

The Expectation Gap in the Egyptian Economy after the January 25th Revolution

Ichiki Tsuchiya

Introduction

Although 18 months have passed since Hosni Mubarak resigned from the presidency, the Egyptian economy is still stagnant. The economic growth rate in 2011 was 1.8%, and the outlook for 2012 is 1.4 % according to the World Bank as of June 2012. It seems that Egypt needs more time for a rebound in its economy to the pre-revolution level, which was around 5%.

It has been demonstrated that a country's economic situation deteriorates during a political transition. In the case of Indonesia, when President Soeharto was forced to resign after 30 years in office in 1998 as a result of a popular uprising, ten years passed before Indonesia's economic growth recovered to 6%, which had been the average growth rate for about 30 years during Soeharto's rule. According to the World Bank, in cases of political transition, the economic growth rate declined by three percentage points before rebounding within a year or two in successfully democratized countries (World Bank 2011, 2¹). Therefore, the difficulties faced by the Egyptian economy during its political transition are not unique.

¹ World Bank, *Investing for Growth and Jobs*, World Bank Middle East and North Africa Region, Economic Developments & Prospects (The World Bank, September 2011).

Nevertheless, in Egypt the economic prospects continue to deteriorate. In the early days of the transition period, optimistic sentiments anticipating economic recovery prevailed. It was expected that economic activities would rebound soon once the political transition was underway. However, this has not materialized as expected.

There appear to be multiple reasons why the Egyptian economy has not rebounded for more than 18 months. One is sporadic political turmoil. Protests movements continued intermittently during 2011. As a result, the transition process stalled occasionally and uncertainty continued even after transition procedure was announced. Another factor in the economic slump is the expectation gap among the parties concerned. There seems to be a recognition of disparities among the factions concerning their expectations. As a result, there is little consensus regarding prior economic strategies. This is not because of different ideologies but because of the lack of accreditation. The situation has not changed even after the presidential election.

This paper examines the expectation gaps among the economic players as a cause of the economic paralysis of Egypt after the revolution. In particular, the gaps between the government and the workers, SCAF and the government, the haves and have-nots, and Egypt and international society are considered.

1 Egypt's Economy under the Mubarak Regime

Before discussing the expectation gaps after the revolution, this section considers the economic policies and the performance of the Mubarak regime as a reference point. The Mubarak regime's economic policy may be divided into two periods, before and after 1991. We focus on the latter period here in order to clarify the economic situation at the time of the revolt.

Egypt possesses accumulated external debt from the 1960s. The government has

reached agreements on Stand-By Arrangements with the IMF several times since the 1960s. However, the agreements have not been carried out fully because the Egyptian government has been reluctant to implement conditional economic reform. As a result, Egypt faced a chronic external debt problem until the 1980s.²

In 1991, the government reached another agreement on a Stand-By Arrangement with the IMF. The government also concluded financial assistance agreements with international financial institutions such as the World Bank.³ The conditionality of the agreements designed by the IMF and the World Bank is set by the Economic Reform and Structural Adjustment Program (ERSAP). The contents of ERSAP were typical of the conditionality in Structural Adjustment Programs adopted by developing countries. Actually, Egypt had been assigned a similar conditionality when it reached agreements with the IMF before 1991.

Unlike before, the government carried out economic reforms seriously in the 1990s. It seems that the government had decided to take active steps to tackle macro-economic imbalances. It can be said that Egypt entered an era of economic reform from the beginning of the 1990s.

The outcome of macro-economic reforms appeared by the second half of the 1990s. For example, as shown in Table 1, the inflation rate decreased to the single digits and the external debt burden was greatly reduced. As a result, the government was freed from its external debt problem for the first time since the 1970s. Moreover, from the second half of the 1990s, privatization of state-owned enterprises was implemented, as shown in Table 2. Egypt was regarded as a

² Khalid Ikram, *The Egyptian Economy, 1952-2000: Performance, Policies, and Issues* (London: Routledge, 2006).

³ An agreement on concessional debt rescheduling was also reached with the Paris Club on the condition of economic reform. It was said that all those favorable arrangements concluded in 1991 were a reward to the Egyptian government for cooperating with the US during the Gulf War in 1990.

successful example of a Structural Adjustment Program by the IMF (IMF 2007).⁴

Table 1: Macroeconomic indicators in the 1990s

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Inflation, consumer prices (annual %)	19.7	13.6	12.1	8.2	15.7	7.2	4.6	3.9	3.1	2.7
Cash surplus/deficit (% of GDP)	2.5	-1.2	4.2	3.0	3.4	-1.4	-1.6	..	..	..
External debt stocks (% of GNI)	89.1	75.1	66.6	62.8	55.5	46.2	37.7	37.5	33.7	28.8
Total debt service (% of GNI)	7.1	6.5	4.8	4.3	3.9	3.4	2.7	2.2	2.3	1.8
Official exchange rate (per US\$, period average)	3.14	3.32	3.35	3.39	3.39	3.39	3.39	3.39	3.40	3.47

Source: World Development Indicators. (<http://databank.worldbank.org>)

Table 2: Privatization Proceeds

	1992-1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<u>Law 203 Companies (total 314 Companies)</u>												
Number	11	14	12	29	23	33	39	11	7	6	9	16
Amount (LE million)	418	867	977	4,595	2,487	1,824	4,694	252	73	49	428	824
<u>Joint Venture Companies</u>												
Number	..	..	..	..	..	..	1	7	3	1	4	12
Amount (LE million)	..	..	..	..	..	..	14	118	879	64	115	4,819

* Fiscal year

· Law 203 companies are state-owned enterprises which were targeted for privatization under Law 203 in 1991.

Source: Financial Monthly (Ministry of Finance).

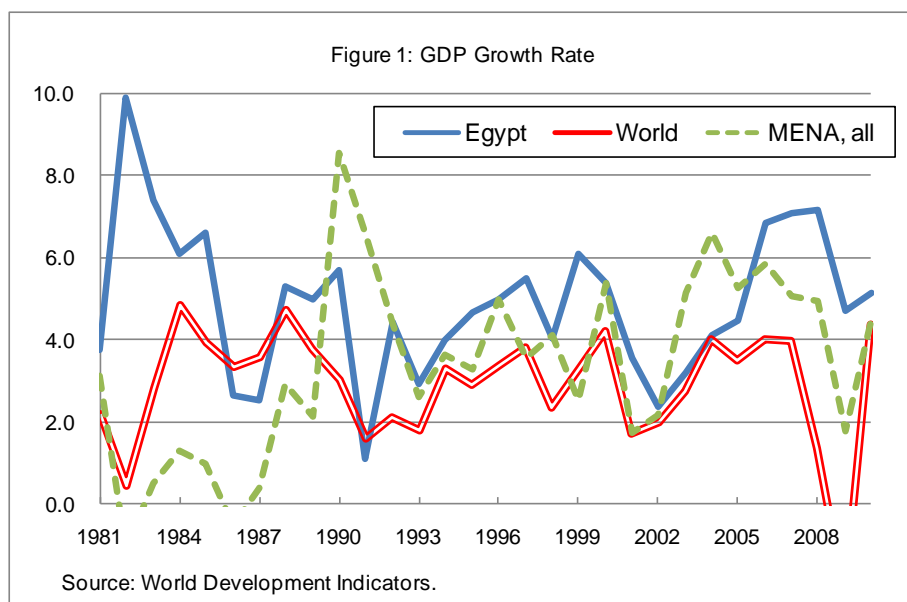
However, the Egyptian economy entered a slump at the end of the 1990s. Part of reason could be political instability in the region and the Asian economic crisis, but the lack of private investment in high labor absorption sectors was also a critical problem impeding sustainable economic growth. Thus, the government was forced to reconsider its economic strategy (Farah 2009).⁵

From the beginning of the 2000s, the then-ruling National Democratic Party

⁴ IMF, *Regional Economic Outlook, Middle East and Central Asia* (Washington, D.C.: IMF, 2007).

⁵ Nadia Ramsis Farah, *Egypt's Political Economy: Power Relations in Development* (Cairo: The American University in Cairo Press, 2009).

clarified its preference for further structural reform through deregulation. The implementation of further economic reform materialized under the Nazif Cabinet installed in July 2004. The purpose of the reform was to promote private business activity by changing the economic system, including the tax system, investment framework, and trade regulations. Economic reform under the Nazif Cabinet made good progress owing to the endorsement of Gamal Mubarak. The World Bank evaluated Egypt as one of the top reformers in the late 2000s in its annual Doing Business report.⁶ The economic growth rate did indeed accelerate under the Nazif Cabinet as shown in Figure 1. In the second half of the 2000s, Egypt experienced its highest economic growth rate in the last 25 years. That is to say, it was in the late 2000s that the Mubarak regime achieved its best results in economic growth.



On the other hand, dissatisfaction with job conditions also arose as an issue in the late 2000s. As shown in Table 3, the number of strikes increased in the late 2000s.

⁶ See the World Bank's Doing Business website (<http://www.doingbusiness.org/>).

This means that not all laborers gained benefits from the high economic growth in this period. Rather, more workers were dissatisfied with their economic conditions in the late 2000s.

Table 3: Number of Strikes from 1999 to 2008

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Government Sector	13	3	6	8	6	24	21	17	36	37
Public Business Sector	10	6	8	3	3	10	13	13	31	17
Private Sector	15	9	5	13	16	9	12	17	43	68
Total	54	40	19	24	25	43	46	47	110	122

• The totals for 1999 and 2000 include strikes that occurred in unspecified sectors (16 and 22, respectively).

Source: Solidarity Center (2010) *The Struggle for Worker Rights in Egypt*.

2 Economic Developments since the Revolution

After the collapse of the Mubarak regime, an interim Cabinet took over economic management under the authority of the Supreme Council of the Armed Forces (SCAF). The primary role of the interim Cabinet was to promote recovery from economic turmoil. However, the economy has not rebounded in the way that was hoped; instead, it stagnated throughout the year, as shown in Table 4. In particular, foreign direct investment (FDI) inflow and foreign tourist arrivals decreased significantly. FDI recorded a net outflow in 2011. In contrast, the amount of exports increased in 2011 because of high international oil prices. It can be said that oil-related exports were a buffer against the foreign exchange shortage.

Table 4: Egypt's Economy in 2011

	2010.10-12	2011.1-3	2011.4-6	2011.7-9	2011.10-12	2012.1-3
Real GDP Growth Rate (%)	5.6	-4.3	0.4	0.3	0.4	5.2
FDI, net inflow (million US\$)	656.0	-164	99	440	-858	636
year-to-year comparison (% change)	-26.7	-109.6	-95.9	-72.4	-230.8	488.6
Foreign tourists (thousand)	4165	1894	2241	2760	2949	2500
year-to-year comparison (% change)	15.8	-45.3	-35.4	-24.0	-29.2	32.0
Export (million US\$)	6,566	6,243	8,081	6,765	6,824	6,480
year-to-year comparison (% change)	7.2	14.6	17.0	10.9	3.9	3.8
Share of Oil sector (%)	40.1	45.4	47.9	47.8	51.4	47.2

Source: Central Bank of Egypt (Monthly Statistical Bulletin), Ministry of Finance (Financial Monthly Bulletin).

On the other hand, Table 5 shows the investments implemented in the second half of 2010 and 2011. Although investment in the government sector decreased by 12% in the latter half of 2011 compared with the same period of 2010, investments of public companies increased by 20% during the same period. As a result, the amount of investment in the public sector during the second half of 2011 was the same as the corresponding period of previous year.

As for the private sector, implemented investments dropped by 15% in the second half of 2011 compared with the same period in the previous year. In particular, investment in the manufacturing sector decreased considerably; likewise, a decrease was observed in the public sector, too. In contrast, investment in the natural gas and real estate sectors increased even in 2011.

Table 5: Implemented Investments

(Unit: LE million)

	Government Sector		Public Companies		Private Sector	
	2010.7-12	2011.7-12	2010.7-12	2011.7-12	2010.7-12	2011.7-12
Agriculture	1,357	1,402	0	0	1,776	1,091
Crude Oil	0	0	127	235	5,500	1,150
Natural Gas	0	0	470	1,370	14,300	17,720
Manufacturing	106	57	2,062	578	14,860	2,260
Construction & Building	33	46	496	309	3,150	380
Communications	246	184	0	0	10,420	6,821
Wholesale & Retail Trade	0	0	31	46	8,000	4,300
Tourism	1	2	250	250	3,500	2,300
Real Estate	131	87	0	0	10,000	17,000
Other sectors	17,616	15,388	8,357	11,332	11,843	18,308
Total	19,490	17,164	11,793	14,120	83,349	71,330

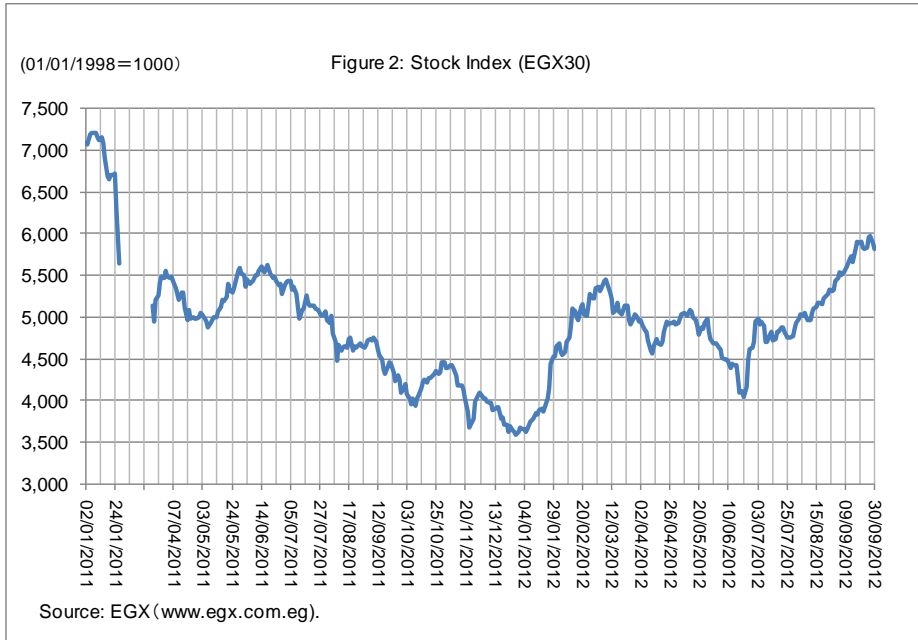
· Agriculture includes irrigation and reclamation.

· Manufacturing excludes oil refining

Source: Central Bank of Egypt (Monthly Statistical Bulletin, 2012.3).

Looking at investment sentiment in 2011, there seems to be less confidence in the second half of the year. Figure 2 shows the change in the stock index (EGX 30) from the beginning of 2011. After the closure of the stock exchange for about two months due to the revolution, the index once showed signs of a rebound in May 2011. However, the index entered a downward trend in the second half of 2011. In 2012, the index increased by 48% during the first two months, but it has remained

stagnant since then. The stock index has been on the increase again since the end of July 2012. As a result, in the middle of September, the index reached its highest point since the resumption of the market in March 2011.



As shown in Table 6, the unemployment rate stood at 12.6% for the second quarter of 2012. It worsened 0.8 percentage points compared with the same quarter of the previous year. Since the labor force size was 26.8 million by June 2012, there were 3.4 million unemployed at that time.

Meanwhile, the inflation rate decreased from 12.2% to 8.4% over the past year. However, an inflation rate of more than 8% is not an acceptable level for most people under the current economic conditions. This is because prices rise much faster than the income of the majority of people.

Table 6: Unemployment Rate and Inflation Rate (%)

	2011			2012	
	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.
Unemployment (total)	11.8	11.9	12.4	12.6	12.6
Male	8.7	8.7	9.1	9.3	9.2
Female	22.5	23.0	23.6	23.8	24.1
Inflation (annual, overall)	12.2	9.3	9.3	9.5	8.4
Core	8.8	7.9	7.2	7.6	7.5
Urban	11.9	9.0	8.6	8.9	8.1

· The inflation rate is three-month average.

· The core inflation index excludes items with managed prices and inherent price volatility such as fruits and vegetables.

Source: Ministry of Finance (The Financial Monthly Bulletin, 2012.8).

After the revolution, government current expenditure increased significantly, as shown in Table 7. Three items, wage and salaries, interest payments, and subsidies, consist of 78% of the total expenditure in the 2012/13 budget. This means that the government will not have adequate resources for public investment unless it increases its borrowing. Since it is not easy to increase borrowing under a chronic state of deficit, growth of public investment can no longer be expected.

Table 7: Government Expenditures

(Unit: LE million)

	2009/10	2010/11	2011/12	2012/13
	Actual		Budget	
Wages and Salaries	85,369	96,271	110,497	136,627
Purchases of Goods & Services	28,059	26,148	29,255	28,765
Interest Payments	72,333	85,077	105,300	133,612
Subsidies, Grants and Social Benefits	102,974	123,125	154,454	145,838
Other Expenditures	28,901	31,364	31,122	33,325
Purchases of Non-Financial Assets	48,350	39,881	45,661	55,618
Overall Deficit / GDP (%)	8.1	9.8	7.8	7.6
Expenditure / GDP (%)	30.3	29.3	30.8	30.0

· The figures cover the budget sector, which includes central administration, local governments, and public services authorities.

· The overall deficit excludes net acquisition of financial assets.

Source: Ministry of Finance (The Financial Monthly Bulletin, 2012.8).

3 Gaps in Economic Prospects

It is true that the primary reason for economic stagnation in 2011 was political uncertainty. There is no doubt that uncertainty has an adverse impact on business. Since uncertainty increases risk, investors hesitate to make new investments.

In addition to uncertainty, expectation gaps result from the opaqueness of the economic prospects. Certainly, there is one consensus among the people including the authorities, which is to achieve social justice. However, there seems to be no consensus about what social justice is and how to realize it. As a result, it is difficult for any leader to design an effective economic policy under current conditions. In this section, we examine some of major expectation gaps that exist under the current economic situation in Egypt.

3.1 Government and economic entities

As seen in Table 3, strikes had increased in the late 2000s. The main demand of the strikers was wage increases. Most workers in both the public and private sectors were dissatisfied with their wage levels. This is because wage increases had not kept pace with the inflation rate. In consequence, many workers faced a decline in their standards of living. In particular, compared with elite businessmen, their living conditions became less comfortable in spite of high economic growth in the second half of the 2000s. This was thought to be an injustice. They thought elite businessmen made excessive profits through their privileged status based on their connections with political power, so that the majority of workers were prevented from obtaining their fair share. Therefore, most workers expected that their economic situation would be improved through fair-minded wage increases soon after the political situation changed. They regarded politics and the economy as being closely linked.

Meanwhile, the economic priority of the interim Cabinet was to restore social stability in order to resume economic activity. The government attached particular

importance to the resilience of incoming FDI, which was one of the main sources of job creation. It was assumed by the government that the economic life of the people would improve gradually only if social stability was maintained and FDI continued flowing in. Therefore, the government attempted to end the cycle of labor protests in order to attain social stability. That is, the government tried to delink politics and the economy. It was thought that, when economic affairs became independent from political power, the economic system would be fair. It was a step on the way to attaining social justice.

There is an expectation gap between the economic entities and the interim Cabinet as to the way of attaining economic fairness. Workers represented by labor unions thought that fairness was attained by political action because politics had influence on the economy. In contrast, the government tried to separate politics from the economy in order to depart from the old paradigm of cronyism which was the primary reason for the dissatisfaction of the public. Both sides desired a fair economic environment, but they had different views on how to attain it.

When Muhammad Mursi became the first-ever democratically-elected president at end of June 2012, he started by launching the 100-day plan. The plan was meant to solve the immediate problems related to security, traffic, garbage, fuel and bread. It is certain that those were the issues with which the public was most concerned, but it did not seem to be the first thing that the people expected to hear from the president. Moreover, Hisham Qandil, who was appointed as the new prime minister by President Mursi in July 2012, was an unexpected choice for the position because investors had long been waiting for an economic expert to be prime minister. Among the initial measures implemented by the president, economic reconstruction is apparently not an urgent matter for him, despite the fact that the most immediate concern of potential investors seems to be economic recovery. On the other hand, it would be a long-term issue for the president to

formulate an economic strategy. There seems to be a gap between the president and the investors regarding the priority that should be assigned to economic matters.

3.2 SCAF and the government

SCAF took over political authority when President Mubarak resigned. Since then, SCAF has maintained the right to make the final decisions on almost all political issues. Meanwhile, the interim Cabinet that SCAF appointed until the election of the new president played a role in steering the economy. The economic team of the interim Cabinet consisted of economic experts. In spite of this, SCAF intervened in the economic decisions of the interim Cabinet until recently.

In May 2011, SCAF dismissed a \$3.2 billion IMF loan on which the interim Cabinet had just reached an agreement. As a result, the interim Cabinet was forced to modify the budget plan. It is said that SCAF was reluctant to increase external debt in the transition period. If so, the priority of SCAF was not to respond to the economic demands of the public through expanding government expenditure but to maintain fiscal discipline. In that sense, there existed a recognition gap between SCAF and the interim Cabinet. While SCAF emphasized the status quo during the transition phase in its economic management, the interim Cabinet attempted to respond to the expectations of the people.

The situation has not changed since the formal government was established. One of the pressing issues for the Egyptian economy is still to secure fiscal resources, and one of the few sources of funds at present is foreign borrowing. Therefore, it is critical to reach an agreement with the IMF because an IMF loan will mark the beginning of foreign loans from other international financial institutions and countries. However, no progress has been seen in negotiations recently. The reason behind this is unclear, but the incumbent government seems to be taking a stay-the-course approach for the moment. This seems to be the same strategy that

SCAF took in the early stage of the transition period. In other words, the authorities now have a similar economic approach, at least for the short term, although this approach will exacerbate the issues.

3.3 Haves and have-nots

In labor protests, workers demanded wage increases as well as job security. They also demanded an increase in the minimum wage. It is natural that workers insisted on a reasonable wage level; the minimum wage was set at LE35 per month in 1984 and had not changed since then. Clearly, a monthly wage of LE35 is not adequate for making a living today. So, it was regarded as a part of social justice to demand an increase in the minimum wage. The interim Cabinet responded to the demand of workers and increased the minimum wage to LE700 per month throughout Egypt.

Although the increase in the minimum wage itself was an achievement of the workers, a more comprehensive labor policy is necessary for the unemployed. After the revolution, the unemployment rate rose about two percentage points, and the unemployed number more than three million at present. Under such an economic situation, the increase in the minimum wage has a negative effect on job creation. It also results in an enlargement of the informal economy. That is, the economic prospects of the unemployed will worsen unless a fresh economic package is formulated for them. The increase in the minimum wage will turn out to make things worse for those who are not employed in the formal sector.

The discrepancy in the views of citizens on economic policy will become clearer if the government does not implement economic policy for the lower income bracket. Social justice for the middle income class from the economic point of view would include fair treatment and equality of opportunity. Therefore, they care much about corruption, transparency and accountability. The government has taken account of this and has made a commitment to realizing this. On the other

hand, social justice for the lower income class would entail appropriate implementation of the social security system. For them, the design of socioeconomic policy and its effective enforcement are critical, but the government has not discussed the overall direction of its socioeconomic policy until now. It would give rise to mistrust of the government among the poor, and moreover, it would highlight the divergence between the middle income class and the lower income class.

Another perception gap exists between those who have invested and potential investors. As seen in Table 4, FDI inflow has dramatically decreased since the revolution. This could mean that potential investors are hesitant to invest in Egypt because of the revolution. On the other hand, there are few existing foreign investors who suspended their investment plan in Egypt after the revolution. In fact, some of the current investors expressed an intention to increase their investment in the Egyptian market after the revolution. There are differences in the views of investors outside Egypt and those inside at the present, although the both seem to agree on the potential of the Egyptian economy in the long term.

3.4 Egypt and international society

In spite of the fact that major countries promised financial assistance to some Arab countries including Egypt under the Deauville Partnership framework at the 37th G8 Summit in May 2011, Egypt received little assistance in 2011. While the Egyptian interim Cabinet expected a quick disbursement of assistance in the transition period, the framework of the Deauville Partnership is based on long-term projects. The primary purpose of the partnership is to support the democratic transition in the fields of both politics and economy. The assistance modality promised by the G8 had little impact on the economy of Egypt during the initial transition period.

Oil rich Arab countries such as Saudi Arabia, Qatar and Kuwait also promised

economic assistance including FDI to Egypt in early 2011. For example, Saudi Arabia promised to offer \$4 billion in grants and loans. Qatar also pledged \$10 billion in investment projects, while the UAE promised \$3 billion for infrastructure projects. The aim of the Arab aid providers was to stabilize the situation in Egypt promptly. Although the implementation of assistance by the Gulf countries was not as quick as expected, it was put into effect by the first half of 2012. Saudi Arabia deposited \$1 billion in Egypt's central bank in May 2012 as a part of its promised aid package. Likewise, Qatar disbursed \$500 million in August 2012 as fiscal assistance. Consequently, the presence of the Gulf countries in Egypt has been strengthened compared with that of Western countries at present. In particular, since Egypt has recently been concerned about the decrease of its foreign reserves, the disbursement was well timed.

In addition to seeking economic assistance, President Mursi has tried to strengthen economic relations with emerging countries. He visited China in August 2012 and Turkey one month later in order to promote economic ties with those countries. Economic diplomacy by the president should help to lead the economy out of stagnation.

Conclusion

The Egyptians had highly optimistic expectations when Mubarak stepped down. However, their economic grievances returned soon after the revolution. Most workers were unable to get their demands met during the revolution. Their main demands were a decent wage with stable employment as well as political change. That is, for them, an improvement in their living standards was as important as the political transition.

On the other hand, the post-Mubarak government seems to put more emphasis on the political transition than on improvement of the economic situation. Indeed, the new political system will inevitably implement policies reflecting the people's

demands, but the authorities in charge seem to be concentrating their efforts on the political field for now.

Consequently, the expectation gap concerning economic prospects between the public and the authorities has widened recently. The result of the widening gap is the continuation of labor protests, and this leads to social unrest, which causes a vicious circle of social instability and stagnant investment. Therefore, Egypt needs to start a nationwide discussion concerning economic policy as early as possible. The economic policy should be formulated in accord with the changes in the political system.