



Economic Repercussions of the Turmoil in Egypt

Mohsin S. Khan says the fear of spreading instability in the region, potentially affecting oil producers, is causing jitters in oil markets and some financial markets.

Edited transcript, recorded February 3, 2011 . © Peterson Institute for International Economics.

Steve Weisman: The political turmoil in Egypt is producing economic repercussions in regional and world markets. Mohsin Khan, senior fellow at the Peterson Institute for International Economics, is here with me, Steve Weisman, to assess the economic impact of the uprising in Egypt. Mohsin, thanks for joining me.

Mohsin S. Khan: My pleasure, Steve.

Steve Weisman: How big of an economic impact are we seeing in the second week of the turbulence in Egypt?

Mohsin S. Khan: I think, Steve, it's too early to tell what's going on in terms of the effects on the economy. As you point out, and as everyone knows, events are still unfolding. Banks have been closed. The stock market has been closed. The impact on manufacturing, etc., is not going to show up for quite a while.

Steve Weisman: On the other hand, the markets are responding.

Mohsin S. Khan: That is a very interesting issue. The markets are not reacting as much in Egypt as they are elsewhere. The reason for that is very simple. The stock market, the Bourse, in Egypt is closed. It dropped 16 percent just prior to it being closed last week. Banks have been closed, and they are supposed to be opened this Saturday. But at the moment, the impact on the Egyptian economy is unknown.

What is bothering people and concerning analysts everywhere is the impact of the Egyptian crisis on the rest of the world and on the Middle East countries and on the world economy. And I think that's where you're seeing some indicators.

One is, of course, the stock markets. The collapse of the Egyptian stock market of 16 percent and [its] subsequent closing also impacted many other markets in the region. The Gulf markets dropped close to 5 percent in Dubai. The Saudi market dropped something like \$50 billion. By the way, the market capitalization of these is around a trillion.

So it's been there. It's not been enormous, but it has been there. Sticking with the financial side, there hasn't been much of an impact on Western banks because Western banks don't have much of an exposure to Egypt itself. Of course, they have a large exposure in the Middle East, but to Egypt by itself, there isn't much.

To get the context right, one has to remember that Egypt has a gross domestic product (GDP) of around \$215 billion. If you think of the world economy at close to \$60 trillion, Egypt is sort of a mere decimal point. Even in the Middle East region, the combined GDPs of Middle East and North African economies would be somewhere around \$2-1/2 trillion. So, this is 10 percent. Even though Egypt is a large country from a population standpoint, it isn't that big a country in terms of gross domestic product.

On the real side, I don't see much of an impact. Even if there was to be a complete collapse

of the Egyptian economy, which is highly unlikely, I don't see much of a direct effect. But what is going to happen on the financial side, again I don't see much of a direct effect.

But what is, I think, worrying most people is contagion. Contagion in terms of: Will similar protests and demonstrations start up in other countries in the region and spread? And if it spreads, one of the biggest worries is, will it spread into the oil producers?

One oil producer has already been hit: That's Algeria. But people are expecting other oil producers to be affected as well, which of course has serious consequences for the world economy and for confidence in the world economy's recovery.

Steve Weisman: Oil prices are spiking. Is that because of the fears you've just mentioned?

Mohsin S. Khan: People used essentially two arguments. The one favored more recently—and I'm not sure I completely buy it—is the possible closure of the Suez Canal. Yes, there's a possibility that it could close. But even if it does close, the Suez carries something between two to three million barrels of oil a day, out of a total world supply of around 80 million barrels a day. So if the Suez Canal was closed and the world was short of two to three million barrels a day, that can easily be made up by tankers going around the Horn.

Steve Weisman: It wouldn't be in Egypt's or the army's interest to close the canal.

Mohsin S. Khan: Oh, I think the possibility of closing the Suez is small. And I think you're right. I mean, I don't think that this is a likely scenario, but people have been talking about that and they always bring up Suez. I actually think that Suez is not the issue here.

Steve Weisman: What is?

Mohsin S. Khan: The issue really is the contagion: Will these demonstrations and protests spread to the oil producing countries and particularly to the Gulf countries, where you can see a potential for supply disruption taking place. Then, I think, you have a serious problem on your hands. I think that the markets are looking at that more than at Suez. So you had a spike in oil prices a couple of days ago. Oil prices, at least in the Brent prices in the UK, contract prices, crossed a \$100 a barrel.

Today they're stable, but they are rising. I think the longer the demonstrations in Egypt go on, the markets are nervous. The oil market is very volatile. It very easily could spike up. And I think if it does spike up, then we'll begin to see consequences for the world economy.

Steve Weisman: Egypt is a very poor country by any measure. It is not blessed with great oil resources, as we note. And yet this revolt seems to be led by the middle class, which has not benefitted in recent years from any other economic improvements in Egypt. How do you read this disaffection and is there a similarly disaffected middle class in the other potentially vulnerable Gulf countries?

Mohsin S. Khan: I think that I would make a distinction between the oil producers of the Gulf and the other Middle Eastern countries. I think joblessness is a very serious issue in all of these countries. You have large groups of young people who are unemployed, graduates of universities. Universities are churning them out in the thousands. And they are not getting jobs, and I think there's a lot of disaffection that way.

There's been some disaffection, of course, with the rise in food prices that affects the lower income groups much more. I think income disparity has been rising in these countries. The rich are getting much richer, and the rest are getting left behind. I think there is that element. But I think that perhaps unemployment and lack of jobs is an important factor.

Now, if you then say, “What about the other countries that are potentially vulnerable to this kind of protest?” Jordan is one: the same problem. The others, well, Tunisia was there. We’ve already seen that happen. People talk about Libya, Algeria, and Syria as potential countries where this could happen. All of them have the same sort of unemployment, joblessness, high prices of food, etc., which will, of course, lead to disaffection among the population.

When you come to the oil producers, the same problem arises, but there is one big difference: and that is, the oil producers have deep pockets so they can afford to buy off the population. In the following sense, you have in many of these countries cradle-to-grave welfare systems. So yes, it’s true that a young Saudi graduating may not find a job, but his education is free. So he’s coming out of school with no debts whatsoever. Housing is provided. Income transfers are made so that in that sense, they’re not suffering.

I mean, they would prefer to be employed, but they’re not suffering, not the way the Egyptian or the Jordanian student in the similar circumstances would face. So I think that Algeria has been doing that, and I think that Libya has been doing that as well. But it’s only a short-term solution, and I think that eventually something will happen. And I think that’s the concern that people have. The oil producers may be able to buy time, because they have money to buy time. But ultimately, something has to give. And as I said earlier, if it does spread to the Gulf countries, then you’ve got a potential of disruptions of oil supplies to the rest of the world.

Steve Weisman: You’ve studied and worked with these countries here at the Institute and previously at the IMF. What are two or three things that you would recommend that the Egyptian government do to assuage the disaffection of this middle class and educated middle class?

Mohsin S. Khan: I think that creating jobs is essential. There’s no other way of doing it. But it’s unfortunately not a short-term solution. There are limited things you could do in the short run. In the long run, of course, you can try and create more jobs, get higher growth rates going so that that creates the jobs. Open your markets up more. Eliminate regulations and so on. Make it much easier to set up factories. Encourage entrepreneurship. All of these are designed to make the sort of life and prospects for the young Egyptians much better. Whether you can do it quickly or not: unfortunately, you can’t.

Steve Weisman: President Mubarak has been in power for decades. Why has he not taken these steps?

Mohsin S. Khan: I think until very recently, Egypt was a highly regulated economy, not an open economy. It was not a competitive economy. There have been some important reforms in Egypt in recent years. But right now, they have not taken hold because one of the things, of course, is that as part of those reforms; you had to reduce the size of government. And you had to reduce the size of government employment. And that led to sort of limited opportunity.

There used to be a time when every Egyptian who graduated from university could be assured a job in the government. That’s no longer true. Now they have to go out and fend for themselves. Market reformers say that is the right thing to do. But then that presupposes you have a private sector that is expanding and is able to absorb these graduates of universities.

I think there’s a real skill mismatch also. For example, the new factories and manufacturing set up in Egypt, particularly those set up by multinationals, require a certain skill level and a skill mix which, in fact, the Egyptian universities are not providing for their students. So you’ve got this problem. You’re coming out and you’ve graduated in Arabic Literature. You’re not going to get a job with any IT company opening up. It goes without saying.

Steve Weisman: Mohsin, thanks.

Mohsin S. Khan: Sure, thanks a lot.

