

## Egypt:

# Structural Reform, Privatization, and the Road to the Cairo Summit

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### Brief Analysis

**T**he Cairo Economic Summit will take place as scheduled. Egypt is preparing for it and anticipating a constructive conference. This conference comes in the context of Egypt's overall structural reform program, initiated twelve years ago, when the government set out "to make Egypt a better place to live." This program is designed to reform Egypt's political, social, and economic environments.

#### Political and Social Concerns

Economic growth requires both physical and human capital and the government realized that these could only be obtained by turning to international markets. To that end, Cairo defined two crucial goals: comprehensive regional peace and excellent bilateral relations between Egypt and all other countries worldwide. Therefore, in the last twelve years, Egypt has been a strong and reliable partner in the peace process and has established and maintained mutually beneficial relations with all but a few countries throughout the world.

Domestically, the government determined that it had to ensure internal stability to attract international capital and prevent domestic capital from leaving. Also, Cairo sought to facilitate domestic participation in the political process that is a prerequisite for growth. In this regard, it focused on three areas: its multi-party political system (Egypt now has twelve parties), the freedom of its press, and the independence of its judiciary.

Socially, the government addressed three major concerns:

- **Population Growth.** In 1984, population growth reached 3 percent. But, with mainly U.S. support, Egypt implemented a successful family planning program, decreasing that growth to 2.2 percent in 1995.
- **Education.** Egypt's illiteracy rate in 1984 was 60 percent; with efforts to expand the reach of its educational resources, education has been made universally available for six year-old children and Egypt currently enjoys the highest student enrollment of any Middle Eastern country 16 million people, more than one quarter of its population.
- **Cultural Heritage.** Recognizing the significance of its cultural heritage, which includes remnants of humanity's greatest scientific and intellectual achievements, Egypt has endeavored to preserve it and make it available to all.

#### The Economy and Privatization

In 1984, Egypt understood that a desire for economic growth demanded a clear, public commitment to transforming its controlled economy into a free market economy. Only a free market economy could achieve faster growth, a more equitable distribution of income, and a more efficient use of resources.

**Infrastructural Development.** The first step (1984-87) to attracting private investors was to rebuild and modernize Egypt's infrastructure. Thanks to these efforts, Egypt currently enjoys excess port capacity (and will offer more ports for private building/operation); has expanded its available use of water resources (due to new dams/canals); has generated a surplus of electricity (which it plans to export, and it is in the process of integrating its electric network with those of Jordan, Syria, Turkey, eventually Europe, and hopefully Israel); has a large surplus of natural gas (and

is in negotiations with Israel to build a pipeline to export this gas); and offers reliable telecommunications (permitting direct access to 210 cities worldwide).

**Macroeconomic Stabilization.** After repairing its infrastructure, Egypt began in 1987, with help from the World Bank and the IMF, to implement a macroeconomic stabilization program to correct economic imbalances, such as a deficit/GDP ratio which reached 27 percent in 1987. The most crucial component of this macroeconomic reform was fiscal reform, and by curbing expenditures on subsidies and introducing new measures to increase revenue, Egypt reduced its deficit ratio to only 1.5 percent last year and hopefully 1.3 percent this year. In addition to fiscal reform, Egypt freed its commodity, capital, and financial markets. In so doing, it pushed interest rates to a positive level which will attract foreign capital, and it stabilized the exchange rate to help control inflation.

**Microeconomic Reform and Privatization.** As part of its structural reform, Egypt also began a four-pronged microeconomic structural adjustment program: privatization, trade liberalization, investment liberalization, and deregulation/civil service reform. Of the four, privatization is the key component. The privatization process is as follows:

- Political and public support. The first step was to ensure a strong political commitment to privatization by seeking public approval by the president, the major political party, and the parliament.
- Dialogue. Then, the government sought through direct dialogue to secure and facilitate participation of interested groups, including labor, the intelligentsia, the media, and the general public.
- Legal licensing. To obviate constitutional challenge, the government obtained clear legal licensing and new laws.
- "Getting the house in order." Finally, the government began to sell its 290 public companies. To determine the order of selling, it classified public companies in four categories: national public enterprises, utilities, financial institutions, and local government enterprises. Egypt first sold national public enterprises (the most successful) and local government enterprises (the easiest to sell).

The procedure for privatization begins with valuation. Valuing a company is a particularly sensitive issue because if set too high, the price signals government insincerity about privatization; if set too low, the price suggests corruption—perhaps a "vested government interest" in a sale. In Egypt, the valuation process took two years for all of the companies.

To prevent an increase in unemployment with privatization, the government decided that market forces should be the arbiter of a company's labor needs but that the government would be committed to protecting any displaced workers. This would be achieved by offering early retirement packages and a retraining program that includes initial "start-up" funds for new small businesses. These programs were financed by the proceeds from the sales of public companies. So far, this effort has proved successful. (In some cases, interested employees have been able to buy their own companies with generous financing agreements.)

At first, market response to offerings of public enterprises was slow but has recently been outstanding. In one and a half years, all local government enterprises were sold, and the government then focused more exclusively on selling national public enterprises. At a rate of one and a half companies per week, the government has sold 90 companies in the last six months, reaping total proceeds of approximately \$2.8 billion. Proceeds have been channeled to compensating unemployed workers, repaying bank debt, and retiring local budget debt. With the "best" companies sold, the government now expects to sell at a slower rate of approximately one company per week. Therefore, the privatization program will continue for at least two more years.

Egypt has gained valuable lessons in privatization through its experience: a) start privatization only after careful evaluation; b) start in the most successful markets with the most successful companies (to send the message that investing is more lucrative than mere saving, to revitalize capital markets, and to signal the seriousness of the intent

to privatize); c) transparency is essential for safeguarding the interests of investors and workers and for instilling confidence in the integrity of the process; and d) strong political support and efficient management are essential.

The Special Policy Forum Report was prepared by Greg Saiontz.

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