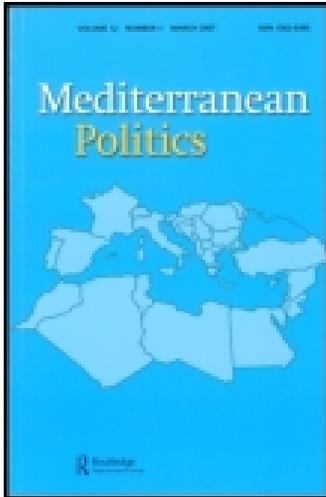


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The Political Economy of the Arab Spring

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PROFILE

The Political Economy of the Arab Spring

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Arab political economies have not been conducive to democracy. As measured by comparative shares of employment, credit, fixed value added, total output and other relevant economic indicators, governments have dominated private sectors to a degree unmatched in other emerging regions. Private sector led industrialization is the necessary if not sufficient condition to lay the economic foundations for sustainable democracy, for only it can generate sufficient capital to sustain autonomous political organization. But industrialization in the Arab world has been held back by poor governance, which in turn has been retarded by the lack of democracy.

The Arab Spring thus begs the question of whether the nascent democracy it has spawned at least in Tunisia and Egypt, and the reforms it has induced elsewhere, might reverse what has heretofore been the vicious cycle of inadequate voice and accountability preventing governance improvements sufficient to facilitate industrialization. Might the Arab Spring convert the vicious into a virtuous cycle of interactions between economics and politics?

A tentative, preliminary answer to this question can be sought by investigating steps taken since Arab springs blossomed that impact elements of governance that directly affect investment, hence rates of industrialization and broader economic growth. The two most vital tasks of governance in this regard are assuring macroeconomic stability and security of person and property rights. Egypt, which can serve as surrogate in this regard for other Arab countries, does not provide encouragement for the hypothesis of the vicious becoming a virtuous cycle.

Macroeconomic Stability

The Supreme Council of the Armed Forces (SCAF) that took power in Egypt in the name of the military on 11 February apparently considers macroeconomic stability

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to be less important than gaining acceptance of its rule and ensuring a modicum of political stability in what it promises will be a transition to civilian rule. It may believe that Egyptians are preoccupied by economic concerns rather than democratization, as indeed a recent survey seems to suggest, and thus conclude that patronage can displace demands for political participation.¹ It probably is also convinced, despite evidence to the contrary, that Egypt's 'friends' ultimately will come to the country's economic rescue, bailing it out with substantial new infusions of public foreign assistance, lest it slide into chaos and/or the hands of radical Islamists.

Whatever the explanation, the SCAF has played fast and loose with the nation's finances at a time when revolutionary upheaval has already exacerbated fiscal and current account imbalances. Capital flight has been manifested by a one-third drop in the capitalization of the Cairo stock market resulting primarily from liquidation of holdings by western institutional investors, who pulled \$5.5 billion out of the market in the second quarter of 2011;² and by a reversal in foreign direct investment from a positive balance of \$1.8 billion in 2010 to a negative one of \$200 million in the six months following the 25 January revolution.³ Foreign currency reserves were reported to have dropped from \$36 billion to \$28 billion over that same period, but since the Central Bank's reporting of that key figure is less than fully transparent and since the value of the currency has only fallen by some 5 per cent, it is widely believed that the Bank's action in propping up the currency has resulted in a more substantial drop in reserves than it officially reports.⁴ By July 2011 reserves of around \$24 billion were sufficient to cover less than six months of imports, a precariously thin cushion above the danger level of 2–3 months of import cover.⁵ Remittances have fallen substantially from some \$8 billion in 2010, as a result largely of some 200,000 Egyptians fleeing Libya and those remaining unable to send money home. Gas exports to Israel and Jordan have been interrupted as a result of the Sinai pipeline having been sabotaged on five occasions since February. Estimates of the GDP growth rate have been reduced by four-fifths, down to around 1 per cent, the lowest rate since 1992.⁶ In June the unemployment rate hit its highest level in a decade, reaching some 12 per cent, with 3.1 million reported to be out of work, fully three-quarters of whom are between the ages of 20 and 30.⁷ Tourism, which directly or indirectly employs one in seven Egyptian workers, was down by 80 per cent in comparison to the previous year.⁸ Inflation in the vital food component of the cost of living index was running at 20 per cent in the early summer.⁹

The SCAF's responses to these various threats to the country's economic well-being have been inadequate. It clearly ordered the Central Bank to prop up the currency at a level that cannot be sustained, which wasted reserves to defend a level that in any case discourages exports of tradable goods. It has opted to add to the substantial stock of domestic debt rather than to accept an IMF loan of \$3 billion offered with virtually no conditionality and at the highly concessionary interest rate of 1.5 per cent. Domestic debt, by contrast, is short term and attracts on average more than 9 per cent interest. To cover the projected fiscal deficit of 8.6 per cent for 2011–12 (itself no doubt an underestimate), the finance minister announced the government will borrow some \$20 billion locally, taking the domestic debt ratio to

GDP from some 70 to above 80 per cent, hence about 100 per cent overall.¹⁰ The desire to project a nationalist image apparently took precedence over commitment to sound economic management.¹¹ The SCAF also directed the minister of finance to include a variety of fiscally unsound measures in the 2011–12 budget, including a 15 per cent wage increase for public sector workers that Mubarak had first announced, allocations to hire an additional 450,000 temporary civil servants which was another of Mubarak's last-ditch desperate moves, further growth in the massive subsidy bill including support to rent-extracting energy-intensive industries and, on the revenue side, rejection of new capital gains and real estate taxes.¹² Not surprisingly, the rating agencies have downgraded the country's outlook from stable to negative, which in turn has made it virtually impossible for Egyptians to obtain letters of credit, thereby exacerbating the downward trend of international trade.¹³ The three major scourges of Egyptian public finances – civil servants' salaries, subsidies and debt servicing – will thus all increase substantially, driving down already extremely low capital investment and savings rates while increasing long-term debt-servicing costs.

Presumably those in the SCAF who think about such matters believe that public foreign assistance will pull the country out of the deeper hole into which they are digging it, but that is wishful thinking if the US response is any indication. The Egyptian delegation that travelled to Washington in the spring to secure what they hoped would be \$10 billion in assistance, went home empty-handed.¹⁴ The \$2 billion the US has promised is in the form of loan guarantees and debt reduction, so in reality an amount for the coming year of some \$200–250 million. The Gulf Cooperation Council (GCC) states are claimed to have pledged truly prodigious amounts, with Qatar heading the list with \$10 billion, but scepticism surrounds these reported pledges.¹⁵ Ultimately Egypt may derive several billion dollars from the Saudis, Kuwaitis, Emiratis and Qataris, but the Saudi government announced virtually simultaneously with its 'gift' that expatriate workers would be limited to six years' residence in the Kingdom, a step that would have a greater impact on Egypt than any other country. If remittances from Egyptians working there were to be halved it would about cancel out the Saudi government's promised assistance. By September 2011, the Saudis were reported to have transferred \$500 m to Egypt's Central Bank, which is one eighth of the total amount it pledged. The various promises from other donors, including the EU and various of its member states, are packaged as part of assistance programmes to Arab states generally and are largely in the form of projected assistance to be spread over several years, as well as some limited debt relief.¹⁶ In sum, if there is a pot of gold at the end of Egypt's rainbow, it is unlikely to be large enough to compensate for the spendthrift approach the SCAF has taken to the country's public finances.

Security

Economic management is beyond the military's competence and normal responsibilities, so its poor record thus far is understandable, if not justifiable. But provision of security for persons and property is its duty, broadly conceived, so the

persisting lack of it is a strong and clear indictment of the SCAF. While the profound breakdown of security in the Sinai exceeds that for any other part of the country, nowhere in Egypt has security on the street returned to its pre-January level. The country suffers from a pervasive sense of insecurity, which the very ruling style of the SCAF at the least does nothing to ameliorate. Highly secretive, it rules through the issuing of communiqués in the same manner as the military did when it seized power in 1952, supplemented by occasional public appearances by its members and yet more infrequent meetings with political activists. Its head, General Tantawi, gave his first public speech in July, some six months after the SCAF declared it was running the country. The naming and removal of key governing figures, including prime ministers and cabinet members, occurs without warning, explanation or justification. The relationship between the government headed by prime minister Essam Sharaf and the SCAF has not been clarified constitutionally, legally or in practice. In July, for example, the SCAF cancelled the brand new cabinet's decision to discharge university presidents.¹⁷ This intervention seemed to suggest that despite the inclusion of some figures obviously independent of the SCAF among the 14 new cabinet members, such as finance minister Hazem Beblawi and deputy prime minister Ali al Salmi, the government as a whole remained subordinate to the SCAF. This interpretation is reinforced by the fact that key portfolios remained in the hands of obvious SCAF loyalists, such as Mansour al Eissawy at Interior, Abd al Aziz al Guindi at Justice, and Fayza Abul Naga at International Co-operation, while the vital defence portfolio remained unfilled, indicating that General Tantawi considers the military still to be his domain. The very day the new cabinet was formed it was announced that the prime minister had been taken to hospital suffering from 'exhaustion'. In sum, the lack of transparency and accountability at the apex of the country's present government reinforces a pervasive sense of insecurity already exacerbated by the breakdown of normal policing and the quasi-insurrection sweeping through the Sinai.

Yet more disturbing is the seeming systematic neglect of the reform and rebuilding of the much discredited administration of justice the SCAF inherited with the fall of Mubarak. That system consists of the police, the public prosecutor and the courts. Key personnel in all three of these components remain largely unchanged. Minister of interior Mansour al Eissawy, who succeeded regime loyalist Mahmud Wagdi, did not serve in a cabinet under Mubarak and is considered more independent, but he formerly had served as a top ranking officer in that much discredited ministry. The public prosecutor, Abd al Maguid Mahmud, is a controversial holdover, while the minister of justice has been closely associated with his predecessor Mamduh Marei, who was brought in by Mubarak in the wake of the 2005 election to purge the judges who had demonstrated their independence from the regime in the monitoring of that election and by their subsequent protests. Given the personnel at the top, it is not surprising that the public has little confidence that the administration of justice has or will soon become effective and fair.

The actions of the three components of the justice system reinforce those feelings. Police presence on the streets is intermittent, while the occasional appearance of thugs to intimidate demonstrators indicates that these much feared auxiliaries of the

Ministry of Interior are still under its command. The crime wave is thought in part to result from the activities of the police and their shadowy accomplices among these thugs, who share an interest in subverting justice and indulging in outright theft. Calls by independent judges for the Supreme Council of the Judiciary to assume many of the administrative functions of the minister of justice have gone unheeded, so judges remain under direct executive control. No steps have been taken to reform the notoriously corrupt court administration personnel. In the meantime the military has expanded its already robust legal system yet further into the civilian domain, with as many as 20,000 Egyptians alleged to have been involved in protests processed through military courts.¹⁸ These protesters are usually incarcerated in military prisons. Its behaviour, in sum, suggests either the SCAF cares more about preserving its power and that of the military than it does about restoring security, or that it is perpetuating the state of insecurity in order to achieve its objectives. Whichever the case, the absence of security has contributed substantially to preventing a recovery of economic activity, including industrial production, tourism, export of gas and so on.

The business community suffers from additional insecurity resulting from unpredictable actions taken against its members and from the absence of clarification of what the intended future role of the private sector will be. There seems to be little rhyme or reason to the indictments and then sentences handed down against leading businessmen, most of them *in absentia*. Possibly the most alarming case is that of former minister of trade and industry, Rashid Muhammad Rashid, a pillar of the conservative Alexandrian business establishment whose business career had primarily been within or representing prominent multinational corporations. The SCAF offered him the post of prime minister in the immediate wake of their takeover, presumably because of his reputation for probity and effectiveness. When he refused he was immediately indicted on what appeared to be trumped up charges. He wisely chose to remain in Dubai where he was at the time and where he has subsequently been joined by many other Egyptian businessmen, with Paris and London being the other preferred cities of refuge. Conviction in June of the long serving and very effective minister of finance, Yusuf Butrus Ghali, who is the nephew of the former UN secretary general, seemed as vindictive as the Rashid case. Whether either of these persons was guilty as charged is impossible for any independent source to establish given the kangaroo nature of the court trials that issued the verdicts. That the SCAF should resort to such questionable legal practices suggests both its desire to cultivate popularity with the street and its intent to intimidate the business community, whose success under Mubarak the military much resented. As if this were insufficient cause for the business community to feel insecure, the SCAF's known preference for a nationalist, neo-Nasserist approach to economic development raises the vital question of what economic role, if any, there might be for those businessmen in the country's economic future.¹⁹ When Egypt's spring occurred, on the World Bank's key financial sector governance measure, which is protection of the legal rights of borrowers and lenders, it scored an abysmal one out of ten. Were this not the lowest score possible, Egypt's ranking presumably would have declined yet further.

Conclusion

Political spring came to the Arab world when its economies were unlikely to provide strong support for the development or institutionalization of democracy. But these political springs do offer the prospect of reversing the vicious cycle, whereby authoritarianism prevents good governance that in turn impedes industrialization, into a virtuous one in which at least the beginnings of democratization pave the way for substantial improvements in governance, hence much more rapid, thoroughgoing industrialization.

Alas, what is systemically hypothetically possible has to be implemented by political actors. Causation is neither automatic nor impersonal but relies on agency, that is to say, the choices and actions of those with political power. In the case of contemporary Egypt, which is a reasonable surrogate for the broader Arab world, the most important actor since the overthrow of Mubarak has been the SCAF. Thus far its actions have done nothing to break the vicious cycle of authoritarianism reinforcing itself through provision of inadequate governance, which in turn inhibits industrialization. The two most vital aspects of governance for global investment in manufacturing industry, hence the accompanying provision of multinational controlled technology, are provision of macroeconomic stability and protection of property rights. The SCAF's economic mismanagement has further exacerbated structural macroeconomic deficiencies and increased the immediate threats to the country's economic well-being resulting from the political upheaval itself. These generals demonstrate little awareness of the magnitude of the economic challenges they and the country are facing and seem to place what may be vain hope in bailouts from regional and global 'friends'. Even if such bailouts are forthcoming, they would not achieve the reforms necessary to start the economy down a self-sustaining path to development. Such reforms require a political base that is not dependent upon governmental largesse to retain day-to-day loyalty, a base that the SCAF does not and will never have. So as long as it or any political offspring it gives birth to unilaterally – as opposed to the emergence of a representative and accountable government through competitive, free and fair elections – macroeconomic management will be held hostage to the politically primordial need to generate and disseminate patronage. And a freely elected government only has the possibility, not the surety, of weaning the political system from patronage. Similarly, the general lack of security combined with the profound insecurity of the Egyptian modern private sector are also products of the political needs and calculations of the SCAF. Security for the country as a whole and for its businessmen in particular would require reforms that it is unwilling to countenance, lest the power of the military be eroded. So as regards the provision of macroeconomic stability and security, unless and until a much more profound political transition is secured, they shall remain in short supply. The much hoped for virtuous spiral that would lift Egypt and the broader Arab world out of economic stagnation seems still to be in the distance.

Notes

The views expressed in this article are those of the author and do not necessarily represent those of the Department of Defense or the US government.

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