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The Post-Arab Spring Economic Outlook in Egypt

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The revolution that overthrew the thirty-year rule of Hosni Mubarak in January 2011 marks the beginning of a new era in Egypt. After decades of economic mismanagement and widespread corruption, Egypt now has the chance to re-emerge as a major economic power in both the region and the world. While the legacies of the Mubarak-era will continue to challenge the new administration, Egypt has enormous economic potential stemming from three factors: (1) a large, young labor force; (2) vast untapped natural resources; and (3) its location at the crossroads of global trade and investment.

The road to economic prosperity will require the implementation of a comprehensive new system of economic governance. This must include: greater government investment in alleviating unemployment and inflationary pressures; strengthening public institutions and the judiciary against corruption; safeguarding an independent press and civil society; and promoting market liberalization.

These are all policies that South Korea successfully adopted during its own economic development and they offer important insights into Egypt's future economic prospects. But, at the same time, the proposed Egyptian model includes a high degree of social justice necessary to stimulate effective demand and stimulate investment and growth. That social justice requires reform of tax systems, subsidies, transfers, and wages. They constitute a necessary response to the demands of the Egyptian revolution.

The Egyptian Economy under Mubarak

Before discussing the future of Egypt's economy, it is worth briefly examining the state of Egypt's economy at the end of Mubarak era in 2011. At the end of 2010 Egypt's gross domestic product (GDP) stood at \$218.9 billion while its gross national income (GNI) had reached \$197.9 billion.¹ This means that net transfers in the negative and total transfers from Egypt abroad were \$34 billion. This has been the cost of being dependent on developed countries and their companies in the oil and gas sectors; giving those companies a lot of subsidies (mainly via energy subsidies); and ignoring their monopoly agreements which raise the price of goods and services in Egypt while making them huge profits.

To appreciate the deteriorating size of the Egyptian economy, it is worth noting that Egypt's GDP in 1965 was \$5.1 billion—equivalent to 1.7 times that of South Korea's GDP at the time which was \$3 billion. In that same year, Egyptian exports were \$605 million—more than 3.5 times that of South Korea, which was \$175 million.² However, by 2010 South Korea's GDP had surpassed a trillion dollars to reach \$1,014 billion—4.6 times that of Egypt's. Similarly, South Korean exports had reached \$363 billion—equivalent to 15.7 times that of Egypt.³

On January 1, 2011, Egypt's internal debt was \$164 billion⁴—equivalent to 75% of GDP and 83% of GNI, which exceeds the red line. This debt comes from a very high accumulated budget deficit. In 2009-10 the deficit was \$15 billion (8.1% of GDP), and in 2010-11 it was \$20 billion (9.5% of GDP). In the beginning of 2011, the external debt was \$35 billion—equivalent to 16% of GDP and 17.7% of GNI, which was an acceptable level. Consumer prices rose by 11.7% in 2010, while the same index was 6.1% for developing countries and 1.5% in developed countries.⁵ The high level of inflation in Egypt comes mainly from the monopoly in production and trade and the budget deficit.

According to official statistics, Egypt's unemployment rate in 2010 was 9%, but these were false. According to my estimates published in the Al-Ahram annual report, "Strategic Economic Direction," unemployment in 2010 was, in fact, 27.4% of the labor force.⁶ In 2010 the official data stated that the proportion of the population

classified as poor was 18%. Again, that statement was not true, with the poor actually making up more than 40% of the population, due to worsening income distribution.

The Scourge of Corruption

Egypt has inherited an enormous amount of systemic corruption from the Mubarak era. This corruption was widespread like a cancer in the body of the economy and affected everything related to public finances, the assets of state-owned companies, land for cultivation or real estate development, and the supply of contracts for goods and services to the state. The “greatest” corruption has been in the privatization program, which led to the squandering of what previous governments and generations had built for less than 10% of the price of the land alone.

One such case was ‘Al-Nasr Boilers,’ publicly known as ‘Steam Boilers,’ one of the many companies that were plundered by bribing the officials responsible for selling them. Babcock & Wilcox, an American-Canadian company, was found to have bought Steam Boilers at an undervalued price after a corrupt local official, Abdel Wahab El-Habbak, confessed to receiving \$91 million as a bribe. This is an extraordinary amount that was paid, while the country only received \$9 million for the whole company. This is amazing given that Steam Boilers’ land holdings alone—130 thousand square meters directly overlooking the Nile in the Manial Sheeha region—was estimated to be worth \$54 million at the time. There are many such examples of public companies and hotels having been sold to American, French, British, Saudi, Kuwaiti, and other foreign companies in the same corrupt way.

However, corruption was not an exception in the privatization program, but was rather methodical. Criteria of privatization to be rated price per square meter in the land of public companies located in the main cities that are put up for privatization as the price of the land for industrial purposes in the nearest new city, which usually revolves around the price of \$15 per meter. This is about 3% of the price of land in major Egyptian cities, buildings are assessed at book value or the amount of \$23 per square meter if the book value is less than this amount.

Among the criteria mentioned, low-profit companies have a minimum assessment

rate which is eight times their average annual earnings during the three years before selling. The buyer can recover all payments through the usual profits in eight years, with multiplier profitability or capital recovery period through annual profit of about 15 years in the Egyptian Stock Exchange and sometimes up to more than 25 years; while it is about 20 years in the American Stock Exchange. The company's profits can be low due to poor management even if it has high-value assets.

The privatization program was one of the conditions for aid from the United States, and has also been imposed under strong pressure from the International Monetary Fund (IMF). Yet there were no guarantees of fairness and transparency in the privatization process under the Mubarak regime. This means that there is a fundamental responsibility to them about the corruption of the privatization program.

When the United States invaded Iraq in 2003 it cancelled all contracts entered into by the former Iraqi President Saddam Hussein with many international oil companies under the pretext that he did not represent the Iraqi people. This precedent gives Egypt the right to review corrupt contracts concluded by Mubarak in the field of oil, gas and mining gold and other minerals and quarantine. For example, under Mubarak, Egypt was exporting natural gas to Spain, Turkey, Jordan, and Israel for less than \$2 per million British thermal units (BTU) when the price on international markets was between \$9 and \$16.

The seriousness with which state finances, resources, and property have been put in the pockets of a corrupt handful has allowed the corruption of small minority to build a culture of public tolerance for corruption. Similarly, the unjust wage system—which is insufficient to achieve even a basic standard of living—means that junior workers are forced to seek bribes to fulfill the basic necessities of life. At the same time, some bureaucratic and political leaders have monthly incomes in the tens of thousands of dollars, and, in some cases, in the hundreds of thousands.

Towards a New System

Egypt should adopt an integrated system based on deterrence to overcome this heavy legacy of corruption. This system must seek to prevent corruption through regula-

tory bodies, boards of directors, and general assembly's that are entirely elected. It must also toughen sanctions on the corrupt and build the institutions of independent oversight. These institutions must have the right to access to all information related to dispositions in public money, whatever financial or in-kind. They must also have the right to convert and report their findings directly to the judiciary without any interference from the executive or legislative authorities.

To ensure maximum effectiveness of the judiciary in the fight against corruption and the victory of right and law, it would require a new constitution defining the separation of authorities and the balance between them. Egypt should also review its system of contracts including: land contracts, privatization deals, public works contracts, deals for the supply of goods and services to the government, and contracts for the exploitation of mineral wealth and quarries. It should also focus on corruption in the management of national newspapers, the public sector, economic authorities, the government apparatus, and localities.

Optimistic Possibilities for the Future

Despite this heavy legacy of corruption, there is great potential for reforming Egypt's economy and making a real breakthrough in economic development. Especially in light of the progress that has been, and continues to be, made in the fight against corruption, Egypt can fundamentally change its economic policies to build a transparent and impartial economic system and a fully free private sector. The state can also balance and penetrate new areas important to the economy which the private sector does not have the courage or the ability to enter, as well as absorb unemployment in real jobs and combat poverty and improve health and education services. Three factors will help policymakers to implement these changes: (1) a large, young labor force; (2) vast untapped natural resources; and (3) its location at the crossroads of global trade and investment. First, Egypt has important economic bases and a large labor force (33 million people) of various skill levels, which are among the lowest paid, even compared with the industrial areas in the east of China. The water that is currently wasted on transportation and flood irrigation could be used for the cultivation of an additional 4 million acres of arable land. Freshwater lakes could also be used to increase fish production and tourism. Egypt also owns long beaches on the

Red Sea and Mediterranean Sea that could be used to develop tourist resorts and marine fish farms.

Second, Egypt has vast natural resources including oil, gas, minerals such as gold, and quarry products such as cement, phosphate, and gypsum. All of the above can allow Egypt to develop labor-intensive industries such as the metallurgical and engineering industries, quarantine and automotive industries, ship-building, leather production and high-tech industries. For instance, the agricultural and livestock industries can develop processing, canning and preserving vegetables, fruit, fish, and meat. The country also owns one-third of the ancient monuments in the world, as well as extensive beaches and deserts. This will allow it to further develop cultural tourism, entertainment resorts and safaris, and accommodate crews passing through the Suez Canal or Egyptian ports. Its long coastline and lakes also allow the possibility of developing aquaculture and the development of processing industries and fish.

Finally, Egypt is well located to attract investors wishing to enter its large domestic market of 83 million consumers, with a GDP of \$499.3 billion based on purchasing power parity,⁷ a consumption rate of 92% of GDP,⁸ and cheap labor costs. Similarly, Egypt's location is exceptional for those wishing to enter their products without customs into the European market, as well as Arab and African countries associated with Egypt by free trade agreements. If those investors come from as far away as East Asia, the United States or Latin America, basing their operations in Egypt will save immeasurably on transport and insurance costs. Consequently, these companies will be better situated to enter the Egyptian, Arab, European and African markets compared to if those investments and their exports come from the countries of origin. Egypt's geographical location at the center of global trade routes makes it unparalleled for storage and transit trade, supply and the repair of vessels transiting the Suez Canal. Egypt is very close to the moment of taking off: who will be with it?

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1. World Bank, *World Development Report 2012*, 392; 398.
 2. International Monetary Fund, *International Financial Statistics Yearbook 1990*, 122.
 3. World Bank, *World Development Report 2012*, 398; 400.
 4. Central Bank of Egypt, *Monthly Statistical Bulletin*, 183 (June 2012): 109.
 5. International Monetary Fund, *World Economic Outlook, April 2012*, 198-202.
 6. Ahmed El-Naggar, "The Basic Indicators of Egyptian Economy, Strategic Economic Directions" *Annual Report 2010*, (Cairo: Al-Ahram Center for Political and Strategic Studies, 2010): 265.
 7. World Bank, *World Development Report 2012*, 392.
 8. Central Bank of Egypt, op. cit., 18.

The views expressed herein do not necessarily reflect the views of the Asan Institute for Policy Studies.



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