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IS THE EGYPTIAN ECONOMY REALLY A SUCCESS STORY?

MUSTAFA METIN BAŞBAY

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Abstract: In recent years, international commentators have increasingly interpreted the Egyptian economy as a success story due to the country's strong growth performance and improving macroeconomic fundamentals. Pro-government Egyptian media have used this narrative of a 'success story' to imply that the economy has fared better under President Sisi than former President Morsi. The secondary implication is that strong-man rule is therefore perhaps better for the country than democracy after all. Careful inspection, however, demonstrates that whatever financial relief the country has experienced in recent years has been due to foreign capital inflows to the country. Official lenders approve of the Sisi administration for its geopolitical positioning while private investors merely seek the high interest rates guaranteed by the IMF programme. Excessive borrowing, most of which is short-term carry trade or is otherwise used for unproductive construction projects, is not sustainable and will likely lead to financial instability in the future.

Introduction

In recent years, the Egyptian economy has been widely praised as a success story., President Sisi's administration can claim its stabilization efforts, supported by the IMF programme, to have worked and contributed to the country's strong economic performance. The African Development Bank, for instance, states that "Egypt's economic growth has been strong and resilient since the economic reforms initiated in 2016."[1] It has been argued that even in the face of the pandemic, Egypt has fared relatively well compared to other emerging economies and has maintained its growth performance. Indeed, Egypt's growth rate has steadily increased since 2013, reaching its peak in 2019 before the pandemic, and the unemployment rate has declined considerably. The implications of this success story also extend to the political sphere as proponents of the Sisi regime suggest that the Egyptian economy's recent economic performance demonstrates that the country functions better under strongman rule.[2]

This narrative breaks down, however, when one realizes that whatever financial relief the country may have experienced in recent years is mostly based on excessive and expensive foreign borrowing. The government is taking large amounts of IMF loans that are conditional on structural adjustment policies as well as financial support from Gulf countries such as Saudi Arabia and the United Arab Emirates. Meanwhile, private lenders are flooding the country's financial markets with capital inflows for high and easy returns. But this financial bonanza is not creating sustainable long-term economic growth because most of the resources flowing to the country are either short-term speculative carry trade or are spent on extravagant construction projects which do not create enough economic surplus to pay back external debts while continuing to add to the country's future debt obligations.

> ***Most of the resources flowing to the country are either short-term speculative carry trade or are spent on extravagant construction projects which do not create enough economic surplus***

It is also tenable to argue that official lenders such as the IMF and Gulf countries favor Egypt for its geostrategic positioning in international politics more than its economic policies. Namely, contrary to the previous Morsi government, the Sisi administration aligns with major powers in regional diplomatic issues, especially concerning issues such as the Palestine-Israel conflict, the Libyan crisis, and maritime disputes in the Mediterranean. It is, furthermore, less of a threat to other authoritarian regimes in the region as it shares their animosity towards established opposition groups (e.g. the Muslim Brotherhood). Under these conditions, official lenders and donor countries continue to support the country economically, and thus foreign private lenders also consider the Egyptian economy a less risky investment at least in the short term.

The trend of increasing debts, denominated in dollars and due back at high interest rates, will most likely result in financial instability. The country's total external debt stock has already more than tripled since 2014, reaching a record $137 billion by the end of 2021.[3] Most of the capital lending that comes through private lenders is short-term (i.e., hot money) which does not really put its trust in the country for long-term growth. At one point, foreign lenders will start to suspect that their loans will not be repaid, which can create a capital outflow that would lead to a real economic crisis. This is a scenario which has played out many times in other developing countries in the past (e.g. 1980s' Latin America crisis, 1997 East Asian crisis). In such a crisis, a sudden drought of foreign exchange coupled with a sharp depreciation of the local currency leaves businesses as well as the government bankrupt, leading to mass unemployment and prolonged depression.

Recent Trends in the Egyptian Economy

Egypt has been through serious political turmoil over the past decade. After the overthrow of the country's 30-year ruler Hosni Mubarak in 2011, the country went through a short period of democratic rule under President Morsi. Morsi was Egypt's first elected president, but his reign did not last long as he was overthrown in 2013 by his commander-in-chief and Minister of Defence Abdel Fattah el-Sisi, who took advantage of the street protests against the president to stage a military coup. The country quickly returned to strongman rule under Sisi, who is now harshly suppressing any opposition in the country even more so than Mubarak.[4] [5]

The Morsi era showed how important it is for a new administration to quickly prove its economic prowess in such an unstable political environment.

Economic dynamics have played a key role throughout this process. According to many analysts, the mass protests against President Mubarak in 2011 were the culmination of not just political frustrations, but also people's long-simmering economic discontent with the ancien régime.[6,7] Decades of high unemployment and a lack of economic mobility in such a young population created a very strong social reaction and empowered the 2011 revolution. Subsequently, the economic stress, caused by a lack of foreign tourists, declining revenues from the Suez channel, and a fuel shortage, were amongst the main reasons for the protests against the Morsi government as well.[8] Though short-lived, the Morsi era showed how important it is for a new administration to quickly prove its economic prowess in such an unstable political environment. The protests against the Morsi government were then used by General Sisi as justification for the military takeover in 2013.[9]

As expected, analysts have been closely watching the economic situation under the Sisi government as well. Since it took power in 2013, the Sisi administration has made reforming the economy its primary objective. The political stability of an autocratic regime has certainly helped. However, without an economic programme, stability means very little economically. As expected, in 2016, Egypt adopted the IMF's stabilization programme. IMF stabilization programmes have been tested in many developing countries with similar conditions before, ranging from Mexico and Argentina to Turkey and South Korea, but with a dubious track record. After decades of experimentation with little success, most economists in both academia and policy circles have become increasingly critical of the standard IMF approach.[10] In fact, recently, even the IMF itself has acknowledged some of the shortcomings of the model.[11] Yet Egypt seems to have decided (willingly or not) to become the latest country to experiment with the standard IMF programme.

IMF's structural adjustment programmes (SAP) involve a major restructuring of the economy with the main target being the improvement of macroeconomic fundamentals, such as price stability, balance of payments, and public finances. IMF provides financial support (in the form of cheap credit) in return for the recipient country's enactment of neoliberal economic policies, including trade liberalization (lower tariffs), interest rate hikes, depreciation of the local currency, balancing the public budget (with budget cuts and increased taxes), privatization of publicly owned enterprises, and in general a more welcoming environment for foreign investors. These policies, it is claimed, improve the macroeconomic environment, providing a fertile environment for the private sector to function more efficiently and create higher economic growth.

Despite stable growth rates and the decline in unemployment, Egypt continues to run considerable current account deficits while the government debt-to-GDP ratio is still around a sky-high 90%

When the Sisi administration signed the IMF agreement in November 2016, the country was struggling with “a balance of payments problem manifested in an overvalued exchange rate, and foreign exchange shortages, large budget deficits that led to rising public debt, and low growth with high unemployment.”[12] As a condition of financial support, the government committed to implementing strict austerity measures, which dramatically affected the living standards of ordinary Egyptians. Government subsidies for energy and other necessities have been gradually eliminated, which increased the prices of all goods, especially food, and disproportionately affected the poor.[13] The government has also depreciated the currency to improve the balance of payments and imposed higher taxes in order to create fiscal capacity. Inflation peaked at around 30% the following year in 2017.

After five years, the programme appears to have had some but not much success in balancing the economy. Despite stable growth rates and the decline in unemployment, Egypt continues to run considerable current account deficits while the government debt-to-GDP ratio is still around a sky-high 90% (see figures below). On the bright side, the 12 billion loan package was surely a relief for the country in some ways. Foremost, inflation rates once again declined to single digits. Furthermore, foreign reserves have been rising while the exchange rate has stabilized. As mentioned above, the country’s gross domestic product has risen relatively strongly, averaging around 4-6% until the pandemic, which is also reflected in declining unemployment rates. Needless to say, both the government and the IMF claim credit for these positive trends.[14] However, this seeming success in growth rates and unemployment figures hides the truth about the long-term side-effects of snowballing external debt volumes.[15]

In any case, combined with a more stable political environment under the autocratic rule of President Sisi, the positive trends in growth and employment have created the impression of a smooth-running and successful economy in Egypt. Indeed, although it is carefully avoided in the analysis of foreign commentators,[16] [17] [18] pro-government media in Egypt underline ‘recovery’, ‘stability’, and ‘reform’ to claim that Sisi’s rule has been an improvement over the former Morsi government. The wider implications, of course, include that Egypt is perhaps better under a strong ruler (such as former President Mubarak or Sisi) and that an open and democratic system will, in fact, only lead to instability and economic ‘misery.’[19] A deeper analysis of the country’s long-term financial trajectory reveals a different conclusion, however.

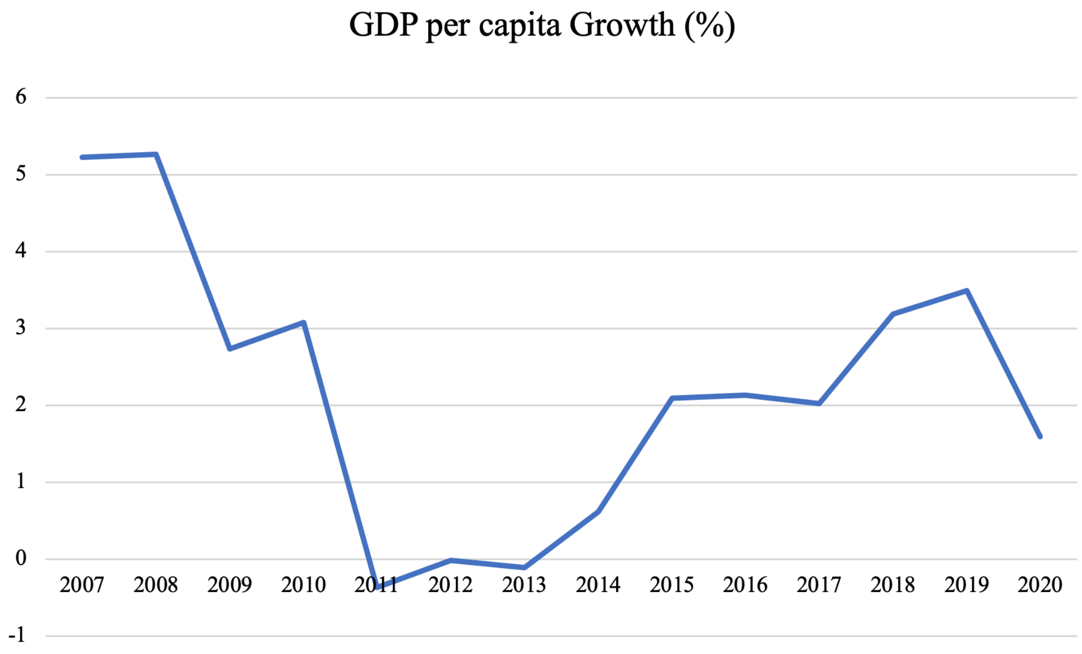

Figure1: GDP per capita growth (annual %) - Egypt, Arab Rep., https://data.worldbank.org/indicator/NY.GDP.PCAP.KD.ZG?locations=EG. Note: GDP per capita is gross domestic product divided by midyear population. The annual percentage growth rate of GDP per capita is based on constant local currency. In Egypt, GDP per capita growth rose after 2013, peaking in 2019 before the pandemic.

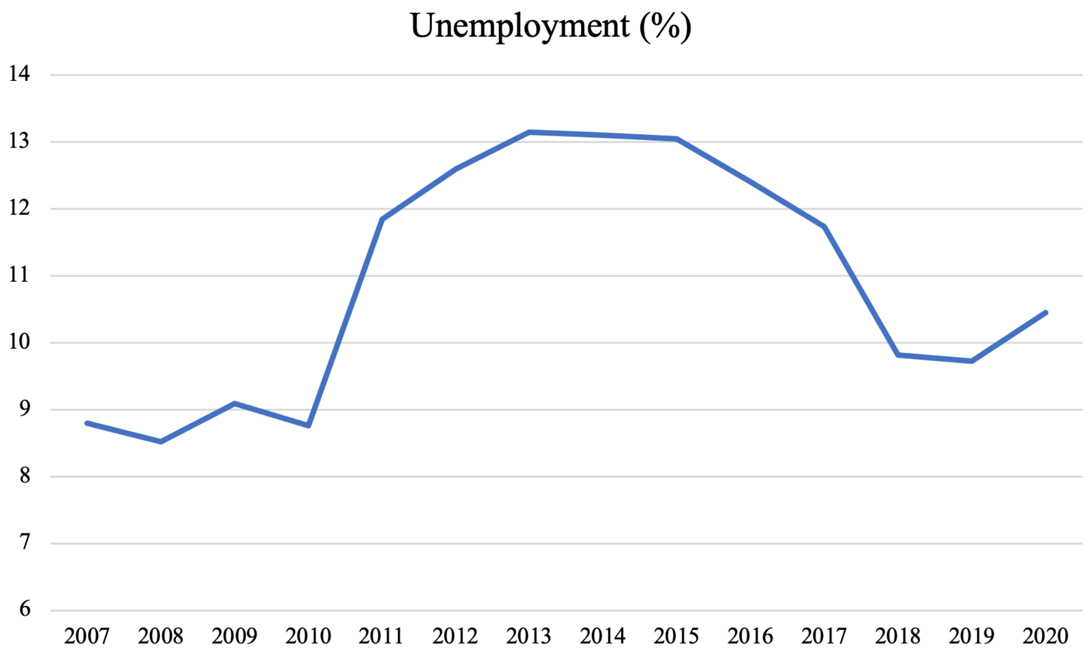

Figure 2: Unemployment, total (% of total labor force) (modeled ILO estimate) - Egypt, Arab Rep., https://data.worldbank.org/indicator/SL.UEM.TOTL.ZS?locations=EG. Note: Unemployment refers to the share of the labor force that is seeking employment but without work. In Egypt, the unemployment rate rose sharply after 2010, peaking around 2013-14 and declining afterwards until 2020, when the pandemic started.

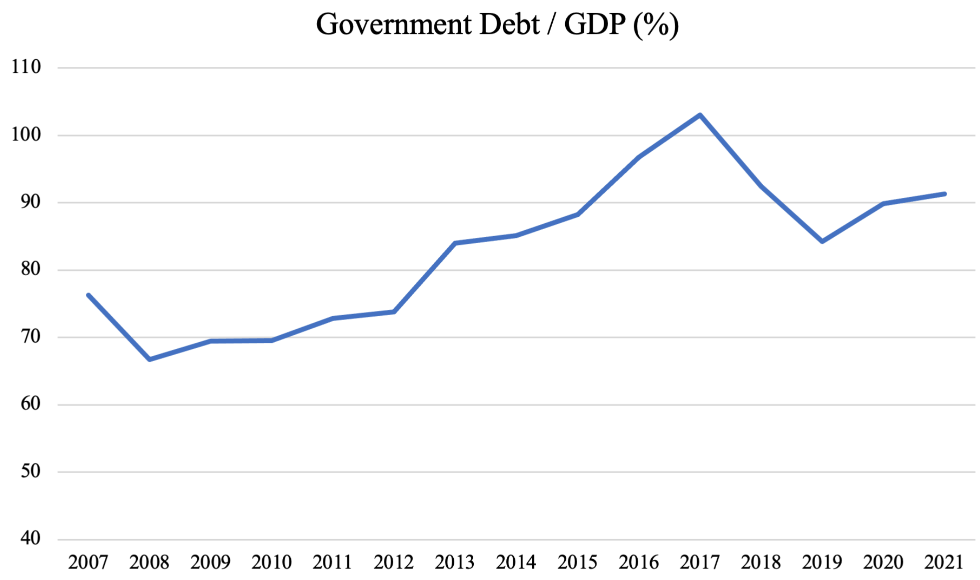

Figure 3: Total Government Debt for General Government for Egypt, IMF. https://fred.stlouisfed.org/series/EGYGGDGDPGDPPT. Note: Government debt is the gross amount of domestic and foreign government liabilities reduced by the amount of equity and financial derivatives held by the government. In Egypt, the ratio of government debt to GDP peaked in 2017 but has not seen a considerable decline since.

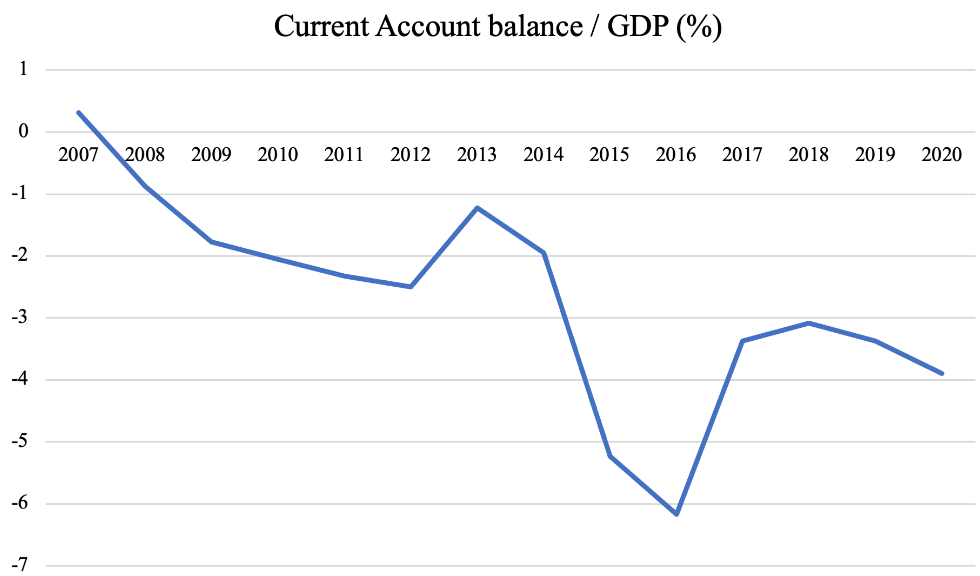

Figure 4: Current account balance (% of GDP) - Egypt, Arab Rep., https://data.worldbank.org/indicator/BN.CAB.XOKA.GD.ZS?end=2020&locations=EG&start=2007. Note: Current account balance is the sum of net exports of goods and services, net primary income, and net secondary income. Egypt's account deficit hit a historic low of -6% in 2016. It has improved since then but is still much below its historic average.

Lifting the Veil on Foreign Borrowing

The success story of the Egyptian economy fails to take into account the fact that the economic 'success' is mostly dependent on external borrowing. The country has experienced financial relief thanks to the flow of foreign capital via private and official channels, which has translated into higher growth rates as well as higher debt obligations.[20] As the World Bank puts it, the country's finances continue to be supported by "portfolio inflows benefiting from attractive rates on domestic, fixed income sovereign debt and the external financing Egypt mobilized, including financing from the International Monetary Fund's (IMF's) Rapid Financing Instrument, worth US$2.8 billion, and the recently completed Stand-by Arrangement, worth around US$5.4 billion, as well as sovereign Eurobond and Green Bond issuances."[21]

IMF loans provided financial relief, but they will still need to be paid back at their maturity. Currently, Egypt's total debt obligations to the IMF stand at $20 billion, the largest in the world after only that of Argentina. Moreover, as already discussed, the loans were conditional on the enactment of SAPs, including cuts in consumer subsidies, higher taxes, and increased fees for "public" services, which led to significant economic suffering on the citizens' part. Needless to say the plan is to improve the economic situation and thus enable the country to pay back its debts in the long run, thus making the short-term suffering worth it. However, there is no guarantee that the IMF's structural adjustment programme will be effective, as IMF plans have already failed in a number of developing countries and caused more economic suffering than the problem they initially promised to cure.

Especially in the 1970s-80s, when debt crises were wreaking havoc across the developing world, many Latin American and African countries found themselves obliged to borrow from the IMF. Just as in the case of Egypt, they were required to enact SAPs despite the devastating impact on local populations. Some of these countries indeed experienced improvements in macroeconomic indicators, some of which were reflected in economic growth as well. However, these improvements were usually short-lived and did not create long-lasting economic development. Moreover, some of the economic reforms required by the IMF, such as fiscal austerity, open capital markets, or higher interest rates, even turned out to be counter-productive for long-term growth. These policies are instrumental in attracting private capital to the country, which gives the illusion of an economic boom, but most of these investments are short-term loans that benefit from high returns, with investors quickly escaping upon seeing a risk of default, leaving the recipient country in turmoil.

> ***Most of the resources have been spent on unproductive construction projects, mostly mega projects including the expansion of the Suez Canal (an $8.2bn), a nuclear reactor ($25bn), and a new capital in the middle of a desert ($45bn)***

Arguably, a similar scenario is happening right now in Egypt. IMF agreement, beyond providing direct loans to the country, also attracts other foreign inflows from private investors. Firstly, IMF funding gives some level of reassurance to private investors that their money will probably be repaid in case the country faces financial hardship, as the IMF can step in with more funding. Furthermore, as a result of harsh austerity policies enacted under the IMF's guidance, the government also has more fiscal space to match rising debt obligations, providing further reassurance to foreign lenders, even if this comes at the expense of citizens' welfare.[22] Most importantly, the IMF programme supports free capital movements (i.e., investors easily entering a country's capital markets and leaving at the same pace) and higher interest rates to reward foreign investors. This is supposed to be a good strategy for capital-poor developing countries where the rate of return on capital is much higher due to its scarcity, but whether these resources are being used productively in Egypt is another matter entirely.

Obviously, foreign borrowing is not bad in and of itself. Egypt needs capital investments to realize its well-paying business opportunities. The government has hiked interest rates in an attempt to attract more capital from abroad so as to finance the country's development. However, it is not difficult to see that in Egypt's case, it is not possible to sustain the current trajectory for long. High yields indeed attract foreign lenders to the country, but most of these lenders are not really interested in long-term productive investments but rather easy profits. The lion's share of the foreign capital flowing into the country is short-term (i.e., hot money) and does not finance real investments on the ground, rather only creating a speculative bubble in the financial market.

The same argument goes for IMF loans to the government as well. Most of the resources have been spent on unproductive construction projects, mostly mega projects including the expansion of the Suez Canal (an $8.2bn), a nuclear reactor ($25bn), and a new capital in the middle of a desert ($45bn).[23][24] In turn, the country keeps revolving previous debts with new loans while total debts are snowballing. Therefore, this is not the case of a developing country utilizing foreign capital for industrialization, technological development, productive infrastructure, and ultimately long-term economic development, but rather a speculative bubble that requires more and more borrowing to maintain.

> ***A sudden outflow of foreign capital can lead to a dearth of foreign exchange and a sudden and sharp depreciation of the domestic currency, leaving the companies and banks that are indebted in foreign currency bankrupt***

It is not clear, however, for how long the country will be able to revolve these debts as foreign capital does not create enough surplus to pay back. The total external debt level is already at a historic high, having steadily increased since 2014. The debt service on external debts has also risen in parallel. At one point, foreign lenders will start to suspect that their money (and the very high interest payments on them) may not be returned, which can easily lead to a capital outflow and debt crisis, the examples of which were witnessed in Latin America in the 1980s and in East Asia in 1997. A sudden outflow of foreign capital can lead to a dearth of foreign exchange and a sudden and sharp depreciation of the domestic currency, leaving the companies and banks that are indebted in foreign currency bankrupt. In the Middle East, this same case was recently witnessed in dramatic fashion in Lebanon. Egypt seems to be headed in the same direction.

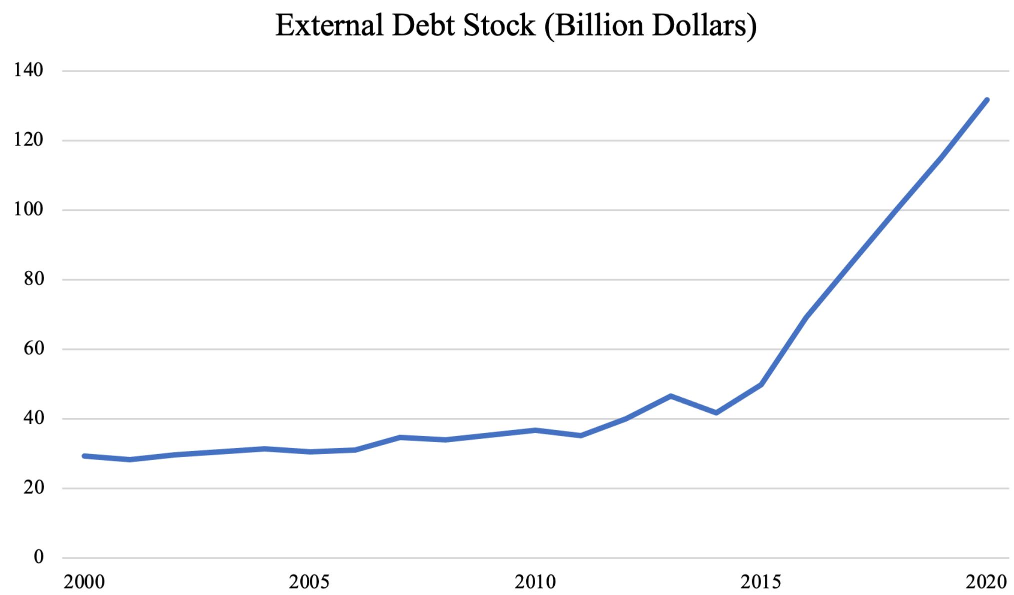

Figure 5: External debt stocks, total (DOD, current US$)–Egypt, Arab Rep., https://data.worldbank.org/indicator/DT.DOD.DECT.CD?locations=EG. Note: Total external debt is all public and private debts owed to non-residents. Data is in current U.S. dollars. After 2014, Egypt's foreign debt has sharply increased, reaching $137 billion in 2021.

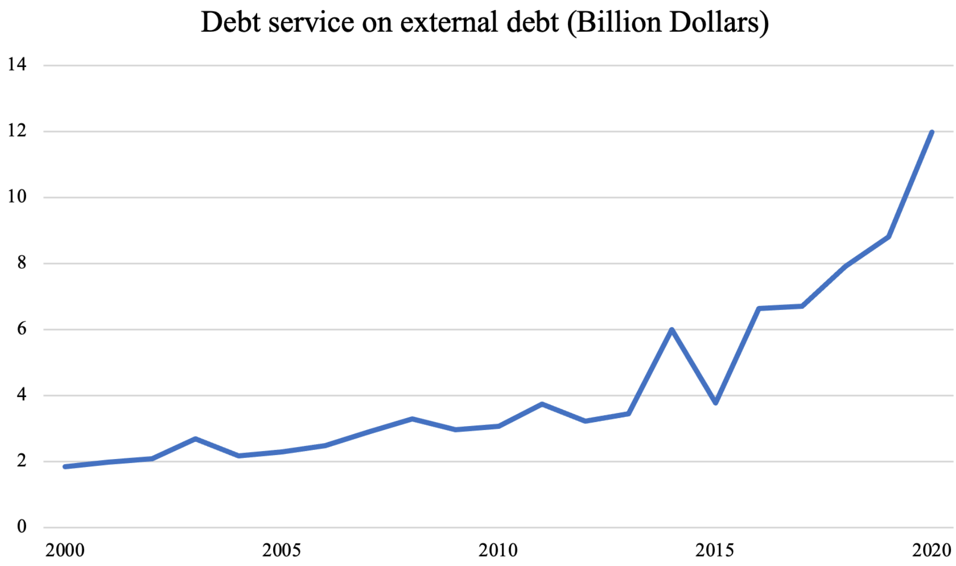

Figure 6: Debt service on external debt, total (TDS, current US$) - Egypt, Arab Rep., https://data.worldbank.org/indicator/DT.TDS.DECT.CD?locations=EG. Note: Total debt service is the sum of principal repayments and interest actually paid on the original debt, and repayments (repurchases and charges) to the IMF. Data are in current U.S. dollars. In Egypt, servicing costs of standing debts have risen steadily and steeply since 2015.

Official Donors and Geopolitical Underpinnings

It is not difficult to see that Egypt's geopolitical positioning is a major reason why official lenders favor the Sisi administration. President Sisi was a loyal supporter of the Trump administration[25] and continues to be a key ally to the US in its foreign policy objectives in the Middle East and North Africa.[26] The strategic relationship between Egypt and the US was questioned when Mohamed Morsi was president, especially in terms of the country's role in Israel-Palestine relations and greater regional politics. In particular, Morsi's diplomatic record was marked by two major developments: rapprochement with Iran and improved relations with Hamas, both of which the US government received with suspicion. With President Sisi in power, these discussions seem to have been buried.[27][28] Egypt returned to its traditional diplomatic positioning, which is defined by an alignment with the US in regional politics. Accordingly, the country remains as one of the largest recipients of US aid in the world, receiving $7.4 billion in aid between 2015-2020.[29] The Biden administration regularly criticizes human rights violations and the oppression of opposition in the country, but this seems to have little impact on aid flow.

The US is not the only donor to the country. Gulf countries have provided substantial financial support to Egypt as well. According to one resource, Egypt received some $92 billion in financial support from Gulf countries between 2011-2019, with Saudi Arabia and the UAE the biggest funders at $8 and $6 billion, respectively, followed by Kuwait with $4 billion.[30] Most of these

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funds were received after President Morsi was replaced with Sisi in 2013 which marked a radical shift in Gulf countries' attitude towards Egypt.[31] Gulf states consider cross-country political activism, represented most powerfully by the Muslim Brotherhood, as a major threat to their internal security as well as the regional order. The fact that President Morsi was a member of the Egyptian Muslim Brotherhood and that the Sisi administration has been fiercely crushing the organisation (in fact all potential opposition in the country) through judicial and extra-judicial mechanisms explains why these countries prefer the Sisi regime.[32]

Moreover, Egypt is a key player in the Libyan crisis, maritime disputes in the Mediterranean between Turkey and Greece, and the fight against illegal migration to Europe from North Africa. Therefore, despite the fact that the country is a military dictatorship with a terrible human rights record, Egypt continues to garner support from both global and regional powers, which can be witnessed in the financial favoritism as well. The EU, for instance, provides financial support both in aid and credit, including €6.34 billion EBDR loans since 2015[33] as well as loans from member states (e.g. Germany €2.8 billion), due to the country's critical role in containing 6 million refugees from migrating to Europe. Egypt's support for Greece against Turkey in the Mediterranean natural gas dispute is also difficult to ignore.[34]

The contrast in IMF's recent attitude towards the country compared to the Morsi era is also worth noting. Before Sisi came to power, Egypt was already in talks with the IMF on a financial relief package. However, despite the deepening economic stress and the high political cost, the Morsi government refused to sign the $4.8 billion IMF agreement for some time due to the austerity measures it involved.[35] Even after the Morsi administration conceded to some of the IMF's demands, the deal was delayed by the IMF which led the Morsi government to have "suspicions of a political motive behind the delay."[36] The delay in the IMF package was a critical factor in Morsi's eventual fall as street protests were already taking place at the time. When Morsi fell, the country had been struggling with a sharp decline in foreign finance and the agreement was expected to unlock $9.5 billion additional investment from abroad,[37] which could have changed the fate of Morsi and thus the country and its still-born democracy.

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Conclusion

In recent years, Egypt has experienced some resilient economic growth along with a decline in unemployment. These positive trends have been interpreted as evidence that the Sisi administration has been successful at stabilizing the economy after years of turbulence. Careful inspection, however, reveals that the improvements in Egypt's economy have largely been accomplished thanks to foreign borrowing. The IMF stabilization programme provides Egypt with large amounts of foreign loans conditional on IMF's structural adjustment policies. Moreover, the US, the EU, and several Gulf countries support Egypt financially because of the Sisi regime's geopolitical stances. Foreign financial support, especially the IMF programme, further encourages private lenders as well. Speculators are flooding the Egyptian economy with short-term funds (i.e. hot money, with maturities less than 12 months) to benefit from the high yields guaranteed by the rate hikes that are part of the IMF programme.

In turn, growth rates increased, unemployment declined (barring the pandemic impact), and foreign reserves and fiscal stance improved. However, all these positive developments came at the expense of Egypt's rising future debt obligations. Importantly, most of the resources entering the country have been spent on the government's mammoth construction projects (Suez extension, a new capital city etc.), which do not generate the financial capacity to pay back debts in future. For the time being, private investors continue to be attracted by the high interest rates, but the process is ultimately unsustainable as it does not create real economic development. As it takes more and more short-term debts and directs them towards unproductive ventures, the Egyptian economy will most likely be derailed by excessive borrowing in the near future. Therefore, the idea that Egyptians have traded political liberties for economic stability is unlikely to stand the test of time.

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ABOUT THE AUTHOR

Dr. Mustafa Metin Başbay is a development economist, focusing on macro-level development policies. His areas of research include international political economy, applied econometrics, macroeconomics, and particularly fiscal policy. Since 2019, he works as a teaching fellow at the Department of Development Studies in SOAS-University of London. He also published analysis papers at TRT World Research Centre between 2021-2018. Başbay holds a PhD and an MA from the University of Cambridge, and an MA from Boğaziçi University. He completed his undergraduate education at Boğaziçi University with a double major in Economics and Sociology

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Address: Istanbul Vizyon Park A1 Plaza Floor:6
No:68 Postal Code: 34197
Bahçelievler/ Istanbul / Turkey
Telephone: +902126031815
Fax: +902126031665
Email: info@sharqforum.org

research.sharqforum.org

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