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MENA Programme: Egypt Dialogue Workshop Report

The Role of International Loans and Capital in Egypt's Transition

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INTRODUCTION

This document is a summary of discussions that took place at a workshop held in Cairo on 29 September 2011, bringing together a specialised group of economists, business people, political activists, and journalists. Part of Chatham House's 'Egypt Dialogue' project, the workshop focused on the role of international loans and capital in Egypt's economy, particularly the role of funding from the IMF, World Bank and other international financial institutions.

Key findings that emerged from the workshop included:

- Widespread distrust of the motivations of foreign lenders reflects a perception that international financial institutions lavished praise on the economic policies of the previous government, despite rising poverty and inequality during this period.
- This legacy of distrust has left many sceptical about the proposed IMF loan, despite there being little awareness of the specific terms under which it has been offered. This has been compounded by a lack of communication on the part of the IMF.
- It is difficult to verify and track the use of public funds. As a result, there are calls for international agencies and governments to prioritise transparency in their financial dealings. This will allow for increased understanding and trust in the role of government, and of foreign loans and capital.
- The impact of financial assistance from the both the West and the Gulf are seen as cause for concern. Participants questioned the motivations and priorities of these funders, emphasising the potential for this aid to distort the dynamics of local civil society.

The meeting was held under the Chatham House Rule and the views expressed are those of the participants. The following summary is intended to serve as an aide-mémoire for those who took part and to provide a general summary of discussions for those who did not.

The Chatham House Rule

'When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.'

SESSION 1: THE ROLE OF THE IMF AND WORLD BANK

In June 2011, the international community was surprised by Egypt's announcement that it would not accept the offer of \$3 billion in budget support from the International Monetary Fund (IMF). The first session explored the reasons for this rejection, in the context of wider political concerns about the role of international financial institutions, and discussed the implications for Egypt's transition.¹

Perceptions of the IMF and World Bank

Objections to the IMF loan largely centred on its perceived political impact. Specifically, there were concerns that foreign loans would place external conditions on the government, making foreign debt less attractive than local debt (although local debt is considerably more expensive in financial terms). Secondly, concerns were also expressed about the risk of increasing debt at a time when some Egyptians have been campaigning for debt relief. Thirdly, a participant also said there was concern that budgetary support could be misappropriated, as had happened with other public funds in the past.

There is considerable scepticism among Egyptian activists about the role of the IMF, World Bank and other international financial institutions. In many quarters they are seen to represent Western, especially US, interests. The World Bank's historical role in Egypt remains a source of resentment (its refusal to finance the construction of the Aswan High Dam in 1954 was said to have precipitated then-President Gamal Abdel Nasser's nationalisation of the Suez Canal). More recently, the World Bank and IMF were seen as praising the former regime, and indeed employed two senior ministers from the Mubarak era. Distrust of the motivations of international financial institutions seems to be shared by leftist civil society activists and by the military, two groups whose viewpoints often differ.

Another participant argued that in lending to the former regime, the IMF and World Bank had lost much credibility in the eyes of Egyptians. Their ability to press for reform appeared weak, and the benefit of their assistance therefore remained in doubt. Both institutions were perceived as having lavished praise on the Egypt's government's policies over the past decade. Some participants noted that senior officials at both institutions have sought to present themselves in a

¹ The Egyptian government subsequently announced their intention to reconsider the possibility of financial assistance from the IMF in December: <http://www.reuters.com/article/2011/12/15/egypt-imf-idUSL6E7NF3FP20111215>

more humble light and to acknowledge previous problems, but scepticism remains.

Conditionality

It was noted that there was a lack of awareness about the specific conditions attached to the loan among many participants. The IMF's only actual condition was that the government and the IMF would need to agree on a medium-term macroeconomic framework, but even this would not have been binding: it would have been a roadmap that would help to give an indication of the direction of future policy. One participant commented that it was possible the IMF had never offered a loan with so few conditions. The key conditions had been, firstly that the government should be transparent about how it used IMF funds and should have its spending independently audited; and secondly, that conflict of interest legislation should be addressed.

However, few participants were aware of these caveats; they were more likely to associate the IMF with policies on subsidies and privatisation. One questioned how seriously international financial institutions had taken the issue of corruption, asking why they had co-operated closely with the Mubarak government when it was clear at the time that corruption was a problem.

Dissatisfaction was expressed at a lack of transparency in the conditions attached to the IMF loan. Although the organisation claims to publish all relevant documents online, participants still perceived a lack of effort by both the IMF and the Egyptian government in explaining the agreed macroeconomic plan to the public.² Conversely, it was said that opponents of the IMF loan had done a better job in promoting their campaign for the loan's rejection, although some unrealistic ideas had been aired, such as the argument that state assets that had been siphoned into foreign bank accounts by former officials would soon be restored and this would solve the country's financial problems.

It was suggested that civil society activists could have adopted a more constructive approach in order to turn the loan discussions to their advantage; rather than opposing the loan outright, they could have asked the government, IMF and World Bank to become more transparent, or could have asked institutions to focus on debt forgiveness or debt swaps instead. It was also noted

² The IMF published several statements about the loan plan in early June. The 12-month loan was intended to support the 2011-12 budget, devised by the Egyptian government, which is publicly available from the IMF: <http://www.imf.org/external/pubs/ft/survey/so/2011/new060511a.htm>. The IMF's statements also say that the government intended to prepare a roadmap for longer-term reform, but it appears this had not been finalised before the government decided (in late June) that it would not take up the loan at that time.

that conditionality is not necessarily a problem in principle but that it depended on what the specific conditions were. If conditionality required the government to be transparent and accountable, for example, then this would ultimately have a positive influence.

The impact of other foreign capital

Business representatives described the size and terms of the loan – \$3 billion at a 1.5% interest rate – in favourable terms, arguing that it would have represented an important vote of confidence in Egypt as a destination for foreign investment. It was suggested that this would have made Egyptian treasury bills more attractive. Conversely, the manner in which the loan issue has been handled – with an announcement of a loan agreement quickly being reversed for reasons that were not made transparent – was said to have affected perceptions of foreign investors as they survey Egypt's business climate. Although few investors are pulling out, very little new investment is coming in to the country, owing to uncertainty and a lack of confidence. The rebuilding of this confidence is vital to Egypt's economic future.

It was said that Egypt rejected the IMF's loan on political, rather than economic, grounds. The about-face in government attitudes towards the loan raised questions for many about who was really driving economic policy, the transitional government or the Supreme Council of the Armed Forces (SCAF).

Participants also noted that the EU had linked some of its own grants to the IMF agreement and it was now unclear how they would proceed. However, it was stated that the European Commission continues to support Egypt through its 'SPRING Programme' (Support to Partnership, Reform and Inclusive Growth)³. During 2011/12, €350 million is expected to be channelled through a cooperation budget. In addition, the EU already provides Egypt with €150 million per year, disbursed as grants for different projects.

Alternative sources of funding

The government's alternative strategy has been to fund the deficit through borrowing from domestic banks. This is feasible, as liquidity is not a problem, but remains a more costly option as interest rates are higher. However, a number of participants were concerned by this. It was noted that the fiscal deficit has widened substantially this year, partly because of increased spending on

³ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/1083&type=HTML>

salaries, although the government reduced its planned spending for 2011-12 after deciding not to take up the IMF's loan.

Egypt has also been offered large sums of financial support from the Gulf countries, particularly Qatar and Saudi Arabia. To date, pledges of support amount to \$10 billion (although only \$500 million of this had been provided at the time of the workshop and there was some scepticism about how much would materialise). Participants questioned whether these loans also have unwritten conditions attached. For instance, it was suggested that the Gulf states that had been closely allied with former president Hosni Mubarak might seek to influence the outcome of his trial. Another participant argued that Gulf pressure may have played a role in the removal of the former post-Mubarak foreign minister, Nabil Al-Araby, who was moved to the Arab League.

Some participants perceived a crucial conflict of interests between the Arab countries that are embarking on democratic transitions and the Gulf monarchies. One described the emergence of a 'two-speed Arab world' in the wake of this year's uprisings. Discussion focused on whether it was advisable to reject the IMF and World Bank in favour of Gulf funding; each source is seen to have links to a specific set of political considerations with implications for Egypt's transition.

Monitoring how funds are used

Instead of focusing on where the money was coming from, it was suggested that questions should instead be asked about how it would be spent. Participants agreed that it was important for Egyptians to be able to assess the extent to which spending was improving education and health, and reducing poverty. At present, there is a need for greater freedom of information. It is extremely difficult to verify reported improvements or to guarantee how effectively new revenues would be spent. In addition, there has been little progress in conflict of interest legislation. Few participants believed that the government publishes enough information on spending or social development indicators. In addition, several argued that Egypt's public sector financial management systems need to be reformed.

The practice of providing economic assistance to non-democratic governments, both before and after the revolution, was criticised, leading questions to be raised about the accountability of the SCAF. One participant said that the EU and international institutions had turned a blind eye to human rights abuses for thirty years and were now lending to a regime that was carrying out military trials and conducting 'virginity tests' on female protestors. Another argued that the world had to deal with the Egyptian government in order to deal with Egypt.

SESSION 2: SUPPORT OR INTERFERENCE? THE BROADER INVOLVEMENT OF INTERNATIONAL LENDERS AND DONORS IN EGYPT

As became apparent in the first session, perceptions of international lenders and donors in Egypt are mixed. Discussions in the second session focused on perceptions of Western and Gulf funding, and debated how best it could be directed.

Non-governmental organisations

The issue of international funding for non-governmental organizations (NGOs) in Egypt was discussed in detail. Some participants were sceptical about the role that foreign funding might play in an NGO; it was argued that accepting money from external sources makes an organization appear unable to secure funding from closer to home, laying it open to charges of foreign interference. However, respondents questioned the alternative to foreign funding, arguing that it is also problematic for NGOs to seek funding from the private sector. In addition, the Ministry of International Co-operation's new restrictions on foreign funding were also criticised for being an obstacle to the success of NGO activity.

Concerns were also raised about the potential for aid to 'corrupt' civil society. One participant argued that external sources of funding had created an 'upper' and 'lower' civil society. The former is western-funded with little connection to the Egyptian people, whilst the latter is domestically-funded with a greater connection to people on the ground. Describing conversations with strikers at the Mahalla textiles factory, the participant highlighted the difficulties facing female activists seeking the sort of legal or financial support that Western donations so regularly fund.

The state vs the private sector

The second session also focused on the question of who will facilitate development: the state or the private sector. Under the previous government, the private sector had sole responsibility for development. Several participants argued that this should not have been its role. Given its associations with the corruption and crony capitalism of the former regime, the private sector would need to boost its credibility and accountability if it is to play any role in development.

One speaker outlined three priorities facing the economy as a whole: infrastructure building, job creation, and poverty alleviation. In order to tackle these, another participant emphasised the need to achieve a greater degree of accountability in both sectors. In addition, they argued that a balance needs to be struck between the notions of independence and choice exercised in public sector institutions: although popular opinion must be taken into account, it was argued that economic needs and political accountability should also remain important considerations.

A range of opinions were voiced on both the suitability and the capacity of the public sector to address the priorities outlined above. One participant emphasized a 'romanticized' perception that many Egyptians have of the public sector, rendering it seemingly untouchable. This was said to be damaging as it prolonged the longevity of institutions that are inefficient, badly managed and hugely over-staffed.

It is clear that the private sector also has a number of challenges to overcome before it can play a more dynamic role in Egypt's economic development. There was consensus among participants that there had been a good deal of corruption in both the public and the private sector under the previous regime. However, opinions differed on the extent to which this problem could be overcome in the coming months and years.

It is clear that the experience of the past few decades has led many sections of society to perceive the private sector in a negative light. However, representatives from the business community raised concerns about the unfair demonization of their industries. One argued that anyone who had been a businessman in the past decade is now regarded as a profiteer without a social conscience. This perception ignores the social role played by businesses, it was argued, as they have hired, trained and developed their staff. In addition, it was argued that Egypt in fact has a history of successful private enterprise, with Egypt Air and Bank Misr cited as examples. Business representatives believe it is unreasonable to argue that private sector corruption in under previous regimes has now permanently discredited the value of a better regulated private sector in the future.

Although most participants saw reform of the public and private sectors as an important step, not everyone agreed that it should be a priority. One speaker argued instead for a greater focus on transitional economic policies and that reform of the public sector should be left to an elected parliament.

CONCLUSIONS AND RECOMMENDATIONS

There remains considerable scepticism about the role of international assistance, especially when it is channelled through institutions such as the IMF or World Bank. However, the day's discussion suggested that there is some scope for such institutions to regain a degree of trust through greater transparency and accountability. Historical mistrust of international financial institutions partly reflects their legacies of dealing with unelected governments whose economic policies were praised internationally but perceived more negatively by the public at home. These institutions may now need to communicate better with the Egyptian public, but may also need to pay more heed to popular concerns.

Egypt needs to implement a national economic development plan in order to prioritize spending, and decide the best way to meet its job creation and social justice needs.⁴ These were all key demands of the country's January 25 revolution. However, it is not easy for a transitional government to make such decisions since it will not be in office long enough to implement them.

Participants suggested that economic decision-makers needed to find ways to restore investor confidence to the Egyptian market. IMF lending might help in that regard. There should also be a focus on turning Egypt's competitive advantages to good use, including its strategic location, human resources and expertise in manufacturing. Some participants called for a new national study of economic strengths and weaknesses in different regions. The development of Sinai is also considered an important national and strategic project.

Developing a manufacturing industry produces low-margin, labour-intensive goods, such as buttons, nails and laptop components, is seen as a way forward to help meet the country's job creation and growth needs. Lifting the financial burden off small and medium enterprises (SMEs) by giving them tax breaks or loan exemptions could also be beneficial.

Finally, there was some debate regarding what agricultural policies to pursue and which crops it would be best to focus on (wheat and corn or fruit and vegetables, for example). One participant argued strawberries would be more profitable to produce than wheat, but another argued wheat was more important to reduce reliance on foreign imports. This discussion was underpinned by varying degrees of nationalist sentiment; some participants favoured co-operative farming, of which there is a long history in Egypt. Again, as in other areas, better data and

⁴ This was a key finding from the weekend's first workshop, 'Egypt's Economy in the Transitional Period': <http://www.chathamhouse.org/publications/papers/view/180929>

research into what is economically most viable for Egypt's agricultural industry would help move this debate along and inform policy.

An overriding theme of the discussion was the need for greater transparency, better data and a stronger evidence base for policy, in virtually every area of the economy. This may be an area where international expertise can be helpful. For their part, international financial institutions and governments allied to Egypt need to be aware of the centrality of corruption as a factor that undermined the popular legitimacy of the previous regime. This has damaged public confidence in business, and remains a key grievance among Egyptians today.

ABOUT THE EGYPT DIALOGUE PROJECT

Egypt is at a critical stage of its post-revolutionary evolution, when it is important that debate continues on a range of issues of concern to a variety of Egyptian constituencies. A series of workshops convened by the MENA programme in Cairo will address elections, moving from military to civilian rule, political alliances, UK and Western policy, the economy and the role of the media. A core aim of this project is to increase political inclusion: to draw previously peripheral or suppressed voices into national and international policy dialogues.

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ABOUT THE MENA PROGRAMME

The Middle East and North Africa Programme, headed by Dr Claire Spencer, undertakes high-profile research and projects on political, economic and security issues affecting the Middle East and North Africa. To complement our research, the MENA Programme runs a variety of discussion groups, roundtable meetings, workshops and public events which seek to inform and broaden current debates about the region and about UK and international policy. We also produce a range of publicly available reports, books and papers.

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