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Chapter · January 2019

DOI: 10.4018/978-1-5225-8247-2.ch003

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# **Political Stability, Austerity Measures, External Imbalance and Debt Impact on the Egyptian Economy**

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## **ABSTRACT**

Economic difficulties manifested by the low GDP per Capita, high unemployment, high rates of inflation, limited sources of foreign currency, mounting internal and external debts, and high subsidies, had been facing Egypt for a long time. Despite the higher growth rates in Egypt in the first decade of the millennium, the persisting economic difficulties and political instability problems led to 2011 uprising.

Against expectations, the political instability, security issues and unrest, which followed the uprising, and the world economic difficulties led to further deepening of the economic problems of Egypt due to the reduction in the limited sources of foreign currency and fragile economic structure.

Egypt dependence on income from remittances, the Suez Canal and tourism as the main sources of foreign currency are inadequate. Egypt should diversify its economic activities by further engagements in the services sector, direct more effort to technological advances and increase the added-value to its products by empowering the large youth and educated population.

## **KEYWORDS:**

Development, Economic Growth, GDP per Capita, Services Sector, Population Growth, Youth Empowerment, Unemployment, Foreign Currency, Remittances, Subsidies, Corruption, Law and Order, Alternation of Power.

## **INTRODUCTION:**

Restoring political stability and security after the uprising of January 2011 in Egypt, and the following few years of unrest, requires an inducing environment of sustainable economic growth, eliminating or substantially decreasing deficits eliminating or minimising debt and economic imbalances. It will also require continuing the efforts to empower the institutions and enforce law and order, curb corruption, improve transparency, and enforcing the constitution for democratic alternation in power among other measures to improve governance. Furthermore, substantial improvement in services and living conditions and quality of life that must be felt by every citizen in the country.

After 2011 uprising, the country was facing increasing economic recession in part due to political instability, as well as the continued unrest. These conditions and the security issues with militants operating in Sinai, supported by international militant organisations, led to a substantial loss of revenue from tourism. The proceeds from the tourism industry, which was expected to grow from USD 12 billion in 2010 to USD 20 Billion, suddenly plunged after 2011 to a historic low level and tens of thousands of tourism workers lost their well-paid jobs, adding to the already high-unemployed workforce.

Because of the ailing political instability and security conditions at that period, Egypt experienced an immediate flight of foreign direct investment, closure of local businesses, transfer of local capital and businesses to other countries, and the reduction in revenues from export.

Also, the continued increase in the current population which is crossing the 100 million in December 2018, pressing needs for better services, and people particularly youth longing for a better quality of life, aggravates the economic conditions and increases the burdens of internal and external debts.

Furthermore, the significant impact of the world financial crises in 2008, and the substantial reduction in oil prices at the end of 2014 changed the world economic conditions and severely affected the region and Egypt conditions. These changes resulted in reduced foreign currency flow from two of the three main sources of foreign currency in Egypt; remittances, and proceeds from the Suez Canal.

The grave security conditions in close neighbouring countries with historical trading ties with Egypt continue to adversely affect the Egyptian economy and threaten its security after the illusive misnomer “Arab Spring” of 2011. Conflicts in Syria, Yemen, Libya and Iraq, which also engage other Arab countries mostly Saudi Arabia, United Arab Emirates and Qatar, have been adding to the impact on Egypt economy. In addition to trading, some of these countries are major markets for the Egyptian labour force. For example, 2.9 million Egyptians were working in Saudi Arabia alone in 2017. The Iraqi unsettled security issues since the intervention in 2003 also have its long-standing effects, as it was an excellent trading partner and large market for Egyptian labour force up to 2003. The Palestinian-Israelis conflict at the northeast borders, with its implications on security and economy, has been going on for decades, and its complicated impact on political and economic stability is not considered in this chapter.

The reliance of Egypt on limited sources of foreign currency from tourism, Suez Canal and remittances together with the political and security problems, coupled with the regional and international economic and security issues forced Egypt into increasing economic difficulties of increasing debts and internal and external imbalances. These internal, regional and international adverse impacts on Egypt economy led to additional burdens and imbalances in addition to the already high budget deficit and heavily burdened economy before 2011. The debt reached its highest value of approx. USD 93 billion in 2018 2<sup>nd</sup> quarter compared to USD 26 billion in 2001

Towards the end of 2016, the country had to deal with the sharp shortage in foreign currency resulting from the shortage of revenues, the other multiple conditions and the inability to get further loans from neighbouring oil-enriched countries, which historically had ties and even received support from Egypt. There were no options but to take courageous economic steps to stop the deterioration or at least bring it under control. The government adopted a gradual but fast increase in the exchange rate and then shortly afterwards announced the floating the local currency. This was against strong internal resistance and somewhat justified fears of an overwhelming “tsunami” wave of price surge on imported food, medical supplies and other essential, indispensable commodities. Although a year later the IMF reported that with the floating of the Egyptian pound, the foreign exchange market normalised, and the parallel market for foreign currency disappeared, a high surge of inflation was unavoidable and hit mostly the poorer despite all efforts to reduce its food prices impact.

By lending the Egyptian government 12- billion dollars, the International Monetary Fund supported new Egyptian economic reforms to restore macroeconomic stability, sustain public finances and at the same time strengthen social protection measures to protect the most vulnerable (IMF, 2017). These reforms included adopting flexible exchange rate regime, energy subsidy reform to reduce the fuel subsidies gradually, the inclusion of women and youth as critical to share the benefits of growth, and higher growth through wide-ranging structural reforms.

The focus of monetary policy is to bring down inflation, which reached more than 30 per cent and adopting a flexible exchange rate regime.

The government increased tax revenues by implementing a value-added tax (VAT) and took steps to reform expenditures, including energy subsidies and efficient spending to slow the accumulation of public debt for reducing the budget deficit.

The government reduced energy subsidies, which benefited mostly the rich, and reallocated part of the reduced subsidies to spending on health and education.

The inclusion of women and youth is critical to share the benefits of growth more broadly to increase employment and labour force participation for women and youth. Higher growth through wide-ranging structural reforms to create more new jobs help reduce unemployment among women and young people, Such as access to financing for small and medium-sized enterprises and less red tape in industrial licensing.

The reforms resulted in improvements in the economic performance of the country and the IMF predicts that the country will raise its economic growth to 5.3 per cent and 5.5 per cent in 2018 and 2019 respectively. This recovery was also due to the increase in the natural gas production and recovery in tourism (IMF, October 2018). Also, the Egyptian Ministry of Finance announced recently that the State budget in Q1 FY18/19 showed that the budget deficit shrank to 1.9 per cent, in comparison with 2.3% in the previous three years (Egyptian Ministry of Finance, 2018). The government expects that due to this positive result in Q1 FY 18/19 Egypt will reach its financial targets, which is achieving a primary surplus in general budget by 2% of GDP.

The definitions and explanations below are for the main items in the chapter and are intended to be simple to help some interested readers to follow the discussions and

arguments in this chapter. Findings of research in other countries included in the explanation may provide some general notions of what to expect if similar work is done for Egypt.

- A. The Impact of Public Debt and Deficit.
- B. Austerity Measures
- C. Political stability

#### **A. The Impact of Public Debt and Deficit.**

The deficit occurs when the government expenditure is higher than the government revenue. The internal and external deficits create debts, which accumulate over the years and can reach dangerously high levels as a percentage of GDP, which is common in developing countries. The debt accumulation might be due to economic reasons for a gap between spending and revenue and may take place due to political reasons when for example taxes are reduced in election times. The economic reasons vary, and they play an essential role in the debt dynamics (Reinhart, Reinhart, and Rogoff, 2015). Economic reasons include, among other factors, basic economics like low development levels, poor productivity levels, specialisation, weak international competitiveness, which creates the need for external borrowing. (Salman and Monastiriotis, 2018).

The primary balance, the interest rate, growth and inflation are the main drivers of sovereign debt dynamics and recent studies on the interactions between them have shown that some of these drivers aggravate the impact of shocks to the debt accumulation, whereas others stabilise debt dynamics (Anaya and Pienkowski, 2015). The monetary policy regime choice is essential in debt dynamics as more risk is experienced by countries with constrained monetary policy (i.e. countries with fixed interest rates or in a currency union). The researchers conducted their research using a model on government debt for 15 advanced economies which jumped from approx. 70 per cent of GDP in 2007 to 105 per cent by 2013 as a result of a deep recession which reduced the nominal GDP and caused the primary balances to deteriorate. The modelling technique used a Structural Vector Auto-Regression (SVAR) estimator, with an endogenous debt accumulation equation.

“Political budget cycles” is the name given for reducing taxes at certain periods for political gains. Lowering taxes rates were found to be in use near election times by municipalities in Italy. This might lead over many elections to increase the public debt without the real need (Alesina and Paradisi, 2017). A similar example is found in Indonesia, where 451 district municipalities resorted to “political budget cycles”, on elections during the period 2010-2014. This appeared in the budget in the form of financial assistance expenditures, donation expenditures and total expenditure, resulting in an increase in the local budget deficit in election years. This supports the idea that elections have a positive impact on government expenditures. (Setiawan and Rizkiah, 2017).

Similar cases can be found but in a different form in many developing countries including Egypt where governments may be tempted to give a relief to citizens on the account of increasing the public debt, which will have to be paid later. A repeated example of this may be found in subsidies for energy going mostly to those who do not need in it many countries. The argument that this is necessary to help the needy are acceptable, but rational application to reduce the government debt burdens is mandatory.

After the global financial crisis, and with the increasing government debts in different countries, it was an important matter to study the impact of growing debt levels on economic growth. A negative impact of - 0.01% is found for each 1% increment of public debt, and debt service has a ten times worse effect on growth, in 14 European Countries, during the period from 1970- 2012, for annual and 5-year average growth, (Afonso and Alevs 2015). A time series analysis shows similar results of negative impact from high levels of Debt-to GDP ratio on economic growth and that economic growth decreases the debt-to- GDP ratio, Also, economic growth is essential to reduce public debt in a study for 10 countries in the European Union for the period from 1970-2014 (Jiménez-Rodríguez and Rodríguez-López, 2015)

(Bökemeier and Greiner, 2016) studied the relationship between public debt and economic growth, based on panel data for seven developed countries during the period from 1970-2012. They found that there is a strong evidence of a negative relationship between debt and economic growth and that the relationship did not seem to be non- linear.

## B. Austerity Measures

Governments use Austerity measures in public as a harsh fiscal program to reduce its fiscal deficit and cover the gap between government revenues and expenditure by increasing revenue or cutting expenses, or both (Moreno-Brid, Pérez- Benítez, Villarreal-Páez, 2016).

Austerity measures used to reduce the budget gaps usually have undesirable socio-political impacts particularly in low- income groups, and may have adverse effects on the economy. Austerity measures in countries confronting economic imbalances have been a controversial issue for some time due to its social and economic impacts. It has been argued that raising taxes and reducing government expenditures, to reduce the budget deficit, will reduce spending and hence, it will affect investment and consequently reduce both employment and growth. Careful applying of austerity measures levels and timing of budget cuts should be balanced with other economic improvements, (Salman, and Bassim).

Application of austerity policies, for example, removal or reducing subsidies on food and energy, can have far-reaching social impact and probable effect on the political stability. Application of additional taxes damages the small, fragile businesses, reduce the demand and affects the economy as a whole. The austerity measures, therefore, should be applied with care, and when necessary. As its socio-political consequence can be devastating, it should be applied in the proper timing, maybe as Keynes suggested *"in the boom, not the slump"*, as far back as 1937.

Policies aiming at reducing the budget and current account deficits and stabilising the exchange rate (Stabilisation Policies), were relatively successful in Egypt and five other south Mediterranean countries which hastily implemented austerity programmes to remove distortions and curb internal and external imbalances through reducing subsidies, cutting expenditures and increase taxes. The economic structures, the overall external vulnerability and the domestic socio-economic problems of inequality and unemployment of these countries remain largely the same. It also had negative consequences, socially as it hurt most those who most needed the subsidies and the economy as it depressed domestic demand (Salman and Monastiriotis, 2018).

Analyses using a theoretical model of the effect of austerity in a case of high debt and imbalance problems have shown that policies of increasing tax and reducing public spending did not solve the debt problem but created a deep economic recession in Greece. However, reducing the interest rate or reducing the exports dependence on imports showed a significant improvement in growth (Elias Soukiazis, Micaela Antunes & Ioannis Kostakis 2017).

### **C. The Relationship Between Political Stability and the Economy**

Economists focused on the importance of political stability to the economic growth in recent years. The unstable political environment is found to be harmful to the country's economic development. Among other economic effects, the political instability can harm foreign direct investment and tourism, and this can reduce foreign currency and negatively affect the economy of the country. Also, it is expected that improvement in the economy would eventually lead to improved political conditions. After the Arab Spring, it is becoming crucial to know and understand the critical role of political stability and its relation to economic growth in the region.

During the periods of political instability, economic growth is significantly lower as have been concluded by (Alesina, Roubini, Ozler, and Swagel, 1996), in a study on 113 countries over the period 1950-1982.

Significant relationship between democracy and economic growth, but no significant sign of joint causality have been reported by (Zureiqat, 2005), in a study conducted to test the relationship between political instability, and economic growth, where the researcher used a panel data for 25 countries in five continents, during the period from 1985 to 2002. The five different continents are Africa, Central and Eastern Europe, Latin America, the Middle East, and Southeast Asia.

Increasing political stability index by 32.35 scores increases economic growth by 1%, according to a study, which tested the impacts of various political instability variables on economic growth. The researchers conducted the study on ten selected countries in Asia, during the period between 1990 -2005, (Younis, Lin, Sharahili, Selvarathinam, 2008). They used an Ordinary Least Square Method to construct their analysis.

: A long-term equilibrium relationship exists among political instability, corruption, and economic development, (Abu, Karim, and Aziz, (2014). They examined the causal relationship between political instability, corruption, and economic development in the Economic Community of West African States (ECOWAS) using the Granger causality test within a multivariate cointegration and error-correction framework during the period between 1996-2012. The cointegration test showed that the variables are cointegrated.

In a similar study on Egypt shows that there is a positive impact of the level of democracy on economic growth. However, the impact of political instability on economic growth is uncertain. The study covered the period between 1972 and 2013, (Abdelkader, 2015). He used the cointegration approach to determine the short- and long-run relationships and a GARCH model approach in Error-Correction Model (ECM) to introduce the uncertainty impact. To confirm his results, he used a Pesaran's bound test.

Significant losses were experienced by firms in Bangladesh when multiple protests happen in the same week, which has a negative impact on the country's GDP as concluded by (Chawdhury, 2016) who conducted a study on the impacts of 'hartals' on the economy (Hartal is a kind of protest that disrupts work and shops).

Political instability has been reported to have an insignificant impact in the short run on economic development. However, it has a significant negative impact in the long run as (Rani and Batool, 2016) show by a research on Pakistan for the period from 1980–2013. Also, the research showed that there is a positive relationship in the short run and the long run between Foreign Direct Investments and economic development. The researchers recommended that it is essential to develop policies to attract more Foreign Direct Investments and enhance political stability.

Economic growth is the strongest driver for political stability and FDI in Malaysia. (Nazeer and Masih, 2017) found a long run and short run relationship between political instability, economic growth and foreign direct investment in a research. They studied the impact of political instability on economic growth and attracting FDI in Malaysia during the period from 1984 until 2013. They used an autoregressive distributed lag (ARDL) approach to cointegration.

In a different study to the above findings, (Kurecic and Kokotovic, 2017) conducted a study, during the period from 1996- 2014 included three group of countries. The first group consisted of eleven small economies, the second group consisted of five developed western economies, with high positive Foreign Direct Investment and politically stable and last group consisted of four countries that usually suffer from violence. The researchers used the Granger causality test and applied a vector autoregressive (VAR) framework. They used the ARDL model for every single country in each panel, to test the sensitivity of the results and avoid robust errors. Their finding showed that there is a long -term relationship between political stability and Foreign Direct Investment for the panel of small economies. Also, there is no indication that this relationship exists in developed countries and countries suffering from violence.

Based on these conclusions and similar other work, we can conclude that there is a strong relationship between the Political stability in a country and its economic growth and on the other hand, economic growth also can enhance the political stability,

It is for these inter-related reasons and several other complex issues that this chapter is written.

## **BACKGROUND**

It is important to note that historically, the Egyptian economy has suffered from macroeconomic imbalances for many decades. This led the country to repeatedly follow strict economic reform programs for many years to help the country to improve its economy

Historically Egypt relied on its fertile land, and the agricultural sector was the main economic sector up to the 1950s. Export of cotton and other agricultural products was adequate to balance the imports and cover the government expenses for the approximately 20 million inhabitants at that time. There were no internal or external budget deficits, and there were surpluses, although little has gone to the poor, uneducated Egyptian peasants and the majority to the wealthy landowners, and exporters of mainly cotton.

In the 1950s plans were made to widen the small privately owned industrial base. Several industries were started as part of a national plan for import substitution,

including the Iron and steel company, the Aluminum industry, chemical and pharmaceutical industries, El Nasr Cars, expanding the spinning and weaving industry, shipbuilding and several others. A growing public sector owned the new expansions in the industry, and eventually, at the beginning of the 1960s, it took over almost all the existing privately owned industries and businesses. The Suez Canal Company was nationalised in 1956 and soon afterwards foreign banks and financial services too, as part of the Egyptian government drive for control over the economic activities.

During the 1970s and until the mid-1980's the Egyptian economy succeeded in achieving high rates of economic growth, maintaining high levels of remittances and attracting foreign direct investments. This was due to the adoption of the open door policies in the mid-seventies (World Bank, 1997). The open door policy, however, did not change the structure of public sector ownership which was formed during the 1950s and 1960s as part of the import substitution policy of these decades.

During the second half of the 1980's the economy suffered from deterioration in economic growth, foreign direct investments, accumulation of foreign debt, increase in the budget deficit, balance of payment deficit and high rates of inflation.

In 1991, Egypt signed The "Economic Reform and Structural Adjustment Agreement (ERSAP)", (Africa Development Bank Group, 2000). Also, the "Structural Adjustment Loan Agreement - (SAL)" with the World Bank and the IMF (Korayem, 1997).

The main aim of the economic reforms was to remove the distortions and imbalances in the Egyptian economy by changing it into a market-based economy and to return Egypt's creditworthiness. The reforms included reforming the public sector and privatisation, increase the private sector participation in the economy and changing the investment policies. Also included, liberalising trade and agriculture prices, and increasing fuel prices yearly until June 1995 to be in line with international prices. Also, reforming the exchange rate, and the monetary policies by imposing a credit ceiling for banks and permitting banks to determine their rates for borrowing and lending. Furthermore, the reforms included increasing the government revenue to reduce the fiscal deficit by changing the fiscal policies. This included increasing sales taxes and presenting a tax on the overall income.

Meanwhile, Egypt managed to get support from other countries and write off its military debt to the USA, Arab debt and 50% of its public debt (Beblawy, 2008). The Egyptian government at that time managed to apply the reforms successfully reducing the internal and external imbalances with a low budget deficit of 1.3 per cent of GDP and reduced inflation to 7 per cent (Radwan, 1997). Also, the government kept the exchange rate under control and allowed for investment in infrastructure and large projects (Beblawy, 2008).

With all of this history and developments in debt, imbalances, structural reforms in mind, the objective of this Chapter is to investigate the complex current and short-term political stability, austerity measures, external imbalance, debt sustainability and their impact on the Egyptian economy. The impact of security issues on the economy and political stability cannot be separated.

## **AN OVERVIEW OF THE ECONOMIC CONDITIONS AND POLITICAL STABILITY IN EGYPT**

Continued Population growth together with the economic weakness of the public sector led the successive governments to borrow increasingly. The large internal and external imbalances in the late 1980s led the country in 1991 to engage in significant stabilisation programs, macroeconomic and structural reforms, in agreements with the IMF. The economic reforms included the privatisation of the public sector, encouraging the private sector to participate in economic activities as well as several fiscal policies including tax increases to increase government revenue.

Egypt and many other developing and developed countries, have been suffering from internal and external imbalances and high debt, and were seeking solutions and ways out (Antonio,2008), (Simon, 2009), (Simon, 2014), (Cristian, 2010) and (Holmes, 2010).

Before January 2011, the government continued adopting economic reforms in a more intensive approach, particularly at the restructuring of the financial sector, departing from the planned import substitution economic policy of the mid-twentieth century, and the privatisation process of public enterprises hoping for the macroeconomic conditions to stabilise. Egypt achieved a high growth rate of 6.8, 7.1 and 7.2 in 2006, 2007 and 2008 respectively.

However, the world economic crises in 2008, affected initially this reasonably high growth rates and the rate went down in 2009 and 2010 to 4.6 and 5.1 respectively. This was higher than many, if not most of the countries of the world and Egypt economy appeared at the time to be reasonably resilient in facing the world economic crises. However, it is essential to note here, that the poor and middle class did not feel the benefits from the high rates of growth. The benefits appear to have accumulated in the hands of a narrow circle of enriching elite and top country politicians. The given reasons why these remarkable rates of growth were not felt by the ordinary average citizens, that “the wealth did not trickle down”, cannot possibly be credible.

Different successive Governments in Egypt provided massive subsidies for example for energy, food, transportation, drinking water, electricity and many other essential items for the life of people. Subsidies were important for alleviating the economic pressures on the poor and needy, however substantial part of its benefits went to the richer. It was essential to support the poor, but it was an added burden on the ailing budgets, and led to further internal and external imbalances, increasing the debts and in the meantime crowding out the limited government budgets and stretched the resources for health and education services for the poor. In reality, unfortunately, Government subsidies went mainly to people who did not deserve it, whereas the increased debt and debt service impact was felt more by the poor in the form of reduced services.

The uprising of 2011 in Egypt was for justified reasons of poor economic conditions, corruption and lack of social injustice, increased unemployment, electoral fraud, alleged attempts for manipulating the constitution, allegations on illegal attempts to pass the presidential seat to the president’s sibling, police brutality, among other economic reasons and political manipulations. The discontent due to fears of unemployment amongst youth and those who lost their job in the privatisation transformation fueled the uprising and was a common factor. The safety system of social funds was not fast enough or perhaps not adequate to alleviate the impact of the structural transformation towards a market economy, following the International Monetary Fund arrangements to reduce the Country large external debt.

Egypt also had experienced a long spell of political power manoeuvres between the political Islamist groups and the Government of Egypt. These groups had been

growing in numbers and influence over a period of nine decades, not only in Egypt but also in several other Countries in all five Continents of the world. Their growth spanned over the entire MENA region. Recent incidents showed the presence of these groups in the United States of America, Russia, Australia, and Europe as well as in several countries in Asia and Africa. They have shown strong presence from Pakistan and Bali in Asia to Nigeria and Mali in West Africa. The growth of these groups suffered a number of setbacks in Egypt due to their role in major political incidents over the nine decades since they started. For example, the assassination of two prime ministers and the Supreme Court judge in the 1940s, the Countries President Sadat in 1981, attempts on the life of Nobel Prize winner in the 1990s, attempt to assassinate Mubarak in Ethiopia and some others.

The premise of “Bread - freedom – Social Justice and Human Dignity” was raised at the wake of the uprising of 2011. This slogan attracted millions of the young generation, longing for a decent life and created a spontaneous solidarity among youth including a vast majority without any political affiliation, and led to the fall of the governing system. The estimated two million young people who actively participated in the uprising, with many more who did not physically participate, out of the approx. Forty million at the age of 15 to 45 years in 2011 have done this with great and well-deserved expectations of immediate results. Unfortunately, after eight long years, their expectations did not fully see the light yet, as several political and economic setbacks were encountered.

The uprising led to a long period of unrest, severe security problems and political instability, which had its impact on worsening the economic situation and caused substantial economic difficulties in Egypt.

Following a transition period after January 2011, an election led to the Islamic groups taking over the seat of the presidency and winning a parliamentary majority. A new constitution was agreed in a national referendum, however, shortly afterwards a unilateral change was made in the constitution by the governing authority.

This led to the second wave of unrest and political instability. In June 2013, only one year after the election, there have been an estimated 35 million people demanding and enforcing yet another change in the governing authority. Another transition period

brought the head of Egypt Supreme Court to take charge as a temporary president, as dictated by the constitution. That transition period was supported by the military because of the sensitive security situation and was followed by a presidential election in May 2014.

These major events led to the second set of changes and were accompanied by political instabilities compounded by security issues. The political instabilities led to failures in the economy as manifested by the low GDP per Capita. Also, Egypt's international credit classification was reduced several times, foreign direct investments flee, and local investors were closing down. The situation worsened as economic and political tension continued for a few years after 2011.

The sudden outbreak of what was labelled the "Arab Spring Revolutions" within few days in 2011, in several Arab countries, devastated both of Syria and Yemen, left Libya in continued internal fighting and got Iraq, which was under occupation, to fight against ISIS and Turkey. These considerable changes in the life of millions of people in several countries cannot be a simple coincidence or purely due to non-democratic rule or even due to the poor economic conditions.

The effect of the Arab spring human tragedies from 2011 until today in several neighbouring countries on the security, political life, economic and social stability scenery in Egypt cannot go unnoticed, be ignored, or unaccounted for when we look at the political stability and economy of Egypt. Its influence on political and economic stability in Egypt cannot be separated due to the long historical trading, labour exchange and direct investments ties. These Countries, as well as all other MENA region countries, have close political, economic, social and historical ties with Egypt. Some have borders with Egypt where arms, personnel and finance can pour in to induce political and economic instability.

The sudden appearance accelerated spread and growth in military preparedness finances, and the unmatched brutality of what became known as the Islamic State (ISIS) and other similar organisations, escalated security problems in the whole region. Political stability for every country in the region including Egypt has become a soaring issue. The safe haven to fighters of these brutal organizations to move from one hot

spot when they become trapped, to other locations allowed hundreds of their fighters to move between Syria and Iraq, where they originally appeared in 2006 as well as to other areas including Libya at the Egyptian west borders and Sinai inside the Egyptian eastern borders. The appearance of these organisations in Libya at the west borders has intensified the security issues, whereas it's appearance in Sinai at the eastern borders with Gaza strip blew-up the tourism sector and led to the loss of one of the main sources of income in Egypt. It eventually led to the loss of thousands of jobs and foreign currency equivalent to billions of dollars, which was necessary for improving the internal and external imbalances. With fears from security goes the foreign direct investments, some of the local investments, employment economic stability and probably political stability too.

The United Nations, Arab Human Development Report 2016, five years after the 2011 Arab spring, attests that some considered the contribution of young people as a glimmer of hope for a new renaissance that would lead the region towards a better future, whereas others considered it a seditious influence dragging the region into chaos and jeopardizing its future.

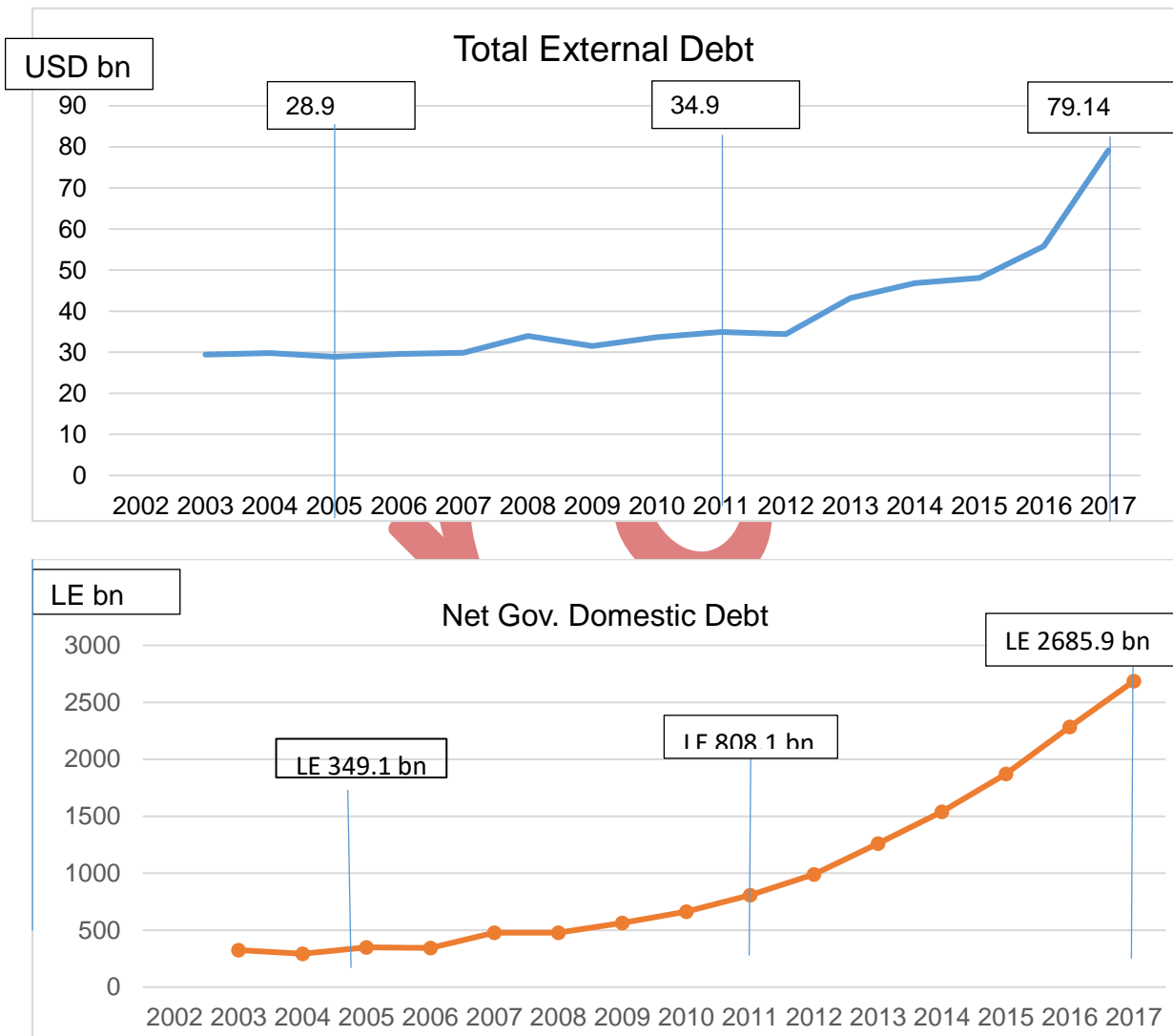
To sum up the political stability is closely connected to several economic, socio-economic and socio-political factors, including among others the internal and external imbalances and the resulting mounting debts that were built up over decades. These are not separable from security, local and international political issues.

### **Egypt Internal and External Debt**

Egypt external and internal debts have been increasing at steady rates up to 2011 when increasingly higher rates started to creep up, see fig(1). Published data in successive annual reports of the Central Bank of Egypt show that at 2011 the external debt was USD 34.9 billion. In 2005, six years before 2011, external debt was USD

28.9 billion, i.e. over that six years, the overall increase was 20%. Whereas, six years later, in 2017, the external debt soared up to USD 79.14 billion, i.e. of 227%, which is more than ten times faster than the previous six years. The reasons for this vast increase are the political instability, security problems, limited sources of foreign currency, the flight of capital, high subsidies and so on as having been described in the chapter.

**Figure 1: Egypt External and Internal Debt.**



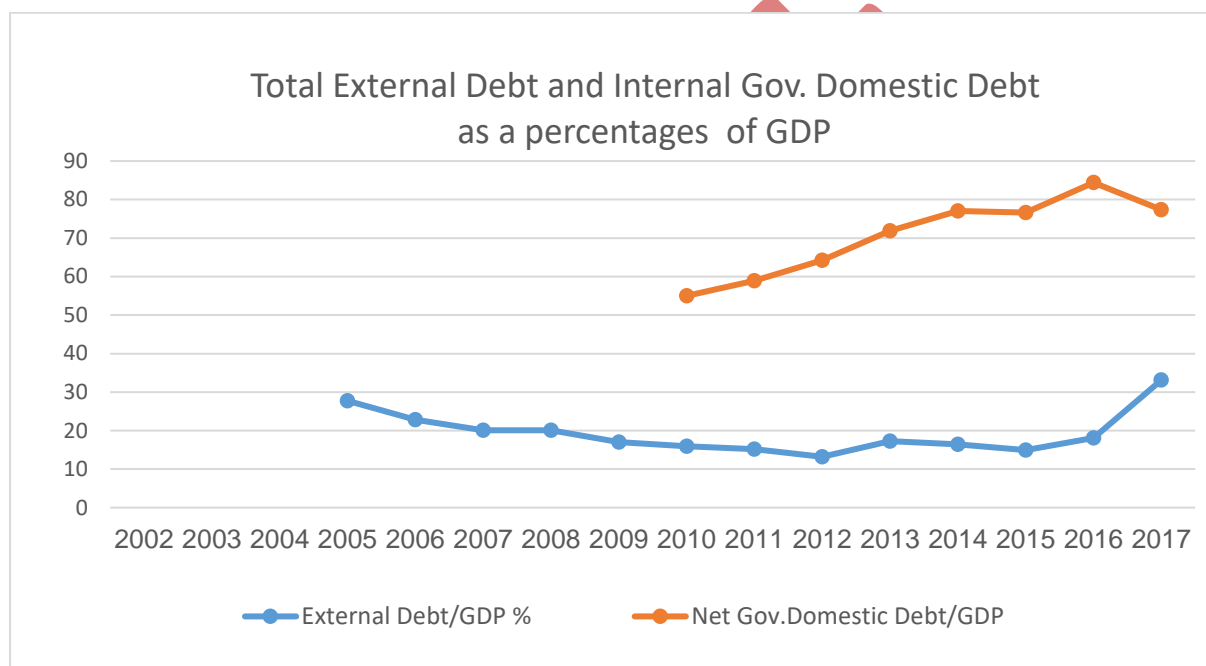
**Data Source:** Central Bank of Egypt, Extracted from Annual Reports (2006-2016)

Internal debt has also increased in a similar pattern, from the large value of LE 808.1 bn. in 2011 to the huge LE 2685.9 bn. in 2017. i.e. 332% which is a huge increment even if the increase from 2005 to 2011 was 231%. It only means that a substantial growth in debt has become even worse. Debts (borrowing) are expected to be used

as investments that would pay back, improve the economy and provide jobs; however, this was not the case in Egypt.

This serious situation was a sign danger, and the Government was forced to resort to enforcing tough and undesirable measures including austerity and floating the currency. The political, security and economic conditions were not the best for this additional challenge.

**Figure 2: Total External Debt and Internal Government Domestic Debt as a Percentage of GDP.**



**Data Source:** Central Bank of Egypt, Extracted from Annual Reports (2006-2016)

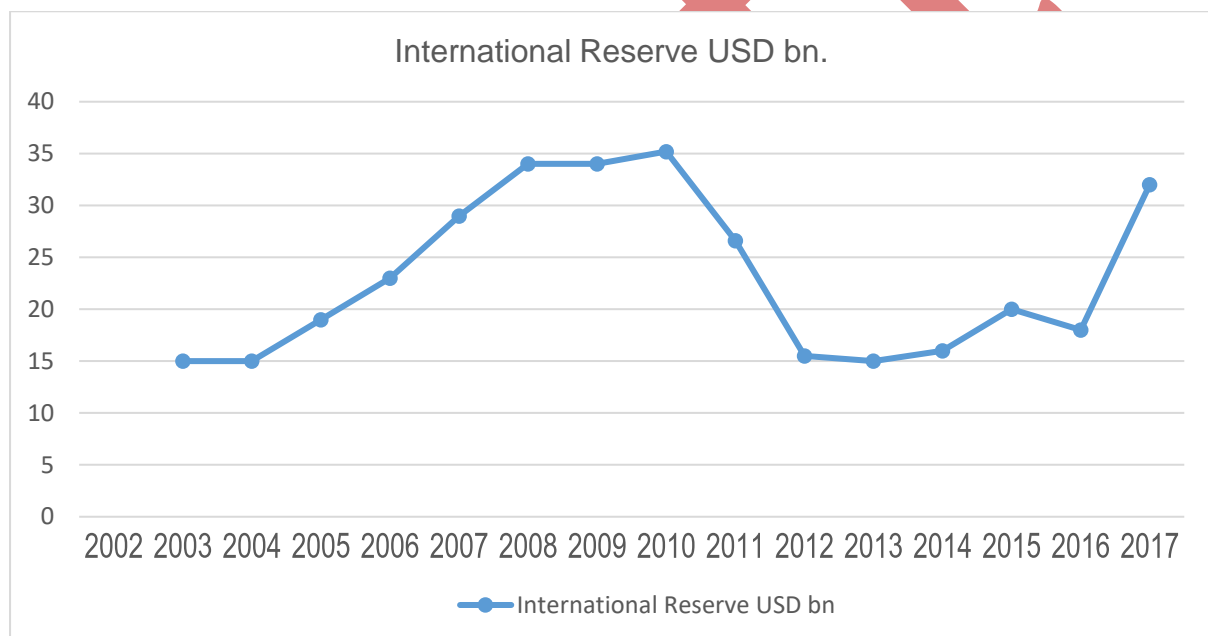
Egypt total external debt to GDP ratio continued to decrease from 2005 to 2012 and then reasonably settled around 14 and 17% for the following three years despite the severe political instability at the time. The up swing from 2015 to 2017 sets a different trend, but this could be due to higher spending in this period on public works, roads, expansion of the Suez Canal and similar projects. Differently, Egypt Internal Debt to GDP ratio has been climbing up year after year and has reached 84.4% of the GDP. The added percentages exceed the 100% mark.

This is a very high debt level, and the successive government will find difficulty in meeting the debt service and debt origin payments while trying to fulfil plans to improve

the education and health services among several other services, which need improvements.

The increase from 14% at Q1FY10/11 to 34% at Q4FY16/17, close to two and half times, is driven by the imbalance and weakness in the traditional resources in foreign currency, i.e. remittances, tourism, Suez Canal, and exports. The decline in remittances from the labour force working in the Gulf area due to the reduced demand on Middle East oil and the collapse in oil prices in 2014/2015 due to US and Canada shale oil and slowdown in world trade (Bassim, 2015)<sup>i</sup>. The internal debt has also grown and though, at a much lower rate, it has reached an unprecedented peak of 97% and 91% in the past two years (Egypt Central Bank, 2017).

**Figure 3: International Reserves USD bn.**

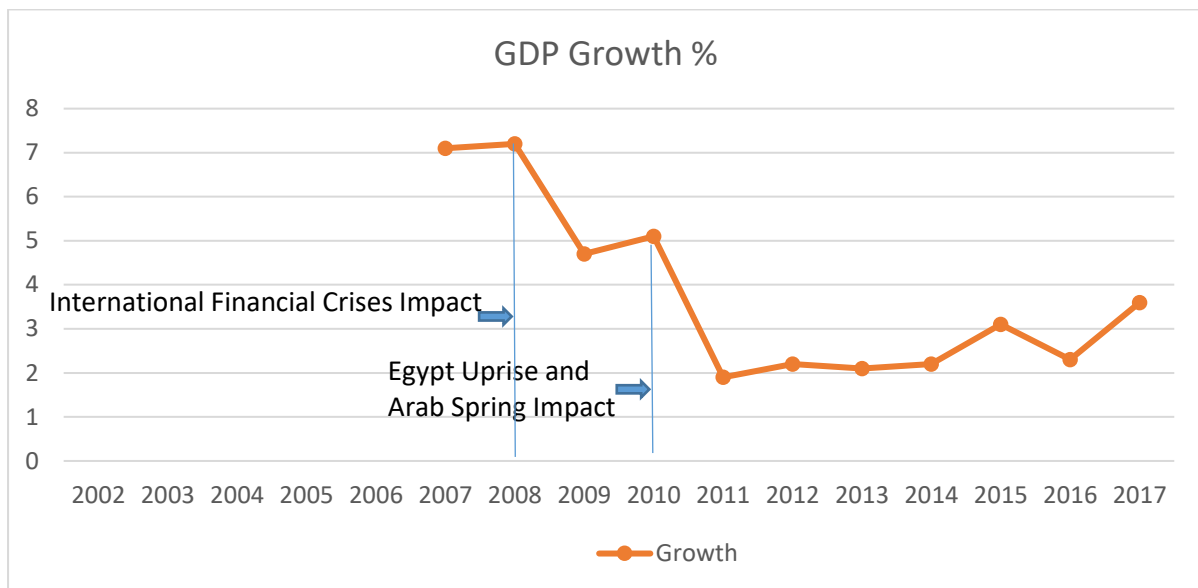


**Data Source:** Central Bank of Egypt, Extracted from Annual Reports (2006-2016)

The collapse of the Egyptian foreign reserve after 2010 from USD 35.2 bn. to USD 15.5 bn. In 2012, it was dramatic. This collapse was coupled with the increase in external and internal borrowing as shown in the external and internal debt curves. Both of these phenomena accompanied the restless political situation period, which followed the uprising of 2011. The severe imbalances of this period appear to have been treated at the expense of withdrawing from the reserve.

The upswing in external debt from 2015 is matched by the increase in the reserve over a similar period, although unfortunately with a far less amount.

**Figure 4: GDP Growth Rate**



**Data Source:** Central Bank of Egypt, Extracted from Annual Reports (2006-2016)

GDP Growth rate suffered a strong initial blow due to the international financial crises in 2008; however, it maintained relatively reasonable level, which was only comparable to the growth rates of China, India and a very limited number of countries, which managed to maintain reasonable levels of growth. With a small improvement to 5.1 in 2010, came the second blow of the uprising and political instability in 2011 where the GDP growth collapsed to 1.9 and continued for the following three years in response to the unrest, collapse of tourism, the retreat of Foreign Direct Investment, security issues, flee of business, etc. The World Bank sees the improvement in 2016/2017 to 3.9% as a trend in response to the economic measures undertaken lately by the government.

The World Bank claims that the reform momentum in Egypt has been sustained and Imbalances are forecasted to be reduced further as improvement in economic activity continues.

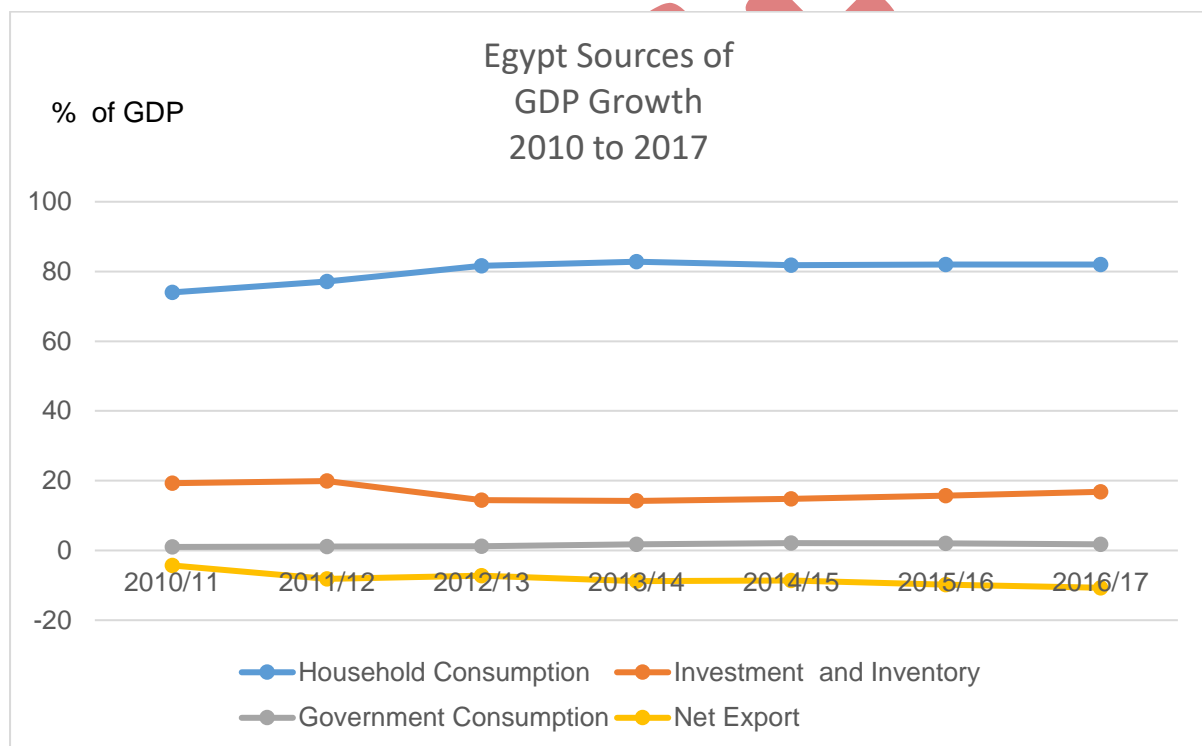
In Fiscal Year 2018, a 5% growth in real GDP is expected, and by Fiscal Year 2020 the World Bank expects GDP growth to increase gradually to 5.8%. Private investment and consumption are expected to drive Growth. Tourism services and gas exports are expected to increase gradually.

In Fiscal Year 2018, the budget deficit is expected to be reduced to 9.8% of GDP. This is due to high oil prices, interest payments, and the high exchange rates. Further

improvement in the budget deficit is expected by increasing revenue for example from VAT receipts, energy subsidy reductions and similar. Current account deficit in Fiscal Year 2018 is expected to be reduced from 6.6% of GDP in the previous year to 4.9% of GDP.

The high inflation rates from 2015 to 2017 and the liberation of the exchange rate in 2016, has reduced the households purchasing power. Upper Rural Egypt continues to show poverty rates three times as high as the Metropolitan Egypt.

**Figure 6: Egypt Sources of GDP Growth 2010-2017**



**Data Source:** Based on data from the Ministry of Planning, Monitoring and Administrative Reform.

This simple graph indicates that investment is a very weak component of the GDP, and a substantial improvement is required to encourage local and foreign investors to participate in the economy. In fact, investment went down from 19.3% to 14.4% in 2012/2013 and had since been steadily increasing to 16.8%.

The negative trade imbalance must be corrected, through plans to increase investments, encourage export, improve quality and competitiveness, reduce unnecessary imports, and encourage products with high added- values. Increasing

exports goods and services, as well as increasing returns from the sources of foreign currency, is essential for the economy to recover.

The sources of GDP growth over the past few years, unfortunately, do not appear to be due to investment or export but mainly due to household consumption. The simple analysis of this figure shows that consumption is the main driver of the GDP in all these years and is four to five times the investment.

Persisting population growth in Egypt has been a fundamental reason for the increased consumption, increased pressure on government limited resources and demand for increased services. In the meant time, unemployment is considered a serious and important issue faced by several countries including Egypt. Unemployment, particularly among youth, was one of the main reasons for the January 2011 uprising and has been a shadow over Egypt for a long time. Unemployment in Egypt remains high particularly for youth and women, although its rate declined to its lowest level since 2010 reaching 11.3% in Q2-FY18 (ii)

#### **Egypt Persisting Population Growth (population inside the Country).**

Indicator	Unit	2010/11	2013/14	2014/15	2015/16	2016/17	% change over (2013/14-2016/17)
Population Inside the Country	Million People	80.4	86.7	89	91.1	93.3	7.6

**Sources:** CAPMAS, *Statistical Year Book*, September 2017; Central Bank of Egypt, *Monthly Statistical Bulletin*, Various issues; the Egyptian Ministry of Finance, *The Financial Monthly Report*, various issues.

Egypt persistent high rate of population growth has added to the socio-economic problems (EU Parliament, 2018). According to the CAPMAS yearbook and the Egyptian Bank statistics, the population inside the country has increased from 80.4 to 93.3 Million in 6 years between 2010/2011 to 2016/2017 as shown in above.

There has been a continued debate for years in Egypt and elsewhere on whether the increase in population means an increase in resources and therefore is useful for the

economy as increase in the labour force and purchasing power, or it is harmful as it reduces the per capita share in education, health and other essential services in the country.

(Todaro, 2015) Provides arguments for the negative and positive consequences of population growth on development. Rapid population growth consequences can be seen as one of the reasons for lower per capita income, low standards of living, resource depletion and environmental destruction, and underdevelopment. The needs for services created by the numbers added every year are beyond the capability of the economy to adjust. It reduces savings rates, retards the prospects for a better life, drains the limited government resource and limits economic, health, and social services, which lead to poverty of future generations.

Theorists of the neoclassical counterrevolution school suggest that the free markets will always-correct scarcities created by population growth, however, this is not observed to be the case in Egypt and many other Countries with limited resources.

Economists who believe in the negative economic consequences as a real concern for developing countries see rapid population growth. They suggest a **population-poverty cycle** theory, which is a simplification of the standard Solow neoclassical growth equation. The standard production function,

$$Y = f(K, L, R, T)$$

i.e. Output Y is a function of capital, labour, resources, and Technology.

When the resource is fixed, the result y be driven that

$$y - l = \alpha(k - l) + t$$

Where y is the rate of GNI growth,

l = rate of labour force (population) growth,

k rate of growth of the capital stock,

$\alpha$  capital elasticity of output (usually found to be constant), and

t the effect of technological change (the Solow residual in empirical studies of sources of economic growth).

Assuming constant returns to scale, this Equation simply states that the rate of per capita income growth ( $y - l$ ) is directly proportional to the rate of growth of the capital-labour ratio ( $k - l$ ) plus the residual effects of technological progress (including improved human and physical capital). Therefore, in the absence of technological

change, the higher the rate of population growth (l), the more rapid the rate of capital stock growth (k) must be and thus the greater the concomitant savings and investment rate to maintain constant levels of per capita income.

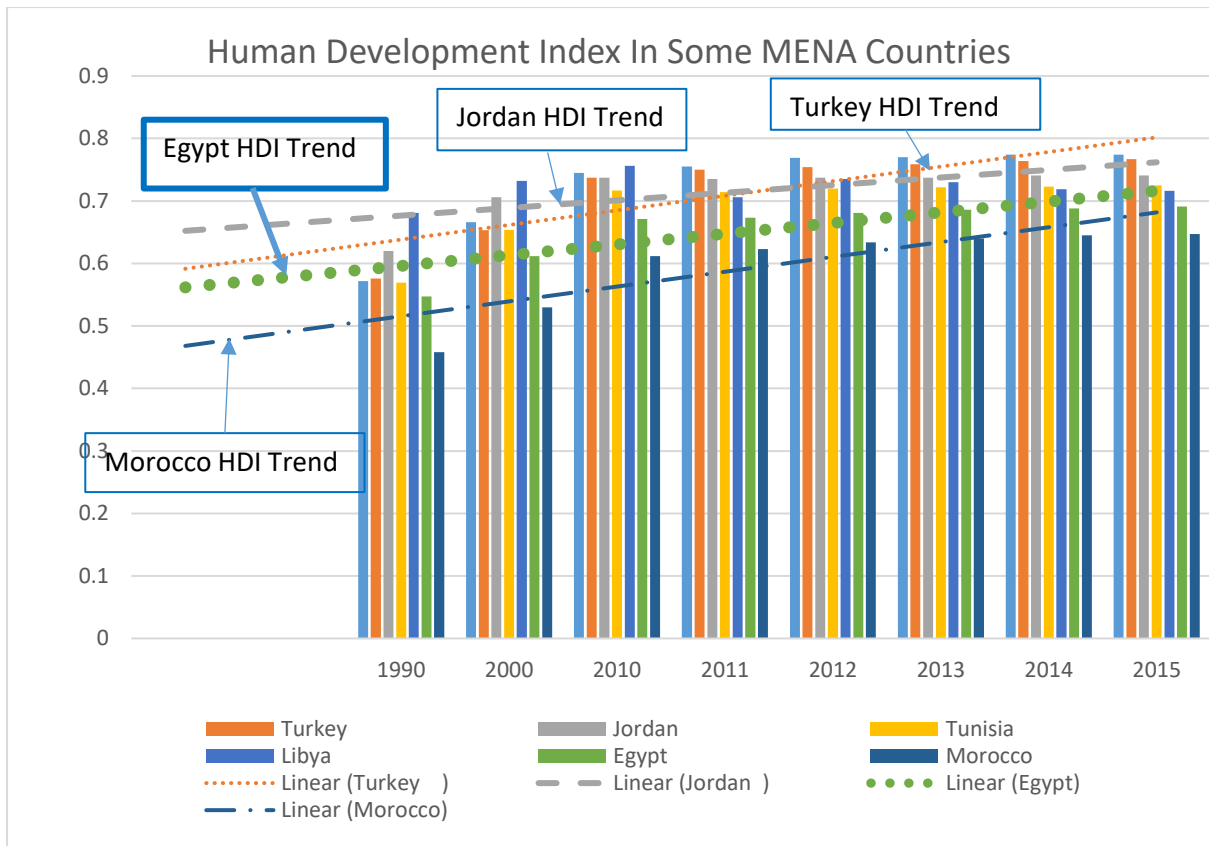
We can deduce that the increase in population can only benefit the country if the available resources are adequate to maximise the investment in human capital.

It is important to note here that although the 2014 Egyptian Constitution, article 41, recognised this and *stated* that “*The state is to implement a population program that achieves a balance between population growth and available resources and maximise the investment in human capital in the context of sustainable development*”. The birth rates and population growth continue to be very high, leading to the consequences explained above.

The challenging population size of 100 million in December 2018, from approx. a high 62 million in 1995 summarises the problem. Despite the successive population control programs which started more than 50 years ago, the current rate of population growth is 1.93 in 2017 (down to 1.87 in 2018), and this will make it difficult to improve human capital and achieve growth.

The Ministry of Health and Population with the support of the USAID started a five years family planning program. The program aims to introduce solutions that will help Egypt to address its growing population problem. The program is, and people in many poor areas will benefit from it, but in order for the program to reach, its maximum benefits there should be a society awareness of the economic growth problem.

Figure 7: Human Development Index in Some MENA Countries



Source: United Nations Development Programs (UNDP), Human Development Reports (Several issues)

Although the Human Development Index appears to be improving in Egypt, the trend appears to be slower than some other countries in the region. The comparison shows a similar trend in Jordan which appears to be affected by a secondary impact from the war and refugees from Syria and Iraq borders. The objective of all economic developments must finally be reflected in the wellbeing of the inhabitants. The human development index being a measure of this wellness as it reflects the improvement in the economy in terms of GDP/Capita as well as the education attainable and health gained. Thus, an improvement in this index reflects an improvement in the life. As such, it appears from the figure that there are improvements, which could be enhanced.

## SOLUTIONS AND RECOMMENDATIONS

The negative response due to shocks or gradual changes in the Political stability, economic growth, debt and economic imbalances, as well as the inter-relations between these variables, appear to be clear. One cannot and should not treat these as separable issues from one another or indeed from the overall factors and variables of the economic growth.

Austerity measures are a bundle of tools to attempt to repair the results a malfunction of the whole economy; however, it does not correct what is causing the malfunction. In the same venue, Austerity is like a bitter medicine, which is necessary to treat a chronic illness, but unfortunately, also it has negative side effects and cannot be taken continuously or for any length of time. However, the real treatment is not in the medicine only but in a wider bundle and a vision of the economy as a unit. The following conclusions are written from this perspective.

1. Improved GDP per capita and GDP growth rate by improving investment, reducing consumption and improve balance the trade.
2. Reduce borrowing except for investment in economically feasible projects with planned return on investment and short payback periods. Essential public works and services projects should follow a strict plan based on priority, feasibility and cost-benefit analysis. It should not be allowed to exceed the available government budgets to avoid the budget gaps and control debt.
3. Continue with the tough austerity measures, but gradually with appropriate safeguards for the poor and needy. Egypt should follow, with discretion, the IMF and World Bank recommendations on the Economy.
4. Improve the work on implementing the comprehensive social procedure to support unprivileged groups suffering from the increase in prices due to the economic reforms. This should be by implementing the minimum wage, increasing pension, reducing taxes, and prices control.
5. Form is working investment groups to plan to reap the benefits from the confidence regained by markets and international credit rating agencies in the Egyptian economy, for encouraging Foreign Direct Investments and Domestic Investors as well.
6. Provide more financial incentives, simplify government procedures, and encourage producers of high technology and services to export.
7. Provide incentives for the service industry to expand internationally and benefit from the reasonably highly educated population in medical, engineering, financial, programming and other services.
8. Egypt should continue working on business reforms that have taken place over the past year. The reforms in Egypt will attract investment, create more jobs

and make the economy more attractive according to the “Doing Business” report, 2019. The report compares the business regulations for domestic firms in 190 economies. The five reforms referenced in the report helped Egypt to advance eight ranks compared to last year and to maintain a global ranking of 120 this year. The reforms covered the Doing Business areas of Starting a business, Getting Credit, Protecting Minority Investors, Paying Taxes and Resolving insolvency (World Bank, 2018).

**9.** In addition to the above, the country should focus more on the areas where it performs well in the ease of doing the business report, for example, Getting Credit and Dealing with Construction Permits, to attract more investors. The cost for completing all procedures to obtain a permit to build a warehouse is only 1.6 per cent of the warehouse value, compared to 4.7 per cent on average in the MENA region (World Bank, 2018).

**10.** Set long-term plans for education to encourage innovative students.

Build on the five years agreement Egyptian Education Reform Project, to improve the quality of education to kinder garden children, teachers and education officials. It will also, provide 1.5 million students and teachers with digital learning resources. In addition, more than 2 million students will benefit from the new student assessment and examinations system (World Bank, 2018). The agreement was signed for 500 million dollars between the Egyptian government and the World Bank, In April 2018. The author recommends that the government and the World Bank should set long-term plans for education and apply similar projects to cover all students, teachers and education officials in the education system. Planning for the success of the project is essential to ensure that the project is successful during the upcoming five years.

**11.** Increase and control spending on technical education and comprehensive training for the talented students, to build a technological base in line with the successful technical education in Britain, Germany, Japan and Korea.

**12.** Set short and long-term plans for implementing the democratic smooth transfer and “Rotation of Power”, promote social justice, and reduce political instability.

**13.** Curb corruption and enforce law and order.

**14.** Faster ruling and judgement in lawsuits is necessary for justice to be served. This is particularly the case in commercial disputes though necessary for even for all cases. Egypt Justice System is independent, respectable and beyond reproach, yet all of this is nearly lost in the time it takes to get a ruling and get it enforced.

**15.** Support investments in health and implement a national health insurance system particularly for the disadvantaged members of the society including

children and the young people below the age of 16, the elderly above 60 and several other categories.

16. Expand and build on the “100 million health” campaign and the national plan for curbing virus C, which has already been expanded to cover blood pressure and diabetes. Other diseases need national plans to achieve international levels and may include for reduction of cancer and increasing the rates of successful treatment.
17. The government should adopt a serious program to improve awareness in schools, worship places, youth social and sports communities and other places on the importance of family planning to solve the enormous population expansion in Egypt.
18. Energy is at the heart of the growth formula, and its generation from natural, sustainable sources is essential for the Egyptian economy growth, despite the initial cost. The world outcry for the damaged environment and the irreversible damage to life and humanity in a short 12 years from fossil fuel, make it essential. Efforts to install one of the largest solar farms, as well as huge wind generating station, should be a start of the plan to spread and reach 30%, 50% and 100% of all energy requirements.
19. Successive elected governments should solicit a public awareness and participation in an overall financial plan and time schedule to address all these points and more.

## **CONCLUSION:**

Egypt has suffered from economic imbalances for a long period. However, reading the history of the past 50 decades it is clear that the economy has been able to overcome these problems and move forward after every major crisis. In the 1991 reforms, Egypt managed to follow the austerity conditions of the IMF and the World Bank and maintain a reasonable level of economic growth and reduced its debt. The internal and external shocks of 2008 world financial crises, 2011 Arab Spring wave which unleashed the security devils and the 2014 collapse in oil prices were all external to Egypt, yet their impact on the economy was colossal. In addition, the internal factors of the 2011 up rise against corruption followed by a long spell of political instability and manoeuvres together with the external shocks set the scene for real economic hardships, shortage in foreign currency and mounting debts.

In 2017, the government was very strict in the following the economic reforms requested by the IMF. As a result, the country managed to raise its economic growth

in 2018 and 2019. In addition, it will continue to reduce its budget deficit, and the government is expecting that the country will achieve its financial targets in the next year and it will reduce its public debt by 70 per cent of the GDP in four years.

Rebuilding requires integrated efforts in several directions that require careful economic planning and rational leadership.

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