24 April 2024

Are Egypt's Reforms built on Sand?

David Christianson

Egypt's decision, taken in March 2024, to float its currency appears to be a signal that the country is taking its pro-market reform programme seriously. The over-valued Egyptian pound has long been symbolic of an economy that has laboured under massive, inefficient, state domination for many years. But the realities of the country's military-dominated political-economy suggests there are decided limitations to how far and fast Egypt will be able to go.

Currency reform may unlock some large international investment flows. This fits with the al-Sisi government's strategy of leveraging development through mega-projects since it came to office in 2014. These include smart cities, a new capital, a further extension to the Suez canal, holiday resorts, a Chinese-funded export processing zone and other public infrastructure. But foreign private investment in these projects has been 'paltry' and the main burden has fallen on public debt.

Egypt announced the currency float after two years of 'managed' currency devaluations and considerable engagement with the IMF and potential investors (the European Union, Persian Gulf sovereign wealth funds). The critical moment came in February when one of the three Emirati sovereign wealth funds, ADQ, agreed to invest USD35 billion in a massive holiday resort and commercial development on Egypt's Mediterranean coast.

The deal appeared to give the Egyptian government the confidence to go ahead with currency reform. A fellow at the Washington Institute commented that 'the IMF and a top Gulf donor have come to the rescue once again'. There is no doubt that Egypt had been experiencing an economic crisis. Growth has slowed to 2.8 percent, its lowest in 11 years, while inflation has run rampant, (with percentage figures in the mid-thirties) since the 2020 Covid crisis. The Egyptian pound has fallen two-thirds against the US dollar in two years. Foreign currency had become all but unobtainable in a context where 47 percent of imports are used as inputs for local production.

In some respects, the immediate crisis has been a matter of limited revenue and foreign exchange. Suez canal receipts are down heavily (40 percent in January) since the start of Houthi attacks on Red Sea shipping. The country's tourism industry, which accounts for a similar quantum of revenue, has been dormant since the start of the Gaza conflict. Even before the immediate crisis, there had been a series of external shocks: Covid-19 and Russia's invasion of Ukraine. The costs of imports, including food, fuel and manufacturing inputs soared while foreign currency dried up. The IMF made a currency devaluation a precondition for a USD8 billion bail-out.

Currency reform appears to have worked in the short-term. The measure unlocked not only the IMF loans but also funds from the EU, the World Bank, the UAE and elsewhere, totalling USD57 billion over the next three years. But there are fears that having averted the immediate crisis, Egypt's government will fritter away new borrowing is the same fashion that got it into trouble in the first place. It is significant that interest payments absorbed 45 percent of government revenue in 2023.

The Egyptian government is nominally committed to liberalising markets. In a letter of intent to the IMF in 2018, it stated its commitment to 'improving the business climate, strengthening governance and reducing the role of the state in the economy'. This theme has been often repeated and seems to be accepted by the IMF which, in April, said that the country was engaged in 'the implementation of reforms that would allow the private sector to become the engine of growth'.

In Egypt's case, there have to be doubts about how serious it is.

The problem is that, as Bloomberg's report on the IMF loan states, 'Egypt has a track record of announcing market-friendly reforms, then dragging its feet'. It adds that 'whether the government is able to fix the economic problems that precipitated the meltdown isn't clear'. An article in The Banker notes that 'privatisation drives have been part of the IMF's loan agreements with Egypt since the 1990s, but there's never been much progress achieved on that front'.

The underlying problem is the outsize role of the military in Egypt's public sector. 60 military-linked companies are active in 19 industries ranging from construction and property development, to telecommunications, manufacturing, transport, pharmaceuticals, food production, retail, petrol stations, tourism, renewable energy, and hydrocarbons. The military is largely exempt from value-added taxes, real estate taxes and income taxes. Analysts argue that conscripts are used as cheap labour.

More than the scale of the military's business operations, it is the distorting effect on markets that is most problematic. Investors know that they have to take the military's interests into account. But the system is unpredictable and opaque. A Carnegie Middle East Centre fellow captures the depth of military influence in the term 'Officer's Republic' which refers to the extensive deployment of retired military officers in government ministries and agencies, regulatory and operational economic authorities, local government, and state-owned enterprises.

Statist dominance, which covered 70 percent of the economy, according to US trade department figures, has long been an obstacle to economic development, squeezing out private investment and baking in systemic inefficiencies. In December 2022, the al-Sisi government ratified a State Ownership Policy document which provides a roadmap for greater private participation in the economy.

In terms of this policy, the government of Egypt intends to withdraw from 62 business activities over 'the next three to five years'. But a year-and-a-half down the line, there has been little substantial progress. Only two companies, a petrol stations operator and a bottled water firm have moved towards private ownership via a listing on the Cairo Stock Exchange.

The 2034 currency float has another implication which is likely to delay pro-market reforms. Egyptian society has been hit hard by inflation and cost-of-living issues in recent years and a weaker currency can only exacerbate the problem. As much as 60 percent of Egypt's 106-million citizens are estimated to live below or close to the poverty line. But military domination of government is the antidote to potential social unrest. Egypt's strategic position in the global economy makes the country, in many respects, too strategically important to fail, which is one of the main reasons for continuing support from western institutions and Gulf states.

Measured against these structural conditions then, the recent currency float looks more like a short-term measure to restore access to foreign exchange. There is little to suggest an appetite for the sorts of creative destruction which would accompany proper liberalisation of the Egyptian economy. A realist might argue that real in-depth reform is simply not on the agenda.

tralac gratefully acknowledges the support of its Development Partners

german cooperation
DEUTSCHE ZUSAMMENARBEIT

Implemented by
giz Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH