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Egypt's Economy: Sisi's Herculean Task

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In July 2014, two months after his election, President Sisi announced a massive cut in subsidies, which accounted for 30 percent of budget expenditures. This radical step will reduce the budget deficit by the equivalent of 2.5 percent of GDP. As a result, the price of octane-95 unleaded gas, mainly used by newer and luxury vehicles, increased by seven percent, while octane-80, used by public and private buses and microbuses that serve a much wider public, rose by 78 percent. Natural gas, the main fuel for taxis, rose by 175 percent and the price of gas for domestic use rose by 350 percent. The prime minister, Ibrahim Mehleb, has said that subsidy cuts will save 50 billion pounds (or $7 billion) annually. The budget for the current fiscal year (1 July 2014 - 30 June 2015) drastically reduced social welfare subsidies that target the poor. Subsidies for medicines and baby milk were cut by 55 percent, while subsidies marked for housing for low-income families were cut by 50 percent, and subsidies for health insurance were ended. The budget for the army, judiciary, and constitutional court were increased by 28 percent.

Subsidized bakeries, on which many citizens rely, have increased the price of a single piece of bread from five Egyptian pence to 35 pence, a seven-fold jump. As a result, the price of a poor person's cheapest meal rose from 50 Egyptian pence ($0.07) to two pounds ($0.28). Fruit and vegetable prices have shot up: before the coup, mangoes were two Egyptian pounds per kilogram ($0.28) and by October 2014 they were 14 to 16 pounds per kilogram ($1.96-$2.24), while the price of tomatoes rose from 75 pence ($0.10) to 6-8 Egyptian pounds ($0.84-$1.12).

The price of electricity has risen sharply, while the electricity supply has been cut from six to four hours daily. There are already regular blackouts in Cairo and other parts of the country because of a shortage of electricity, and industry is operating at about 60-70 percent capacity as a result, adding to the problems of unemployment and shortages of vital commodities, such as cement. The issue is not a shortage of generating capacity, but the country's inability to import the raw materials necessary to produce power. Egypt already relies on cheap oil and gas from its Gulf allies and has not been able to finance all the extra supplies needed.

In order to reduce leakages to the black market and present consumers with a wider array of subsidized food options, the government is introducing a new system of wheat distribution. Those with a monthly income less than E£1,500 (about $210) will be able to register for it.

As a result of the subsidy cuts and tax increases, inflation has accelerated. In July 2014 the consumer price index for urban areas rose by 3.5 percent, compared with an average monthly increase of 0.5 percent, while the index for food prices rose even faster.

Other announcements were designed to increase the level of economic activity, raise morale, and improve the government's standing as it faces huge economic and security challenges. In September, President Sisi announced plans to build a parallel channel to the Suez Canal at a cost of $8 billion. The canal, which allows ships to travel from Europe to Asia without having to pass southern Africa, only provides one-way traffic, with occasional room for ships to pass each other. The new 45-mile channel would allow ships to travel in both directions for just under half of the canal's 101 miles. Some sections of the existing canal will be widened and deepened, and car and rail tunnels will be dug underneath. The president has ordered that the project's original three-year construction be reduced to one year in order to demonstrate political strength.

To help finance the canal's expansion, state-owned banks will issue investment certificates open only to Egyptians for E£60 billion ($8.4bn). The project should eventually increase Suez Canal revenue by 260 percent: in 2012-2013 Suez Canal tolls brought in $5 billion a year.

Domestic and foreign investors will be invited to participate in the second phase after a master plan has been completed in approximately eight months. Since the official launch of the project in August 2014, some 50 companies supervised by army engineers have been reported to have started digging the parallel channel.

The subsidy cuts and tax increases have impressed international capital markets for two reasons. First, they were much more radical, or harsh, than had been expected. Second, they were met with little if any resistance. Egypt has lived in the shadow of the riots that accompanied President Anwar Sadat's decision to end subsidies on flour, rice, and cooking oil in January 1977. The decision led to riots throughout Egypt, and as many as seventy-nine people were killed and over 550 injured in the protests that only ended with the deployment of the army and the re-institution of the subsidies.

As a result of the current subsidy cuts and tax increases, in October 2014, Moody's Investors Service changed its assessment of Egypt's outlook from negative to stable and affirmed its low (Caa1) government bond rating. The reasons given for the change in outlook were the stabilized political and security situation, the launch of fiscal consolidation, signs of a growth recovery and an improvement in macroeconomic stability, and strong support from external donors. However, Egypt's Caa1 government bond rating remains affected by high fiscal deficits and government debt, very large fiscal borrowing needs, and continued challenges hindering the recovery of economic growth in the post-revolutionary political and economic environment.

Another serious problem that President Sisi has promised to tackle is the shortage of agricultural land and water. Egypt depends on water from the Nile, but relies on agreements dating back to colonial days that limit use of the river's water by most of the countries through which it flows. Those countries are no longer willing to accept these limitations and are claiming more water for themselves. This is a threat to Egypt, which already suffers from a water shortage and the situation could get worse over the next few years.

Sisi has announced a plan to reclaim and cultivate an additional 4 million acres of agricultural land, despite the country's dwindling water supply from the Nile, estimated at 55 billion cubic meters yearly.

The Nile Basin Initiative (NBI) was launched in February 1999 by the nine countries that share the river: Egypt, Sudan, Ethiopia, Uganda, Kenya, Tanzania, Burundi, Rwanda, the Democratic Republic of Congo (DRC), with Eritrea as an observer. NBI is a partnership among the Nile riparian states to develop the river in a cooperative manner, share socio-economic benefits, and promote regional peace and security. In May 2010, five upstream states signed a Cooperative Framework Agreement to seek more water from the River Nile — a move strongly opposed by Egypt and Sudan. Ethiopia, Kenya, Uganda, Rwanda and Tanzania were original signatories and Burundi joined at the signing in February 2011.

Egypt and Sudan are threatened by the initiative in that they would lose their share of the Nile's water supply set by previous agreements. As Egypt's share of the Nile's waters is not large enough to meet its needs, Sisi has ordered the government to search for alternative water sources for his proposed ambitious agricultural cultivation project. This may involve using groundwater, processing agricultural wastewater and reusing it, or industrial desalination of sea-water. The Ministry of Water Resources and Irrigation declared that it would be possible to provide the needs of the first phase of the cultivation project, which will be implemented during the first year of Sisi's mandate, and covers an area of 1 million acres, including the controversial Toshka project begun under Mubarak in southwest Egypt. This will be accomplished by drilling wells to extract groundwater.

These plans to extract groundwater are taking place despite evidence suggesting that the sources of groundwater are nonrenewable, leading to a wave of objections from water experts. Opponents have stated that there is no groundwater reservoir in Egypt capable of catering to the needs of a project this size. Relying on groundwater to conduct the project would drain its limited supply and will harm the quality of water in the aquifers. Previous governments have already made the same mistake in projects such as Toshka.

The shortages of agricultural land and water should be viewed alongside Egypt's demographic crisis. Egypt is now suffering from the effects of the acceleration of population growth that occurred during recent years. The number of births in 2013, at 2.6 million, was 15 percent higher than in 2010 and almost 50 percent higher than it had been ten years earlier. Population policies, that had been relatively successful during the 1980s and 1990s, started to weaken during the last years of Hosni Mubarak's government – and were neglected in the chaos that followed his removal in 2011. And after the Islamist Mohamed Morsi was elected president in 2012, negligence became official policy and his administration publicly declared that population control was not a government concern.

According to the demographers Mona Amer and Philippe Fargues, when child and infant mortality declines there is often a lag before fertility declines. As a result, the early stages of demographic transition are characterized by rapid population growth that eventually slows as fertility declines. In Egypt, this process led to a demographic phenomenon known as the "youth bulge," a period characterized by the rapid rise and then eventual decline of the share of youth in the population.

In 1988 the peak of the bulge was among the 0-4 year-olds, who survived at increasing rates because of medical advances that lowered mortality rates in early childhood. By 1998, the peak of the youth bulge was centered around 10-14 years of age. Because the decline in fertility caught up with declines in mortality, in 1998 there were fewer 5-9 year olds than 10-14 year olds. At the same time the leading edge of the youth bulge, the 15-19 age group, entered the labor force, which accelerated growth of the labor supply. By 2006 the peak of the youth bulge was centered among the 15-24 age group and continued to exert substantial pressure on the labor market. By 2012, the peak of the youth bulge was in the 25-29 age range.

By then the youth bulge had been integrated into the labor market. Following the youth bulge was a "trough," especially among those 15-19 years old in 2012, a group which was substantially smaller than the preceding youth bulge cohorts. The relatively smaller size of this group is currently exerting less pressure on the labor market and education systems than was the case earlier. Besides being integrated into the labor market, the youth bulge generation is now taking on parenthood. This is apparent in the "echo" of the youth bulge, which had already begun in 2006 when the leading edge of the youth bulge became parents. As of 2012, the echo had grown substantially, with a cohort of 0-9 year-olds that was much larger than the cohorts of 10-19 year-olds that preceded them. The echo of the youth bulge is the result of several demographic forces, including the unprecedented number of mothers of prime childbearing age, but also *rising fertility rates* among these mothers. The number of children, especially young children, is unprecedented. The generation that formed the peak of the youth bulge, those who were 25-29 in 2012, was about 8 million. In contrast, there are more than 9 million 5-9 year olds and more than 11 million 0-4 year olds as of 2012.

The increase in births has yet to level off, and all signs indicate that even greater numbers of children will be born, at least for the next several years. The 2.1 million children born in 2008 are now, in 2014, turning six and are entering primary school. These already represent an unprecedented number of primary school entrants, with more to follow. The 2.6 million children born in 2013, five years later, will represent a 28 percent increase in the number of potential primary school entrants, assuming enrollment rates do not increase further. In addition, starting within a decade, there will be an unprecedented number of labor market entrants. Egypt needs to be ready for these new workers, and to take advantage of the temporary lull of slower growth in the current labor supply to reform the labor market.

As a result of these demographic trends, between 600,000 and 800,000 young people are entering the labor market a year. Between 2010 and 2013 the rate of unemployment rose from 9 percent to 13.2 percent. In 2010 there were 2.4 million unemployed, and in 2013 3.6 million were unemployed. In 2013, 31 percent of the unemployed were university graduates while only 10 percent were illiterates. The rate of unemployment has risen and demand for better educated workers remained lower than demand for less well or uneducated workers.

The unemployment rate does not reflect changes in job quality, job security, and labor force participation. All jobs are not created equal; as in other lower middle-income countries, many Egyptian workers are informally or irregularly employed.

Distinguishing formal employment from these potentially lower quality jobs provides a more nuanced view of the vitality of the Egyptian job market. The official unemployment rate also masks the degree to which unemployment is concentrated among two vulnerable groups, youth and women.

The fiscal measures have been announced while the government is fighting terrorism in Sinai and elsewhere in Egypt on an unprecedented scale. The President's decision to cut subsidies is a significant indication of his determination to improve Egypt's very tough economic conditions. Sisi has strong support from the Gulf Arab states that have given Egypt billions of dollars since he took power. Whether he can galvanize the bureaucracy and push the economy onto a growth path and change demographic trends remains to be seen.

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