Deutsches Institut für Entwicklungspolitik
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Reform programme

# Is Egypt’s economy stabilising the country?

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The Current Column
*of 29 January 2018*

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*Bonn, 29.01.2018.* This Thursday, the seventh anniversary of the 25 January uprising that overthrew former Egyptian President Hosni Mubarak, is an opportunity to assess the economic situation in the country. The West's fear of radical Islam means it has great interest in a stable Egypt. The IMF and other donors are providing loans worth 21 billion US Dollar to support this stability. Can the reforms associated with these loans address years of deep-rooted structural problems and help launch Egypt onto a new, higher but shared growth path? Or is the money being used to fund a programme of mega-projects to maintain the political popularity of an increasingly repressive regime?

The reforms aim to restore macroeconomic imbalances by reducing government expenditure through cuts to gas, water and other subsidies as well as reducing public investment and capping public wages. The government has also levied a value added tax (VAT) to raise revenue, floated the currency, and eased capital controls to eradicate the parallel foreign exchange market, improve the trade balance and increase reserves.

In the short-run, these measures have had the following effects: First, on top of the loans, foreign currency flowed into the country through investments in government bonds. Foreign exchange reserves grew substantially and the black market nearly vanished, but the Egyptian Pound has devalued sharply. Second, the trade balance has improved with an increase in exports and a fall in imports, though at a lesser rate than hoped. Despite some improvements, poor export performance and an over-reliance on natural resource exports remains problematic. However, much of Egypt's moderate processed exports are based on imported inputs and capital goods, so imports will inevitably rebound. Third, prices have risen sharply driven by the floating of the Pound, higher import tariffs, the VAT and the removal of subsidies. People have not yet taken to the streets, despite inflation's erosion of their purchasing power. Fourth, the growth rate increased, albeit by less than pre-loan expectations. Future prospects are poor given the limited flow of foreign direct investment, weak consumer spending, interest rate hikes and the decline in government investment. Fifth, the budget deficit declined but remains high at 10 percent of GDP. Without reforms to reduce leakages, tax and customs authorities' revenue will not reduce the deficit. Sixth, the government relied heavily on borrowing to finance the deficit pushing total domestic debt to over 90 percent of GDP and foreign debt to 40 percent (the latter previously never exceeded 20 percent).

The short-term prognosis is thus mixed. The small improvements have been driven by short-term debt rather than sustainable investment or reform. Soon this debt will have to be repaid, but the government has been buying time ahead of elections later in 2018.

For the long-term, in 2013 Egypt adopted a development vision based on real estate development and mega-projects such as the new capital city and Suez Canal projects. But construction and real estate development are symptoms of weak structural transformation away from tradable higher productivity sectors and services, and are unable to transform Egypt into a dynamic high growth inclusive economy. Egyptian development should support sustainable growth through an effective export strategy.

The current development vision lacks three essential elements: 1) Political development: requires devolving power via guarantees of integrity and neutrality by state agencies in electoral processes; ensuring the independence of judicial and legislative institutions, and maintaining a balance between civil, political and economic institutions and the security/military apparatus. 2) Human development: means allocating resources towards more spending on education and health. 3) Sustainable and comprehensive development: requires a broader vision taking resource depletion into account. It develops the youth's creative energies, fosters peace and reconciliation, and cements a new lasting social contract between state and society.

Egypt's current development vision is based on the façade of political reform. Political representation lacks the simplest legislative and parliamentary functions and the integrity regarding elections is widely questioned. Reconciling civil-security relations is entirely absent from the agenda. An unequal playing field dominated by military firms limits free competition. Recently, the assets of dozens of companies were frozen to procure political loyalty. These measures are oppressive and curtail investor confidence in the economy. Investment in human capital is neglected in favour of populist mega projects and will only be effected through a shift to a participatory model or a full democratic transition. To date, both transformations are absent. The sustainable development that the people long for is missing from the leadership's vision altogether. Egypt's development vision lacks a genuine dialogue among the various segments of society instead of the current pretence of a version. At the heart of this dialogue are political reform and a new social contract, without which there will be no economically prosperous or politically stable Egypt.