Introduction

When a country has a continuous history of more than five thousand years, dating the genesis of an issue requiring reform can become a little arbitrary. It seems that in Egypt's case, no matter which date is chosen, it is almost always possible to look back to find pre-echoes of political-economy issues that are being discussed today. "This country is a palimpsest," wrote Lady Duff Gordon in 1863 "in which the Bible is written over Herodotus, and the Koran over that" (Gordon 1969).

Even the time of the pharaohs offers important instances of matters with which present-day administrations continue to grapple. A modern policymaker would be no stranger, for example, to wrestling with problems of controlling and distributing the Nile's waters; to managing an extremely centralized administration; to examining issues raised by the level of government intrusion in the economy; to assessing the consequences for the country's cropping patterns of farmers' not having to pay for irrigation water; to estimating the taxes to be levied in the coming year; to concerning himself with the role of religion in the polity; and many more questions that can trace their roots to pharaonic times.[1]

Or one could start with Napoleon's expedition to Egypt (1798–1801) because it marked the beginning of the most recent serious interaction between Egypt and the West and has political, economic, social, and cultural consequences that continue to unfold to our day. Moreover, the reign of Muhammad Ali (1805–49), who assumed power after the departure of the French, and his successors saw the introduction of many policies—such as those relating to the ownership of land; the expansion of the canal network; the steady replacement of basin by perennial irrigation in order to meet the requirement of increasing the country's limited cultivated and cropped area; the government's sponsorship of industrialization; protection against imports and the consequences of removing it; the enlargement and modernization of the armed forces; the raising of revenues to pay for the policies of economic expansion; the construction of the Suez Canal and the resulting deeper integration of Egypt into the international economy; the rise of external indebtedness and the political vulnerability that it created; and several others that have molded much of Egypt's contemporary economy and society. These policies delivered many of the strengths that buttress the country but also initiated problems that continue to engage the attention of today's regimes.

This book has a more limited compass. The discussion focuses on the era since the Free Officers staged a coup on July 23, 1952, but refers back to earlier periods to show how an issue arose and how deeply, with time or reiteration, it has become embedded in the political and economic structures of the country. It discusses the principal economic challenges that Egypt faced and looks at the interaction of politics and economics that went into determining the policies devised to deal with the challenges. In discussing these policies, one must almost inevitably raise the question of whether other approaches would have been more effective.

Four points concerning the approach and the scope of the book should be stated at the outset. First, this is not a book about the politics of Egypt per se; rather, it deals with how political and economic variables interacted to produce the crucial economic outcomes for the country since 1952.

Second, its underlying assumption is that the most important responsibilities of a government are to create a better life for its citizens and to keep the country free from external domination. While many different elements go into the creation of a better and more secure life, the economic element is critical; this includes policies that would bring about a sustainable development of the economy and a better distribution of its fruits. These criteria are taken as the touchstone against which to appraise the effectiveness of economic strategies.

Third, much of Egypt's economic development since 1952 has involved the use of foreign resources, contracted bilaterally, multilaterally, or commercially. One could even say that a good deal of Egypt's political maneuvering since 1952 has been in the quest to obtain such resources. How providers of external resources reacted to Egypt's economic policymaking, and what the impact of their policy advice was, therefore requires scrutiny.

Fourth, there is no attempt to provide a recipe for dealing with an immediate situation, such as, for example, that resulting from the overthrow of the Mubarak regime in January 2011. The discussion of the way forward is on the enduring structural issues in the economic field that will have to be tackled by whatever regime is in power over at least the next two or three decades.

The Importance of Economic Health

Egypt's economic future matters. With a population that accounts for about 40 percent of the Arab world; with a preeminence in Arab culture, education, and media; with a large and well-qualified diaspora that underpins the economic and social development of many other Arab countries; with a strategic location where the Suez Canal provides the shortest passage between Europe and Asia; and with the largest armed forces among the Arab countries, Egypt should rank as one of the most important countries in the world. And yet there is a perception that the country's performance has fallen short of its potential.

While many reasons—historical, political, and other—have contributed to this state of affairs, economic weaknesses have been responsible for many of the country's most serious political ills. To take but one example: even 150 years ago, the failure to generate sufficient foreign-exchange earnings created both the need for Egypt to borrow externally for the construction of the Suez Canal and also its inability to service this debt. The default provided the creditor countries a pretext to set up the Caisse de la Dette Publique in 1876 that, together with the "advisors" imposed on the Egyptian ministries (especially after the British occupation of Egypt in 1882), dictated Egypt's principal economic policies and appropriated the country's financial and material resources for the benefit of the creditors. The occupation continued de jure until the ratification of the Anglo-Egyptian Treaty in 1936 and de facto until the withdrawal of the British troops in 1954. Economic weakness cost Egypt its political sovereignty.

Lest one think that this is all ancient history, more recent examples of the interactions of economics and politics impacting powerfully on Egypt can readily be offered. Thus, because Egypt could not mobilize sufficient resources domestically to pay for the construction of the High Dam at Aswan, it had to seek funds from abroad. When the foreign loans that had originally been expected were canceled, President Gamal Abd al-Nasser took the political decision on July 26, 1956 to nationalize the Suez Canal and use the transit fees to pay for the dam's construction. "The Canal will pay for the dam!" said President Nasser, according to two French eyewitnesses (Lacouture and Lacouture 1958, 472). This was a political policy undertaken in pursuit of an economic goal. The nationalization led to a war with the United Kingdom and France—the major shareholders of the Suez Canal Company—that in addition to damage inflicted on Egypt's infrastructure induced the country to reorient its political and economic relations away from the West and toward the Soviet Union. These political actions had long-term economic consequences. They cut off Egypt's access to the financial and technical resources of the West, thus potentially restricting the investment and growth rate of the country and constraining it to rely for its development on the less efficient technology of the communist countries.

Ironically, the political fallout from economic weakness did not impact only on Egypt—the British victory in the Suez episode was Pyrrhic. The uncertainty created in the region by the hostilities, the interruptions to trade caused by Egypt's blocking of the Suez Canal, and the spike in oil prices made investors very nervous and led to an attack on sterling. In order to defend the exchange rate, the Bank of England was compelled to draw down its reserves (between September and November the United Kingdom lost 15 percent of its gold and dollar reserves), which began to approach a level at which a devaluation of the British currency looked inevitable.[2] This alarmed the British government, which felt that a debased sterling "would probably lead to a breakup of the sterling area or (possibly even the dissolution of the Commonwealth) . . . and currency instability at home leading to severe inflation."[3] The government approached the United States for financial help, but the latter agreed to offer this assistance only under a number of conditions, such as complying with a U.S.-sponsored United Nations resolution that required Britain to quickly relinquish its military gains and withdraw its troops from the Suez Canal area. Subramanian (2011, 15) reports a senior advisor to the British government writing, "This was blackmail. . . . But we were in no position to argue." Economic vulnerability had enfeebled Britain's political hand and erased the country's diplomatic weight. Another case of economic weakness begetting political subservience.

Other examples can be offered where external pressures resulting from Egypt's economic weakness produced serious long-term results. With continuing inability to match government revenues and expenditures, Egypt was compelled to accept diktats from the International Monetary Fund (IMF) in 1977 to cut subsidies on bread and other consumer items. This resulted in the worst riots to take place in Egypt since 1952, with considerable damage to public infrastructure and production facilities. Perhaps even worse, the incident left scars on policymakers' psyches that have to this day made them very wary of undertaking reform policies.

Some Conclusions

The book covers too much ground to allow a simple summary, but some points are worth emphasizing.

First, the overriding issue during the period covered by this study concerns the role of the state in the economy. The state spent the earlier part of the period imposing an extensive set of discretionary controls on the economy, and the latter part in dismantling many of them. Neither experience was entirely satisfactory. The task defined in Ikram (1980, 8) still remains: "The government will have to continue trying to strike a balance between the conflicting objectives of *liberalization* for the sake of productivity growth and *intervention* for the sake of an equitable distribution of income."

Second, accelerating the GDP growth rate is imperative; Egypt's demographic dynamics do not permit an alternative.[4] Every two years Egypt adds a New Zealand or Ireland to its population; every three, a Denmark or Finland; every four, an Israel or Switzerland; and every five, a Sweden or Portugal. And while it adds the population, it does not add the capital assets, the technical knowledge, the institutions, and the governance of these countries.

Moreover, Egypt is not only experiencing a bulge in the population's working-age cohort, but it also has an even larger "echo" generation below the age of ten that will enter the labor market in the near future. In 2016 there were about 10 million Egyptians aged 25–29, but also more than 13 million below the age of five years. This age structure offers a potential dividend, but also creates a danger.

The dividend is provided by the rapid increase in Egypt's labor force and productive capacity, while the experience of countries that have passed through a similar demographic transition suggests that it could also raise the country's savings rate. But if the economy fails to create a sufficient number of meaningful jobs, the demographic dividend could turn into a demographic nightmare as hundreds of thousands of young men and women crowd Egypt's streets desperately seeking jobs, income, security, housing, and access to health and education for themselves and their families—a mouth-watering prospect for a recruiter for any extremist ideology.

Third, Egypt's experience since 1952 also shows the influence exerted by external forces in the country's development. These external forces have been foreign governments, international agencies, and commercial financial institutions. The influence can come from the financial resources they provide, from the technical advice they offer, or more generally from a combination of the two. The experience suggests that Egypt should have been more proactive in deciding which elements of the economic advice to act upon and which parts to decline. But "Who pays the piper calls the tune" remains the most compelling maxim of international politics, and Egypt will only be able to reduce external political pressure if it takes more serious measures to mobilize domestic resources and to correct the anti-export bias in its incentive structure.

Fourth, Egypt is ripe for "second generation" reforms. The distinction between first- and second-generation reforms is to some extent a semantic question and the two forms of reform can overlap. However, Naím (1994) provides a useful way of classifying the main differences. First-generation reforms can be undertaken relatively quickly, focus on actions that need to be taken (on "inputs," so to speak), and face political opposition that is largely diffused. Examples of first-generation reforms would be macroeconomic stabilization, reductions in import tariffs, budget cuts, changes in tax rates and coverage, privatization, and similar policies. These are technically easy to identify and, if the authorities are serious about economic policy, the policies need not take very long to implement.

On the other hand, as Navia and Velasco (2003, 265–68) point out, second-generation reforms are often "merely statements of desired outcomes (for example, civil service reform or improving tax collection), without a clear sense of policy design." Moreover, second-generation reforms frequently raise a different level of technical difficulty. As Navia and Velasco put it: "Any economist can tell you that curtailing inflation requires lower money growth; fewer are prepared to put forward a proposal for supervising operations in derivatives by banks and other financial institutions, or for solving failures in the market for health insurance." Thus, for first-generation reforms, identifying the outcome to aim at and the means to attain it are both, in principle at least, fairly straightforward; for second-generation reforms, the desired outcome may be discernible only in a rather general form, and the means of attaining it can be far from clear.

Moreover, second-stage reforms commonly take much longer to implement because they require fundamental changes in the organizing and/

or functioning of institutions—their chief aim is to improve governance. And the widespread experience is that faith-, ideology-, and culture-based attachments to institutional structures, or those rooted in a long history, are fiercely resistant, or even immune, to policy. Thus, for example, second-stage reforms generally require a reform of the bureaucracy. This is seldom easy and could be particularly difficult in Egypt. More than one-fourth of the country's labor force is employed in various parts of the government—in 2016 there was one government employee for every thirteen citizens (even this figure excludes the Armed Forces)—and is set in its attitudes and methods of working. The reforms might also require creating entirely new institutions or politically empowering existing ones, such as regulatory agencies that would actually restrain monopolistic or oligopolistic behavior by firms. They would also require fundamental changes in the functioning of the commercial judicial system in order to speed up judgments and to reduce the case burden on judges. And measures would also have to be put in place to ensure that judicial decisions were implemented promptly.

The two stages of reforms also raise different issues of political economy. Apart from some exceptions—such as businesses that might be compelled to compete against international firms because reforms had cut import tariffs—the groups affected by first-stage reforms are often too fragmented or too poor to carry much political clout and thus their concerns can be set aside more easily. But, as Navia and Velasco (2003, 268) put it, "By contrast, the set of interests potentially affected [by changes in governance] in the next stage reads like a *Who's Who* of highly organized and vocal groups: teachers' and judicial unions, the upper echelons of the public bureaucracy, state and local governments, owners and managers of private monopolies, and the medical establishment." Their resistance can prove lethal to the reform program.

Fifth, most of Egypt's GDP growth of the last fifty years has come from adding more labor and particularly capital; the contribution of total factor productivity (TFP), that is, the efficiency with which factors of production are used, has been very small. Productivity in this sense results not only from technology change, but also from any other changes that influence the efficiency with which inputs are converted into output.[5] Of particular importance are such factors as changes in regulations and the working of institutions that govern the economy. A discussion of the principal conceptual issues relating to TFP measurement and of Egyptian data problems will be found in Ikram (2006, 101–16); here only the main results from recent studies will be summarized.