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EGYPT'S NEW IMF AGREEMENT IN HISTORICAL PERSPECTIVE

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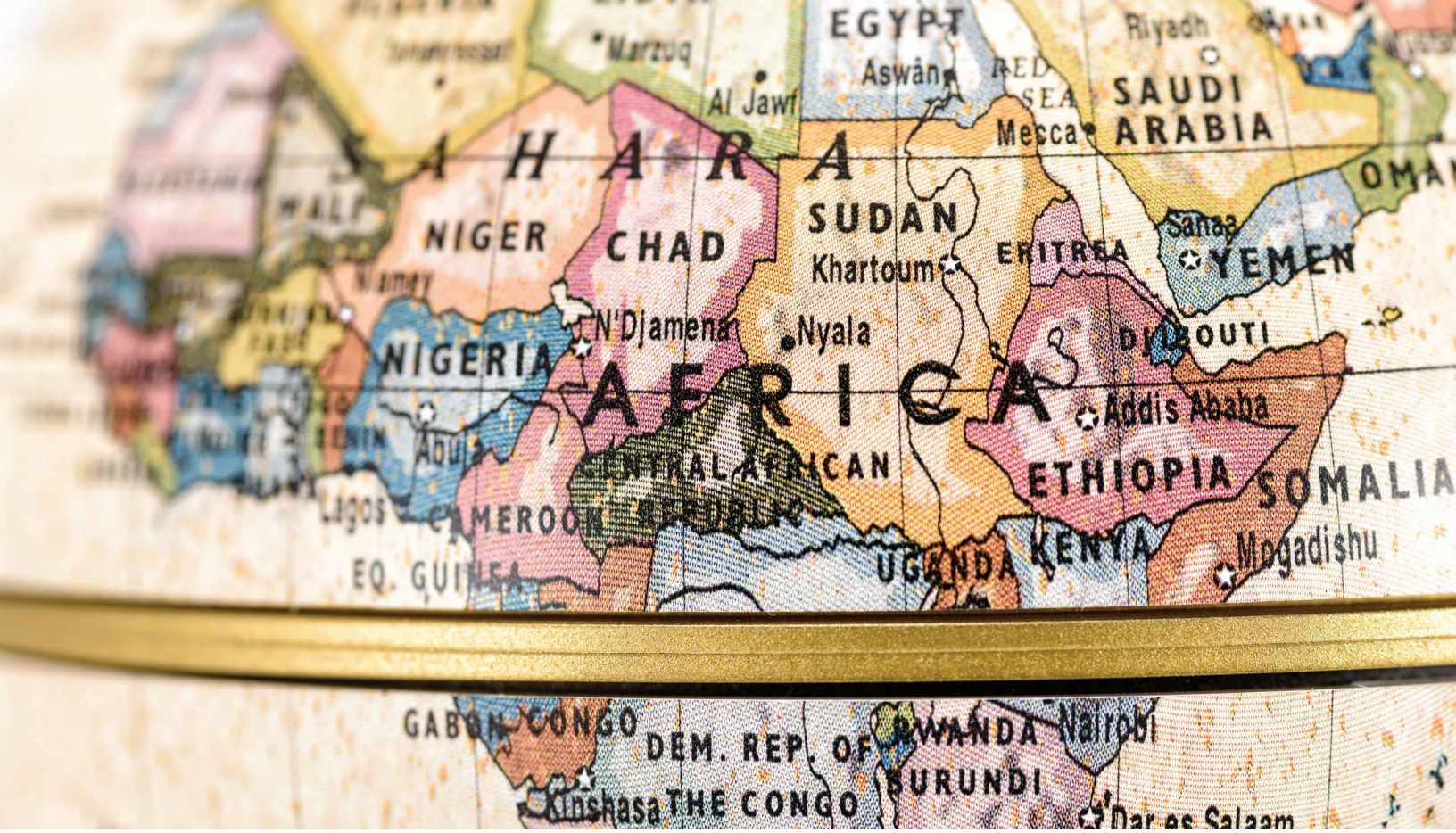

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1.0 Introduction

AS THE AUTUMN OF 2016 BEGINS, Egyptian President Abdel Fattah el Sisi can finally breathe a sigh of relief. A dangerous balance of payments crisis was averted at the 11th hour. In August 2016, Sisi reached a three-year agreement – which provides Egypt with a $12 billion loan – with IMF. The IMF deal paves the way for $2 billion to $3 billion in Eurobond loans. Egypt also has access to a $3 billion World Bank loan and a $1 billion loan from the African Development Bank. On the bilateral front, Saudi Arabia has agreed to provide a $12 billion aid package to Egypt.

But earlier in the summer, Sisi was battling a full-blown financial meltdown. Egypt's financial reserves fell to a dangerously low three-month import cover for essential food and energy. After depleting its financial reserves to prop up an overvalued pound, the central bank was forced to devalue its foreign exchange rate over 12% in March of 2016. In addition, Egypt was near cash flow insolvency and default. That means it was at risk of not meeting financial obligations in numerous areas. For instance, its current account deficit hit a record high of almost 7% of GDP. To put this in perspective, Mexico and Thailand had current account deficits that hit 8% of GDP before their financial meltdowns. Its budget deficit and overall debt were also dangerously high. It was running a budget deficit of 12% of GDP and its overall debt of over 100% of GDP. The EU Maastricht criteria say budget deficits over 3% of GDP and debt over 60% of GDP are financially unstable. To make matters worse, inflation – the cruelest tax of all to the working poor – was 14% and unemployment was also high at about 13% of the population. And 45% of Egyptians were still living on less than two dollars a day.

Why the economic and financial mess? For starters, it's important to keep in mind that economics and security are a seamless web. This is particularly true when it comes to economics and terrorism. Two cases in point. After EgyptAir flight 804 from Paris to Cairo plunged into the Mediterranean Sea back in May 2016, tourism in Egypt collapsed to its lowest level in a decade, thus worsening the shortfall of foreign currency in the country. Then in October 2015, a Russian Metrojet exploded over the Sinai after taking off from Sharm el-Shiekh, killing 224 people. That helped to scare off Russian visitors, Egypt's largest source of tourists. No wonder the economy struggled, when the contribution of travel and tourism to employment in Egypt (10.5% of Egypt's employment in 2015) collapsed.

That said, the problems facing Sisi are not new. For 10 years, Egypt has historically struggled to synchronize the three legs of the shared prosperity – strong growth, an inclusive society and financial stability. For a while, Sisi could rely on foreign aid to fill financial gaps. In the wake of Sisi's late May 2014 victory in the presidential election, the UAE and Saudi Arabia announced $20 billion in new aid for Egypt. The money temporarily beefed up financial stability in Egypt.

But the challenge for Egypt for the past 10 years has been to synchronize all three legs of shared prosperity. However, this synchronization requires the kind of economic transformation that is far from easy.

For the past decade (2004-2014) Egypt's economy has been on a roller coaster ride. The financial reforms which President Mubarak began in 2004 started to bear fruit in 2006, with three years of GDP growth of 7% – the fastest GDP growth in two decades. Then came 2008 and food prices soared early in the year. That triggered widespread public discontent and even a few violent riots.

GLOBAL FINANCIAL CRISIS. Then the global financial crisis hit, threatening gains from reforms. Optimism faded about making a dent in pervasive poverty. The good news was that Egypt was in a strong financial position going into the economic slowdown.

REFORMS CUSHION BLOWS. Mubarak's financial reforms helped to cushion the negative impact of the global financial crisis. Its responsible regulatory framework and financial discipline kept over-borrowing to a minimum. So there was little exposure to the bad mortgages or bad private loans that decimated US and European banks. Most importantly, Egypt did not experience a liquidity crisis.

PUBLIC INVESTMENT. That meant Egypt could mobilize this liquidity to improve the investment climate and reduce industry costs. For instance, the government spent $2.75 billion on an infrastructure-based stimulus package made up mostly of water, sanitation, road and transport projects.

Weak Demand. Unfortunately, Egypt's business friendly financial reforms could not protect it from the negative macroeconomic shock from the global financial crisis. Global demand was now much weaker for Egypt's key economic drivers – tourism, remittances, Suez Canal revenues, foreign direct investment (FDI) and Egyptian exports.

NO SOCIAL INCLUSION. The economic growth that did exist under Mubarak also lacked social inclusion. The fruits of strong economic growth failed to trickle down enough to poor and middle class Egyptians. Poverty and unemployment was way too high. The frustration of the Egyptian masses with Mubarak's "crony capitalism" finally boiled over into the streets. Mubarak was ousted as part of "Arab Spring." The violence of the Arab Spring caused tourism to plummet. The demonstrations in Tahrir Square and the increasing crime directed against tourists also caused investment to dry up.

MORSI WORSENS ECONOMY. The economy was ailing when President Morsi came to power in July 2012. But Morsi's inability to create a sound economy caused the economy to worsen even more. During the three-year period after the fall of Mubarak in 2011, GDP growth fell from nearly 6% to under 2%. This economic slowdown weakened tax revenue and the budget deficit more than doubled to 14% of GDP. Egypt's national debt rose to over 100% of GDP. On the social front, unemployment rose from 9% to over 13%. The poor/near poor rose from 40% to 50% of the population.

CURRENCY WEAKENS. On the international financial front, the Egyptian pound fell 6% from 2011 to the end of December 2013, a low against the U.S. dollar not seen since 2004. In spite of an emergency loan from Qatar, the pound continued to weaken. Not surprisingly, Standard and Poor's downgraded Egypt's credit rating, thus bringing Egypt's standing to the same level as Greece.

REMITTANCES FALL. Despite the fact that the transfer of funds from Egyptians abroad back home was unreliable, Egypt was forced to depend on remittances to offset trade imbalances. That's because Egypt imported twice as much as it exported. Unfortunately, remittances also fell sharply in 2009 due to economic troubles in the US and Europe as a result of the global financial crisis.

FINANCIAL BRINK. Morsi's central bank faced a no-win dilemma.

- It could allow the pound to fall to conserve dwindling foreign reserves. But a weaker pound would raise the cost of imports and add to the inflation rate. More government subsidies would be required to keep food prices from rising. That would increase the budget deficit and the national debt.
- Instead, the central bank opted to defend the value of the pound (by selling foreign reserves and buying pounds). Half the foreign reserves were consumed in what proved to be a futile effort to defend it. Foreign exchange reserves fell from $35 billion to just under $15 billion (the bare minimum for three months of import cover) by July 2013.

MILITARY COUP & GCC AID. Egypt's military responded to Morsi's economic incompetence and street protests with a military coup against Morsi and the Moslem Brotherhood in July 2014. Saudi Arabia, the UAE and Kuwait all responded favorably. The Gulf States initially committed about $12 billion in cash, interest free loans, oil and oil products. The speed with which Gulf States announced their financial aid – less than a week after Morsi was overthrown – was as important to financial markets as their size.

UAE ECONOMIC LEADERSHIP. In terms of GCC economic leadership, UAE took the lead.

- The first round of almost $4 billion in UAE aid was used to protect the Egyptian currency and keep the economy from collapsing. Egypt's foreign reserve burn rate was much slower than before, with the October 2012 drop coming in at just $120 million, compared to around $1 billion per month earlier in 2012 when Morsi was still president.
- The second round of almost $3 billion in UAE aid came in February 2014, less than six months after the first round. The goal was for Egypt to use the $ 3 billion as a fiscal stimulus to boost the underlying economy. Instead of a strict IMF-style conditionality, the UAE started working closely with Cairo's interim government to guide development efforts and make the investment climate more attractive for foreigners.

EGYPTIAN ECONOMIC EXPERTISE. GCC aid also bought Sisi time to attract four outstanding Egyptian economists to head the interim government – Hazem El Beblawi, a former finance minister as prime minister; Ziad Bahaa Eldin, a liberal former financial regulator as deputy premier; Ahmed Galal, managing director of the Economic Research Forum, as minister of finance; and Osama Saleh as investment minister.

SOCIAL INCLUSION. Sisi and his economic strategists also had long term plans to create the inclusive society leg of shared prosperity. These plans included:

- A Suez Canal special economic zone
- An integrated development of East Port Said
- Open prospects for new development outside the Nile Valley and Delta

SINAI RESETTLEMENT. Sisi and his economic brains trust also planned a resettlement of nearly 1.5 million Egyptians in Sinai and the implementation of the integrated development strategy of Sinai across the tourism, urban, service, agricultural and industrial sectors of the economy. They also estimated that it would create more than half a million new jobs.

MARKET-FRIENDLY REACTIONS. Markets and the private sector reacted positively:

- The Egyptian stock market – which is a leading indicator of the economy 6-18 months down the road, showed a sharp jump since July/August of 2013 and hit its highest level since January 2011.
- Standard and Poor's upgraded Egypt's risk rating for the first time since the 2011 revolution.

- Egypt's purchasing managers' index (PMI), which tracks monthly changes in local business conditions, showed business recovery outweighing contraction for the first time in nearly three years.
- For instance, the construction and manufacturing sectors of the economy, which dropped like a rock in 2011, started to expand at pre-revolution rates. In short, business confidence was up.

IMPROVING SHARED PROSPERITY. Based on the assessment above, it's clear that Sisi made every effort to work closely with the UAE to optimize the social inclusion leg of the shared prosperity trinity. It's also clear that the markets and the private sector responded favorably to the military coup against Morsi as well as the election of Sisi as president. That promised to strengthen the 2nd leg of shared prosperity: GDP growth. The interim government expected GDP growth between 3% to 3.75% in 2015 and around 2% in 2014. GDP growth rates promised to increase to 5% to 6% in three years.

FINANCIAL STABILITY? But was there enough capital to create the financial stability leg of shared prosperity? Would Egypt have enough foreign reserves to offset its trade imbalance? Would it be enough to reduce Egypt's fiscal balance to a safer level? Would this money also jumpstart Egypt's economic development plans?

ROBUST UAE-SAUDI AID. Initially, the answer appeared to be yes across the board. The UAE and Saudi Arabia are committed to $20 billion in new money for Egypt. First and most importantly, the $20 billion aid package included deposits in the central bank to boost foreign reserves and support the Egyptian pound, which has lately suffered a drop against the US dollar. The aid package will also include low-interest loans; investments in water and sanitation projects; schools; financing of projects for low-income citizens and the poor; establishment of a Saudi-funded residential city in El Alamein; financing the creation of silos for storing grain and fulfilling the needs of Egypt's petroleum products (particularly gas and diesel).

BUYS TIME. At a minimum, this UAE/Saudi aid package beefed up the financial stability leg of the shared prosperity trinity for the next year. However, this money was arguably still stop-gap in nature. If so, what was Sisi trying to do to make Egypt more self- reliant? Sisi arguably needed to bite the bullet and get serious about generating more tax revenue and importing less energy by slashing energy subsidies.

ECONOMIC RESTRUCTURING. At first, Cairo appeared to be getting serious on both taxes and energy subsidies. On the eve of the late May 2014 election, Finance Minister Hany Kadry Dimian announced that the interim government was planning to restructure the economy.

- Cairo planned to expand the value-added tax (VAT) to include a broader swath of the sectors, instead of just manufacturing and slash energy subsidies. These two tax hikes actions promised to reduce the government's budget deficit by 2% of GDP in 2015 from its current level around 12% of GDP.
- On the corporate front, Cairo planned to roll out a 1 billion-Egyptian-pound ($143.3 million) stimulus package over 18 months to subsidize a restructuring of the telecommunications, manufacturing and tourism industries, through lower borrowing rates.
- Taken together, this economic restructuring promised to curb financial turmoil, reassure international investors and spur strong enough growth to ease dangerously high unemployment.

2.0 Global Investment Conference

FAST FORWARD TO MARCH OF 2015. At a 13-15 March 2015 landmark economic event in the Egyptian resort city of Sharm Elshiekh, Egyptian President Sisi walked into a global arena and spoke to investors from all over the world. He told them how bad the political instability and economic turmoil were that he inherited. He told them he restored political stability and turned Egypt's economy around. He also told them about the financial opportunities which would await them if they invested $35 billion in mega-projects in the Arab world's most populous country. And then the ball moved to the investors' court. Would Sisi inspire a vote of confidence from foreign investors and jumpstart investment flows?

POSITIVE SIGNALS. At first, the signals appeared positive. For instance, bidding wars by European and regional groups for two food companies (Bisco Misr and Arab Dairy) appeared to be strong signals that foreign investors were interested in returning to a 90 million strong market after four years of political instability and economic turmoil. However, food was not the only foreign economic sector which "jumped the gun" and started to return to the Egyptian market before the economic conference even started.

- In December, BP announced plans to invest $12 billion in Egypt over the next five years, doubling gas supply for the domestic market.
- In January, Nestlé announced plans to invest $138 million to create a manufacturing base for new products in its nutrition and health businesses.
- That same month, Kellogg's acquired a majority stake in Cairo-based Bisco Misr, a brand-name domestic baking company.
- Industry insiders thought this move signaled Kellogg's plans to grow its North African snack business, joining a raft of consumer-goods firms investing in Egypt the previous year, including Coca-Cola, PepsiCo and Saudi Arabia's Almarai.

WHY WERE THESE FOREIGN INVESTORS PLANNING TO RETURN TO EGYPT? For starters, they credited Sisi with restoring relative political stability despite a low-level armed Islamist rebellion in the Sinai and clashes between police and Muslim Brotherhood supporters. But actually, the hesitancy to invest in Egypt was less about political stability and more about such problems as shortages of foreign currency, which hampered the repatriation of profits, stifling bureaucratic regulations or uncertainty over taxes.

In any event, Sisi and his team took bold actions to improve the business climate. For instance:

- The cabinet approved a new investment law in an effort to address some of the issues ahead of the economic conference. Changes included simplifying the process for obtaining permits and making deals less vulnerable to legal disputes by third parties.
- Energy shortages, another concern for investors, were being addressed by moves to import natural gas and permit the use of coal in electricity generation and manufacturing. The government also established a legal framework for investment in renewables.
- Other confidence building measures included slashing energy subsidies by a third and devaluing the Egyptian pound, which fell 5% against the US dollar. That promised to help investors planning to use Egypt as a platform for exports.

Ashraf Salman, Egypt's Investment Minister, argued that these kinds of initiatives helped Egypt expand its potential GDP. The massive infrastructure projects, such as the expansion of the Suez Canal, were designed to double daily capacity in the strategic waterway. And the launch of an associated industrial and logistics hub promised economic growth in the wider canal-zone. By creating an environment for the growth of small- and medium-size enterprises (SMEs), these projects would help attract more FDI.

In addition, Egypt worked with the UAE to develop a new economic development model. How was it different from the typical economic development models of the past and why was it attractive to investors? Emerging-market growth was often driven by the extraction of primary resources such as oil or by making low-cost products for developed markets. Both models had their pitfalls:

- Oil-based growth often crowded out other industries and precluded the development of indigenous expertise.
- Export-driven growth without the development of a domestic consumer market created a dependence on the economic cycles of export markets.

The Egyptian government was aiming for a middle path that maximized Egypt's natural resources and encouraged export industries while retaining and building on the country's robust consumer market. As a result, the economic model was more inclusive and sustainable. Foreign investors began to recognize this diversity and placed their money behind this multi-industry model.

SOCIO-ECONOMIC VULNERABILITIES. Of course, this economic turnaround did not happen overnight. When Sisi first started planning the economic conference in Sharm Elshiekh, the Egyptian economy was struggling to dig itself out of a deep hole. GDP growth was falling.

- The GDP downturn plus wasteful spending caused the budget deficit to more than double to 14% of GDP, over four times the 3% Maastricht trigger for financial turmoil.
- Similarly, Egypt's public debt rose to over 100% of GDP, far higher than the 60% Maastricht trigger for financial turmoil.

On the social front, unemployment rate rose from 9% to over 13% in 2013/2014. Over a quarter of the population was now living in poverty. The poor/near poor group rose from 40% to 50% of the population.

Rapid population growth had the potential to outrace economic gains. And for those with jobs, their standard of living continued to deteriorate. Reminiscent of the Arab Spring, ordinary Egyptians were frustrated with a lack of opportunity and little social mobility. And if they wanted clean water, that was increasingly scarce as well.

ECONOMIC CONSTRAINTS. Why wasn't the Egyptian economy performing better? Actually, Egypt's GDP growth was relatively buoyant during 2004–10 (5½ % annually on average). However, this growth failed to produce enough jobs to absorb the young and growing Egyptian population and to ensure social inclusion that contributed to Arab Spring. The most binding constraints to growth and job creation in Egypt were macroeconomic risks, microeconomic distortions, weak productivity, inadequate access to finance, and weak external competitiveness.

Macroeconomic risks reflected in fiscal and external vulnerabilities which affected confidence and investment. Microeconomic distortions stemmed from still high subsidies, inefficient labor markets, weak governance, perceived corruption, and constraints to doing business. Productivity was weak because of low human capital, as evidenced by poor health and education indicators, and poor infrastructure— especially roads and electricity. An over-borrowed public sector crowded out private sector access to finance. The external sector of the economy was uncompetitive due to an over-valued exchange rate and an unattractive business climate.

POLITICAL STABILITY. Had President Sisi held this economic conference in Sharm Elshiekh shortly after he was elected President in June 2014, chances are this struggling economy would have scared off potential investors. But President Sisi had this conference in March of 2015. And in the eight months immediately after his election, a lot happened. While a spate of bombings on the eve of the conference reminded us that there were still

social and political tensions in Egyptian society, the restoration in Egypt of relative political stability gave Sisi an opportunity to address longstanding economic challenges.

MORE REVENUE. Unlike his predecessor, Sisi seized this opportunity and showed he was serious about reducing over-borrowing in the government. Sisi took bold actions to actually implement economic reforms. Right off the bat (in July 2014) he pushed through politically risky cuts in fuel subsidies (by raising fuel prices 40-80%). He zeroed out cotton subsidies. He increased subsidized fertilizer prices by a third. In addition, he opted for sin taxes, hiking taxes on alcohol and increasing tobacco taxes three times in 2014. He also came up with a new capital gains tax, property taxes and new income taxes on high earning individuals and corporations. These bold actions promised to yield savings of 2½ % of GDP.

In addition, Sisi's Finance Ministry plans to roll out a new VAT this spring. The VAT, the sale of a telecom license, and the adoption of a new mining law promised to yield revenue worth 1% of GDP. Sisi planned to keep this up for five years in order to reduce the budget deficit from 12% of GDP to 8% and the public debt from 95% of GDP to 80-85%.

FISCAL STIMULUS. Armed with this new revenue, Sisi started to fill the gap in aggregate demand with two fiscal stimulus packages. He boosted spending on infrastructure and social spending by almost 2% of GDP. To attract and retain good civil servants, Sisi increased the minimum wage for government workers by 70%. To foster a healthy, well-educated workforce, Sisi raised the wages of teachers and doctors. To improve social conditions and make sure his new economy was inclusive, Sisi boosted spending for low income housing and public transport.

HEALTHY BANKS. The good news is that Egypt's commercial banks were financially stable even during the global financial crisis. The banks continued to be resilient in the Sisi era. Building on financial reforms dating back to the Mubarak era, the profitability of Egyptian banks continued to improve and non-performing loans were in decline, while provisioning coverage reached 98%. The central bank did regular stress tests that indicated that plausible losses could be absorbed by the profits and capital buffers of Egypt's financially sound commercial banking system.

STRUCTURAL REFORMS. Of course, investors stayed away from Egypt until it started to become more business friendly. What kept foreign investors away from Egypt in the past?

- Egypt ranked 112 out of 189 in the World Bank's 2014 Doing Business Survey, because of considerable red tape, cumbersome regulations and poor enforcement of contracts.
- Egypt ranked 119 out of 144 in the World Economic Forum 2014-2015 Global Competitiveness Index due to an over-borrowed macroeconomic environment and particularly poor scores on labor and goods market efficiency, financial market development and education. It also received poor marks for poor transportation infrastructure, traffic congestion, distribution bottlenecks and electricity, fuel and water shortages.

Sisi did his best to persuade investors that this dismal business environment was actually improving. He got off to a good start. For instance, Sisi's team settled a number of disputes with local and foreign investors and are advancing toward further settlements. Case in point: Egypt repaid $3.5 billion in amounts due to foreign oil companies since July 2014. That in turn led to new energy investments.

But Egypt has a long way to go to change its low Doing Business and Competitiveness rankings cited above. For instance, while the banking system is

financially sound, it could be a lot more innovative for the private sector. Toward that end, Sisi is trying to enhance financial inclusion and improve the business climate. A new microfinance law and plans to develop mobile banking promised to enhance access to financial services.

In addition, Sisi tried to get rid of red tape. Efforts were underway to remove regulatory and bureaucratic obstacles that stand in the way of domestic and foreign investors. Sisi's team also promised to remove legal hurdles facing private contracts with the government.

Sisi's economists and lawyers were also working on reforms of the regulatory framework to foster private sector-led growth. They amended the competition law and prepared major revisions to the investment, bankruptcy, and corporate laws and regulations, as well as those pertaining to access to land. Sisi's team also promised to remove burdensome regulations, level the playing field for all businesses, support small and medium sized enterprises (SMEs), and reduce corruption. In most cases, legislation was not been finalized, and it would be important that the legislature not water down the proposed reforms. But one thing was certain. Sisi was business friendly and focusing on the right issues.

INTERNATIONAL ECONOMIC CHALLENGES. On the international financial front, Sisi inherited a mess that did not lend itself to a quick fix. Egypt's economy suffered from capital outflows, weak FDI, and a rising deficit in its current account. The political instability in the Morsi era caused tourism to drop 50%, which in turn caused Egypt's current account deficit to rise to a disturbingly high 5% of GDP. At the same time, net FDI in the net capital account was flat.

The Egyptian central bank sold large amounts of foreign reserves in an attempt to stabilize Egypt's foreign exchange rate. Foreign reserves fell from $35 billion or almost seven months of import cover at the end of 2010 to $14.5 billion or just 2.5 months of import cover by the end of 2014. Fortunately, Egypt's external financing gaps were covered by $20 billion in Gulf aid. But that kind of GCC largess was not likely to happen every year, especially with low oil prices hurting the GCC bottom line.

WHY WAS THIS HAPPENING? If we compare Egypt's inflation rates to its trading partners, we discover that Egypt's inflation rate was persistently higher than its trading partners. This high inflation differential hurt Egypt's export competitiveness. The other thing which hurt its export competitiveness was its foreign exchange rate. Its current real effective exchange rate (REER) was almost 30 % above its average for the past 10 years. The combination of Egypt's high inflation differential and its overvalued exchange rate priced Egypt out of far too many markets. In fact, Egypt's non-oil exports fell 40% between 2008/09 and 2013/14. That caused imports to be much higher than exports. While oil and gas exports still represented 50% of total exports, low oil prices hurt Egypt's export prices.

WEAK CAPITAL ACCOUNT. Given Egypt's dismal current account picture, all eyes are on Egypt's capital account, which measures net capital flows from investments. FDI was especially low – less than 1.5% of GDP. In addition, portfolio investment (stocks and bonds) was historically low in Egypt. This deadly combination of structurally high current account deficits and persistently low capital inflow was not sustainable. When balance of payment problems like this occurs, the country's central bank chief usually has a number of ways to manage the problem. For instance:

- First, the central bank chief could tap into his foreign reserves to temporarily fill the gap in the current account. But this did not look promising for Egypt. As of the end of December 2014, foreign reserves stood at 2 ½ months of import

cover or 40% of the standard reserve adequacy metric for fixed exchange rate regimes. This represented a large decline from the average coverage of 117 % of the reserve adequacy for the past 10 years.

- Second, the central bank chief could raise interest rates. Investors make money off interest rate differentials. New Zealand likes to do this. If interest rates go high enough, a capital account surplus offsets the current account deficit and the result is a balance of payments. The down side is Egypt's exchange rate would get even more over-valued and exports would fall along with the export jobs associated with these exports. High interest rates also dampen GDP growth.
- Third, the Egyptian central bank chief could let his over-valued Egyptian pound float. The exchange rate falls against the dollar. Given normal elasticity of demand, imports get more costly and tend to fall. Egypt's exports get cheaper and tend to rise as they gain new markets. Jobs associated with exports rise and the market clears. This was arguably the best option.

WHY THE CONFERENCE MATTERED. Actually, President Sisi hoped that he could forego all three options cited above. Instead, he hoped he would be able to persuade investors at the conference in Sharm Elshiekh to scale up investments in Egypt. Theoretically, this could solve the problem by creating a large enough capital account surplus to totally offset the current account deficit. However, IMF felt this was unlikely. IMF estimated that even with anticipated foreign investment, Egypt would still need $6 billion per year for the next five years to close the external financial gap.

MEGA-PROJECTS. In any event, the mega-projects Sisi was trying to sell initially appeared attractive. The Suez Canal Regional Development project was Sisi's flagship project.

- It promoted Egypt's role as a global trading and logistics hub.
- Plans included digging of a parallel canal and the widening of the current one by mid-2015.
- The project also included four new seaports, a new airport, a new industrial zone west of the Gulf of Suez and a "technology valley" in Ismailia.

In addition, there were five other promising projects Sisi promoted: a) building a million houses around greater Cairo, b) constructing and rehabilitating 3,000 new roads, c) reclamation of one million acres of land, d) renewable energy projects and e) the "Golden Triangle" aiming at exploiting natural resources while developing the area for touristic, industrial, commercial and agricultural activities.

TURN-AROUND. Moreover, the timing of the conference was fortuitous. As a result of relative restored political stability and significant economic reforms, the economy appeared to be turning itself around.

- Unemployment and inflation rates and the budget deficit, while high, were falling.
- GDP growth, which was hovering around 2% for the past 4 years, was expected to exceed 4%.
- After plummeting to only 2.2billion in 2010-11, FDI bounced back to over $4 billion in 2013/2014.
- And since Morsi left office, the Egyptian stock market more than doubled.

In retrospect, Egyptian President Sisi performed about as well as could be expected. President Morsi left him political instability and economic turmoil to sort out. Thankfully, Saudi Arabia, UAE and Kuwait came to his rescue when foreign reserves were running out. That gave him time to explore a new economic model with UAE, one that will depend on foreign investment rather than donor aid in the future. To his credit, President Sisi restored relative political stability and started to implement economic reforms. A positive economic turnaround was already visible and foreign investors were returning to Egypt.

That said, Egypt's economy still had economic risks and vulnerabilities in its balance of payments. While foreign investment now appeared to be pouring in, attracting a capital account surplus that is 5% of GDP to offset a current account deficit of 5% of GDP would be quite a trick. That's why IMF calculated that Egypt's external financial gap would be $6 billion per year for the next five years even if the anticipated foreign investment was robust.

That's why Sisi was encouraged to hedge his bets. Sisi was advised to go to IMF and negotiate a line of credit for up to $6 billion a year. Sisi was also encouraged to consider a more flexible exchange rate as a quid pro quo. That would help clear the market, improve the availability of foreign exchange for foreign investors to repatriate profits, strengthen competitiveness of exports and tourism, attract FDI, and foster more export jobs and growth. The central bank was encouraged to build up its financial buffers. Raising foreign reserves and preparing contingency plans with its GCC friends in case risks materialized would be useful to address unforeseen shocks and boost confidence. By August of 2016, Sisi had no realistic choice but to go to the IMF for a financial bailout.

ELUSIVE TRINITY. This historical study shows that synchronizing all three legs (strong growth, financial stability and an inclusive society) of shared prosperity in Egypt has been elusive. President Mubarak deserves credit for his financial reforms which enabled Egypt to maintain financial discipline and stability during the worst of the global financial crisis. The Egyptian economy under Mubarak also produced 7% GDP growth for a three year period after his financial reforms were in put in place.

Unfortunately, Mubarak's top down economic model omitted the all-important inclusive society leg of the shared prosperity trinity. So when the global financial crisis hit, poverty and high unemployment worsened. That set the stage for the Arab Spring. The Arab Spring underscored the need for a more bottom up economic model which could reduce poverty and create more jobs.

President Morsi promised to do just that. But his narrow, Islamist government was economically incompetent and actually made the economy even worse. He omitted all three legs of the shared prosperity trinity. The Egyptian economy was on the brink of a balance of payments crisis at the time Sisi led a military coup. The GCC rewarded Sisi's military coup against the Moslem Brotherhood with enough money to help Egypt initially avert a balance of payments crisis. There was also enough GCC money for budget support and a fiscal stimulus.

GCC aid after the military coup also bought Sisi time to think about the economic mistakes of Mubarak and Morsi. What lessons has Sisi learned? What will his economic strategy look like? Will the economic strategy be successful? For starters, Sisi was painfully aware that he could well be the victim of another Arab Spring unless his strategy was more bottoms-up than Mubarak's.

In judging Sisi's economic strategy and performance, economic historians need to discard their new yardstick and think back to yardsticks that were used during the Great Depression. Prior to the stock market crash, the US enjoyed strong economic growth. But there was no financial discipline. The result was rising unemployment. President Roosevelt's first priority was the New Deal, a massive public investment program designed to put people back to work.

Similarly, the Arab Spring was an outcry against Mubarak's top down economic model that kept poverty and unemployment at high levels. Like FDR, Sisi wanted to put people back to work. Sisi's infrastructure plan promised to create social inclusion. It also promised to foster strong job creation and reduce the violence of the Moslem

Brotherhood. Sisi initially hoped that their soft core rank and file could be constructively employed in the workforce. Sisi's fiscal expansion (with more public and private investment) also promised to boost GDP growth.

While there is still a lively debate about whether or not Sisi could have sustained the financial stability leg of the shared prosperity trinity, the new $20 billion UAE/Saudi package thankfully beefed up this leg of the shared prosperity trinity over the next year or so. In addition, Cairo was also developing its own economic restructuring plan to strengthen financial stability over the longer term.

3.0 Can the US Help?

The US cannot compete with the $12 billion in GCC aid after the military coup, Arabtec's $40 billion housing investment and $20 billion in new UAE/Saudi aid. But this does not mean the US cannot play an important role when it comes to Egypt's future. The US should continue to use its comparative advantages (in education and health care) to foster a healthy and competitive Egyptian workforce, which in turn will attract US foreign investment in Egypt.

On the military front, the US has long ties with the Egyptian military. Those ties are based on personal relations, not doctrine. In this regard, the US should not turn its back on the Egyptian military because of its new role in Egypt's nation building. The US military did lots of nation building when America was a young nation. And countries like Brazil have used its military over the years to bring in the harvest. Therefore, the US Corps of Engineers should consider helping Egypt's military in national building, in the first instance with training and behind-the-scenes engineering design and advice.

4.0 Conclusions

For ten years, Cairo has struggled to synchronize all three legs of elusive shared prosperity – strong growth, an inclusive society and financial stability. Unfortunately, synchronizing these three legs of the trinity has proven to be extraordinarily difficult.

President Mubarak's market friendly reforms created strong GDP growth until he was ousted. Mubarak's financial reforms also helped Egypt soften the blow from the global financial crisis. But Mubarak was ousted because he omitted social inclusion leg of the shared prosperity trinity. To make matters worse, President Morsi omitted all three legs of the shared prosperity trinity.

President Sisi tried to use an infrastructure plan to create social inclusion (strong job creation and less violence). He also hoped to use fiscal expansion (more public investment) to boost GDP growth leg of shared prosperity. In addition, $20 billion in new UAE/Saudi aid initially promised to beef up financial stability leg of shared prosperity.

But then Egypt was hit by a double whammy. First, GCC aid had limits once the price of oil plummeted. Second, terrorism dried up tourism and foreign investment. This double whammy put downward pressure on Egypt's foreign exchange rate. Instead of letting the pound float downwards and clear the market, Sisi's central bank tried to prop up an overvalued pound by depleting Egypt's foreign reserves. Facing a balance of payments crisis, Sisi was forced to go to IMF for a bailout in August of 2016. Once more, Egypt failed to synchronize all three legs of elusive shared prosperity – strong growth, an inclusive society and financial stability.