endnotes

Available at: [http://goo.gl/mnexUT](http://goo.gl/mnexUT)
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18 Official Journal, *No. 32 bis “C”*, August 10, 2015, p.74-75
19 [http://www.szone.com.eg/English/aboutszone/Pages/visionandstrategy.aspx](http://www.szone.com.eg/English/aboutszone/Pages/visionandstrategy.aspx)
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