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Egypt's Agony

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The events of January 2011 and July 2013 in Egypt have at least one thing in common: both events were staged by the army and both were in response to massive public protests that brought millions onto the streets. The army remains the ultimate arbiter of power in Egypt capable of replacing two presidents (one of whom was democratically elected) and their governments. The fact that it only acted following public protests suggests that its main aim is to restore stability rather to rule directly.

In January 2011, Hosni Mubarak was removed from power by the army against a background of rising food prices, widening income gaps, and widespread opposition to the corruption, nepotism, and violence that characterized his regime. Mubarak's attempts to promote his son Gamal as his successor infuriated Egyptians. Although Mubarak's final years brought economic growth, his regime created massive tension as a result of increasing inequality and repression. While the poor experienced higher living standards, they did so much more slowly than did the rich and well connected. When food prices rose on international markets and the government tried and failed to compensate with ever-increasing subsidies, public anger developed.

In July 2013, Mohamed Morsi was removed from power by the army against a background of economic collapse. The economy has virtually stopped growing, real income per capita has fallen, and the budget deficit rose sharply to an estimated \$28.8 billion or 11.5 percent of GDP in the financial year July 2012 - June 2013. What's more, the exchange rate

plunged by 20 percent between January 2011 and July 2013, foreign exchange reserves fell by 50 percent to dangerously low levels, foreign tourist revenues and foreign investment collapsed, and unemployment increased. In 2012 unemployment was officially estimated at 12.7 percent, although the real rate was much higher, especially among the young (see *Iqtisadi* May 2011, December 2011, May 2012, and August 2012).

As a result of these developments Egypt's credit rating has suffered. In March 2013, Moody's cut the country's credit rating, citing unsettled political conditions and public finances. It cut the credit rating by one notch from B3 to Caa1, and stated that it saw a nearly a 10 percent chance of Egypt defaulting on its debt over the next year, and slightly less than a 40 percent chance of a default within five years. This was Moody's sixth downgrade of Egypt since January 2011. In May, Standard & Poor's again lowered Egypt's long-term credit rating from B- to CCC+, and its short-term rating from B to C given worries about the country's ability to meet its financial targets and maintain internal order. In July, Fitch lowered Egypt's issuer default ratings and country ceiling to B- from B. Both of these credit ratings are non-investment grade or "junk" ratings six notches below investment grade. Fitch's outlook for the economy suggests that further downgrades are possible.

In addition to economic distress, there was also widespread opposition to Morsi's attempts to Islamize the constitution and the bureaucracy, replace judges appointed by the Mubarak regime, and extend his own powers. He officially declared himself to be temporarily immune to any judicial review, and then appointed an allied prosecutor-general to go after the private media and the opposition while shielding the Muslim Brotherhood (*Ikhwan*) from legal oversight.

When Morsi came to power in June 2012 and replaced the defense minister Mohamed Tantawi with the much younger Abdel Fattah al-Sisi, many interpreted it as a sign that the army was so weak that it could no longer impose its will. Sisi, chosen by Morsi because he was a more observant Muslim than many other generals, disproved this when the army staged the July coup. Despite the coup, the army's power is limited, mainly because of the need to quickly restore stability so as to reduce the economic hemorrhaging that threatens to destroy the army's own assets. If it did not realize it before the coup, the army quickly realized that the Muslim Brotherhood would not stand idly by after Morsi was removed from power.

The army's main interest is to maintain its position as the ultimate arbiter in the political process and to protect its assets. These are huge: it is estimated to control up to 30 percent of the economy. The military economy includes the numerous factories and production facilities that are controlled by the Ministry of Defense and Ministry of Military Production. These also include companies affiliated with the Arab Organization for Industrialization and National Services Production Organization. In theory, these are state-owned entities but their accounts are not subject to financial oversight by the government's Central Auditing Organization.

The military produces a huge array of goods including kitchen cutlery, televisions, agricultural and household chemicals, refrigerators, industrial machinery, railway cars, car assembly, and clothing. It is also involved in large infrastructure projects, such as building roads, bridges and ships. Piped gas is supplied by the military as are foodstuffs, cement, and gasoline. Another source of the military's wealth is its landholding, which is increasingly being converted into gated communities and resorts. The military has other advantages: it does not pay taxes nor does it have to deal with a bureaucracy that strangles the private sector.

In 1979, following the peace agreement with Israel, the military – which then numbered about 900,000 – had to be downsized. The need to find alternative employment for large numbers of officers resulted in many of them being absorbed by the military industries. It also resulted in the military entering civilian production. Some 250,000 officers were retired during Mubarak's 30-year presidency and to retain their loyalty and to offer future prospects for those still in service, the army's economic empire was developed. Egypt's standing army numbers 450,000 and other security forces total 403,000. Maintaining this huge force is one of the key ways in which the government keeps unemployment down. The defense budget, estimated at \$4.4 billion, accounts for five percent of the state budget and 1.8 percent of GDP.

What are the prospects for the economy? Since the coup, Egypt has been offered aid worth \$15 billion: Saudi Arabia has offered \$5 billion, Kuwait has promised \$7 billion, and the UAE has pledged \$3 billion. This beneficence results from the strong opposition of these states to the Muslim Brotherhood and the opportunity to replace Qatar as Egypt's benefactor. While Egypt needs this massive injection of aid, it will only help if this is part of a reform program that includes subsidy cuts and other reforms. Energy subsidies

currently cost some \$15-17 billion a year, equal to about seven percent of the national income. Over a quarter of the budget is spent on interest, the result of borrowing needed to finance budget deficits. In order to make changes that affect significant sections of the population at least two conditions have to be met. The first is that the pain caused by government spending cuts has to be seen to be fairly shared and it has to be perceived as short-term. The second is that there needs to be a political consensus behind economic reforms; without this, foreigners will not invest in Egypt. Until this is achieved the prospects are bleak, but Egypt cannot afford to wait because the population is increasing by 100,000 each month!

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