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Egypt in the Arab Spring: Multidisciplinary Research Perspectives

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On the Unintended Consequences of Economic Integration in the Age of Neoliberal Globalisation: The Cases of Tunisia and Egypt

Abstract. The first two regimes affected and brought down by the Arab uprisings were also the two regimes in the Middle East to have received more praise from international financial institutions and main donors for their economic reforms. This paper aims to investigate this irony from an International Political Economy (IPE) perspective, in order to grasp whether the relation between the supposed economic success and increasing political instability leading to popular upheaval and eventually regime change is an entirely spurious one or whether a causal path can be identified and reconstructed. The argument advanced is that the economic reforms carried out by Tunisia and Egypt during the 1990s and 2000s led to a form of differential integration into the global political economy (in sectoral, spatial and social terms), which produced major vulnerabilities in the national economy. On the one hand, greater market integration increased exposure to the effects of the Great Recession following the global financial crisis. On the other hand, the implementation of the complementary policy changes usually adopted in the most recent phase of globalisation left both states with fewer instruments for ameliorating the adverse impact of the global economic downturn. Hence, differential integration and self-imposed weakening of state economic capacity left incumbent regimes ill-equipped to face mounting discontent, providing two necessary – though not sufficient – conditions for regime change to occur in Tunisia and Egypt.

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Introduction

The last couple of years have seen an understandable surge in the literature attempting to grasp the many causes of the Arab uprisings, and of the regime change that ensued in several Middle Eastern countries. A yearning for civil and political freedoms denied by repressive regimes has been considered almost unanimously one of the reasons leading to the mass protests first in Tunisia and then in many other countries in the region. Forms of emulation deriving from the increased diffusion of means of mass communication have also been often mentioned as important triggers for the regional contagion. Other authors have pointed to the explosion in youth unemployment produced by the combination of the reverberations of the global economic crisis and blockages in national labour markets. Some other authors have identified rising food prices as the single most important factor for explaining the Arab uprisings (Lagi, Bertrand and Bar-Yam 2011).

To date, however, not many scholars and commentators have discussed how the overall process of economic reforms carried out by some Arab countries, and by Tunisia and Egypt most notably, might have created some fundamental preconditions, which provided the essential groundwork on which all the aspects mentioned above, and many more, interacted producing the fall of Ben Ali and Mubarak. This essay undertakes this task. More specifically, it investigates whether there is anything more than an unfortunate coincidence between Tunisia and Egypt being considered the poster children of structural reforms in the Arab world and these same two countries also being the first ones to see their rulers toppled by popular upheavals. Whereas the need for substantial transformations of their national economy cannot be contested, this essay suggests that the direction and the form in which reforms took place in both countries through subsequent waves starting in the early 1990s produced major vulnerabilities in the economy. More specifically, while the attempt to become more integrated in the global political economy was not necessarily harmful in itself, the way in which it was pursued ended up both weakening the national economy and most importantly weakening the state, leading to a crisis of its effectiveness that in the wake of the global food and financial crises also became a crisis of legitimacy. This provided a fertile ground for a broad-based, if temporary, alliance between discontented middle classes and increasingly impoverished sections of the working classes. Thus, in causal terms, the

argument advanced is that the reforms implemented in order to achieve greater integration in the global economy provided a necessary – though in itself not sufficient – condition for regime change to occur in both Tunisia and Egypt.

The paper proceeds in the following way. The first section discusses the rationale behind the Washington Consensus reforms pushed upon the Tunisian and Egyptian governments since the late 1980s and contrasts it with the understanding of successful economic development provided by two traditions in heterodox political economy, and more specifically institutional economics and critical political economy. This comparison will serve to expose the contradictions within the mainstream discourse on economic development promoted by international financial institutions and main donors, and to a significant degree accepted by successive governments in Tunisia and Egypt. The second section analysing the consequences of increased economic integration achieved via orthodox policies, focusing more specifically on three forms of differential integration in the global political economy, creating ever-wider fractures between finance and production, rural and urban areas, and between haves and have-nots. The third section then discusses how exogenous shocks, such as for example the global food crisis and the recession following the global financial crisis, impacted on the Tunisian and Egyptian social fabric, characterised by these several layers of differential integration. This will give the chance of analysing how global and domestic crises, as well as economic and political crises, interacted mutually reinforcing themselves, and how this provided a crucial precondition for the revolutions bringing down Ben Ali in Tunisia and Mubarak in Egypt.

Orthodox prescriptions in the light of heterodox political economy

The modalities in which economic reforms in both Tunisia and Egypt have been conceptualised, promoted and implemented have been discussed at length in the relevant literature. At the same time, it is imperative to pay some attention to the dynamics of economic reforms, and of the interactions between national and international institutions in negotiating such reforms, in order to understand the narrative constructions of both cases of 'success stories' of structural reform in the Arab world.

In the mid-1980s Tunisia and Egypt shared similar economic problems. In the former case, the window of opportunity for structural reform appeared in 1987 with the power handover from Bourguiba to Ben Ali, whose very first motto once taken office was *le changement* (change). This change was to be mostly economic, with very little advancements made with respect to a consistent pluralisation of the political system. In Egypt, Hosni

Mubarak had become president already in 1981, a week after the assassination of Sadat. However, there is a vast literature that discusses how the first years in office by Mubarak were very much characterised by continuity with Sadat's economic policies, whose impetus towards opening (*infitah*) had waned already by the late 1970s. Galal Amin suggested that it was only with the fiscal crisis of 1987, and the following engagement with the IMF, that within the ruling circles there was a 'reckoning' of the unsustainability of the economic path (1995: 16). Indeed, the 1987 crisis is also important because it represented the first attempt on the part of international financial institutions (IFIs) to impose on Egypt the set of reforms usually known under the label of 'Washington Consensus', as summarised in John Williamson's famous decalogue of economic policy prescriptions (1989).

Table 1 – Washington Consensus

1. Fiscal discipline
2. Redirection of public expenditure away from generalised subsidies and towards education and health
3. Tax reform (lower marginal tax rate and broadened tax base)
4. Interest rates liberalisation
5. Competitive exchange rates
6. Trade liberalisation
7. Liberalisation of inflow of FDI
8. Privatisation
9. Deregulation
10. Secure property rights

In theoretical terms, the Washington Consensus was grounded in the neoclassical synthesis, which aimed at overcoming what were perceived as the rigidities of the Keynesian model while at the same time keeping some of its elements. More specifically, the idea that the government had to be activist in macroeconomic policy was not rejected altogether, as often believed, but rather only fiscal activism had to be abandoned, whereas the government was required to be if possible even more activist with respect to monetary policy. However, the objective of monetary policy changed radically since the Keynesian phase running from World War II until the end of the collapse of the Bretton Woods exchange rate regime. Whereas then monetary policy was modelled around the trade-off between inflation and unemployment as conceptualised by the Phillips curve, both theories of rational and adaptive expectations suggested that consistently loose monetary policies would produce higher inflation without a corresponding decline in levels of unemployment. To some degree both theories thus supported a return to the classical quantity theory of money, thus rolling back time to the late XIX century and the first wave of globalisation. Following from this, and from the collapse of the Bretton Woods system which forced central banks to focus

on keeping the peg, the main aim of monetary policy was to ensure price stability and thus low inflation. In turn, this would allow the economy to operate close to its output frontier while at the same time avoiding the rise of the twin deficits (current and capital account) and of public debt beyond sustainable levels (Cornia 2012). At the same time, another inescapable element characterising the Washington Consensus is the belief in the ineffectiveness of barriers to capital movements. It is in this specific point that one could locate the link between open economy macroeconomics, working on the 'unholy trinity' as developed by Mundell and Fleming, and theories of rational and adaptive expectations.

Starting from these theoretical tenets, accompanied by a few others which will be discussed further below, it only makes sense for IFIs to suggest developing countries to abandon the *étatist* path they had been following since the 1950s and follow the policy directions suggested in Table 1. For the sake of analytical conciseness, these could be further summarised into three groups. Firstly, general macroeconomic policies focusing on the fiscal stance of the state and the potential for sustained growth. An important corollary of this first element relates to the rather narrow understanding of what macroeconomic policy is, which translates into an attempt at reducing substantially state presence in the economy, for example through the privatisation of public sector enterprises. Secondly, the liberalisation of the financial sector with respect to both capital movements and banking sector ownership. Thirdly, trade liberalisation in both its internal (abolition of price controls and phasing out of subsidies) and external (removal of tariff and non-tariff barriers) components.

Indeed, if these are dimensions upon which reform had to take place, then both Tunisia and Egypt fared remarkably well. If one looks at the latter example, the evidence of a successful, even if patchy, transition seems rather convincing. Inflation fell from an average of 19% a year during the 1987-91 period to 4.6% in 1997. The budget deficit was drastically reduced, from 15.3% in 1991 to 1.3% in 1996, 'an effort that has perhaps few international parallels in recent history'. On this point, however, it is important not to forget that more virtuous fiscal policies were accompanied by substantial debt forgiveness on the part of Paris Club countries in exchange for support in the first Iraq war. Dollarisation and the rate of liquidity growth also fell considerably, thus conforming to the key tenets of monetarism.

Although on less unilateral terms, results were positive also with respect to the other dimensions entailed by the Washington Consensus. With respect to trade liberalisation, the number of items subsidised by the government fell from 17 to 4 during the first years of macroeconomic stabilisation and structural adjustment (Ikram 2006). This was gradually

accompanied by the relaxation of price controls and the reduction of tariff barriers, further accelerated by WTO accession in 1995 (Abdel-Khalek 2001). Privatisation during the 1990s, though not as wide-ranging as demanded by IFIs, led to the sale of more than a hundred state-owned enterprises (SOEs), with the Egyptian programme being ranked the fourth in the world in terms of privatisation receipts as a share of GDP (IMF 1997). In finance, the liberalisation of interest rates effectively preceded the signing of the 1991 stand-by agreement with IMF and World Bank. However, in the banking sector the government was much more reluctant to give up shares of the big four public banks and of the myriad joint-venture banks. However, after a phase of stall in the reform process, this task was pursued with much more decision since 2004 under the Nazif cabinet, which supervised the divestiture of 94% of share in joint-venture banks as well as the privatisation of Bank of Alexandria, the smallest of the big four.

With minor variations, this same situation is mirrored in the Tunisian case.

Thus, on the parameters of interest to IFIs, while not entirely satisfactory, economic reforms in Tunisia and Egypt since the late 1980s went a long way in transforming the national economy in the direction hoped for by international organisations and main donors. This was also reflected in generally positive, if somewhat inconsistent, growth trends. Thus, it is fair to say that the success narrative did have some empirical elements to cling on to. Egyptian policy-makers started to portray their country as 'the Tiger on the Nile', recalling the East Asian developmental experience, and similarly Tunisia was defined by an external observer as 'a country that works'.

At the same time, it is equally important to point out that these transformations did not incur in any costs, and that the path undertaken by the Tunisian and the Egyptian governments were not free of risks and pitfalls. However, this aspect of the threats posed by the direction of these transformations is largely obscured by the mainstream narrative, partly because of theoretical inclinations (i.e.: income inequality seen as engine of growth rather than a problem, as it encourages risk-taking on the part of entrepreneurs who want to climb the wealth ladder), and partly derived from genuine misreading of the peculiarities characterising each developing country, and even more so in the case of Arab countries such as Egypt and Tunisia (one-size-fits-all on the part of IFIs combines with the benefits and risks of dealing with post-populist regime which are also second-order rentier states where wealth is largely managed in patrimonial and patronage-related ways). For these reasons, it is better to refer to heterodox traditions in order to understand the risks of the application of

the Washington Consensus recipes and how they might have played out in the cases of Tunisia and Egypt.

More specifically, this study refers to two rather different traditions of heterodox political economy which in my view can be combined fruitfully for understanding the problems brought about by the transformation of these economies. On the one hand, I refer to the analysis of the economic risks of orthodox recipes as put forward by heterodox institutional and post-Keynesian economists such as Ha-Joon Chang, Ilene Graebel and Giovanni Andrea Cornia. On the other hand, I refer to the tradition in critical political economy focusing on the challenges and contradictions of capitalist development in the age of neoliberal globalisation. It is possible to identify two significant tensions running between these two traditions. The first relates to how the lessons of history are taken into account. The argument of institutional economists is best summarised by the image of industrialised countries 'kicking away the ladder', as eminently put by Chang. In other words, while historically the state has been fundamental for the rise of any given economy, when becoming dominant in a given sector – or by extension in the whole economy – it becomes advantageous to call for the dismantlement of state intervention, as prior state intervention has now been absorbed by market actors who have enjoyed state protection during the first phases of their growth. Calling for more market and less state would amount to depriving poorer countries of the main tool for achieving sustainable development. Thus, for institutional economists the central role of the state is a necessary condition for catch-up, and hence for successful economic development. On the other hand, critical political economy tends to put a heavier emphasis on the relational dynamics that are inherent in capitalist development, and that thus limit the potential of positive (or negative, for that matter) state intervention. This is mostly for two reasons: (1) Earlier developers inevitably alter the structure of constraints and opportunities facing each country that is attempting to develop afterwards; this was true for the economic development of Germany during the times of the Pax Britannica as it has been more recently for China and India in the times of US hegemony. (2) Since the late 1960s we have witnessed an unprecedented increase in flows of capital, goods, services and people that act as a further element changing the options available to developing and underdeveloped countries. In other terms, the ability of capitalism to renew itself after each epochal crisis translates in a change in both the possibilities of catching up successfully and the modalities through which this can happen.

The second tension is more general and refers to what is the main problematique concerning development. For heterodox economists, the main objective is catch up, and thus

the reduction of global inequalities. On the other hand, critical political economists such as Ben Fine suggest that this is only a partial understanding of development, which should also pay attention to changes in within-country inequality. Indeed, one of the side points here is that rising within-country inequality was one of the key elements driving both the Tunisian and the Egyptian protests. A focus also on within-country inequality thus allows us to pay more attention to the winners and the losers of the reform process, and thus – ultimately – to issues pertaining to broader social and power relations.

Heterodox institutional economists suggest that there are risks on all the dimensions of reform entailed by the Washington Consensus. In general macro terms, the main risks concern what is called stabilisation overkill (larger-than-expected improvements in the budget deficit but also larger-than-expected contraction of GDP) and falling public revenues which derive from the interaction of tighter public spending and complementary changes, particularly regarding profit and corporate taxes, aimed at attracting foreign investors but ending up reducing the amount of total taxes paid. Thus, while they aimed at improving both growth and fiscal stance, the very same Washington Consensus policies contained elements that might potentially undermine the potential of achieving their very goals. With respect to the financial sector, liberalisation without adequate financial regulation and supervision might increase the volatility of inflows and outflows, while allowing for the capture of benefits from financial globalisation on the part of a small minority. With respect to trade liberalisation, negative effects might materialise because of the so-called 'skill-enhancing trade hypothesis' (you attract capital-intensive technology from abroad which raises the demand of skilled labour which you lack) and because of the so-called third-party effects (you expect to specialise in labour-intensive production, but then countries with even better labour to capital endowments enter the world market: thus, your producers are not shielded anymore domestically and their comparative advantage abroad is not enough and indeed overcome by lower-cost producers: thus, export-led growth cannot happen).

However, developing countries do not face only these problems directly related to catch-up. Rather, there are some more political economy risks which are best captured by literature rooted in the field of critical international political economy, and thus looking at how dynamics of capital accumulation on the global stage inevitably transform both the options for insertion in the global economy, and the way in which such insertion in the global economy impacts on different social groups within society. Three of the points emerging from this literature are of paramount importance here: (1) state weakened both with respect to its welfare provision (spending cuts better than tax increases for budget

reduction) and *vis-à-vis* large companies, both domestic and foreign (emerging of a new business class which has a strong influence on policy and more generally on government); (2) increasing inequality and social polarisation; (3) traditional channels of representation are not enough anymore to express discontent with the direction the economy and society are taking.

Dimensions of differential integration

The combination of these two strands of critique to the Washington Consensus allows us to consider the hidden face of the neoliberal transformation experienced by both the Tunisian and the Egyptian economy. More specifically, it appears that most of the risks involved in the mainstream recipes outlined by heterodox and institutional economists were very much verified in the Egyptian case.

Thus, despite the improvement of aggregate indicators on which the success narrative was based, the transformation in economic fundamentals meant that the catch-up motivating the adoption of mainstream recipes was not illusory, but in fact obfuscated the fact that even the prospect of catch-up in the medium to long-run had become less and less likely because some of the reforms were undermining the productive potential of the Egyptian economy.

At the same time, the focus on critical political economy, and thus on how capitalist development in the era of neoliberal globalisation affects power relations within countries, helps us understand the other side of the dramatic transformation experienced by Tunisia and Egypt. Indeed, all of three risks suggested by the relevant literature very much materialised in the wake of reforms.

(1) The state got weaker in two ways: on the one hand, reduction of welfare provision, shift towards cost-recovery in health and towards increased privatisation in education; on the other hand, this very privatisation, combined with transformations with respect to the workings of representation mechanisms (more below), produced a disproportionate influence on the part of big business, foreign but more often Egyptian itself.
(2) Increasing polarisation and inequality, visible in the increased impoverishment of the 'second stratum' but also in the increased pauperisation of the working classes and the informalisation of the labour market. This can be linked back to the point made by heterodox economists that the benefits of financial globalisation, which were to a degree present, were entirely captured by a very tiny part of the

population. This is particularly visible for example with respect to bank lending, with about 50% of total credit in 2010 being available to 0.18% of the Egyptian companies. This can also be related to the dramatic increase in informalisation (recall some of the relevant debates in order to say that this is not a transitional phase, but rather a structural transformation).

(3) These deeper dynamics also had implications for the functioning of populist representation. On the one hand, we had the rise of a new business class that – contrary to the one emerged from the *infitah* – did get directly involved into decision-making, as witnessed by the composition of the Nazif cabinet. On the other hand, the representation of the interests of the weaker groups in society became less and less effective. For example one could see the cooptation of the trade unions and the total disempowerment of workers in the factory (which to some degree underpins the remobilisation taking place since 2007). Something similar, even though less heard of, took place in the countryside, with the land reform (agrarian counter-revolution) killing small farmers.

The take-away point here is that these reforms, while improving aggregate indicators in the short-term (recall growth and FDI fetishism), were at once worsening the long-term prospects of catch-up and empowering those who already had at the expense of those who had little or nothing. This was compounded by the highly uneven forms of integration in the global political economy. It is indeed possible to identify three fundamental fractures in this respect, which effectively reverberated strongly both materially and symbolically in the fabric of Egyptian society. The first dimension of differential integration relates to the systematic precedence that exchange takes over production. This can be seen in the substantial increase of the role of financial intermediaries (banks most of all) *vis-à-vis* productive enterprises. The second dimension of differential integration is instead a geographical one, and relates to the ever-greater urban bias (already there), with urban areas significantly more exposed to foreign investment and more generally to the potential benefits of globalisation, and rural areas becoming ever poorer. The third dimension of differential integration relates to the dramatic increases in wealth and income inequality. The figures mentioned above regarding access to credit are rather telling, and could be corroborated with both empirical evidence and anecdotes on the incommensurate lifestyles of globalised Cairenes who would travel abroad several times a year and the millions of people housed in Boulaq al-Dakrur who have never been to Zamalek a mere miles away. Indeed, income inequality has also been further exacerbated by the dramatic decrease in

working rights, which derives directly from the increasing role of the informal sector (where rights are few or non-existent almost by definition) as employer of last resort.

Thus, what we could was improvement in aggregate indicators, but also increase in the general vulnerabilities of the economy and in the levels of inequality between different strata of the population. This was hardly a recipe for long-term success. Enter the global financial crisis.

The international political economy of mutually reinforcing crises

Legitimacy crisis in general, which had also led to the rise of middle-class protest movements, particularly during the 2005 electoral campaign (however, middle class mobilisation usually ebbed and flowed) → The rise in food prices interacts with the remaining subsidies on wheat, which effectively produces bread undersupply (price increase is a by-product of this rather than a direct effect – see Cook 2012) → The populist state, which because of its deficits in representation had to count so much on providing for its citizens, cannot do this anymore; thus the crisis of legitimacy is also compounded by a crisis of effectiveness, which is particularly felt by lower-income strata → Preconditions for a widespread crisis are set up; this is the background socio-economic story without which the revolution could not have happened → This is a necessary but absolutely not a sufficient condition for the overthrow of Mubarak and Ben Ali, but at the same time it tells us a lot about the risks of relying excessively on the guidance of international organisations which do have their own agenda, which does not necessarily transpose into the best agenda for the developing countries they are engaging with → In this respect, without necessarily going in the direction of the total transformation of power relations in the country (which still would be 'advisable'), it might make sense in developmental terms to look more closely at the experience of those countries which have succeeded to implement a strategy of 'defensive integration' in the global economy (Bresser-Pereira 2011), adopting what has been called a new structuralist approach to reform → List of reforms that do not conform with the WC template

1. Reducing dependence on foreign savings and mobilising domestic savings → against the FDI reliance on WC;

2. Controlling capital inflows and harnessing their allocation → against liberalised capital account and hands-off financial sector growth;

3. Exchange rate policy geared towards first avoiding currency crisis and then boosting growth → away from exchange rate competitiveness to allow for export-led growth;

4. Long-term equilibrium or surplus of the current account balance → against *de facto* deficit financed via FDI and portfolio flows;
5. Increase in intra-regional trade → against increase in multilateral trade targeting developed countries;
6. Countercyclical fiscal policy, with greater role of automatic and discretionary stabilisers → against absolute priority of closing down budget deficit;
7. Progressive taxation → against increase in regressive forms of taxation such as VAT;
8. Countercyclical monetary policy, allowing for relatively higher and more flexible inflation → against the priority given to low inflation;
9. Stricter bank and financial sector regulation and supervision → against financial *laissez faire*.

→ Most importantly, these unorthodox strategies, while effectively allowing catch up, have also managed to keep levels of inequality relatively under check.

Conclusion

Strategy of passive integration (do what you are told) turns out to be – despite the praise of IOs and donors – much less successful than a strategy of 'defensive integration'. At the same time, given what has been happening over the past weeks in Brazil, and what appears to be imminent in China, even this strategy of integration might be starting to show its cracks. Structural transformation towards a more equitable distribution of power, wealth and resources as the only way out of the long-term crisis we are in?