

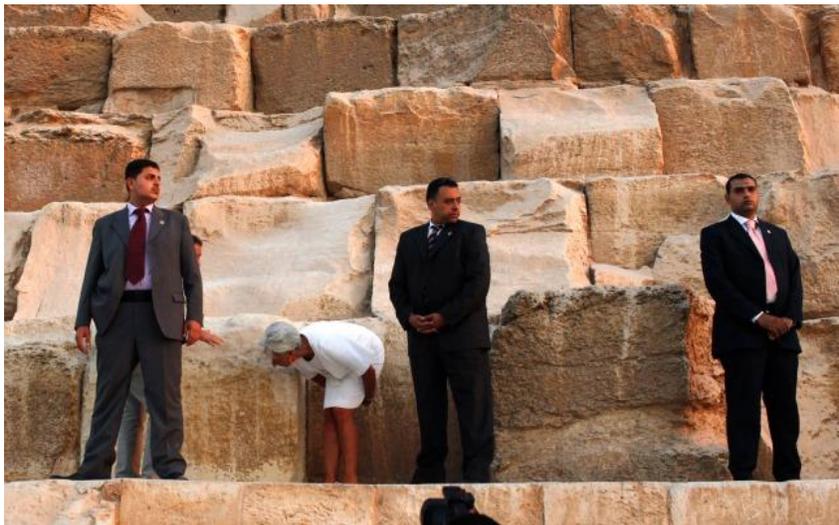


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Forget the Coup: Egypt's Economy Is the Real Problem

By: Ben W. Heineman Jr.
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Any new permanent government will face the choice Morsi had but never made: market economic reforms on the one hand and a command-and-control statist economy on the other.



Egypt's political dilemmas are based, in important part, on its economic dilemmas. But since the overthrow of the Morsi government, far less attention has been paid to crucial economic issues than the [political and constitutional conflicts](#). But economic issues--and the lack of a legitimated economic vision--have been as much a cause of the unrest, change and uncertainty in Egypt, and during [both the Mubarak and Morsi tenures](#). And they may be more intractable.

Any new permanent government will face the choice Morsi had but never made: between market economic reforms on the one hand, led by economists and business people to promote growth, jobs, and trade, and a command-and-control statist economy on the other, which provides subsidies for essentials like energy and staples like bread, rice, and sugar--and also provides sinecures for ex-military officers. Part of the problem is that "liberalizing" reforms--there have been three waves since the end of Nassar's

regime than 40 years ago--are perceived as helping the rich and reflecting crony capitalism, rather than raising Egypt as a whole.

Morsi's inability to chart a clear economic path led to a significant worsening of Egypt's economic straits, which in turn helped mobilize the powerful street opposition. From just before 2011 to today: GDP growth is down (from nearly 6 percent to under 2 percent); unemployment is up (from 9 percent to over 13 percent); foreign exchange reserves are down (from \$35 billion to just under \$15 billion); the budget deficit has more than doubled (from nearly \$110 billion to over \$230 billion); a quarter of that budget are subsidies to poor and middle class; and the poor and near-poor total approximately half of the population. Tourism is down significantly due to security concerns; direct foreign investment has declined sharply; gasoline and power shortages bedevil the population; a slide in the Egyptian currency has raised prices of foreign goods such as food imports; wealth distribution is badly skewed; the nation's credit rating is cratering; the hidden "black" economy constitutes as much as 40 percent of Egyptian economic activity. And corruption continues.

The critical economic issue is not the scope of the problems but what to do about them--a subject lost in the political swirl, but essential to any future regime stability. As with constitutional and political reform, a consensus economic program must resolve deep conflicting interests: between liberal elite capitalists and the military elite, between competitive enterprises and huge state subsidies for energy and food; between a private-sector middle class and a government-employed middle class that makes up fully one third of the workforce; between the 45 million Egyptians under 35, poor or professional, and those who control the economy through what the young regard as corrupt and non-meritocratic means; between urban and rural; between a variety of secular and Islamic views of the economy.

In the fall of 2011, the International Monetary Fund proposed one set of reforms as part of \$4.8 billion standby agreement aimed at creating economic growth. More than \$5 billion in additional funds from the EU and the U.S.--beyond the current \$1.3 billion in military assistance--were to follow. The IMF conditions included the following controversial items: removing energy subsidies for all but the poor; raising revenue through a broadly applicable value-added tax; using those funds to reduce the budget deficit and increase infrastructure spending; reducing a bloated bureaucracy; and significantly increasing transparency in government budgeting and finance--transparency that in Egypt would threaten longstanding corrupt activities.

Morsi initially agreed to the IMF conditions. But within three weeks, he stunningly renounced the agreement because of strong opposition to reduced subsidies and new taxes on many Egyptians and because many criticized the lack of transparency in IMF negotiations. The depths of controversy on the reforms simply overwhelmed an economic way forward. All this occurred before the first anniversary of the original Tahrir Square demonstrations. Egyptian economic reform was effectively dead.

With no new IMF, EU, or U.S. funds, the Morsi government received about \$8 billion in stopgap funding from Qatar and, in smaller amounts, Turkey and Libya. None of that financing imposed any economic reform conditions. Today, with those nations critical of the Morsi government's demise, it appears that Saudi Arabia and the United Arab Emirates, both of them critics of the Moslem Brotherhood, will step up to provide billions in emergency funding. But again, it seems unlikely that these funds will come with any demands for economic reforms.

So the economic dilemmas are, for the foreseeable future, likely to remain acute. It is hard to imagine that the current interim government will take any of the major reform steps that would inevitably create winners and losers--even though a moderate and experienced Egyptian economist, Hazem el-Beblawi, will be interim prime minister. And a revised constitution, duly elected parliament, and newly chosen president are not likely to be in place until sometime next year. Already, the interim government's recent proposals for these fundamental processes are being widely criticized.

If and when a constitutionally based and fairly elected government takes office next year, it will still have an extraordinary challenge addressing the economic dilemmas and conflicts embedded in reducing subsidies, trimming the government, raising revenues, rejuvenating the private sector, limiting the military's commercial activities/sinecures, and dealing with endemic corruption and the black economy. Without a broad consensus on an economic plan, the IMF, EU, and U.S. are not likely to provide funding tied to such reforms. And funds from Arab nations may forestall basic economic issues--but not resolve them.

A government that can create a societal consensus on an economic way forward seems more distant today than in the heady period of the first Tahrir Square demonstrations, two and a half years ago. The world will watch to see if Egypt can avoid economic, not just constitutional, tragedy.

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