Egypt's Economic Prospects and Challenges[1]
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The global economic crisis poses new challenges for the Egyptian authorities, but so far the economy is weathering the crisis better than most. Economic growth continues, albeit at a slower pace than in recent years. After exceeding 7% in 2007 and 2008, real GDP growth is expected to fall to 3-4% this year. The boom of the past few years was based on soaring exports, which were aided by key policy and procedural reforms, and on rising private and public investment. Hydrocarbon prices are on the rise once more but drastically lower economic growth in Europe will hurt Egypt's non-oil exports. FDI is falling.

With the onset of the global crisis, the challenges facing Egyptian authorities have changed radically. Just over one year ago, the most pressing issue, as the IMF saw it, was to contain inflation when monetary and fiscal policies were constrained by limited exchange rate flexibility, large capital inflows, and the growing cost of food and fuel subsidies. Now inflation appears to have passed its peak and the most urgent challenges are to maintain growth and balance of payments stability in the context of global financial crisis and a weak international economic outlook.

Reforms have bolstered Egypt's development and should help it weather the crisis. Egypt's relatively favorable performance in the face of a difficult world environment is partly attributable to the achievements of the reform program that the GOE adopted from the mid-1990s on, partly in response to donor urging. Early reforms included pension reform and partial privatization. Later the Central Bank was given greater freedom to define monetary policy, which led to bank restructuring, liberalizing the exchange rate, and facilitating portfolio investments. In 2004-2006 the government acted to reduce tariff rates and simplify customs administration, to revise the tax law to lower maximum rates, expand the tax base, and encourage investment; and to resolve deficiencies in the sales tax.

According to a 2007 review by the OECD, the reforms contributed to a great expansion of private investment and facilitated both domestic and foreign investment in sector other than oil and gas. The OECD noted that while investment in manufacturing has been fully liberalized (except for defense-related industries) and foreign participation in financial services and private telecommunications is permitted up to 100%, restrictions remain on foreign equity participation in several sectors, notably construction, electricity and transportation.

In May 2008, the government announced that it would spend $2.5 billion to increase public sector salaries by 30% and provide additional funding for food and fuel subsidies. In the following November, as the global crisis worsened, it announced a $2.7 billion fiscal stimulus package of public works expenditures focused on water, wastewater, and transportation, with all funds to be spent by June 30, 2009.

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The fact that Egypt has the most diversified economy in the Middle East has helped its development as well as its resilience in the face of adversity. Combining agriculture with a relatively small but growing industrial sector and a substantial energy sector has proved beneficial. The large service sector provides a great deal of employment and its tourism sub-sector in particular helps to drive economic growth. Tourism receipts rose through mid-2008 but are now falling.

The economic slowdown will hurt the poor and probably cause social discontent and sporadic protests this year, but these should not threaten the regime. Egypt has relatively little extreme poverty. In 2004/2005, 18% of the population lived on less than $2 a day in purchasing power terms and less than 2% lived on less than $1.25 (World Bank estimate). The World Bank reported that the incidence of poverty had fallen by three percentage points by early 2008 but it may have begun to rise again since then. The poorest Egyptian families spend more than half their family budgets on food and were severely affected when grain prices soared in 2008. Further tensions arose in May 2009 when the government misguidedly announced that all pigs would be culled to contain swine flu.

Exports will fall sharply this year, probably by more than 30%. The decline will affect both goods exports (e.g., textiles) and services (tourism and Suez Canal receipts). Import prices will also fall and the trade deficit should narrow. The current account of the balance of payments will remain in moderate deficit (less than 1% of GDP).

Unemployment is rising. Unemployment declined from 11.2% in 2005 to 8.4% in 2008 but was recently reported to have risen to 9.4% in the first quarter of 2009. This means that there are 2.4 million job seekers out of a labor force of 26 million. The tourist industry has shed workers and falling demand for textiles and other industrial products is expected to cause further layoffs. Egypt has high rates of school enrollment and there are 700,000 school leavers each year. Ninety percent of the unemployed are said to be graduates. A likely cause of additional unemployment in the coming months is repatriation of Egyptian workers from the Gulf States, where some 500,000 Egyptians work. Informalization of the labor market accelerated in the 1990s after employment guarantees for graduates were rescinded and now continues unabated. By 2006, 61% of all employment was estimated to be informal. Moreover, 75% of the new entrants who joined the labor force in the first five years of this decade are thought to have taken up informal work.

Foreign direct investment is falling. Along with Saudi Arabia and the UAE, Egypt has been a major recipient of FDI in the Middle East. Because the major areas of investment have been real estate and the energy sector, however, FDI has not created large amounts of employment. Most European investment has been from the UK into the hydrocarbons sector, where several discoveries have been made and expansion continues. A lack of liquidity in the Gulf is expected to reduce FDI for a while. Nevertheless, the GOE is trying to attract more FDI to help offset the recession. Having offered tax breaks and other benefits to promote free trade zones, it is now marketing its low corporate tax rate of 20%, recent reductions in red tape, and improved infrastructure. A large industrial park is to be built as a Spanish-Egyptian joint venture. It will host Spanish (and later other) manufacturers of electrical and white goods, food products, and building materials and is expected to create 20,000 jobs. The Ministry of Investment has announced new manufacturing- and tourism-related FTZs in the Alexandria, Sinai, and Suez areas. Unconfirmed reports in the local press state that an ambitious plan has been developed to build a new city north of Sixth of October City to accommodate one million residents and attract various industrial and tourism-related firms.

The government budget will be in deficit. The government's budget continues to be burdened by the cost of food and fuel subsidies, which divert funds from investment and operating expenses. The GOE reduced fuel subsidies in 2008, then suspended the reduction until the end of 2009 because of the recession. Rising prices caused the cost of food and fuel subsidies to soar in 2007/2008. Falling prices for foodstuffs this year, however, should to help reduce the budgetary cost of the subsidies.

The main announced policy goal of the draft budget presented to Parliament in May 2009 is to maintain the level of economic activity and employment during the world recession. The budget projects a 19% drop in tax receipts and a deficit equivalent to 8.4-8.5% of GDP. There is hope that the revenue decline will be mitigated by income tax amendments that should increase the number of filers. A value added tax may be introduced in 2009/2010, but the recession has raised doubts about whether that will occur. Amendments to the property tax law have lowered the rates while expanding the tax base.

Inflation is slowing. Consumer prices rose by 18% in 2008, but lower rates of about 9% and 7% are expected in 2009 and 2010, respectively. The financial sector remains relatively strong because of improved bank supervision, conservative monetary policies, and Central Bank deposit guarantees. Past bank consolidation should help the banks weather the recession. Yet banks may encounter difficulties as some borrowers have trouble repaying their loans. The Central Bank is loosening credit and cut interest rates in February and March of this year.

Reform of the business enabling environment has been impressive. Egypt's standing in the World Bank's *Doing Business* indicators has risen fairly dramatically. Egypt ranked a miserable 152^{nd} among countries of the world in overall ease of doing business in 2006 but improved to 114^{th} out of 181 countries in the 2009 rankings. Nevertheless, considerable room for further improvement remains. Relatively favorable aspects of the business environment according to the World Bank's most recent survey include trading across borders, starting a business, protecting investors, getting credit, and registering property. Areas in which Egypt still ranks quite low include dealing with construction permits, enforcing contracts, paying taxes, and closing a business. The ease and cost of starting a business have been sharply reduced since 2007. But building a warehouse still involves 28 procedures, takes 249 days, and costs 377% of Gross National Income per capita according to World Bank data. The time required to enforce a contract through the legal system remains extraordinarily high at 1,010 days – nearly three years.

Telephone and internet density are growing but are still very low relative to densities in Jordan and Turkey. Transportation infrastructure is relatively sound, but extension and upgrading are needed, particularly for railroads and in Upper Egypt.

Egypt's near-term economic future depends on the timing and pace of world recovery as well as on the GOE's responses. So far, Egypt has not been placed on USAID's watch list of developing countries likely to be most heavily impacted by the recession. An optimistic scenario for the near-term future that would see the growth rate return to 7% or so in the next few months is possible but unlikely. A pessimistic scenario would involve 2-3 years of slow or even negative growth with rising unemployment and poverty. Perhaps the most likely prospect, however, is a moderate scenario that would see some degree of recovery begin in 2010. Achieving that fast a recovery will depend on continued government efforts to stimulate domestic demand and on the revival of demand for Egyptian exports overseas.

There are unexploited opportunities to boost intra-regional trade. Trade among countries in the Near East and North Africa is low. One reason is that countries in the region have similar production structures, reducing opportunities for trade. Other impediments are uneven tariff rates, high non-tariff barriers, and poor logistics. Trade agreements negotiated among countries in the region have focused on easing tariffs (and did succeed in lowering tariffs in the region from a simple average of 20% in 2000 to 13% in 2007 and shortened the time needed for import and export processing), but the non-tariff barriers remain high and logistics are well below world standards. Infrastructure linkages are improving, however. With EU help, Egypt, Jordan, Lebanon, and Syria are establishing a regional gas market that will ultimately be linked to the EU market. More such measures are needed to make the region more competitive in international trade.

Efforts are being made to facilitate US-Egyptian dialogue on trade and investment issues. US firms see significant potential in the Egyptian market and see Egypt as a regional hub. Bilateral trade has grown in recent years and reached $9 billion in 2008. Proposed dialogue topics include trade facilitation, services, intellectual property rights (copyright enforcement, pharmaceuticals), agriculture (sanitary and phytosanitary issues, tariff, and trade), the environment, investment, and labor. More broadly, ties with the US remain strong despite some tension arising from efforts to push democratization.

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