



Spectre of bankruptcy haunts Egypt

By Adel al-Toraifi May 9 2013

There were two worrying pieces of news from Egypt this week. One was the reshuffling of Prime Minister Hisham Kandil's cabinet based on partisan calculations, rather than competencies as was initially hoped. The second piece of news was the report that Egypt's population now stands at more than 84 million. This is the result of the birth rate doubling during the revolution due to the decline in birth control programs, which had previously been sponsored by the government and international institutions. The population increase is a concern for a very simple reason; it will present additional financial and environmental burdens on Egyptian society, particularly in the country's already overcrowded cities and slums.

Two decades ago, Egypt was one of the world's largest agricultural exporters, whereas today it is one of the largest importers of wheat. For this reason, it is no surprise that we find President Mursi requesting that his Russian counterpart Vladimir Putin—at the height of Russian military aid to the Bashar al-Assad regime in Syria—grant Egypt preferential rates in an attempt to reduce the cost of subsidizing bread. There can be no doubt that the economy could force political concessions simply to guarantee the price of bread. In a country where incomes have declined over the past two years, more than 60% of foreign currency reserves have evaporated, and the Egyptian pound has lost 7% of its value since the beginning of the year, talk about a program of economic reform is not just necessary, it is crucial. Unfortunately, it does not seem that the ruling party today—or the Brotherhood, if you prefer—is serious about solving the problems facing the Egyptian treasury and the economy at large, not to mention putting an end to the weakening of the Egyptian pound and record inflation.

Delaying the crisis

However, more dangerous than this is some observers resorting to the tactic of “delaying the crisis” for future budgets, saying that the deficit in the trade budget is normal under such circumstances, and that this can only be resolved in future budgets. This is because expenditure, from their point of view, is necessary to revive growth during the current stage of economic slowdown that Egypt is experiencing.

In principle, this proposal has merit. However, in terms of implementation during the Mursi era, expenditure—rather than investment—is already on the rise, thanks to government assistance programs,

not to mention other financial burdens on the state. Of course, there are those in Egypt who play down the risk of the treasury becoming bankrupt, believing that the Egyptian economy is, as they say, too big to fail. They base this on Egypt's huge human resources and wealth, and expected sources of financing, such as foreign investment and tourism, particularly if political stability can be ensured.

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Those who hold this opinion believe that domestic demand will prevent the Egyptian economy from facing bankruptcy. But hold on—this view is based more on the sense of Egyptian national dignity, rather than the language of numbers. Brazil and Mexico would have announced bankruptcy during the 1980s were it not for the intervention of the International Monetary Fund (IMF) and the World Bank. Everybody knows how countries like Chile in 1975 and Yugoslavia in 1989 and Nicaragua in 1990 went bankrupt, or, to put it in the language of economists, experienced huge inflation and the collapse of the national economy.

Let us take Argentina in the 1980s as an example. Argentina borrowed in a way that repayments became a heavy burden, and following the loss of political stability in the country—as is happening today in Egypt—international lenders refused to help. As a result, the country had no choice but to devalue its currency in order to reduce the value of its debt. This was a way of announcing bankruptcy.

Egyptian vulnerability

Is the Egyptian treasury vulnerable to bankruptcy? Not yet, but if it continues on this course then there can be no doubt that this will be its fate. There can also be no doubt that some people are relying on Western or Gulf assistance; nobody wants to see the Egyptian treasury declare bankruptcy, as it would have political and security consequences for everybody.

However, at the same time, the Egyptian government is not helping itself or allowing others to help it to fix the situation. What does it mean for Kandil to name an al-Azhar professor specializing in Islamic jurisprudence and murabaha (Sharia-compliant sale) as the country's new finance minister? What does specializing in Islamic studies have to do with the USD 4.8 billion interest-based IMF loan? The answer is that this minister was appointed simply because he is affiliated with the Muslim Brotherhood, and he only has the power to pass directives—not to implement the required corrective plan.

Although the judgment against the new finance minister may come a little early, would it not have been better to choose a competent Egyptian with international experience who enjoys the confidence of the national private sector. If you remain unconvinced of the possibility of bankruptcy, then you must face the facts: Egyptian GDP per capita is less than U.S. \$2,000 per annum and the average Egyptian household's expenditure on foodstuffs represents more than 50% of its annual income, despite government subsidies of bread, cooking oil and fuel.

According to a study by researcher Dalibor Roháč of the Washington-based Cato Institute entitled "Towards a reform of Egypt's commodity subsidies," a third of Egyptian public spending goes on subsidizing foodstuff and other goods, while around 80% of the Egyptian population depends on government financial assistance. This is the state of affairs created by the 1952 revolution, which turned Egypt into a consumption-based economy, establishing a black market which, for decades, specialized in pillaging this financial assistance. Roháč's study shows that only a quarter of this assistance finds its way to Egypt's poor, with the rest benefitting the middle and upper income brackets.

Reforming government support

It is true that some of the ruling Freedom and Justice Party members have spoken on a number of occasions about their intentions to reform the system of government support, suggesting a number of mechanisms that failed to achieve much. However, the IMF loan conditions are based mainly on the gradual reduction of fuel subsidies, which is a pledge that Qandil's government has failed to fulfil, fearing the response of the street which is still in a "revolutionary" mindset.

Egypt could try replacing the government subsidization system—which is a program whose corruption and lack of effectiveness has been proven for decades—with direct support for the poor: directly providing funds, or coupons, to the poor so that the government can revive market competition. There are a number of successful examples of this model; however, that does not necessarily mean that it would succeed in Egypt. There are a number of reasons for this, most prominently the government's lack of administrative competence, not to mention the lack of legitimacy that would allow the ruling party to take difficult decisions without the street rising up against them.

In Iran, for example, President Ahmadinejad tried to implement this in two stages. However, the result was an increase in expenditure, as more than 95% of the people applied for direct financial assistance, while the political parties and forces rejected the price increase imposed on fuel. In other words, the results were both counterproductive and costly: the people know how to take advantage of the government's funds.

The Freedom and Justice Party are facing a huge challenge, and failing in this task may take Egypt back decades, both economically and politically.