



Economic Crisis in Egypt: Enter the IMF

Mohsin S. Khan discusses why Egypt has reluctantly turned to the International Monetary Fund for help and the outlook for negotiations to rescue its economy.

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Steve Weisman: The political and economic turmoil in Egypt has taken a new turn with Egypt turning to the IMF [International Monetary Fund] for help. This is Steve Weisman with Mohsin Khan at the Peterson Institute for International Economics. Mohsin, why did Egypt decide to turn to the IMF for assistance?

Mohsin Khan: I think that the basic reason why they've done it is that they are in a serious economic crisis. The main issue is, unlike last year, when they were negotiating with the IMF, they have suffered a severe loss of international reserves. At the beginning of 2011, the Central Bank of Egypt held something in the region of \$35 billion in reserve, a very comfortable level.

However, in December of this past year, they were down to \$17 [billion], so they had lost close to \$18 to \$19 billion. Part of this is of course related to the developments in the economy: the loss of tourism receipts, the reduction in remittances, etc. But a lot has to do with an outflow of capital, both foreign investors leaving the country and domestic residents shifting their money out.

Last year it was foreseen that they had an external financing gap of between \$10 and \$11 billion. Now it's estimated that the financing gap, the amount of money they need in order to keep reserves just at \$17 [billion], would be in the region of \$15 billion. They need the finances, and I think that's what led this government to turn to the IMF once again.

Very preliminary discussions started in January. It wasn't a full-fledged team from the IMF that went out there to have negotiations. It was just the senior staff of the relevant department that went out there to gauge whether, in fact, the Egyptians were interested in having a program. And the message they received was, yes they were.

But with the caveat, of course, that a new government will come into place. Therefore the IMF staff that were in Cairo also had discussions with the Freedom and Justice Party, which is bound to be in the government, to see what their views were.

I think that both sides are assessing the situation now, and if the Egyptians say, "Yes, we want to go ahead," a full-fledged team will go out there and help put together a program that will provide financing from the IMF, which is not going to be that much. More importantly, it might unlock the promised financing from other sources, and that's the big deal.

Steve Weisman: Such as?

Mohsin Khan: Such as the financing that was promised by the Gulf Arab countries -- Qatar, for example, and Saudi Arabia. But also, the funding that was sort of promised by the Europeans as part of the Deauville Partnership, the so-called Friends of Egypt. They haven't come through yet. I think, of the \$35 billion promised to Egypt, less than a billion has come in.

Steve Weisman: This was promised when the so-called Arab Spring [got started]?

Mohsin Khan: Correct. And that money hasn't flowed. The feeling is that an IMF program could do two things. First, it could unlock the flow of funds. Second, it could potentially open up the possibility of debt relief for Egypt, because having an IMF program has sort of become a necessary condition for debt relief. So in two ways, it could turn out to help Egypt, and particularly Egypt's external finances.

Steve Weisman: Egypt was reluctant to do this because, presumably, of the conditions it feared might be imposed. What are these conditions?

Mohsin Khan: The rationale given last year, when they [Egypt] decided not to proceed, was an interesting one. It had to do with conditions, yes, and I'll come to that. But it also had to do with this idea that the care-taker government did not want to leave the incoming government with a larger debt burden, because this would be a debt.

Now, the conditions that the IMF talked about were, in fact, quite easy, and they were not very severe. So I think it had more to do with the fact that there was this issue of the debt, but it had more to do with the fact that the government in power at that time, last summer, as is the case now, didn't feel that it was empowered to negotiate a program with the IMF, and [that] this should be left to the elected government rather than a care-taker government.

Steve Weisman: Still, whether it's the care-taker government or the elected government, what can we expect Egypt will have to do?

Mohsin Khan: First let me talk about the financing. Last year, the financing that the IMF was going to come up with was a little over \$3 billion. At that time, Egyptian reserves were \$28 billion, [and] that seemed to be OK. I think they're talking about \$3 billion again for the new program. I think that figure should be upped considerably, and it should be in the region of \$5 to \$6 billion of lending by the IMF. So the IMF should have greater financing provided.

What are the conditions? I think that it's not clear what conditions they will have. We know what conditions they had in the previous program. It's likely that some of them will still be there. I would argue that right now is not a time for fiscal austerity in Egypt. That will never fly. That is almost always the case with IMF programs, that there is a degree of fiscal austerity. So, you have a fiscal deficit of close to 8 and a half to 9 percent of GDP. I think that the IMF would like to have that reduced. I would say, I think it could even be increased temporarily, but that's one condition.

The other condition is a tighter monetary policy, which will mean higher interest rates. That will be a problem. Cuts in subsidies will be a problem. Will the IMF have conditions on public sector wages? I don't think that that would fly.

In fact, I doubt very much that if you have a standard IMF program with fiscal austerity, tighter monetary policy, cuts in subsidies, cuts in public sector employment, cuts in public sector wages, increases in taxes, etc., that's not going to fly. It's just not going to get off the ground.

Steve Weisman: You mean the Egyptians won't accept it?

Mohsin Khan: The Egyptians won't accept it. They couldn't, and the reason they couldn't is, because this has to be negotiated by the elected government.

Steve Weisman: Let me ask about political conditions. Egypt-US relations are fraught right now because of the crackdown on US-backed non-government organizations. Indeed some Americans are being held at the US Embassy.

Mohsin Khan: On the travel ban, yes.

Steve Weisman: And they have a travel ban. The US is very upset about this. There's a lot of talk on Capitol Hill and in the administration of cutting military aide. Doesn't that have to be resolved before any of this goes forward?

Mohsin Khan: I think it's all sort of part of the same problem. I would say the issue between the United States and Egypt is between the United States and the Egyptian military. I don't think the political parties are the ones going around imposing travel bans or closing down offices or taking away the computers of the various US-based non-government organizations that operate in Egypt.

Something has happened on the military front, between the US and the Egyptian military. Yes, of course you're right, that has to be resolved. I think the political parties, particularly the political parties that are likely to be the next government, are standing back, are hanging back. They don't want to get involved in this issue.

But I expect this issue to be resolved—most of the aid that the United States gives is to the military, and virtually all of it goes to the military, so it's an issue the United States has to resolve with the Egyptian military.

The IMF program, which we were talking about earlier, is then a negotiation between the current government and hopefully the next government. Because this program will stretch over at least a year, probably 18 months, the IMF itself has to be sure that the incoming government won't renege on the commitments made by the previous government. And the current government has to be sure that the conditions that it agrees to will be acceptable to the incoming government.

Steve Weisman: It can be carried out by them.

Mohsin Khan: If I was likely to be in the new government, and I thought that, yes, we do need the financing, and yes, we do need the discipline of an economic program, I would push this government to negotiate it. Then, I could turn around when I was in power and say, "Look. We had a commitment. The country made a commitment. We have to live by that, irrespective of how I really feel about it."

You know, Steve, in my own experience in negotiating programs, it sometimes has been much easier to negotiate with a caretaker government, because the next government—and when talking to the future government, you talk to the politicians— [can say]: "Yes, sign a deal with these guys, and when we come in, we'll adhere to it."

Steve Weisman: Right; we're seeing this in Europe.

Mohsin Khan: Exactly. I think that we are seeing a situation where the Egyptian economy is in a crisis and something has to be done, and I don't think they can wait through the summer. They have to do something by the spring.

Steve Weisman: Thank you, Mohsin.

Mohsin Khan: My pleasure, Steve. Thank you.

