

# Short Term Pain – Long Term Gain? Doing Business in Egypt After the Arab Spring

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In the past decade or so Egypt has been portrayed as the poster-child of economic growth in the Middle East. Successive governments followed to the letter the structural adjustment recipes of the International Monetary Fund (IMF) and the World Bank and were widely praised by the international officials. In 2008, an IMF report had the bolded headline: “Egypt: Reforms Trigger Economic Growth.” The report stated “Growth in Egypt has picked up steadily since 2004, making it one of the Middle East’s fastest-growing economies” (Enders, 2008). Egypt’s free-market approach was heralded as excellent for international investors wanting to take advantage of a stable and welcoming climate. The government cut regulations, taxes, and sold government owned industries. What IMF experts and other analysts failed to notice was how uneven Egypt’s economic growth really was. Most of the growth and national wealth became highly concentrated in the hands of a few corporate leaders connected to the Mubarak family while the majority of Egyptians experienced progressively deteriorating economic conditions. As the events of the Arab Spring have demonstrated, this inequality was clearly unsustainable.

After the “Day of Revolt” on January 25th, 2011 – the day that marked the beginning of the Arab Spring – Mubarak and his cronies were not the only ones that were surprised. Their allies in the local, regional, and global business communities were also largely unprepared. Many managers and academics are still speculating about the lasting impact of the Arab Spring in doing business in the region. In this report, we focus on Egypt as a case study for the greater Middle East region. We hope to distinguish and discuss in greater depth the short-term impacts as opposed to the long-term effects of the Arab Spring. Many events that appear destabilizing and disconcerting in the near future might bear fruits for sustainable economic growth in the time to come and vice versa.

## **The Arab Spring and the Aftermath**

February 12, 2011 was not like any other day in Egypt’s history. Mubarak, who was Egypt’s longest serving ruler since Muhammad Ali Pasha, left power and transferred the responsibility to the Supreme Council of the Armed Forces (SCAF). There was nothing in the accepted Egyptian constitution of 1971 that mandates or even permits such takeover. However, most Egyptians were content to see the ailing dictator go and welcomed the generals with open arms. Early on, the SCAF public statements were assuring and the generals repeatedly maintained that they

would transfer power to an elected government within six months. Public protest receded as many Egyptians wanted to go back to normal life. Nevertheless, this honeymoon between the generals and the revolutionaries was short. Many started criticizing the SCAF roadmap to transition and the generals' heavy-handed policies. Massive protests in Tahrir Square became commonplace and violent clashes between the police (civilian and military) and the protesters left behind scores of casualties. The public started to question the intentions and abilities of the generals to lead a smooth transition to civilian rule. While some studies indicate that the levels of domestic violence did not sharply increase, the reporting in national and foreign media intensified, increasing the feeling of insecurity. This had significant negative implications for Egypt's economic outlook.

The first setback to the nation's economy was a precipitous drop in tourism. Egypt's tourism minister announced that the number of visitors to Egypt in 2011 was down 32% (Sharp, 2011, 2013). The difficulty attracting foreign tourists closely resembled the bigger problem of winning back the full faith and confidence of global investors. Financially, foreign investment was weak due to uncertainty about the country's future. The U.S. Export-Import Bank approved \$80 million in insurance coverage to support letters of credit issued by Egyptian financial institutions. The U.S. administration also instructed the Overseas Private Investment Corporation (OPIC) to provide financial support to encourage private sector investment in Egypt (Sharp, 2011, 2013). Additionally, in late 2011 Standard & Poor's downgraded Egypt's sovereign credit rating by one notch to B-plus, due to deterioration in its political and economic profile. The rating cut came after S&P warned that this change was likely if political turmoil placed further pressure on Egypt's net international reserves. In 2011, the rating agency "expect[ed] reserves to continue their downward trend. Net international reserves had fallen steadily to \$22 billion... from \$36 billion at the start of the year," (Falconer, 2011). Pessimists continue to forecast that Egypt's emerging democracy will crumble under the weight of its socioeconomic problems, believing that future governments will be burdened by high debt, a bloated welfare state and military, and a largely uneducated, unproductive workforce (Sharp, 2011, 2013).

These disappointing results call into question the initial hopes and wishes of the revolutionaries. It was originally thought, and widely portrayed by the media, that the revolutionaries had a purely utilitarian motivation - they wanted to maximize the overall good for any and all people affected by the proceedings. However, upon Mubarak's departure the country seemed to be descending into an economic quagmire. Before protests began in January 2011, Egypt was viewed one of the most promising Middle Eastern economies (Enders, 2008; Greenwood, 2011). A liberalization program had pushed annual economic growth to more than 7% in 2007 and 2008. Investments were pouring into the country, which had surprisingly sidestepped much of the fallout of the global financial crisis. However, in the two years following the Arab Spring, Egyptian economic growth has been less than 2% (Bradley, 2011b; The World Factbook, 2013). Clearly the turmoil has had negative effects. The country's inflation rate also rose after the revolution to a high of 11.1% in 2011 and has remained above 10% ever since.

The interim government has also caused turmoil in a country already distrustful of authority. Late in 2011, critics charged that although the ruling SCAF acquiesced to demonstrators' demands, it privileged its own survival over the welfare of the Egyptian population. First of all, the SCAF has repeatedly discouraged efforts to increase budget transparency (Sharp, 2011, 2013). Then the military used brutal force to control sectarian clashes. This ultimately led to the resignation of Finance Minister Hazem al Beblawi who protested the government's handling of the situation. This was one of the first public censures of the government actions (Bradley, 2011a). Very soon after the promise of the Arab Spring it seemed as though the country was

falling back into familiar patterns of poor economic growth, brutal military force and secretive government.

## **The Constitution and Governance of the Second Republic**

The regulatory structure of Egypt since 1952 followed the age-long tradition of centralized authority and gave imperial powers to the presidency. One scholar put it nicely,

*“The Egyptian Constitution gave the president of the Republic a curious mixture of powers. He practically had powers equivalent to those of the prime minister in the British system and to those of the president of the French Fifth Republic” (Mikawy, 1999).*

Other than the widespread dislike of the old oppressive regime, there is still little agreement about the political future of the country. Intellectuals, politicians and activists have different opinions about which system of government will be most suited to achieve the dual objectives of maintaining liberty and ensuring stability. Would Egypt continue to function as a presidential system, maybe something along the lines of the US model? Would it move into a Westminster form of government? Or would it create a semi-presidential system similar to France? In addition, the air in Cairo is thick with political discussions about civil-military relations, the role of Islam in politics, and rights and liberties of citizens and groups. These critical matters and many more are constantly debated in living rooms, coffee shops and on national and international media. Egypt’s new constitution that was passed on December 26th, 2012 will be entrusted with the task of setting the foundation for a modern state. The business community cares mostly about the ability of the new constitutional framework to provide for stability and efficient and effective governance. In the short term most of the focus will be on the reactions to the new constitution. Then attention will be focused on the ability of elected leaders to faithfully apply the constitutional principles to Egypt’s emerging institutional structure.

The issue of the constitution continues to be highly controversial in the country. Currently, people are protesting that the committee in charge of drafting the new constitution is too “Islamist.” The liberal protesters want the committee dissolved because they are “concerned that its Islamist majority is trying to create the basis for an Islamic state” (Fahim & El Sheikh, 2012). The country’s history demonstrates a deep cultural commitment to the importance of Islam in the public sphere. However, people are becoming increasingly comfortable with entertaining a more secular rule of law. There is also a new norm of political activism that has emerged after the revolution that is continuing to influence the emerging nation. There has been constant action in Tahrir Square since the revolution, protesting about issues from the interim government to women’s rights. In October vicious uprisings started in Egypt after a derogatory video about Muhammad appeared online. These protestors were not just motivated by religious sensitivity, however, but their definition of freedom, “the right of a community, whether Muslim, Christian or Jewish, to be free from grave insult to its identity and values” (Kirkpatrick & Ayyad, 2012). The citizens are still conflicted about western values, demanding similar freedoms but appalled by the low level of control on citizens. The country’s Prime Minister stated that they hoped to form a managed democracy that will become a full democracy in years to come (Lyons, 2011). These public and very active debates about freedom, religion, democracy and the marketplace will form the institutional framework for the country for years to come. If the current storm of confusion and instability can be effectively managed, the resulting structures will be much more sustainable than if they were established by decree from an illegitimate and interim presidential custodian.

## **The Economic Policies of the New Regime**

Mohamed Morsi was the representative of the Islamist Freedom and Justice Party when he won the election for Egypt's presidency in the summer of 2012. The newly elected-president and the parliament majority have begun the difficult process of charting new economic policies for the state. The policies of the new government are of great concern to local and global businesses. Mubarak's regime, despite its rampant corruption, was stable, predictable and generally good for business. The policies of the new government are largely unknown and untested and therefore a source of uncertainty for global investors.

The uncertainty about the policy trends of the new regime is unsettling and might have played a role in keeping foreign investment and domestic business from expanding at least in the short term. What is assuring however is the fact that all major parties that make up the new parliament are supportive of the capitalist enterprise. The Freedom and Justice Party of the Muslim Brotherhood, the Noor Party of the Salfi movement, the Free Egyptians Party established by the business tycoon Naguib Sawiris, and the Wafd Party with its liberal heritage are all to the right of the political center in matters regarding the economic nature of the state and the economic role of the government. Their programs differ little from each other or from that of Mubarak's. To calm investors' fears Islamists party's leaders gathered at Cairo Stock Exchange to ring the bell and open the market in December, 26th 2011. Their public comments about Egypt's foreign commitments and the principles of modern markets are also encouraging.

In particular, the electoral program of the Freedom and Justice Party, which has emerged as the largest party in parliament, is significant. The FJP emphasizes the need to tackle the chronic budget deficit, fight unemployment, attract more tourists and foreign investments, increase competition, and enhance the role of small business. The FJP also devotes a special section to fighting corruption and highlights the need for an independent and efficient judiciary, a freedom of information act, and freedom of the press. There is little in the official program that might scare away foreign or domestic business.

Many experts believe that post-revolutionary Egypt will reflect the population's long-standing rejection of unfettered capitalism. The neoliberal economic policies had become synonymous with corruption and the crony capitalism that flourished during the Mubarak era (Sharp, 2011). While this is difficult for many of Egypt's Western allies, this new attitude shows a commitment to the spirit of the revolution and the necessity of change. Revolutionary activists frequently argued that politically well-connected persons often received generous bank financing and reaped the rewards of privatization deals, foreign franchise distribution rights, government contracts, and land deals. Nonetheless, few serious observers believe that Egypt can afford to return to its socialist days. Therefore the main challenge President Morsi and his government face is to disentangle liberalizing reforms from Mubarak-era corruption (Sharp, 2011).

Immediately following the revolution the outlook of the economy appeared bleak, however, many believe that with US and other foreign aid the Egyptian economy is primed for strong growth. The Morsi administration announced that between \$150 million and \$165 million in existing Economic Support Funds (ESF) would be reprogrammed to support, among other things, economic recovery and democracy promotion to support nascent political parties and new elections. In addition, the U.S. Export-Import Bank has approved \$80 million in insurance coverage to support letters of credit issued by Egyptian financial institutions. The U.S. administration also has instructed the Overseas Private Investment Corporation (OPIC) to provide financial support to encourage private sector investment in Egypt (Sharp, 2011). Revolution may have put the brakes on the Egyptian economy for the moment, but analysts

expect it to regain its growth trajectory as soon as political stability returns. The World Bank has predicted growth of around 2% for the last two years. That compares to 5.2% in 2010 and pre-recession levels of 7% or more. But whenever normal business is resumed, Egypt will be in a position to capitalize on its many advantages. These include fast growing ports on the Mediterranean and Red Sea linked by the Suez Canal and its vast untapped natural gas resources. As with other CIVETS countries, Egypt has a large and youthful population of 82 million with a median age of 25. Aberdeen Asset Management sees the large private Egyptian bank NSGB – a subsidiary of Société Générale – as well positioned to take advantage of Egypt's underdeveloped domestic consumption by importing a business model it uses in Eastern Europe. "There is a structural under-penetration of people borrowing money in Egypt" (Greenwood, 2011). Furthermore, Egypt has begun working with Turkey to bolster an alliance that could represent a significant geopolitical shift in the Middle East and in turn help bolster its weakened economy. This would unite two countries with regional ambitions each headed by parties with roots in political Islam. ("Egypt News - Revolution and Aftermath," 2013). Optimists commonly point to Turkey, a Muslim-majority nation with a robust economy ruled by a moderate Islamist party, as a positive and realistically attainable model for Egypt to emulate.

### **Egypt – U.S. Economic Ties**

Egypt and the United States have historically deep economic ties and this hasn't changed as a result of the Arab Spring. Egypt is the 39th-largest trading partner of the United States. The United States is Egypt's largest bilateral trading partner and currently has an annual trade surplus with Egypt amounting to \$4.5 billion in 2010 and \$4.1 billion in 2011. Egypt is one of the largest single markets worldwide for American wheat and corn and is a significant importer of other agricultural commodities, machinery, and equipment. The United States also is the second-largest foreign investor in Egypt, primarily in the oil and gas sector. Since the mid-1990s, Egyptian officials have sought to negotiate a Free Trade Agreement (FTA) with the United States, claiming that an Egyptian-American FTA could significantly boost Egypt's economy. However, due to an array of concerns (human rights, intellectual property, etc.) an Egyptian-American FTA has not moved forward.

In 1996, Congress authorized the creation of Qualified Industrial Zones (QIZ) in order to entitle goods jointly produced by Israel and either Jordan or Egypt to enter the United States duty-free. In December 2004, Egypt finally reached an agreement with Israel to designate several QIZs in Egypt under the mandate of the U.S.-Israeli Free Trade Agreement. Goods produced in Egyptian QIZs allow Egyptian-made products to be exported to the United States duty-free if the products contain at least 10.5% input from Israel. Egypt would like to see this percentage reduced to around 8%, which is the case with the U.S.-Jordanian-Israeli QIZ agreement. Most products exported from Egyptian QIZs are textiles, and products manufactured in QIZs now account for one-third of Egyptian exports to the United States (Sharp, 2011).

President Obama's 2009 speech in Cairo envisioned greater U.S. collaboration with Middle Eastern and Muslim-majority nations. This effort has continued throughout the events of the Arab Spring. The U.S. administration has created several new small-scale initiatives, dubbed the Cairo Initiatives, to promote science, business, and technical cooperation with certain countries in the region, including Egypt. In December 2010, the United States launched the President's Global Innovation through Science and Technology (GIST) program in Alexandria, Egypt. Egypt also is a significant participant in the Administration's Global Entrepreneurship Program (GEP), a USAID-funded program designed to assist entrepreneurs in Muslim communities around the world. Several GEP pilot programs have been launched in Egypt to train entrepreneurs and assist them with access to foreign investment.

In response to the Arab Spring and the need to bolster the Egyptian economy, the President of the United States has also promised to work with Congress to create a U.S.-Egyptian Enterprise Fund to expand trade to the Middle East region. This proposal will expand the Qualified Industrial Zone (QIZ) program that allows goods produced in 13 industrial zones in Egypt to be shipped to the United States duty free (Sharp, 2011). Finally, in 2012 President Obama relieved over \$1 billion dollars of Egyptian debt ("Egypt News - Revolution and Aftermath," 2013).

## Conclusion

In this report, we have focused on examining Egypt's revolution to distinguish and discuss in greater depth the short-term impacts as opposed to the long-term effects of the Arab Spring. Events such as protests, governmental manipulation, etc., that appear destabilizing and disconcerting in the near future might potentially bear fruits for sustainable economic growth. Conversely, if the government and the people cannot reach a stable outcome the uncertainty that persists will overshadow any opportunities that global investors once imagined before the Arab Spring.

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