THE ILLUSION DISPELLED

Egypt's Economic Crisis:

Causes – Alternatives - Remedies

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Introduction

25 January 2013 saw the passing of two years since Egypt's revolution, an uprising inspired by demands for social justice and equitable distribution of wealth. It is argued in this paper that the post revolution administrations[1] not only failed to realize a new economic reality but also accelerated the decline of the nation's economy.

The economy has suffered from an extended period of slow growth, coupled with an ever-increasing budget deficit and declining foreign currency reserves. As more Egyptians continue to fall well below the poverty line, the current regime's economic mismanagement could signal huge challenges ahead for Egypt. The situation is likely to be further exacerbated as the majority is increasingly excluded from political and economic decision making.

The post revolution economic strategy has so far only focused on financing an expanding budget deficit and stabilizing the Egyptian pound in the face of a growing balance of payment deficiency. The current regime is adopting similar economic policies to those of the Mubarak era, i.e. resorting to short term measures. Borrowing money is favored to focusing on more structural changes such as reforming energy subsidies, developing productive sectors and creating employment. Moreover, current policymakers refrain from taking basic steps to restructure the budget by reallocating expenses and raising tax revenues to be able to upgrade public investment in public services such as education, vocational training and health. Unlike Mubarak's regime, which was able to adapt to a chronic fiscal crisis, the current regime does not have the luxury of a generous bail out[2] as it lacks the relative political stability of Mubarak's initial years in power.

This reluctance to implement important economic decisions is likely to weaken the regime's relations with Egypt's business community. Furthermore, it will probably lessen the Muslim Brotherhood's (MB) chances in any forthcoming elections, as the economy has effectively reached a critical juncture which could threaten the regime's stability.

Late 2012 to early 2013 saw a series of developments, most of which represented economic warning sirens for the regime. These indicators include the budget deficit exceeding 176 billion EGP for the first nine months of 2012/2013 (Finance, 2013), the Egyptian Pound reaching a record low since 2004 and capital flight continuing to soar as an estimated 5 billion USD had left the country in 2012 (Samhouri, 2013). Furthermore, a recent report by the Economist[3] projected a 2.2% growth rate for Egypt, which is lower than the announced revised growth forecast of 3% by the Egyptian government.[4]

In what has become a recurring theme over the last two years since the revolution, the Egyptian government is once again fully focused on a fourth round of post revolution International

1 Under both the military and Muslim Brotherhood regimes.

2 Mubarak was able to withstand the fiscal crisis after benefiting from a substantive debt forgiveness plan by the Paris Club debtors in the early nineties.

3 Economist Intelligence Unit, Egypt Country Report March 2013, Economist Intelligence Unit Limited 2013.
4 Down from an initial forecast of 4% GDP growth.

Monetary Fund (IMF) discussions. This time around, the government hopes to finally attain the loan and the claimed breakthrough it should bring in terms of investments and further loans/grants.

After failing to secure the IMF funds in November 2012 and the continuous decline in foreign income receipts, the Central Bank (CBE) acceded to IMF's pressure and resorted to currency devaluation. This resulted in the pound losing almost 10% of its value since early January, subsequently reflected in a sudden increase in the prices of basic commodities. Whereas the CBE quotes inflation at 8.7% percent, officials from the Department of Food in the Chamber of Commerce indicate that 17% is a more accurate figure (Assyasy magazine). Considering that savings have reached as low as 6.1% of GDP and that 57.5% of the Egyptians do not earn enough to cover their basic needs,[5] a socioeconomic crisis is in the making.

Another major concern is the lack of clarity on who heads up the decision making process. In an interview with Reuters Hassan Malek,[6] the longtime MB member and business tycoon appointed by President Mohamed Morsi to chair a business development council, defied the central bank and the government by revealing the devaluation of the pound was a condition set by IMF (Taylor, 2013). He went on to make public that more painful reforms would be implemented after the parliamentary elections. This indicates that the government, which is anticipating a wave of dissent in an increasingly polarized political atmosphere, has as yet failed to develop any social safety structures to support and protect the most marginalized segments of society. If the regime believes an elected parliament's legitimacy will prevent mass protests of the most deprived, they are likely to be disproved. They need only to examine Jordan and Morocco, both facing serious difficulties in implementing austerity measures despite having much more political stability in comparison to Egypt (Gad, 2013).

This document highlights the economic predicaments and policy shortcomings initiated since 25 January 2011 that have contributed to the ongoing deterioration of the Egyptian economy.

5 Al Masry Al Youm article referring to a survey carried out by the Cabinet's Information and Decision Support Center (IDSC) http://www.almasryalyoum.com/node/1540816.

6 Malek established the Egyptian Business Development Association (EBDA), whose board of directors includes many Muslim Brotherhood members. In July 2012, President Morsi appointed Malek to chair a new business development council to advise the president on attracting international investments.

Current Situation and Depth of Crisis

The current administration faces the daunting challenge of convincing the IMF and prospective lenders that it has sufficient political authority to implement austerity measures. Such painful economic cutbacks are immensely challenging when governing a population already paying the price of decades of social injustice and inequality.

The previous round of elections last November casts doubts on the current regime's ability to carry decisions through to completion. After an initial agreement with the IMF mission, the government proved incapable of implementing the proposed regressive plan. In December 2012, it announced a slight increase in gas and mazut prices, and struggled to enforce these decrees on the energy intensive industries, but failed.

The definitive moment of weakness came in the same month, December, with the release of a series of price increases and tax hikes with no dialogue or prior notice. Then, to its humiliation, the government backed down succumbing to the pressure exerted by the public outcry that followed.[7] This ultimately led to postponing the discussions and any economic reform until the government becomes able to propose an amended plan to the public.

On the other hand, in February Egypt's credit risk rating was downgraded[8] for the fifth time since the revolution, and subsequently most International Financial Institutions (IFI) and prospective lenders shelved negotiations indefinitely. More significantly, whilst trades and industries benefitted from the postponement of price and tax hikes, consumers were not spared the cost. Traders pre-empted the unimplemented decisions by raising consumer prices, resulting in a 20% increase of basic commodities prices according to officials from the Federation of Egyptian Chambers of Commerce (Assyasy magazine). The government also discreetly passed a 15% increase for household electricity according to the Ministry of Electricity (Assyasy magazine).

7 See EIPR commentary for more details Amended tax laws and postponed implementation: The Worst is yet to Come.

8 Unlike previous downgrades, on this occasion it occurred following the transitional process. At this point, a new president had been elected and a new constitution was passed, thus indicating both continuous political instability and economic deterioration.

How did the economy reach this state?

One would think that such alarming economic indicators would rouse the government to take urgent measures. However, instead of developing an economic plan to address pressing economic needs, the current and previous administrations undertook measures to merely maintain a dysfunctional semi-rentier economy at the expense of the welfare of citizens who have been the strongest supporters of the economy, with remittances for example increasing by 40% in 2012 to reach 19 billion USD (Al Mal, 2013), at a time when Foreign Direct Investment (FDI) and tourism continued to decline. Also domestically, bank deposits have been the main source of finance for the government through treasury bills issued to local banks at interest rates as high as 16% (Al Mal , 2013). These deposits, basically composed of citizens' savings, funded the budget deficit, which, as we said, exceeded 176 billion EGP so far this fiscal year.

Unfortunately the government continues to ignore its major stakeholder choosing to set up fictitious cosmetic dialogues rather than establishing genuine citizen engagement to develop a social safety net, consider different models of subsidy allocation or address the economy's structural deficiencies. The government, instead, used dialogue forums to promote the economic measures needed to secure the IMF loan.

The set of austerity measures billed to save up to 31 billion EGP by the end of the fiscal year (June 2013)[9] are yet to be implemented as we approach the final weeks of the fiscal year. These measures were even not properly discussed to become part of a coherent economic strategy. Instead the government developed a set of revised measures (discussed in further detail below) that rely once again on the broader base of the population shouldering the costs. Measures set forward include lifting subsidies, imposing consumption taxes and allowing the pound to depreciate, which will apply further inflationary pressure to an existing wave of price increases.

It is difficult to see how an economy in recession can recover and reform its structural problems through a series of austerity measures and regressive taxation that will only deepen the financial crisis in the long term and create further social unrest. Most of these measures will incur the wrath of both the business community, which will refuse to absorb the price hikes shouldering them on the consumers, and the vulnerable majority of the population who are already overwhelmed.

Furthermore, the fact that the government plans to collect 19.5 billion USD through borrowing raises the question on how this money would be allocated and whether it would be directed to the social and productive sectors of the economy to solve its structural deficiencies or to other, temporary, remedies to meet short term pressures.

As a Carnegie report outlines, these issues are of immediate concern: "In a country that imports

9 By saving up to 9.2 billion EGP through VAT taxes, 5 billion EGP from adding a new income tax bracket (25% for annual incomes above one million EGP), 10 billion EGP from lifting energy subsidies and a further 6.8 billion from coupons for gasoline with scant details of the measure's timeline and how prices would be controlled.

60% of its food and 40% of its fuel, and where over 25% of the population, 50% of them in rural areas and city slums, live below poverty line. Add to this a jobless rate of 25% among young Egyptians, and the result is an explosive socioeconomic mix at hand (Samhouri, 2013)."

From this overview of Egypt's economic activity since January 2011, a recurring trend emerges; rather than tackling structural challenges in the economy, each administration, transitional or elected, has focused on political point-scoring, making little use of the already limited fiscal and monetary policy space. Moreover, instead of developing a long term economic plan or industrial policy, regimes continued to present the same short-sighted and ill-advised economic prescriptions through the economic reform plans presented to the IMF.

In this paper we look at the mismanagement, or lack thereof, of the economy in the past two years as well as the gaping void of economic vision in spite of the rapid development of a full-fledged crisis. We critically examine the budgetary, fiscal and monetary policies and the lack of a long term planning.

Economic Blunders

Despite the glaring economic indicators mentioned above and the accelerating rate of decline in the socio-economic conditions of the people, it seems the current regime has yet to grasp the economic challenges facing the country. In fact, avoiding taking critical decisions and developing long term plans to combat the economy's structural deficiencies emerge as a trend amongst the transitional governments that preceded the current elected administration.

Accordingly, this approach has led to a budget deficit of 11% of GDP in 2011/2012 and an expected deficit of 12-13% in the current fiscal year. Moreover, foreign reserves fell below the "critical level" set by CBE at 15 billion USD to reach 14.4 billion USD, raising serious doubts over Egypt's ability to sustain its basic needs of fuel and food next summer. A recent Reuters report stated that "Egypt has hit a breaking point in its ability to pay for imports of oil, wheat and other basic commodities… the credit crisis is now so acute that it [the government] can no longer buy crude oil in the market, leaving its oil minister scrambling to cut diplomatic deals with Libya Qatar and Iraq" (Julia Payne, 2013).

Egypt's wheat reserves would be completely consumed by the end of June 2013, and owing to the depleted funds, the state grain buyer has not purchased wheat since February (Julia Payne, 2013).

As for crude oil, the country has not received any oil cargo from open market suppliers since January (Julia Payne, 2013). Hossam Arafat, the head of the petroleum products division at the Federation of Egypt's Chambers of Commerce, explained that Egypt does not have the foreign currency to sustain its importation of petroleum products, including diesel, which accounts for about 60% of its consumption (Moustafa, 2013). Arafat had little hope that what he described as "the weak government" would solve the diesel crisis, particularly under the current turbulence in its security apparatuses (Moustafa, 2013).

In the next section we will take a quick glance at how the economy is being managed. We will focus on budgetary (non)transparency, monetary and fiscal (mis)planning and the shortcomings of the economic strategies.

1. Monetary Policy (post revolution capital flight)

In terms of monetary stability, the CBE has struggled to counter the pressure on the Egyptian pound, spending over 20 billion USD to defend the local currency, with foreign income from tourism and investments continuing to decline. Meanwhile, reserves are depleting at an average of 1.4 billion USD[10] per month (Samhouri, 2013) and the CBE is turning to bond sales and foreign deposits from Qatar, Saudi Arabia and Turkey to salvage the situation. Nevertheless, this approach failed to prevent reserves from falling to a level that can barely cover more than 2 months' worth of imports.[11] Panic ensued when banks started to withdraw from their overseas accounts and the pound continued to drop at a significant pace. The CBE reacted by adopting a

10 These 1.4 billion USD do not include the debt service payments of around 3 billion in January and July, and the undisclosed amounts spent on defending the Egyptian pound, not to mention both the legitimate and illicit cash flows.

11 Foreign reserves dropped from 36 billion USD to 13.6 billion USD in the two years that followed the revolution before reaching 14.4 billion USD in April 2013.

new auction mechanism to buy and sell dollars. However, CBE's desperate attempts to introduce restrictions on foreign capital outflows through restricting individual foreign currency transfers and corporate withdrawals were too little too late.[12] Similarly, the belated decision to prioritize imports by making money more available to strategic and basic importers had little effect.[13]

The government's earlier reluctance to adopt more stringent capital controls for fear of sending a negative message to potential investors and international financial bodies were a mark of poor economic decision making. It was actually well within the government's rights to impose at least temporary restrictions on capital outflows and imports of non-strategic commodities at an earlier stage. Countries suffering from widening balance of payments and financial crises are allowed, within the financial regulations of institutions such as the World Trade Organization (WTO) and more recently the IMF, to consider imposing temporary capital controls. In Egypt's case, they certainly had warning signals as early as March 2011, when the reserves lost 3.5 billion USD in one month, more than the total that Egypt planned to borrow from the IMF at that time (Hussein, 2012).

Furthermore, there is mounting evidence that capital account openness tends to lead to increased susceptibility to financial instability due to swings in capital flows reacting to volatility or speculation (Akyuz, 2012).There are also unlearnt lessons from previous financial crises which were triggered by the reversal in capital flows in the 1990s and 2000s, e.g. the Asian financial crisis in 1997, Mexico in 1994 as well as Brazil and Russia in 1998, to name but a few examples. The IMF itself has internally indicated its willingness to reconsider, to a certain extent, its stance on capital account liberalization.

2. Fiscal Policy (Mubarak's economic legacy continues)

On the fiscal front, criticizing the government's policies has become repetitive with each administration refusing to develop a new approach to public financial management. Essentially, in spite of the revolution and the opportunities it afforded for a new economic strategy aimed at combating long term ills of corruption and an ailing public sector, there has been little or any change. Critical aspects of economic and social reform, starting from budget planning and allocation, to genuine reform of Egypt's subsidy policies and public sector wage, remain unaltered. In addition, there is reluctance towards adopting progressive taxation and other forms of measures that would raise more fiscal revenue and reduce the gulf between classes.

It is unsurprising to note that the budget deficit is expected to reach more than 200 billion EGP, almost 13% of GDP, particularly in light of the fact that almost 80% of the budget is allocated to wages, subsidies and debt servicing. With the government continuing to delay taking any critical decisions regarding energy subsidy, due to the political and social price associated with it, and its reluctance to implement measures like public sector wage caps and progressive taxation, any discussion by government officials over limited policy space has to be seen as self-inflicted.

12 Some 30,000 USD for corporations and 10,000 USD for individuals travelling to or from Egypt.

13The import of commodities reached almost 60 billion USD, exports only amounted to 27 billion USD.

More worrying is the fact that running alongside the government's stagnation in its policy making duties is a staggering growth in debt levels. Egypt's total public debt is almost the size of its GDP, and the government debt as a percentage of domestic banks' total deposits and of total credit amounts to 55% and 56%, respectively (Samhouri, 2013). Moreover, the external debt levels are currently around 42 USD billion with an expected inflow of a prospective 4.8 billion USD IMF loan and another 10 USD billion funds[14] over the current and next fiscal year.

A simple calculation of the increasing debt service obligations and other factors (for example Egypt becoming a net importer of gas, the devaluation of the pound and the rise in the cost of raw materials) leaves no doubt that the deficit situation will only continue to worsen.

3. **Budget transparency:**

To promote Egypt's economic development, the first and most significant step is a transparent account of the economy's resources and obligations. According to the Open Budget Survey, which assesses accessibility of key budget documents to the public, Egypt's Open Budget Index 2012 score is 13 out of 100 (EIPR, 2013).This is well below the average score of 43 for all the 100 countries surveyed including neighboring Jordan, Morocco, and Lebanon. Egypt's score indicates that the government provides the public with scant information on the national budget and financial activities. This makes it challenging for citizens to hold the government accountable for its management of the public's money.[15] Of the eight key budget documents evaluated for the assessment only three were published, namely the enacted budget, the periodic in-year reports measuring the trends of actual revenues and expenditures and the year-end report. The rest of the documents are either not published or produced for internal use only.[16]

The issue of transparency is exacerbated with the existing budget law (no. 53/1973 with its amendments: 11/1979, 87/2005 and 109/2008), which stipulates that the Economic Authorities (agencies controlling public utilities such as water and petroleum), special funds, National Agency for Pensions and Social Insurance and the National Investment Bank are excluded from the state budget.[17] Furthermore, a big portion of Egypt's economy including fees from the Suez Canal, natural gas income, foreign aid as well as returns from multiple taxes, tariffs and fees is managed directly by the Presidential Office without parliamentary supervision (Kennedy, 2012).

Another controversial issue is the size of the military economy, which ranges from the unrealistic lows of 5% to the exaggerated highs of 40% of the economy with no official

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14 Contingent on the IMF loan.

15 For the Open Budget Survey Egypt Country Summary: http://internationalbudget.org/wp-content/uploads/OBI2012-EgyptCS-English.pdf.

16 These include: the pre-budget statement (not produced) which links government policies/priorities and budgets through setting the parameters and projections that will define the budget proposal, (ii) citizen's budget (not produced) which is a nontechnical presentation to enable broad public understanding of a government's plans for raising revenues and spending public funds in order to achieve policy goals, (iii) audit report (produced for internal use) is an independent evaluation of the government's accounts by the country's supreme audit institution.

17 Each of these has separate budgets.

accurate figures declared (Shana Marshall, 2012). Not only are army holdings classified as state secrets, but also reporting on them can result in incarceration. Furthermore, military assets are too vast and dispersed to estimate with any confidence (Shana Marshall, 2012). Unlike the civil sectors of the economy, the military's economy appears to be thriving well, to the extent that the Supreme Council of the Armed Forces (SCAF) lent the Egyptian Central Bank 1 billion USD in December 2012 (Shana Marshall, 2012). Moreover, the new constitution ensured continued operation for the Egyptian military as effectively a state within the state by guaranteeing that its budget is exempted from any oversight, thus depriving the Egyptian economy from a huge financial resource.

This lack of transparency with regards to the real size of the country's resources casts further suspicions over policy makers' persistent claim that borrowing and austerity measures are the only routes out of the crisis.

Is the IMF loan the solution?

Over the past year the government has consistently communicated that the only route to salvage the economy is in securing the IMF loan. All economic plans have thus been shaped and geared towards gaining the approval of the IMF board, which would sanction a significant inflow of foreign debt from bilateral and multilateral partners aiming to supposedly cure the foreign reserves crisis. The government also continuously claims that the IMF loan will serve as a stamp of approval that will unlock billions of foreign direct investment and hence reduce the marked lack of resources and deficit.

Despite not being able to settle on an economic reform plan or to implement any substantive subsidy or tax reforms, the new economic reform program presented to the IMF unrealistically plans to drastically reduce the budget deficit from an expected 12% of GDP to 10.9% in the current fiscal year and 7.7% by 2014/2015. The first step was to increase gas prices for cement and brick factories by 50% to reach 6 USD per million BTU.[18] The following step was to raise the price of mazut from 1000 to 1500 EGP per ton with the aim of reaching the international market price, which is above 4000 EGP per ton, in three years.[19] These measures almost immediately led to a rise in cement prices, which fuelled in turn price hikes in the construction sector, and which will surely be reflected in higher prices of housing units.

The more contentious issue is that of fuel subsidies which the government plans to start rationing in July. According to Reuters, the government plans to provide subsidized fuel to smart card holders[20] with a quota of around five liters for a private car and 30 liters per taxi per day.[21] According to the minister of petroleum, the first three months of 2013 saw the commencement of the diesel crisis with fuel shortages reaching a peak in March, the harvest season. As a result, the Ministry of Finance fell 200 million USD short of providing the required import needs for March 2013.[22] This shortage was reflected in higher prices of food commodities with increases ranging from 7% to 30% (Shorouk, 2013). Such deprivation has already resulted in violent clashes in several governorates with long queues of citizens struggling to get their share of the limited quantities available. These circumstances are expected to have drastic socioeconomic consequences in the absence of any price controls or social safety nets.

With regards to taxation, the government revised the list of commodities subject to VAT from the original 25 to six goods, namely: iron, cement, alcoholic beverages, carbonated beverages, mobile phone use and cigarettes. For each of these products VAT increased between 2% and

18 Still way short of the market price, Egypt might end up importing from Qatar at 10-12 USD per BTU.

19 Decree no. 110 for the year of 2013 – Official Gazette.

20 Smart Cards are provided by the Egyptian Ministry of State for Administrative Development to implement the food stamp application in Damietta, Dakhalalia, Ismailia, Helwan, Qenna, Aswan, Red Sea, South and north Sinai. http://www.egyptsmartcards.com/all_news.asp.

21 Beyond these quotas, the price increases are expected to be in the range of 5.71 EGP for 90 Octane gasoline from 1.75 per liter and more contentiously diesel prices are expected to reach 5.21 from 1.10 pounds per liter http://www.aljazeera.net/ebusiness/pages/266748ce-2a09-4a59-a051-d2c2cc94049b.

22 The government is only able to satisfy 60% of the country's domestic diesel needs.

5%. A new tax of 0.001% on stock market transactions was proposed to replace the 10% on transactions after an Initial Public Offering (IPO).[23] Finally, regarding income tax, minor changes were made as the government refuses to abandon its neo-classical tax policy which entails reducing the number of income brackets and imposing a similar tax rate across a segment despite the significant disparity in income levels. Instead of applying progressive taxation on higher income groups, the rate remains at only 25% for individuals while the unified rate for all firms is set at 25%, with no view to create new tax brackets. The plan itself is not seeking effective measures to change a legacy of failed economic policies that have lasted for decades, but rather a set of austerity measures aimed solely at bringing the deficit down and replenishing the reserves.

In the following lines we will provide a short critical review of the governmental plan's very assumptions and foundations:

(i) More debt to keep economy afloat. The estimated accumulation of 19.5 billion USD planned in the current and next fiscal years might delay the collapse of the Egyptian economy but not for any significant period if we take into account that the country needs importation valued at a minimum of 20 billion USD this year. Coupled with the rising costs of fuel and food and the devaluation of the Egyptian pound, this assumption seems to do more harm than good. A continuation of this debt policy is bound to lead Egypt's economy to a dreadful conclusion.[24]

(ii) IMF seal of approval will open the floodgates for new investments. Attracting investments will not come through the IMF loan, certainly when set against the government's inability to make economic decisions or to propose its own strategy/vision. Furthermore, anti-democratic actions and violence against citizens are all factors that will negatively affect investment opportunities. In addition, given the global economic recession and the decline in FDI indicators, one has to ask about the possible sources of new capital flows.

(iii) **Fixation on Deficit /Austerity.** As proven in the Eurozone, austerity measures are more likely to sink an economy into deeper recession than provide solutions. Growing awareness of the failure of current policies is causing social discontent, civil disorder and political instability, with the recently concluded Italian elections and the growing popular resistance to Greek reforms serving as clear indicators (Papantoniou, 2013). The reasons are not entirely sophisticated: fiscal austerity essentially undermines the very thing that allows economic growth to proceed, which is aggregate spending. It is difficult to see how austerity measures might instigate growth in an economy where 40% of the population live below the poverty line and in which total consumption accounts for 94% of GDP. Economic growth is intrinsically linked to breaking the cycle of economic and social exclusion, which will only happen when the government develops a growth strategy that focuses heavily on employment and generating demand.

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23 This measure has been vehemently opposed by the businessmen community and it remains to be seen if it will be implemented.

24 Please refer to EIPR's report "In the Absence of a Comprehensive Economic Strategy and Planning: Is Egypt's Debt Policy a Recipe for a Disaster?"

Finally, instead of adopting plans that are tailored exclusively to IMF's debt conditions, policies should be focused on short term measures to revive the economy as well as long term strategies to transform Egypt from a semi-rentier economy to a productive and industrial one.

The way out

The policy challenge being addressed is how to design and implement a broad-based culture of growth that can successfully reduce poverty. The core of this approach lies in developing a growth strategy that focuses heavily on employment and generating demand (Radwan, 2012). The government should immediately begin to implement a significant stimulus package for investment in noninflationary areas such as infrastructure, education, health, and social housing (Radwan, 2012). In the long term, there must be a rehabilitation of the agricultural and manufacturing sectors, with the former's productivity in significant decline and the latter being the largest source of employment (Saif, 2012).

In post-revolution Egypt, there is nothing preventing the implementation of a massive makeover of all these policies. Of course, the private sector should also be incentivized to participate in this process. However, its role should be governed by the state to ensure inclusive economic growth. Other important steps might include undoing cronyism and the reallocation of land unfairly distributed under Mubarak to create a broad-based private sector in a more transparent and productive manner. The even distribution of property rights, in addition to property registration, would be further steps towards a more inclusive development model.

The big question remains as to the financial sources to fund this stimulus package in light of the ever-growing budget deficit. First, it is paramount to have a clear and accurate picture of the country's resources and expenditure allocations. Second, an understanding that budget deficit reduction is not an end in itself, but rather a policy tool that might sometimes be suspended for the sake of higher strategic considerations, represents an important element of any sound economic policy making. Having said this, we should add that the best long term cure to budget deficit, or any other structural deficiency of the economy, is sustainable economic growth. Third, it is important to note that public revenues are quite low when compared to that of other middle income countries, which means there is potential to increase the government's revenue from direct taxation measures that are not detrimental to social justice. All these measures have to be coupled with investment in human capital, as it will make them politically viable in the short term as well as ensure sustained economic return.

The following recommended short term and long term measures could provide a platform for economic reform in Egypt:

1. **Budget (revealing the actual size of obligations and resources in a transparent budget):**

The Open Budget Survey[25] lists a number of recommendations, which call for some very basic and essential steps like producing and publishing a pre-budget statement and holding a formal policy debate before tabling the executive budget proposal. This stage is crucial as it helps in initiating a dialogue on the priority areas for expenditure and sources of income. In this way the controversial issue of allocation of funds can be addressed with forward planning rather than working with predetermined budgets. The survey also recommends producing a 'citizen

25 For the Open Budget Survey Egypt Country Summary: http://internationalbudget.org/wp-content/uploads/OBI2012-EgyptCS-English.pdf.

budget'[26] (a simplified budget that can be read by the average citizen). Another crucial recommendation is empowering the supreme audit institution and publishing its report, which is currently only published internally. Needless to say, to ensure any accountability this step must be implemented.

A legal amendment allowing for including the budgets of the Economic Authorities and special funds in the national budget would complement these initiatives. One cannot project the resources and obligations of the economy without a clear picture of the country's resources. The same applies for the military budget and the size of the military economy, which should be considered as a resource and not treated as a separate entity.

2. Fiscal policy (reform of fiscal policies)

For fiscal and monetary policy recommendations it is useful to refer to UNDP's 2011 Arab Development Challenges Report ("ADCR"), which addresses the legacy of failed approaches in these policy areas.

As the ADCR stresses, public financial management, based on taxation without representation, is clearly no longer tenable (UNDP, 2012). The report elaborates that efforts to revamp fiscal space by examining issues such as sustainability of public debt and public investment should be complemented by strong monitoring and evaluation of the impact of fiscal policy on development results (including the thorny issue of food and fuel subsidies).

Additionally, wider representation in the formulation of fiscal policy is integral. While the reform of fuel subsidies must commence, there has to be a clear plan to develop a social safety net and price controls.[27]

Moreover, at a time of recession adopting an expansionary policy is vital to revive the economy and protect the vulnerable majority from plunging into total destitution.

3. Monetary policy

The ADCR emphasizes, as with fiscal policy, that monetary and exchange rate policies occupy a pivotal role in the functioning of the Arab rentier political economy. Furthermore, the report highlights that exchange rates were at times undervalued to benefit large exporters, who were often part of, or connected to, the ruling elites. Such instances led directly to higher prices of imported foods with detrimental effects for poor and low-income families. The same report also describes restrictive prescriptions to target inflation handed down by the IMF which lead to specific instances where exchange rates were overvalued to suit the interests of importers, who also had close ties to the political elite. Such acts of self-interest demonstrate utter disregard to the impact on investment in the productive sector and on competitiveness of local producers in global markets. Moreover, monetary policy and operations of the financial sector have also been slanted towards providing cheap credit to the politically well-connected while

26 This was only produced once under former Minister Youssef Boutrus Ghaly and was merely cosmetic as it didn't serve its intended purpose.

27 For more details on subsidy, please see EIPR's commentary on Energy Subsidies (Arabic) http://eipr.org/pressrelease/2012/09/30/1502.

small and medium enterprises responsible for most jobs are deprived of access to formal credit.

The ADCR report calls for a thorough analysis of monetary policy and mechanisms as a necessary step towards the proper determination of exchange and interest rates. In addition, the report demands norms for bank credit operations that aim to support productive sectors and firms, including small and medium enterprises (SME) (UNDP, 2012). In Egypt there are around 2.5 million SMEs representing 75% of the total employed workforce and 99% of the agricultural private sector establishments (Hala El-Said).

The ADCR report concludes that ending economic and social exclusion is contingent upon implementing mechanisms for financing employment-intensive industrial, agricultural and service sectors. This can be achieved by providing preferential interest rates to strategic sectors, public and private loan guarantee facilities and lowering the required reserve ratio for banks that target small and medium enterprises, particularly in rural areas (UNDP, 2012).

4. Designing and launching a long term industrial policy

Egypt's economic future depends on launching a new phase of industrialization based on increased competitiveness, enabling it to deviate from its current rentier model to a more competitive and sustainable model of economic growth. Twenty years ago a report titled "Industrial Policy and the Role of State in Egypt" (Mona Said, 1995) issued by the Economic Research Forum set forth relevant recommendations that could easily be applicable in 2013.

The mentioned report refers to the rise of "the government failure school" with its policy prescriptions – large scale deregulation and trade/market liberalization – which were proposed and implemented from the 1970s onwards in Egypt through the Economic Reform and Structural Adjustment Program, (ERSAP). At the time of the report, these policies were judged to have failed to deliver their promises; a warning signal duly ignored for the next two decades and even after the 2011 revolution. The report uses case studies such as the successful industrialization experience in East Asia to stress the complexity of the process that goes far beyond the change of trading regimes and ownership structure. It argued instead for a developmental state that takes on the responsibility of designing and implementing a coherent industrial plan/strategy.

For more than 50 years, reports and studies on industrial development in Egypt emphasized the root cause hindering economic development: a lack of a national project or focal point of coordination to drive the nation's industrialization. Of course a major pre-requisite for developing a national project is that it should be based on a social coalition and has to reflect shared political and economic values. This pre-requisite, which is in fact the most difficult aspect of the challenge, must be satisfied for the state to play a key role beyond merely correcting market failures in the conventional sense. These roles include: (a) provision of an entrepreneurial vision and coordination for large-scale changes, (b) institution building in public and private sectors, (c) prudent management of integration in the world economy, d) prudent management of internal conflicts in the domestic economy (Mona Said, 1995).

Finally, the current and prospective economic indicators leave little room for optimism. However, there is no reason not to be hopeful that with a change in approach and better use of policy space, a new socioeconomic reality can be realized for Egypt.

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