MEI@ND
www.mei.org.in
Middle East Institute @ New Delhi
...for Openness and Credibility

COMMENTARY

No. 58 **Thursday, 5 July 2012**

Will Mursi Rise to Egypt's Economic Challenges?

Ibrahim Saif

Carnegie Middle East Center, Beirut

The new Egyptian president has no time to waste. A number of difficult economic challenges are forcefully imposing themselves on his agenda. One and a half years since the revolution began; the Egyptian economy is still suffering from a severe downturn. If this economic trend continues, it will result in a serious crisis that will be associated with political and social repercussions.

The biggest challenge facing the new president is how to restore growth and market confidence, and how to coax investors into financing projects again. The jump in Egypt's stock indexes after Mohammad Mursi was declared the victor in the presidential elections was a fairly clear signal that investors are looking for the return of a confident and stable political environment where they can predict what will happen next.

The second challenge facing the president will be addressing the Egyptian street's high — and mounting — expectations. The sharp economic downturn is translating onto a budget deficit and depressing state revenues. The question now is how the need for more spending can be reconciled with the desire to limit the deficit, which rose by about 10 percent in the approved 2012–2013 budget. Managing the state budget will be one of the most difficult issues to address, especially taking into account some of the fixed public expenditure items, including salaries for about 6 million public sector employees and servicing the public debt in addition to subsidies.

These items represent 78 percent of public expenditures and not much immediately can be done about them.

The third challenge is the absence of a general framework identifying future economic trends. Many economic analyses are unclear about the role each of Egypt's political and economic actors should play in the coming phase, adding to uncertainty. Will policies be determined by the [Muslim Brotherhood's] Freedom and Justice Party? Or will they be controlled by the Supreme Council of the Armed Forces, which has a firm grip over Egypt's destiny? Uncertainty when it comes to who actually has what power is limiting the ability of decision makers to implement long-term reforms.

Compounding the difficulties facing Egypt's economy and its new president is the reluctance of the international community to work with the existing government. How Egypt will receive a US $ 3.2 billion International Monetary Fund (IMF) loan has not yet been resolved. This loan is a test; and Egypt's behavior will determine if it will be offered additional loans from various development funds. If Egypt is unable to secure the IMF loan, the new president will have an even more difficult time. It is not yet clear how President Mursi will deal with this issue, given the tenuous conditions attached to that long-dormant loan.

These challenges and the mismanagement of the economy in general have had several repercussions, the most prominent of which is the decline in the central bank reserves by US $ 1.4 billion per month. The reserves are now at about 40 percent of what they were in January 2011. This has prompted the central bank to lower the minimum reserve ratio for local banks from 20 percent to 14 percent in March 2012 and then again to 10 percent in May 2012. The government also tried to boost liquidity by issuing bonds to foreigners. But these attempts failed. The cost of borrowing from local banks, according to the most recent treasury bills auction, has reached its highest level in fifteen years.

These indicators have raised serious concerns about the exchange rate in Egypt, which has remained relatively stable over the past eighteen months. However, it is unclear whether it will be possible to continue protecting the Egyptian pound given the deteriorating indicators regarding the country's ability to attract foreign currency, including the significant decline in tourism.

Given these challenges, how should the new president approach these issues?

First, he should send signals that restore confidence in the government's economic policies, especially as regards the private sector. This sector has so far been absent from the political scene, primarily due to its poor record and the public's low opinion of it. The government should clarify its stance on many issues and specify the roles expected of economic actors.

The image of the private sector needs to be rehabilitated; it cannot continue to be associated with Hosni Mubarak and his son Gamal if it is to be a productive player in Egypt. In Egypt, the term "private sector" continues to carry negative connotations — it is synonymous with corruption and collusion with the security services.

The government should also stop borrowing from the domestic market. By doing so, it is absorbing a significant amount of liquidity that otherwise could benefit other economic sectors. Continued government borrowing raises borrowing rates, contributes to the budget deficit and postpones many pressing decisions, such as reconsidering the tax structure and government subsidies. These two policy areas consume a large portion of public expenditures. Only a government with real political legitimacy can address subsidy and tax policies, and only the new president is capable of leading such a transformation.

Giving more attention to small and medium size enterprises, which employ the largest number of workers in Egypt, can further help to restore economic growth. It is difficult for these projects to receive funding or access to markets. Allocating a portion of development funds to these projects will ease pressure on the government and reduce the need for increased public spending.

In the long term, there must be a rehabilitation of the agricultural sector, whose productivity is declining but is able to absorb a large number of workers. The manufacturing sector — considered the single largest source of employment — requires similar treatment. With the new situation in Egypt, there is nothing preventing the implementation of new manufacturing and agricultural policies to help restore balance to the economy after the neglect and misguided policies of the past decades.

In any eventuality, economic issues — from the transportation and traffic crises to the decline in foreign currency reserves — will be the most pressing items facing the new president. He will need to move fast.

Note: This article was originally published in ***Carnegie Middle East Center***.
Web Link: http://carnegie-mec.org/publications/?fa=48758&lang=en

Dr. Ibrahim Saif is a Senior Associate at Carnegie Middle East Center, Beirut.
Email: isaif@carnegie-mec.org