

## INTRODUCTION

*The budget is the skeleton of the State stripped of all misleading ideologies.*

—Rudolf Goldshield<sup>1</sup>

IN HIS 1989 BOOK *Mubarak's Egypt*, Robert Springborg, a well-known scholar of Egyptian politics, ventured some predictions about changes in the political orientation of the Egyptian regime, which was facing a stifling fiscal crisis toward the end of the 1980s.<sup>2</sup> Failing to continue the repayment of its foreign debts in 1989, the Egyptian state reached a situation of near-bankruptcy. Springborg believed that this crisis would cause the political regime to adapt to the deterioration of its resources and a reduction in its beneficiaries, and therefore would be more accommodating toward its increasingly numerous and influential opponents. Springborg presented a number of possible scenarios for political transformation in Egypt. The first was a dictatorship based on an alliance between the military and capitalism that would rule with an iron fist and implement ultraliberal economic policies. This is the scenario that prevailed in Latin America in the 1970s and 1980s, where countries were also exposed to acute indebtedness crises. The second scenario shares the first one's economic orientation and authoritarian tendency, with the difference being that the system would forge an alliance with the Islamists in order to give religious legitimacy to its monopoly of power, as did Ja'far al-Numayri in Sudan.

Springborg's third scenario eventually materialized, namely that the Egyptian regime would seek to entrench the de facto situation while once again awaiting an inflow of resources. This took place when Saddam Hussein's tanks rolled across the Kuwaiti border in August 1990. In the resulting war against Iraq, the international coalition led by the United States needed Egypt's participation and consequently agreed to write off about half of Egypt's

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foreign debts and pump aid into the empty public treasury. The state's fiscal crisis was mitigated, and the political regime was able to resume its authority and domination.

No one expected such a miracle to occur so quickly. For example, Reuters' analysis on the economic crisis in Egypt in 1990 quoted an Egyptian economist who said that every time analysts expected the Egyptian economy to reach an impasse, a miracle happened, but he predicted that there would be no miracles this time.<sup>3</sup> Only two weeks following this statement, Saddam Hussein occupied Kuwait, and foreign resources again flowed into the public treasury.

The momentum gained by the state in the early 1990s slowed down halfway through the decade, and the fiscal crisis resumed by the decade's end. As of 2010, there has not been another new miracle, other than a limited financial inflow from the United States in 2004 to compensate Egypt for losses incurred as a result of the U.S. invasion of Iraq.<sup>4</sup>

The relative improvement in the public treasury at the beginning of the 1990s was a brief hiatus in a long series of crises. Since the mid-1980s, the Egyptian state has been exposed to a structural fiscal crisis whose main symptoms are large budget deficits and chronic indebtedness, both external and internal. This is considered the most serious fiscal crisis faced by the state since the royal dynasty established by Muhammad Ali in 1805, with the exception of the debt crisis suffered during the reign of Khedive Ismail (1863–79), which culminated in foreign intervention and the British occupation of Egypt.

The Egyptian regime is achieving limited success in mobilizing and generating additional income to meet the increasing requirements of the state, but it has been unable to cut back its expenditures to match its declining public revenues. The deficit is the most fundamental challenge that has confronted the Egyptian political regime in the Mubarak era. Although the regime has failed to resolve the state's fiscal crisis, it has coped with it and has achieved relative political stability. The last phase of coping is managed by Minister of Finance Youssef Boutros Ghali, who has occupied this position since 2004.

This book explains how a political regime has succeeded in dealing with a rapid and steep decline of revenue. When Mubarak assumed power in 1981, the state's revenues stood at around 60 percent of GDP; now the state must make do with only half of what was available at the beginning of the 1980s.<sup>5</sup>

This success in achieving political stability, as we will later observe, is not due only to the regime's restriction of freedoms or to its resort to a higher level of repression.<sup>6</sup> Egypt since the mid-1970s is an instance of an authoritarian regime whose stability has depended on a quasi-rentier state that obtained large influxes of money from oil, Suez Canal revenues, and foreign aid. But how has the Mubarak regime managed to perpetuate its stability despite the sharp drop in rentier revenues since the mid-1980s, and how has Egyptian politics changed as a consequence of this decline? These were the central questions that prompted this study.

The stability of Mubarak's political regime should not obscure the political transformations taking place in Egypt as a result of the fiscal crisis, the attempts to overcome it, and the strategies to cope with it. In this book, we follow the causes of the fiscal crisis and analyze the regime's attempts to deal with it. We study its impact on the state and the state's relationship with society and analyze the increased share of public resources for some institutions and the drop in the share for other institutions. We also attempt to explain how the fiscal crisis led to a complex phenomenon: the accelerated tendency toward centralization of the state accompanied by an inclination to fragmentation into isolated islands. Moreover, we focus on the regime's attempts to boost state revenues and show how these attempts failed, one after another, and how the nature of the political regime is an obstacle to increasing revenues. The book monitors and analyzes the political consequences of the state's ailing finances, particularly the growth of independent economic centers of power that are moving into the political arena and seizing positions in the political regime. This seizure is facilitated by the increasing political role played by the president's son, Gamal Mubarak, who transmits demands and influence from the rising bourgeoisie to the old ruling bureaucracy, whose main representative has been his own father, Hosni Mubarak.

### **THE POLITICAL ECONOMY OF THE STATE**

This study adopts the methods of political economy, the discipline that focuses on the dialectical relationships between the economic and political fields in order to explain the transformations in both. We believe that political economy is the most suitable perspective to study a subject such as state finance, in which economic and political variables must be taken into account to enable understanding. Since the inception of classical economic theory in the eighteenth century, mainstream economics has steered far away from

politics, despite the close connection between the two. The discipline of economics was originally known as “political economy.” This term was used by classic thinkers like Adam Smith and David Ricardo, and was later adopted by the radical Karl Marx to define the science that studies production and exchange.

Since the publication of Alfred Marshall’s book *Principles of Economics*,<sup>7</sup> the term *political economy* has been supplanted by the term *economics* and has come to carry a leftist and radical connotation, sometimes being used in the sense of “radical economics,” the tradition that focuses on issues like the theory of value, income inequality, and redistribution of wealth. Our approach in this book draws upon the radical and Marxist tradition of political economy, fully adopting the Marxist premise that political power has an important socioeconomic foundation. In other words, the question of who and how a group of people in a society hold political power cannot be answered without understanding who and how economic resources are owned and managed. The influence of the Marxist tradition on the study is most noticeable in Chapter 5, where the diminishing size of the state and the rise of Egyptian capitalism are shown to exert deep changes on the political front.

This study draws as well upon the political economy of the neo-Weberian tradition that has been expanding since late 1980s, with many scholars studying the impact of political variables on the economic field. This tradition was not confined to studying the impact of the economy on politics but also studied the impact of the state and its institutions on the evolution of economic systems and on their success or failure. The neo-Weberian tradition has revived the field of political economy since the 1980s, after its marginalization because of its Marxist and radical flavor.

The revival of political economy has been accompanied by increased interest in the state. This can be attributed to many factors, the most important being the success of capitalist development in Southeast Asian countries. This development did not occur without the participation and even the leadership of the state. The Asian success produced wide-ranging discussions on the nature of the state in Southeast Asia, comparing it to the state in Latin America, where capitalist development was less successful. Some researchers explained that the Asian state was strong, especially according to the neo-Weberian approach,<sup>8</sup> whereas the Latin American state was weak. State strength here does not mean the ability to suppress opponents, but rather the ability to penetrate and change society, while also efficiently formulating and strictly implement-

ing rational development policies. Here, Michael Mann's typology of state power makes the point. According to Mann, there are two types of state power, despotic and infrastructural. Despotic power refers to the range of actions that state elites can undertake without routine negotiation with civil society groups. Infrastructural power, in contrast, is the institutional capacity of a central state, despotic or not, to penetrate its territories and implement decisions.<sup>9</sup>

This neo-Weberian approach tried to formulate quantitative and qualitative indicators to measure the strength of the state. The quantitative indicators included the ability of the state to mobilize economic resources, as demonstrated by indicators such as the ratio of taxes to GDP. It also included the state's ability to mobilize human resources by reading indicators such as the ratio of children and youth enrolled in education. Qualitative indicators included phenomena such as harmony and internal unity of the state (low level of internal conflict) and "the State's ability to reorganize society and reshape its daily life," according to Joel Migdal.<sup>10</sup>

This study draws upon the important concept of state strength proposed by the neo-Weberian tradition in the last two decades, but not without a critique. Writings concerned with state strength often suffer from a theoretical problem: The indicators they use to measure state strength are often the variables that explain this strength. Therefore, the harmony and internal unity of a state, for example, are not only indicators of the strength of this institution but also factors that explain it. However, if a state's strength can be attributed to the existence of a technocratic developmental elite within it, and therefore its weakness would be due to disunity and conflict therein as maintained by these writings, where does the developmental elite come from? What are the factors that determine harmony or internal conflict in a state? These writings are sometimes trapped in circular logic, for they explain the state by the state. Therefore, a state is strong because it is strong. The authors of the strong state thesis started with the idea that the success of economic development is not related to the nature of the state (democratic or otherwise), but is closely related to the degree of the state's strength. They noted that capitalist economic development had succeeded in countries governed by authoritarian regimes. That is why they did not give much importance to the nature of the political regime when explaining the success or failure of development. This was a significant error. It is true that the success of capitalist development has little to do with whether a ruling regime is democratic or authoritarian. There are

successful development examples under democracy and others under authoritarianism. But the nature of a political regime is not only measured by the degree of democracy but also by its relationship with society—that is, the social alliance upon which the regime is based. Even the most repressive regimes require some social support to achieve economic or social objectives.

In other words, the strength of the state is derived from the ruling social coalition that is formulated and organized by the political regime. This alliance permits the regime to realize the institutional changes needed for capitalist development process. This hypothesis stems from the observation that successful capitalist experiments in the third world occurred in countries that witnessed strong social polarization that reached an explosive stage. Authoritarian regimes in Asian countries and in Chile came to power following social conflict that was ended by force of arms. Most of these countries had leftist (Chile) or communist (Indonesia) movements that managed to assume power or came close to doing so. That is why social conflict reached its zenith, dividing society into two large camps. This problem was resolved militarily, and one party suffered a crushing defeat. The road was thus opened to implement capitalist development by force. The Asian dictatorships, however repressive, had a social constituency composed of a solid societal alliance between capitalist groups and sections of the middle class founded on fear of the communist or leftist alternative. This strengthened the efforts of regimes in applying radical institutional changes. A solid social alliance is the prerequisite for carrying out institutional reform that will have adverse effects on certain groups in society, a matter that will foment hostility against the regime by those who will lose positions or benefits. In this case, the regime will not be able to impose change unless it can rely on a societal alliance as it daily encroaches on the state's institutions in a bid to redefine them. Hence, countries that have succeeded in capitalist economic development have in the past had strong anticapitalist movements, either leftist or communist. Countries where socialism or communism had a certain measure of success are those where capitalism eventually succeeded. Those countries that failed, failed in both socialism and capitalism. That is to say, polarization is very important in the formation of a strong state.

Thus while this study benefits from the neo-Weberian concept of the strong state and uses it to understand the crisis of economic development and of public policies, it does not share the neo-Weberian disregard of the nature of the political regime and the class foundation of that regime. How can one

study a state without understanding the nature of the organized ruling group managing that state? We hold that the state is the sum total of public institutions ruling a certain territory. The state is a structure, and it is transformed into an agent only by the management and leadership of an organized ruling coalition. The regime. This book, therefore, tries to correct the simplistic duality of state and society by a triangle of state, society, and political regime.

### THE IMPORTANCE OF STATE FINANCE

While reading literature related to the state, I noted references that indicated that public finance was among the main gateways to studying the state. In the forefront is a 1918 article by Joseph Schumpeter, the well-known economist, calling for establishment of a new discipline called fiscal sociology to study the interrelationships between society and state finance.<sup>11</sup> Schumpeter noticed that state expenditures had a great impact on societal culture and structures. This article did not receive due attention, and Schumpeter's name continued to be associated with his theory on the entrepreneur.

To study public finance from a political economy perspective, one should look to the main three traditions of political economy that have dealt with the question: Marxism, rational choice, and neo-historical institutionalism. In the following sections, we point to these traditions' most important contributions to the question of state finance. The objective is to show how they influenced the research and how it responds to their contribution.

#### The Marxist Approach

Although Marx did not develop an elaborate theory of the state, he had a distinct view of this institution. To him, the state is not a neutral arbiter between antagonistic classes prevailing in a society, but instead an instrument used by the dominant class to repress the dominated classes. In a capitalist mode of production, the state is the "executive committee of the bourgeoisie," as *The Communist Manifesto* suggests.<sup>12</sup> Under certain circumstances—that is, a weakness of the antagonistic classes—the state can elevate itself and dominate all classes in society, even the bourgeoisie. This was the case of the Bonapartist state proposed by Marx in his *Eighteenth Brumaire of Louis Bonaparte*.<sup>13</sup> It appears then that the main question that preoccupies the Marxist approach to the state has been the relationship between it and social classes. The main Marxist debate on the state dealt with the question of the relative autonomy of the capitalist state vis-à-vis the bourgeoisie.<sup>14</sup>

The concept of relative autonomy has been a step forward in the Marxist conception of the state. Without it, how could one account for the fact that the state in capitalist societies has imposed some regulations against the will of the bourgeoisie? The sole solution is Poulantzas's distinction between the short- and long-run interests of the bourgeoisie on the one hand, and the individual and collective interests of this class, on the other.<sup>15</sup> A good example involves wages. The short-run individual interest of a capitalist is to minimize, as far as possible, wages paid to his workers. But the long-run collective interest of the capitalist class as a whole is to accord the working classes some increase in real wages. This increase means a widening of the market for capitalist production, and it functions as a moderation mechanism for the working class, with social peace as the final outcome, in the interest of the dominant class. The state is the institution that can perceive and defend this collective interest of the bourgeoisie. Left to their own will, capitalists may destroy the system in which they are the dominant class. This conception of the state as the defender of the collective interests of the bourgeoisie and as the savior of the capitalists from their enemies, and even from themselves, later inspired James O'Connor, who produced the elaborate Marxist theory of state finance in his book *The Fiscal Crisis of the State*. His main research problem was the fiscal crisis of the state: Why does the state in modern times suffer from a chronic budget deficit? O'Connor answers this question with the following reasoning:

Our first premise is that the capitalist State must try to fulfill two basic and often mutually contradictory functions—accumulation and legitimization. This means that the State must try to maintain or create the conditions in which profitable capital accumulation is possible. However, the State also must try to maintain or create the conditions for social harmony. A capitalist State that openly uses its coercive forces to help one class accumulate capital at the expense of other classes loses its legitimacy. But a State that ignores the necessity of assisting the process of capital accumulation risks drying up the source of its own power, the economy's surplus production capacity and the taxes drawn from this surplus.<sup>16</sup>

State expenditures thus have a twofold character corresponding to the capitalist state's two basic functions: social capital and social expenses. Social capital involves expenditures required for profitable private accumulation,



such as infrastructure projects and state-financed industrial-development parks. Social expenses are projects and services required to maintain social harmony to fulfill the state's legitimization function, such as the welfare system.<sup>17</sup>

To this point, O'Connor's reasoning is correct: The capitalist state has two functions: accumulation and legitimization. I draw upon O'Connor's categorization of state expenditures in the discussion of the Egyptian regime's attempts to reorganize public expenditures in order to adapt to the contraction of public revenues in Chapter 2. However, the rest of his reasoning is based on incorrect assumptions. O'Connor thinks that state expenditures are characterized by the iron tendency to increase. First, the state should increasingly intervene in the economic sphere and raise expenditures on social capital (such as infrastructure and education) in order to make private capital profitable. Why? "The general reason," according to O'Connor, "is that the increase in the social character of production (specialization, division of labor, interdependency, the growth of new social forms of capital such as education, etc.) either prohibits or renders unprofitable the private accumulation of constant and variable capital."<sup>18</sup> In other words, he argues, contrary to conventional wisdom, that the growth of the state sector is indispensable for the expansion of private industry: The greater the growth of social capital provided by the state, the greater the growth of the monopolist capitalist sector; the greater the growth of the monopolist capitalist sector, the greater the state's expenditures on social expenses of production. According to O'Connor, capitalist production has become more interdependent, more dependent on science and technology, with labor functions more specialized and the division of labor more extensive. Consequently, capitalist production requires increasing numbers of technical and administrative workers. It also requires growing amounts of infrastructural transportation, communication, R & D, education, and other facilities.

Although the state has supported capitalists by assuming rising capital costs, profits continue to be appropriated privately. The socialization of costs and the private appropriation of profits create a fiscal crisis, or structural gap, between state expenditures and state revenues. The result, according to O'Connor, is a tendency for state expenditures to increase more rapidly than the means of financing them.<sup>19</sup> This formulation is very close to the Marxist contention that the basic contradiction in a capitalist society is between the social character of production and the private appropriation of the means of

the production. In addition, the state should also increase its expenditure on social expenditures (the legitimization function) because “the growth of the monopoly sector is irrational in the sense that it is accompanied by unemployment, poverty, economic stagnation, and so on.”<sup>20</sup> The fiscal crisis of the state then, according to O’Connor, is not something situational, but rather structural. In other words, the deficit of the state budget is due to the structural tendency of state expenditures to increase more rapidly than revenues. The only solution, according to him, is socialism; for there is no solution under capitalism.

O’Connor’s theory has been defeated by the facts: The fiscal crisis of the state was lessened during the 1980s and 1990s. The Maastricht treaty has imposed a maximum fiscal deficit of 3 percent. Except some cases like Greece, European countries managed, more or less, to keep their deficits close to this limit. The empirical fallacy of O’Connor’s predictions is a result of a deep epistemological problem in O’Connor’s theory: the functional nature of his explanations. Because state expenditures are somehow functional or beneficial to capital, he concluded that the state increased its expenditures in order to maximize capitalists’ profits. In other words, he considers the result of an action as its cause. So everything the state does should be in the interest of capital. Nicos Poulantzas’s relative autonomy of the state does not solve the problem. His proposition that the state can act against the short-term interests of the bourgeoisie in order to save its long-term interests dooms the state to always serve capital. Indeed, the state knows capitalists’ interests more than do the capitalists themselves. We find here the same functionalism: The function of something explains its existence, and the result of something is automatically transformed into its cause. Wage increases, for instance, according to functional explanations, are caused by the need of capital to expand its market. More wages mean more consumers for goods. So because wage increases are beneficial for capital, we should consider that they came into being because capital needed them.

This reasoning neglects the role of politics and class struggle. Wage increases, for instance, were imposed on capitalists via syndicalist resistance and by the process of democratization, which permitted the working classes to acquire more leverage on social and economic policy. The same applies to the rise of the interventionist and the welfare state since the 1930s. Moreover, ideas (such as Keynesianism) were central to the rise of the welfare state by providing the theoretical tools to formulate new economic policies. The main

error of this kind of Marxist functional explanations, as elaborated by Anthony Giddens, is its supposition that social systems have needs, or functional exigencies. The best example is Marx's discussion of the reserve army in a capitalist economy. Capitalism has its own needs, which the system functions to fulfill. Since capitalism needs a reserve army, one comes into being. This argument, according to Giddens, does not explain anything about why a reserve army of unemployed workers exists: "not even the most deeply sedimented institutional features of societies come about, persist, or disappear because those societies need them to do so. They come about, historically, as a result of concrete conditions that have in every case to be analyzed."<sup>21</sup>

The second epistemological mistake in O'Connor's theory is its structuralism. The theory accords no role to agents, to institutions, or to ideas. Actors are naked social classes acting according to their structural positions and promoting their "objective" interests. O'Connor did not write about objective interests in this book, but it is the underlying concept of his reasoning. When he writes about interests, he never bothers to search for interests as defined by the actors themselves—by parties, by trade unions, or by business associations. He takes classes as actors, when classes are not actors. They can become actors via institutions that structure their interests. In this case, institutions of representation do not only reflect the interest of the classes they represent, but they often structure and shape their very interests.

The limitation of O'Connor's structuralism can be shown in his analysis of legitimacy. He thinks that state legitimacy is preserved by social expenditures that promote the well-being of the working classes. The state, therefore, cannot lessen its social expenditures without creating a legitimacy crisis that can threaten the whole social order. In reality, states did lessen their social expenditures in the 1980s and 1990s without creating a threatening legitimacy crisis. The process of liberalization was not undertaken without harsh resistance from social groups losing some gains accorded to them by the welfare state. But O'Connor underestimated the capacity of states to decrease social expenditures because he undervalued the role of institutions and ideas. He thinks in terms of objective material interests. Hence, the objective interest of the working class should be to increase its share in national wealth in the short term, and to destroy the capitalist state and create its own state in order to get control of the means of the production in the long term. The objective interest of the capitalist class should be to make profits in the short run and to preserve the social order in which it is the dominant class in the long run.