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COMMENTARY

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# Chasing Egypt's Economic Tail

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A little-noticed decree issued by Egyptian President Abdel Fattah el-Sisi at the end of November 2015 empowered the agency responsible for managing real estate no longer used by the Egyptian Armed Forces to engage in profit-making enterprises and form commercial ventures with domestic and foreign counterparts. A few weeks later, in early January 2016, he instructed the central bank to incentivize the country's banking sector to inject US$ 25 billion into small and medium-sized businesses, which are increasingly struggling in today's Egyptian economy.

These and a host of other decrees issued since Sisi assumed the presidency in 2014 are symptomatic of his routine bypassing of the government institutions nominally responsible for economic policy making and management. This reflects his sense of urgency regarding the need to resolve the country's social and economic problems. But his exercise of an inordinate role in setting Egypt's economic agenda and overall direction is unlikely to deliver on the intended goals, and may exacerbate existing problems or generate new ones.

Sisi's decrees and economic initiatives also betray his limited understanding of the nature and causes of the structural problems facing Egypt—poverty, unemployment, low productivity, a so-called clustering around extremes of high- and low-skilled occupations with inadequate demand for those in the middle (manufacturing and routine jobs), and inadequate investment, to name the most obvious. The undertakings reveal an equally poor grasp of how to address them. This is exacerbated by his tendency to announce some of his most important economic initiatives—such as the construction of the second Suez Canal—in public speeches before consulting the relevant ministries most directly concerned, taking them by surprise. In the case of the canal, the Ministry of Finance had neither been consulted nor warned in advance, and was forced to devise the necessary investment instruments to solicit public shares in the project within a mere forty-eight hours of its announcement. But while this demonstrates the ministry's technical skill and professional competence, it only underlines the vulnerabilities of policy being made on the fly.

More broadly, Sisi's approach has resulted in a mix of legislative and administrative decrees characterized by inconsistency and inherent contradictions. This is evident from a review of just three areas: the excessive emphasis on megaprojects to drive economic growth, the broad-brushstroke approach to administrative reform of the civil service, and the one-sided view of how to generate significant new capital in the economy.

The emphasis on megaprojects appears to reflect a simplistic belief that their sheer scale will somehow alleviate unemployment, which is significant. At the end of 2015, the unemployment rate stood at 12.8 percent in a registered workforce of 28 million, a slight improvement on the post-uprising trough in 2013 but worse than a year earlier, as reported by the Central Agency for Public Mobilization and Statistics. More worrying according to the agency is that the unemployment rate among youth in the eighteen to twenty-nine age bracket, who represent 23.6 percent of the total population, is at 26.3 percent. One consequence is that 26 percent of the total population of Egypt lived below the poverty line in 2014, while 51.2 percent of youth are close to or below it, according to a joint survey by the Egyptian Population Council and Central Agency for Public Mobilization and Statistics. Another consequence is that 17.2 percent of all Egyptians aged fifteen to twenty-nine years old wished to emigrate, with the rate rising to 25.8 percent among men.

The megaprojects have done little so far to reduce this unemployment. The second Suez Canal, for instance, was dug by the army's engineering department and select private companies. Meanwhile, the projects that could employ large numbers have either stalled (such as a plan to build 1 million housing units) or will take years to start implementation, if they ever leave the drawing board—such as the new administrative capital. As importantly, this perspective does not acknowledge Egypt's need to raise labour skills—which are generally mid-level yet relatively overpriced—and productivity. Indeed, the impressive growth rates of the decade up to 2011 came almost exclusively from real estate and related construction and from natural gas production, while other sectors registered stagnation or an actual decline in productivity.

Administrative reform, the second area, could make a significant difference, and Sisi has been right to declare this a major focus. But it requires a far more concerted effort than he has allocated so far, and it will take years to make an appreciable dent even then. The state bureaucracy is bloated, though exact figures vary widely: the Central Agency for Organization and Administration reported 5.6 million government workers in 2010, while the Center for International Private Enterprise put the total at 6.8 million, citing other official statistics. Sisi himself has acknowledged that there have been a rising number of civil service employees since

2011; the increase is believed to come to 900,000, and the World Bank estimated the Egyptian civil service stood at 7.2 million by the end of 2014.

The variance in estimates partly depends on whether temporary employees have been included or not, but the large discrepancy and continuing lack of certainty about the size of Egypt's state bureaucracy speak volumes about its failings. If the state cannot even keep track of how many people it has on the payroll, how can it engage in meaningful economic management or effectively support growth-oriented policies? Furthermore, in taking on the civil service, even Sisi may have bitten off more than he can chew. The proposed new civil service law revising salaries and incentives as well as procedures for recruitment and dismissal was not developed in consultation with the extensive, powerful public sector employee unions, and it has met considerable resistance. The pushback prompted the government to declare that only 40 percent of civil servants will actually be subject to it. The government also faces serious difficulty in enforcing the maximum-wage law as the police, judiciary, and public banks, to name just a few sectors of the state bureaucracy, have simply opted not to follow the law, despite being formally subject to it. And on 21 January, finally, the newly elected parliament rejected the law by a large majority, despite being heavily stacked with Sisi supporters.

In any case, the main problem is not the sheer number of civil servants, which as a proportion of the overall population or labour force is not exceptionally high compared to world averages for similar, middle-income countries. Rather, more serious challenges are reducing corruption in public administration and increasing efficiency. A World Justice Project survey in 2012 showed that corruption may have affected as much as 60 percent of ordinary bureaucratic transactions; about half of those surveyed had bribed an official in order to obtain a necessary permit or process a document. In 2014, Egypt ranked 94 out of 175 countries worldwide on Transparency International's Corruption Perceptions Index, based on expert and business surveys. Moreover, any serious effort to reform Egypt's administration and generate economic growth and a trickle-down effect would have to include—if not start with—a thorough overhaul of local government, but this is not on Sisi's declared agenda at all.

Sisi has been considerably more successful in the third area of economic initiative. The Egypt Economic Development Conference held in Sharm el-Sheikh in March 2015 generated pledges worth US$ 72.5 billion in investments, aid, and loans, according to then Prime Minister Ibrahim Mahlab. The final tally was closer to US$ 60 billion, but this still promised a very significant flow of capital, with over US$ 18 billion of the funds actually committed to projects in the course of the year. In mid-December, Saudi King Salman pledged a further 30 billion riyals (US$ 8 billion) in investment and aid over the coming five years, and a week later, the World Bank confirmed US$ 5 billion in new lending, bringing its loans to Egypt for the coming five years to US$ 8 billion overall. This is in addition to capital raised through the issuance of government bonds or loans from other Arab and international organizations, such as the African Development Bank.

These are considerable achievements, many of which have been negotiated or authorized in person by Sisi, and reflect a powerful political commitment to stabilizing Egypt by important Arab and Western governments. But they do not resolve its structural problems, and can neither eliminate the need for major reforms and changes nor substitute for them. The inflow of financial assistance from Saudi Arabia, the United Arab Emirates, and Kuwait between July 2013 and early 2015 has been massive, and yet sufficient only to keep the economy and the state afloat. With an annual import bill of US$ 60 billion, Egypt still faces a crushing foreign currency crisis that is impeding economic recovery after five years of economic slowdown. And since imports consist mainly of inputs of production—raw materials, capital, and intermediate goods such as fuels and minerals, chemicals, and machinery, as calculated from the World Trade Organization time series—and of food, they cannot be significantly reduced without affecting output, exports, and growth.

The hard truth is that Sisi's relentless drive to generate new investment effectively seeks easy income, but sidesteps the need to tackle Egypt's structural problems more fundamentally. The vast majority of projects for which funds were pledged at the March 2015 conference, for example, were related either to energy and extraction (electricity, renewables, oil, gas, and mining) or to land (construction, transportation, and logistics). While these will certainly generate income and provide needed inputs such as electric power to other sectors of the economy, they will do much less to raise productivity or significantly increase employment in those sectors, which continue to lag worryingly behind. Indeed, of up to US$ 200 billion in new investments that the government sought at a megaprojects conference it co-sponsored in early December, a mere US$ 1.665 billion (less than 1 percent) was intended for industrial development according to one source; the rest was once again for construction (56 percent), energy (32 percent), and infrastructure (11 percent).

The fact that the government's subsidies bill actually increased by a staggering 300 percent in the year up to August 2015, after Sisi had been applauded internationally for introducing major cuts in 2013–2014, illustrates the contradictory dynamic starkly. Consequently, even after receiving over US$ 40 billion in loans and grants from Gulf countries since 2013, Egypt's foreign reserves remain under severe pressure, leaving it chronically dependent on politically motivated cash injections. No less worrying is that financial assistance pushed external debt to just over US$ 46 billion by September 2015 (12.7 percent of GDP). This is relatively low compared to other countries in the Middle East and North Africa, but when the country's US$ 248 billion in domestic debt is added, the total debt comes to around US$ 294 billion—almost double the amount on the eve of the 2011 uprising of approximately US$ 149 billion. As a result, Sisi has additionally set debt reduction as a primary goal.

Similar motives prompted the imposition of new regulations at the start of 2016 to reduce low-quality imports and increase the burden of certification on foreign companies trading a wide range of goods in Egypt. But the declared aims of slowing the drain of foreign currency reserves and protecting local industry may violate the country's World Trade Organization obligations and discourage foreign investment. These restrictions are moreover unlikely to appreciably dent the trade deficit, which grew by nearly 14 percent between 2014 and 2015, or to generate significant revenue for investment in public infrastructure that the government recognizes is in need of major overhaul and expansion. And the small and medium-sized businesses initiative in January 2016, which ambitiously seeks to finance 350,000 companies and create 4 million new jobs over four years, appears to have contributed to an exodus of foreign investors, already apprehensive of growing regional instability, from the Egyptian market.

These contradictory trends are highly unlikely to change, because Sisi's approach to economic management is driven primarily by political expediency. He responds to the general public's expectations for job creation and improved living standards, and to the priorities and interests of the narrow range of corporate actors—primarily the dominant state institutions, along with a scattering of big businessmen—that form the exceedingly loose coalition ruling Egypt today. Consequently, the contribution of central government ministries and agencies to economic planning and agenda setting is consistently overshadowed.

Fixing Egypt's economy and achieving sustained growth poses a massive challenge. But the current approach reproduces its long-standing reliance on rent, and condemns the country to pursuit of a goal that keeps moving out of reach. Having assigned himself such a central role in securing jobs and growth, Sisi risks perpetually chasing Egypt's economic tail.

**Note**: This article was originally published *Carnegie Middle East Centre*, *Beirut* and has been reproduced under arrangement. Web Link: http://carnegie-mec.org/2016/01/21/chasing-egypt-s-economic-tail/it1c

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