

## Research Article

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# Economic Policies, Structural Change and the Roots of the “Arab Spring” in Egypt

**Abstract:** This paper analyses the economic challenges facing Egypt in the post-Mubarak period, demonstrating the ways in which economic policy choices over the 2000s have contributed to the economic and social outcomes witnessed in the run up to the 2011 uprisings. The article investigates three specific policy areas and demonstrates their role in reducing employment opportunities, eroding wages and facilitating the creation of an increasingly unequal economic and social structure in Egypt. The three policy areas addressed by the article are (i) the general misplaced fiscal focus on expenditure-reduction rather than revenue-enhancement and the lack of progressive revenue growth; (ii) the manipulation and use of subsidies in Egypt to appease the populous instead of fostering employment generation; (iii) the failure to adequately promote employment-intensive investment.

**Keywords:** Egypt, uprising, economic policies, growth, employment

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## Introduction

Within the context of the continuing political and social developments that began in January 2011 in Egypt, commentators and researchers are still debating the factors and triggers that led to such historic upheavals. These have included the unprecedented role of new social networks and the targeting of corruption and political repression as well as the general disenfranchisement of young people under the Mubarak regime. Some writers have also acknowledged the contribution of high food prices and rising wealth gaps as important economic factors.

However, research has not yet adequately linked the political and social developments in Egypt with the underlying economic policy framework under Mubarak.<sup>1</sup> In fact, many commentators had lauded the economic achievements of

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<sup>1</sup> A notable exception is Adam Hanieh’s recent work (see Hanieh 2011).

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many of the Middle Eastern governments, including Egypt, over the course of the 2000s. The IMF and World Bank were particularly congratulatory of Egypt's high growth rates and its associated adoption of liberal policies. Even when weaknesses in terms of economic and social outcomes have been linked to political upheaval, the analysis has tended not to go far enough and often does not consider the role of economic policies in particular. For example, high levels of youth unemployment have been linked to cultural and demographic features of Egyptian society (Ahmed, Furceri, and Guillaume 2012), rather than understood as a result of economic policies adopted by the Mubarak regime.

The paper takes a historical perspective and considers the extent to which Egypt's economic policies in recent years contributed to social and political upheaval. Given the widespread literature and debate around liberalisation and privatisation policies in Egypt and the Middle East more generally (for an introduction see Harik and Sullivan 1992), and for the sake of brevity, this paper will not delve into these crucial background contextual issues. Instead the focus here is on policies adopted subsequently, particularly in the late 1990s and 2000s and in the wake of widespread economic liberalisation under the oversight of the IMF and World Bank. Crucial here, is that the adoption of the earlier liberalisation and privatisation policies, opened the door to allow the Mubarak regime's to adopt the subsequent policies, discussed in this article.

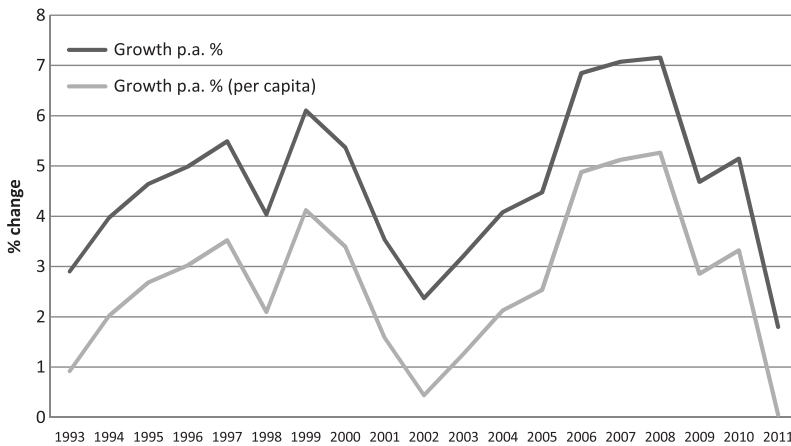
The paper will first outline the underlying economic situation before focusing on the nature and pattern of economic growth, employment and structural change. It will then analyse more closely the economic policy trajectory in Egypt over the last 15 years and seek to document how three specific areas of economic policy have helped lay the basis for ongoing social and political turmoil. In conclusion, the paper emphasises the importance of developing an alternative economic policy framework for Egypt.

## **Investigating the evidence on Egypt's pre-crisis economic and social performance**

### **General trends in economic growth and poverty reduction**

Prior to Egypt's 2011 upheaval, international data have frequently been cited in order to support Egypt's progress in relation to growth and poverty eradication. For example, a 2008 MDG Progress Report noted that "sustaining recent economic growth coupled with pro-poor policies holds great promise for fast reduction of poverty in Egypt" (Ministry of Economic Development 2008). Similarly the most

recent IMF assessment of 2010 concluded that “World Bank estimates suggest that strong growth during 2005–08 contributed to a 14 per cent decline in the proportion of the population living below the (upper) poverty line in Egypt” (International Monetary Fund 2010). However, closer investigation of the data reveals a different reality. Figure 1 captures Egypt’s economic growth rates over the last two decades while Table 1 is based on national information on poverty levels over time.



**Figure 1:** Nominal GDP growth in Egypt 1993–2011

Source: World Bank, World Development Indicators.

**Table 1:** Poverty headcount ratio using national poverty line

|                                | 1990 | 1995 | 2000 | 2005 | 2009 |
|--------------------------------|------|------|------|------|------|
| Poverty headcount ratio, Urban | 20.3 | 22.5 | 9.3  | 10.1 | 11.0 |
| Poverty headcount ratio, Rural | 28.6 | 23.3 | 22.1 | 26.8 | 28.9 |
| Poverty headcount ratio, Total | 25.0 | 22.9 | 16.7 | 19.6 | 21.6 |

Source: CAPMAS, World Bank.

Economic growth was slow in the early 1990s. For example, GDP growth per capita averaged about 1.4% during 1991–1995. The slowness of growth helps explain, no doubt, the modest decrease in the poverty incidence in this period. Between 1996 and 2000, in contrast, the growth of GDP per capita accelerated to 3.2%, and, correspondingly, poverty declined more rapidly – at least in urban areas.

However, the early 2000s were marked by a significant decline in economic growth. The rate of increase in GDP per capita declined to 1.6% during 2001–2005. During this same period, poverty began to increase in both urban and rural areas, with a more pronounced increase evident in rural areas.

By the mid-2000s, however, economic growth was clearly accelerating. During the 3 years of 2006–2009, the rate of increase of GDP per capita averaged 4.5%. In 2009, after the onset of the global financial crisis, per capita GDP growth fell to 2.9% and is estimated to have been 3.2% in 2010. This recent deceleration could help to explain the rise of poverty from 19.6% in 2005 to 21.6% in 2009, despite the earlier spurt of growth during the mid-2000s.

Nonetheless, comparing the upward trend in GDP growth over the whole period of 2000–2009 with the corresponding rise in income poverty underscores the likelihood of problems in the *character* of Egypt's economic growth. For example, while nominal GDP growth rates averaged 4.5% for the 4 years through 2009, such rates have evidently not served to reduce income poverty. Furthermore, if one believes that Egypt's income distribution, as measured by the Gini coefficient, improved marginally over the last 10 years (World Bank 2013),<sup>2</sup> one would expect the country's growth to have been more equitable. Yet income poverty has been on the rise in Egypt since 2000.<sup>3</sup>

Inequality trends do not appear to be credible if there was indeed an increasing concentration of economic assets (Karshenas and Alami 2011, 2012; Achcar 2013). The widespread complaints about the severity of economic inequality in Egypt, especially based on the concentration of income at the top of the distribution, do not appear to square with some of these recent estimates. Taking a multi-dimensional measure of inequality, as done by El-Laithy (2012), demonstrates increasing inequities in various human dimensions. In fact, such inequalities have resulted in reducing Egypt's HDI ranking in recent years. The major reason for this is inequalities in education (Aran and Ersado 2013).

The findings confirm that wide differences in school enrollment persist, notably at the higher levels, and mostly based on the family's socioeconomic background. (Aran and Ersado 2013, 17–18)

Egypt also has one of the highest Gender Inequality Indices in the region, indicating that the gap between men and women in Egypt remains a major concern. A further interesting trend emerges from inequality perception surveys, conducted by the World Bank. Comparing the surveys from 2000 and 2008 indicates that subjective aversion to inequality has intensified and for all social groups. In other words across all income groups in Egypt, individuals perceived greater inequality in 2008 than in 2000 (Verme 2013).

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<sup>2</sup> According to World Bank (2013) estimates, the Gini coefficient rose from 32.0 in 1990/91 to 32.8 by 2000/01 before dropping back down to 31.1 in 2008/09.

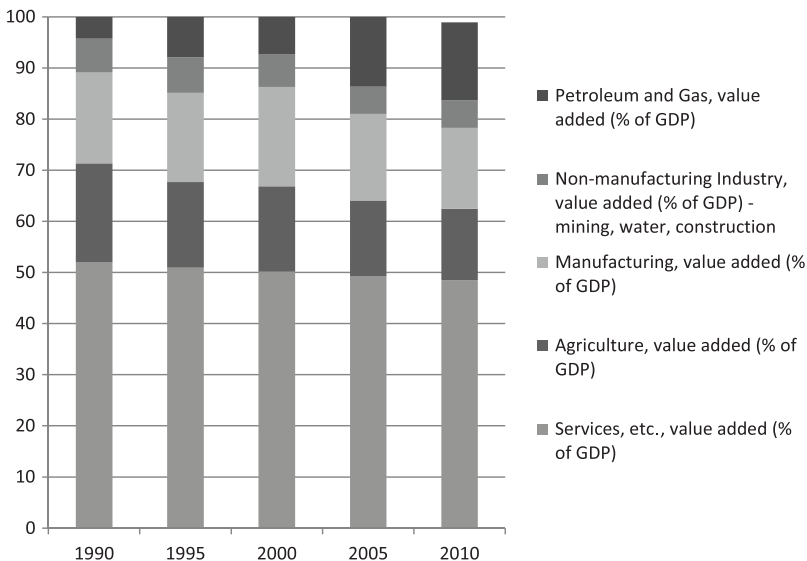
<sup>3</sup> The distinction between urban and rural poverty is particularly problematic in the Egyptian context largely due to issues pertaining to data collection. A recent UN Habitat study describes such concerns in depth (UN Habitat 2011).

Clearly, Egypt's record on poverty reduction was moving in the wrong direction long before the political crisis of 2011. We hope to shed some light on why these differing trends have occurred by examining changes in the nature of growth and employment creation.

## Sectoral growth trends

Examining sectoral growth trends in Egypt can help to understand the *pattern* of economic growth, not just its pace, and therefore illuminate why economic growth has failed to generate benefits for the majority of Egyptians. As in many emerging economies, the role of the agricultural sector has been declining in Egypt. It has been growing slower, and its share in GDP has declined from almost 20% in 1990 to around 13% in 2010. Industry (including the oil and gas sector) had more rapid growth in the late 1990s than in the early 2000s. While this sector's rate of growth did increase during 2005–2009, this was largely driven by the oil and gas sector. Since the mid-1990s, growth of the services sector has been relatively stable, at around 50% of GDP (see Figure 2).

According to Figure 2, the sector which made up for the decline in agriculture has been the oil and gas sector, whose share has risen from under 10% in the 1990s to over 15% in the mid-2000s.



**Figure 2:** Sectoral GDP composition in Egypt (selected years)

Source: Ministry of Economic Development, <http://www.mop.gov.eg/>

It seems evident that economic growth in Egypt was leaving agriculture and rural areas behind in the 2000s. Further, even when growth was rapid during this period, it is unclear whether it benefitted large proportions of the urban population. In fact, given the increased role of oil and gas, a notoriously capital-intensive industry, the picture that emerges is increasingly biased against both rural and urban workers and the poor.

## Employment and labour force trends

Looking at sectoral *growth* trends paints a questionable picture regarding the Egyptian economy's ability to create remunerative jobs and lower poverty. A closer look at employment trends themselves can help illuminate the historical trajectories and status quo. There have been both positive and negative demographic trends in Egypt during the 1990s and 2000s. The rate of growth of the total population has remained relatively stable. During the period 1988–1998, it was 2.1% while during the period 1998–2006, it was 2.0%. But the growth of the working-age population (15–64 years of age) has been faster in both periods (3.0% and 2.7%, respectively).

As a result, youth unemployment has remained a major challenge for Egypt. For example, 27% of the population aged 15–24 years is formally unemployed<sup>4</sup> (UNDP 2005; Assaad 2007, 2009). Between 1997 and 2007, the 15–25 age group comprised 57–66% of total unemployed (see Table 2).

**Table 2:** Unemployment according to age in Egypt

| Years   | 1997 | 2003 | 2007 |
|---------|------|------|------|
| 15–25   | 57%  | 66%  | 63%  |
| 25–39   | 42%  | 33%  | 36%  |
| 40–54   | 1%   | 1%   | 1%   |
| Over 60 | 0%   | 0%   | 0%   |

Source: ILO, *Laborsta* database.

<sup>4</sup> The unemployment rate is often a misleading indicator of labour-market conditions in developing countries. While it can indicate the inability of better-off workers to find employment appropriate to their education and skills, it tells us, in reality, very little about the prospects of poorer workers.

There has been a general mismatch between young people's educational achievements and the nature of the demand for workers generated by the economy (Korshid et al. 2011). While public-sector employment has diminished, the private sector has not grown rapidly enough to productively absorb young workers.

Many younger workers have been thwarted in finding decent, formal-sector jobs. The trend towards informalisation, which had increased in the 1990s, continued during the 2000s. A major concern is that the public sector (including both public enterprises and the government) has become unable to provide jobs in line with the growth of the labour force. Its share of the employed fell from 39% in 1998 to 30% in 2006 (Assaad 2007). Meanwhile, the formal private sector did little to take up the slack: its share of total employment rose from only 8% to 10% (Assaad 2007). In contrast, informal wage employment, which was growing by 7.7% between 1998 and 2006, increased its share of total employment from 13% to 17% (Assaad 2007). In other words, the growth of employment in the informal private sector took up some of the slack from the loss in formal public-sector jobs (Angel-Urdinola and Semlali 2010). This is likely to be one major reason why the acceleration in economic growth in Egypt during part of the 2000s did not translate into rising real incomes and, thus, any meaningful reduction in poverty.

Also, the rural labour force has continued to grow more rapidly than the urban labour force. There has been a continued rapid growth of the rural working-age population (which was growing by 2.8% during 1998–2006, according to Assaad 2007) and an increased participation of women in the rural labour force. This growth in the rural labour force has not been matched, unfortunately, by a corresponding increase in economic activity and thus job creation in rural areas. The resultant disparity between the growth of the labour force and the availability of gainful employment has been a major explanation for the continuance of poverty in Egypt and the marked increase in widespread economic and political discontent (Joya 2011).<sup>5</sup>

An additional problem is that most wage employment remains concentrated in small firms. For example, nearly half of all wage employment in 2006 was in micro-enterprises having fewer than five workers (Assaad 2007). And this segment was growing, in fact, much faster than larger firms. Most of the wage

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<sup>5</sup> Joya (2011) highlights the increase and changing nature of labour unrest in Egypt since 2006. Protests in recent years have been in response to the privatisation of public-sector firms and the lowering of wages and benefits for workers that have accompanied this process.

employment in small firms is informal. In firms with fewer than 10 workers, for example, the proportion of informal employment in the total is over 80% (Assaad 2007).

If we examine the ILO categorisation of status in employment, we find that between 1995 and 2006, there were no significant improvements in the Egyptian labour market. The share of workers in wage and salaried employment rose only marginally. In 1995, this share was 57.1%; in 2000, it was 59.9%; and by 2006, it was 61.8%. This represented only about an 8% increase over this period (International Labour Organization 2013).

The share of workers in “vulnerable employment” exhibited a different pattern during this period. Own-account workers and contributing family workers (often unpaid) are regarded by the ILO as constituting the vulnerably employed. The combined share of these two classifications totalled almost 24.2% in 1998. By 2002, this share had fallen to 22.4%, with both classifications contributing to the decrease. This trend reversed, however, between 2002 and 2006 so that the share of the vulnerably employed had risen back up to 24.8% in 2006 (International Labour Organization 2013).

As a result, there had been little change in the prevalence of vulnerable employment in Egypt between the mid-1990s and the mid-2000s. These trends appear to be consistent with the U-shaped trend of extreme income poverty, which first decreased between 1995 and 2000 and then rose during the 2000s. Poverty and vulnerable employment are closely associated.

Finally, a closer look at the development of real wages indicates further worrying trends in the Egyptian labour market over the 2000s. Unsurprisingly, real wages in agriculture remain the lowest of all the sectors in Egypt (around two thirds of the average wage). However, more importantly, while real wages were following a general upward trajectory up to 2000, they have since declined. Unfortunately data are only available until 2006 by which time real wages in the services sector had dropped by 35% from their highpoint in 2000, and wages in agriculture had reduced by 13% over the same timeframe (International Labour Organization 2013).

### ***Analysing employment generation and growth in Egypt using the Job Generation and Growth Decomposition (JOGGS) tool***

ILO data suggest that trends in sectoral employment also underwent only modest changes between the late 1990s and the mid-2000s. For example, the



share of the total employed who are in agriculture started out at 30.7% in 1997. Even by 2002, this share had dropped significantly, namely, to 26.9%. However, by 2006, this share had risen back up to 30.4%, almost the same as in 1997 (International Labour Organization 2013). Since the share of agriculture in total GDP had dropped over this same period, the inevitable implication is that those workers who continued to be employed in agriculture had a lower average income per worker. Surplus labour in agriculture remains excessive since there are few promising employment opportunities in urban areas.

Using the World Bank's JOGGS tool can further demonstrate important changes in Egypt with regard to employment for the period 1995–2008. The JOGGS tool<sup>6</sup> is an Excel-based macro-spreadsheet, which allows users to easily decompose growth in GDP per capita in two periods into its employment, productivity and demographic components, both at the aggregate and sectoral levels (World Bank 2007). The interpretation of results evidently depends on the availability and reliability of the data used. In this case the data have been taken from the World Bank's World Development Indicators 2013. The main questionable aspect of the data on Egypt used here relates to the employment and productivity data. Klau (2010) details these data concerns and limitations.

Bearing in mind the data caveats, the JOGGS remains a useful tool for analysing the links between economic growth and the generation of jobs and productivity in a country such as Egypt. Specifically, the JOGGS tool allows us to answer the following questions: (i) how is growth reflected in employment generation and in changes in output per worker; (ii) how is growth reflected in the sectoral pattern of growth; and (iii) what are the sources of changes in output per worker?

As indicated above, Egypt's GDP growth over this timeframe has been mixed, although it has averaged 3.2% per annum. Using the JOGGS tool, this growth can be shown to have been made up of an increase in productivity (measured as output per worker) of 1.9% per annum, annual increases in population of working age of 0.8% per annum, and an average annual increase in the employment rate of 0.5%. The increase in output per worker explains around 60% of the increase in GDP growth witnessed in Egypt. The remainder is

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<sup>6</sup> For more information regarding the JOGGS tool and examples of practical applications in other countries, please visit: <http://go.worldbank.org/461KJUVOX0>.

explained by increases to the working-age population and changes in the employment rate.

Considering a breakdown by sectors helps demonstrate where growth has been particularly employment intensive and where it has not. According to the JOGGS decomposition, total employment grew by 48% over the period 1995–2008. However, due to the simultaneous rise in the working-age population, the employment rate (measured as total persons employed as a proportion of working-age population) actually only grew by 6% over the whole period.

It would appear that during the period 1995–2000, the services and manufacturing sectors significantly drove the increase in the employment rate over this period. However, in the period after 2000 the opposite has been the case i.e. the drivers of any the increase in the employment rate were from the agricultural and non-manufacturing industrial sectors. The services sector on the other hand saw its relative importance in terms of employment generation reduce over this later timeframe.

On the whole, average output per worker increased in Egypt over the period 1995–2008. This increase was roughly equivalent over the period 1995–2000 and 2001–2008. However, what was driving this increase was indeed quite different for the two periods. Between 1995 and 2000, labour productivity increased across the various sectors roughly equally. Furthermore, there was a significant inter-sectoral shift suggesting that, on average, labour was moving from low-productivity to high-productivity sectors. In fact the agricultural sector, with the lowest productivity, witnessed a reduction in employment share, which exerted a positive effect on increasing productivity (see Table 3).

In the period 2001–2008, however, the only sectors in which output per worker increased were services and to a much lesser extent, industry (both manufacturing and non-manufacturing). Significantly, agriculture saw output per worker decrease and the inter-sectoral shift component was negative, indicating that during this time workers were, on average, moving from high-productivity sectors to lower productivity sectors. We saw earlier that over this timeframe employment in agriculture increased. It would therefore seem that some of the increase in output per worker witnessed in the other sectors may have been as a result, at least partially, of workers being forced to find employment in the lower paid agricultural sector. Over the period 2001–2008, the employment share in agriculture increased, exerting a significant effect on reducing productivity.

Bringing the above analysis together in Tables 3 and 4 reveals the major distinctions between the 1995–2000 and 2001–2008 periods, in terms of growth and employment generation.

**Table 3:** Growth decomposition. percent contribution to total growth in GDP (value added) per capita, Egypt 1995–2000

|                                     | Contribution of<br>within-sector<br>changes in output<br>per worker (%) | Contribution of<br>changes<br>in employment<br>(%) | Contributions of<br>inter-sectoral<br>shifts (%) | Total<br>(%) |
|-------------------------------------|-------------------------------------------------------------------------|----------------------------------------------------|--------------------------------------------------|--------------|
| <i>Sectoral contributions</i>       |                                                                         |                                                    |                                                  |              |
| Agriculture                         | 15.4                                                                    | -23.7                                              | 13.7                                             | 5.4          |
| Manufacturing                       | 14.8                                                                    | 9.9                                                | 4.9                                              | 29.6         |
| Services                            | 7.6                                                                     | 35.4                                               | 2.6                                              | 45.6         |
| Industry excluding<br>Manufacturing | 12.2                                                                    | -11.4                                              | -7.0                                             | -6.2         |
| <i>Subtotals</i>                    | <i>50.0</i>                                                             | <i>10.2</i>                                        | <i>14.2</i>                                      | <i>74.3</i>  |
| Demographic component               | -                                                                       | -                                                  |                                                  | 25.7         |
| <i>Total</i>                        |                                                                         |                                                    |                                                  | 100.0        |

Source: Author's calculations based on World Bank 2013 data.

**Table 4:** Growth decomposition. percent contribution to total growth in GDP (value added) per capita, Egypt 2001–2008

|                                     | Contribution of<br>within-sector<br>changes in output<br>per worker (%) | Contribution<br>of changes<br>in employment<br>(%) | Contributions<br>of inter-sectoral<br>shifts (%) | Total<br>(%) |
|-------------------------------------|-------------------------------------------------------------------------|----------------------------------------------------|--------------------------------------------------|--------------|
| <i>Sectoral contributions</i>       |                                                                         |                                                    |                                                  |              |
| Agriculture                         | -2.9                                                                    | 14.3                                               | -4.6                                             | 6.8          |
| Manufacturing                       | 5.8                                                                     | 5.2                                                | 1.5                                              | 12.5         |
| Services                            | 52.3                                                                    | -6.7                                               | -1.7                                             | 43.9         |
| Industry excluding<br>Manufacturing | 4.2                                                                     | 6.2                                                | 2.4                                              | 12.7         |
| <i>Subtotals</i>                    | <i>59.4</i>                                                             | <i>18.9</i>                                        | <i>-2.4</i>                                      | <i>75.9</i>  |
| Demographic component               | -                                                                       | -                                                  |                                                  | 24.1         |
| <i>Total</i>                        |                                                                         |                                                    |                                                  | 100.0        |

Source: Author's calculations based on World Bank 2013 data

Evidently, over both periods, demographic changes only contributed around a quarter of all the changes in GDP growth. The remaining three quarters are largely explained by increases in within-sector output per worker in both periods (see final column in both tables). The share of the working age population had a smaller positive effect, although it is clear that in the 1995–2000 period,

employment in agriculture and non-manufacturing industry (oil and gas, mining and construction) decreased (second column in Table 3) while in the post-2000 period employment in these sectors grew (second column in Table 4). Similarly, while employment in services saw considerable growth pre-2000, employment in this sector declined again post-2000. These observations are supported by the final contribution to GDP growth, that of inter-sectoral shifts. In the pre-2000 period, the net effect of such moves was ultimately positive while in the post-2000 period the net effect was negative, indicating labour movement away from high-productivity to low-productivity employment in agriculture and industry.

The overall picture that emerges from the JOGGS exercise supports the evidence presented so far. Overall growth in the Egyptian economy, particularly since 2001, has not been generating jobs in the sectors which have witnessed the highest growth. The sector with the highest average growth rates, services, has not been able to absorb new labour market entrants. Instead, the largely stagnant and low-productivity agricultural sector appears to have increased its employment contribution since 2001.

## **Egypt's economic policy environment: How much are the wrong economic policies to blame?**

So far, this article has demonstrated how the Egyptian economy has failed to provide adequate employment-enhancing and poverty-reducing growth for the majority of Egyptians. The following section of the paper investigates the contributory role of economic policies in fostering such narrow and inequitable growth. In order to demonstrate the ways in which economic policies have contributed to the status quo, three specific issues will be investigated: (i) the general misplaced fiscal focus on expenditure-reduction rather than revenue-enhancement and the lack of progressive revenue growth; (ii) the manipulation and use of subsidies in Egypt to appease the populous instead of fostering employment generation; (iii) the failure to adequately promote employment-intensive investment. Taken together these three policy areas offer important insights into how economic policy-making in Egypt over the 1990s and 2000s contributed to the social and political tensions that erupted in 2011.

### **Regressive fiscal policy**

Egypt's fiscal balance recently deteriorated and in 2011 the deficit reached -10% of GDP. This has largely been driven by small increases in expenditure following

the global crisis and a large drop in revenue in 2011 in particular. However, considering the pre-crisis period, Egypt has maintained fiscal balances that have ranged from +4% of GDP in the early 1990s to around -4% of GDP in the mid-2000s. However, it is clear that fiscal balances have been following a downward trajectory since the mid-2000s. It is important to ascertain how this has occurred. It is argued here that the focus on curbing expenditure rather than raising revenue has hampered employment-enhancing economic growth in Egypt.

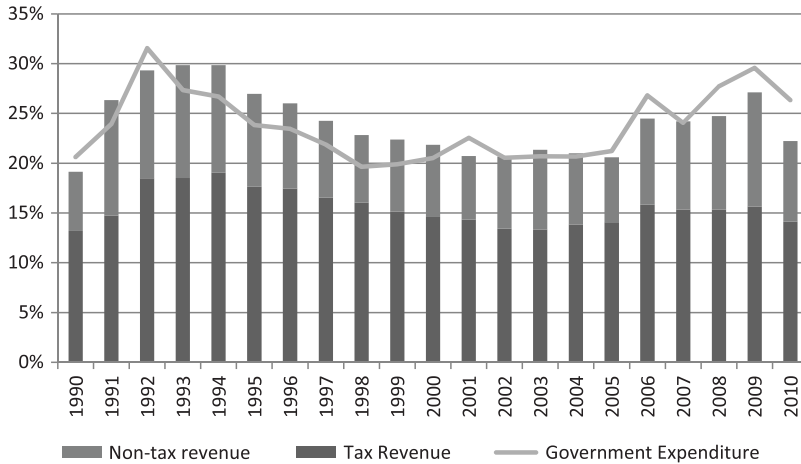
Prior to the global economic crisis, Egyptian policy-makers were aiming to achieve a fiscal target of 3% deficit to GDP ratios by 2010/11. In light of the global crisis, this target has been postponed and is to be reached by 2014/15 (Abdallah 2012). Instead, and in response to the global crisis, the Egyptian government did allow for a wider fiscal deficit in the short-term. The stimulus package covered public-private partnership<sup>7</sup> investment in infrastructure delays to planned reductions in fuel subsidies and lower tariffs on some imported intermediate and capital goods. However, even according to the World Bank, Egypt's stimulus package can be seen as somewhat conservative. "... the stimulus package of 1.5 percent of GDP (which includes public investment as well as other categories of public spending) will not be sufficient to restore growth to the 2008 level" (World Bank and Ministry of Finance 2009).

Looking more closely at Egypt's revenue and expenditure performance over the past 20 years (see Figure 3) it is evident that government expenditure has largely stagnated over time, although it rose temporarily in 2009 to cope with the global crisis. According to World Bank data, the increase in expenditure in 2009 was largely directed to subsidies and social benefits.<sup>8</sup> What is particularly worrying about such expenditure stagnation is that it has been regressive, with detrimental outcomes regarding child health and nutrition among the poorest (Assaad et al. 2012). Compensation of state employees has remained low, and the payment for goods and services has shrunk. Social benefits which were only counted separately in the late 1990s were initially significant at around 2% of all spending in the early 2000s but have been eroded to 0.4% in 2011 (International Monetary Fund 2013).

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7 PPPs replaced unsuccessful arrangements for partnerships with the private sector over the 1990s. In 2006 the PPP Central Unit was established with the aim of pursuing partnership with the private sector to provide a new source of investment capital and financing for infrastructure projects, and with the secondary aim of reducing the government's fiscal burden. However, the success of such projects remains to be seen, given concerns over terms and the potential risks the Egyptian government could be left with (Hussein 2012).

8 We will discuss this further below. However, the increase in spending in subsidies since 2008 can be seen as a wider shift away from government spending in productive capacity-enhancing areas and towards subsidies and welfare support. See UNCTAD (2006) for an argument in favour of productive government spending for job creation, growth and poverty reduction.



**Figure 3:** Government revenue and expenditure as a per cent of GDP

Source: World Bank, World Development Indicators

The government's spending on education has also shrunk in real terms, according to World Bank (2013) data. In 2003 education expenditure made up 16.2% of all government spending. By 2008 this had shrunk back to 11.9%. Similarly, the share of government spending on healthcare has steadily declined from a peak of over 8% of total government spending in 1998 to a trough of 5.9% in 2008. The latest estimate for 2010 puts the figure at 6.1% (World Bank 2013). Concurrently, out-of-pocket spending on healthcare has steadily risen over the 1990s and 2000s (World Bank 2013). Such out-of-pocket spending on healthcare represented around 48% of total spending on healthcare in 1995. By 2003 this had risen to 61% and 58% in 2011 (World Bank 2013).

Revenue performance has also been unimpressive, especially the increased reliance on non-tax revenue and domestic sales taxes over time. Overall tax revenue performance has been particularly poor, remaining at around 15% of GDP since 1999. According to recent IMF data, Egypt's tax revenue performance is below average, when compared to other lower middle income countries. In fact only four out of 24 lower middle income countries had, on average, lower tax (to GDP) ratios than Egypt<sup>9</sup> (International Monetary Fund 2011). In its place non-tax revenue has increased its share, due to an increased reliance on Suez Canal receipts and mineral (natural gas) rents (Nashashibi 2002; Oxford Business Group 2013).

<sup>9</sup> Data are taken from Pessino and Fenochietto (2012).

Additional evidence on fiscal changes in Egypt highlights the historic trend away from direct tax collection, which is more progressive, towards a more regressive indirect tax regime, focused on the collection of value-added and sales taxes from consumers (Moore 2012). This is supported by considering the share of taxation of goods and services,<sup>10</sup> generally agreed to be more regressive (Zolt and Bird 2005; Norregaard and Khan 2007), in total revenue in Egypt. Over the period 1990–1997 such goods and services taxation represented, on average, 13.3% of all revenue collected. However, by 2011, this figure had almost doubled to 25.2% despite revenue as a whole having declined as a percentage of GDP over time (see Figure 3 and Table 5). The share of income, capital gains and corporate taxation in total revenue has, on the other hand, increased only marginally over the course of the 1990s and 2000s and remained 25% of total revenue in 2010. Crucially, as a result of trade liberalisation since the 1980s, receipts from trade-related taxes have reduced their share significantly since 1990 (Refaat 2000). By the IMF's own admission, in the case of Egypt, the authorities failed to recover the lost revenues from trade taxes (International Monetary Fund 2005b).

A further regressive move was taken by the Egyptian government, under IMF advice (International Monetary Fund 2005a) in 2005 to reduce the top marginal tax rate on income and profits from 32% to 20% for individuals and from 40% to 20% for corporations and partnerships (International Monetary Fund 2011). The rationale of such a move is summarised by the IMF, as follows:

While rate reductions would lower revenues in the short run, other measures introduced by the legislation, notably the elimination of all exemptions and tax holidays, in addition to the increase in prices of domestic energy products and electricity should offset this short-fall. The law also introduces measures to expand the tax base, including through provisions to encourage the informal economy to legalize its status. (International Monetary Fund 2005a, 2)

However, such a policy has evidently not generated sufficient increases in revenue to allow the Egyptian authorities to reverse the regressive expenditure policies discussed above. A closer investigation of the composition of tax revenues in Egypt demonstrates the shifting burden towards regressive indirect taxation over direct taxation of incomes and profits since 1990. In Table 5, indirect taxation in the form of taxes on goods and services had increased its

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**10** Taxes on goods and services include general sales and turnover or value-added taxes, selective excises on goods, selective taxes on services, taxes on the use of goods or property, taxes on extraction and production of minerals and profits of fiscal monopolies (World Bank 2013).

**Table 5:** Egypt's government revenue composition (1990–2010)

| Percentage of total revenue               | 1990  | 1995  | 2000  | 2005  | 2010  |
|-------------------------------------------|-------|-------|-------|-------|-------|
| Non-tax revenue                           | 32.4% | 35.4% | 35.6% | 32.6% | 39.7% |
| Tax revenue (of which)                    | 67.6% | 64.6% | 64.4% | 67.4% | 60.3% |
| Taxes on income, profits, & capital gains | 23.1% | 22.1% | 24.7% | 28.5% | 28.6% |
| Taxes on goods and services               | 16.3% | 17.3% | 27.0% | 28.4% | 25.0% |
| Taxes on int'l. trade and transactions    | 16.5% | 13.4% | 12.5% | 7.0%  | 5.5%  |
| Other taxes                               | 11.7% | 11.8% | 0.2%  | 3.6%  | 1.2%  |

Source: IMF 2013 (Government Financial Statistics).

share of total revenue from 16.3% in 1990 to 28.5% in 2005. By contrast more progressive taxes on income, profits and capital gains have increased more moderately from 23.1% in 1990 to 28.6% in 2010.

This pattern of increasingly regressive fiscal patterns is supported by other studies of Egypt (Kienle 2004; El-Meehy 2009)

...comparing indirect taxes and welfare spending levels in relation to the GDP reveals a trend towards inequity since the second half of the 1990s. (El-Meehy 2009, 109)

Given the structure of Egypt's economic growth in recent years it is apparent that fiscal policies over the 1990s and 2000s have done little to support a more progressive economic system. Instead, the focus has been on curbing expenditure with worrying reductions in education and health spending, in particular. On the revenue side too little was done to support a more progressive taxation system. Rather than supporting an equitable, progressive tax system, over time, the silent majority of Egyptians have had to increase their contribution to government revenue, often indirectly, via the levying of regressive sales taxes.

## The food subsidies conundrum

With regard to subsidies in Egypt it is argued here that the ongoing debate over the cost and poor targeting of subsidies (World Bank and Ministry of Economic Development Arab Republic of Egypt 2007; Mohieddin 2010; Ramadan and Thomas 2011) is a rather tangential one. Instead, the pertinent issue in relation to consumer subsidies has been their use by Egyptian authorities to increasingly appease the Egyptians masses, at the expense of providing them with appropriate employment opportunities. The decline in spending on subsidies and the concurrent rise in food and energy costs over the 2000s helps to explain how this part of the "social contract" broke down and fuelled the revolts of 2011. Had



the Egyptian authorities, concurrently to reducing subsidy spending, focused on raising the incomes of the majority of Egyptians via the creation of jobs, social tensions may have been contained.

Many recent studies (World Bank 2009; World Bank and Ministry of Economic Development Arab Republic of Egypt 2009; World Bank and Ministry of Finance 2009) have argued that social policies in general and the food subsidy system in particular have been costly, regressive and poorly targeted. These studies contrast the food subsidy bill of 2009 (which stood at 2% of GDP) to that of the late 1990s (when it stood at below 1% of GDP) to underline what they believe to be the unreasonably heavy fiscal burden of providing such subsidies. The food subsidy system underwent dramatic reforms during the 1980s and 1990s, with its total costs being reduced from 14% of GDP in the early 1980s (Gutner 2002) to just 2% of GDP today. These early reforms of the 1980s took place mainly at a time of declining or stable world food and energy prices.

Mohieddin (2010) shows that the distribution of food subsidies has mostly benefitted the better off. While the extreme, moderate and near poor received only 38% of all food subsidies in 2006, the remaining 62% of subsidies went to the better-off proportions of the population. In addition, a recent study (World Bank and Ministry of Economic Development Arab Republic of Egypt 2009) has suggested that urban areas have benefitted disproportionately from food subsidies in Egypt. In per capita terms, benefits from food subsidies were around 10% higher in urban areas than in rural areas in 2008/09.

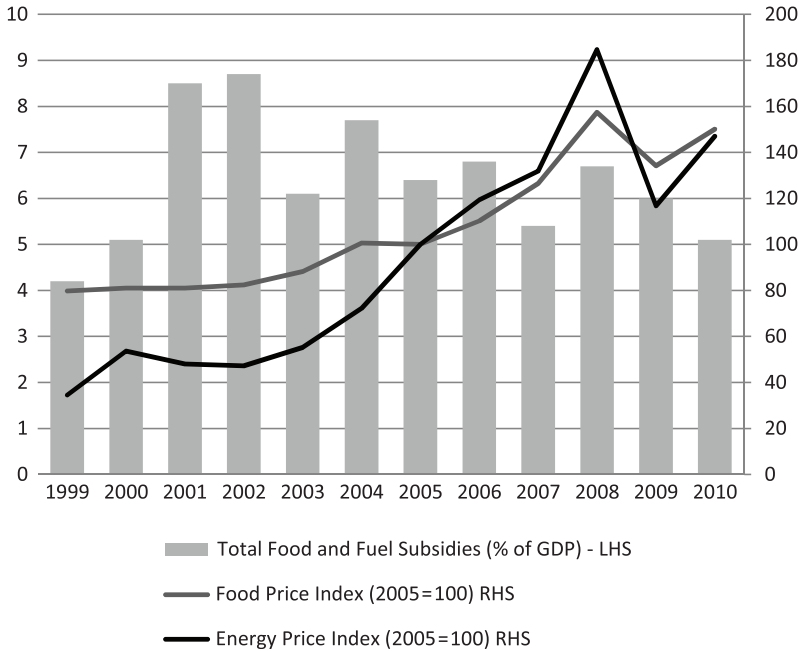
This negative picture can, however, be questioned. Evidently, without subsidies, the poor, as well as a sizeable proportion of the non-poor population, would have been appreciably worse off. The above World Bank co-authored report acknowledges, for example, that “food subsidies lifted 9 percent of Egyptians out of poverty in 2008/09” (World Bank and Ministry of Economic Development, Arab Republic of Egypt 2010). An additional consideration is that many Egyptian households have income levels just above the extreme poverty line so food subsidies help those vulnerable to poverty as well as those already suffering from it.<sup>11</sup> One recent study considering the welfare effects of changes to Egypt’s subsidy provisioning concludes that the impacts would be

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<sup>11</sup> In addition, the beneficial impact of food subsidies might be understated by referring to changes in standard indicators of nutrition and human poverty. For example, Egyptian children might no longer be recorded as being underweight but the nutritional content of their food could have been significantly downgraded as a result of rising prices (see Sabry 2009). Food insecurity has been a major problem in the Middle East in general, and in Egypt in particular. This would have certainly adversely affected the poor but it would have also adversely affected the real incomes of a much broader proportion of the population, contributing to thereby stoking widespread popular discontent.

widespread. Eliminating the baladi bread subsidy would in fact make all groups of the population worse off (Ramadan and Thomas 2011).

Studying more recent data (see Figure 4) illustrates that the share of Egypt's budget devoted to both food and fuel subsidies has not kept pace, in fact, with the rising trend in food and energy prices over this time.



**Figure 4:** Total food and fuel subsidies recorded on the budget in Egypt and food prices  
Source: IMF, various years from IMF Article IV consultations and FAO (2013).

Food subsidy coverage has historically been very broad in Egypt. Receiving such a subsidy is regarded by many as an entitlement. It is therefore a politically very sensitive issue (Gutner 1999). Some researchers have started to link the rising cost of food across the Arab world directly to the recent political and social uprisings (Lagi et al. 2011; Harrigan 2012). Historic lessons (see Gutner 1999) suggest that previous political upheavals in Egypt have been closely associated with exactly such developments, e.g. the regime-threatening 1977 bread riots. There are evidently parallels between ongoing social tensions in Egypt and the reduction in spending on subsidies since 2002.

The impact of reduced spending on subsidy provision has been particularly harsh on a broad spectrum of the population in Egypt, precisely because this process has occurred alongside a diminishing access to well-paid jobs.

In the absence of better paid jobs cuts in subsidies may, for instance, send numerous “middle classers” tumbling down the poverty staircase. (Kienle 2013, 26)

The role of consumer subsidies in particular can act as a prism to understand the ways in which the Mubarak regime clung on to power and managed to appease the vast majority of Egyptians while concurrently diminishing their opportunities for real economic enhancement through employment. The food subsidy bill in Egypt began to rise in the early 2000s, long before food and fuel prices rose (see Figure 4). This period coincided with increasing jobless growth in Egypt. As such it demonstrates the failure of fiscal policies over the 2000s to support growth in those sectors that could have provided Egyptian’s with stable and secure employment.

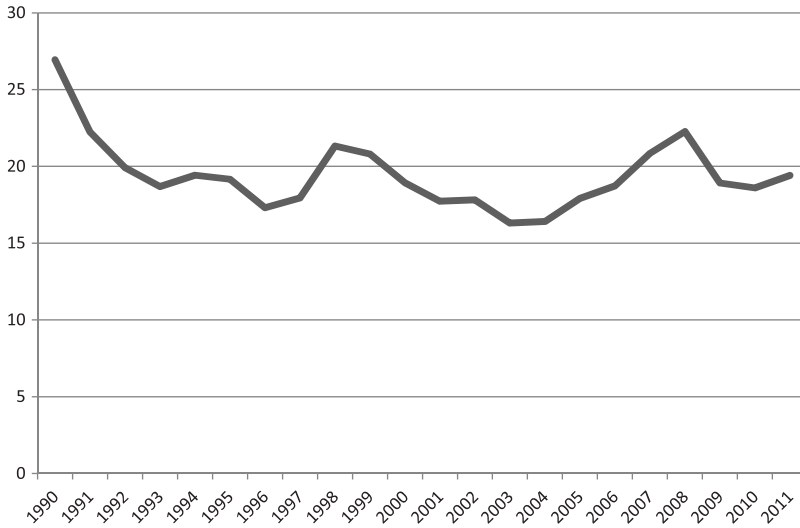
While it is clear that food and fuel subsidies have played an important role in preventing further increases in widespread poverty in the country, future policies will need to complement such social protection with productive investment and strategic support to industries and sectors in which stable and secure jobs are possible, including a new role for the public sector.

## Policies that have promoted narrow investment

Investigating investment policies in Egypt can throw further light on the regressive nature of policies adopted by the Egyptian government over the course of the 2000s, which in turn contributed to the narrow GDP growth detailed above. Many of the concrete policy changes discussed below build on a broader debate and discussion of the privatisation policies undertaken by the Egyptian authorities over the 1980s and 1990s. These will not be delved into here but readers are referred to a number of other studies that provide a detailed account of these processes and their impacts (see Biygautane 2011; Harik and Sullivan 1992; Khattab 1999).

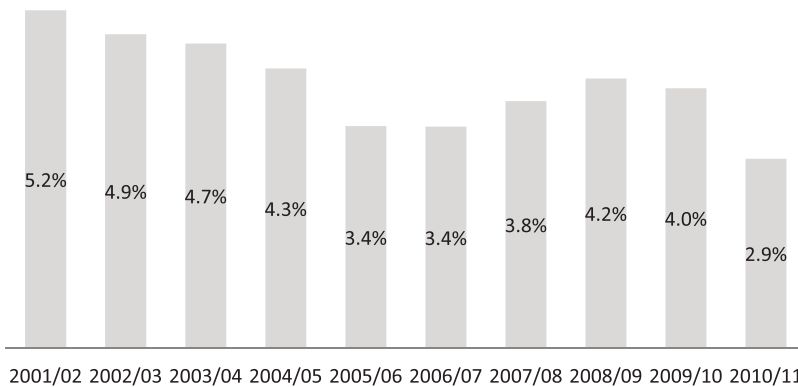
Data on gross fixed capital formation (World Bank 2013), a useful measure of investment, show a gradual decline as a share of GDP from around 29% in the 1980s to 21% in 1990s and further to 19% in the 2000s. Since 2000, however, it would appear that investment has increased modestly, from 17% of GDP in 2003 to 22% in 2008 before the global financial crisis (see Figure 5).

Dobronogov and Iqbal (2005), however, highlight that *public* investment in Egypt has declined significantly over time. Public investment, according to them, represented the majority of investment and remained above 15% of GDP for much of the 1980s and early 1990s, before declining sharply to below 10% of GDP for the latter half of the 1990s and early 2000s. More recent data (The Arab Republic of Egypt 2013) reveal a further dramatic decline from 5.2% in 1999/2000 to just 2.9% in 2010/11 (see Figure 6). The reduction in public investment



**Figure 5:** Gross fixed capital formation (per cent of GDP)

Source: World Bank, World Development Indicators 2013.



**Figure 6:** Public investment in Egypt as a per cent of GDP

Source: Arab Republic of Egypt 2013.

was targeted by Egyptian authorities under World Bank and IMF advice, in order to reduce fiscal deficits in the short- to medium-term (World Bank 2005; International Monetary Fund 2006).

The Egyptian authorities and the World Bank (2005) expected private investment to, at least partially, fill the gap left by the reduction in public investment. This is especially the case since the Egyptian authorities reduced corporation and income taxes significantly in 2005 and introduced various other tax exemptions

and incentives to private investors over the 2000s (Korshid et al. 2011).<sup>12</sup> To some extent, such a growth in private investment was in evidence for a short period in the mid-2000s (see Figure 5). A brief glance at the Egyptian authorities' own documents (The Arab Republic of Egypt 2011, 2012; The Arab Republic of Egypt 2013) over the last 5 to 6 years also supports the perception of increased private investment, particularly in the form of foreign direct investment.

However, Korshid et al. (2011) reveal that the sectors in which public investment has declined have not attracted sufficient private sector investment to plug the gaps.

In FY 2006/7, real public investment in electricity, education and health dropped by 20%, 13% and 35% respectively. This causes for an alarm as private sector investment is either inexistent in the sector as in the case of electricity sector or it cannot be extended to cover different income groups as in case of health and education sectors. (Korshid et al. 2011, 14)

Instead, private investment has been dominated by growth in petroleum-related activities and has not generated sufficient or indeed skill-enhancing employment. Government statistics do not provide a sectoral breakdown of private investment over time beyond the rudimentary categories of agriculture, industry and services. Extrapolating information for the first quarter of 2011/12 (The Arab Republic of Egypt 2012) reveals the breakdown given in Table 6. Evidently, investment mainly flowed to the mining and petroleum-related sector (31.7%) followed by the Suez canal-related activities (18.5). Agriculture, manufacturing,

**Table 6:** Sector breakdown of total investments (percentage shares)

| Sector                       | Share (%) |
|------------------------------|-----------|
| Agriculture                  | 3.4       |
| Manufacturing                | 12.1      |
| Construction                 | 1.3       |
| Mining and Petroleum-related | 31.7      |
| Tourism                      | 3.5       |
| Comm. and Info. Technology   | 10.1      |
| Suez Canal-related           | 18.5      |
| Social Services              | 13.3      |
| Trade                        | 6.1       |
| Total                        | 100.0     |

Source: The Arab Republic of Egypt (2012).

<sup>12</sup> Based on a number of reforms that have facilitated doing business in Egypt, the country has been ranked the "Top Reformer" in the world for 3 years consecutively (2007–2009) by the World Bank's annual report "Doing Business" (World Bank, various years) – <http://www.doingbusiness.org>

tourism and construction, all sectors that are traditionally employment intensive, together only made up 20% of all investments in this period.

Looking at FDI flows, in particular, reveals an even more extreme trend towards mining and petroleum-related investments. For the period 2004/05 to 2009/10, investments in this sector, on average, amounted to almost half (46%) of all FDI flows (The Arab Republic of Egypt 2013).

The final note with regard to the nature of private investment in Egypt relates to the lack of incentives and policies to foster relevant and widespread employment generation. There is a clear mismatch between the levels of education of labour market entrants and the types of jobs offered by new investments in capital-intensive sectors. This problem was already in evidence in the late 1990s. Over this period there was a general trend towards employing more capital-intensive technology in the manufacturing sector, with investment biased against small- and micro-enterprises that typically used more labour-intensive techniques (Fawzy 2002).

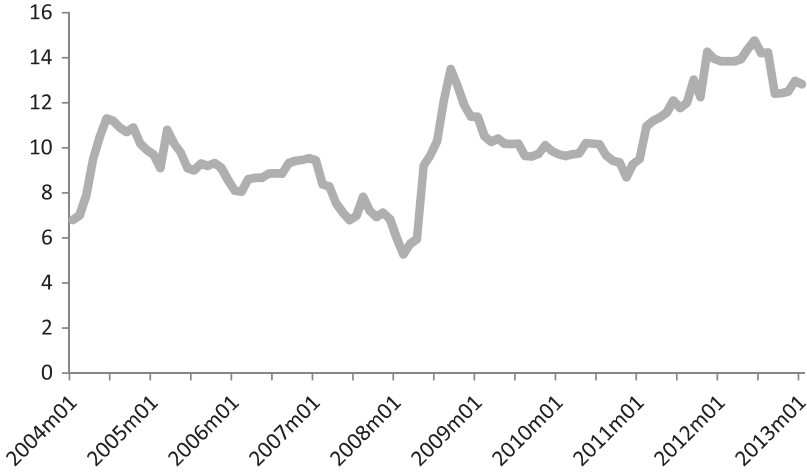
Investigating more recent data supports this trend. Intermittent monthly data covering the period December 2008 to July 2013 indicates that the vast majority of jobs created from new investments have been blue-collar jobs. For the month of July 2013 the percentage of blue-collar jobs out of total new jobs created stood at 69.8% (The Arab Republic of Egypt 2013). A further worrying trend is the creation of jobs targeted explicitly at men. Across the last 5 years more than three quarters of new investment-linked jobs have been labelled “male” jobs. In contrast only 2.7% of jobs in July 2013 were explicitly labelled “female” jobs. Unfortunately, Egyptian government policy over the 2000s did little to encourage new private investment that was linked to appropriate employment creation for Egyptian men and women.

Turning back to the role of policy in facilitating private and public investment it is apparent that Egypt’s investment performance could have been better, particularly given the apparent attractiveness of “doing business” in Egypt over the last few years (World Bank 2010) and when compared to other lower middle income countries (World Bank 2013). In particular, more private investment could have been encouraged in productive industrial and services sectors where there is an urgent need for job creation. It is therefore worth investigating what other factors might have held back private investment in Egypt in the 2000s.

An obvious concern in relation to private investment-related policies is the role of interest rates. Interest rates in Egypt have been pushed up over the 2000s in an attempt to curb inflationary pressures, despite the causes of such inflation most likely being structural (due to rising food prices) rather than monetary in origin (Kandil 2011).<sup>13</sup> Figure 7 highlights the general upward trend of treasury

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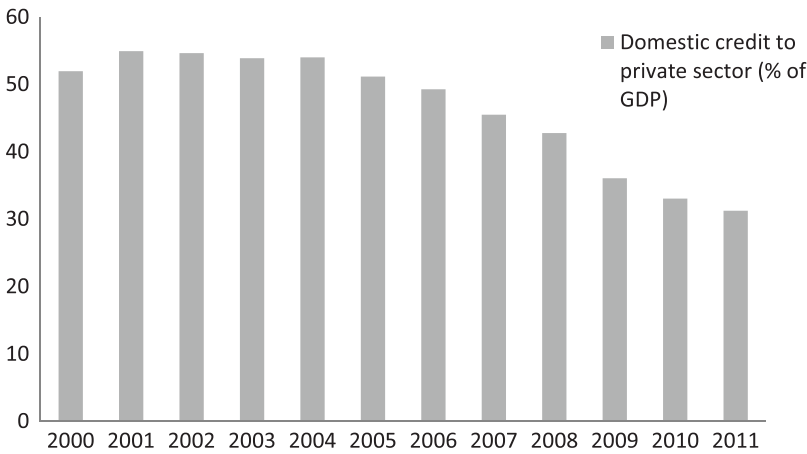
<sup>13</sup> The earlier discussion concerning subsidies is also relevant here (see Figure 4).



**Figure 7:** Treasury bill rates (January 2004–January 2013)  
Source: IMF (2013).

bill rates, with particularly large increases in 2008 and again over the course of 2011.

While this trend is worrying, lending rates have more recently begun to come down (International Monetary Fund 2013). The lack of access to credit in Egypt, particularly for small- and medium-sized enterprises, has been a particular concern since the mid-2000s, as can be seen in Figure 8. There has been a



**Figure 8:** Access to credit in Egypt (2000–2011)  
Source: IMF (2013).

clear decline in private sector credit provisioning since the early 2000s, with a more dramatic decline since the global financial crisis in 2009.

A recent article (Herrera and Hurlin 2013) explains this reduction in private sector lending by demonstrating the change in the sources of and uses of funds by commercial banks in Egypt since 2005. Despite increased demand for credit by the private sector, commercial banks have been investing in government treasury bills instead. They have done so, partially because such bills are deemed less risky (Abdel-Baki 2012) and because treasury bill rates have increased in recent years. Treasury bill rates averaged 8.8% between January 1997 and December 2006. Between January 2010 and December 2012 average rates had increased to 11.7% (International Monetary Fund 2013).

Since Egypt's Economic Reform and Structural Adjustment Program (ERSAP) under the World Bank and IMF involved the privatisation of many of Egypt's state-owned banks, alternative sources of funding for the private sector are limited (Esam-Fayed 2013).

## Conclusions

This paper set out to outline the economic policy challenges in Egypt today and to demonstrate the probable contribution of particular economic policies to the Egyptian political uprisings, via the erosion of employment opportunities, wages and an increasingly inequitable economic structure in Egypt, supported by regressive economic policies. The first part of the paper set out the economic situation in Egypt over recent years. The second part considered more closely the role of three particular policy areas in contributing to the general picture described. Three critical areas were considered in turn: (i) fiscal consolidation and the shifting regressive nature of tax collection efforts; (ii) the role of consumer subsidies instead of employment-focused productive investments by the state; and (iii) the lack of an employment-sensitive investment policy framework.

An obvious question to emerge from the discussion in this paper is why actors in Egypt are not proposing an alternative, more employment-focused economic framework or why such a framework is not gathering support among Egyptians? This is largely a political question, beyond the scope of this paper. But what is clear is that without a clear break from previous economic policies under Mubarak, many Egyptians remain dissatisfied and frustrated with what the main political parties and alliances are offering in terms of economic plans and policies. As long as the crucial underlying economic challenges



outlined in this paper remain unaddressed, continued social and political unrest seems a likely scenario going forwards.

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