

Egypt's Looming Economic Shock Doctrine

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Egypt is teetering on the edge of an economic crisis. Cast adrift in a deepening political quagmire over the past fourteen months, the economy has now reached a critical juncture, as the country faces the pressing challenge of financing a large budget deficit as rapidly dwindling foreign currency reserves threaten to crack apart an already fragile situation.

Yet, more than a year after the launch of a revolution driven in large part by economic grievances, the budgetary and fiscal proposals being considered to secure external financial assistance are geared more towards furthering Mubarak-era policies than to promoting social justice.

The state deficit for the fiscal year that ends in June is expected to exceed 140 billion Egyptian pounds (\$24 billion), or 8.7 percent of expected economic output, according to the Finance Ministry. Meanwhile, the central bank's foreign reserves have been shrinking by roughly \$2 billion every month, precipitated by a sharp decline in tourism and foreign direct investment since the revolution began.

Over the past year, the government has used up more than \$20 billion to prop up the local currency. In February, foreign reserves stood at \$15.7 billion, enough for just three months of imports, and with it, the looming prospect of devaluation.

Egypt, like many developing countries, relies heavily on imports, including for staple items such as wheat. (Egypt is the world's largest importer of wheat, relying on foreign supplies for about 60 percent of domestic consumption). A currency devaluation would increase import prices across the board, severely deepening the recession and prolonging any economic recovery.

"The economic situation is dire but really the Achilles Heel comes with the balance of payment position and mainly with the fact that we don't have enough dollar reserves," says Amr Adly, the head of the Economic and Social Justice Unit at the Egyptian Initiative for Personal Rights.

In January, the military-appointed interim government formally requested a \$3.2 billion loan from the International Monetary Fund (IMF). The government says it needs \$11 billion to avoid a balance of payments crisis and signing a deal with the IMF is expected to open the door to aid packages from the United States, the European Union and the Gulf. The IMF requested the Egyptian government draw up an economic reform plan supported by political consensus in order to secure the loan.

"The IMF has become quite smart lately in the sense that they don't impose direct conditionality in order to give money," Adly says. "They ask the government to design the program and they have to accept it so they can release the tranches. So it is indirect conditionality because they won't give you the money unless they approve of the plan."

The Ministry of Finance, the Ministry of International Cooperation and the Central Bank drafted a reform program to present to the IMF, the details of which were not released publicly—although a copy was leaked to the media. While the plan's proposed policies are extremely vague—with few specifics and little in the way of proposed timetables—the document includes the classic phrase associated with IMF loans across the developing world: "structural adjustment," and with it, a slew

of controversial economic amendments.

Aimed at slashing the budget deficit, the document proposes tax reforms to increase government revenues. While lacking any concrete details, it mentions amending income taxes by broadening the pool of tax paying citizens—echoing the policies of Mubarak’s finance minister, Youssef Boutros-Ghali—with no proposals for a move towards progressive taxation.

Reforms to sales tax laws and the possibly of instituting a Value Added Tax are also mentioned. Sales taxes, while easier to implement from an administrative standpoint, are indirect and regressive by nature, targeting different sectors of society with the same taxes when they purchase goods, regardless of income level. In Egypt, where half the population lives below the poverty line and spends the biggest proportion of their income on basic goods, sales taxes place a higher burden on the poor majority.

The document also includes an element of energy subsidy reform—long a contentious subject within Egypt’s government budget. Energy subsidies absorb a whopping 95 billion Egyptian pounds (\$15.8 billion) of Egypt’s budget outlay, or roughly 20 percent. Beneficiaries span the board, from taxi drivers to multi-national corporations—particularly those in energy-intensive industries like cement. Yet the government’s proposal for subsidy reform remains ill-defined and does not indicate which particular energy subsidies will be cut. Even if they were to target the 19 percent that goes to industry, as many have called for, no measures are outlined to counter any attempts by corporations to pass the rising costs to the end-consumer.

“In a word, the government reform plan is lousy,” says Samer Atallah, assistant professor of economics at the American University in Cairo. “It’s basically neoliberal economic policy that doesn’t seem to get the new reality of Egypt.”

Egypt’s last IMF loan came in 1991 to help alleviate the country’s \$35 billion foreign debt crisis. The government was forced to adopt a set of structural adjustment policies as a condition of the deal that laid the groundwork for a sweeping wave of privatizations throughout the next two decades. The farming sector was deregulated and a 10 percent sales tax was introduced, among other economic and financial reforms.

“These policies had an extreme adverse affect on the majority of Egyptians,” Atallah says. “People talk about economic indicators that improved after these programs such as the budget deficit and the balance of payments but these measures don’t reflect the daily lives of the majority of poor people in Egypt.”

Negotiations surrounding the current IMF loan come at a time of growing political turmoil in Egypt and the signing of any agreement hangs in the balance. The powerful Muslim Brotherhood, which controls nearly half the seats in parliament through its political arm, the Freedom and Justice Party, has locked horns with the ruling military council in recent weeks after largely walking in lockstep with them for much of the past year. The Brotherhood is pressing the generals to remove the military-appointed government, led by Prime Minister Kamal el-Ganzouri, and appoint a new one before the completion of the so-called transitional process in June. The group is also coming under fire for its dominance of the constituent assembly and, most recently, for reversing its previous pledge to field a presidential candidate.

The IMF has made clear that any agreement is conditional on broad political backing, which in practice means the support of the Brotherhood since it will likely lead the next government, whether it comes before or after the Supreme Council’s scheduled handover of executive authority to a newly-elected president.

The Brotherhood has said it supports the request for an IMF loan but first wants the government to produce a more coherent plan. After meeting with an IMF delegation that arrived in Cairo for talks in mid-March, the Brotherhood issued a statement critical of the economic reform package as “general and vague” and said the government did not outline “how this loan will be used, or how it will be paid off.”

For its part, the IMF delegation said the talks were fruitful and a technical team is scheduled to return this week to “continue work on Egypt’s economic program which could, in turn, be supported by the Fund,” according to IMF spokesman David Hawley.

The IMF deal has also come under heavy criticism for the complete lack of transparency that has surrounded the talks. “The fact is this economic reform program was never presented publicly and was never put up for a serious public debate,” says Ahmad Shokr, a founding member of the Popular Campaign to Drop Egypt’s Debt.

The Campaign monitored news reports regarding international commitments made by the post-Mubarak transitional government over the past year. It found at least \$800 in financial assistance had come into the country through various sources. “Where has all this money gone? What is it being used for? Were there any conditions attached?” asks Shokr. “Now they want to go borrow an additional \$3.2 billion? That should be unacceptable.”

The shroud of secrecy on economic affairs is nowhere more prevalent in Egypt than within the army, which maintains a sprawling business empire that accounts for between 15 to 40 percent of GDP. Utilizing a mass conscripted labor force, army divisions manufacture everything from television sets and off-road vehicles to bottled water and fertilizer.

Since Mubarak’s ouster, which brought the military to power, the army has provided the ailing Egyptian government with no less than 12 billion Egyptian pounds (\$2 billion), including a \$1 billion loan to the Central Bank to prop up foreign reserves.

“We have an army that has a separate budget totally away from the control of civil government. It’s beyond belief,” Attalah says. “The way this was discussed in the public discourse was ‘wow we should be grateful for the army that stepped in and helped our economy.’ For God’s sake this is our money!”

The ruling Supreme Council, and the successive governments it has appointed in the post-Mubarak transitional period have repeatedly laid the blame for Egypt’s economic difficulties on the revolutionary protest movement and widespread labor strikes. While political protests have dwindled in number and frequency as of late, labor protests, primarily in the form of strikes, have continued unabated and have, in fact, increased in recent weeks as workers push for the revolution to tackle long-standing socio-economic grievances.

Yet the pressing issues the economy now faces—particularly the depletion of foreign reserves—are more likely the offspring of a badly mismanaged political transition that has forced the country into a fiscal cul-de-sac. Despite a major political upheaval compounded by economic troubles plaguing Europe—Egypt’s main trading partner—the Egyptian economy grew by nearly two percent in 2011. Egypt’s current economic woes are primarily confined to the super-structure—monetary issues like the budget deficit, balance of payments, inflation—rather than the infrastructure, which remains largely unchanged.

“The military council are the ones to blame, it’s not about the revolution,” Adly says. “They were the ones in control and they managed the political transition in a very stupid way, either deliberately or

not.”

Successive military-appointed governments, as well as the central bank, did little to mitigate the problem of foreign reserve depletion in the aftermath of Mubarak’s ouster. Possible measures, like applying restraints on imports or restrictions on capital outflows (as much as \$12 billion was transferred abroad since January 2011), were ignored. Meanwhile, an enduring climate of political instability has kept investors and various forms of financial assistance from re-injecting foreign currency into the economy.

By most accounts, the Egyptian economy will need of some kind of financial aid within the next few months to avoid a severe downturn. It remains unclear when or if an IMF loan will be signed or what economic reforms will be agreed upon by the Muslim Brotherhood. What is becoming clear is that signs point to a continuation and deepening of many of the same policies that stirred up last year’s revolt.

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