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An alarm for the potential 2020 recession and its' impacts on the developing countries: Evidence from Egypt



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ABSTRACT

This article review provides an insight into the main signals that will be responsible for the coming recession that will start from developed countries and will reflect negatively on developing countries that witness a decreasing level of development. The paper starts with the main seven signals that will initiate the recession. The second section will provide an analysis of the applied procedures and the economic reform that the government adopted to attract investment to overcome the previous and the coming challenges. Finally, the paper provides future expectations and paths for developing countries to overcome the recession.

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Introduction

The consequences of globalization and decreasing trade barriers create a winner and loser in terms of trade. The winner who have a trade surplus while the loser who end up with a twin deficit. Countries are fighting incremental increasing of debt in addition to trade deficit. A situation that reflected on adopting protectionism policy. An incident that reflected on anticipating global recession by the beginning of 2020 at the same time as the US presidential election. The US action reflects signals for the coming recession. The impact of the country is backed to its 25 % of the world's economies recording around 20 trillion but the US national debt (21.6 trillion) actually comes to about 107% of GDP (Xu, M. et al. 2016). US recorded 2.5% economic growth which is back to the increase of consumer demand as the US government pumped cash into its financial markets that could not be seen as a sign of recovery. America and the rest of the developed world are heading for a structural crisis because the financial structure of developed countries is already unbalanced and is exacerbated by the crisis initiated by the transfer of private debts to their central governments, weakening their capacity to provide services in education, health, employment, pensions these imbalances accelerated unemployment rate.

There is no agreement among economists about what brought productivity down in the 1970s and 1980s and then back up in the 1990s. As the countries' economies improved following the stagflation of the mid 1970s and then the recession of 1981-82 rates of capital accumulation remained low. But investment alone cannot be the only culprit. Looking at technological advances, this period coincides with the technology revolution. Scholars' who study productivity changes argue that the importance of the technology was not fully realized in the economy until the 1990s with networks and the internet. But labor productivity has again slowed down from

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right before the Great Recession through the end of 2012. Has technological change slowed? Perhaps not, as we continue to see advances in electronics, bio-technology, and energy production, just to name a few key industries.

Main Sixth Signals Reflecting on Forthcoming Recession

There are main sixth signals reflecting on the coming recession related to economic and political factors reflecting on the international relation. From these signals the first is the trade war that is escalated between the United States of America and Republic of china. This trade war is a big part of the reasons for recession. The current situation reflects negatively on many global firm’s operation by freezing their activities and hold investment. As many companies can’t forecast if the imposed tariffs will go away soon or will last as part of their cost of doing business. The uncertain situation reflects on the financial markets and placed it in a more conservative situation. If this will be the case then holding investment and freezing hiring consequently will reflects on consumer spending to pull back their buyer behaviors. If the economy falls in the contraction situation, and corporate debt is high than the economy is placing them in volatile situation which may create a wave of bankruptcies.

Second signal is the currency war, the announcement of the People’s Bank of China (PBoC), the country’s central bank, the intention to launch is digital currency central bank digital currency (CBDC) a reply to the move done by Facebook’s Libra project. However, crypto currency is characterized by its volatility but if it became stable and issued by the stable regulators status. Than it would be hard for the U.S. Securities and Exchange Commission (SEC) to view it as a security, which requires that buyers expect appreciation in the value of securities. This inspires compliant players such as Facebook or large banking institutions, which have everything to lose from any compliance irregularities.

Third signal is capturing the global leadership of future technologies (artificial intelligence (AI), robotics and 5G networks war (and their effects will be reflected in slowing growth and rising inflation. According to Zhang, M. L., & Chen, M. S. (2019) China’s overall digitalization puts the size of China’s digital economy about 30 percent of GDP, compared to 59 percent in the U.S. and 46 percent in Japan, and around 20 percent in Brazil, India, and South Africa. China ranks 50th out of 131 countries based on the World Bank digital adoption index. . On e-commerce: China accounts for over 40 percent of global transactions, and the penetration of e-commerce around 15 percent, compared to 10 percent in the U.S. On fintech: Chinese companies account for more than 70 percent of the total global valuations. The value of China’s consumption-related mobile payments by individuals totaled US\$790 billion in 2016, by 11 times that of the U.S, Zhang, M. L., & Chen, M. S. (2019). The estimated venture capital (VC) industry in China has grown rapidly especially on the digital sector from US\$12 bn in 2011-2013 (6 percent of global total) to \$77 billion in 2014-2016 (19 percent of global total), with \$38 billion invested overseas, see figure 1.

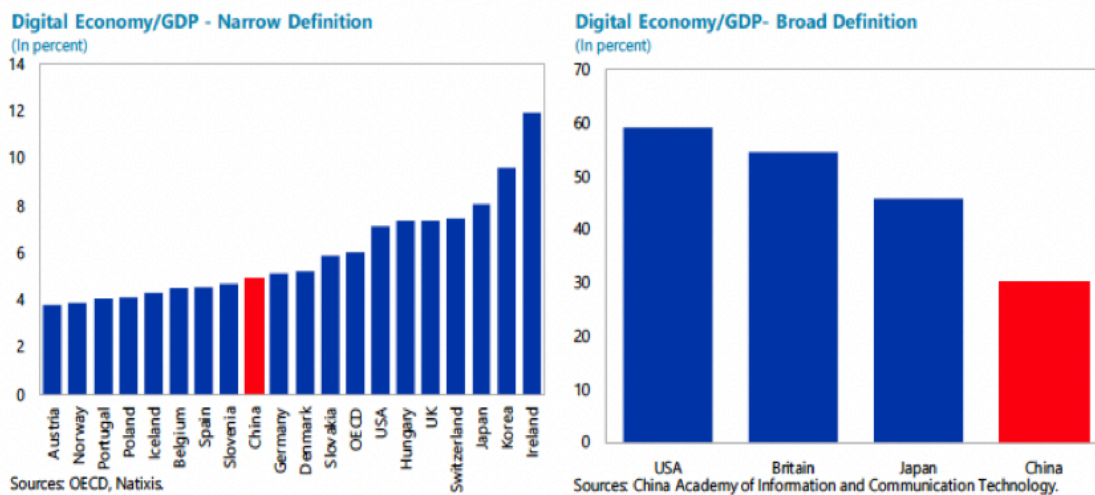


Figure 1: show the participation of the digital economy across top countries from GDP; Source : Najmi, A. (2019). The Determinants of Venture Capital Funding in G7 Countries.

Fourth signal is the demolishing of globalization, because countries and companies can no longer rely on the long-term stability of integrated value chains. As well US Federal Reserve hikes US dollar interest rates dramatically increases US inflows, this reduce the value of glowing financial flows to emerging and developing countries. Fifth is the fear of the possibility of the US confrontation with Iran. Despite leader’s response to slowing growth and high unemployment during the election year they will shift concerns to a foreign political crisis rather than addressing the problem. However, as the United States is already in a trade war with China and cannot attack North Korea, the only goal available is to launch a military confrontation with Iran. This would be a geopolitical shock with huge inflationary effects, as was the case in 1973, 1979 and 1990, when oil prices rose sharply. This clash if it escalates to the

point of military conflict, world oil prices may jump into a deep recession, as happened in the Middle East before. Sixth is the Brexit impacts which is considered the main trading and investment partner with the Egyptian economy. Final global warming and climate change will alter all the future expectation carrying more uncertainties' in the near future. All these signals will reflect negatively on trade, investment, unemployment and economic growth.

Current Situation Analysis

The current situation is a wake-up call. We now have time, so why not move to assess this situation and to remedy its potential impact on our economy and take protective measures, or at least take the initiative to alleviate the shock of this crisis. Developing countries are expected to be adversely affected in the long run by declining capital flows and investing in them for export to other countries. Egyptian exports themselves may be adversely affected by the developments in the long term and increase the measures taken by each country to increase the attractiveness of its products and impose customs on imports. At the time, one of the most important objectives of economic reform and exchange rate liberalization was to increase the attractiveness of Egyptian exports. Imports may also be affected if US-China measures continue in the long run. For example, any products that Egypt imports from the United States and includes Chinese production components, will increase its cost to Egypt, and the stock markets and global currencies may be affected and thus have repercussions on the rest of the countries.

According to the World Investment Report 2019 issued by the United Nations for Trade and Development, Egypt will continue to be the largest recipient of FDI in Africa in 2018 despite its global decline, according to the summary prepared by the Investment Policy Sector of the General Authority for Investment and Regions on the UN report. The report pointed out that Egypt came at the top of the African countries most receiving foreign direct investment, and ranked second in the Arab world with \$ 6.8 billion, after the UAE, which attracted \$ 10 billion, and before Oman, which received \$ 4.2 billion in 2018, while flocking to Morocco \$ 3.6 billion, And \$ 3 billion for Saudi Arabia. Egypt ranked fourth in Africa among the top 10 economic zones, after Kenya, Nigeria and Ethiopia with 61, 38 and 18 regions respectively. Also, the report pointed out that the investments of multinational companies from developing countries increased in Africa, although France is the largest investment in the continent, followed by the Netherlands, which concentrates two thirds of its investments in Egypt, Nigeria and South Africa.

The report attributed the reasons for the increase in investment in Egypt to several factors, including the signing of several agreements, including 12 agreements of exploration and production with international oil companies, and BP's increase in its activity in Egypt during the past two years, where its investments in Egypt rose to 2 Billion dollar .Egypt also signed an agreement to establish a \$ 1 billion good city with a Saudi investor, another grain storage project with a Ukraine company with investments of up to \$ 2 billion, and a textile city project in the Suez Canal Economic Zone, the report said. The report pointed out that Egypt has taken measures to facilitate the investment and promotion environment, as it exempted limited liability companies from the need to appoint Egyptian managers and is expected to be one of the countries that will amend the International Investment Agreements (IIAs) by the end of this year through the development of those the quality of agreements to achieve the SDGs.

The Egyptian government adopted reform of fiscal and tax policy and stability of the most important factors to attract and increase investments, which in turn contribute to the growth rates, and the decline in unemployment, which has already fallen to 8.9%. According to a statement from the Ministry of Finance. In addition, to the progress to establish a fair tax system with modernization of its mechanisms and procedures, as it seeks to finalize the automation of work systems at the Tax Authority, which is a qualitative leap in the methods of dealing with taxpayers.

In fact, the automation of the work of the Egyptian Tax Authority also contributes to tightening control over the tax community and facilitate inventory operations, and thus ensure the collection of full rights of the public treasury and increase the volume of public resources, so that the State to increase spending on public budget programs, and raise the efficiency of services provided to citizens, especially Education and Health. According to Selwaness, I., & Messkoub, M. (2019) they highlight on the Egyptian social protection system: coverage gaps, challenges and opportunities. In Social Policy in the Middle East and North Africa. Kerr, M. H., Salacuse, J., & Serageldin, I. (2019) emphasis on the trial of the Ministry of Finance will include the informal sector under the state umbrella, especially since many studies indicate the inflation of this sector, reaching about 60% of the size of the formal sector. The minister said: "We are working on the issuance of a package of laws and legislation encouraging this sector with the building of bridges of confidence with its dealers, so as to benefit from the many services provided by (the government) for this important sector." Also, the fiscal policy aims to raise economic growth rates to 6% in the next fiscal year after the recent rise to 5.5%, and the success of the state in achieving balance in the growth between the various economic sectors. Actually, the current economic reform program that Egypt started implementing since 2016 is highlighted by some positive results as the economic performance indicators and the state budget declined yearly.

On the other side, recently, the Egyptian House of Representatives approved a bill submitted by the government to amend some provisions of Law No. 157 of 2018 establishing the Upper Egypt Development Authority. Ahmed, D. A., & Ahmed, A. A. (2019) highlight on the law aims to develop a plan to accelerate the comprehensive development of Upper Egypt, and to plan projects that achieve a development return and high percentages of employment while working to attract the necessary investments to achieve sustainable development and economic and social returns for the targeted areas, and that the authority has a special budget. In addition to the Executive Regulation of the Investment Law No. 72 of 2017 was issued and included 141 articles.

The most important thing stated in the regulation is not to allow administrative authorities to cancel the project license or stop or withdraw the real estate allocated to it, except by warning the investor and granting the right of reply and the latter all means of litigation. The regulation ensured the investor the right to expand his project and financing it from abroad without restriction, as well as the right to receive and transfer profits and granted the foreign investor the right to reside in Egypt for the duration of his project. The Regulation required the General Authority for Investment to decide on the application within one day only. The company has since acquired the legal personality. Also, the Authority is issuing permits for projects before allocating them to the investor so that they are ready for investment. Also enabling the investor to establish his company online by setting up an account on the investment portal. The regulation supported the local worker and encouraged reliance on local raw materials and exports. The regulation focused on community development, giving the investor the right to allocate not more than 10% of his net profits due to deduction of tax for community development.

Moreover, the House of Representatives approved the draft law submitted by the government on amending the Law on Joint Stock Companies and Limited Liability Companies, issued by Law No. 159 of 1981, and the new legislation provides for the establishment of single-person companies. The law enables the small investor to establish a company on its own and these companies have limited liability in the value of capital, which protects the investor from risk in its full financial assets. The law limits the phenomenon of establishing mock companies to meet multiple partners, a formality requirement. Also, establishing investor service centers. Facilitates the procedures of obtaining the investor to obtain the approvals, permits and licenses necessary for his investment project and transfer to the representative of the administrative authorities represented in the center all the authorities required to implement the investor's procedures in accordance with the investment law No. 72 of 2017. All these economic reforms works to deepen the Egyptian economy competitiveness and attract more investments.

Conclusions

All constant assumptions that we can build our forecasting become a stochastic one under the current volatile situation. From the previous review, there is a necessity in Egypt to intensify promotional efforts to invite investors in those countries to invest in Egypt for export, as this war is an important opportunity to continue entry of their exports because Egyptian products are not subject to such protectionist measures as well as benefit from free trade agreements concluded between Egypt and most of these Countries. Focusing on inviting Chinese companies to invest in labor-intensive industries such as: textile industries, automotive components and home appliances to create more job opportunities as well as increasing Egyptian exports.

This trade war provides opportunities to localize investments in Egypt as part of the Chinese President's Belt and Road Initiative launched in 2013, which is mainly to revive the ancient Silk Road and establish a network of logistics projects linking China, Eastern Europe and North Africa. It will also benefit from the China Initiative on Africa, under which the Chinese government encourages Chinese companies to invest in Africa, including Egypt. As well provides various financing mechanisms for these companies to facilitate their business through the China Development Bank, the China-Africa Development Fund and the Asian Infrastructure Investment Bank. If China and the United States war will drop trade and escalate prices of most commodities, giving an opportunity to restructure the global supply chain map that was based mainly in China on technology. Thus, Egypt could use its strategic location, especially the Suez Canal to attract many Chinese as well as international companies looking for a new location to settle their investments and production lines, which would promote the attraction of Chinese and international companies affected by economic war and encouraging investment in to increase exports and substitute imports to compensate for the gap in the trade balance between Egypt and China.

Than developing countries and specially Egypt need a huge effort to their economic system driving forces. From the supply side, the Arab countries need to enhance and diversify its' economic valued added and targeted more technology base products in order to sustain the global competitiveness market. While on the demand side, there are potential opportunities in domestic demand that have not been exploited, and smart incentives that have not been unleashed to activate the potential of local communities by investing in infrastructure and key services such as education, health care and skills development, and unleashing energies whose opportunities have been lost by waves of controversy over the role of the private sector, public sector, centralization and decentralization. Emerging markets still have room for growth. Poor countries catch up with their wealthy counterparts when productivity and labor capital levels rise close to levels in developed economies.

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