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Al-Sisi's Egypt: The Military Moves on the Economy

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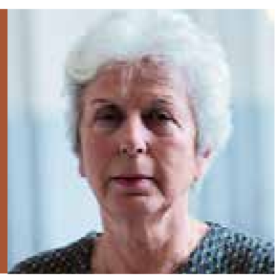

Egyptian President Abdel Fattah al-Sisi has explicitly chosen an authoritarian political model for Egypt, arguing that democracy is a luxury the country cannot yet afford and that the constitution, while good, cannot be implemented immediately. Al-Sisi has emphasized the priority at present must be to restore security and rebuild a strong Egyptian state, and citizens must sacrifice their own interests to those of the state. Military support is key to the imposition of this authoritarian model, freeing the regime of the necessity to court the support of political parties, civil society organizations, and voters.

Al-Sisi's economic model for Egypt, while still not fully developed, is also relying heavily on the military. Two elements of this model to have clearly emerged so far: al-Sisi wants rapid economic growth in order to restore Egypt to its former position as a regional power; and he believes that rapid economic growth can best be brought about by the implementation of large projects under military supervision. Although al-Sisi does not dismiss the importance of the private sector in his speeches, the policies he has put in place so far favor the military economy. Whether or not this approach can generate rapid eco-

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About the Middle East Program

The Middle East Program was launched in February 1998 in light of increased U.S. engagement in the region and the profound changes sweeping across many Middle Eastern states. In addition to spotlighting day-to-day issues, the Program concentrates on long-term economic, social, and political developments, as well as relations with the United States.

The Middle East Program draws on domestic and foreign regional experts for its meetings, conferences, and occasional papers. Conferences and meetings assess the policy implications of all aspects of developments within the region and individual states; the Middle East's role in the international arena; American interests in the region; the threat of terrorism; arms proliferation; and strategic threats to and from the regional states.

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nomic growth, it will undoubtedly strengthen the position of the military.

Any economic policy in Egypt today is bound to affect the balance of power among the three major components of the economy: the state, private, and military sectors. The state sector, though diminished by a wave of privatizations in the 1990s and early 2000s, remains a source of employment for Egyptians and of power for bureaucrats who oversee it. The private sector, which is comprised of 91 percent of microenterprises with one to four workers and one percent of enterprises with over 100 workers, has not established itself yet as the major driver of economic progress. Finally the military economy, which ranges all the way from bakeries, butcheries, and service stations to major engineering projects such as the enlargement of the Suez Canal, is a steadily growing force likely to expand to an unprecedented extent and in unprecedented sectors as a result of the policies favored by the al-Sisi regime.

Shifting Balance among the State, Private, and Military Economies

A brief overview of how the state, private, and military economies developed in Egypt from the days of President Gamal Abdel Nasser in the 1950s and 1960s to the present shows how the importance of these three components has shifted over time.

Nasser wanted Egypt to grow economically, rapidly becoming a modern industrialized country. Like many developing country leaders of the day, he saw the state as the main agent of development, making up for a sluggish and, in his view, exploitative private sector that was not delivering. Under his leadership, large landholdings were broken up; by 1969 the upper limit on private farms had been set at 50 feddan (about 50 acres), and all farmers were subjected to state directives concerning crops and crop rotation. The state also invested in heavy industry and infrastructure projects, first and foremost the building of the Aswan Dam. The policies created a large state sector and a government bureaucracy with a vested interest in the perpetuation of that sector, which created jobs and patronage and was a source of power for its top officials. Under Nasser, the private sector continued to account for about two-thirds of the economy, actually growing as a result of the opportunities provided by the government's investment in heavy industry and infrastructure. It was not, however, the driver of change nor did it exercise much influence in the system. In this period many military officers went on to become managers in the new state sector. Even more importantly, the military economy (which had developed historically to provide the armed forces with goods it needed) started expanding by taking a leading role in infrastructure and land reclamation projects requiring heavy engineering and by investing in the production of consumer products such as domestic appliances.

The balance between public and private sector underwent a change under President Anwar al-Sadat, once again for reasons that were as much political as economic. Following in the wake of the immensely popular Nasser, Sadat faced the challenge of asserting himself as a leader in his own right, coming out from under the large shadow cast by his predecessor. He established his own political identity by launching the October 1973 attack across the Suez Canal into Israeli-occupied Sinai, becoming the "Hero of the Crossing," and eventually negotiating the return of the entire Sinai to Egypt. He also sought to fight the influence of the Nasserites by allowing the revival of the Muslim Brotherhood and more broadly of Islamist organizations—ironically, he was assassinated by Islamist radicals in 1981.

In the economic realm, Sadat established his identity by launching the "open door" policy, or *infitah,* which started a shift in the balance between public and private sector. He had been considering a new economic policy to open up the economy since he had come to power—the state-led policies had proven unsustainable in the long run, and the economy had been in a slump since the 1967 Six-Day War with Israel. However, he only unveiled a new policy in 1974, after the war with Israel had increased his political stature.

Like Nasser's state-centric approach, the open door policy developed and evolved over time. Sadat did not subject Egypt to the shock therapy of massive privatization, as many formerly socialist countries would do in the 1990s. Rather, he started removing the controls that had hemmed in the private sector without dismantling the public sector. For example, private banks nationalized by Nasser reopened, competing with public sector banks for deposits and remittances from abroad. But the government maintained strict control on the value of the currency, rather than allowing the Egyptian pound to float. Nevertheless, opportunities for small and large entrepreneurs expanded rapidly. Remittances from the growing number of Egyptians working in Gulf countries after the rise in oil prices were invested in small family businesses; and travelers returned to Egypt with large amounts of merchandise of all types to be resold—the gigantic size of Cairo airport baggage carts in this period was a visible reminder of the importance of this activity. At the other end of the spectrum, large fortunes were made in construction and trade, though initially not in industrial development.

The growth of the private sector triggered tensions between the new entrepreneurs, who wanted more space and opportunities, and bureaucrats, who controlled the public sector economy and saw the changes brought about by the *infitah* as a threat to their power. Much of the bureaucracy had little incentive to design and implement economic reforms that would benefit private entrepreneurs and diminish its own control.

The military economy also benefited from the open door policy, although the full extent of the change only became clear during the 30-year presidency of Sadat's successor, Hosni Mubarak. Sadat himself had played down the military economy, focusing efforts on the production of arms and commodities the military itself consumed. But Law 43 of 1974, which launched the *infitah*, and Law 32 of 1977, which amended it, provided opportunities for the military to enter into partnerships with domestic and foreign investors and to expand the scope of its activities.

Mubarak, as cautious in his economic policies as he was in everything else, was slow to introduce further measures to facilitate the expansion of the private sector, despite pressure from domestic businesses as well as international donors and financial institutions. Only in the early 1990s did the government introduce more reforms and start privatizing state-owned enterprises, which at the time accounted for about 70 percent of invested capital. In 1994 the government announced a privatization campaign targeting some 300 enterprises, but the campaign proceeded slowly. By the time of the uprising in January 2011, about half the targeted enterprises were still in government hands, and the process had ground to a halt. By then, the companies most attractive to investors had already been privatized and resistance to privatization was mounting because the process was perceived to be corrupt, favoring individuals with ties to the government, and because the newly privatized companies inevitably fired workers in order to reduce the bloated payroll.

Despite the problems, privatization shifted the balance between private and public sector, with mixed consequences: GDP growth rates increased, reaching over 7 percent between 2006 and 2008, but so did income inequality. By the time the 2011 uprising put an end to Mubarak's rule, Egypt had become a country of stark contrasts. At least a quarter of the population was mired below the official poverty line, with many more hovering just above it. At the other extreme, a wealthy and ostentatious elite had emerged. In Cairo, the differences were represented graphically by the contrast between the decaying slums and the new gated communities.

Like the private sector, the military economy was also booming. As in Nasser's days, the military was a contractor on many infrastructure projects, but most importantly it entered into partnerships with foreign and domestic investors without becoming any more transparent about what it was doing. Lack of transparency is the reason why there are no reliable studies of the size and functioning of the military economy. Estimates vary wildly, from a low of 5 percent to a high of 40-50 percent. Low-end estimates, which the military supports, appear to be based on the businesses that the military openly controls—from arms manufacturing to bakeries and service stations, many of which employ conscripts as free labor. The high-end estimates appear to include a much wider array of undertakings in which the military has an interest, from Red Sea resorts to land deals that transfer to commercial development land, over which the military was given control decades ago for security reasons. Scholars have so far been unable to produce good data on these deals and are unlikely to succeed as long as the military is free of civilian oversight and treats such information as a military secret. Nevertheless, the conclusion is warranted that the military economy at the end of the Mubarak period had two components: one functioning along the lines of the old state-owned enterprises and one functioning more like the free-wheeling and often corrupt private sector.

Al-Sisi's Vision: Big Projects and Military Entrepreneurship

Al-Sisi inherited the economy of the late Mubarak period, only in worse conditions. Neither the Supreme Council of the Armed Forces (SCAF), which ruled the country from the fall of Mubarak to the end of June 2012, nor President Mohammed Morsi, in the following 12 months, introduced measures that changed the character of the economy. But the overall economic situation worsened because the prolonged instability dried up foreign and domestic investments and reduced the flow of tourists and of the foreign currency they brought into the country to a trickle, slowing down the GDP growth rate. Structurally, however, Egypt remained a country with an important but shrinking state sector, a private sector with strong ties to the political establishment, and a significant military economy with growing ties to domestic and foreign entrepreneurs. The economy was also burdened by the policy of subsidizing energy and basic foods as a form of welfare. By 2013, subsidies introduced by Nasser were consuming 26 percent of total public spending, or 11-12 percent of GDP, according to IMF estimates. Energy subsidies—on electricity, bottled gas, and gasoline for cars—accounted for most of the expenditure. High rates of absolute poverty as well as growing income inequality created discontent manifested in a large number of strikes and protests that the government could not control either before the uprising or during the turbulent years of the SCAF and Morsi, and not even after the 2013 coup d'état.

President al-Sisi's emerging, ambitious vision for Egypt appears detached from the reality on the ground. Egypt is essentially bankrupt and kept afloat by financial support from Saudi Arabia, the United Arab Emirates, and Kuwait, which have infused some $20 billion into Egypt's economy since 2013. Yet the president's plans include multibillion dollar investments in undertakings of dubious financial viability. As explained in "Egypt Profile April 2015," a document produced by the American Chamber of Commerce in Egypt, al-Sisi believes the future of Egypt rests on 12 pillars, 4 of which are predominantly economic. The economic pillar calls for an average growth rate of 7 percent per year between 2013 and 2030, reaching 12 percent by 2030. By that year, it is expected that investment will reach 30 percent of GDP and the unemployment rate will be reduced to 5 percent. The urban development pillar calls for building 7.5 million homes by 2030 and resolving the slum problems. The energy pillar and the environmental pillar set equally ambitious targets for energy efficiency, air pollution, and garbage collection and disposal. There are no promises of immediate relief for Egypt's hard-pressed citizens. It is a vision for the greatness of the state, and al-Sisi has warned his countrymen that they need to be ready to sacrifice their interests to those of the state. And although the president has repeatedly declared that the private sector is key to Egypt's greatness, the specific projects he has announced so far cannot be carried out by the private sector alone.

The projects al-Sisi has announced so far are nothing short of grandiose. First among them is the broadening of the Suez Canal to allow ships to travel simultaneously in both directions, thus shortening waiting and transit time and allowing more ships to use the waterway. Government projections forecast a doubling of the canal revenue as a result of the improvement, but provide no evidence that there is enough pent-up demand to make the predictions come true. Independent estimates of increased traffic are far less sanguine than official projections, even raising doubts about the economic viability of the project.

The Suez Canal project started a year ago and the first phase was unveiled during an official opening ceremony on August 6. The project was carried out under military management and with heavy reliance on foreign contractors to undertake the dredging work because neither the military nor the Egyptian private sector had the capacity to move as quickly. The financing so far has come mostly from the Egyptian private sector: in September 2014 the government issued investment certificates yielding a 12 percent interest rate, far above market, to finance the project, reportedly attracting two-thirds of the $8.4 billion needed for the project in just one week.

The improvement to the canal is seen as the first phase of a project which will also entail the development of a new industrial zone along the waterway and of facilities to make Egypt into a Dubai-like transshipment point for international trade. The latter would involve merchandise being transferred from larger to smaller ships for distribution to different countries or, conversely, collected from various points of origin and consolidated onto larger vessels. Both projects were announced with great fanfare at an international investors' conference held in Sharm el-Sheikh in March 2015, accompanied by slick brochures but not, as far as this author can uncover, by serious studies of their economic viability. Serious doubts about the viability of the Suez Canal enlargement have already risen, as mentioned earlier. And it remains to be seen whether Egypt can establish itself as a transshipment hub in a competitive environment in which Dubai and Singapore are already well established and enjoy a strong record of efficiency.

Another grandiose project al-Sisi has announced is the building of a new administrative capital for Egypt between Cairo and the Suez Canal at a cost of some $300 billion. The prospectus for the project unveiled at the Sharm el-Sheikh investors' conference depicts an ultramodern town of skyscrapers and green parks. How the challenge of providing water, transportation, and housing for those working there will be addressed is not discussed anywhere in the prospectus, while statements by some officials that the new city will be inhabited only by highly educated people raise even more questions about whether such a city could ever function. A Memorandum of Understanding signed at Sharm el-Sheikh between the Egyptian government and the Emirati businessman Mohamed Alabbar for the construction of the first, $5 billion phase of the project was already threatened in June by disputes over financing and the failure of the military, which controls the land in the area, to make it available for free. Apparently, the military's interest in maximizing returns from the land it controlled trumped al-Sisi's interest in seeing the new capital built, suggesting al-Sisi does not have total control over the military's affairs.

A $40 billion project to build low and moderate cost housing announced in March 2014 by then Minister of Defense al-Sisi, was also in trouble before starting. The project, to be managed by the military, calls for the construction of one million housing units over a five-year period by the Emirati company Arabtec on land provided for free by the Egyptian government and with financing provided by Egyptian and foreign banks. In April 2015, the Chief of Staff of the Armed Forces Engineering Authority announced that the agreement had been suspended, with Arabtec complaining that the government was not making the land available for free but was trying to sell it, and that it expected Arabtec to raise all financing from outside Egypt.

The early difficulties encountered by these projects, touted by the al-Sisi regime as the backbone of the effort to rebuild Egypt into a modern, dynamic country, suggest that the big project approach will probably not work better under al-Sisi than it did under his predecessors. Although Nasser did succeed in building the Aswan Dam, a project that brought permanent change to Egypt, most big projects in Egypt have been a failure. In recent years, Mubarak's "New Valley" or Toshka project, which aimed at developing some 600,000 acres of new irrigated land in the Western desert and relocating 20 percent of Egypt's population there was such an abject failure that it is rarely mentioned by the Egyptian government. More recently, a low-cost housing project launched by the SCAF in 2011, which was supposed to deliver 50,000 housing units by June 24, 2014, only managed to produce 57 units by October 2014. Projects such as those unveiled so far would require some form of state participation in any developing country. What is notable in Egypt at present is that state participation appears to mean exclusively participation by the military. This suggests a further shift in the balance of power between the old, stagnant state sector controlled by the bureaucracy and the new sector controlled by the military, through which new projects are channeled.

The shift is likely to be long-lasting, even if the current projects fail, as they are likely to do. A presidential decree issued on May 18, 2015 has created a new military company called Military Production Company for Engineering Projects, Consultancies and General Supplies. The decree authorized the company to engage in a wide range of activities including development, contracting, and construction for housing, sports facilities, schools, hotels, tourist resorts, hospitals, factories, and roads, as well as urbanization and urban development activities, public relations and advertisement, real estate development, and tourism—very little seems to be omitted from the scope of the new military company. The military is thus poised to become the new, dynamic face of state intervention, but like everything that involves the military it will remained shrouded in secrecy.

The economic consequences of favoring the military-run sector over the state-run one are unclear, and may not be significant: there is no data showing one is more efficient, better managed, or less corrupt than the other. But the political consequences are clear. By putting the military economy at the center of its strategy, with control over the most important projects, the al-Sisi regime is strengthening the power of the military and its reach, and pushing the possibility of a return to civilian rule further into the future.

By channeling big projects through the military and empowering the military economy to expand into all sectors, the al-Sisi regime is also reducing the space for the private sector. The business community is worried about this development although few dare to voice their concern openly. One who has done so is Naguib Sawiris, the head of Orascom, one of Egypt's largest conglomerates. But many fear that al-Sisi's approach will reduce private companies to the role of subcontractors in projects dominated by the military.

The al-Sisi regime has taken some important steps toward putting Egypt's economic house in order, slowly reducing the budget deficit and cutting back energy subsidies and even bread subsidies. Such measures were badly needed—even the Morsi regime had tried to implement some of them—and the rate of growth has started to inch up. Even as needed reforms are implemented, and even if some of the large projects are eventually abandoned as the Toshka project was, the consequences of the present policies will be felt for a long time. Nasser created a bureaucracy with a vested interest in the perpetuation of the state sector. Al-Sisi is strengthening the importance of the military economy and in the process creating a new set of vested interests.

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