The Egyptian Financial System - Does Ownership Matter?

Amr Khafagy

22.06.2018

IEE
Institute of Development Research and Development Policy
Institut für Entwicklungsforschung und Entwicklungspolitik

Research objective

To understand the influence of the financial sector structure (ownership) on income and wealth distribution since the banking reforms of 2003 until 2017.

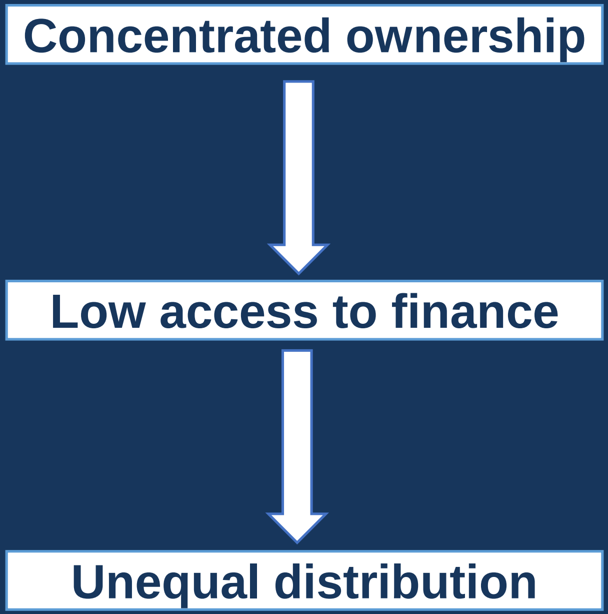
Research questions

1. How the Egyptian state shaped the controlling ownership over financial resources and the allocation of these resources through the financial sector?

2. What are the instruments used by the State to influence the structure of the financial sector?

3. What are the motives behind adopting a financial inclusion policy after 2011, and are these new policies sufficient to improve the allocation of financial resources?

4. How the structure of the financial sector influenced wealth and income distribution?



"The state can influence directly the allocation of credit; either by state banking or by allowing concentrated ownership over banks" (Haber and Perotti, 2008:7)

Wealth and income inequality in Egypt

- Conventional measurements of income inequality, like Gini coefficient based on household's surveys, showed a continuous declining trend for over last decade.
- The Gini coefficient declined from 32.8 in 1999 to 29.8 in 2012, and last available estimation was 31.8 in 2015 (World Bank, 2017).
- Household income and expenditure surveys are almost systematically underestimate top incomes, because of top coding, inaccurate responding by top income households and unit nonresponses (Alvaredo and Piketty, 2014: 4-5; Hlasny and Verme, 2016)).
- Fiscal data much more reliable than self-reported surveys.

Wealth and income inequality in Egypt

- Van Der Weide et al. (2017) construct an adjusted Gini coefficient for urban Egypt after correcting for the missing upper tail data.
- Using available data on real estate prices to estimate the upper tail of the income distribution and combine it with the household survey to estimate the bottom shares of income distribution.
- Their adjusted Gini index for urban Egypt increase to 52 compared to 39 as per the conventional measurement.

Wealth and income inequality in Egypt

- Credit Suisse puts Egypt among the top 12 countries with high levels of wealth inequality.
- One of the nine countries that witnessed extreme growth of wealth inequality.
- The wealth share of the top 10% in Egypt increased from 61% in 2000 to more than 73% in 2014, and from 31% in 2000 to 48% in 2014 for the top 1% (Credit Suisse, 2014: 125-126).
- The average annual growth in the wealth of the richest 1% was 7% and 5% for the top 10%.
- The average annual growth rate of the GDP per capita was only 2%.

State of the art

- Political economy of financial development

Nienhaus, 1993; Pagano and Volpin, 2001; La Porta et al., 2002; Rajan and Zingales, 2003; Khwaja and Miang, 2004; Joh and Chiu, 2004; Cull and Xu, 2005; Khwaja and Miang 2005; Barth et al., 2006; Faccio, 2006; Caprio, Laeven and Levine, 2007; Girma and Shortland, 2008; Haber and Perotti, 2008; Faccio 2010; Perotti, 2014

- Finance and income inequality

Greenwood and Jovanovic, 1990 Banerjee and Newman, 1993; Galor and Zeira, 1993; Aghion and Bolton 1997; Piketty, 1997; Clarke et al., 2006; Beck, et al., 2007; Kappel, 2010; Kim and Lin, 2011; Hamori and Hashiguchi, 2012; Panico, 2012; Law et al., 2014; Denk and Cournède, 2015; Haan and Sturm, 2016; Ben Naceur and Zhang, 2016;

Ownership, control over financial resources (Lenin, 1999: 45 [1916])

Politics of finance and inequality

Egypt's financial sector structure: historical background

- During Nasser, and the adoption of nationalisation policies, the Law no. 22 of 1957 has abolished the operations of British and French banks, and supressed small banks.
- Sadat issued the Law no 120 in 1975, aiming to liberalise the financial sector.
- Escalating fiscal deficit enforced the government to adopt structural adjustment programme in 1991.
- Claims to private sector as percentage of the GDP increased from 22 percent in 1991 to 54 percent in 2003 after the removal of credit ceiling (World Bank, 2017).
- Non-performing loans remained high recording 24 percent in 2003 (IMF, 2009: 220).

Egypt's financial sector structure: historical background

- Banking reforms in 2003 and the introduction of Law No. 88 helped in increasing the number of banks controlled by foreign entities from only five in 2004 to fifteen in 2008.

- Private banks' share in the total assets and deposits exceed 50 percent against only 20 percent in 2004,

- Non-performing loans of the banking sector dropped to less 15 percent

(WorldBank/International Bank for Reconstruction and Development, 2008: 18; IMF, 2009: 220).

Egypt's financial sector structure: historical background

- Number of banks fell to 38 by 2016 compared to 62 at the time.
- Foreign ownership increased to 15 banks by 2008.
- One of the four state banks was privatized (Alex Bank to Intesa Sanpaolo).
- State banks sold large portion of their shares in private joint venture banks (Diwan, 2016: 6).

Egypt's financial sector structure: historical background

- Asset share of state banks fell from 79 percent in 2001 to 56 percent in 2010 (Farazi et al. 2011: 171).
- Total domestic credit as percentage to GDP went down from 105 percent in 2003 to 69 percent in 2010 (World Bank, 2017).

Egypt's financial sector: overview

68.9% firms had savings account[1]

6.6% firms had a bank loan[1]

64.8% net claims on government as % of domestic credit [2]

27.3% claims on private and public sector as % of domestic credit [2]

2.1% of banks' credit went to SMEs[3]

68% of banks' deposits are households deposits[2]

13.9% of total households deposits are pensions [4]

14% have bank accounts[5]

1) 2016 World Bank enterprises' survey
2) As of December 2017, 02/2018 Monthly Statistical Bulletin, Central Bank of Egypt
3) Own calculations based on El Ahram newspaper, 26 April 2018
4) 2014/15 Annual Bulletin of Individual Savings Statistics at Key Savings Vessels Central Agency for Public Mobilization and Statistics
5) World Bank, 2015

Egypt's financial sector: overview

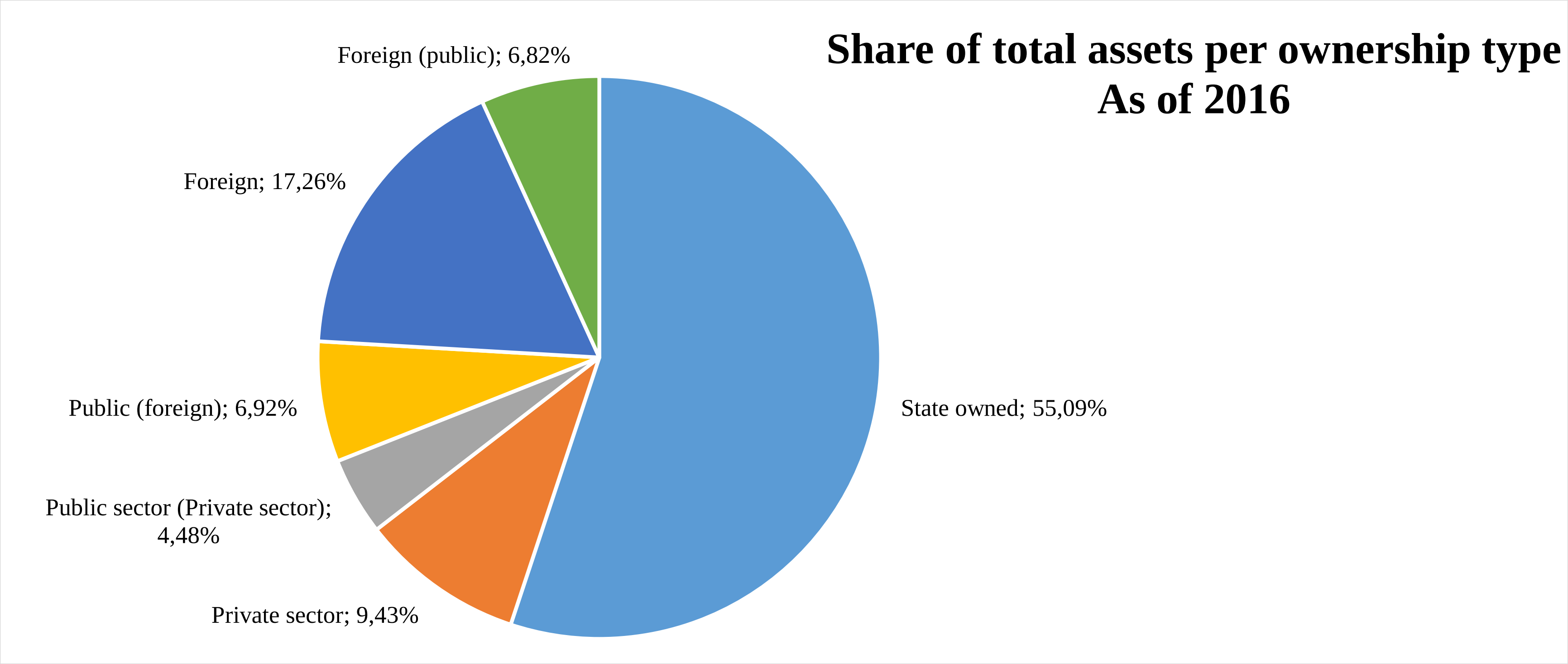
- Egyptian banks had the most concentrated credit portfolio compared to their counterparts in the Middle East and North Africa.

- The top 20 loan exposures were consuming more than 50% of banks loan portfolios in 2010 and only 5 percent of total loans went to small and medium enterprise by 2009 (World Bank, 2010: 104-105).

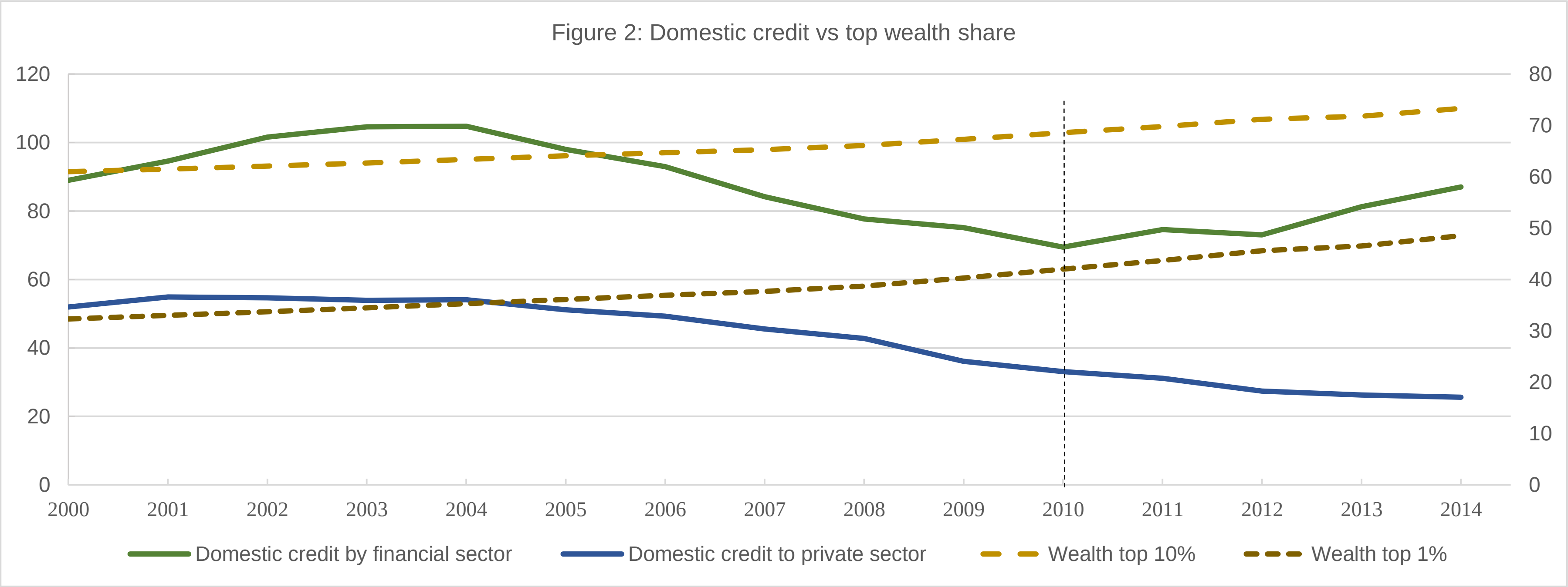
Egypt's financial sector: overview

- “Historically, the banking sector has concentrated its lending to the government, and private sector credit is mostly directed to a few large firms” (International Monetary Fund, 2017: 11).
- Preferential credit provided to politically connected businessmen before and during Mubarak’s regime (Mohieldin, 2000: 19; Mohieldin and Nasr, 2007: 712; Roll, 2010: 353; Diwan, 2016)
- In November 2014, the first microfinance law was issued.
- In February 2016, the Central Bank instructed that 20% of banks’ loan portfolio should be disbursed to Small and Medium Enterprises (SMEs).

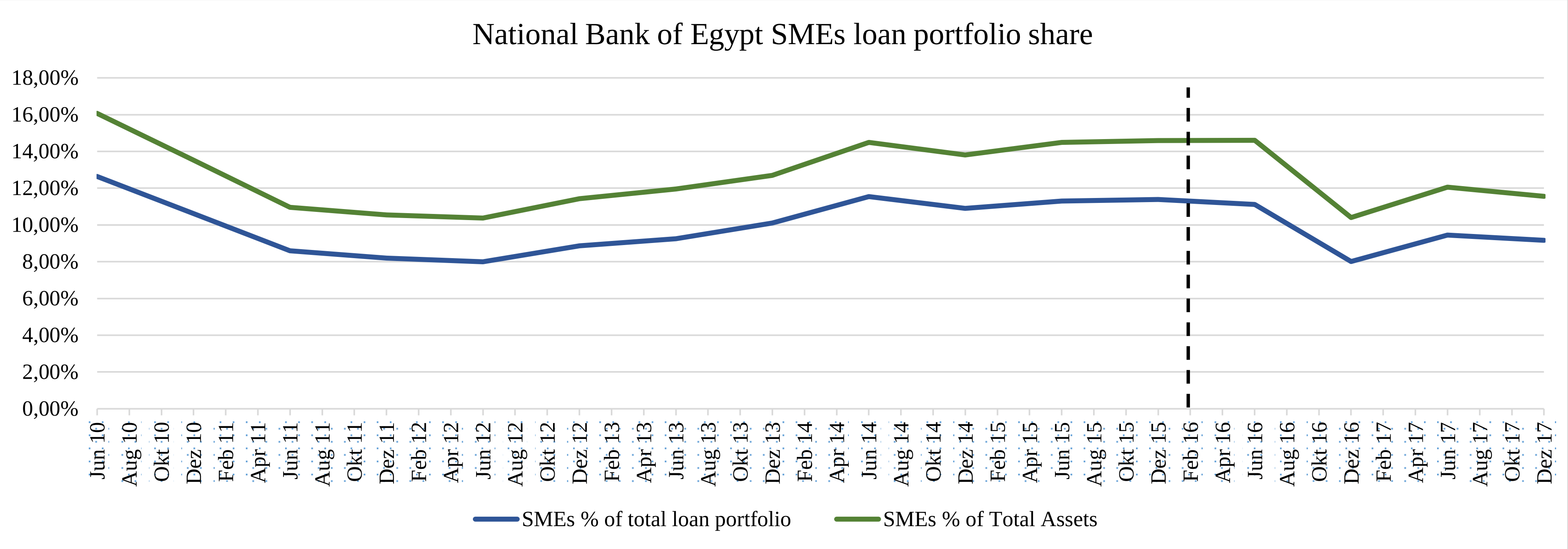
Banks ownership in Egypt



Finance and inequality in Egypt



SMEs finance in Egypt



RUHR UNIVERSITÄT BOCHUM RUB

Thank you