Egypt's Capital Market Development: A Fashion of the Past?

By Khaled Fouad Sherif
Special to the Middle East Times

IT WOULD seem that economic reform in Egypt takes a different trend from season to season, just like fashion. During certain periods, there are things that are 'in' and others that are 'out.'

One of the current 'in' things is privatization, even though it is already slowly moving toward obscurity. One of the earlier 'in' things was capital market development. Every economist in Egypt was head over heels in love with this concept, which can probably be best described as the fashion of the late 1970s.

The government spent at least $100,000 in the late 1970s and early 1980s to prepare three major studies on capital market development in Egypt, two of which were also partially funded through various international donor agencies. Upon the completion of these reports the government was handed several different scenarios that outlined a full strategy for the expansion of trading activities on the Cairo stock exchange.

Yet today, very few people talk about capital market development as they did in the past, and the government has failed to link privatization efforts in local government, tourism and joint ventures to Egyptian stock market expansion. Instead, it has been selling off assets at auction and has paid little attention to expanding stock ownership within the Egyptian community.

The government is also closing its eyes to any possibility of making future equity injections in state enterprises a function of capital market development. In addition, the employee stock ownership schemes that were widely discussed at the peak of the privatization debate and endorsed by the government for application in some state enterprises seem to have faded away.

Why has everyone forgotten about the need to revitalize the capital market? Is it because the Capital Market Authority (CMA) that was established for this purpose has failed in its revitalization efforts?

A quick look at the level of trading on the Cairo stock exchange, excluding government bonds, shows that the volume of trading is rising year after year, having jumped from E£45.9 million in 1983-84 to E£175.9 million in 1986-87. Today's peak level of transactions exceeds E£200 million, a figure which

22 Oct 90

A Point Of View

still represents less than 0.5 percent of gross domestic product. This negligable achievement comes almost eight years after the government made a commitment to revitalizing the capital market.

Egypt's failure to get the capital market to work again is a reflection of the government's inability to mobilize domestic savings from a broad spectrum of the population. To a great extent, this failure reflects the reason why so many people turned to various so-called Islamic finance houses to invest their savings.

Given an interest rate set by the Central Bank at well below the rate of inflation, and the lack of share offerings with high return on investments in the capital market, those looking to sink a part of their wealth into a risky venture in the hope of making a quick and high return were lured by what Islamic finance houses had to offer.

Just to get an idea of how inactive Egypt's capital market really is, one has to realize that there are a paltry 25 companies whose shares are traded with any regularity on the Cairo stock exchange, even though several hundred firms are registered.

Also, what of the government's unwillingness to tie privatization efforts to capital market expansion? Egypt can learn much from countries such as the United Kingdom, which virtually doubled public share ownership through the sale of one state enterprise: British Telecom.

One can argue that in the developed world, with a functioning capital market, getting activity to rise quickly is a much simpler task than in Egypt. But then, what of countries such as Jamaica, which has had as its objective the promotion of broad share ownership and has successfully linked all of its privatization efforts to capital market development? Egypt can learn a lot from them, too, and from their media campaigns explaining to the general public the advantages of share ownership.

And what has become of the government's perennial desire to link wages to productivity? Is not employee share ownership the best way to do just that? If an employee owns stock in his firm and it generates negative returns, he receives no dividends. On the other hand, he can receive considerable financial benefit if it generates positive returns.

Why beat around the bush and continue to pay state employees virtually identical wage and bonus levels regardless of their firms' profit or loss position when partial share ownership can end this problem once and for all? Why not solve the wage-productivity problem through employee stock ownership plans and at the same time use this mechanism to revitalize the capital market?

In my opinion, the majority of privatization programs should be implemented through the capital market, with the objective of promoting broad share ownership.

Maybe it is even time for the Egyptian government to launch media campaigns such as those in Britain and Jamaica to explain the advantages of share ownership to the public.

On thing is for sure: the country's inability to revitalize the capital market is a reflection of its failure to mobilize domestic savings. As long as Egypt continues to fail in this sphere, economic stagnation is the only natural outcome.