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Why should Brazilians do business in/with Egypt?

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I. Introduction

With a huge difference in their economies' sizes, both Brazil and Egypt, to an extent, are considered by the international financial institutions (*e.g.*, International Monetary Fund "**IMF**") as emerging markets. This is due to sharing several characteristics between the two economies like: large market sizes with more than 100 million consumers, still the presence of noticeable presence of state-owned entities in economic activity, and abundance of labour force due to demographic similarities in terms of median ages. However, the most important shared characteristic is the significant interest of both economies to attract foreign investments to stimulate economic growth, develop infrastructure, create job opportunities, and alleviate poverty.

No one denies the Brazilian happening in the first decade of the 21st century. This leap was reflected on several fields, but mainly, encouraged Brazilian companies and investors to pursue investment opportunities abroad like in the case of Embraer and BRF SA. With these considerations in mind, this article sheds some light on Egypt as a potential investment destination for Brazilian investors interested in: *(a)* cutting the production costs; *(b)* changing supply chains due to the Covid-19 crisis; and *(c)* accessing other MENA markets to which Egypt plays the key gateway role by virtue of its central geographical location in MENA, and its control over the Suez Canal. The article tires to bridge possible gaps between Brazilian investors and the Egyptian economy.

The article is split into four sections addressing the following:

(i) Section II: the current economic status of the Egyptian economy after the recent changes;

(ii) Section III: the Egyptian legal framework governing the investment climate and the market;

(iii) Section IV: the Egyptian legal framework governing trade and how MERCOUSR can open access to new markets; and

(iv) Section V: Conclusion.

II. Economic status

II.A Background

To understand the current status of Egypt's economy that has a population of over 100 million and an annual population growth of almost 2 percent[1], we must revert five years backward. After the political turbulences starting in 2011 and lasting until 2014 when some political stability was restored by concluding the transition phase.

By attaining political stability, the policymakers moved to stimulating and developing the economy as a second priority. The Government of Egypt ("**GoE**") set a vision to reform its legislative and budgetary systems[2], and the first action occurred in November 2016 by concluding an extended fund facility with the IMF for USD 12 billion disbursed over a three-years period depending on GoE's satisfaction of agreed benchmarks[3].

II.B IMF program and its components

The GoE's program agreed with the IMF included three major components:

(i) liberalizing Egypt's foreign exchange system: by adopting a flexible exchange rate regime where the Egyptian pounds' ("**EGP**") value – versus foreign currencies – is mainly determined by market forces. The liberalization of November 2016[4] – resulting in EGP losing around 50 percent of its value versus the US Dollar – targeted boosting Egypt's competitiveness and specifically its tourism, exports, and ability to attract foreign direct investment ("**FDI**");

(ii) limiting the budget deficit through measures to boost GoE's revenues: by introducing, in September 2016, the long-awaited value-added tax ("**VAT**") system to substitute the obsolete general sales tax system. One of the relevant changes in the new VAT Law[5] is extending the VAT application to all goods and services unless

[1] https://www.worldometers.info/world-population/egypt-population/
[2] https://www.theguardian.com/world/2015/mar/15/egyot-sharma-el-sheikh-rumbles-grand-promises
[3] https://www.imf.org/en/News/Articles/2016/11/11/PR16501-Egypt-Executive-Board-Approves-12-billion-Extended-Arrangement
[4] https://www.bloomberg.com/news/articles/2016-11-03/egypt-free-floats-pound-raises-lending-rates-to-spur-economy
[5] VAT Law No. 67/2016.

explicitly exempted, which differs from the preceding regime applying the general sales tax on only the explicitly listed services;

(iii) introducing structural reforms to stimulate an inclusive growth: by setting legislative agendas for parliament and policymakers to issue laws and regulations necessary to enhance the investment climate and ease the doing of business. As will be further discussed below, the agenda involved successfully issuing among others: *(a)* a new law on investment; *(b)* a law on facilitating the licensing of industrial activity; *(c)* a new law on bankruptcy and its procedures; *(d)* a new law to liberalize the gas sector and market allowing the private sector to participate in it; and *(e)* an amendment to the companies' law permitting incorporating one-person companies.

II.C Outcomes of the IMF program

By sticking to the above measures throughout the three-year program until its successful completion by the final IMF review in July 2019, the Egyptian economy by the end of 2019 entered a new reality. With a GDP growth rate of 5.6 percent in H1 of 2019-2020[6], the Egyptian one was way above the IMF's calculated average of global GDP growth in 2020[7].

On the current account side[8], by the end of December 2019, the deficit narrowed due to among others: *(a)* an increase in non-oil merchandize exports by 11 percent compared to H1 2018-2019; and *(b)* a significant increase in net FDI into Egypt by 19 percent compared to H1 2018-2019. The interesting fact is the 60 percent jump in greenfield investments (*i.e.*, non-oil & gas investments). Other relevant macroeconomic indicators include an inflation rate of 5.1 percent y-o-y in March 2020[9], and unemployment rate of 8 percent by the last quarter of 2019[10].

II.D Egyptian economy after Covid-19

From the above, Egypt's economy seemed going in the right way. However, the Covid-19 pandemic has a significant impact on Egypt's indicators as with the global economy.

[6] GoE's budget starts on 01 July and ends on 30 June of the following year.
[7] https://enterprise.press/stories/2020/02/20/egypts-gdp-growth-reached-5-6-in-1h2019-2020-12389/
[8] Central Bank of Egypt report on the "*Balance of Payments Performance in the First Half of FY 2019/2020*".
[9] http://www.emiratesnbdresearch.com/research/article/?a=egypt-inflation-falls-in-march-1758
[10] https://wwww.dailynewssegypt.com/2020/02/15/egypts-unemployment-rate-inches-slightly-to-8-in-4q-2019/

Nevertheless, based on the IMF's latest outlook of economic activity in the MENA region, Egypt's economy is expected to be the only economy to grow in the MENA region in 2020[11]. It is true that the forecasts of growth rates for 2020 have been revised downwards to 2 percent[12], still an economy's contraction is excluded.

In any case, and like many other peers, GoE sought the IMF assistance – and is still negotiating – to mitigate the impact of Covid-19 on Egypt's economy[13].

III. Legal framework on investing in Egypt

III.A Background

Prior to delving into Egypt's legal framework relating to investments, a background is necessary. Egypt's legal system is civil law based and is widely inspired by the French Civil Code[14]. The system's primary law is the Constitution of 2014, followed by laws, ministerial decrees, and finally regulations. Specifically, international treaties prevail over domestic laws and regulations. The Court of Cassation comes on top of the civil courts system and the Supreme Administrative Court tops the administrative courts system.

Recently, the parliament and the GoE joined efforts to introduce several legislations to enhance the investment climate and ease the doing of business in Egypt. The interest is to issue legislations aiming to adopt the latest international practices and standards as well as to align Egypt with its obligations under international treaties. Considering the focus of this article, the next subsection provides insights on the Investment Law No. 72/2017 ("**IL**")[15] being the prime legislation governing investments local and foreign.

III.B Guarantees and incentives under the IL

The IL provides investors, local and foreign, guarantees mirroring the latest principles of the international investment law. The guarantees include, first, complying the national treatment principle by according foreign investors a fair and equitable treatment like that accorded to national investors[16]. Second, the IL prohibits expropriation in all forms

[11] International Monetary Fund. *World Economic Outlook*. April 2020. P. 23.
[12] https://enterprise.press/stories/2020/05/04/govt-cuts-growth-outlook-for-fy2020-2021-again-15421/
[13] https://www.imf.org/en/News/Articles/2020/04/24/pr20188-egypt-statement-by-imf-manag- ing-director-kristalina-georgieva
[14] https://www.nyulawglobal.org/globalex/Egypt1.html
[15] Law No. 72/2017, Official Gazette, Issue No. 21-bis(c), 31 May 2017.
[16] Art. 3 of the IL.

including creeping and indirect expropriations[17]. Third, and regardless of currency controls, the IL grants investors rights to collect, own, manage use, and alienate the profits of an investment project and transfer them abroad[18].

Fourth, investments are eligible – without registering in the importers' register – to import anything necessary for incorporation, expansion, and operation, including raw material, production necessities, machinery and spare parts[19], and same applies for exports. Finally, the IL allows investments to hire non-Egyptian employees with a maximum of 10 percent the investment's total employees[20].

On the incentives side, the IL grants a special investment incentive in the form of a tax deduction (deductible from the taxable income) to investments. The two tax deduction rates (*i.e.*, 50 and 30 percent) are provided depending on the investment's geographical location and field of investment. By satisfying certain conditions, and based on the nature of an investment project, the latter can be incorporated under the free zones' regime. By then the investment project itself (*e.g.*, its generated profits) and its payable dividends are not subject to ordinary Egyptian taxation or fees[21].

In general, and apart from the special incentives granted under the IL, legal entities resident in Egypt for income tax purposes are subject to corporate income tax at the rate of 22.5 percent. For legal persons not residing in Egypt for income tax purposes, a permanent establishment ("**PE**") is subject to Egypt's corporate income tax as if it was a company resident of Egypt only in relation to the income attributable to the PE. Dividends paid from Egyptian entities to shareholders are subject in Egypt to a final withholding tax at the rate of 10 percent and can be reduced to 5 percent provided certain conditions are satisfied.

IV. Legal framework on trading with Egypt

IV.A Background

With its big sized market, geographical location in the Middle East and close to Europe, and devalued currency making its abundant labour cheaper, Egypt is well positioned to be a favourable destination for Brazilian goods and services, but more importantly also

[17] Art. 4 of the IL.
[18] Art. 6(1) of the IL.
[19] Art. 7 of the IL.
[20] Art. 24 of the IL.
[21] Art. 41 of the IL.

for Brazilian investments. The bilateral relations between Brazil and Egypt are principally based on the Egypt-MERCOSUR free trade agreement ("**FTA**"), which entered into force on 01/09/2017 upon Argentina's ratification. On Egypt's side, the FTA has been approved by the Presidential Decree No. 404/2012 ("**FTA Decree**")[22].

IV.B Actual flows of trade

After signing a framework agreement in 2004, the MERCOSUR members' representatives and Egypt went through six rounds of negotiations until reaching the final form of the FTA in 2010[23]. The FTA creates a free trade area between the four members of the MERCOSUR bloc and Egypt[24]. Under the FTA[25], goods are grouped in five categories with different reduction rates of tariffs over a different number years. By the entry into force of the FTA on 01/09/2017[26], 2535 items of goods – Category A of goods including vaccines, sugar beet, and sheep – began trading free of duties. By 01/09/2020, goods itemized in Category B – including several hydrocarbon products like nitrogen and propane – will be traded free of duties.

The latest disclosed information from the Egyptian Ministry of Industry[27] showed that Brazil's exports to Egypt reached USD 3.08billion in 2018 against USD 2.4billion in 2017 with a 28.3 percent increase that can be attributable to the entry into force of the FTA. From the different data, it is obvious that the main component of Egypt's imports from Brazil is food products including meat, where 53.5 percent of Egypt's imported meat in

[22] Presidential Decree No. 404/2012, Official Gazette, Issue No. 17-cont.,27 April 2013.

[23] http://enterprise.press/wp-content/uploads/2017/10/Final-Version-of-Mercosur-Report-1.pdf P. 5.

[24] Art. 3 of the FTA Decree.

[25] Item of Art. 11 of FTA Decree.

[26] https://www.youm7.com/story/2018/2/7/%D8%B3-%D9%88-%D8%AC-%D8%A3%D9%87%D9%85-%D8%A7%D9%84%D8%A3%D8%B3%D8%A6%D9%84%D8%A9-%D8%AD%D9%88%D9%84-%D8%A7%D8%AA%D9%81%D8%A7%D9%82%D9%8A%D8%A9-%D8%A7%D9%84%D9%85%D9%8A%D8%B1%D9%83%D8%B3%D9%88%D8%B1-%D9%88%D9%83%D9%8A%D9%81-%D8%AA%D8%B3%D8%AA%D9%81%D9%8A%D8%AF/3637824

[27] https://almalnews.com/%D8%A7%D8%B1%D8%AA%D9%81%D8%A7%D8%B9-%D8%A7%D9%84%D8%AA%D8%A8%D8%A7%D8%AF%D9%84-%D8%A7%D9%84%D8%AA%D8%AC%D8%A7%D8%B1%D9%8A-%D8%A8%D9%8A%D9%86-%D9%85%D8%B5%D8%B1-%D9%88%D8%A7%D9%84%D8%A8%D8%B1%D8%A7/

2016 was from Brazil[28]. Recently, the Egyptian authorities approved 42 beef and chicken producers to export their products to the Egyptian market[29].

IV.C Opportunity for Brazilians

In terms of foreign trade, Egypt has a decent network of free trade agreements. Hence, having a production facility in Egypt allows Brazilian companies to access not only 100 million Egyptians, but also other big markets like for example East Africa by being eligible to benefit from the Common Market for Eastern and Southern Africa ("**COMESA**") agreement[30]. This comes along the lines of Rubens Hannun's – president of ABCC – statement during the Brazil-Egypt Economic Forum held in Cairo last June, who when announcing the opening of a second representative office for ABCC[31] in the MENA region and will be located in Cairo, emphasized that "*Arabs represent not only a large consumer market of 450 million people but also an extended market of 2 billion consumers*". The opening of a new office commercially makes sense since Egypt is not only the third largest importer of Brazilian products in the MENA region (after Saudi Arabia and the UAE), but more importantly, is the only state with an enforceable FTA with Brazil.

IV.D Future works

While it is true that the FTA includes an article[32] dealing with promoting investment, it falls short from guaranteeing protection to investments as similarly provided in the models of bilateral investment treaties. At this stage, it is important to highlight that Brazil and Egypt do not have neither a bilateral investment treaty in place nor a double tax treaty. This can adversely impact the flow of investments between the two economies. However, the structuring of the bilateral transactions and the pursued economic benefits can justify proceeding with a potential investment in absence of a bilateral investment treaty and/or a double tax treaty.

[28] http://enterprise.press/wp-content/uploads/2017/10/Final-Version-of-Mercosur-Report-1.pdf P. 15.

[29] https://www.thecattlesite.com/news/55143/egypt-authorises-42-brazilian-meat-plants-for-exports/

[30] https://www.gafi.gov.eg/Arabic/Sectors/Pages/Trade-Agreements.aspx

[31] https://www.zawya.com/mena/en/business/story/Brazilian_Chamber_to_open_second_Middle_East_representative_office-ZAWYA20190623101408/

[32] Art. 23 of the FTA Decree.

V. Conclusion

Egypt and its economy should be revisited by Brazilian investors interested in expanding their business abroad. An economy with a vast unlocked potential and with a wide room for Brazilian investors to exploit. The market size and the geographical location of being central in MENA, the proximity to European markets, and the control over Suez Canal offer Egypt a unique opportunity to play the role of MENA's gateway. Although Covid-19 is distressing global economy, however, the good composition of Egypt's economy prior to the pandemic will allow it to recover in a quicker pace compared to its peers.

On the legal framework to invest, and in absence of a bilateral investment treaty, the IL guarantees a treatment like that accorded under the international investment law. Being an important pathway to access other African and MENA region markets, investing in Egypt under its welcoming IL is an obvious invitation for Brazilian investors. Depending on the investor's interest and nature of investment, the IL can guarantee tax-related incentives to attract foreign investors.

On the trade side, the FTA is the guiding and prevailing umbrella. With continuous increases in the flows of trade since the FTA entry into force, the Egyptian market represents a wide opened opportunity for the Brazilian products that kind of created a level of mutual trust and increased competitiveness with a depreciating local currency. It is true that exports of meat represent a wide component of Egyptian imports, however, this is not expected to last since the continuous promotion of Brazilian exports will assist in diversifying the nature of traded products pushing it towards more complexity and development.

Finally, and considering the huge potential flows between the two economies, the policymakers of both countries should definitely engage in negotiating the conclusion of a double tax treaty to encourage and promote bilateral investments.