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Egypt’s Successful Stabilisation without Structural Reform

Introduction

In 1991 Egypt launched the Economic Reform and Structural Adjustment Programme (ERSAP) under the auspices of the IMF and World Bank. Within six years the country had achieved a remarkable stabilisation success, bringing down inflation, the fiscal deficit and the current account deficit and building up the country’s external reserves. External debt was also brought under control and there was a large surge in capital inflows reflecting renewed confidence in the economy. However, the government failed to build upon this success with a deep enough set of structural reforms. Although privatisation and reform of an inward-looking trade regime took place, these reforms did not go far enough to fundamentally change the structure of the Egyptian economy. We speculate that one of the reasons for this was a lack of World Bank leverage in Egypt due to the ready availability of alternative sources of external funding especially in the form of the large and lenient US aid programme. In addition the successful stabilisation programme brought problems of its own, especially in the form of capital inflows and associated real exchange rate appreciation leading to Dutch Disease type effects in the economy. Consequently, the growth that followed the stabilisation experience was largely geared towards the domestic market and concentrated in the non-tradables sector and inward looking manufacturing. This has meant that Egypt has failed to generate export-led growth of the type necessary to absorb a growing labour force.

This chapter analyses stabilisation and economic reform in Egypt from 1991 to the present and pays particular attention to the role of the IMF and the World Bank in the process.

Reforms prior to ERSAP

Following two decades of state socialism Egypt introduced the ‘Open door policy’ or infitah under President Sadat in 1974. The policy started off with a
timid invitation to foreign capital but proceeded to gradually open up more of the economy to private sector initiative. Many deregulation and liberalisation measures were introduced and steps were taken to encourage the private sector in all areas of activity including production, distribution, finance and foreign trade. A major foundation of the initiative was the Investment Law 1974 and its amendments in 1977 and 1983. At the same time urban clusters were established in the desert regions and efforts were made to upgrade the country’s infrastructure. However, full scale liberalisation was prevented by the need to abort the 1977 IMF agreement following a popular revolt throughout the country triggered by the attempt to remove food subsidies. Following the riots the government cancelled a series of measures including large price hikes and significantly slowed down the pace of liberalisation. The deliberate gradualism meant that this period became an essentially mixed economy mode of development in which the state continued to play a dominant role alongside a growing private sector with many joint ventures established. The government continued to dominate production and distribution and the allocation of inputs as well as running a huge subsidy and employment guarantee system.

The infitah period initially led to considerable growth between 1973 and 1985, in what has been described as ‘an unprecedented boom’ (World Bank 1998a p.1). It is generally acknowledged that capital accumulation was the main driving force behind growth in this period despite the country’s labour abundance (Kheir-El-Din and Moursi 2001 p.34, Abdellatif 2003). By 1988 investment had reached a peak of 34 per cent of GDP. However, capital accumulation was financed more by increasing sources of external rent than by domestic savings accumulation. External rent took the form of aid inflows, migrant workers remittances, Suez Canal revenues, oil exports and earnings from tourism as Egypt increasingly took on the characteristics of an inward looking rentier economy. However, the collapse in oil prices in the early 1980s affected rental income from Arab aid, migrant remittances, Suez revenues and oil exports. Investment fell sharply and growth declined. This exposed the fundamental weaknesses of the Egyptian economy – inefficient investment due to distorted incentives, a huge overburdened and inefficient state sector, and lack of technical dynamism and technical progress in the production process (Steindel and Stiroh 2001) which brought diminishing returns to capital in the latter part of the 1980s (Khier-El-Din and Moursi 2001 Figure 2). By the late 1980s major structural imbalances in the Egyptian economy were hindering growth. These included imbalance between government revenue and spending, between savings and investment, imports and exports and labour demand and supply. By 1986 the government was forced to abandon its policy of guaranteeing state sector jobs to all secondary