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POLITICAL ECONOMY REVIEW OF EGYPT

Alan Richards
(University of California, Santa Cruz)

Raymond Baker
(Williams College)

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I. INTRODUCTION

1.1 The world's political-economic systems seem to be converging on a single form: market democracy. The recent worldwide shift toward pluralist polities and market economies started in Latin America (Chile, Argentina, Mexico, etc.), spread most dramatically to the former Soviet block, and penetrated Sub-Saharan Africa (Kenya, South Africa). In Asia, the Philippines and Thailand have experienced parallel developments. Despite considerable regional and national variation, the broad outlines are everywhere the same: the rise of the market (if the country had previously suffered from a highly statist system) and the beginnings or expansion of popular political participation.

1.2 The Arab world has often been singled out as an exception to this general rule. It is alleged, particularly in the popular press, that here only dictators and absolute monarchs hold sway, with little or no popular participation in governance. Those countries which had embraced the ideology of Arab Socialism remain highly statist. Neo-Orientalists argue that such authoritarian structures of rule and economic organization have deep cultural roots which preclude the Arab world's participation in the global resurgence of market democracy.

1.3 Such a view is far too facile. Without denying the power and tenacity of entrenched non-democratic, anti-market forces, Arab political economies show signs of change. Proposals for a consultative council (**majlis ash-shura**) have been promulgated in Saudi Arabia; the Kingdom of Jordan now has an elected Parliament, in which open, often bruising debate occurs. Most countries have begun to shift toward less state control of the economy; indeed, economic liberalization considerably antedates political change: Tunisia began decontrol in the early 1970s, while Egypt's "Open Door" policy, for all its faults, also began the shift of the largest Arab economy away from the Arab Socialist system in the 1970s.

1.4 This Report examines the need and potential for deepening the process of economic and political reform in Egypt. Egypt faces daunting challenges in the 1990s. It must provide food, jobs, education for a growing population. It must greatly improve the level of management at all societal levels. It must rationalize the use of water to economize on what is an essentially fixed natural resource. And it must overcome the baleful legacy of nearly 40 years of an excessively centralized economic system.

1.5 There is widespread recognition on the part of the Egyptian ruling elite that economic reform is necessary. The country has signed Stabilization and Structural Adjustment Agreements with the IMF and the World Bank, respectively. At the same time, there are increasing calls by Egyptians in many walks of life for increased popular participation in governance. The

Egyptian government has recognized these calls, and is officially committed to a process of political reform. Egyptians enjoy a reasonably free press and wide freedoms of oral expression. Significantly, the Egyptian judiciary has repeatedly demonstrated its independence from the authorities, indicating the consolidation and expansion of the rule of law.

1.6 This document offers an overview of the process of economic and political reform. Several limitations of our analysis must be noted at the outset. First of all, in most countries, including the U.S., politics consists of (at least) three axes or sets of interrelated issues: the politics of economic policy, the politics of political system change, and cultural politics. (In the US, examples of each would be, respectively, fiscal policy, reapportionment or term limits for legislators, and the abortion debate). In the Egyptian context, "economic politics" is dominated by the politics of structural adjustment and economic reform, "political-system politics" focuses on whether and how to expand popular participation and the rule of law, while "cultural politics" is overwhelmingly concerned with the definition and role of Islam. There is no Egyptian national consensus on **any** of these issues (although the need for **some** kind of economic reform is almost universally recognized). Our charge is to analyze the political economy of structural adjustment and the politics of political system reform. **Our analysis focuses only on the first two "axes" of Egyptian political life; we refer to "cultural politics" only when we believe that it may impinge upon the politics of economic and/or political reform.** There is therefore no pretension to "comprehensiveness", even conceptually.

1.7 A second limitation is the background and beliefs of the authors. Like most Americans, we are strongly committed to the principles of human rights, limited government, and a mixed market economy. We are also concerned with the fate of those whom such a political economy may leave behind. Such beliefs inevitably color our analyses. In particular, we are aware of the argument that "authoritarians do it better", that only a government barricaded against popular pressure can implement economic reform. Although it is plausible that **some form** of "insulation" of **some aspects** of economic policy is desirable (for example, a high degree of Central Bank independence, as guaranteed by the charter of the German Bundesbank), we reject the notion that authoritarian political systems as a whole are more effective reformers. After all, the very insulation from popular pressure which permits implementing sweeping reform also allows persisting in mistaken policies. Examples of the latter range from Chilean economic mismanagement in the early 1980s (when the unemployment rate came to exceed 30%, thanks to a highly insulated group of technocrats and policy makers maintaining a flawed macroeconomic policy) to the ghoulish disaster of the Chinese "Great Leap Forward", in which well over 10 million people perished (Edwards and Edwards, 1990; Dreze and Sen, 1989). As a **practical matter**, we plead guilty to a bias in favor of more

undoubtedly interacts with and influences the other in complex ways. Indeed, one might argue that specification of such interactions is precisely what policy analysis is all about. We first define these axes of change, and then apply them to the analysis of the political economy of structural adjustment in Egypt.

2.2 We use the orthodox definition of **economic growth**: the increase over time in real per capita output. Such growth is, of course, always quite uneven, with some sectors expanding far more rapidly than others, leading to changes in the relative economic weight of different sectors and industries. **Structural transformation** is the rubric applied to the outcome of this differential growth, such as the decline of the percentage of output and employment derived from agriculture and the increasing urbanization and educational levels of the population. By **state structures and policy** we mean the organization of the monoply of coercive means within society, the interventions into the resource allocation process which such a monopoly makes possible, and the institutions through which such intervention is carried out. We also include the mechanisms through which popular participation in governance is organized, and the legal framework for economic and political activity. Finally, by **social actors** we mean groups of people who share a certain set of property rights or who occupy a certain location within the structure of production. This definition is broad enough to include lower-ranking civil servants as well as more conventional interest groups such as private-sector exporters. Note finally that the **identification** of such social groups does not guarantee that they can, or will, engage in collective action. Our analytical framework is illustrated in FIGURE 1.

2.3 Some examples of the **interaction** of these principal variables and their use below are as follows (see FIGURE 1):

A. Government policy affects the pattern of economic growth and development. In an Egyptian context, the main issue here is how misguided economic policies have generated large foreign debts and relatively few jobs. In short, it is how past economic policies have brought the nation to its current impasse, and what policies must be adopted to move on. We discuss this in Section III below.

B. The pattern of economic development can (and in Egypt has) necessitate a policy response. This is really the "flip side" of "A": if population and labor force grow independently, if international trade obeys certain well-known economic laws, if rational economic actors respond to incentives in predictable ways **and if** economic policy is misguided, the independent process of economic development will **force its attention** onto policy makers, necessitating a shift in economic policies. This is discussed in paragraphs 3.25-3.34.

C. Past patterns of economic growth and structural transformation, influenced by government economic policies, have created certain social actors/interest groups. For example, the growth of an export-oriented sector will fairly swiftly create an interest group of private sector exporters; rapid economic growth is often associated with the rise/strengthening of the middle class, as in Thailand during the past decade. Whether these people engage in collective action or not, and what policies they favor, must be determined in each case. We seek to do this in Section V.

D. Even in a state with great "autonomy" from any social class has to pay at least some attention to non-state social actors. Certainly this is the case in Egypt: there are influential social groups, which can and do act collectively to influence government policy. We examine this issue in Section V.

E. State policies can and have **created** interest groups/social actors. Examples in Egypt range from the impact of past land reforms on the rural class structure to the creation of the vast civil service. Analyzing such processes is here part of the identification of interest groups (paragraph 5.2). Still more importantly, the current package of structural adjustment policies is likely to generate gains and losses for different social actors (paragraphs ssssss). Finally, the organizational structure of the state mediates the impact of social actors on policies by affecting their capacity for collective action. In an Egyptian context, the "corporate" structure of the state has important implications here (see Section VI).

F. Theoretically, the social structure can affect the process of economic growth and structural transformation directly. For example, a relatively high degree of inequality in asset ownership can affect the extent to which people with wealth are willing to tax themselves to finance the public good of universal literacy through compulsory public education. This aspect of the process of LDC political economy will not be stressed in this analysis.

III. THE NECESSITY OF STRUCTURAL ADJUSTMENT [2]

A. Origins: Macroimbalances and Microdistortions

3.1 On the eve of the Gulf War, Egypt had accumulated international debts of nearly $50 billion. Its debt/GNP ratio of roughly 150% was one of the highest in the world. At the core of Egypt's macroeconomic crisis are three **macroimbalances**: the gap between domestic savings and investment, imports and exports, and government revenues and spending. The first gap is illustrated in TABLE 1. The collapse of savings may be attributed to the decline of public sector savings as oil revenues dwindled and as public sector companies accumulated losses. Private savings available to the economy were held down by negative real interest rates on Egyptian pound deposits and by great uncertainty by private wealth holders as to the future direction and credibility of economic policy. The problem was not Egyptians' savings' propensity, as the response to the recent banking reform clearly demonstrates. Rather, until that reform there were few incentives for wealthy Egyptians to place their savings in the domestic banking system.

3.2 The pattern of investment was also unhelpful. Most funds went into infrastructure, which received some 45% of investment from 1982-1987, rather than into traded goods production (Handoussa, 1989). Although some infrastructural investment may have been necessary to launch export-led growth (it is difficult to do business without telephones), the relative neglect of manufacturing did little to foster exports and create jobs. Further, investment had a capital intensity bias: the incremental capital-output ratio (ICOR) rose from about 2.5 in FY 1976/81 to 6.5 in FY 1984-88 (World Bank, 1990). More recent figures are still more disturbing: seven-year moving average ICORs for the most recent years were: FY 1990, 8.1; FY 1991, 11.1, while the projected FY 1992 ICOR is a frightening 22.1! (World Bank 1991a) The average capital-output ratio rose from 2.7 (1972-82) to just under 7.0 (1982-87) (Hansen, 1991). Still worse, the capital-labor ratio rose at just under 15% **per year** during 1975-85 (Handoussa, 1989).

3.3 The weaknesses in the volume and pattern of investment contributed to the second gap, that of the current account. the gap between exports and imports of commodities and nonfactor services is shown in TABLE 2. The gap has not shown any marked tendency to decline since the early 1980s; if anything, the resource gap has widened. By 1989 the current account deficit was 7.2% of GDP and by 1991, 10.2% (World Bank, 1991a). Since roughly two-thirds of Egyptian imports are intermediate and capital goods, there is relatively little room for remedying the resource gap through reduced imports. Modest import growth resumed in 1990 and 1991. The conclusion is inescapable: **export performance must improve.**

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[2] This section is based on Richards (1991b).

3.4 Export developments during the 1980s were dominated by the decline in the value of petroleum sales, which fell from $2.9 billion in 1983 to $1.36 billion in 1987. Other traded goods failed to take up the slack created by the decline of oil. Agricultural exports continue to deteriorate, with cotton export volume in 1990 only one-third that of the early 1980s, when it had already declined by 50% in comparison with 1974. In 1987 the deficit of agricultural trade was some $2.8 billion or about one-third of the total trade deficit. Industrial exports performed only slightly better. Textiles and related products account for some 60% of such exports: these and other expanding industrial exports (e.g., alumuinum) enjoy substantial subisidies. Successful private sector perfomers such as horticultural products and rugs were simply too small to plug the trade gap.

3.5 Invisible earnings fared better. Tourism grossed over $2 billion per year on the eve of the Gulf Crisis and provided the only really bright spot of the economy in the late 1980s. Although the 1991 season was badly hit by the Gulf War, tourism quickly rebounded, and is currently enjoying a substantial boom. Workers' remittances outperformed most predictions until the Gulf Crisis. The dip in FY 1985 may have been caused by the Iraqi government's imposing severe exchange controls and by the increasingly severe real overvaluation of the Egyptian pound (See FIGURE 2). It is currently estimated that some 700,000 Egyptians were violently repatriated during the Gulf Crisis; Egyptian migration experts do not believe that these people have returned abroad (Ferghany, 1992). However, balance of payments data strongly suggest that many Egyptians have recently found jobs in Libya or Saudi Arabia: current estimates of remittances place them at a record $5 billion. Of course, those returning from Kuwait and Iraq and those going to Libya and Saudi Arabia may not be the same people.

3.6 Remittances have been very helpful, but they have not sufficed to finance the difference between imports and exports, and savings and investment. In the final analysis, Egypt, like so many middle-income countries, plugged the twin gaps by borrowing from abroad. Possible sources included private direct foreign investment, private portfolio investment (e.g., commercial bank loans), or public portfolio investment, i.e., foreign government lending to Egypt. The first type of investment was severely inhibited by the mire of bureaucratic regulations and the macro-problems enumerated above. Such deficiencies, combined with the political volatility of the region, inhibited private bank lending as well. Accordingly, Egypt relied overwhelmingly on borrowing from foreign governments. Although as usual there are conflicting estimates of debt, due to underreporting and multiple exchange rates during the last two decades, a rough estimate would be that Egypt's foreign debt climbed from about $2 billion in 1970 to about $21 billion in 1980 to just under $50 billion in early 1990. This latter figure was roughly 150% of GNP; in 1990 debt service payments consumed over 25% of exports. The situation in mid-1990

may fairly be characterized as one of crisis, in which foreign exchange for wheat imports was hard to locate and in which the GOE came perilously close to violating the Brooke Ammendment.

3.7 The twin gaps were exacerbated by the government deficit. Although its size fell somewhat at the end of the decade, the average deficit for FY 1982-1990 was 21.2%; the deficit in 1991 was some 21.9% of GDP. Revenue fell with oil receipts, while spending was inelastic downwards for the usual political reasons: blockages by vested interest groups who would lose sinecures and economic rents, and fears of popular wrath over subsidy cuts. Some 80% of government spending consists of subsidies, public sector salaries, interest on the public debt, and the military. The last two are sacrosanct, which forces all adjustment on the spending side onto the first two.

3.8 As new foreign lending dried up in the latter half of the 1980s, the deficit was increasingly financed by the banking system. Inflation accordingly reached roughly 25%, and had the usual baleful results: further distortion of price signals, sharply negative real interest rates which exacerbated the savings-investment gap, and (thanks to fixed nominal rates) a steadily increasing overvaluation of the exchange rate (See FIGURE 2). Such under-pricing of increasingly scarce foreign exchange discouraged the production of traded goods, and favored imports over exports; in short, it greatly exacerbated the trade gap.

3.9 The decision of the GOE to reduce the government wage bill by freezing nominal wages and new hires rather than by lay-offs has had very serious consequences for governmental effectiveness. Real wages in the public sector in 1989 were only 55% of their 1973 level; official incomes of lower level public servants fall below the poverty line (World Bank, 1990b). As the old joke in Communist Poland had it, "We pretend to work, and they pretend to pay us". It is unsurprising that the quality of governance (e.g., implementation) was impaired as public servants necessarily devoted as little time as possible to their public duties while scambling to eke out a living on the margins of the private sector ("moonlighting").

3.10 Microeconomic distortions reinforced these macroimbalances. Egyptian price distortions are internationally notorious. The divergences between private and social rates of return in industry have been little short of astonishing. In the second half of the 1980s, price reforms began to be implemented in agriculture, but cotton remains underpriced. Prices in Egypt have borne little relation to social scarcities.

3.11 Price distortions have interacted synergistically with the regulatory environment to create a producer's nightmare. As as example, consider the increase in capital intensity. On the one hand, the relative price of labor to capital rose as labor

emigration pushed up wages, while accelerating inflation and financial regulations created strongly negative real interest rates. Supervisory personnel, so crucial to successful labor intensive production techniques, were particularly scarce during the migration boom. At the same time laws which made it almost impossible to fire workers coverted labor, every textbook's example of variable costs, into overhead. This is but one example of the regulatory environment of which it has been aptly said, "That which is not explicitly allowed is forbidden" (US Embassy, 1990).

B. The Magnitude of the Challenges of the 1990s

(1) Jobs

3.12 The seriousness of the situation can only be appreciated when we consider the **magnitude of the challenges** facing the Egyptian economy in the medium run. One of the most potentially destabilizing problems is that of **employment creation.** Egypt needs to create a minimum of **six million** jobs during the 1990s, simply to keep up with additions to the labor force. If current levels of unemployment are to be reduced significantly, another 1.5 to 2 million jobs must be found. Since the current labor force is approximately 14-15 million, the implications are stark: **during the 1990s, roughly 40% more jobs must be created simply to prevent unemployment from rising; to reduce unemployment significantly, the number of jobs must rise by about 50%.** Still more daunting, hundreds of thousands of employees in the public sector are redundant. Since heightened efficiency of governance requires their dismissal (paragraph 3.9), yet more jobs will have to be created to absorb them. Further, all of these calculations assume that the current very low rates of women's labor force participation (about 12%) [3] remain unchanged. Increasing women's market activities typically raises the opportunity cost of children and contributes to reduced fertility rates. These important long-run beneficial effects will be foregone unless even more jobs can be created.

3.13 It is important to realize that these simple calculations focus on the need to create jobs **at the same real wage.** To reduce poverty, real wages need to rise, which means a still more rapid outward shift in the demand for labor. Poverty is, of course, a very serious problem in Egypt. Unfortunately, the last national Household Budget Survery to have had its results published was conducted in 1981-82. Predictably, different analysts give alternative figures for the number of households in poverty. A few generalizations are still possible. Between 1974-75 and 1981-82,

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[3] There are serious problems of undercounting women's work activities in agriculture; the official 12% figure is an gross underestimate. However, the beneficial consequences of women's employment for population growth are probably limited to urban work.

rural poverty certainly, and urban poverty possibly, declined (World Bank, 1990b; Korayem, 1987). Poverty probably began to increase after the end of the oil boom in the mid-1980s. Not only was the rate of per capita income growth negative in several years in the late 1980s, but data on real agricultural wages shows a decline of over 40% from 1985 to 1990 (see FIGURE 3). Since most farm workers are close substitutes for unskilled urban laborers, it is likely that similar trends have prevailed in the cities. And we have already seen (paragraph 3.9) that real wages of civil servants have plummetted. Only a massive surge of job creation can hope to dent this gnawing social and human problem. **The challenge of employment creation is arguably the greatest socio-political challenge facing the GOE in the 1990s.**

3.14 This looming crisis was predictable at least 15 years ago, which is when today's entrants to the labor force were born. But since the challenge lay in the future, little was done. Instead, government employment swelled, spawning artificial jobs at ever lower levels of real remuneration, sacrificing governmental effectiveness at the altar of tired Nasserist formulas for distributive justice and social stability. Over half (55%) of all jobs created from 1976-1986 were in the public sector (Handoussa, 1989). This was not a sustainable employment strategy, as became evident by the mid 1980s. The other source of employment creation down to the crisis of mid-decade was emigration to the Gulf States, especially to Iraq. Since these jobs were either dependent on the oil boom or upon the course of war, they, too, could not continue to expand. The old sources of employment creation cannot be relied upon any longer. Compounding the employment problem is the (apparent) fact that the agricultural sector, which used to act as a "shock absorber", releasing labor during booms and absorbing labor during recessions, no longer can play this role, thanks to mechanization and the limits of labor absorption on a severly limited land base. **Structural adjustment and the shift to a strategy of labor-intensive manufacturing for export is the only way out of the employment crisis.** [4]

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[4] This is not to deny that rising domestic incomes (e.g., of farmers) might not also provide an important domestic source of demand for labor intensive products and therefore for labor. It is simply to assert that such an export strategy is a necessary component of any job creation strategy. And of course, only increased exports can generate the foreign exchange which is vital to the country's future welfare.

(2) Food

3.15 Egypt must also export in order to eat. The growth of the demand for food depends upon the rate of population growth, the growth of income per capita and the income elasticity of the demand for food. [5] During the 1980s Egypt "added a Cairo" to its population: about 12 million additional mouths to feed. By the year 2000 there will be at least 65 million Egyptions, or "yet another Cairo" to feed. Because of very slow per capita income growth in the late 1980s, the demand for food grew much less rapidly during the 1980s than during the 1970s. Should income growth resume, however, the rate of growth of the demand for food will surge well above its current pace of about 2.5% per year.

3.16 Domestic farm supply response was far better during the 1980s than in the 1970s. From 1979 to 1990, Egyptian agricultural output grew at 4.1% per year, while food production rose by 6.8% per year. [6] Even the growth rate of cereal production (3.0%) exceeded that of population. Agricultural and food production per capita in 1990 were some 13% and 23%, respectively, above that of 1979-81 (FAO, 1990).

3.17 This is an impressive performance, and is partly explained by reform of price policies and by the pay-off from foreign technical assistance (e.g., plant breeding). Unfortunately, there is no cause for complacency. Consider the fact that, despite the impressive expansion of wheat production--which more than doubled from 1986 to 1990--the cereal self-sufficiency ratio remained essentially unchanged during the decade. Continuiing population increase, revived income growth, and the water constraint will doom any plans for national food self-sufficiency. **Egypt's only road to food security lied through diversified, competitive exports of farm and factory products.**

(3) Human Resources

3.18 Any viable strategy of export-led growth (or indeed any other growth strategy) will require upgrading the quality of the one resource which Egypt has in abundance, human beings. One of the most serious deficiencies of Egyptian public policy during the past generation has been the failure to provide all Egyptians with basic literacy. Only in the late 1980s were all, or nearly all, Egyptian

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[5] Formally, $D = n + e*y$, where D = rate of growth of demand, n = rate of population growth, y = rate of growth of per capita income, and e = income elasticity of demand.

[6] OLS growth rates calculated from data in **FAO Production Yearbooks**. Continued price disincentives for cotton production largely explain the the differential between food and agricultrual production growth rates.

boys enrolled in primary school; nearly one-fourth of Egyptian girls are still not enrolled. Meanwhile, only roughly half of all adult Egyptians are literate.

3.19 This legacy will haunt Egypt in the 1990s. The economics Nobel Prize winner Theordore Schultz (1971) aptly characterized human capital as the "ability to deal with disequilibria", to respond to shifting technological and market conditions. If Egypt must export in order to employ and feed her citizens, she must be able to compete in the international market place. Egyptians must produce quality articles and market them successfully. They must be aware of new technologies, and utilize them effectively. An illiterate workforce is poor material out of which to craft an export-led growth strategy.

3.20 What sort of competition does Egypt face? If Egypt must produce labor-intensive comoodities, it must, accordingly, compete with other low wage countries. And what do their literacy rates look like? Consider: in 1985, when roughly 56% of adult Egyptians were illiterate, corresponding figures for some Asian countries were: Thailand--9%; Vietnam--10%; Sri Lanka--13%; China--31%; Malaysia--27%; and Indonesia--26% (World Bank, 1991b). These countries (not Taiwan or ROK, who are already far ahead) are the competition in labor-intensive manufactures in the 1990s. Closer to the Mediterranean, the Eastern European countries, currently undergoing radical structural adjustment and reform, have typically universal literacy and a high level of skills (by LDC standards). **The competition during the 1990s will be very intense, and past underinvestment in human capital places Egypt at a disadvantage.**

3.21 It should be noted that Egypt's policy makers have some real achievements to their credit in the area of human capital development during the 1980s. Infant mortality rates fell from 120 per 1000 in 1980 to 83 in 1989 and primary school enrollments rose swiftly. The problem is two-fold: 1) the legacy of decades of past underinvestment, and 2) the current conditions of budgetary stringency which magnify the difficulties of raising the quality of education at all levels. During the 1980s, for example, education's share of total government spending remained roughly constant; however, this hopeful statistic conceals the ever-rising share of teachers' salaries at the expense of materials, books, libraries, labs, etc. Only if students can learn to think for themselves can education truly produce "the ability to deal with disequilibria", and only if students have some materials other than their teachers' inputs can they learn to think for themselves. The conclusion is therefore that **in a context of austerity, more funds must be found for education. This implies still deeper cuts elsewhere, most probably in the inefficient, loss-making public sector enterprises.** After all, why should Egypt lose money on chocolate factories while neglecting to educate its children??

(4) Water

3.22 Egypt's total water supply for the coming decade is essentially fixed at 55-56 billion cubic meters per year. Whatever developments may occur with improved storage and sharing of water among Nile riparian states, they are unlikely to have much positive effect for at least ten years. Indeed, it is easy to foresee negative developments, as, for example, increased Ethiopian utilization of Blue Nile water resources or greatly expanded Sudanese irrigation projects. Prudence dictates assuming a fixed supply of water in Egypt for the foreseeable future.

3.23 It follows that more sophisticated demand management will be essential. This is overwhelmingly the responsibility of the agricultural sector, since about 85% of all Egyptian water is used in farming. The impact of ongoing agricultural price reforms, a critical component of structural adjustment, may have perverse effects on water use unless water is priced by increasing the production of water-intensive crops. Some output price reforms will help, e.g., removing the protection afforded to sugar-cane and raising fuel prices to international levels. On the other hand, although cotton uses far less water than rice or sugar cane, it too is relatively water-using; accordingly, raising cotton prices should increase the demand for water. Rationalization of output prices as a whole could raise the demand for irrigation water, and thereby jeopardize the long-run sustainability of the agricultural sector.

3.24 There is, of course, a remedy: charge a price for water. There are, however, serious technical, cultural, legal, and social barriers to explicit water pricing in the Old Lands. Some social substitute, which "micmics" pricing, at least to the level of a small group, needs to be found. The current water allocation system is essentially "supply driven": the central government decides how much water goes where and when. Greater efficiency in water use implies shifting to a more "demand driven" system in which farmers' actual needs have a greater influence over allocations. This will require not merely a greatly improved and more sophisticated central delivery system (and therefore more investment) but also the enhanced performance of water users' associations and other mechanisms for collective action at the local level. Such action must be coordinated with, and have influence upon, the decisions of the central government. Greatly improved governance and expanded participation will be necessary if Egypt is to meet the goal of greater social efficiency in water use.

C. The Reform Program of 1991

3.25 The short, medium, and long-run challenges to the Egyptian economy all point toward the same conclusion: a process of export-led growth must be launched. The role of the private sector must greatly expand, the effectiveness of the government in providing public goods (e.g., irrigation maintenance and education) must markedly improve, and prices must reflect social scarcities. Egypt has recently signed Stabilization and Structural Adjustment Agreements with the IMF and World Bank. These programs provide some, but not all, of what will be required if the legacies of the past are to be overcome so that the challenges of the 1990s may be met.

3.26 It is clear enough what needs to be done. The problems of the Egyptian economy were the outcome of a strategy of state-led, import-substituting industrialization. The old strategy manifestly cannot meet the challenges of the coming decade. It is evident that Egypt must stimulate savings, reduce consumption, increase exports, and heighten efficiency while maintaining a minimual social safety net and increasing investment in human capital. The obvious strategy, given Egypt's paucity of natural resources and its abundant labor, is that of manufactured export-led growth, with an expanded role for the private sector.

3.27 Implementing such a strategy implies price liberalization, public sector enterprise reform, including extensive privatization, and dramatically improved macromanagement. Economists agree that the needed reforms are a "package", a set of mutually reinforcing, internally consistent combination of policies. Jeffrey Sachs has eloquently made the case for "reform as package":

> ...refcrm is a seamless web. Piecemeal changes cannot work, since each part of the overall reform has a role in strengthening the other parts. Financial control of the public sector requires active competition. That in turn depends on free trade and free access to foreign exchange. Currency convertibility at a stable rate in turn requires restrictive monetary and fiscal policies. So macro- and microeconomic reforms go hand in hand (Sachs, 1990, p. 23).

3.28 On the eve of the Gulf Crisis of 1990, there was agreement that a coherent Egyptian reform would require cuts in the budget deficit by targeting food subsidies, eliminating energy and all other producer subsidies, and reducing the number of employees in the public sector. Such steps would lower inflation, thereby raising real interest rates and lessening the difficulties of maintaining a realistic exchange rate. The latter should be unified, so that all remaining subsidies became "transparent" or explicit. The currency was to be made convertible, which, if coupled with raised nominal interest rates and reduced inflation,

would induce Egyptians who hold foreign exchange to convert their wealth to LE deposits. Competition needed to be stimulated by unifying and lowering tariff rates and by reducing quantitative restrictions. Price distortions should be eliminated as quickly as possible, as the regulatory environment must be radically reformed to promote the growth of private manufacturing. Only if costs are cut will price decontrol not rekindle inflation. Finally, many believed that even with the best policy reform package, success would be impossible without a substantial reduction in Egyptian debt.

3.29 Before the Gulf War the GOE temporized, failing to confront the domestic lobbies who stood to lose from reform. Although they signed a stand-by agreement with the IMF in May, 1987, they had failed to meet their agreed targets within six months. There followed several years of complicated negotiations, in which the GOE used its strategic importance to extract favors from the US, and to induce the US to lobby the IMF to exercise great restraint in dealing with Egypt. While this dance was performed, the problems mounted. As noted earlier, the patience of all parties was running out, as Egyptian policy makers appeared to take an ever-shorter perspective on the problem.

3.30 Enter the **deus ex machina**, in the unsavory guise of Saddam Hussein. The Gulf Crisis and War created an entirely new situation, and allowed the GOE to obtain a very favorable deal. The essence was simple: Egypt would adopt a reasonably conventional stabilization and structural adjustment package, which would cover most of the policy changes outlined in paragraph 3.28, in exchange for massive debt relief. Such a bargain was attractive both economically and politically. Economically, the reduction of up to $20 billion of debt cut yearly interest payments by $2 billion for the next ten years. Politically, the deal was easier to sell domestically, since the government could plausibly argue that its creditors were shouldering part of the burden of past mistakes. Creditors have hoped to avoid a re-run of 1987 by making debt relief heavily conditional, with reforms "front-loaded", that is, required early in the process.

3.31 Accordingly, in May 1991 agreements with the Fund and the Bank were signed. The program contains six fundamental aspects.[7]

1) The stabilization program contains the usual **macroeconomic measures**. In particular, the program mandated a banking reform, which made the Egyptian Pound a convertible currency, created new financial instruments (in effect, "Treasury Bills" issued by the Central Bank) and raised nominal interest rates. Macroeconomic targets which are monitored are net foreign assets, net domestic assets (government + state-owned enterprises + private sector) and

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[7] The sketch of the programs follows that of El-Serafy (1992).

public sector borrowing (government + state-owned enterprises).

2) The Structural Adjustment Loan (SAL) provided for a **privatization program** covering sale of government assets and setting up legal and institutional mechanisms for a better management of the public share in corporations. The Central Bank's regulatory functions are also to be strengthened.

3) **Price liberalization** measures include raising the farm-gate price of cotton in steps to be equal to the world price in 1995, except for a small export tax on extra-long staple cotton, in which market Egypt has some market power. Cotton marketing and trade are to be liberalized, subsidies on fertilizers and pesticides, halved in FY 1991, are to be completely liberalized by FY 1993. Energy prices are to rise to international levels by 1995, rail tariffs are to be raised, and price guidelines for intercity bus transport are to be removed.

4) **Trade liberalization** will be achieved by cutting import bans and licensing requirements, eliminating import deposits, lowering tariffs to between 10% and 80%, and reducing the variability of tariffs. Export restrictions are to be reduced and then eliminated, and the drawback system is to be extended to indirect exports.

5) **Investment licensing** is to be abolished by December, 1993. Trade in fertilizer and cement is to be privatized, and labor laws are to be reformed so that private companies can more easily lay-off or fire workers.

6) A **Social Fund**, with a capital of some $600 million largely provided by European donors, is to reinforce the social safety net by: a) providing labor-intensive public works to generate employment, b) offering loans to small and microenterprises, and c) retraining public sector workers.

3.32 Where are we now, one year after this program was agreed upon? The first component of reform, macroeconomic stabilization, is doing very well. Debt relief and banking reform are the keys here, although there are also other factors. Some 30% of the present value of the debt has already been forgiven, while another 20% will be if the reforms are fully implemented. Tourism is booming, and remittances are very strong. Thanks to the banking reform package, Egyptians have been turning dollar holdings into Egyptian pounds, generating a current account surplus of some $3.5 billion. International reserves are accumulating. Price reforms in the agricultural sector are also largely proceeding according to plan, and the IMF believes that the government has increased its real revenue by replacing indirect taxation with sales taxes.

3.33 The bad news is that reforms have so far been largely limited to the financial sector; the real economy continues to lag. Indeed, the very success of the banking reform has reduced pressure on the exchange rate, which has probably led to real overvaluation. The growth of non-traditional exports has slowed, as local costs have risen and the exchange rate stayed up. The banking system is awash with cash, but the public's holdings are mainly in very short term (1 - 3 month) instruments. Any shock to confidence could lead to rapid conversion of Pounds to dollars, precipitating a sharp, sudden devaluation.

3.34 More fundamentally, the problem is that the short-term liquid savings are not being translated into investment in the real economy. **Only such investment can generate sustainable employment growth.** There is consensus among observers that reforms of the real economy are proceeding sluggishly. In particular, there has been little progress on privatization. It is true that the GOE has agreed to Basle Standards for asset valuation, and has formed public holding companies to increase the autonomy of public enterprise managers. However, (historically speaking) high interest rates and especially, the general lack of public confidence in the stability of a "level playing field" for private and public enterprise have so far stymied private investment in traded goods production. In other words, one year and one-half million new job seekers after adopting the reform package, little has been done to correct the fundamental weakness of the Egyptian economy, **the absence of private investment in labor-intensive traded goods production.** Structural adjustment, as opposed to Stabilization, has really only barely begun. How can Egypt accelerate this vital process? We must begin by analyzing the state structures or the political system within which reforms are formulated, implemented, and defended.

IV. STATE STRUCTURES AND POLITICAL PROCESSES

A. The Structure of the Presidential System

4.1 The Egyptian political system concentrates power, responsibility and initiative in the office of the Presidency. The activist presidency in turn demobilizes the workers and the peasants, restricts middle class political activity to a tightly controlled public arena, and effectively incorporates the upper levels of the army and the police. Incorporation of the bodies that control the use of force and the generalized provision of material incentives for government loyalty provide an official system of cross-cutting cleavages that transcend class or ideological interests. At the same time, the role of repression should not be underestimated as a means of enforcing this integration.

4.2 Egyptian social scientists, working in a variety of university and research centers, have produced detailed characterizations of the workings of their government. Because they are themselves entangled with official power on the terrain of their own activities, Egyptian scholars offer a close-up view of a powerful, purposeful Egyptian presidency as it appears to those forced to engage it in political contests. Using these sources, supplemented by the traditional Western treatments, this study of official politics in Egypt focuses attention on the resources of power available to the Presidency as an institutional actor rather than on general goals imputed to a given president. From such an angle of vision, the Presidency emerges as a highly complex structure, disposing a large staff and diversified instruments to administer all other key players on the political field.

4.3 Presidential power derives in the first instance from the relationship to the armed forces and the police and is exercised through domination of the government bureaucracy. Even though the armed forces and the police are not parts of the executive according to the constitution, they are totally integrated into and dependent on the executive authority. The government favors the army and the police as corporate bodies, assuring them a large and growing share of the pie and an expanding sphere of social and economic activity. Important Egyptian families, regardless of ideological orientation or economic interest, have members in both institutions; both the army and the police also provide important avenues of social mobility. Because the upper ranks are satisfied with the system so long as they themselves prosper, because they can offer material incentives to their men, and because the institutions themselves mirror rather than conflict with the dominant social order, the army and the police have become the essential pillars of the government.

4.4 Essential strategic connections place the Presidency at the very heart of the political system. Neither the judicial nor the legislative branches of government, nor any of the legally organized opposition political or social forces alter this fundamental reality of executive primacy resting on control of the military and the police. The Egyptian president possesses an array of political, legal and constitutional instruments that assure clear dominance over all legislative bodies from the local to the national level. The president asserts direct legal controls over key political functions such as elections, nominations, restrictions on the exercise of political rights, and the establishment of parties that compete for seats in local or regional government and in parliament. Exercising these powers to control entry into the political arena, the President can guarantee that the potentially most powerful opposition forces such as the Muslim Brothers or, until this year, the Nasserists as well have at most a quasi-legal presence in local government and in parliament where political forces loyal to the government leadership dominate. The weak parliamentary opposition is tolerated in part because its presence lends surface plausibility to the official claim that Egypt is developing a parliamentary democracy, in part because the President can ignore the opposition with impunity. Constitutional article 127 makes clear the responsibility of the cabinet to the President rather than parliament; according to this provision, the prime minister is accountable to parliament only with express presidential approval. In addition, article 115 provides that parliament has no independent power to amend the budget. Any disagreements between the executive and the legislature can be settled by referenda which only the President can call.

4.5 Executive instruments for control over the judiciary have traditionally been even more impressive, although, as will be pointed out later, the judiciary has asserted itself against the executive with growing effect in the last few years. Leaving these most recent developments aside for the moment, note that the constitutional sanction for the executive strong hand lies in articles 170 and 173 which give the President, as the first representative of the people, the general responsibility to organize the affairs of justice. The minister of justice and minister of the interior have broad power to supervise judiciary processes, while the President may also establish special courts, issue decrees having the force of law, and make judicial appointments.

4.6 The independence of the judiciary in Egypt is sharply restricted by the fact that judges rule according to the laws issued by the legislature that is, in turn, dominated by the President's party, the National Democratic Party (NDP). The presidential decree is also a powerful instrument for forming exceptional courts and making judicial appointments, giving the judiciary the appearance at times of a public utility with its personnel viewed as public employees.

4.7 Meanwhile, the highest courts are prevented by Law 47 of 1972 from exercising any supervision or judicial challenge over a whole array of executive functions that are designated as "security functions." These specially shielded executive authorities refer to measures related to the government relationship with the legislature, including any regulations on elections; governmental practices in the field of legislation, such as proposing laws; tasks concerning international and diplomatic affairs; measures concerning the conclusion of agreements, declarations of war and truces; and certain tasks related to state security, especially during exceptional conditions, such as declaring emergency laws or calling for referenda.

4.8 While exploiting the constitutional weakness of the legislative and judicial branches, the Egyptian President has also relied on emergency powers that exceed even those allowed by the legal, political, and constitutional order. The President periodically calls on parliament to extend the emergency laws, with the compliant parliament acceding to his request despite over the minority opposition's objections. On occasion, additional laws are passed amplifying presidential powers even further, such as those granting the President broad discretionary powers in military industry and finance, or such as the recently passed draconian anti-terrorism statute.

4.9 Over the last ten years two key practices have provided critical mechanisms for the actual deployment of these sweeping presidential powers: the presidential political or advisory group and presidential decrees. The idea of creating an advisory agency for the President first surfaced in 1980; on March 19, 1981 it was constituted by presidential decree of 58 experts from the different academic and technical specializations. However, this official body did not last; President Mubarak cancelled the advisory group and relied instead on his office staff, supplemented by meeting with important governmental figures. Although these meetings were never fully routinized, they eventually occurred with enough frequency to win the title "President's political group" from the press. The members of the group and the timing of the meetings were unstable, though one or more members of the President's office always attended. The political group aimed to rationalize presidential decision-making, to coordinate practical moves of the various state bodies necessitated by a presidential decision, and generally to tighten the hold of the President over the state apparatus.

4.10 The second practical tool for asserting executive prerogatives has been the President's discretionary right to conclude agreements and issue decrees having the force of laws. The opposition challenged the sweeping character of the presidential right to make agreements, especially military agreements related to state security, because it gave the

Presidency the right of disposal of so large a percentage of the state budget; the government majority, however, has assured a regular vote of renewal. In a six month period the President has issued as many as 250-300 such decrees. The majority deal with executive, judicial, and military matters; however, on occasion they concern important organizations of civil society, such as universities and university faculty clubs, that enjoyed nominal administrative and legal independence.

4.11 This impressive grid of Presidential power did not emerge fullblown from any one constitutitve act but developed gradually over the last four decades. It did so in response to historical and social forces larger than its own simple perpetuation. We next present a brief review of the historical evolution of Presidential rule.

B. The Evolution of Presidential Rule

4.12 Gamal Abdul Nasser laid the foundations for the essential structures of the Egyptian presidency, described above, during his eighteen year rule from 1952-1970. Mass acquiescence in such extreme concentration of power in the Nasserist Presidency was closely tied to the successes of an impressive national project, registered for the most part in the years from 1954-1966. In a bid to buttress mass support in the dangerous aftermath of the June 1967 defeat, Nasser, the architect of Egypt's presidential system of rule, also put liberalization on the national political agenda.

4.13 Popular support for Nasser's authoritarian rule is too frequently attributed to a catch-all "charisma." The term masks more than it reveals, especially about the sources of Nasser's appeal and the controversy that still surrounds his role. In the eyes of a trusted Nasserist minister, "the Nasser revolution cohered around the ideas and principles of pan-Arabism, positive neutrality, and the social revolution." Nasser, as his ex-minister put it, "took the side of the poor, just as he took the side of development, democracy, Arab unity, and non-alignment." Admirers point to such Nasserist "monuments" as independence from the British, the High Dam, public sector industrialization, land reform, and greatly enhanced social mobility; they believe that even in the changed conditions after Nasser's death, Nasserist "principles will undoubtedly take new forms; yet, the ideas are still alive and they still move people."

4.14 Nasser's critics have emphasized instead his authoritarianism and bitter defeats. Anwar al-Sadat, his successor as president, charged that Nasser's vaunted social revolution degenerated into "a huge, dark, and terrible pit, inspiring fear and hatred" and that Nasser's relentless hostility towards Israel had given Egypt only "years of defeat and pain," undermining prospects of achieving peace and prosperity while accomplishing little to realize Arab goals.

4.15 Debate about the ultimate historical judgement rule does not preclude identification of key turning points that both supporters and detractors accept as decisive. For purposes of this study, the most important such turning point came in the mid-sixties when the Nasserist regime lost momentum. The quintessential Nasserist period came in the decade from 1956 to 1967, beginning with the victory at Suez. It ended with the defeat of June 1967.

4.16 The good years were impressive, indeed. Possessed of new political will personified by Gamal Abdul Nasser, Egypt suddenly took flight, or so it seemed. The slogans of socialist revolution, pan-Arabism, and positive neutrality defined the new sense of direction and purpose. Nasser's first decade was an era of "politics in command." Nasser's politics, that is, for he cleared the political field. The old parties were disbanded. Potential political challengers, the Muslim Brothers in particular, were relentlessly persecuted. At the same time, the high drama of the slaying of an old order and the building of the new rallied important new social resources. Mass enthusiasms, not all manufactured from above, gave the regime an air of invincibility. And things did happen. Nasser strived to realize a socialism for Egypt that had industrialization and improvement of mass welfare at its heart. The long range goal was the creation of a heavy industrial base through an import-substitution strategy. Before the predictable foreign exchange crisis crippled growth, 'Aziz Sidqi, Nasser's talented minister of industry, presided over a remarkable expansion of the nationalized public sector. (The efficiency of these industries is another matter!) Unfortunately, advances in agriculture did not match the industrial gains registered in the decade after Suez, which were diluted further by a rapidly expanding population. Still, Nasser did create the public sector and improvements in health and education reached even the countryside in limited ways. The issue of rural transformation was put on the national agenda.

4.17 The defeat at Israel's hands in 1967 killed the momentum, already decelerating from the underlying contradictions of import-substituting industrialization. After the debacle of June, 1967, no further social gains were registered. The shell remained, thanks to the massive demonstrations, that coaxed Nasser into remaining in power. The flaws of the regime, notably new forms of corruption made possible by state ownership, an inability to create sound political institutions, and terrible violations of human rights, received devastating attention. On a variety of fronts, notably, political reform and the continuing confrontation with Israel, the regime managed some final halting steps. Most important for purposes of this study was the announcement of the March Program of political reform, calling for a "democratization"of the political system, focused on a rejuvenation of the ruling Arab Socialist Union Party that would make genuine mass participation possible.

4.18 Anwar Sadat's constitutional assumption of power on Nasser's death in 1970 allowed a smooth continuation of the transition already underway. At first, the old Nasserist themes were still heard. But, if at first only in whispers, there were also hints of a new orientation. Sadat's full-blown "political contract" promised Egyptians peace, democracy, and prosperity that would come by stopping the continuous war with Israel and by allying with the West, particularly the United States. This grand national strategy, Sadat argued, necessitated a free presidential hand in foreign policy, backed by the preservation of the ultimate powers of the authoritarian Presidency. However, Sadat did launch a political opening that called for some new self-restraints on the actual exercise of presidential power and a serious revival of civil society that had withered but not been destroyed in the Nasser years.

4.19 Sadat gave the Nasser's call for political reform a new content when, under the banner of de-Nasserization, he began the process of courting and reestablishing the dispossessed middle classes with such slogans as "the rule of law" and "a state of institutions." Sadat emphasized individual and property rights but also launched a limited multi-party experiment that would add to his middle class support. Giving his political move a characteristic moral tone, the President also used Islamist rhetoric and then the Muslim Brother cadres released from the jails to contain the left.

4.20 There were broad hints in official speeches of a new attitude toward Israel. They evoked no response from a Jewish state still preoccupied with the digestion of the territories won in 1967 and an America apparently enthralled with Israeli military power. Electric shocks would be required to get the world's attention and Sadat was prepared to administer them.

4.21 The October War of 1973, fought in effective alliance with Syria and making use of the oil weapon, did the trick. Sadat understood early on that superpower detente would eventuate in American dominance. In his view, if Egypt were to survive let alone develop, it had no choice but to realign itself with the West. In the October War the Egyptians and their allies fought just well enough to give Sadat the political leverage he needed at home to make his peace with Israel. In a series of political happenings geared to the media age, the world watched Sadat fly to Jerusalem, negotiate at Camp David, embrace Carter and Begin in the Rose Garden, and sign a peace treaty with the Jewish state. At home he launched in earnest the Open Door policy. Economic liberalization, the complement to his political opening, would cement the relationship to the United States and guarantee Egypt its future in the last half of the twentieth century. By the mid-seventies nearly all the key Nasserist policies were reversed or under attack. The age of political dreams was over; Egypt had

entered that period of "economics in command" that continues to hold sway.

4.22 Many Egyptians, especially the upper classes, welcomed Sadat's economic liberalization, his relaxation of Nasserist authoritarianism, and his achievement of peace with Israel. However, by the late 1970's political liberalization proved no substitute for real economic progress and domestic discontent mounted. When the government cut back state subsidies in 1977, riots swept Egyptian cities, reflecting popular anger at the new rich and their foreign-influenced lifestyle, while so many Egyptians had barely enough to eat.

4.23 Sadat's peace agreement with Israel carried with it the promise of American-backed prosperity. But the prosperity never came, and the treaty became increasingly a liability. His critics accused him of betraying the Palestinians and of gaining little substance in return. Sadat responded to these pressures heavier repression, effectively reversing the political liberalization process. His political moves became more and more chaotic and confused. Throughout the Arab world he was an outcast. In the West, his prestige as a Nobel laureate obscured these difficulties. The illusion was shattered on October 6, 1981 when members of an Islamist radical cell in the army assassinated the president while he was reviewing a military parade.

4.24 President Sadat's assassination, coming in the midst of so much confusion, hardly raised a ripple. The Mubarak era represented continuity on all essential elements, including the Sadatist political contract. It was only in the period after 1985 that one could begin to detect such distinctive marking of a Mubarak era as the important improvements in relations with the Arab world, the long term freezing of the peace with Israel, and, most important of all, a deepening of the political liberalization that Sadat's last year's had jeopardized. The expanded role of civil institutions, notably the judiciary, the media, and the professional associations, seems to be gradually redefining the existing political contract. The assertions of the judiciary, in particular, point to the slow emergence of de-facto limits on executive power in an overall climate of improved legality and constitutionality. The outlines are appearing increasingly clear of an historic new political contract for Egypt that would join a presidency with its legitimacy resting squarely on legality in a partnership with a civil society, having a generous arena of public action and a share by right in making and bearing responsibility for national public policy. Serious obstacles remain and reversals may yet wipe out these gains; but this possibility is now clearly on the Egyptian national agenda.

4.25 A controlled political pluralism and at times vibrant interest group activity is now a quite ordinary fact of political life in Mubarak's Egypt. For the propertied and professional

classes, the public arena provides varied means for active participation. The press, both official and opposition, boasts an impressive range of opinion. And, as many official taboos have fallen, the press, especially the opposition press, has become livelier and more engaging to read. Cabinet members, including the Prime Minister, can be criticized and even caricatured; political figures are routinely savaged. People now have an expanded choice of political parties, including a recently approved Nasserist party, that operate openly, although not without well grounded complaints about the fairness of elections and incidents of official harassment.

4.26 Parliament, despite domination by the ruling party, does present itself as a national arena, although its most important function may well be the articulation of middle class interests. Meanwhile, the judiciary has made perhaps the most important assertions, aimed at curbing arbitrary authority. The courts in the last several years have taken a series of measures that have strengthened their own independence and enhanced respect for constitutional rights and procedures generally. In a series of important moves, the courts overturned a ban on the Wafd party, the 1984 election law because it did not allow independents to stand for election, and a Sadat decree issued outside parliamentary channels. In 1987 a well publicized trial detailed police excesses in the treatment of Islamist activist, clearly backing the rights of individuals against the state. In 1990 the Supreme Constitutional Court overturned the electoral law because of the discrimination against independents and ordered the People's Assembly elected under that law dissolved.

4.27 How do the persistent realities of presidential power and new developments in political liberation affect the policy-making environment? Precisely because of the impressive character of the recent gains of Egypt's political opening, it is especially important to have a sharp sense of how underlying political continuities interact with these more recent and more dramatic changes. Standing back and putting the matter in stark terms, the present policy environment remains one of presidential initiative and decisive decision-making, mass demobilization, middle class containment within a public arena of limited clout on the major national issues and virtually no influence at all on foreign policy decision-making. In this environment the Presidency and official political channels function preemptively by taking the most important decisions by executive decree and then using official structures to mobilize support for them. Confronted by these presidential assertions, the institutions of civil society now have the option of applause or criticism (without yet having much experience of the criticism carrying great weight). The mass of citizenry, as always, remain mere spectators.

4.28 To win support or at least tolerance of painful and unpopular economic reforms, President Mubarak will rely on the

dominant alliance of senior bureaucrats, army officers, businessmen, and the rural notability. This support will be channelled through official structures, notably the NDP with its dominace of parliament and the Egyptian Confederation of Labor and the Agricultural Cooperative Movement that can mobilize the depoliticized majorities of the midle class, laborers, and farmers. However, this appears to be essentially the coalition for "muddling through". Serious effort at economic restructureing will requiree that these political resources be supplemented, for reasons which we now discuss in more detail.

V. POLITICAL PROBLEMS OF STRUCTURAL ADJUSTMENT: GENERAL THEMES

A. The Conflicting Logics of Economics and Politics

5.1 One general difficulty with implementing structural adjustment programs anywhere is the conflicting logics of economics and politics. As argued above (paragraphs 3.27), economics strongly suggests that viable economic reform is a "package", a mutually reinforcing set of policy changes, any one of which makes little sense if taken in isolation from the others. Unfortunately, precisely such a "bundling" of policy changes is anathema to politicians, who often perceive economists' prescriptions for economic reform as a recipe for political suicide. The very interrelatedness and internal coherence of a well-designed economic reform package often runs afoul of the political axiom, "Do not hurt everyone at once!" (Waterbury, 1989) Politicians fear that at a stage of pain before gain and especially pain associated with foreign pressure, vocal opponents of economic reform might capture the political field, stimulate mass or student eruptions, and generally try to undermine the reform process. Defending reform will be made difficult if significant former elements of the ruling coalition have reduced their support of the government, thanks to their having incurred losses from structural adjustment. Politicians need to maintain a ruling coalition, and somehow to placate their opposition. Both tasks are greatly complicated by structural adjustment.

5.2 Structural adjustment necessarily hurts most people in the short run. Recall (paragraphs 3.1-3.9) that structural adjustment was necessary because the country lived beyond its means: investing more than it saved, buying from abroad more than it sold to foreigners, and consuming more than it produced. It follows that structural adjustment, with its short-run recessionary macro-package, must hurt more people than it will help in the short run. The more coherent and thorough-going the economic reform package, the larger the number of potential opponents to the policy. Economic and political logics conflict.

5.3 Economists quite rightly insist on the importance of "transparency" and "automaticity" in policy. That is, they want all subsidies and taxes to be explicit, so that the full consequences of policy are visible and recognized. Similarly, they dislike giving wide discretionary powers to government, arguing (sensibly) that such discretion throws the door wide open to rent-seeking and corruption, and inhibits private investment, especially for the long term. These arguments are fundamentally correct, but again, there is a conflict between economic and political logics. Politicians need to retain some discretionary use of resources to maintain their coalition and to weaken opposition to their policies. For example, they need some discretion over the allocation of compensatory payments to the losers. If payments to losers are entirely "automatic", the government cannot use them to

encourage cooperation with its program.

B. Machiavelli's Problem

> ...there is nothing more difficult to arrange, more doubtful of success, and more dangerous to carry through than initiating changes in a state's constitution. The innovator makes enemies of all those who prosper under the old order, and only lukewarm support is forthcoming from those who would prosper under the new. Their support is lukewarm partly from fear of their adversaries, who have the existing laws on their side, and partly because men are generally incredulous, never really trusting new things unless they have tested them by experience. In consequence, whenever those who oppose changes can do so, they attack vigorously, and the defence made by the other side is only lukewarm. so both the innovator and his friends are endangered together.
>
> (Niccolo Machiavelli, **The Prince**, VI).

5.4 Modern political economy has put the pithy summary of the Great Florentine into a cost-benefit framework. A fundamental problem of political leadership during structural adjustment is that of surviving the short-run so that the benefits of the long-run may be realized (or, equivalently, so that the long-run catastrophe of "business-as-usual" may be avoided). This is essentially a problem of the **time horizon** of the political leadership. Are there any circumstances under which political leaders might dispense with the short-run rents which accrue from large-scale interference in the economy? Such rents can be allocated to reward friends and punish enemies; they are a vital resource for staying in power. One model suggests that **if** the political leadership can take a longer view, they might be willing to give up these discretionary resources. In this view, if (as economists believe) reducing government interference will considerably enlarge total economic benefits, and if the government can tax some of this, the total resources which the government captures may **rise**.

5.5 Such an optimistic view, however, has two requirements.

(1) The benefits must actually materialize in the longer run, and the government must believe that this will happen. However, although economists believe that there is no other way out of Egypt's current impasse than the path of economic reform, there is and can be no guarantee of success. After all, exogenous international events could derail private-sector led, export oriented growth: a regional war, a collapse of GATT, sudden unfavorable terms of trade developments, etc. The "future benefits of reform", however persuasive to economists, look quite uncertain from the perspective of national political leadership. Economic outcomes are rarely unambiguous; economists do not agree on the probability of success of structural adjustment. Non-economist

political leaders often find themselves bewildered by conflicting advice, which reduces their credulity as to future benefits of reform.[8] Such uncertainty reduces the utility of reform to current leaders. Egyptian policy makers may well be "generally incredulous, never really trusting economic reform until tested by experience".

(2) The leadership must have considerable confidence in its own political longevity. Even if the benefits do materialize, the leaders must still be in office to reap them, or they gain little (politically speaking) from their "far-sighted" strategy. The implications for Egypt are ambiguous: although the current leadership may be fairly characterized as "cautious" and although there is no dearth of opponents to the current government, many analysts doubt whether there really exists any credible alternative to the current regime, given the political system, the economic problems, and the regional balance of power. These considerations suggest that the current government could afford to take the longer view, and thereby overcome Machiavelli's problem.

5.6 The alternative model is that of "dilatory reform". The model has two components. First, Americans are all too familiar with the classic blockages to meaningful economic reform which vested interests create: witness the U.S. budgetary deficit. In Egypt, past policies of import-substituting, state-led growth have created powerful vested interests who will lose from structural adjustment (see below, paragraphs 5.5-5.7; 5.12-5.13). They naturally oppose such changes. However, although such vested interests are a necessary component of policy stasis, their existence is not sufficient. In both the US and Egyptian cases, inaction leads to mounting economic problems, which would force reform--unless foreigners come to the rescue with finance (for the US deficit and the "triple gaps" in Egypt). Nearly a half-millenium after he wrote, Machiavelli's dilemma bedevils reformers.

C. "Can the Leopard Change His Spots?"

5.7 In the Egyptian context, the "dilatory reform" model questions the credibility of the current leadership's "conversion to reform". After all, today's Egyptian government is the same as that which agreed, and then reneged, on the IMF agreement of 1987. The credibility of the reform process is vital: only if private Egyptians **believe** that the government is truly committed to reform (rather than simply manipulating foreign donors) will private investment in traded goods production increase. On the negative side, private Egyptian businessmen often point out that the Mubarak government has been very cautious. Although they believe that this is generally desireable, many feel that the current crisis demands

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[8] Recall the famous quip attributed to Harry Truman: "Give me a one-armed economist! They're always saying, 'On the one hand...on the other hand...'!"

bolder action than that which they are accustomed to see. They are also disturbed by the continuity of decision makers, believing that too many representatives of the "old order" are in the Cabinet, for example.

5.8 On the other hand, there are reasons to believe that the government is truly committed to economic reform. First, the international climate has changed dramatically. The end of the Cold War, combined with increasing domestic concerns, implies that the US is less likely to lobby the Fund or the Bank to "go easy" on Egypt. (Indeed, there are some signs that the US is now more impatient than the Bank with the pace of economic reform). Second, Egyptian leaders have had long connections with Eastern Europe. The events there have demonstrated to at least some of them that the old centrally-planned model is simply not viable, and that the political penalty for waiting too long to change can be very severe indeed. Third, several decades of professional training in the West are now making their mark, as the recipients of such training mature and move up the bureaucratic ladders within important Ministries. These men (they are mainly men) understand clearly the necessity of sweeping economic reform and are committed to its implementation. Finally, no political leadership likes to have its "back to the wall", to run out of significant options. But that is precisely what had happened to Egyptian policy makers on the eve of the Gulf Crisis. Although the outcome of the War permitted the Egyptian leadership to reap important gains, there is a sense that such a sharp narrowing of options could be repeated if reform is not successfully implemented.

D. Tactics for Managing Opposition

5.9 If we assume that the GOE is committed to reform, and if reforms necessarily create many losers in the short-run, we must ask how the government can manage opposition, particularly in a context of reduced discretionary government intervention into the economy (paragraph 4.3). There are really four main tactics for managing opposition (Nelson, 1989):

(1) Persuasion,
(2) Partial compensation,
(3) Obfuscation,
(4) Threats and repression.

Although the regime will probably employ all four methods to some degree, successful structural adjustment will require that the first two be used relatively intensively, and the last two less so.

4.10 **Persuasion** in the Egyptian context is really a **pedogogical** function: the public needs to be educated about the necessity of structural adjustment. There is now widespread appreciation among virtually all Egyptian economists that some fairly drastic economic reform is essential to the nation's

welfare. A case can be made that structural adjustment is not something which foreigners impose on a weak Egypt, but something which Egypt must do herself if she is to consolidate and extend her position as the leading Arab state. President Mubarak has recently begun to make speeches on this theme. An institutional implication would be to strengthen the professionalism and competence of journalists. The government often (rightly) criticizes the irresponsibility of some Egyptian newspapers. Strengthening independent think tanks could have similar effects. Higher professional standards could assist the government to educate the public about the compelling logic of economic reform.

5.11 **Partial compensation** is part of the structural adjustment package: the Social Fund. This program seems to have started very slowly, largely for administrative reasons. Some plausibly argue that the Fund represents a vital potential source of patronage, and that unsurprisingly, Ministries are competing to obtain access to the Funds. In other words, the need for "discretionary funding" for political purposes (paragraph 4.3) is at work; this is hardly surprising from a political economy perspective. The delays in implementing the Social Fund's programs may not be too serious yet, simply because there has been relatively little structural adjustment in industry and the government bureaucracy; there are accordingly relatively small losses to compensate. But if and when the pace of structural adjustment accelerates, the government will have to sort out the precise political uses of the Fund. Partial compensation seems to be the center-piece of the regime's strategy for coping with opposition.

5.12 **Obfuscation** is really part of the "political logic" which clashes with economists' demands for "transparency". The avoidance of transparency is very useful politically. The maintenance of "plausible deniability" can weakens the opposition's ability to persuade others that government policies are actually inflicting losses on large numbers of people. Classical examples in the Egyptian context are the "reform by stealth" measures of the mid-1980s, such as reducing food subsidies by reducing the size of the bread loaf and eliminating the job guarantee for university graduates not by decree but by steadily lengthening the waiting time for a government job. The government will very probably seek to retain some latitude to use this tactic; however, the the gravity of the economic problems facing the country and the economically deleterious consequences of such "policy opacity" suggest that a successful political strategy for structural adjustment will resort to obfuscation only sparingly.

5.13 **Threats and repression** are, of course, a last resort for containing opposition. Some argue that the wide-spread short-run losses of structural adjustment imply that authoritarian rule is necessary for successful economic reform. Without pretending that the debate is conclusive, we disagree, both in general and in the specific Egyptian context. Repressive regimes often fail miserably

economically: consider much of sub-Saharan Africa. Further, repression requires physical, financial, and political resources. The end of the Cold War has made potential foreign patrons either unavailable or less willing to tolerate supporting repression in the pursuit of other regional national security goals. The international conjuncture is one of resurgent democracy; dictatorial rule is in retreat, and lacks legitimacy. Now that the Cold War is over, it will be increasingly difficult for the US or any other donor to justify supporting repression abroad to their own domestic constituencies.

5.14 The Mubarak government also clearly prefers to use the tactic of repression sparingly, and by regional standards, successfully limits its recourse to "the stick". Whether from calculation or conviction, the government is committed to a process of consultation with important social actors and of political reform. The government's style, in marked contrast to that of its predecessor's, has been one of consensus building. From the point of view of economic reform, this has sometimes, perhaps rightly, been viewed as a weakness. It is important to stress, however, that it is also a political strength.

5.16 Finally, although one can argue that short-run repression may help economic reform, in the long run, market economies are not compatible with authoritarian rule. For all their differences, every single advanced industrial economy is also a market democracy. Successful market economies require **information** and **the rule of law**: economic actors must be well-informed, and it is difficult to "seal off" economic information from other types, particularly given today's technologies. Property rights must be clearly specified, and contracts must be enforceable. Highly authoritarian regimes which have been economically successful, like the Republic of Korea, Taiwan, Thailand and Chile, have faced great pressures to expand popular political participation. The process of economic growth and development creates a professional and commercial middle-class which is typically unwilling to be governed in the old authoritatian manner.

5.17 Although Egypt's economic progress has been flawed, the rapid growth of the 1975-85 period did contribute to the prosperity of a middle class. Like their counter-parts elsewhere, they are increasingly unwilling to remain outside the political system. The strength of civil society in Egypt has been growing steadily during the past half-generation. (See Section VI) This is especially visible in the professional organizations and in the courts. Successful structural adjustment and revived economic growth led by the private sector will probably require expanded political participation and strengthened constitutional government.

E. The Changing Social Contract

5.18 Observers of Egypt's political economy often employ the metaphor of the "social contract" to describe relations between society and the state (e.g., Waterbury, 1983). The Nasserist formula, continued and indeed extended by Sadat, may be sketched as follows: the regime gives the people social welfare, the populace gives the state political acquiescence. However, because of budgetary stringency, the government can no longer fulfill its part of the bargain. The old social contract has been broken, and it cannot be mended: a new one is required.

5.19 There are really only two options: repression or participation. As argued above, available evidence and logic suggest that the regime prefers not to pursue a repressive strategy, which in any case might do as much harm as good to the process of economic reform. It follows that a viable new social contract will, as the government seems to recognize, require greater political participation. The government has opted for deepening the political opening in the hopes that, by defusing dissastisfactions with the reform effort, the concessions necessitated by the political opening will be a small price for maintaining the substance of power. The new social contract may be described as one in which the populace acquiesces in the short-run pain of structural adjustment, in return for greater political participation. If the 18th century cry was "No taxation without representation", the late 20th century one may be "No subsidy cuts without representation". [9]

5.20 Linkage between economic and political reform is an empirical reality in Egypt; such a "reform package" appears to be the government's development strategy. There are, however, three alternatives: 1) Nasserist, 2) Islamist, and 3) "muddling through" by the current regime. The last of these, the "dilatory reform" strategy has been discussed above in paragraphs 4.6-4.7. It is not a viable long-term strategy, for the reasons enumerated in paragraphs 3.12-3.24: the challenges of the 1990s are simply too severe. For similar reasons (see Sections III and IV) it is most unlikely that a Nasserist strategy could cope with the problems of the 1990s.

5.21 The Islamist strategy has the advantage of being relatively untested (although the experiences of Iran and Sudan hardly inspire the confidence of Egyptian economists!). Two points should be made about this alternaative: 1) above all, it is "cultural politics" which dominates their program; all other considerations are secondary, at best. 2) Insofar as they have any economic strategy, it seems to be a private enterprise, market-

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[9] After all, a tax is a negative subsidy. Imposing a tax or cutting a subsidy are economically identical.

oriented one. This is especially true of the more moderate wing of the Muslim Brotherhood. Their strict interpretation of the Islamic injunction against usury (which they understand to forbid paying interest on loans) really is simply a demand that all capital be equity, rather than debt. Although this introduces some complications into financial and macro-management, it need not be an insuperable barrier to development. Their key problems probably lie elsewhere: in their dubious ability 1) to raise foreign exchange if all non-Muslim foreigners eschew investment or loans to Egypt, and 2) to avoid a military confrontation with Israel. Despite its weaknesses, the Islamists are the principal political alternative to the current regime. The main alternative to the government's current strategy of combined economic and political reform may, however, be a return (?) to "dilatory reform" and "muddling through".

F. The "Orthodox Paradox", Improved Governance and Participation

5.20 Some observers of structural adjustment programs have detected what they believe to be a conflict between the policy prescriptions and the institutions responsible for implementation. This "orthodox paradox" contrasts the policy imperative of reducing state intervention with the fact that the state itself is in charge of implementing these changes (Nelson, 1989). In effect, state agencies are being asked to preside over their own demise. Since state employees will likely lose jobs, patronage, "discretionary funds", etc., and since they are responsible for implementing government policies, the opportunities for sabotaging structural adjustment in implementation are considerable.

5.21 To some extent, these difficulties are unavoidable. However, they can be minimized if key government officials can be persuaded that a properly implemented and successful structural adjustment program actually **strengthens the state**. The GOE has relatively weak implementation ability; in actual fact, the state's power is relatively weak. This is in large part because the state is trying to do too much: it is simply spread too thinly to be truly effective. Viewed in this light, privatization and other measures to streamline government will raise the effectiveness of the remaining state activities. Like a firm undergoing a crisis of overexpansion into too many product areas, the GOE will become stronger, not weaker, as it sheds certain activities so that it can focus more sharply on improving its performance where it has the greatest comparative advantage.

5.22 If structural adjustment can strengthen the state, the converse is also true: successful structural adjustment and economic growth requires effective government. The GOE needs to stop doing some things, start doing others, and do still others better. Structural adjustment certainly requires that the government stop directly producing goods which could be made under

reasonably competitive conditions: privatization is essential in many areas. However, the government needs to do other things much better: it needs to provide strong macroeconomic management, for example, as the tax and monetary authority, and as the regulator of the banking system. Markets cannot work properly if the infrastructure is weak: especially in today's highly competitive international economy, rapid response is required, and this necessitates excellent transportation and communication sytstems. The existence of the Social fund, with its provision for public works employment for the poor, can combine infrastructual improvements with poverty alleviation. Both require effective, strong governance.

5.23 Markets will not work at all if information is absent: none of the neo-classical benefits of markets obtain in situations of poor and highly skewed access to information. Governments have a critical role to play in providing such information to all. Rapid data collection and dissemination and the provision of all types of information is a critical public function which must be greatly strengthened if a sustainable economy is to be created. And, of course, the government must do much more to raise the educational level of the population, to enhance the "information processing capability" of the citizenry.

5.24 No matter how well markets function, some citizens will be left behind. The GOE is committed to providing a "social saftey net" for the very poorest members of society. This is an ethically laudable and politically wise commitment. Proper functioning of the Social Fund is an important component of the political sustainability of structural adjustment. The funds have come from abroad, but the management must be local. Only if the government can quickly identify the poor and swiftly implement programs to provide them with jobs or other help can the humanitarian and political purposes of the program be realized. The Social Fund could made very important contributions to sustainability, but only if it is properly managed.

5.25 In short, the "orthodox paradox" can be resolved by reforming and strengthening governance, which is both a cause and a result of successful structural adjustment. There is a final implication here: if governance is to improve, popular participation must rise. First, a more effective government means that some functions must be turned over the the private sector, which as argued earlier (paragraph 4.16) requires secure property rights, enforceable contracts, and the rule of law. Second, some remaining governmental functions need to be decentralized. Finally, no bureaucracy (national or local) can function effectively without feedback from those whom it purportedly serves. Uninformed decisions are bad decisions. Greater participation by the citizenry is essential if this information is to be provided. The design of participation mechanisms will of course be worked out through trial and error; they will probably include a mixture of "voice" (or

collective action) and "exit" (market or quasi-market mechanisms) (Hirschman, 1970). In either case, greater participation will be essential.

5.26 A good example of the interaction between improved governance and participation may be found in the design of more efficient water allocation mecanisms. It is often suggested that "water wholesaling" or charging water fees to groups of farmers is more administratively feasible than trying to price water to individuals in the Old Lands. Allocation of water within groups then requires collective action, or participation. The Ministry of Public Works and Water Resources allocates water only to the entrance to the **meska** or field canal in the Old Lands and to the main pumping station in the New Lands. Improved participation/ collective action will be essential if water is to be used more efficiently in the coming decades.

5.27 Experience elsewhere in the world (e.g., Taiwan) also strongly suggests that more effective water users' groups also improve the efficiency of higher levels of the irrigation delivery system. Basically, water users' groups act as a "pressure groups" which "lobby" the public authorities to respond to their needs (Small and Carutners, 1991). Water conservation requires a more "demand driven" irrigation system; this in turn necessitates heightened participation. **Greater participation and improved governance are complementary.** And, as argued above (paragraphs 4.18-4.19), greater participation is likely to be a necessary part of the emerging "New Social Contract" in Egypt. The interactions between improved governance and enhance popular participation are summarized in FIGURE 4.

VI. THE POLITICAL ECONOMY OF STRUCTURAL ADJUSTMENT IN EGYPT

A. A Taxonomy of Egyptian Interest Groups

6.1 As first approximation, social actors or interest groups are defined with respect to their **primary source of income.** This classification will closely parallel people's location in the national labor market: as employers or workers in the principal economic sectors. Such an approach also has the advantage of treating public sector workers as an explicit interest groups, which is obviously essential for any sensible discussion of the political economy of structural adjustment in Egypt. This general taxonomy will be broadened to include two groups which cannot plausibly be included in the above classification scheme, but which are too important to ignore (the military, and student/youth/intelligentsia). We ask four questions:

(1) Who are these groups?
(2) Do they win or lose from structural adjustment in the short run?
(3) How might they act politically?

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to the economy and generating at least some employment opportunities. Here, too, Egypt has had good luck.

6.27 The consequences of the current pattern of macroeconomic reform are politically favorable to the regime. The banking reforms create very few losers, with the notable exception of private sector capital which was able to borrow before the reforms. However, because credit rationing was so wide-spread before the reforms, it is unclear just how badly they have been hit. **The center-piece of stabilization policy, exchange rate and banking reform, has created few losers.** We suggest that this may be an additional reason why the government has so quickly implemented this phase of reform.

6.28 Note, however, that the ledger could change rapidly if fate ceased smiling on Egypt. If regional conflict rose, if the "hot money" described in paragraph 3.33 left the country, there would once again be a foreign exchange crisis, a collapse of the pound and severe pressure for heightened austerity. In such a macroeconomic scenario, there are millions of losers, and precious few winners.

6.29 **Privatization** imposes losses on workers in state-owned enterprizes, on middle management, and (possibly) on higher management. However, as argued above, top management may gain if they remain with the privatized company. Informal sector labor probably stands to lose indirectly, as public sector lay-offs increase the supply of labor, pushing down wages. Private importers and exporters might gain, but "rent-collectors" among them will lose. Privatization will help, of course, those who acquire the assets and who are then successful. It could help firms who have had to rely for inputs on unreliable public sector delivery. On the other hand, many firms using public sector industry inputs will have to pay higher prices. The price change will likely precede the enhance efficiency of delivery. As is well known, **the number of losers from privatization far exceeds the number the winners**, and the losers are well-organized. Politically speaking, privatization is much more difficult than macroeconomic reform, which, of course, explains the regime's continual dithering on the issue.

6.30 **Price liberalization** fares better politically, since at least in agriculture, it creates definite winners. In urban areas, however, price reforms mainly create losers in the short run. Decontrolling **energy prices** offers the most obvious example. Every urban Egyptian is a consumer of butagas for cooking; the vast majority are consumers of electricity, while fuel prices directly affect the cost of urban transport. In the short run, the price hike hits all consumers, which is to say, all urban (and most rural) Egyptians. To be sure, past subsidies have inflicted great harm on the mass of poor Egyptians by creating a capital-intensive bias in industry which has reduced the demand for their labor. But they do not know this: the "opacity" of such economic connections

blocks understanding. Most Egyptians see only the ever-increasing cost of lighting, cooking, and commuting. Fortunately, Egypt has been lucky: the international prices toward which domestic prices are adjusting is relatively low. Even oil-exporting Egypt gets some benefit from low oil prices! [14]

6.31 **Agricultural price reform** is different: here there are many winners, as well as losers. Perhaps unsurprisingly, reform has been underway for some time in this area: the real taxation of the agricultural sector has been falling for over 15 years (Dethier, 1990). As argued above, the agricultural sector is likely to be one of the main winners from structural adjustment, although there are certainly losers as well.

6.32 Consider reform of **cotton pricing**. If we compare the benefits of raising the cotton price from roughly one-half to equality with the international price, who would benefit and by how much? Using AID's 1988 data on net returns for crops, and assuming the standard Delta three year crop rotation, a 50% price increase would raise farmer's yearly net revenue by nearly 40%. This very simple calculation assumes that only the price changes: costs and crop mixes remain the same. If we combine this figure with the data in Table 4 on income sources by farm size, we see that the incomes of 0-1 feddan holders would rise by about 9%, those of 1-5 feddan holders by some 16%, those of 5-10 by 20%, and those of 10+ feddan holders by 24%. Needless to say, these are very crude calculations, which apply only to cotton farmers. But even if we add livestock price changes, it is still likely that cotton farmers who hold more than one feddan will win. Finally, even landless laborers benefit from price increases, which raise the marginal value product of labor. Unquestionably, however, the vast majority of the benefits of farm price increases will accrue to the owners of land because the supply of labor is more elastic than that of land.

6.33 If these calculation are accepted as indicating general orders of magnitude, several implications follow. First, the gains of decontrolling cotton prices to farmers are significant. Second, the gains are an increasing function of farm size, assuming larger farmers grow cotton. However, the estimate may be exaggerated both economically and politically. Economically, the increase in cotton's relative price will lead to crop reallocations, and hence to some reduction of revenue from, say, reduced maize acreage. On the other hand, the fall in real wages will reduce the costs of this labor intensive crop, making it still more lucrative. However, other costs, especially energy prices, rise. The back-of-the envelope calculations given above are no subsitute for detailed analysis using farm level data. It is also critical that the reform

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[14] Of course, the costs to the Egyptian economy outweigh the benefits so long as Egypt's oil exports are quantitatively significant.

of cotton marketing not engender the emergence of significant market power on the part of cotton merchants; the greater the market power of the buyers, the lower the gains to the farmers. On balance, however, it is likely that reform of cotton prices will create significant gains for all cotton-growing farmers.

6.34 The complex timing of agricultural price reform may have obscured the benefits, thereby weakening their political utility. Decontrol of prices has been a long, gradual affair; benefits have accordingly been spread out, rather than concentrated. On the other hand, the very fact that cotton price reform has been delayed for so long may have a political silver lining: even as input costs (other than labor) rise, and even as livestock prices fall, the price of a major crop rises significantly. Note that politically speaking, the more rapid the reform of cotton prices, the greater the benefits: large improvements in welfare are more visible.

6.35 Reform of output prices will be **regionally concentrated.** The benefits of cotton price reform will mainly accrue to the central and southern Delta (Crop Zone II) and to Middle Egypt (Crop Zone VI) where most cotton is grown (USDA/USAID/GOE-Ministry of Agriculture, 1976). There may be significant benefits for cotton growers in violence-plagued Middle Egypt. Such benefits may help the Government to undermine the appeal of religious fanatics; on the other hand, the higher incomes of cotton farmers might provide greater resources to the extremists. This is a good example of the conflict of "economic" with "cultural" politics.

6.36 Reform of **farm input prices** offers a similarly complex case. Nearly all land preparation, water lifting, and threshing in Egypt is mechanized. Energy price hikes will raise the costs of these operations. The impact on net revenue will depend on the ease of subsititution of other inputs, and on their prices. Some substitution is certainly likely, even in the short run. Here small farmers, who hold most of the livestock, may have an advantage over larger farmers.

6.37 The reform of fertilizer prices offers a good example of the interaction of price reform with privatization. On the one hand, decontrol of fertilizer prices will raise and (if domestic prices follow international prices) destabilize prices. On the other hand, privatization of fertilizer distribution will probably improve the reliability and timeliness of delivery, with the exception of remote areas. This has been the case in several countries which simultaneously decontrolled fertilizer prices and privatized distribution, e.g., Bangladesh. Unfortunately, the price increase is likely to precede the improved reliability of distribution. The worst combination is a price increase with PBDAC in place.

6.38 **Trade liberalization** will harm workers and owners in import-substituting industries, and help those in export-oriented

activities and in non-traded goods sectors using imports. **Abolishing investment licensing**'s impact in fertilizer has been analyzed above. A similar story may be told for cement. The key here is the speed with which a reasonably competitive private sector can replace state-owned monopoly. A lengthy, confused transition, or the emergence of significant private market power, weakens the economy and dissipates the political benefits. The reform of the **labor laws** is straightforward: workers lose, employers gain.

6.39 The last component of the SAL, the **Social Fund**, has the great political attraction of having **only winners**. It cannot be overemphasized that real protection during the painful years of transition is vital to the success of the entire effort. The Fund confronts a series of problems: 1) it is being implemented when domestic unemployment is high and job opportunities abroad are low; 2) funding is inadequate; and 3) various Ministries squabble over the resources, greatly impeding implementation. Despite the obstacles, the Social Fund remains important not simply as a means to weather the worst of austerity (which may lie ahead), but as a promise to those harmed by reform that they too will have a stake in the future. The Social Fund has a political importance that transcends its direct beneficiaries: it shows that the regime seriously cares about all Egyptians.

6.40 Finally, recent changes in **land tenure** legislation have considerable destabilizing potential. Economies of scale in agriculture do exist; however, it is most unlikely that they are particularly significant in the Old Lands. Although New Lands are another matter, existing legislation already recognizes this. Most cross-section studies in Egypt show little variation in crop-yield or any other efficiency measure by farm size. This is consistent with world-wide evidence. The problems of farm fragmentation are easily exagerrated: consolidation through land rental markets has a long history in Egypt. The land tenure changes are really a shift in property rights: they are likely redistributive, with relatively few efficiency benefits.

6.41 However, the die is cast: the new law has been passed. Americans who know anything of the social consequences of New Deal farm legislation for the US South should be alert to the possibility of increased evictions of tenants, to the risk of a kind of "enclosure movement". Should such a possibility materialize, it will be highly destabilizing politically. Not only will the losers be aggrieved (those who lose even **de facto** property rights rarely think that the change is just), but the employment consequences may be significant: such changes shift out the supply function for labor. The revised land tenure laws may simply compound the already daunting employment problem. However, the legislation does suggest that rich peasants and capitalist farmers have the ability to affect policy formulation, as well as implementation. These groups are among the major beneficiaries of

structural adjustment; expanding their capacity for political action could strengthen the reform process.

6.42 The reforms which have actually been implemented have either produced few losers (e.g., banking reform, steps toward forming a stock-exchange), or have been responses to pressure groups like capitalist farmers. There has been much less change in areas like privatization or the labor laws, where there are numerous, well-organized potential losers. The international environment has also been quite favorable to Egypt. In short, the key elements of the "dilatory reform" model--entrenched interest groups and international rent "bail-out"--remain operative. No one knows how long this can continue, especially in a worst case scenario of the impact of land tenure "reform".

E. Modalities of Political Action

6.43 How could such interest groups act politically? There are four principal modes:

(1) market action
(2) collective action to affect policy formulation
(3) shaping implementation
(4) mass protest action.

Market action, or "voting with your feet or wallet" is a vital, too often neglected, political force. For example, the current disappointing levels of private investment in traded goods production is a kind of signal: entrepreneurs are expressing their skepticism as to the government's commitment to economic reform. **Action to affect policy formulation** is the most "orthodox" form of political action; it requires both the capacity to act collectively as a group, including institutional arrangements which permit such action and create mechanisms for views to be expressed and to affect policy formulation. In a word, it depends upon political institutions, which are examined in Part VI of this report. **Shaping implementation** may be the most effective way for civil servants to mould policy, as briefly discussed in paragraph 4.20 above. Finally, the fear of **mass protest**, the "ghost of 1977", haunts Egyptian policy makers. The fear, of course, is that austerity and declining living standards will prompt youth, students, urban informal sector workers and perhaps others to express their dissatisfaction illegally and violently.

6.44 These are the main ways our identified social groups can act politically. Political economists believe that people will always act in markets. If the incentives are right, the response will be there. The political point then becomes identical with the economic one: "get the incentives right". **The prospects for successful structural adjustment are maximized to the extent that the winners from structural adjustment can act in mode #2; since the winners have little "implementation power", this is the only**

remaining course of action. This, in turn, implies that the political system must be open to their input. And, of course, the more action by the losers in modes #2, 3, and 4 can be "managed" (see above, paragraphs 4.9-4.17), the greater the chances of successful adjustment.

F. Can They Act?

6.45 What is the potential for action of these groups? The military, public sector managers, organized labor, the civil service, private importers, and capitalist farmers could clearly act to affect either policy formulation or implementation. It is possible that rich farmers and private exporters could also so act, but it is likely that further institutional change/enhanced collective efforts on their parts will be necessary. Medium and small farmers, rural informal sector workers, and agricultural laborers are unlikely to be able to act in any mode, while students and youth, (urban) informal sector labor and informal sector entrepreneurs are likely to act, if at all, only in the "mass protest" mode.

G. Conclusions

6.46 Several conclusions emerge from this (necessarily tentative) analysis.

(1) FIGURE 5 shows our assessment of **winners and losers** from structural adjustment, together with their likely "mode of political action", if any. The core support of structural adjustment consists of: private exporters, the military, some private importers and informal sector employers, and the better-off farmers. This picture is not significantly altered by taking a more realistic piecemeal view of reform, as in FIGURE 6.

(2) The largest number of potential supporters of economic reform are the better-off farmers. Since they are relatively under-organized, expanded political participation and greater latitude for their collective action could support the economic reform process.

(3) It remains the case that the **constituency for economic reform alone** is both relatively small and not very well organized. This suggests that a "New Social Contract", which includes political reform, could help economic reform by broadening the coalition for change.

(4) Finally, it is important to remember that "cultural politics" may be more important to many Egyptians than either economic or political reform. It is also vital never to forget that the GOE is caught on the horns of a dilemma: politics dictates caution, but the economic situation demands boldness.

6.47 Two final caveats must be registered here.

1) The very complexity and interlocking nature of the policy package of structural adjustment often blurs the extent to which any group wins or loses, as the example of small farmers suggests. The "opacity" of benefits combines with wide-spread ignorance of economics to produce a situation in which it is often very unclear to a person whether or not the totality of government policies have helped or hurt him. This difficulty suggests that there is a great role for persuasion, for argument, and also for other, competing "political logics" to play an important, even central role in determining a group's political orientation and action.

2) The opacity of policy's impact on individual and group welfare also magnifies the role of political institutions in mediating between the goals of a group and its effective political expression. For example, although it seems straightforward that structural adjustment will hurt organized labor, Egyptian trade unions support the government's NDP, including the policies of structural adjustment (see, e.g., the discussion in Awad, 1991). We believe that a strengthened civil society can assist the restructuring and strengthening of the state which can make successful structural adjustment possible.

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FIGURE 1: AN ANALYTICAL FRAMEWORK

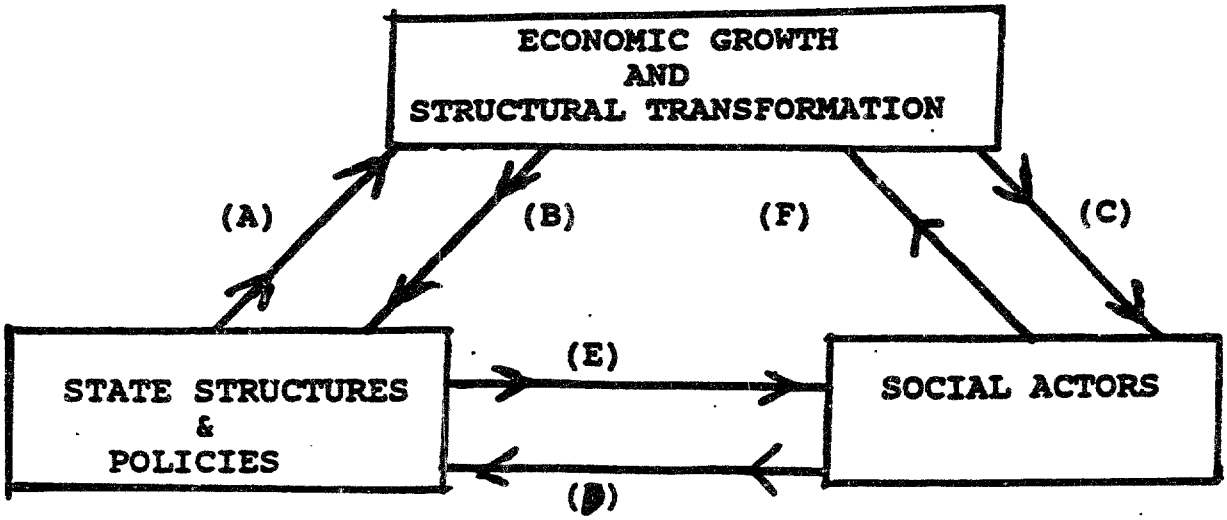
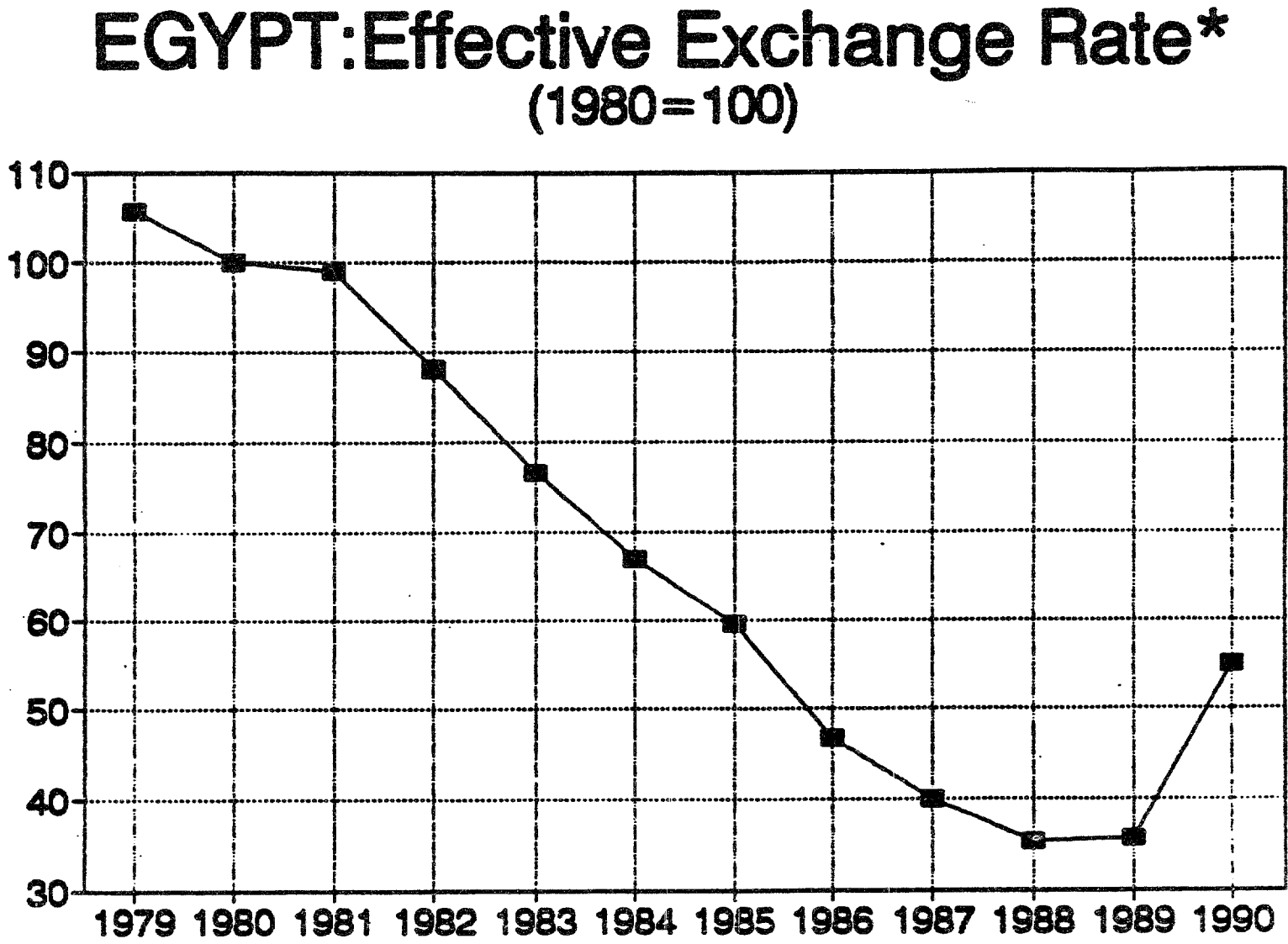


Figure 2



* Price of Foreign Exchange or "Real L.E. price of real U.S. dollar"

Figure 3

INDEX OF REAL AGRICULTURAL WAGES, 1938 – 1990

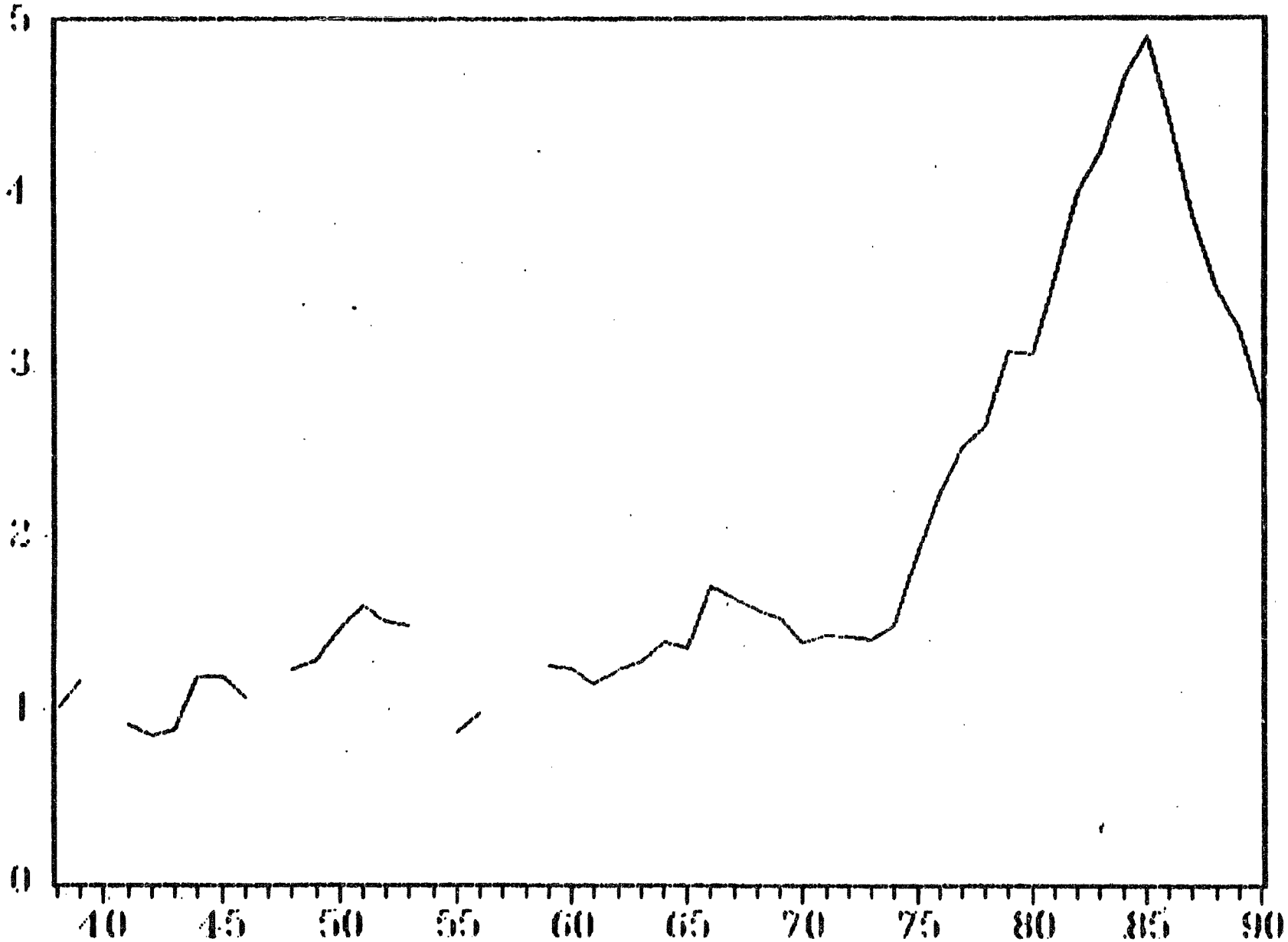


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FIGURE 4: SUMMARY OF PARTICIPATION AND GOVERNANCE FOR SUSTAINABILITY

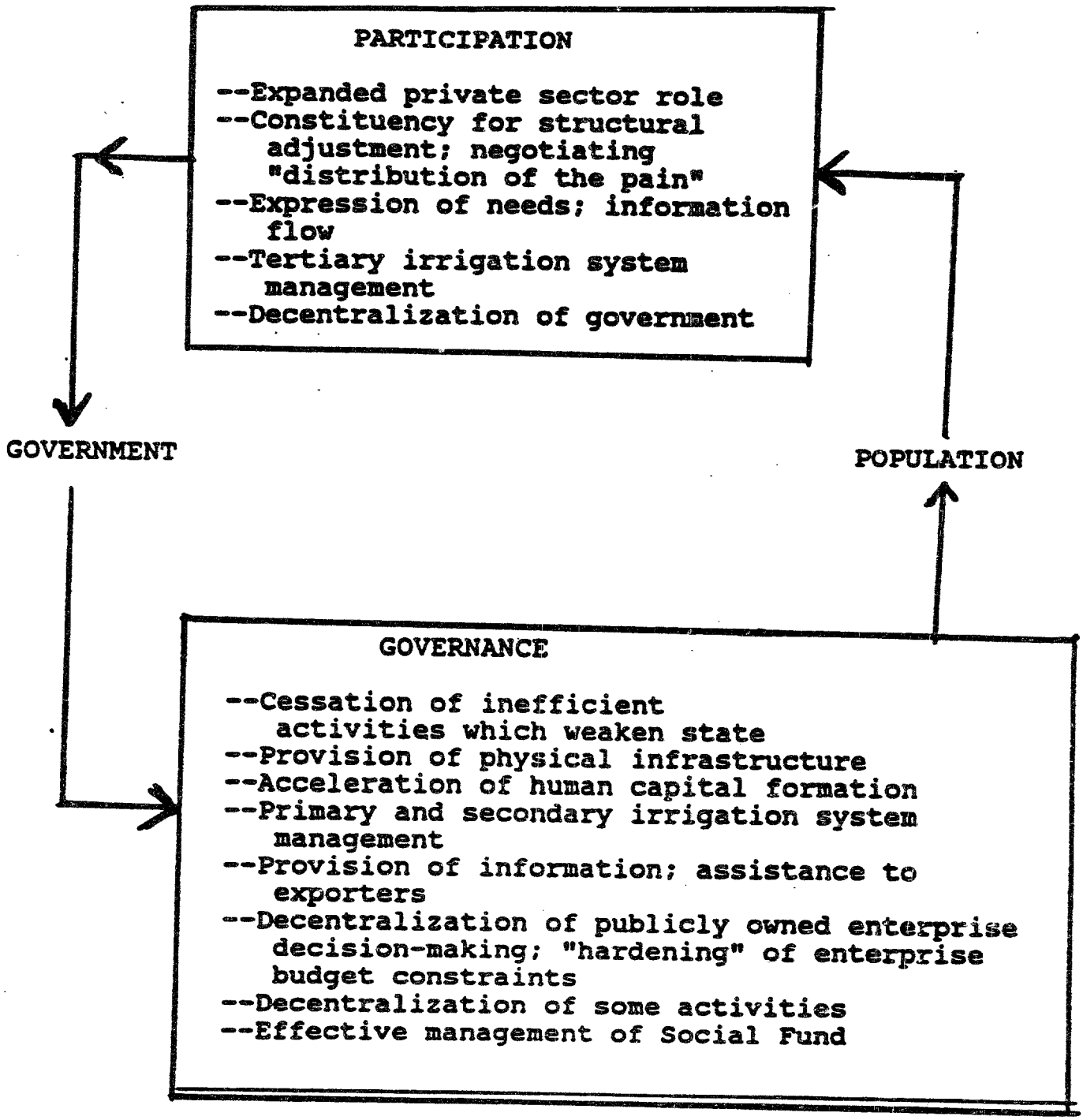

FIGURE 5: WINNERS AND LOSERS FROM STRUCTURAL ADJUSTMENT AND THEIR LIKELY MODES OF POLITICAL ACTION

SOCIAL ACTOR	WIN OR LOSE?	MODALITY OF ACTION*				
		0	1	2	3	4
1. Civil Servants	Lose	0	x	x	x	0
2. Organized Labor	Lose	0	x	x	x	x/?
3. Public Sector Managers	?	0	x	x	x	0
4. Private Importers	?	0	x	x	0	0
5. Private Exporters	Win	0	x	x	0	0
6. Informal Sector Capital	?	x	x	0	0	x/?
7. Informal Sector Labor	Lose	0	x	0	0	x
8. Capitalist Farmers	Win	0	x	x	0	0
9. Rich Peasants (>3 feddans)	Win	x	x	0	0	0
10. Small Farmers (1-3 feddans)	?	x	x	0	0	0
11. Very Small Farmers (<1 feddan) & Landless Ag Workers	Lose	x	x	0	0	0
12. Military	Win/ Do Not Lose	0	x	x	x	0
13. Students, Youth	?/Lose	0	x	0	0	x

*Modes of action:
0. No Political Action
1. Market Action (applies to all actors)
2. Collective Action to affect <u>policy formation</u>.
3. Shaping <u>implementation</u>
4. Mass protest (riots, strikes, etc.)

("x/?" indicates possible action)

FIGURE 6: WINNERS AND LOSERS FROM PIECEMEAL REFORM

SOCIAL ACTOR	IMPACT* OF REFORM**						
	1a	1b	2	3	4	5	6
1. Civil Servants	-	-	-	-	-	-	+
2. Organized Labor	-	-	-	-	-	-	+
3. Public Sector Managers	±	-	±	+	±	±	0
4. Private Importers	-	-	0	±	+	+	0
5. Private Exporters	+	0	0	+	+	+	0
6. Informal Sector Capital	0	-	0	±	+?	0	+?
7. Informal Sector Labor	-	-	-	-	0	0	+
8. Capitalist Farmers	+	-	0	+	+	+	0
9. Rich Peasants (>3 feddans)	+	-	0	+	+	+	0
10. Small Farmers (1-3 feddans)	+	-	0	+	+?	+	0
11. Very Small Farmers (<1 feddan) & Landless Ag Workers	-	-	0	-	0	0	+?
12. Military	0	0	0	0	0	0	0
13. Students, Youth	-	-	0	-	0	0	+

*Key: + = gain; - = loss; ± = mix of gains and losses; 0 = no effect

**Component of Structural Adjustment Loan Agreement:

1a. Macroeconomic measures: expenditure switching
1b. Macroeconomic measures: expenditure reducing
2. Privatization program
3. Price liberalization
4. Trade liberalization
5. Demise of investment licensing
6. Social Fund

TABLE 1

SAVINGS AND INVESTMENT AS A PERCENT OF GDP, 1965-1986/7

Year:	1965	1982/83	1983/84	1984/85	1985/86	1986/87
GDS:	14%	18%	13%	13%	12%	8%
GDI:	18%	26%	24%	23%	21%	20%
GAP:	-4%	-8%	-11%	-10%	-9%	-12%

Source: IMF.

TABLE 2

COMMODITY EXPORTS AND IMPORTS, 1982/83 -1986/87
(US $ billion)

Year:	1982/83	1983/84	1984/85	1985/86	1986/87
Exports (1)*	3.5	4.0	3.7	2.8	2.6
Imports (1)	9.0	10.3	10.5	9.5	7.7
X-M	-5.5	-6.3	-6.8	-6.7	-5.1

Year:	1984	1985	1986	1987	1988
Exports (2)*	1.85	2.00	1.50	2.00	1.80
Imports (2)	9.25	8.34	6.60	7.40	6.10
X-M	-7.4	-6.34	-5.1	-5.4	-4.3

Source: IMF.

*(1): Customs' receipts data.
(2): Balance of payments data.

TABLE 3: EMPLOYMENT PROFILE, 1986

SECTOR	NUMBER (Millions)	PERCENT OF EMPLOYMENT
Agriculture	4.53	38.7%
Private Informal	3.08	26.3%
Private Formal	.311	2.7%
Public Enterprise	1.2	10.2%
Government	2.6	21.9%
Other	.26	0.2%

Source: Sample Population Census, 1986.

TABLE 4: INCOME SOURCES BY FARM SIZE, 1984
(Percent of Income)

	Farm Size: (feddans)				
	0-1	1-3	3-5	5-10	10+
Income Source:					
1. Crop Agriculture:	23.2%	40.0%	39.3%	49.6%	59.8%
2. Livestock:	19.9	10.6	8.9	9.6	23.0
3. Rent:	4.8	3.8	12.5	22.5	5.2
4. Agricultural Wages:	14.5	13.9	3.4	0	0
5. Non-farm Wages:	32.0	27.4	29.2	12.2	12.0
6. Other	5.6	4.3	6.7	6.1	0
1+2+3:	47.9	54.4	60.7	81.7	88.0
1+3:	28.0	43.8	51.8	72.1	65.0

Source: Calculated from data in Simon Commander (1987). **The State and Agricultural Development in Egypt Since 1973**. London: Ithaca Press for the Overseas Development Institute, pp. 213, 217.

TABLE 5: FARM SIZE DISTRIBUTION, 1982

Holding Size (feddans)	Area		Holdings	
	Feddans	%	Number	%
0-1	399,357	6.0	796,394	32.3
1-3	1,903,198	28.7	1,096,845	44.4
3-5	1,180,975	17.8	330,621	13.4
5-10	1,098,224	16.6	173,248	7.0
10-50	1,206,156	18.2	67,350	2.7
50+	844,548	12.7	3,950	0.2
Total:	6,632,464		2,468,408	

Source: Ministry of Agriculture, Agricultural Census, 1982. Table 2-A.