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Egypt's Economic Winter

By Ben W. Heineman Jr.

December 18, 2012

Morsi's power grab has made headlines, but the world's most populous Arab country has even bigger problems on its hands.

The international media have made a huge story out of Egyptian President Mohamed Morsi's power-consolidating decrees and the balloting on his proposed constitution. How the fundamental political disputes -- between factions of the religious and secular, Islamic and Christian, and civilian and military, and between rich and poor and urban and rural -- will be resolved in the Middle East's most populous nation is seen as a harbinger for the political impact of the Arab Spring.



A companion story has received much less mainstream media attention: Egypt's escalating economic crisis since the Tahrir Square uprising. Yet the question of whether and how Egypt deals with these economic issues is deeply intertwined with the salient political questions, and has significant implications for the future. Indeed, a lack of economic opportunity was arguably as significant a cause of the Egyptian "revolution" as political repression.

The downward spiral of the Egyptian economy is reflected in almost every economic indicator. GDP growth has declined from over 5 percent to under 2 percent. Unemployment has climbed to 12 percent, with half of those aged 15-24 lacking jobs. Inflation has spiked to over 10 percent. Foreign direct investment has withered from \$2.9 billion in the first quarter of 2011 to \$219 million in the first quarter of 2012. Foreign currency reserves have dropped from \$35 billion to about \$15 billion, as both tourism and foreign investment have suffered a precipitous decline. The total market value of stocks traded on Egyptian exchanges has declined by more than half. The budget deficit has climbed to 11 percent of GDP. Twenty-five percent of the government's \$84 billion in

annual outlays subsidize food and energy, not just for the poor but for better-off Egyptians. Yet the number of those who are poor or near poor has climbed to nearly 50 percent of the population of 80 million. These trends have continued [unabated](#) from a year ago.

The fundamental dilemma facing Morsi after his election was a choice 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.

Three waves of market reforms enacted starting in the seventies did increase growth and investment. But they were associated with "crony capitalism." These changes benefited an elite close to power (including Mubarak's son Gamal), increased corruption, and, with their pursuit of efficiencies, hurt employment. They did not benefit the poor or the millions who were employed by government. Nor did the "statist" economy, with its high subsidies and high deficits, its favoritism for the military, and its support of a creaky government machinery, create conditions for new industry and new employment. That failure means today that the conditions are not in place for the high growth necessary to reduce current unemployment and create new jobs.

After assuming power, President Morsi indicated that he would try to steer Egypt toward market reforms to increase growth. These ideas were set out in some detail in a social and economic program called al-Nahda ("the renaissance"), which certain elements of the Muslim Brotherhood had been developing for years. The hope was that those who benefited from dynamism in the private sector might well be Islamic, or might share the goals of greater equity in the creation and distribution of wealth.

Because of political uncertainties, though, the government took few concrete steps -- with one major exception. It dramatically reversed course and sought overseas aid from the International Monetary Fund, which in late November announced a \$4.8 billion preliminary agreement to revive Egypt's economy and improve market performance. The IMF funding was complemented by \$5 billion in prospective aid from the EU and \$1.4 billion in direct aid and financial guarantees from the US, in addition to \$1.3 billion in the US's continuing military assistance.

With the foreign assistance came some tough medicine, which Egyptian leadership developed with the IMF. Energy subsidies for those who are not poor would be cut; the bloated state sector would be reduced and coils of red tape shortened; through a more progressive income tax and taxes on consumers, revenues would be selectively raised to enable deficit reduction and investment in infrastructure and education.

Just three week after the agreement was announced, Egypt stunningly reversed course and postponed its request for the IMF loan. There were multiple causes: the political unrest due to Morsi's decrees; the heated debate over the constitution; the promulgation and then almost immediate withdrawal of sales taxes on certain consumer goods; the lack

of transparency in the IMF negotiations, which played into anti-foreign suspicions within Egypt; and the general tough economic love the IMF requires. A nation already bitterly divided would not follow Morsi's lead on another highly controversial set of issues.

So the process of economic reform under the Morsi government has seen a short cycle of start-stop. The IMF request may be renewed next year, but its delay slows down other aid from the US and the EU. And resolution of these aid issues will turn on the ability of the government to secure support across a fractured Egyptian society.

For now, this leaves the Egyptian economy still spiraling downward, with a threatened currency devaluation that would raise the cost of imported food and other imports, rampant corruption, the unexamined role of the military in the old "statist" economy, and the continuing "black economy" of illicit underground business, which by some estimates constitutes as much as 40 percent of all Egyptian economic activity. All economic indicators are moving in the wrong direction.

The media spotlight is on Egypt's constitutional and political issues. But the conflicts and uncertainty in the Egyptian constitutional polity since Tahrir Square are more than matched by the conflicts and uncertainty in economic policy. The future of Arab transformation that began last year turns just as much on whether, and how, the Egyptian economic crisis can end in a way that, even if does not satisfy everyone, is seen by most as legitimate--and effective.

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