

The Effect of Privatization on the Egyptian Banking Sector

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Abstract

Egypt has experienced different stages of development over the course of its economic evolution. In the 1950s and 1960s, the government nationalized several enterprises across Egypt, bringing them under state ownership and control. Nationalization proved to be unsuccessful because it did not solve the underlying economic problems, namely slow growth and huge deficits. Later, in the early 1990s, Egypt introduced liberalization and privatization as a step towards becoming a free-market economy. This paper conducts a thorough literature review on the impact of the privatization reform on the Egyptian economy. More specifically, this paper analyzes the impact on the Egyptian banking sector of privatization and of the banking reform plan adopted by the Central Bank of Egypt. Furthermore, this paper considers the effect of the global financial crisis and of the 2011 revolution on the Egyptian banking sector.

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1. Introduction

Beginning in the 1990s, many economists have centred their study of structural reforms on the privatization of publically owned enterprises in the Middle East. The Egyptian economy is important in these studies because it plays a crucial role in linking economic activities among African, Asian and European countries. Egypt has experienced multiple stages of development over the course of its economic evolution. In the 1950s and 1960s, the government implemented a policy change in an attempt to nationalize enterprises across Egypt, bringing them under state ownership and control. Nationalization proved to be unsuccessful because it did not solve the underlying economic issues, namely slow growth and huge deficits. Later, in the 1990s, the introduction of liberalization, greater market freedom and increased awareness of foreign investment and trade enabled major structural reforms to take place within the Egyptian economy. Privatization was considered to be a solution to reverse the economic damage caused by nationalization. Any analysis of such a structural reform needs to be looked at from the perspective of its impact on the banking sector in order to understand the full effect of privatization on the economy. In this paper, I analyze the effect of privatization on the banking sector and, more specifically, the ways in which the reforms adopted by the Central Bank have increased the banking sector's resilience when confronting a financial crisis and political instability. The main objective of this analysis is to establish whether or not the policy was successful in terms of banking and economic indicators such as growth, efficiency and competition.

It is well established in the literature that privatization has had a crucial impact on the Egyptian economy (Doherty, 1968; Mohieldin & Nasr, 2007; Ikram, 2005; Gebba & Ahmed, 2013). Privatization has a substantial impact on competition, economic growth, financial health and, in particular, banking soundness. This paper mainly seeks to investigate the effect of privatization on Egypt's banking sector.

Given the fact that the Egyptian economy is well connected with global financial markets, it was exposed to the negative effects of the 2008 financial crisis. Some macroeconomic indicators were sensitive to the crisis, such as economic growth, inflation and investment, and these have helped to shape the banking sector's operating environment. Furthermore, Egypt has experienced political instability since the revolution of 2011, which has created some obstacles to ensuring the prosperity of the banking sector. Thus, it is worth noting the effect of the

economic and political instabilities on the economy in general and on the banking sector in particular.

This paper begins with a definition and a delimitation of the subject, followed by a discussion of the history of the Egyptian banking sector and its privatization. Then, the latest banking reform plan and the indicators of financial soundness are analyzed. Finally, the effects of the global financial crisis on the domestic banking sector and on post-revolution banking performance are analyzed.

2. Definitions and Objectives of Privatization

Privatization is a structural reform that involves the transfer of ownership of publicly owned assets, enterprises or entities to the private sector (Megginson et al., 1994). The phenomenon can be observed globally, but it reflects a country's unique experience in the extent to which it is applied (Kikeri & Nallis, 2002). Boubakri et al. (2009) discusses privatization in the following terms:

Privatization, defined as the sale of state-owned enterprises (SOEs) to the private sector, is a global trend that aims to reduce the role of the government as a dominant actor in the economy and to favour the emergence of an active private sector. Privatization induces a change in the ownership structure of the firm, and improves its corporate governance by introducing a better monitoring, and new incentives for managers to improve performance and maximize profits. (p. 367)

The above definition sheds a positive light on privatization initiatives as they improve performance in terms of productivity, revenue generation and competition in the market. According to Omran (2007), privatization can be applied completely or partially to public-sector enterprises. In the case of a mixed proprietorship, the majority of the ownership could be private or public. Local as well as foreign investors may be involved in the privatization process.

Privatization may be chosen as a policy in order to achieve several objectives. One objective of transferring an enterprise to private ownership is to benefit from the private sector's ability to invest, which can lead to an increase in the growth and productivity of the privatized enterprise. Moreover, Boycko et al. (1996) explain that the performance of public corporations is

generally lower than that of private corporations, which explains why privatization spread dramatically since the 1990s. In addition, Boycko et al. (1996) cite Donahue (1989) who argued that it is more costly for the public sector to provide some services, such as municipal services, within a country than for the private sector to provide them, with or without the use of foreign investment. This could lead to better cost reduction and revenue generation relative to the public model. Donahue (1989) argued that one reason why the United States introduced privatization into its economy was to reduce the costs of services provided by municipalities. Boycko et al. (1996) also report the conclusion of Lopez de Silanes (1993), who states that a privatization program in Mexico in the 1980s was aimed at increasing the profitability of firms. Furthermore, they accept the thesis of Vining and Boardman (1992) that the implementation of a strategy of privatization improves efficiency. In addition, Kikeri and Nellis (2002) indicate that privatization has beneficial impacts on overall welfare, fiscal and macroeconomic variables, and a firm's operation and financial performance.

A major motivation underlying the move towards privatization was the desire to boost efficiency in previously nationalized enterprises. Economists hope that this structural reform will provide a more competitive market environment, which will benefit all sectors of the economy. Privatization can lead to an efficient restructuring reform when it is associated with a strong monetary policy and also when new investors are maximizing profit (Boycko et al., 1996). Bonin et al. (2005) also affirm that privatization is associated with a higher level of efficiency by pointing out that a high percentage of foreign ownership leads to a high level of efficiency in the banking sector.

3. Literature Review

3.1. Positive Consequences of Privatization

Privatization can play a crucial role in economic growth through increased total factor productivity and labour productivity alongside increased total capital productivity (Kamaly, 2006), decreased government deficits (USAID, 2002), higher quality operational performance (Omran, 2007), and improved efficiency of financial markets (Daradkah & Miani, 2011).

Pivovarsky (2001) shows the existence of a robust relationship between privatization and economic growth. This author considers privatization to be one among several factors that

promote economic growth. He uses privatization as a proxy for several measures of structural reform. In addition, studies have shown that privatization is more effective for economic growth in competitive industries (Kikeri & Nellis, 2002). Moreover, Galal et al. (1994) state that privatization has positive effects on economic welfare. The study investigates the welfare implications of privatization in Chile, Malaysia, Mexico, and the United Kingdom. According to the study, the enhancement of economic welfare after privatization is captured mostly by the improvement in labour productivity, the increase in investment, the expansion of diversification and the rise in competition.

In addition, some studies have focused on the relationship between privatization and environmental considerations. Indeed, the efficient implementation of privatization can be associated with environmental improvements. Inefficient use of resources and poor financial performance of state-owned enterprises lead to higher abatement costs, to lower investment in pollution-control technologies and thus to higher pollution levels (Kikeri & Nellis, 2002). More specifically, it has been proven that state-owned enterprises generate more environmental damage than privately owned enterprises (Dasgupta et al., 1997). Furthermore, an investigation of pulp mills in Bangladesh, India, Indonesia and Thailand reveals modest pollution-reduction efforts in state-owned firms in comparison with those in privately owned firms (Hartman et al., 1997). Lovei and Gentry (2002) demonstrated that a successful privatization process leads to economic gains and social benefits in addition to environmental improvements. Moreover, Lovei (1999) describes the privatization transactions in some countries' experience as an environmentally friendly process. The author uses several channels to justify the proposition that environmental improvement is associated with privatization. The efficient use of resources and exposure to foreign direct investment are usually associated with new clean technology investments that provide opportunities for environmental improvements. He highlights three factors that motivate privatized enterprises to improve the environment. These are the higher efficiency gained from increasing profits, the need to comply with environmental regulations, and the need to respond to consumers' and environmental agencies' pressure to improve environmental behaviour.

Privatization is a structural reform that can increase competition and therefore increase efficiency. For instance, Tandon (1995) defines privatization as a form of deregulation that enhances the degree of competition in the market. In addition, Kikeri and Nellis (2002) argue

that, in order to have a successful privatization, the creation of a competitive market and the removal of entry barriers are essential. Furthermore, Allen and Gale (1999) highlight the important role of competition in increasing the efficient use of resources.

Several studies document the macroeconomic consequences of privatization and its positive role in public finance. Firstly, as stated by Davis et al. (2000), privatization has macroeconomic effects on economic growth, investment and the labour market. They indicate that a higher private-sector share of the economy is associated with a higher rate of economic growth. Megginson et al. (1994) investigate the effects of privatization on capital investment expenditures. Their study shows that there was an increase in capital investment expenditures as a portion of sales in a sample of 61 privatized companies in 18 developed and developing countries.¹ On average, the increase in capital investment expenditures was 67%. Davis et al. (2000) indicate that this number is higher in developing countries. In fact, Boubakri and Cosset (1998) in their sample of developing countries² conclude that, as a result of privatization, the unadjusted and market-adjusted value of capital investment expenditure increased from 10.5% to 23.7% and from 0.9% to 3.6% respectively. The study also indicates the existence of employment security after privatization, which implies that these countries did not experience labour lay-offs due to privatization.

Secondly, privatization has positive consequences on government revenue. Several studies such as Davis et al. (2000) and Kikeri and Nallis (2002) show that privatization results in a diversification of sources of government revenues rather than their limitation to sales income. In addition, Kikeri and Nallis (2002) indicate in their sample of 18 countries³ that overall there is a significant decline in government transfers due to privatization. This results in a substantial decline in budget deficits. More specifically, they indicate that in Egypt the gross budgetary transfers and subsidies to public enterprises declined from 1% of GDP in 1990-1992 to almost 0.5% of GDP in 1997.

¹ Companies selected in this study were privatized partially or fully during the period from 1961 to 1990 through a share issue sold to the public rather than through state-owned enterprises being sold to other companies.

² The study includes a sample of low, lower middle and upper-middle-income economies. The countries are: Bangladesh, India and Pakistan as low-income economies; Chile, Jamaica, Nigeria, the Philippines, Thailand, Tunisia and Turkey as lower-middle income economies; and Argentina, Brazil, Greece, Malaysia, Mexico, Portugal, Singapore, South Korea, Taiwan, Trinidad and Tobago, and Venezuela as upper-middle income economies.

³ The sample includes 18 countries of which 10 are non-transitional economies (Argentina, Bolivia, Côte d'Ivoire, Egypt, Mexico, Morocco, Mozambique, Peru, the Philippines and Uganda) and eight are transitional economies (The Czech Republic, Estonia, Hungary, Kazakhstan, Mongolia, Russia, Ukraine and Vietnam).

Caprio and Honohan (2001) elaborate on fiscal status by concluding that the banking industry's privatization experience revealed a significant increase in the level of savings. One example is the experience of banking privatization in Argentina, which was accompanied by the reduction in the number of state-owned banks by half from the early 1990s to 2000. These state-owned banks mostly weakened the financial system. Thus there was a need to increase the number of privately owned banks (Caprio & Honohan, (2001)). Low and middle-income countries have a particularly acute need for privatization due to the large proportion of state-owned banks. Caprio and Honohan (2001) indicate that, under a favourable environment and in a strong regulatory context, carefully designed privatization leads to higher efficiency. Privatization led to improvements in banks' income statements and balance sheets in Argentina (Caprio & Honohan, 2001). More specifically, there was a decline in the ratio of administrative costs to revenues, an improvement in resource allocation and an increase in credit availability to public enterprises. Furthermore, as stated by Caprio and Honohan (2001), state-owned banks impede the development of the financial sector. According to Barth et al. (2001), there is a negative relationship between the degree of development of the financial sector and the share of state-owned banks. They also demonstrate that, as the asset share of state-owned banks increases, there is an increase not only in the probability of state financial crises but also in the possibility of the country in question experiencing less development in its financial sector.

Other studies have examined the economic consequences of privatization in developing countries (Megginson & Netter, 2001). One important conclusion derived from Megginson and Netter's (2001) research is that merely transferring ownership from the state to the private sector does not necessarily guarantee economic gains or improvements. This fact is also articulated by Zhang et al. (2005) in their study of the effects of the progression of privatization, competition and regulation in electricity generation using a sample of 25 developing countries.⁴ Their study highlights the importance of creating an independent regulatory power as well as establishing competition prior to privatization in order to ensure that privatization yields greater benefits. One of the most important justifications for the existence of competition, in addition to privatization, is that competition is associated with lower costs and higher production efficiency (Bouin &

⁴ The sample consists of 25 developing countries. All the countries experienced privatization of the electricity generation sector during the period from 1985 to 2001. The countries are: Argentina, Barbados, Bolivia, Brazil, Chile, Colombia, the Dominican Republic, Gabon, Georgia, Guatemala, Hong Kong, India, Kazakhstan, Malaysia, Morocco, Nicaragua, Pakistan, Panama, Peru, Qatar, Senegal, South Africa, Thailand, Trinidad and Tobago, and Venezuela.

Michalet, 1991). Moreover, Cuervo and Villalonga (2000) highlight the importance of competition and regulation in characterizing the benefits that can be derived from privatization. In addition, competition and regulation are more important than ownership in improving efficiency in imperfectly competitive markets (Vickers & Yarrow, 1988; Yarrow 1986, as cited in Cuervo & Villalonga, 2000). Cuervo and Villalonga (2000) also point to the importance of synchronous modifications and adjustments in competition and regulation in order for privatization to generate economic gains.

3.2. Negative Consequences of Privatization

Even though privatization has positive economic consequences, some studies have indicated that it has negative impacts on labour market outcomes (Gupta et al., 2001; Bayliss, 2002; Fernandez et al., 2007; Monteiro, 2010; Kallianiotis, 2013), on social welfare (Estrin et al., 2009; Kallianiotis, 2013; Bayliss, 2002; Barrerra-Osorio, 2009), on total factor productivity (Estrin et al., 2009), on national wealth and sovereignty (Kallianiotis, 2013), on the utility sector (Bayliss, 2002; Barrerra-Osorio, 2009; Ikram, 2005), on distributional effects (Bayliss, 2002), and on the banking sector (Otchere, 2005).

The most obvious negative consequence of privatization is its impact on labour market outcomes. Several economists, such as Gupta et al. (2001), Bayliss (2002), Fernandez et al. (2007), Monteiro (2010) and Kallianiotis (2013), have studied how privatization can lead to wage cuts, job losses and unemployment. Gupta et al. (2001) examine the relationship between privatization and the level of employment and wages using empirical evidence.⁵ They extrapolate that different methods of privatization have different impacts on labour market outcomes. More specifically, they divide the privatization process into three periods: pre-privatization, privatization and post-privatization. They eventually conclude that the level of employment is shaped as a U-curve, which implies that the level of employment goes down during the first two periods and increases in the long run after privatization has been completed.

Bayliss (2002) indicates that there could be some negative effects of privatization on poverty. This study indicates that, on the one hand, poor people become worse off after privatization if prices increase and employment decreases. On the other hand, low-income people

⁵ This result is reached by investigating privatization impacts in a sample of countries from 1960 to 1998. The countries are: Argentina, Bangladesh, Benin, Burkina Faso, Central African Republic, Chile, Cote d'Ivoire, Czech Republic, Ghana, Togo, Guinea, Hungary, Korea, Lao People's Democratic Republic, Malaysia, Mexico, Morocco, Nepal, Pakistan and Zambia.

may benefit from privatization when private services become more reliable and affordable for poor people. The International Labour Organization (ILO) (1999) summarizes the impact of privatization on employment (as cited in Bayliss, 2002). The ILO (1999) demonstrates that the impact of privatization on employment varies from one industry to another. It states that, in general, the water, electricity and gas-utility sectors experienced a decline in their level of employment and that this decline can affect around 50% of the workforce (ILO, 1999). Moreover, the specific method of privatization could affect the unemployment level (ILO, 1999). More specifically, the level of unemployment is higher when privatization is total or when it is combined with restructuring.⁶

According to Fernandez et al. (2007),⁷ privatization may have different impacts on employment depending on whether the worker is employed on a part-time or full-time basis. They claim that the replacement of the government with private-sector, profit-maximizing firms in the provision of public services can affect full-time public workers negatively while it can have a positive impact on part-time workers. For example, Monteiro (2010) considers the consequences of privatization on wages in the Portuguese banking sector during the period from 1989 to 1997. The study concludes that privatization has temporary negative effects on men's and women's wage growth rates in the short term. In addition, the study shows that the workers who suffer the most from wage cuts are workers with relatively high educational and experience levels as well as those who have highly developed occupational skills. A recent study by Kallianiotis (2013), which investigates the privatization experience of Greece, shows the negative effects of privatization on social welfare as a consequence of unemployment associated with privatization. It shows that, while the average unemployment rate was 25.4% in August 2012, the unemployment rate of young people rose to 50%. Furthermore, it indicates that privatization makes multinational firms more dependent on foreign capital, which leads to a decrease in national wealth and social welfare. Estrin et al. (2009) point out that, while privatization has positive effects on foreign owners' firms within the Commonwealth of

⁶ The ILO extrapolated its results by using data on labour market outcomes and companies and trade unions in privatized water, electricity and gas sectors for ILO members.

⁷ Fernandez et al. used the International City/County Management Association's Alternative Services Delivery Surveys (ICMA) data in addition to the U.S. Census of Governments' finance and employment/payroll surveys from 1997 to 2002.

Independent States, it has either a negative or an insignificant effect on domestic owners' firms. This study shows that, in order to ensure positive results from privatization, the process should be accompanied by sound management and corporate governance.

As noted several times above, privatization has both positive and negative effects on the economy. In order to derive positive effects from privatization, a target structural reform plan should be accompanied by a robust regulation and supervision policy. The following section examines the importance of privatization for the Egyptian banking sector, and then the effect of the Egyptian privatization experience on the same.

4. The Importance of Privatization to the Egyptian Economy

Privatization appears to be crucial for the Egyptian economy for multiple reasons, the most substantial one being the need to reverse the negative ramifications of nationalization in 1957 (Mohieldin & Nasr, 2007). Law 60 in 1957 led to the public sector's acquisition of a substantial share of foreign and private properties and businesses. This was a decision of the president Nasser regime; the Economic Development Organization was in charge of administrating the economic activities of the nationalized assets (USAID, 2002).

As stated by Issawi (1963), a statutory nationalization program was widely applied in Egypt in 1961 (as cited in Doherty, 1968). As Issawi (1963) notes, the nationalization program was enabled by three main laws.⁸ The first law targeted "42 large industrial, transport, commercial, financial, and land reclamation companies" (p. 349, footnote 96, Issawi, 1963, as cited in Doherty, 1968) and nationalized all banks and insurance companies. The second law mandated that 82 companies should be partially nationalized and transferred to Arab joint-stock companies with the condition that at least 50% of the shares should be owned by the public. The third law required that for 148 Egyptian companies private-ownership must be restricted to a market value of E£10,000 or less.⁹ It is worthwhile to mention that, as stated by Doherty (1968), the market value of the shares that were affected by these laws was estimated to be around E£258 million of which the foreign share was estimated to be around E£ 33 million.¹⁰

⁸ As stated by Issawi (1963), the law No is 117-119 of July 19-21, 1961 (as cited in Doherty, 1968).

⁹ The exchange rate on March 14, 2014 was E£1 equals C\$0.16.

¹⁰ Under the nationalization program, the interest rate was equal to 4% for 15 years on non-negotiable bonds and it was the same for both domestic and foreign investors.

USAID (2002) notes that, as a consequence of nationalization, Egypt suffered from significant economic crises in the 1980s. A few of the major negative consequences are as follows:

- Foreign debt increased from US\$20 billion to US\$49 billion in the 1980s;
- The balance of payments deficit increased to US\$11.4 billion;
- The budget deficit increased to 17% of GDP;
- Economic growth decreased to an annual rate of 2.5%;
- The annual inflation rate jumped to 20%;
- The unemployment rate increased to between 15% to 20%; and
- GDP per capita declined (USAID, 2002).

The combined effects of these consequences had a devastating effect on the Egyptian economy and forced policy makers to reconsider the merits of nationalization. In consequence, it was necessary to adjust and reform the Egyptian economy. In addition, international financial institutions highly recommended that governments reform their economies by implementing privatization initiatives. The International Monetary Fund, the World Bank and the African Development Bank highlighted the importance of replacing state ownership with private ownership and offered assistance to countries in order to make the transition smoother (Boubakri & Hamza, 2005). Furthermore, the World Bank facilitated Egypt's structural reforms towards privatization with a US\$300 million loan, while the African Development Bank and the European Commission assisted Egypt with a credit of US\$260 million towards liberalization and privatization. Under this initiative as enacted by Law 203, 133 companies were converted to majority private ownership and 55 were partially privatized. The largest sector in terms of sales proceeds through privatization was cement and building materials at 39 percent, followed by food and agriculture at 15% (USAID, 2002). Consequently, the Egyptian government passed laws to facilitate the privatization process.

According to Ikram (2005), the initial stage of the Egyptian privatization experience began in July 1991 when Law 203 was passed. Under this statute, 314 non-financial state-owned enterprises were reorganized initially into 27 holding companies and then in 1993 into 17 holding companies. In Egypt, there were five different ways to privatize a state-owned enterprise: selling the state-owned enterprise to anchor investors or an Employee Shareholder

Association, liquidating the enterprise, selling the enterprise through the stock market and selling the assets of enterprise (Ikram, 2005).

After the introduction of privatization, the market structure in most sectors changed from monopoly to competition. This competition has benefited the economy in terms of enhancing the ability of several domestic and foreign investors to introduce new technologies as well as new products in different sectors, such as food, textiles and garments, cement and so forth. Based on the USAID (2002) study, during the period of nationalization, most markets in the Egyptian economy were structured as monopolies. Public-sector enterprises dominated the market activities in almost all the sub-sectors since the government controlled 80-90% of the Egyptian economy.

Ikram (2005) and Gebba and Ahmed (2013) summarized the main objectives of the privatization program in Egypt as follows:

- Enhancing competition and thus improving assets' efficiency while also decreasing the borrowing level of the public sector;
- Extending share ownership;
- Increasing the competitiveness of capital markets;
- Redistributing income and wealth;
- Reducing government intervention and giving more freedom to producers; and
- Improving efficiency in the governmental use of financial resources by decreasing public funds and disinvestment in unsuccessful public enterprises.

Privatization in Egypt had positive effects on economic growth. According to the International Monetary Fund (1999), GDP growth increased by 3% after privatization. It grew from 5% to 8% when compared to 1988 and 1998 respectively (Afifi, 2001). Moreover, the study documented a decrease in the prevailing account deficit from US\$1,048 million to US\$192 million during the same period. The diversity of capital ownership in the Egyptian economy has led to higher economic growth (Boubakri & Hamza, 2005). Furthermore, according to Kamaly (2006) total factor productivity increased after privatization because of foreign direct investment.

Since privatization began, Egyptian enterprises have become more efficient in utilizing available resources and assets. This increase in efficiency has resulted in better liability ratios and hence in a more resilient financial position and lower vulnerability to economic shocks

(USAID, 2002). Furthermore, privatization reduces financial risk by providing diversity in ownership, which tends to dampen the effect of financial shocks and ease the financial constraints that threaten the stability of any economy. One goal of implementing privatization in Egypt was to reduce the burden of financial crises on state-owned enterprises (Mohieldin & Nasr, 2007). In addition, Davis et al. (2000) compare the initial debt stock before privatization with the debt stock at the end of the last year of active privatization. They conclude that Egypt has experienced a significant reduction in its stock of public debt as a percentage of GDP. They state that the initial debt stock in Egypt was estimated to be 129.4% of GDP in 1993 (the start of the active privatization period), while the year-end debt stock was 89.6% in 1998 (the end of the active privatization period).

A major reform of the financial sector took place in the form of a comprehensive Egyptian government program from 2004 to 2008 (Nasr, 2009). The financial-sector reform was designed to increase the contribution of the private sector within Egypt's financial system. The reform program aimed to improve competition, enhance financial intermediation, increase the efficiency of savings mobilization and guarantee systematic financial health by altering banking laws, regulations and supervision. At this juncture it is necessary provide a historical overview of the Egyptian banking industry.

5. Privatization and the Banking Sector in Egypt

5.1. The History of the Banking Sector in Egypt

Before discussing the legitimacy and appropriateness of the privatization reforms, it is important to establish the historical context within which bank privatization was chosen as a policy direction. The banking sector is one of the oldest economic sectors in Egypt and plays a direct role in all Egyptian financial activities. It represents more than 60% of the financial assets in Egypt.

The National Bank of Egypt has been considered to be the cornerstone of Egyptian banking since 1898, and it began to play the role of Egypt's central bank in the 1950s (National Bank of Egypt, n.d.). As mentioned by Daradkah and Miani (2011), there are several major financial institutions that have played a great role since the early 1900s in Egypt's economy. Banque Misr, the Bank of Alexandria and the Bank of Cairo are the biggest players in the

Egyptian financial market and their financial performance has a crucial impact on the Egyptian banking sector since these three institutions are the largest banks in the country. The Banque Misr has been a part of the Egyptian banking sector since 1920, while the Bank of Cairo was founded in 1952, followed by the Bank of Alexandria in 1957.

Mohieldin and Nasr (2007) imply that the Egyptian banks were nationalized in the 1960s on the premise of a “development view” aimed at encouraging growth and development by providing employment and subsidies and by funding social programs and projects that would not be considered feasible by privately owned banks. As mentioned by La Porta et al. (2002), policy makers argued that, through a state-owned banking system, economic growth and financing would be guaranteed – in contrast to the case of privately owned banks that often find it impossible to fund the financial needs of entrepreneurs.

By 1970, however, a full decade into the nationalization experiment, there was plenty of evidence to suggest that the performance of the state-owned banks had fallen drastically and that the economy was suffering the repercussions in terms of slow growth and lack of competition and innovation. The government realized that it was time for another set of reforms – this time, a move towards liberalization and privatization aimed at reconstructing the economy by allowing private owners to manage enterprises on a profit-maximizing basis. Part of this reform process was the “Infitah”, the Economic Reform and Structural Adjustment Policy (ERSAP) introduced in 1991, and the Financial Sector Reform Program in late 2004 (Mohieldin & Nasr, 2007). These policies centred on regulating and restructuring the banking sector in order to promote efficiency and market-based allocation of resources, as opposed to the politically motivated allocation that previously prevailed in state-owned banks.

According to Daradka and Miani, (2011), back in 1975 Egyptian policy makers understood the importance of expanding the banking industry and recognized that an essential stage of the evolution of the Egyptian banking system consisted of passing legislation to encourage the establishment of different types of banks – for example, investment, commercial and other specialized banks. The study mentions that one remarkable innovation was a law that distinguished between different institutional bank structures. As a result, several banks were established with different structural forms. For instance, The Industrial Development and Workers Bank of Egypt (IDBE) is specialized to finance the private industrial sector (IDBE, n.d.). In addition, the Egyptian authorities encouraged foreign banks to enter the Egyptian

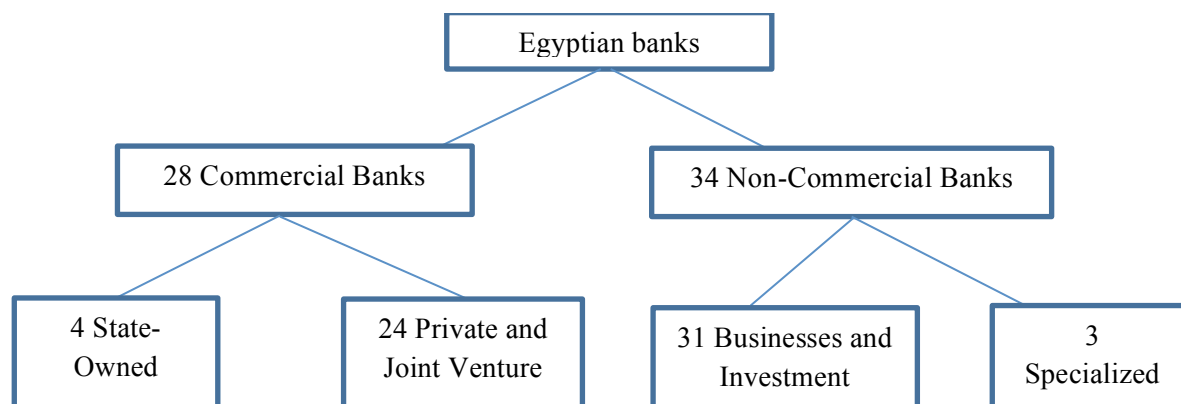
banking industry. For example, Société Arabe Internationale de Banque (SAIB), Misr Iran Development Bank, Commercial International Bank and Barclay's Bank Egypt are all foreign commercial banks that were introduced to the Egyptian banking sector as a result of liberalization policies implemented in the 1990s. A study done by Mohieldin and Nasr (2007) mentions that, as of 2005, there were 55 banks operating in Egypt, of which only four were state-owned. Yet, these state-owned banks control 60% of the total assets in the banking sector along with 85% of the branch networks. Nasr (2009) indicates that in 2006 the full privatization of the Bank of Alexandria was an essential part of Egypt's privatization agenda. This is because the Bank of Alexandria was the fourth largest state-owned bank in Egypt, accounting for more than 6 percent of the banking sector's assets.¹¹

More recently, Gebba and Ahmed (2013) indicate that the Egyptian government launched a bank privatization program in 1994. This program aims to improve market competition and decrease market concentration by privatizing state-owned banks and joint-venture banks. Furthermore, Gebba and Ahmed (2013) indicate that, if banking-sector privatization were successfully applied in Egypt, around half of the financial-sector services would be provided by the private sector. As they indicate, in 2013, 70% of the financial services were provided by state-owned enterprises. Furthermore, around 1% to 2% of the additional output of overall GDP would shift from the state-owned enterprises to the private sector. These statistics indicate that, despite all the efforts towards privatization, state ownership is still dominant in the Egyptian banking sector.

It can be claimed that privatization was introduced to the Egyptian banking sector in the 1990s not only as a way of sharing the financial risks between the public and private sectors but also as a tool to benefit from the private sector's ability to finance different requirements, such as capital investments and operational costs. The current structure of the Egyptian banking system is as follows:

¹¹ The main objectives of privatizing the Bank of Alexandria were to increase foreign direct investment, to introduce new technologies and to improve management performance. The privatization of the Bank of Alexandria was accomplished in two stages: the first stage was in October 2006 when 80% of the bank was sold to an anchor investor (San Paolo IMI), with a total transaction value of US\$1.6 billion; the second stage was in December 2006 when the bank was fully privatized (Nasr, 2009).

Figure 1 - Structure of the Egyptian Banking System



Source: Central Bank of Egypt (2013)

5.2. Privatization in the Egyptian Banking Sector

As Mohieldin and Nasr (2007) indicate, the state-owned banking approach had noble ambitions for promoting social welfare; in reality, publically owned banks are acutely vulnerable to political pressure. In order to finance public financial needs, deficits and non-profit programs, efficiency is often compromised in favour of expedience. Furthermore, these inefficiencies together with non-performing loans (NPLs) add to the cost of operations and result in losses and lower growth, thus making these banks more vulnerable to external shocks. Hence, in order to help defend the banking sector against these vulnerabilities, privatization was considered as a means for promoting a more efficient allocation of resources and the inclusion of the private sector in the banking industry, which in turn would encourage greater competition and innovation in the economy.

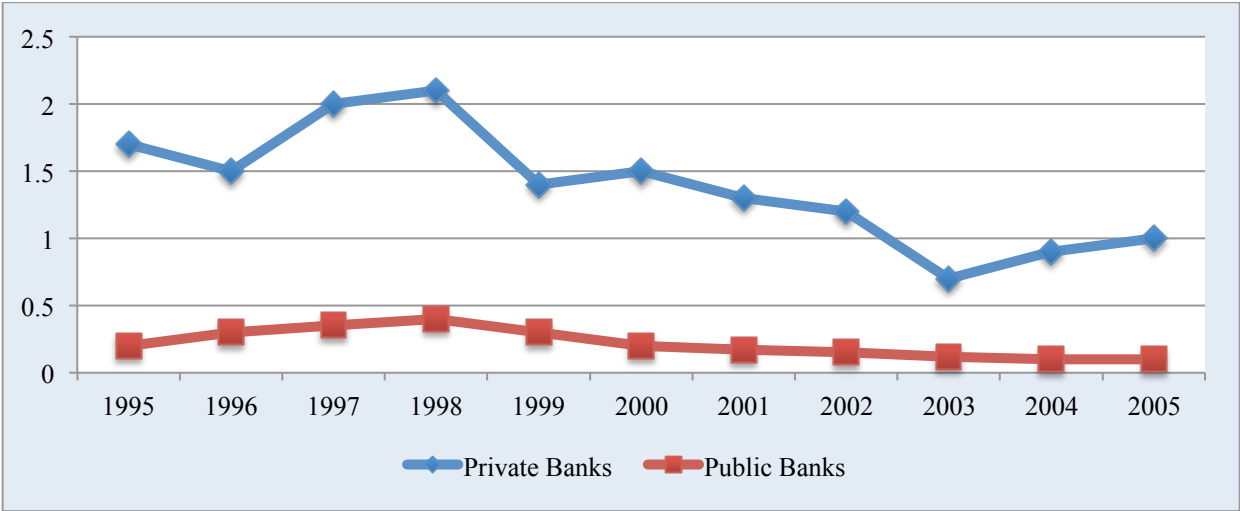
Mohieldin and Nasr (2007) analyze the performance of publically owned versus private banks using an inter-temporal comparison of performance indicators such as capital adequacy, asset quality, management soundness, earnings, profitability and efficiency ratios over a ten-year period between 1995 and 2005. They conclude that state-owned banks lack efficiency and innovation. State-owned banks are poorly regulated and do not follow effective guidelines and industry best practices to ensure profitability; in consequence, they suffer from a significantly higher number of non-performing loans, bad asset quality and poor capitalization.

That paper argues that the level of capital adequacy for a bank depends on its risk tolerance. A bank with poor asset quality therefore needs to maintain a higher level of capital in order to effectively manage risk and protect itself from market shocks. Using the equity-to-asset

ratio as a proxy for capital adequacy, the paper states that, on average, state-owned banks have an equity-to-asset ratio of only about half that of private banks (i.e., 3.5% versus 6.7% for private banks) (Mohieldin & Nasr, 2007). As a result of being so grossly undercapitalized, state-owned banks are significantly more vulnerable to external economic shocks than their privately owned counterparts.

The lending practices in state-owned banks are politically motivated rather than commercially and economically based, and therefore these have an impact on asset quality. The state-owned banks extend non-performing loans to state-owned enterprises, which are already operating with losses and are not commercially fit candidates for the loans. Consequently, the public bank portfolio ends up with a very high proportion of non-performing loans (NPLs), an amount that represented 22% of total loans in 2005. These NPLs accumulate year after year and make the banks extremely inefficient and vulnerable to market shocks. Private banks, on the other hand, have shown evidence of better equity-to-asset ratios, more thorough credit screening and a lower ratio of NPLs. Private banks also tend to have lower investments in treasury bills and to engage in less lending to state-owned enterprises, which are more likely to own the NPLs (Mohieldin & Nasr, 2007).

Figure 2 - Return on Assets



Source: Mohieldin and Nasr (2007)

The paper also analyzes management indicators such as expense-to-revenue ratios and earnings-per-employee ratios. It reports that private banks have higher expense ratios due to a greater amount of investment in employees and innovation. However, private banks display

higher earnings per employee for the entire ten-year time frame, thus demonstrating how overstaffing and poor management in public banks affects the bottom line in terms of lower profitability. Other profitability indicators, such as return on assets and return on equity, also show better performance for private banks. The paper cites Goldstein and Turner (1996) in arguing that the poor performance of state-owned banks is due to a lack of incentives to innovate and upgrade and a lack of due diligence in conducting credit screening to select good customers. Based on the above-mentioned indicators, Mohieldin and Nasr (2007) conclude that empirical evidence shows private banks to have superior performance in comparison with that of state-owned banks.

Table 1 - Key Management Indicators for the period 1998 - 2005 (average values)

Indicator	Public Banks	Private Banks
Expense to Revenue Ratio	84.06	86.36
Earning per Employee	19.06	28.04

Source: Mohieldin and Nasr (2007)

Omran (2007) studies the pre- and post-privatization performance of 12 joint-venture Egyptian banks that were fully or partially privatized between 1996 and 1999. He concludes that better financial performance in terms of profitability and efficiency is associated with less state ownership.

Economic theory is consistent with the idea of privatization resulting in greater efficiency through increased competition, which in turn leads to economic growth and the development of the banking system. The reallocation of a country's resources, such as financial resources through privatization, plays an important role in improving the banking sector. The adoption of a private ownership system allows for the focus on banking-sector development to take priority over responding to any political motivation. USAID (2002) states that in other sectors there has been progress in financial performance where net income, return on sales and return on assets have all increased.

Several other authors have also found significant growth in the Egyptian financial sector since privatization was implemented. According to Daradkah and Miani (2011) in their study of the Egyptian banking industry and of the impact of privatization on banking performance, between 2002 and 2009 there was significant growth in commerce, business and investment, as

well as in specialized banks' deposits. The compound annual growth rate of those banks' deposits was 11.43%. Moreover, the study affirms that the total credit facilities of the three types of banks grew at an annual compound rate of 10%. This implies that there were positive effects on the financial industry as a consequence of the reforms to the Egyptian banking sector. Privatization proved to be successful as it facilitates loans to investors. More flexibility in lending practices increases foreign direct investment as well as investment by domestic businesses and individuals. The provision of loans by specialized banks improves enterprises in different sectors, such as agriculture and manufacturing. Expanded credit facilities improve the ability of commercial banks in generating money and lending money to investors. Business and investment banks are able to provide more funds to enterprises, which then leads to higher deposit growth as these funds are redeposited into the banking system. The expansion of bank deposits encourages banks to invest in profitable enterprises, thus leading to higher future returns. Higher future returns help banks to finance their needs.

Roe (1998) highlights the effects of liberalization of the financial sector in Egypt in the early 1990s. The study indicates that, as a result of the structural reform in the early 1990s, there was an improvement in the fiscal deficit. In addition, the exchange rates, interest rates and lending decisions were unified. In 1992, the controls on banks' interest rates and lending ceiling were removed, while other controls were applied to the financial system. The nominal interest rate increased slightly after privatization and then declined. More specifically, for short-term deposits, the nominal interest rate increased from under 10% to 17% by the middle of 1993, whereas it decreased to 10% by June 1995; the average bank's lending rate was almost 14%. Moreover, the study indicates that banking privatization that targeted Egypt's large banks has led to the elimination of the excessive ownership relationships between banks, which are believed to be a major factor limiting competition in the Egyptian banking sector.

Kalhoefer and Salem (2008) indicate that public banks in Egypt suffer from major profitability problems in addition to a high level of NPLs. They conducted research on the Egyptian public banks' return on equity from 2003 to 2005 by using data from financial statements in order to investigate the performance of these institutions. They conclude that there were income problems in these banks. In addition, the investigation of the banking balance sheets revealed that, for both private and public banks in Egypt, there was a decrease in the net

interest margin from consumer businesses. The authors claim that the decrease in the net interest margin indicates that the Egyptian banking sector suffered from major structural issues.

Naceur and Omran (2011) also investigate the impact of macroeconomic indicators on banking performance. They use per-capita GDP growth and inflation as the main macroeconomic environment proxies. In addition, they employ market-based and bank-based indicators of financial development. More specifically, they use the ratio of stock-market capitalization to GDP as a proxy to capture the size of the equity market. They use the magnitude of the ratio of private-sector credit as a percentage of GDP as a bank-based indicator. The empirical results reveal that, with the exception of inflation, the various macroeconomic and financial-development indicators do not significantly affect the net-interest margin, which is a banking performance indicator. Moreover, the study finds that a well-developed banking sector experiences lower operating costs. Finally, the study concludes that the banking sector in the MENA countries needs essential improvements in its governance environment and developments in its capital market, as well as increases in competition.

From the foregoing, it is obvious that privatization in the Egyptian banking industry was a necessary step towards achieving increased efficiency and compensating for the damaging effects of nationalization. At this point it is imperative to discuss the impact of privatization on competition in the Egyptian banking sector.

6. The Effect of Privatization on Competition in the Banking Sector

Competition in any market is considered beneficial for consumers as it provides incentives to firms to offer the most attractive deals to consumers in order to secure their business. The same is true for the financial markets. Competition in the banking sector increases the quality and the range of the financial services such as mortgages, lines of credit, business loans and so forth that are provided to consumers. The Egyptian banking sector suffers from a lack of innovation and needs improvement in terms of technology and procedures. Privatization encourages the new owners to invest in technology infrastructure and in human capital, as well as to ensure that the banking sector's growing need to update its service offerings for the information-technology age is fulfilled in order to serve its clientele more effectively. The implementation of cutting-edge technology in banking systems will enable the Egyptian banks to meet global standards and to secure greater foreign investment. Adherence to international

standards will ensure effective interaction with international financial institutions and will increase the level of foreign remittances to the Egyptian economy. Moreover, technological progress will improve electronic banking, which will facilitate bank services in terms of increasing the transactions' level convenience and security. In addition, electronic banking will play a substantial role in reducing operational costs and maximizing banks' profitability.

El-Shazly (2009) analyzes the impact of privatization on the efficiency of different types of banks using panel data from 1992 to 2006 and distinguishes among the banks according to ownership and type of activity. His analysis of efficiency focuses mainly on profits and costs, and includes a comparison of a bank's performance against the industry best-practice bank group. Efficiency is computed in the range of 0 to 1. The best-practice bank group has a minimum possible level of costs and a maximum possible level of profit given the industry conditions. Holding asset quality fixed, he concludes that the performance of the public and private banks is mixed. The hypothesis of no inefficiencies is rejected. Private commercial banks have lower cost efficiency, but higher profit efficiency. This indicates that, although private commercial banks are better at generating profits, they accomplish this at a higher cost relative to other types of banks. El-Shazly (2009) finds that cost efficiency is high for foreign and private investment and for business banks, which could be due to the higher level of investment in human capital and innovation. However, the cost efficiency of public banks could be biased downwards due to lower wages and stricter budgets. El-Shazly (2009) also states that the lower profit efficiency in public banks is an indication of government influence and poor management. He also suggests that improving efficiency and competition in the Egyptian financial market through privatization will lead to greater technological progress, but only if accompanied by stricter financial regulations to ensure good governance and sound corporate management practices.

Mohieldin and Nasr (2007) also note the importance of privatization as a tool to introduce competition into the financial market. Their study states that, under a competitive financial market, the commercial banks benefit from new investments, cutting-edge technology and more efficiency in terms of reducing operational costs. As a result, the authors conclude that more privatization in the Egyptian banking sector is advisable following the recognition by the public sector of the benefits and importance of expanding such a structural reform.

The previous studies show that, in order to enable the banking sector to perform more efficiently, there is a clear necessity to establish additional regulation and reform. Therefore, a principal concern of the Central Bank of Egypt (CBE) is to design a new banking reform plan to restructure the banking industry to adhere to global standards. The latest banking reform plan was initiated in 2004 and lasted until 2011. This study aimed at specifically investigating the effect of such a reform on banking performance.

Before undertaking a more detailed examination of the latest banking reforms in Egypt, it is worth studying the country's current general economic situation. As a result of the revolution of 2011, the Egyptian economy has suffered from instability and uncertainty, which has had adverse consequences on the banking industry. The following section briefly presents Egypt's overall economic condition.

7. The Economy of Egypt

Given the fact that there is a causal relationship between the banking sector and the general economy, it is worth noting the major aspects in the Egyptian economy with an emphasis on the macroeconomy. The growth rate of GDP and its major components such as investment and consumption, in addition to capital, inflation and the interest rate, can stimulate banking and financial development. Therefore, this section discusses how macroeconomic conditions affect the Egyptian banking industry.

During the last decade, there were two major crises that had substantial impacts on the Egyptian economy. The Egyptian economy was affected by the financial crisis of 2008, especially because the Egyptian economy had been exposed excessively to privatization and to open-market operations in the early 1990s (Abu Hatab, 2009). Since then, the financial and banking sectors have been highly integrated with the global financial market. The financial crisis has had a significant impact on Egypt's real economy. Several macroeconomic variables were sensitive to the crisis, such as economic growth, inflation, investment and employment.

Furthermore, since 2004 the Egyptian economy has generally experienced the benefits of the structural reform (Abu Hatab, 2009). The plan involves liberalization, the privatization of state-owned enterprises, monetary policy, the management of public finances and the upgrading of the banking sector's supervision and performance. The post-reform annual rate of GDP growth subsequently increased as a result of the stimulation of foreign and domestic investment.

More specifically, censuses indicate that the post-reform annual rate of GDP growth was more than double relative to its average measured over the preceding decade. In fact, the real GDP growth rate was 4.1% in the 2003-2004 fiscal year, while it was 7.2% in the 2007-2008 fiscal year. Furthermore, real GDP per capita reached 1.2% in 2003-2004, while it was 5.2% in 2007-2008. In addition to improvements in GDP growth, unemployment decreased from 11.1% in 2003-2004 to 8.9% in 2006-2007 and then to less than 8.4% at the end of 2007-2008. Furthermore, Abu Hatab (2009) indicates that Egypt experienced a substantial structural change due to the increase in economic growth brought by capital accumulation, which actually rose as a result of the structural change in foreign direct investment (FDI). Additionally, Abu Hatab (2009) notes that there was a drop in the overall deficit for 2007-2008. It reached 6.8% of GDP in 2007-2008 which was an improvement relative to 2006/2007's 7.5% of GDP and was superior to the targeted level of 6.9%.

In alignment with Abu Hatab (2009), the Ministry of Finance (MOF)'s (2009) study investigates the domestic macroeconomic impacts of the financial crisis. The MOF (2009) indicates that the annual headline Consumer Price Index (CPI) inflation persistently declined and reached 10.2% in May 2009, while the cumulative decrease in this variable was 13.4 percentage points since the peak of August 2008. Furthermore, the deficit in 2007-2008 declined by 3.5% of GDP relative to its level in 2003-2004. In fact, the deficit in 2007-2008 reached 1.0% of GDP even though there was an increase in social expenditures in the same year. In addition, by the end of June 2008, there were improvements in debt indicators in the budget sector since total gross debt declined significantly relative to its ratio in 2004-2005. More specifically, the budget sector's total gross debt reached 82% of GDP at the end of June 2008, which was 38% lower than its 2004-2005 level.

Another crisis that affected the Egyptian economy was the revolution that began on the July 25th, 2011 and forced President Mubarak to resign. Protesters stridently expressed their need for a new political regime that would address political, economic and social needs like freedom and justice, as well as issues like corruption, low wages, high unemployment levels and inflation. Since then, Egypt has experienced political and economic instability and social tensions.

According to Moody's Investors Service report issued in March 2013, the Egyptian banking sector's outlook is negative. Based on this report, this outlook is affected by the fiscal pressure on the government, difficulties in securing IMF loans, and intense political and social

pressure. The report summarizes the main facts that are expected to determine the performance of the Egyptian banking system over the coming years. More specifically, the Moody’s Investors Service study shows how macroeconomic, competitive and regulatory factors can determine the quality of assets, liquidity, capital, funding and profitability. Table 2 summarizes the growth rate of real GDP, the inflation rate, the general government financial balance as a percentage of GDP and the general government debt as a percentage of GDP over the last 5 years. As Table 2 shows, real GDP growth dropped by 3.3% from 2010 to 2011 due to the revolution. The other important indicator of fiscal improvement is the inflation rate. A low inflation rate – especially when combined with sustainable economic growth – is an important aspect of the macroeconomic environment that positively affects the banking sector.

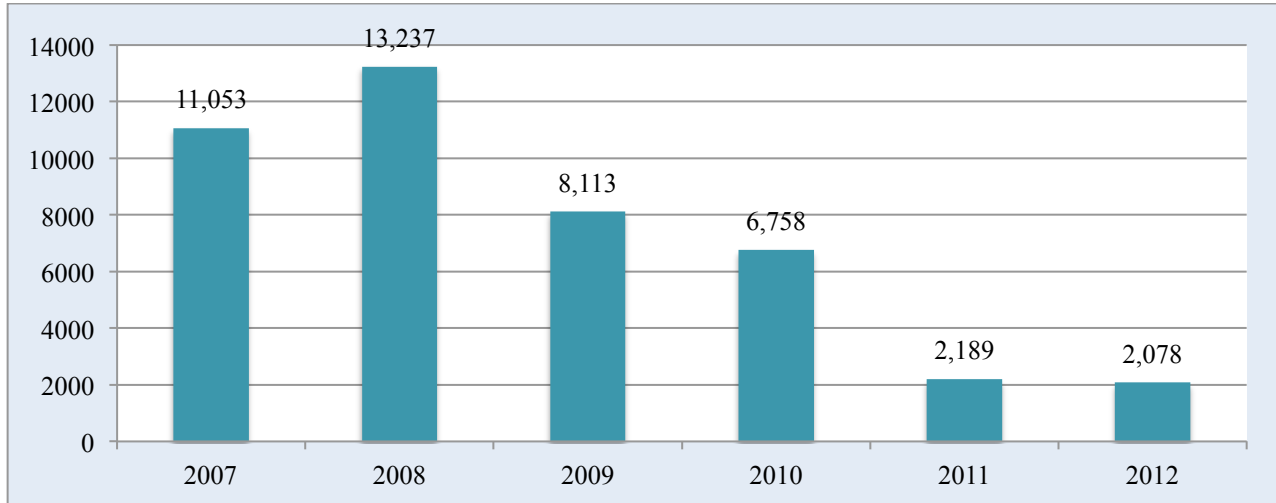
Table 2 - Macroeconomics Indicators

Macroeconomic Indicator	2009	2010	2011	2012	2013F
Growth in real GDP (%)	4.7%	5.1%	1.8%	2.0%	2.4%
Inflation rate (CPI % change)	16.2%	11.7%	11.1%	8.7%	9.4%
General government financial balance as a % of GDP	-6.5%	-7.8%	-10.1%	-10.9%	-10.4%
General government debt as a % of GDP	72.9%	73.2%	76.6%	80.5%	83.3%

Source: Moody’s Investors Service (2013)

Moody’s Investors Service report (2013) predicts that the operating environment will continue to be an obstacle to credit growth in Egypt. The report points out the persistent weakness of Egypt’s fiscal and external position due to an unstable and uncertain political situation. Furthermore, the report anticipates that the negative aspects of the operating environment in the Egyptian banking system are due to the major fiscal challenges faced by the government and also to the decrease in official international reserves. This leads to an inefficient investment environment. According to the CBE (2013), FDI was US\$13,237 million in 2008, compared with US\$2,078 million in 2013. This reflects the negative impacts of political and civil instability on investment decisions. Figure 3 shows the trend in FDI in Egypt since 2007. Moreover, the CBE (2013) census shows that official international reserves declined from US\$36 billion in 2010 to US\$13.5 billion in 2013.

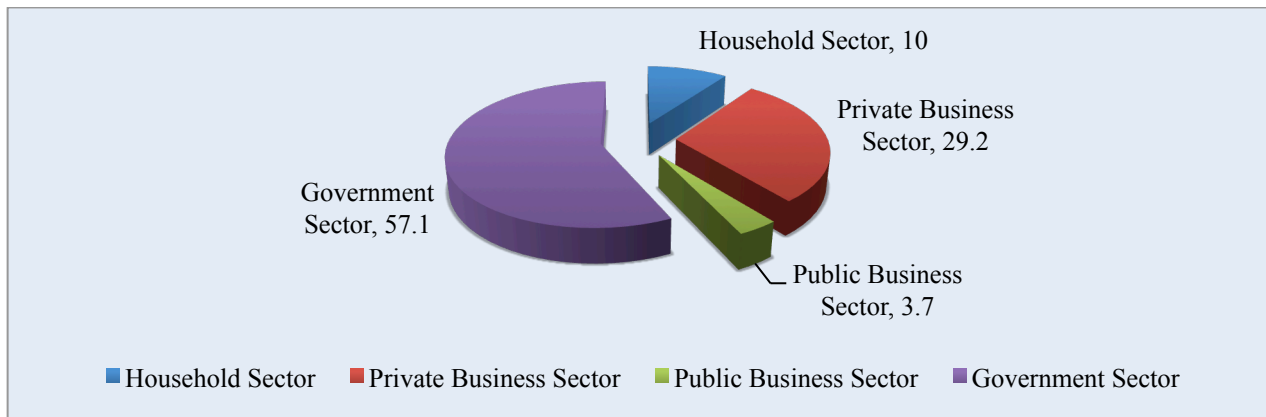
Figure 3 - Foreign Direct Investment (FDI)
(in million US\$)



Source: Moody's Investors Service (2013)

Moody's Investors Service report (2013) indicates that the key source of credit risk in Egypt is the government's intensive credit concentration. This report predicts that government bonds will increase due to the government's high deficits and the dependence of the government on funding from the Egyptian banks rather than on foreign funding for its deficit. As noted by the CBE (2013), the government sector accounts for 86.4% of the increase in domestic credit in all sectors. This increase is mainly due to the government securities that are held by the banking industry. Figure 4 shows the domestic credit by sector at the end of December 2012.

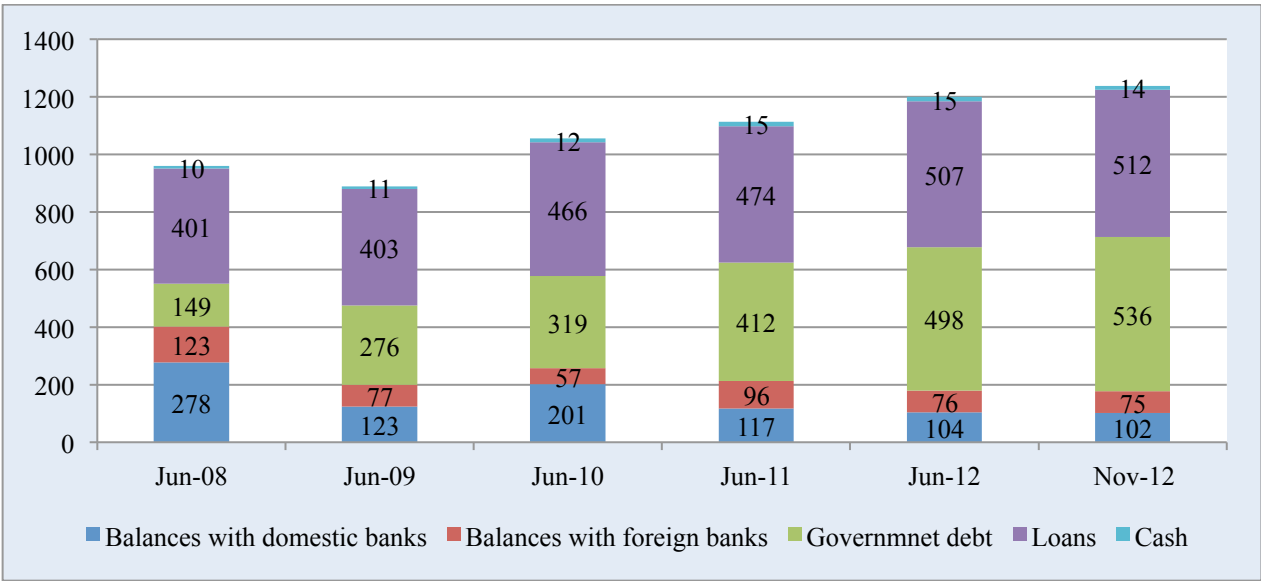
Figure 4 - Domestic Credit by Sector



Source: Central Bank of Egypt (2013)

The census shows that the Egyptian government depends on its domestic banking industry for funding rather than on foreign sources. Given this approach and given the fact that the Egyptian economy has experienced high deficits, the government bonds in the banking sector have increased (Moody’s Investors Service, 2013). Figure 5 shows the government’s exposure to the Egyptian banking industry. As can be seen, in November 2012 government bonds accounted for 37% of total banking assets.

Figure 5 – Banking Sector’s Exposure to Government Bonds



Source: Moody’s Investors Service (2013)

Table 3 summarizes the main banking indicators in Egypt from 2003 to 2008. The census indicates that there were positive changes in these indicators during these years. The positive changes not only reflect improvements in the regulation of the Egyptian banking sector, but also indicate the crucial role of the CBE in implementing the banking reform plan. As explained by the Egyptian-British Chamber of Commerce (2009), in 2003 the Egyptian government introduced legislation aimed at improving the soundness of the banking sector. In 2004, the elected reformist Egyptian government recognized the importance of restructuring, liberalizing and improving supervision of the banking sector by implementing additional privatization and fiscal reforms.

Table 3 - Banking Indicators

Banking Indicator in E£	2003	2008	Percentage Change
Total Assets	577,938	1,083,311	+ 87.7%
Total Deposits	403,144	747,199	+ 85.3%
Loans and Discounts	284,722	401,425	+ 41.2%
Capital and Reserves	29,960	53,436	+82.7%

Source: Egyptian-British Chamber of Commerce (2009)

Table 4 shows an overview of the five largest Egyptian banks in 2013.

Table 4 - Egyptian Banks in 2013

Bank	Total Assets (In E£ billion)	Domestic Market Share (loans, in %)	Domestic Market Share (Deposits, in %)
Bank of Alexandria	40	4%	3%
Bank du Cairo	51	2%	4%
Bank Misr	188	15%	16%
Commercial International Bank	94	7%	6%
National Bank of Egypt	321	22%	27%

Source: Moody's Investors Service (2013)

The Egyptian banking sector is anticipated to continue experiencing a negative operating environment due to several factors (Moody's Investors Service, 2013). Civil instability, a weak fiscal position and the decrease in official international reserves have contributed to an unfavourable investment environment and a low level of consumption and investment. In consequence, the growth rate of real GDP is anticipated to be lower than the level needed to overcome major economic challenges such as high youth unemployment and low living standards.

8. Egyptian Banking Reform Plan

The development of the banking sector was launched in September 2004 with the announcement of the banking reform plan by the CBE. The main goals of the banking reform plan are to improve the financial health of the banking industry, to increase the efficiency of the business environment and to expand the share of the private sector in the banking system. It is notable that the reform plan aims to improve regulations and the supervision structure of the Egyptian banking system. In this section, this study provides a review of the framework and of

the effectiveness of the reform plan by mainly focusing on privatization. Therefore the reform plan, including its objectives and pillars, are studied in general and then banking indicators before and after the implementation of the reform plan are compared.

According to the CBE (2012), the banking reform plan has two phases. The first phase started in September 2004 and ended in July 2009. This phase prepared and applied a thorough program for the financial restructuring of the commercial state-owned banks (National Bank of Egypt (NBE), Banque Misr (BM) and Banque du Caire (BdC)) and of the specialized state-owned banks (Principal Bank for Development and Agricultural Credit, the Egyptian Arab Land Bank and the Industrial Development & Workers Bank of Egypt).

As indicated by the CBE (2009-2012),¹² the first phase of the banking reform was based on four main pillars. The first pillar focused on privatizing and consolidating the banking sector. As a result of the first pillar, the number of banks in Egypt declined dramatically from 57 to 39 from December 2004 to December 2008. Furthermore, the ownership of the Bank of Alexandria was altered with 80% of the ownership being sold to the private sector (the Sanpaolo Bank). Furthermore, the ownership was divested among a number of state-owned joint venture banks.

The second pillar was the restructuring reform of the Egyptian state-owned banks. The reform aimed to improve efficiency in all departments, in addition to building new departments for risk management, management information systems, information technology and human resources. The third pillar dealt with NPLs. As a result, this particular pillar of the reform resolved more than 90% of the NPLs (not including the debts of the publically owned business sector). Furthermore, 62% of the irregular debt of the public business sector enterprises was paid back to the public banks in cash. Moreover, the remaining 38% of this irregular debt was agreed to be paid in cash by the end of June 2010. The fourth pillar was aimed at improving the supervision sector of the CBE. This pillar specifically sought to enhance the efficiency of supervision by applying risk-based notions of supervision. In addition, it focused on improving the banking human capital by improving the employee qualification requirements and by developing the management information systems (MIS) (CBE, 2009-2012).

According to Nasr (2009), the first phase results clarify the fact that restructuring the state-owned commercial banks increases their efficiency and positively affects their

¹² This section depends on different Economic Review reports issued by the Central Bank of Egypt from 2009 to 2012.

performance. In addition, the implementation of the first phase proved to be particularly effective as it supported the Egyptian banking sector during the international financial crisis. Furthermore, there was an improvement in the banks' asset quality as a result of the first phase (CBE, 2011). More specifically, there was a decline in the ratio of non-performing loans to total gross loans. This ratio declined from 13.6% in 2010 to 11% in 2011, which was a result of cancelling out some NPLs by the state-owned banks. Moreover, during the same years, there was an increase in the ratio of provisions to total non-performing loans, which increased from 92.5% to 93.6% (CBE, 2011).

Along with the CBE (2011), Nasr (2009) highlights the positive consequences of the first phase of Egypt's banking reform. She indicates that there has been an increase in the efficiency and profitability of the commercial state-owned banks (National Bank of Egypt, Banque du Caire and Banque Misr). Furthermore, credit practices and policies have been improved, banking services have been upgraded, more varieties of lending products to the non-corporate sector have been made available, and product offerings have been expanded for the new environment thanks to the adoption of new regulations. She also argues that the Egyptian government determined a time frame for the state-owned banks to manage the problem of NPLs. With regard to the banking consolidation agenda set out in the reform plan, Nasr (2009) elaborates on how banking-sector competition was enhanced. She argues that, due to the consolidation process, small private and joint-venture banks exited the Egyptian banking sector while many capable and more efficient foreign banks entered to fill the gap.

As a result, a higher level of competition was created in the banking sector. Several banks in Egypt, due to this specific phase of the reform, lost their licences, while other banks have been merged and some have been qualified to acquire licences based on their level of capital. In this context, Nasr (2009) reports that there was a significant reduction in the number of foreign banks and their branches. More specifically, in June 2008, foreign banks and their branches declined from 57 to 37. Moreover, Nasr (2009) highlights the importance of the accelerated and comprehensive consolidation process by pointing out its impact in exploiting economies of scale, promoting financial renovation and decreasing the costs of financial intermediation.

Nasr (2009) also notes that the privatization of the Bank of Alexandria is a remarkable consequence of the first phase of the restructuring reform. The significance of privatizing the Bank of Alexandria results from the fact that, during this process, the bank's assets accounted for

more than 6% of the entire assets of the Egyptian banking sector. The bank also had extensive brick-and-mortar operations with 188 outlets and branches throughout the country. In addition, Nasr (2009) indicates that the shares of 15 joint-venture banks were divested. She points out the significance of such diversification by arguing that the shares of the 15 joint-venture banks accounted for 20% of the banking sector's assets, in addition to the diversification of ownership of the largest banks' shareholders in Egypt, which are the National Société Générale Bank, the Misr International Bank, the Egyptian American Bank and the Commercial International Bank. Such diversification promotes competition and improves the banking system domestically (Nasr, 2009).

According to the CBE (2010 - 2011),¹³ the second phase of the banking reform started in July 2009 and ended in September 2011. This is the most significant phase. It was prepared mainly to enhance the Egyptian banking sector's soundness and efficiency, to intensify the level of competitiveness within the banking industry and to strengthen the banks' performance in risk management in order to support their position as a financial intermediary.

Given the fact that the second phase of the banking reform is the most vital part, it is worth noting the main pillars of this phase. The first pillar focused on improving the specialized state-owned banks (the Principal Bank for Development & Agricultural Credit (PBDAC), the Egyptian Arab Land Bank, the Industrial Development & Workers Bank of Egypt). The banks' improvement was effectuated through a comprehensive financial and administrative restructuring program.

The second pillar was aimed at pursuing the outcomes of the first restructuring phase in which the National Bank of Egypt, Banque Misr and Bank du Caire were subject to the restructuring reform. The second phase was designed to complete the final essentials needed to improve their competitiveness and financial performance.

The third pillar of the second phase was aimed at developing the banking sector's services and activities with a greater focus on small and medium-sized enterprises. In order to promote the banking credit of these companies, some exemptions were made. More specifically, the CBE excluded banks' deposits from the reserve requirement ratio, which is equal to 14%, when they finance small and medium-sized enterprises. In addition, as a procedure to improve and finance these enterprises, the CBE, the Egyptian Banking Institute, and the Central Agency

¹³ This section mainly depends on different reports generated by the CBE (2009-2011).

for Public Mobilization and Statistics contributed in conducting a field survey. The survey provided adequate and reliable data on small and medium-sized enterprises from June 2011 to February 2012.

The fourth pillar was directed at improving banking governance by applying and reviewing international governance standards and by approving governance regulations created by the CBE. Last but not least, Basel II standards were implemented in order to help the Egyptian banks improve their risk management performance. In order to enable the Egyptian banking sector to implement Basel II standards successfully, the CBE has signed an agreement with the European Central Bank and seven national European central banks. The agreement included an assistance program that lasted for three years, starting in January 2009.

The implementation of the Basel II standards in Egypt has four main stages. The first stage started in January 2009 and ended in June 2009; the second stage started in July 2009 and ended in June 2011; the third stage started in July 2011 and ended in December 2011; and, finally, the fourth stage started in January 2012.

The main focus of the first stage was on preparing the core team in the CBE and on qualifying the team members to pursue such a strategy, in addition to designing a procedure to apply the Basel II standards. The first stage ended successfully. With regard to the second stage, which is a fundamental stage in the banking reform, the CBE comprehensively coordinated with all Egyptian banks in discussing major issues related to the appropriate application of the Basel II standards. In addition, the second stage quantitatively measured the consequences of applying such standards. The second stage also ended successfully.

The third stage of implementing the Basel II standards centred on setting supervisory regulations that are related to the implementation of the Basel II standards. The new regulatory framework concerns banks' obligations to meet the minimum level of capital adequacy determined by the regulation. Furthermore, while the second stage of implementing the Basel II standards included a quantitative measure of the consequences of Basel II, the third stage measured the qualitative consequences. The qualitative consequence measure was conducted based on a sample of banks and was concerned with the internal level of auditing. This measure facilitated setting the new supervisory regulations. Moreover, there was an improvement in regulatory performance in the Supervision Sector after using the European Union's supplied

sources. Additionally, an updated data-warehousing regime was initiated in order to develop the gathering and storage of data, which reconciled the new supervisory framework.

The last phase was a parallel run of Basel II. Furthermore, the data-warehousing regime was initiated. Given the fact that the CBE always seeks prosperity in Egypt's financial and banking sectors, it takes into consideration the implementation of Basel III, which will make its application in Egypt smoother in the future. Basel III is expected to have been fully implemented in the international banking market by 2019.

Nasr (2012) studied the second phase of the banking reform in Egypt. She analyzed how the 2011 revolution affected the banking reform plan. Furthermore, she indicates that, even though Egypt experienced a revolution, the CBE maintained its banking reform progress with only minimal delay in finalizing and completing the second phase of the reform plan. More specifically, the second phase of the banking reform was planned to end in July 2011 but was delayed until September of the same year.

Nasr (2012) elaborates upon the importance of the second phase of the reform plan in shaping and designing the regulation of banks in Egypt. She indicates that the new regulatory framework centred mainly on issues related to operational, credit and market risk, in addition to funding issues. She highlights the role of the CBE in cooperating and coordinating with all banks in Egypt and in adhering to Basel II standards when designing the new regulations. Furthermore, she states that the successful implementation of the second phase of the reform was due to the incorporation of the banks in the process of setting the regulations as well as to the realization of the importance of such a reform and capacity building.

Nasr (2012) also points out one of the core outcomes of phase two, which is building or updating a new data system that facilitates the implementation of the newly designed regulatory framework. In addition, she indicates that, given the political instability in Egypt, the application of the new data was delayed and required further assistance. One challenging task during the implementation of the second phase was to prepare a suitable environment for the application of Basel II. More specifically, Nasr (2009) mentions that there was insufficient coordination between the main parties involved in the application of the Basel II standards. A higher degree of coordination between the task group of Basel II, the European Central Bank's experts, the CBE's Information Technology (IT) department and the banking supervision department is required. Furthermore, Nasr (2009) indicates that inside Egyptian banks there was a necessity for a higher

degree of coordination in order for the banks to supply the CBE with the data needed to successfully apply the Basel II standards.

9. The Effect of the Global Financial Crisis on the Egyptian Banking Sector

The 2008 financial crisis led to a decrease in global demand as well as to an increase in domestic inflation. Consequently economic growth and employment were affected negatively in Egypt (MOF, 2009). Fortunately, the Egyptian economy was resilient at the beginning of the global financial crisis due to the robust supervisory structure of the Egyptian banking sector and the effect of efficient prudential regulations. More importantly, the Egyptian government started to design a plan, which was mainly focused on stimulating demand and supporting sectors that were negatively affected. More specifically, the CBE adopted a stimulus plan that targeted the monetary system. According to the MOF (2009), the CBE played a significant role at the beginning of the global financial crisis in 2008, including affirming its obligation to insure all of the banking sector's deposits. Abu Hatab (2009) explains that, in order to maintain price stability, the CBE announced that it would fulfill its responsibility to ensure the soundness of the financial and banking sector when confronting global crises.

Abu Hatab (2009) indicates that the 2007/2008 financial crisis has shaped Egypt's monetary policy. More specifically, a non-expansionary policy was applied in order to better control the inflation that resulted from higher demand. In this context, the CBE raised the overnight rates¹⁴ for deposits and for the lending activities within its corridor system. On six consecutive occasions, the increase in the corridor system accounted for 275 basis points (bps). Eventually, as the domestic economy started to absorb the effects of the global financial crisis and the inflation rate started to decline, the CBE arranged three successive Monetary Policy Committee (MPC) meetings, which took place between February and May 2009. The main goal of these meetings was to make a decision about cutting the corridor spread rates. Specifically, the CBE reduced the corridor-spread rates by 250 bps during the MPC's meetings. During the last meeting of the MPC the corridor-spread rates declined by 50 bps to 9.5%; the decrease in the overnight lending rate was 100 bps, which brought it down to 11%. Consequently, the corridor decreased from 2% to 1.5%.

¹⁴ The overnight rates refer to the rate at which banks and financial institutions borrow and lend, which is determined by the central bank.

The MOF (2009) indicates that during the financial crisis the CBE attempted to facilitate financing for small and medium-sized enterprises (SMEs). The CBE's board exempted 14% of the reserve requirements for a bank's deposits when they finance SMEs. Such an exemption can help economic activities to flourish and can reduce unemployment since most SMEs are labour intensive. Further, the CBE aimed at stimulating private-sector investment by determining a maximum three-year maturity period for the corporate sector. Likewise, the two largest Egyptian state-owned banks supported the economy during the financial crisis. For instance, as part of an initiative to boost private household consumption, they decided to lend E£10 billion to retail banking which was specifically assigned to finance personal and car loans and the purchase of durable goods.

According to Nasr (2012), during the financial crisis the percentage level of the commercial banks NPLs was reduced. This is because the provisions to NPLs were over 90% during the financial crisis. In particular, the provisions relative to existing and new NPLs increased dramatically compared to their level in 2008. The provisions relative to existing and new NPLs reached 92.1% of 14.8% in June 2008. In addition, the return to assets remained constant at almost 1% during the global crisis. Nasr (2012) believes that the resilience of the banking sector during the global crisis was due to the improvement in banking supervision and the upgraded regulations associated with the CBE's structural reform.

Radwan (2009) indicates that, even though the financial crisis adversely affected the Egyptian real economy, it did not have a severe impact on the banking sector. He justifies the non-severity of the impact of the financial crisis on banking performance by arguing that the banking sector was not highly integrated with the global financial market. Further, like Nasr (2012), the author highlights the importance of the CBE's role in reforming the banking sector since 2004 – in particular, the CBE's role in consolidating the banking system, controlling debts, upgrading banking management and improving banking governance rules. Moreover, Radwan (2009) points out the resilience of the Egyptian banking system by investigating the liquidity and lending-to-deposit ratios, which reveal the robustness of the banking system relative to those of other countries. Indeed, he indicates that the lending-to-deposit ratio was lower than 53% after the financial crisis.

10. Post-Revolution Banking Performance

Egypt's economy has been affected by political instability, especially after the revolution, 2011. This political instability has created obstacles for the CBE to achieve its goal of ensuring the monetary stability of the banking sector, especially because the revolution of January 25 occurred during the implementation of the second phase of the banking reform launched by the CBE. Social tensions as well as uncertainty surrounding the Egyptian political situation have affected different macroeconomic variables and initiatives. For instance, Egypt's privatization plan has been affected negatively by post-revolution reductions in foreign direct investment (FDI). Thus, a well-designed economic policy should be implemented in order to recover economic growth and development.

After the revolution, the Egyptian banks were closed temporarily and this resulted in a shortage of financial services. As mentioned by Galal (2011), the crucial role played by the CBE in the Egyptian banking sector was exemplified by the decision to temporarily close all of Egypt's banks during the period from January 27 to February 6, 2011. During the period when the banks were closed, the Egyptian banking and financial sector experienced some payment difficulties and a cash shortage (Nasr, 2012) and an interruption in production domestically (Galal, 2011). After February 6, Egypt's banks started to operate successfully and the CBE guaranteed enough readily available cash and also ensured deposits (Galal, 2011). In fact, the Egyptian banks successfully supplied the public with the requested cash and there was a recovery in deposits instead of a decrease.

Further, according to CBE (2013), there was a significant increase in non-government bank deposits by the end of March 2011 compared to their level in December 2010, as demonstrated in Table 5. In March 2011, the non-government bank deposits reached 99.3% of their December 2010 level. In addition, there was a slight decrease in deposits in the local currency, but deposits in foreign currencies increased. More specifically, the March 2011 increase in deposits of foreign currencies was 22.1%, which was greater than the December 2010 increase of 19.3% (Nasr, 2012). Galal (2011) indicates that the domestic political uncertainty proved to be economically costly. He indicates that there was a decrease in the level of capital from January to March 2011. More specifically, the study states that the capital decrease included US\$6 billion in treasury bills held by foreign investors.

Nasr (2012) suggests that there was a recovery in aggregate bank deposits as banks resumed their operations in February 2011, a fact that indicates the robustness of the Egyptian banking sector. Further, according to the March 2011 data on financial soundness indicators collected by the CBE, Egypt's banking sector has proven to be strong following the revolution, notwithstanding some weaknesses. By the end of March 2011, the average core capital ratio was 13.6%, which is sufficient to support the banking sector in the event of an economic recession. In particular, the commercial banks' level of capital before the global crisis occurred in fiscal year (FY) 2008-2009 reached 14.7% and 6.2% of risk-weighted assets and total assets respectively. Galal (2011) indicates that the CBE did not impose significant regulations on capital outflows, rather, only imposed further investigations on significant withdrawals by politicians under legal investigations.

Hosny et al. (2013) indicate that there are no data supporting the argument that there was an increase in the level of non-performing loans (NPLs) after the revolution. However, censuses by CBE show that since 2006 there was a 64.2% increase in the net interest margin, which increased operating profits. Moreover, there was a lower level of profitability due to the resources engaged in the clean-up of NPLs (Nasr, 2012). Liquidity continued to be in an outstanding situation and the loan-to-deposit ratio was high. By the end of March 2011, deposits were at the same level as in December 2010.

Given the fact that these are all lagging indicators, Nasr (2012) points out the importance of monthly monitoring of these soundness indicators and more specifically of the level of NPLs. Furthermore, Galal (2011) indicates that according to the banks' reports, it is anticipated that NPLs will increase dramatically due to the low GDP growth rate, an inactive tourism sector, and current social and political instabilities in Egypt.

Other various factors could cause NPLs to increase (Nasr, 2012). Important factors include the deterioration of many properties' market value and hence value as collateral, the possibility of appropriations and transformations of a property's ownership, and finding borrowers who have stopped making payments. Galal (2011) indicates that the Egyptian government announced a structural adjustment to the labour market, which includes a revision of the minimum wage and increasing salaries and pensions. This announcement increased expectations and motivates protesters in all sectors and more specifically workers in the banking sector. Nasr (2012) indicates that following the failure of the banks to match the Cabinet's

announcement of a 15% increase in government-sector wages and pensions, the staff in some of the state-owned banks went on strike asking for higher salaries and pensions. The CBE responded by arranging a meeting with bank-staff representatives in order to find a compromise. As a result, the CBE agreed to increase their wages. This increase in wages adversely affected the expense ratio since the banks' personnel costs increased by almost 15% to 30%.

The CBE is playing a fundamental role in ensuring the soundness of the banking sector following the revolution. This can be seen in the CBE's efforts to reopen the Egyptian banks after their temporary closure on January 27, 2011. In addition, the CBE engaged in negotiations with the banks' staff representatives to reach a compromise. Nasr (2012) also indicates that the CBE upgraded its monitoring system and the banks' requirement to undertake a stress test¹⁵ and to evaluate the quality of their assets. More specifically, the CBE requires banks to test their credit portfolios and to monitor them on a regular basis. Furthermore, as a response to the unstable environment that continued from January to February 2011, the CBE issued six circulars that are mostly concerned with risk management, cash withdrawals and cash transfers.

The CBE upgraded its level of monitoring and supervision of the performance of the banking sector by investigating the banks' reactions to the stress test. Nasr (2012) states that, after the revolution and as of December 2011, the commercial banks applied the stress test and confirmed the soundness of the banks' performance with respect to their capital.

The hypothetical scenario in the commercial banks was related mainly to the banks' loan portfolios, which were assumed to have declined in value by a very small amount. Such a decline would have decreased the value of collateral assets by 50% and also would have reduced profit levels by 25%. The application of the stress test revealed that the ratio of capital to risk-weighted assets remained at almost 11.5%, which was 10% above the required level. Thus, the results suggest that the commercial banks were characterized by a high level of provision and capital-ratio coverage. According to Galal (2011) there was an increase in borrowing costs after the revolution. The increase in the borrowing costs was mainly attributed to the rise in the Treasury bill yields. The increase in Treasury bill yields accounted by 200 basis points compared to their level before January 25.

Nasr's (2012) results also show that the liquidity ratios and the ratio of government debt

¹⁵ Stress tests are used to assess banks' resilience and robustness when confronting economic and financial crises and unexpected market events. Stress test employs a stimulation model to assess the performance of a bank in various hypothetical situations (Mamonov et al., 2013).

to total deposits were high, with the latter accounting for 40%. Galal (2011) indicates that the government's borrowing costs increased after the revolution. Further, he indicates that there was an increase in the pressure on the balance of payment due to the current deficit and the decisions made by foreign investors to decrease their investment in Egypt. Also, Galal (2011) notes that the government's financing gap was estimated to be US\$12 billions. More specifically, the 2011 fiscal year's financing gap was US\$2, while the 2012 fiscal year's financing gap was US\$10 billion.

Furthermore, Nasr (2012) provides data on the values of various indicators that reflect the soundness of the Egyptian banking sector starting in fiscal year 2006 and ending in March 2011, as demonstrated in Table 5. In addition, the decrease in the NPL ratio was attributed partially to state-owned banks' reduction in NPLs.

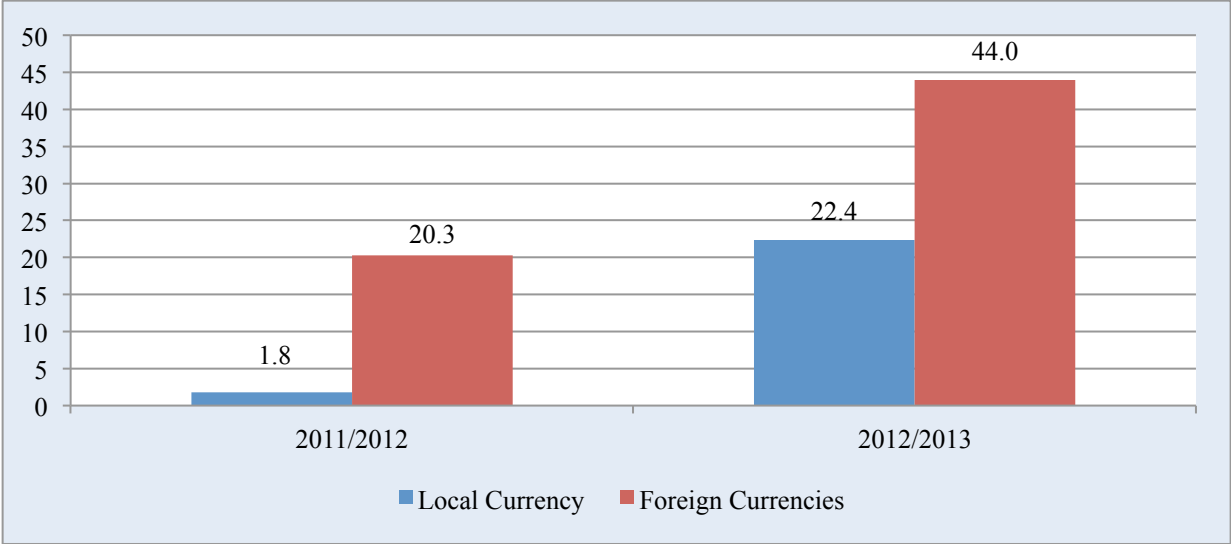
Table 5 - Banking Sector Financial Soundness Indicators

Ratios	FYE 2006	FYE 2007	FYE 2008	FYE 2009	FYE 2010	Position Mar 11
Bank regulatory capital to risk-weighted assets	14.7	14.8	14.7	15.1	16.3	16.3
Tier 1 capital to risk- weighted assets	10.3	10.9	11.5	12.0	12.7	13.6
Equity to assets	5.8	5.5	6.2	6.4	6.7	6.6
Non-performing loans to total loans	18.2	19.3	14.8	13.4	13.6	11.2
Provisions to non- performing loans	76.2	74.6	92.1	100.4	92.5	93.7
Return on average assets	0.8	0.9	0.8	0.8	1.0	N/A
Return on average equity	14.3	15.6	14.1	13.0	14.3	N/A
Net interest margin	1.4	1.6	1.7	2.2	2.3	N/A
Liquidity (<i>local currency</i>)	38.8	26.6	34.5	43.4	44.7	52.8
Liquidity (<i>foreign currency</i>)	55.4	51.9	46.8	41.0	40.6	47.9
Loans to deposits (<i>local currency</i>)	57.7	51.6	52.0	46.5	44.0	45.1
Loans to deposits (<i>foreign currency</i>)	51.0	60.1	71.3	69.3	75.8	65.2

Source: Nasr (2012)

Figure 7 shows the change in Deposits in local and foreign currencies during the period from 2011/2012 and 2012/2013 FY.

Figure 7 - Change in Deposits by Currency during July/December



Source: Central Bank of Egypt (2013)

Table 7 provides sectorial data on the banks' deposits in local and foreign currencies during the period from June 2012 to December 2012. Figure 8 shows the change in deposits from each sector during the period from June to December of 2012 in local and foreign currencies.

Table 7 - Deposits at Banks by Sector

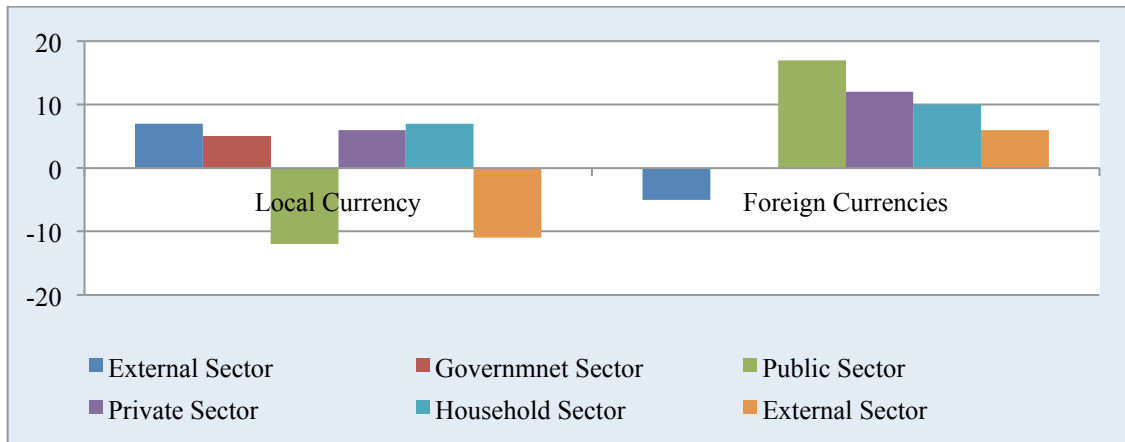
(E£ million)	Local Currency		Foreign Currencies	
	June 2012	Dec. 2012	June 2012	Dec. 2012
Total	777,806	821,789	245,711	266,030
Government sector	58,930	61,464	55,731	55,798
Public business sector	24,843	22,052	8,812	10,310
Private business sector	92,697	98,673	64,496	71,825
Household sector	59,7459	63,6144	112,859	124,053
External sector	3,877	3,456	3,813	4,044

Source: Central Bank of Egypt (2013)

According to statistics provided by the CBE, the largest share of the total increase in deposits in local currency was attributed to the household sector; this share accounted for 88.0%. By the end of December 2012, the household sector's deposits increased by almost 6.5%. Additionally, private business sector deposits increased by 6.4% while government sector deposits increased by 4.3%. In contrast, public business sector deposits and the external sector's deposits decreased by E£2.8 billion and E£0.4 billion respectively.

On the other hand, as can be seen in Figure 8, the increase in foreign-currency deposits was due to the increase in deposits from all sectors. The private business sector had the highest growth rate in these deposits, which was 11.4%, followed by the household sector which experienced a growth rate of 9.9%. This implies that the Egyptian privatization plan is one of the effective policies, which induce the private and household sectors to increase their share of deposits in the banking sector.

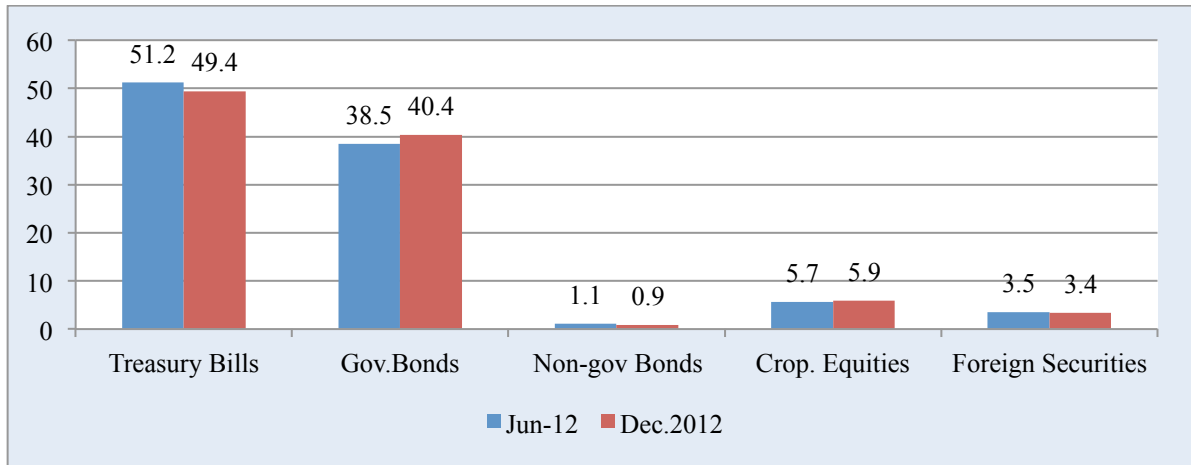
Figure 8 – Change in Deposits by Sector during July/December



Source: Central Bank of Egypt (2013)

In order to describe the structure of the major components of the banks' investment portfolios, the CBE uses the aggregate financial position of the Egyptian banks. Figure 9 illustrates the relative structure of the banks' portfolio investments. Figure 9 shows that the banks' largest investments in securities and bills were mainly in the form of government bonds and treasury bills (CBE, 2013). The increase in government bonds was estimated to be E£33.5 billion, while the increase in treasury bills was estimated to be E£18.5 billion. The investment in corporate equities increased by E£4.4 billion while the investment in foreign securities increased by E£1.4 billion. On the other hand, the investment in non-government bonds decreased by E£0.4 billion. As indicated above, based on the latest census the relative banks portfolio investment tend more into government sector which implies that Egyptian banking sector needs to be more privatized.

Figure 9 - Relative Structure of Banks' Portfolio Investments



Source: Central Bank of Egypt (2013)

11. Conclusion

Egypt's privatization experiment of the 1990s has performed remarkably well as an economic reform initiative. It is worthwhile to mention that this experiment achieved its stated objectives, which are to improve the health of the Egyptian economy in terms of growth,

competition and efficiency. Even though privatization has not solved all of Egypt's economic issues, it is still a crucial reform initiative for stimulating the Egyptian economy and overcoming the repercussions of nationalization.

Privatization in Egypt has proven to be beneficial for various economic agents. The introduction of new domestic and foreign investors into the Egyptian economy has led to more competition. This helps to ensure that higher quality goods and services are produced by the Egyptian economy (El-Shazly, 2009; USAID, 2002; Mohieldin & Nasr, 2007; Daradkah & Miani 2011). Furthermore, the introduction of new technologies into the production process has increased efficiency in terms of the management of assets and resources and has also diversified investment (USAID, 2002). Moreover, privatization is leading to higher levels of efficiency in terms of costs and profits (El-Shazly, 2009), lower financial risk and more financial resources to serve the economic needs of the privatized enterprises (Mohieldin & Nasr, 2007).

This paper investigated the effects of privatization on the Egyptian banking sector from 2004 until 2013. It is important to conduct a study on this subject for three main reasons. First, Egypt launched a comprehensive banking reform in June 2004. Second, the financial crisis occurred in 2008, which affected overall economic conditions around the world. Third, the revolution of 2011 has been a catalyst for political instability, which has had its own impact on Egyptian economic activities.

Historically, the Egyptian banking sector has experienced different phases each with its own remarkable impact. The National Bank of Egypt started to operate in 1898, followed by Banque Misr, the Bank of Alexandria and the Bank of Cairo as major contributors to the Egyptian economy. Nationalizing the Egyptian banks in the 1960s proved to have negative impacts on the financial sector and on the overall economy in terms of slow growth, lack of competition and lack of innovation. Consequently, there was an essential need for the Egyptian economy – and more specifically for the banking sector – to be exposed to privatization through domestic and foreign ownership. Motivated by this need, a privatization initiative was launched in 1991. The main objectives of introducing privatization into the Egyptian economy in general and into the banking sector in particular were to create a regulatory environment that would promote efficiency, increase competition and improve the soundness of the banking sector.

Several studies have compared the performance of state-owned banks relative to their privately owned counterparts. These studies investigated the following: equity-to-asset ratios;

banks' vulnerability to external economic shocks; capital adequacy; the level of NPLs in state-owned and privately owned banks (Mohieldin & Nasr, 2007); financial performance in terms of profitability and efficiency (Omran, 2007); the compound annual growth rate of banks' deposits and total credit facilities (Daradkah & Miani, 2011); short-term deposits, the nominal interest rate and the average bank's lending rate (Roe, 1998); the return on equity and net interest margin from consumer businesses (Kalhoefer & Salem, 2008); and credit risk, bank capitalization, the profitability of the banking system, cost efficiency and the net interest margin (Naceur & Omran, 2011).

Restructuring the banking sector is essential not only to ensure its soundness, but also to prepare the financial sector to adequately confront unexpected political and economic instability. Thus, one remarkable role of the CBE is the banking reform plan that was launched in 2004. The reform plan enabled the Egyptian banking sector to perform its role with a higher level of efficiency during the financial crisis and during the 2011 revolution. According to the MOF (2009), the CBE played a significant role at the beginning of the global financial crisis in 2008, including affirming its obligation to insure all of the banking sector's deposits. Abu Hatab (2009) explains that, in order to maintain price stability, the CBE announced that it would fulfill its responsibility to preserve the soundness of the financial and banking sector when confronting global crises.

As indicated in this paper, the CBE is playing a fundamental role in ensuring the soundness of the banking sector following the revolution. This can be seen in the CBE's efforts to reopen the Egyptian banks after their temporary closure on January 27, 2011. Nasr (2012) indicates that the CBE upgraded its monitoring system and the banks' requirement to undertake a stress test and evaluate the quality of their assets. More specifically, the CBE requires banks to test their credit portfolios and to monitor them on a regular basis.

Most of the studies included in this literature review agree that, despite certain short-run drawbacks of privatization, in the long run the benefits of privatization easily outweigh its negative ramifications. For instance, efficiency in the banking sector witnessed a significant increase under foreign ownership. The higher level of competition encouraged new entrepreneurs to enter the market as well as greater investment in new technologies. This leads to higher relative share of private sector. A higher private-sector share of the economy is associated with a higher rate of economic growth (Davis et al., 2000).

In summary, the privatization initiative in Egypt is considered to be successful in terms of promoting efficiency, reducing costs, generating profits, and promoting the efficient allocation of assets and resources. For future studies, this paper suggests that research be done on cases that combine financial and institutional privatization in order to gain insight into the factors that increase the efficiency of reform. This will help identify comprehensive policies that promote the quality of the privatization program. Another area would be to conduct empirical research into the effects of the banking reform during and after the revolution because the current lack of data makes it difficult to investigate these effects.

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