

ISSUE BRIEF

The Economic Decline of Egypt after the 2011 Uprising

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The popular uprisings in the Arab world in early 2011 gave citizens hope that a long-awaited transition to a democratic and pluralistic system was finally coming to their countries. Egypt, which in many respects defines the Arab world, was the example to be emulated by other countries in the region. Tahrir Square became the iconic symbol of the so-called Arab Spring and “bread, freedom, and social justice,” the battle cry for people across North Africa, the Levant, and even the Gulf. Five years on the political picture is mixed in the Arab countries in transition,¹ but in all of them, including Egypt, the economies worsened after 2011 and are still floundering and far from recovery.²

Arresting the downward slide and stabilizing the economy has to be the first order of business for Egypt’s government. Then it can move on to creating the conditions necessary for sustained higher growth that would generate sufficient jobs to absorb the rapidly growing and young labor force. Achieving macroeconomic stability is the easy part. But transforming the economy requires a vision of the economic model that Egypt should adopt. Unlike Central and Eastern European countries, Arab countries do not have a readymade European Union economic model to which they can aspire. Egypt has to develop its own model. Should it be primarily a market-oriented and private-sector-led economy, or a state-controlled economy? This is a question that

The Atlantic Council’s Rafik Hariri Center for the Middle East studies political and economic dynamics in the Middle East and recommends US, European, and regional policies to encourage effective governance, political legitimacy, and stability.

- 1 Only in the case of Tunisia is there consensus that significant advances have been made on the political front. See Mohsin Khan and Karim Mezran, “Tunisia: The Last Arab Spring Country,” Atlantic Council, October 9, 2015, <http://www.atlanticcouncil.org/publications/issue-briefs/tunisia-the-last-arab-spring-country>. More modest political changes are also evident in Jordan and Morocco.
- 2 See Mohsin Khan, “The Economic Consequences of the Arab Spring,” Atlantic Council, February 13, 2014, <http://www.atlanticcouncil.org/publications/issue-briefs/the-economic-consequences-of-the-arab-spring>.

successive Egyptian governments since 2011 have been wrestling with, while simultaneously implementing populist policies to appease the immediate demands of the public.³

The Egyptian Economy before the Uprising

Egypt started to move slowly from a state-dominated and closed economy to a more open and market-friendly one in the early 1990s. However, the economic reforms were fairly modest and did little to restructure the economy in any meaningful or major way. It was only in mid-2004 that the government of then Prime Minister Ahmed Nazif launched a number of ambitious economic reforms.⁴ This reform program was designed to transform Egypt into a more market-oriented and private sector-led economy, by expanding financial reforms, reducing onerous business and investment regulations, lowering tariffs, and selling off state-owned enterprises.

These reforms led to an increase in Egypt's economic growth from 4.5 percent in 2005 to 7.2 percent in 2008, which was significantly higher than the growth over the same period in the overall Middle East and North Africa (MENA) region (see figure 1). Despite the global recession, Egypt continued to grow at a very respectable average annual rate of about 5 percent in the 2009-10 period.

Growth was also driven by increased exports and imports, larger workers' remittances from overseas, higher Suez Canal receipts, and substantial inflows of foreign direct investment (FDI). Tourism receipts also jumped from \$7 billion in 2005 to \$12.5 billion in 2010. Because of the substantial improvement in the external accounts, the Central Bank of Egypt (CBE) nearly doubled its holdings of international reserves from \$19 billion in 2005 to \$35 billion by the end of 2010.

Even though the government was able to create some 2.5 million jobs over a five-year period, the impact on unemployment was only marginal (see figure 2). The

overall unemployment rate fell from 11.5 percent in 2005 to 9.2 percent in 2010, with youth unemployment coming down from 34 percent to 25 percent. Basically, unemployment remained high partly because the public sector slowed down its hiring, but mainly due to a fundamental skills mismatch between those seeking jobs and the demands of the private sector. Small- and medium-sized enterprises (SMEs), the main job creators, continued to face restrictions on access to credit and were severely hampered by regulations on both their establishment and expansion. As such, the higher growth rates did not yield greater economic opportunities for a large segment of Egypt's population, with many migrating abroad or moving into the growing informal and unregulated economy to seek jobs.

Despite the positive macroeconomic situation over the 2005-10 period, by the end of the Nazif government the major structural flaws in the Egyptian economy had not been addressed. These included still-high rates of youth unemployment, crony capitalism, inadequate infrastructure, a large and inefficient bureaucracy, and widening income and wealth inequalities. Given these factors, and the economic grievances they created, Egypt was a ticking time bomb waiting to explode. As such, in hindsight, the uprising in January 2011 was not a surprise.

Economic Developments and Policies since the Uprising

During the 2011-15 period, following the fall of President Hosni Mubarak, the macroeconomic picture worsened significantly.⁵ Economic growth during this period averaged a tepid 2.5 percent per year and by 2015 the unemployment rate had risen to 12.9 percent with youth unemployment reaching a staggering 35 percent (see figures 1 and 2).

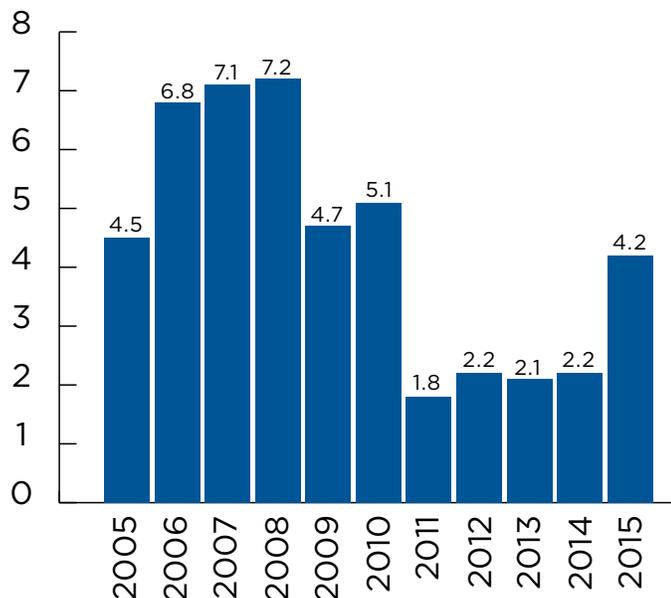
On February 11, 2011, the Supreme Council of the Armed Forces (SCAF) assumed power as the transitional government, led by Field Marshal Mohamed Hussein Tantawi. In the first year of the SCAF government, growth fell sharply to below 2 percent, while unemployment jumped to over 10 percent, one of the highest levels in ten years. The transitional government

3 For a discussion of this issue, see Mohsin Khan and Svetlana Milbert, "Economic Policies in Egypt: Populism or Reforms?" Atlantic Council, October 10, 2012, <http://www.atlanticcouncil.org/publications/issue-briefs/economic-policies-in-egypt-populism-or-reform>.

4 These reforms were pushed by the economic team of Minister of Finance Youssef Boutros-Ghali, Minister of Trade Rachid Rachid, and Minister of Investment Mahmoud Mohieldin, all of whom were close associates of Gamal Mubarak, the son of the former President Hosni Mubarak, and thus presumably in a position to persuade him of the merits of these reforms.

5 For an additional description of Egypt's economy from 2011-15, see Mohamed El Dahshan, "The Egyptian Economy," in *Egypt after the Spring: Revolt and Reaction* (London: Routledge, 2016), <https://www.iiss.org/en/publications/adelphi/by%20year/2015-9b13/egypt-after-the-spring-2ba4>.

Figure 1. Egypt—Real GDP Growth (in percentage), 2005-15



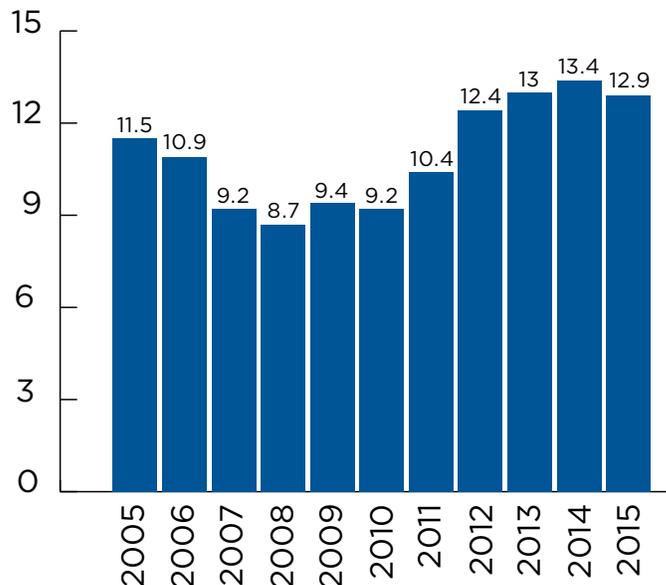
Source: International Monetary Fund.

decided not to tackle the main economic problems, but instead resorted to a number of populist measures to appease the public, including increasing subsidies and government employment and wages. As a result, the fiscal deficit jumped to 8.6 percent of gross domestic product (GDP), leading to an increase in inflation to 11 percent; the external current account deficit increased to nearly \$5 billion.

A major policy mistake was keeping the Egyptian pound stable, which resulted in the CBE losing over \$20 billion of its foreign exchange reserves between December 2010 and May 2012. It was the sharp decline in international reserves that led to the three major credit rating agencies—Moody's Investors Service, Fitch Ratings, and Standard & Poor's—downgrading Egypt's sovereign credit rating.

The government of President Mohammed Morsi that was elected in June 2012 found an economy in dismal shape. Tackling the immediate and long-term problems would have tested any government. For the Muslim Brotherhood, with no experience running the country and the economy, it was an overwhelming challenge. Furthermore, the government was totally absorbed in trying to handle the myriad political problems that kept arising and the economy was put on the back burner.

Figure 2. Egypt—Unemployment (percentage of total labor force), 2005-15



Source: International Monetary Fund.

Absent the implementation of a meaningful economic plan, the economy continued to drift, with the growth rate in 2012 only a little above 2 percent, and unemployment averaging nearly 12.5 percent. Foreign exchange reserves remained low and would have been almost completely depleted had it not been for the external support of wealthier oil-producing Arab countries. As such, the Egyptian pound remained under continual pressure. It is clear that the Morsi government failed to address the economic problems during its term in office and the year it was in control of the country was effectively wasted. Very few, if any, of the promises that Morsi made to the Egyptian public at the beginning of his presidency were kept. The collapse of the economy was averted only by the financial support from Egypt's friends in the Middle East and not as a result of any policy action. Ultimately, time ran out for Morsi and, citing political overreach and a disintegrating economy, the military intervened and removed him from office on July 3, 2013.

The appointment of the transitional government of President Adly Mansour in August 2013 led immediately to some positive economic developments, although these were admittedly more associated with the political change rather than the result of any specific economic

measures. The appointments of Prime Minister Hazem el-Beblawy and Minister of Finance Ahmed Galal, both prominent and well-respected economists, were received very positively by the media that took the view that these “liberal” economists had the requisite expertise and experience to reverse Egypt’s fortunes.⁶ The receipt of \$12 billion in external assistance from Kuwait, Saudi Arabia, and the United Arab Emirates (UAE) greatly eased the pressure on the country’s balance of payments and exchange rate. Also, the stock market rose sharply, with the EGX 30 Index rising by 6 percent in just one day on July 4, 2013.

Nonetheless, by the end of its term in office in March 2014, the Beblawy government had made virtually no progress in turning the economy around. The inflow of funds from the Gulf countries was a boon and it provided the government with the budgetary resources for expansionary fiscal policies to boost growth. Two stimulus packages worth \$8.5 billion (about 3.5 percent of GDP) were introduced for investing in infrastructure, supporting factories, restructuring state-owned enterprises, and covering the increases in minimum wages for public sector employees. Unfortunately, however, growth remained stuck at 2 percent, unemployment remained high, and inflation was still in the double-digits.

The Egyptian Economy under President Sisi

President Abdel Fattah al-Sisi took office in June 2014 with a mandate to revive the economy and set it on a path of sustained high economic growth and low unemployment. Egypt must consistently grow at a rate of at least 6-7 percent per year to create sufficient jobs to reduce unemployment and absorb the new entrants into the labor market, which will require the implementation of major economic and institutional reforms. But these reforms take time to yield their outcomes. President Sisi has recognized this; in 2014, he stated that “...maybe a generation or two will not reap the benefits (of reform), but that may be necessary so others can live.”⁷

The most immediate policy priorities for the government of President Sisi and Prime Minister Sherif Ismail are to increase the energy supply, improve public finances,

attract external financing, move to a flexible exchange rate regime, and expand the private sector.

Energy Supply

Egypt has been in the midst of a serious energy crisis that is evident in country-wide electricity shortages and daily power cuts. While the focus has mostly been on the inconvenience and hardships they cause for households, electricity shortages have also negatively impacted industry, such as cement production and other heavy industries, which in many cases are operating at only 50-60 percent capacity. This naturally has led to a significant reduction in industrial production and employment.

The proximate cause of the energy crisis in Egypt is shortages of inputs, principally oil and gas. Installed electricity capacity is almost 25,000 megawatts while current consumption is only 13,000 megawatts. Consequently, the solution in the short run is not adding new power plants, even though they will be needed eventually,⁸ but rather ensuring that gas and oil inputs are available to the existing plants. Three key policies are being used to achieve this objective:

- **Eliminating payments arrears** to international oil and gas companies, which amounted to \$3 billion at the end of 2015. The Ministry of Petroleum has said it aims to completely pay off outstanding arrears by the end of 2016.⁹
- **Raising electricity tariff rates for households and industry** to a level that covers the costs of production and eliminates government subsidies for electricity. In 2014 the government announced that electricity tariffs will double by 2019 to remove power subsidies completely.¹⁰

8 In 2014, President Sisi announced that Egypt intended to invest in new power plants at a cost of \$12 billion over the next five years. See Lin Nourished, “Egypt President Says No Magic Bullet for Power Problems after Major Blackout,” Reuters, September 6, 2014, <http://uk.reuters.com/article/2014/09/06/egypt-sisi-blackouts-idUKL5N0R70GX20140906>.

9 “UPDATE 1-Egypt Arrears Owed to Oil Firms Rises to \$3 Billion at End-2015,” Reuters, January 3, 2016, <http://www.reuters.com/article/egypt-oil-debt-idUSL8N14N05S20160103>.

10 The Minister of Electricity and Renewable Energy is reportedly considering extending this deadline. See Mohamed Faraq, “Ministry Considering Extending Timeline for Lifting Electricity Subsidies,” *Daily News Egypt*, March 21, 2016, <http://www.dailynewsegypt.com/2016/03/21/ministry-considering-extending-timeline-lifting-electricity-subsidies/>.

6 See Mohsin Khan, “Can the Transitional Government Turn the Egyptian Economy Around?” *EgyptSource*, July 30, 2013, <http://www.atlanticcouncil.org/blogs/egyptsource/part-i-can-the-transitional-government-turn-the-egyptian-economy-around>.

7 Hazma Hendawi, “Correction: Egypt-El-Sissi’s Run Story,” Associated Press, March 9, 2014, <http://bigstory.ap.org/article/egypts-military-chief-reluctant-candidate>.

- **Obtaining oil and gas supplies from the Gulf Arab countries** as grants or on a deferred-payment basis. In 2014, it was reported that the UAE would supply \$9 billion worth of petroleum products during 2015, covering all of Egypt's petroleum needs for a full year.¹¹ In January 2016, the Kuwait Petroleum Corporation said it would supply Egypt with about three million barrels of crude oil per month and jet fuel supplies amounting to \$1.2 billion for nine months.¹² And in April 2016, Saudi Arabia signed an agreement to supply Egypt with \$23 billion worth of petroleum products under easy payment terms over five years.¹³

Public Finances

During the 2011-15 period, Egypt's fiscal accounts deteriorated substantially, leading to an average fiscal deficit of nearly 12 percent of GDP. This large fiscal deficit and consequent rise in government debt, which in 2015 amounted to over 88 percent of GDP, is clearly unsustainable. This fact was acknowledged by President Sisi during his election campaign in 2014 when he called for reducing the fiscal deficit to 8.5 percent of GDP over the next three years,¹⁴ and later when he followed up on his commitment by returning the budget for 2014-15 to the Ministry of Finance for revision to ensure the projected deficit would be no more than 10 percent of GDP.¹⁵

The key question is how to improve Egypt's public finances without adversely affecting economic growth. The answer is that the government will have to create the fiscal space for expansionary expenditure policies that are essential for generating growth and jobs in the short run. Improving the public finances requires the following:

- **Increasing taxes on high-income earners and on luxury products.** The government has moved on this front by imposing an additional income tax of 5 percent for a period of three years on taxpayers earning more than 1 million Egyptian pounds a year. The government also intends to introduce a full-fledged value-added tax (VAT) to replace the Generalized Sales Tax (GST) in 2016. Finally, a property tax, which the Morsi government had proposed earlier, and the current government is implementing, will help in both increasing revenues as well as reducing wealth gaps. However more recently, the Sisi government announced that it would extend the postponement of a planned 10 percent capital gains tax until May 2017.¹⁶
- **Reforming the generalized subsidies system.** Subsidies eat up an average of 10 percent of GDP every year and a quarter of the government budget. In fact, along with social benefits, subsidies are the biggest ticket item in the budget, exceeding even wages and interest payments. As part of the 2014-15 budget, the government took a major step in reducing subsidies by increasing fuel prices across the board, although they still remained well below international prices.¹⁷ All previous Egyptian governments going back to Anwar Sadat have not addressed the subsidy issue because of the potential political fallout. Finally an Egyptian government was willing to take the risk and bite the bullet. And it paid off since the protests following the fuel price increases turned out to be relatively muted. However, even after the July 2014 reforms, subsidies remain large, amounting to 8.5 percent of GDP in 2015. The government should now move to formulate a long-term plan to reduce and eventually eliminate subsidies, and communicate this plan to the public.

11 "Emirates to Finance Oil Product Purchases for Egypt Worth \$9 Billion: Press," *Ahram Online*, August 27, 2014, <http://english.ahram.org.eg/NewsContent/3/12/109347/Business/Economy/Emirates-to-finance-oil-product-purchases-for-Egypt.aspx>.

12 Mohamed Adel, "Egypt to Import 3m Barrels of Crude Oil per Month from Kuwait, Contract to End in September," *Daily News Egypt*, January 4, 2016, <http://www.dailynewsegyp.com/2016/01/04/egypt-to-import-3m-barrels-of-crude-oil-per-month-from-kuwait-contract-to-end-in-september/>.

13 "Saudi Arabia to Supply Egypt with 700,000 Tonnes of Petroleum Products a Month," Reuters, April 11, 2016, <http://uk.reuters.com/article/uk-egypt-saudi-oil-idUKKCN0X815C>.

14 "Egypt's Sisi Aims to Bring Deficit Down to 8.5 Percent by 2017/18," Reuters, May 21, 2014, <http://af.reuters.com/article/topNews/idAFKBN0E11FK20140521>.

15 The budget sent for his approval had a projected fiscal deficit of 12 percent of GDP.

External Financing

With little near-term prospects of a turnaround in tourism and private capital flows, Egypt will need substantial foreign support to fill a projected external financing gap of some \$16-20 billion annually in the

16 "Egypt Extends Suspension of Capital Gains Tax," Associated Press, May 4, 2016, <http://abcnews.go.com/International/wireStory/egypt-extends-suspension-capital-gains-tax-38879511>.

17 Mohsin Khan and Svetlana Milbert, "Finally Some Action on Subsidies in Egypt," *EgyptSource*, August 4, 2014, <http://www.atlanticcouncil.org/blogs/egyptsource/finally-some-action-on-subsidies-in-egypt>.

coming years.¹⁸ Furthermore, additional external financing will be required to ease the energy crisis and support any further fiscal stimulus. The \$12 billion in assistance received from Kuwait, Saudi Arabia, and the UAE in 2013 eased the pressure on Egypt's external position and the exchange rate and provided budgetary support for the two fiscal stimulus packages initiated by the Beblawy government. As such, Egypt was able to avoid a full-blown foreign exchange crisis in 2014.¹⁹ But the Sisi government still has to generate substantial external financing over the next three to five years. How can this be done? There are three possible ways:

- **Seeking further assistance from the Gulf Arab countries.** Egypt should aim to obtain at least the same amount per year as was provided in 2014. This financing would go into budgetary support and projects that President Sisi has highlighted as essential to Egypt's future: infrastructure, housing, and employment. At the Egypt Economic Development Conference in Sharm al-Sheikh in March 2015, in which Egypt signed investment deals worth \$36 billion, Saudi Arabia, Kuwait, and the UAE pledged \$12.5 billion to stabilize Egypt's economy.²⁰ However, many of the investment pledges made at the conference have not yet materialized.²¹
- **Negotiating a program with the International Monetary Fund.**²² This could bring in at least \$5-6 billion, and possibly as much as \$8 billion, directly from the International Monetary Fund (IMF) on very favorable terms, as well as additional financing from the European Union and other international financial institutions whose support is conditional on an IMF program being in place. The IMF has sent strong signals to the Sisi government that it

will be flexible regarding the policies and reforms included in the economic program, with Christine Lagarde, Managing Director of the IMF, indicating the readiness and willingness of her institution to assist Egypt.²³ Subsidy reform, bringing the fiscal deficit down, and implementing a more flexible exchange rate policy would be the key elements in an IMF program, and the Egyptian government has already adopted these policies. Since there now seems to be a meeting of minds between Egyptian policymakers and the IMF on the broad parameters of a program, there is no value in waiting. Having an IMF program would send a strong signal to investors that Egypt is committed to getting its economic house in order and that it is on a path of economic recovery and transformation.²⁴

- **Floating bonds in the international capital markets.** These markets are generally flush with liquidity with investors looking for higher rates of return. Egypt should sell \$2-3 billion worth of bonds with long maturities on relatively favorable terms. While it is true that the interest costs would be substantially higher than for the financing from the Gulf countries and the IMF, the mere act of going into the market would show that Egypt is once again ready to be an investment destination. In fact, Egypt issued its first international bond sale in five years in June 2015, selling \$1.5 billion worth of ten-year bonds, carrying an interest rate of 6 percent. The government has delayed a second issue, but recently said it may tap the international bond market by the second half of 2016.²⁵ Egypt could also ask the United States to revive President Barack Obama's offer in his speech on May 19, 2011, to provide the country with \$1 billion in loan guarantees, similar to what the United States has provided Israel and Tunisia.²⁶ The Obama offer

18 Assuming that all the short-term dollar-denominated debt coming due is rolled over, the financing gap would still be in the \$10-12 billion range.

19 Absent the Gulf financing, international reserves would have fallen to \$3-4 billion, and would have possibly been completely exhausted as Egyptians shifted into foreign currencies.

20 Ehab Farouk, "Egypt Says over Half of Summit Promises Turned into Projects: Planning Minister," Reuters, August 1, 2015, <http://www.reuters.com/article/us-egypt-economy-idUSKCN-0Q63BE20150801>.

21 Isabel Esterman, "The EEDC One Year Later: Some Progress, but Most Promises Unmet," *Mada Masr*, March 13, 2016, <http://www.madamasr.com/sections/economy/eedc-one-year-later-some-progress-most-promises-unmet>.

22 See Mohsin Khan, "An IMF Program for Egypt Finally?" *Egypt-Source*, June 2, 2014, <http://www.atlanticcouncil.org/blogs/egyptsource/an-imf-program-for-egypt-finally>.

23 See Asa Fitch, "IMF Cozies Up to Egypt amid Economic Reform," *Wall Street Journal*, October 7, 2014, <http://blogs.wsj.com/middleeast/2014/10/07/imf-cozies-up-to-egypt-amid-economic-reform/>; and Adam Koppeser, "Economic Reforms a 'Must' for Egypt Growth: Lagarde," *Daily News Egypt*, May 3, 2014, <http://www.dailynewsegypt.com/2014/05/03/economic-reforms-must-egypt-growth-lagarde/>.

24 In April 2016, Egypt said it had not begun talks for an IMF loan. See "Egypt Delays International Bond Issuance, Is Not in Talks with IMF," Reuters, April 16, 2016, <http://www.reuters.com/article/us-egypt-debt-idUSKCN0XD0TY>.

25 Ibid.

26 See John Williamson and Mohsin Khan, "Debt Relief for Egypt?" Peterson Institute for International Economics, 2011, <http://www.piie.com/publications/interstitial.cfm?ResearchID=1979>.

Table 1. Egypt's Competitiveness Rankings

Survey	Rank	Total Economies
World Bank's 2016 Doing Business Report	131	189
Heritage Foundation's 2016 Index of Economic Freedom	125	186
World Economic Forum's Global Competitiveness Report 2015-16	116	140

seems to have been forgotten but because it has not been formally retracted, Egypt could still ask for its implementation. With US loan guarantees, the cost of floating bonds in the international capital markets would be substantially lower even for bonds with long maturities.²⁷ It may also be possible to get similar loan guarantees from the Gulf countries, particularly the UAE, which also have very high international credit ratings.

Exchange Rate

The CBE has historically prioritized maintaining the stability of the Egyptian pound with respect to the US dollar. From 2010 to 2015, the pound depreciated by an average of only 7 percent a year, despite strong balance of payment pressures that resulted from political instability and insecurity.²⁸ In the immediate years after the 2011 revolution, Egypt preserved a tight exchange rate range of 5-6 Egyptian pounds to the dollar. From 2010 to 2013, the cost of keeping the pound stable resulted in a fall in international reserves from \$35 billion to \$14.5 billion. In the eighteen months between Mubarak's fall and Morsi's election, the pound depreciated by only 3.5 percent, while the loss of international reserves was some 60 percent. Absent financing from Egypt's Gulf allies, the country's reserves would have been completely depleted. Following Morsi's ouster in mid-2013, the pound weakened by about 9 percent, its largest fall in ten years. After Sisi's election in 2014, the CBE continued its policy of keeping the pound relatively stable and used a mix of foreign exchange intervention and interest rate policy to keep a tight control on the exchange rate.

- **Moving toward a more flexible exchange rate.** In March 2016, the CBE devalued the pound by about 14 percent and said it would move to a more flexible exchange rate regime.²⁹ Meanwhile, the pound continued to depreciate in the black market: in the weeks after the CBE's decision to alter the official rate, the pound fell to an unprecedented 10 Egyptian pounds to the US dollar.
- **Changing the monetary policy regime.** A move to a more flexible exchange rate is needed to reduce imports, help exports, attract foreign direct investment, and reduce external imbalances that have created the need for additional foreign financing.³⁰ This change would require Egypt to shift to a monetary policy framework that targets inflation rather than the exchange rate. This is the only way to control foreign exchange pressures and reduce the need for external financing.³¹ An inflation-targeting monetary policy framework would also contribute to deepening financial sector reforms, enhancing the transparency of the CBE's operations, and reducing the role of the government in conducting monetary policy. However, it remains to be seen whether the CBE is truly committed to going ahead with a flexible exchange rate system.

Promoting the Private Sector

Egypt is not viewed internationally as a business-friendly country, ranking very low on the standard indicators of competitiveness (see table 1).

In the World Bank's 2016 *Doing Business Report*, Egypt ranked 131st out of 189 countries (and 11th among the 20

27 For example, in the recent issue of \$500 million of bonds with the US loan guarantee, Tunisia will be paying only 2.45 percent for seven-year maturities. US government bonds with a seven-year maturity are currently paying 2.2 percent.

28 Mohsin Khan and Elissa Miller, "After the Coming Devaluation of the Egyptian Pound, What Next?" *EgyptSource*, February 17, 2016, <http://www.atlanticcouncil.org/blogs/egyptsource/after-the-coming-devaluation-of-the-egyptian-pound-what-next>.

29 "Egypt Devalues Pound, Announces More Flexible Exchange Rate Policy," Reuters, March 14, 2016, <http://www.reuters.com/article/us-egypt-currency-idUSKCN0WG1X7>.

30 Mohsin Khan and Elissa Miller, "What's Wrong with the Egyptian Pound?" *EgyptSource*, November 17, 2015, <http://www.atlanticcouncil.org/blogs/egyptsource/what-s-wrong-with-the-egyptian-pound>.

31 Khan and Miller, "After the Coming Devaluation of the Egyptian Pound, What Next?" op. cit.

Table 2. Economic Growth Projections for 2016 (in percentage)

Survey	2015	2016
International Monetary Fund	4.2	3.3
World Bank	4.2	3.3
Institute of International Finance	4.0	3.7

MENA countries in the sample). It ranked particularly low on construction permits (113), investor protection (122), paying taxes (151), enforcing contracts (155), and resolving insolvency (119). By contrast, the UAE, which has the highest overall ranking in MENA, actually ranked first in the world in paying taxes, second in dealing with construction permits, and 10th in registering property.³²

The Heritage Foundation's *2016 Index of Economic Freedom* takes a wider perspective than the World Bank and evaluates a country on more categories—the rule of law, limited government, regulatory efficiency, and open markets. On this index, Egypt's score put it in 125th place out of 186 countries evaluated. Furthermore, Egypt was the third-lowest-ranked country of the fifteen Middle East countries evaluated, beating out only Algeria and Iran.

According to the World Economic Forum's *Global Competitiveness Report 2015-2016*, Egypt's ranking slipped from 81 out of 139 countries in 2010 to 116 out of 140 countries surveyed in 2015, and the country's rating on investor protection went from 69 to 113. The reasons for the fall in the ranking can be attributed to political instability; government instability (number of changes of government); reduced access to financing by businesses, particularly SMEs; the introduction of foreign exchange regulations on international transfers; and the deterioration of infrastructure.

For Egypt to become a market-oriented economy in which the private sector has the primary role, the government will have to undertake a long list of economic reforms:

- Streamlining business and investment regulations to encourage domestic and foreign investments.
- Revising bankruptcy procedures to allow firms to cease operating and creditors and shareholders to be fairly treated.

- Modifying anti-monopoly laws and regulations to increase competition and prevent individual firms from dominating sectors of the economy.
- Improving labor market flexibility to make it easier to hire and fire workers.
- Advancing the privatization process of state-owned enterprises and banks, and revising laws to protect private buyers from legal challenges by third parties.
- Promoting SMEs and increasing their access to financing.
- Developing infrastructure, such as roads, housing, and electrification.

Progress has been made in certain areas. The Egyptian cabinet has recently undertaken a series of pro-business reforms. In March 2015, the government amended Egypt's 1997 Investment Law, which aims to remove obstacles for foreign investors and facilitate overseas funding of projects in Egypt. The law also accelerated bankruptcy proceedings to some extent, and the government is preparing new bankruptcy legislation to more permanently address continuing concerns. The current Commercial Law 17 of 1999 contains a chapter on bankruptcy, but it has serious omissions and ambiguities regarding settlements and the reduction of settlement risks. The new Labor Law of 2013 (Law No. 12) introduced a degree of flexibility into employer-employee contracts, but needs to be extended. Additional reforms promised by the government include a company law, amendments to the capital markets law, and a new insurance law.³³

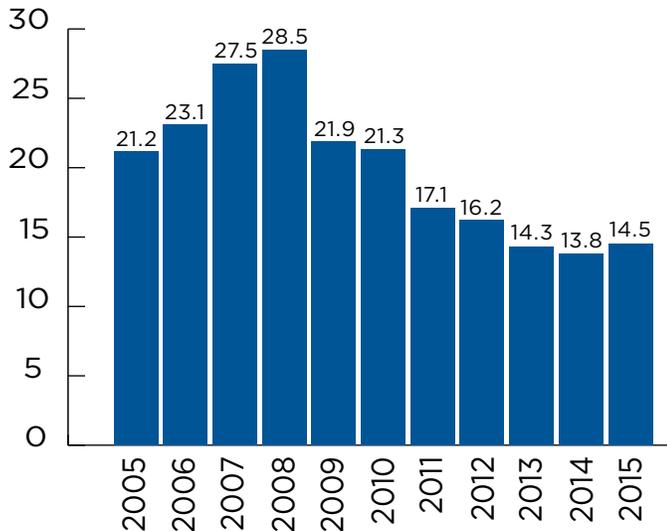
Projected Growth and Investment

The policies that the Egyptian government has implemented, and in particular the lagged impact of

³² However, it is worth noting that the UAE did not score particularly high in resolving insolvency (91). These issues seem to be prevalent across MENA countries.

³³ "2015 Investment Climate Statement - Egypt," US Department of State, May 2015, <http://www.state.gov/e/eb/rls/othr/ics/2015/241546.htm>.

Figure 3. Investment (percentage of GDP), 2005-15



Source: International Monetary Fund.

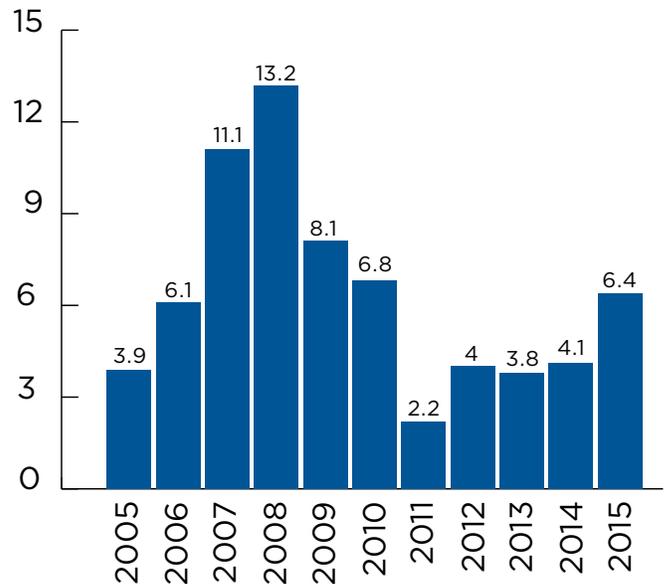
the two fiscal stimulus packages, should result in better economic performance. Nevertheless, the projections for growth in 2016 are low by historical standards and even below the growth rate in the past year (see table 2). The consensus forecast is that economic growth will be considerably below 4 percent, which is not nearly enough to create the number of jobs the country needs.

Ultimately, private investment will have to be the main engine of higher economic growth in the medium to long term. Unfortunately, both total investment and FDI have been steadily declining since the beginning of the uprising. Total investment as a proportion of GDP fell from 21.3 percent in 2010 to 14.5 percent in 2015 (see figure 3). It is projected to rise to close to 16 percent in 2016, but this is because of an increase in government investments made after receiving Gulf financing. Private investment has continued to fall, despite the announcement in July 2013 by billionaire Naguib Sawiris of Orascom, one of the largest conglomerates in Egypt, that he and other investors would be “investing in Egypt like never before.”³⁴ Furthermore, an investment rate of 16 percent is nowhere near enough to generate economic growth rates of 6-7 percent.³⁵

34 Edmund Blair, “Egypt Billionaire Sawiris Family to Invest ‘Like Never Before,’” Reuters, July 15, 2013, <http://www.reuters.com/article/2013/07/15/us-egypt-sawiris-idUSBRE96E06Z20130715>.

35 For example, in 2007-08, when growth averaged over 7 percent

Figure 4. FDI Inflows (USD billions), 2005-15



Source: International Monetary Fund.

The level of foreign investment is a very good indicator of how well a country is doing economically. Foreign investments bring in financing and technology transfers, and convey confidence in the economic prospects of the country. FDI inflows to Egypt began to grow very rapidly in 2004, peaking in 2008 at \$13.2 billion, a more than six-fold increase (see figure 4).

There was a slowing down in the following two years, but the inflows still remained relatively high. In the aftermath of the uprising, however, FDI collapsed, falling in 2011 to \$2.2 billion, close to what inflows had been a decade earlier in 2003-04. Since then they have remained in the \$3-4 billion range, although recent Gulf investments pushed FDI inflows up to more than \$6 billion in 2015. The Sisi government clearly has to set a high priority on policies to raise the overall investment rate and attract FDI inflows.

The Way Forward

The government of President Sisi has repeatedly signaled that reviving the economy is its central priority. But over five years after the uprising the economy is still in a relatively poor state. In fact, 2016 is shaping up to be a worse year than the previous one,

a year, investment as a percentage of GDP was at its historical peak of 28 percent.

a trajectory that is extremely worrisome and must be altered.³⁶ The government has to get its house in order and address the economic grievances of the Egyptian public that led to the 2011 uprising. Transforming the economy to meet the aspirations and hopes of the Egyptian people will be difficult and will take time. But to make Egypt a thriving private sector-led economy that provides jobs and shared prosperity to all its citizens, the government will have to make immediate efforts to implement policies to achieve that goal. This will involve at a minimum the following:

- **Pursuing macroeconomic stability.** This is essential with or without an IMF program, and will involve policy measures to improve public finances and reduce government debt. This implies continuing with reforms of the tax and subsidy systems. Further fiscal stimulus packages may also be needed in 2016 and beyond to boost growth.
- **Ensuring sufficient external financing.** This financing could be used to ease the energy crisis and support the ambitious infrastructure megaprojects that President Sisi has announced, such as the Suez Canal project, the new administrative capital, the building of one million houses around greater Cairo, and the construction and rehabilitation of roads and a variety of energy plants, including renewable energy projects.
- **Implementing key reforms to make Egypt investor-friendly.** While government-led infrastructure projects are necessary, private domestic and foreign investments are going to be essential for the future growth of Egypt. For this to happen the government must streamline business and investment regulations. Potential investors have identified key reforms needed in the following areas: protecting intellectual property rights to generate innovations; revising labor laws and regulations to bring greater flexibility into the labor market; and introducing a modern bankruptcy law along with a clear and transparent dispute settlement mechanism.
- **Changing the monetary policy regime.** Egypt has to reduce foreign exchange pressures by letting the pound adjust to market forces. Eschewing

fears of a floating exchange rate system and shifting the CBE's focus to inflation control rather than the stability of the pound would go a long way towards reducing dependency on foreign financial assistance.

- **Implementing the 2016 economic plan.** The government announced its long-term economic plan in March 2016,³⁷ following the election of a parliament, a cabinet reshuffle, and the formation of a new economic team.³⁸ The plan targets 5-6 percent GDP growth and a budget deficit below 10 percent by the end of fiscal year 2017-18.³⁹ The plan also calls for the adoption of a 10 percent VAT and the sale of stakes in government companies.

If the Egyptian government commits to this agenda and follows through with it, the international community will undoubtedly be ready to provide different types of financial and technical support to the country. As Egypt goes, so goes the Middle East. It has been the leader in MENA and what it does on the economic front—going all the way back to the days of former Presidents Gamal Abdel Nasser and Anwar Sadat—is followed by other countries in the region. This is well understood and appreciated by the Gulf Arab countries, the United States, Europe, and the international financial and development institutions. It is thus in everyone's interest that Egypt is successful in reviving the economy, and soon.

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36 Mohsin Khan and Elissa Miller, "Is 2016 Finally a Breakout Year for the Egyptian Economy?" *EgyptSource*, February 4, 2016, <http://www.atlanticcouncil.org/blogs/menasource/is-2016-finally-a-breakout-year-for-the-egyptian-economy>.

37 For a brief description of this plan, see Mohsin Khan and Elissa Miller, "Egypt's New Economic Team and New Economic Plan," *MENASource*, April 28, 2016, <http://www.atlanticcouncil.org/blogs/menasource/egypt-s-new-economic-team-and-new-economic-plan>.

38 For a discussion on the cabinet reshuffle, see Elissa Miller, "Egypt's Cabinet Reshuffle Reflects Economic Difficulties," *EgyptSource*, March 24, 2016, <http://www.atlanticcouncil.org/blogs/menasource/egypt-s-cabinet-reshuffle-reflects-economic-difficulties>.

39 "Egypt Targets Higher Growth, Deficit Reduction in New Government Program," Reuters, March 27, 2016, <http://www.reuters.com/article/us-egypt-politics-idUSKCNOWTOL3>.

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