

Islamic Parties in North Africa and the Challenges of Economies in Transition

Adeel Malik

Globe Fellow in the Economies of Muslim Societies
Oxford Centre for Islamic Studies
Islamic Centre Lecturer in Development Economics
University of Oxford

The Arab revolts that began in December 2011 were fed by a demand for bread, freedom, and social justice. Youth unemployment and widespread economic discontent were also important contributory factors. Two years after the Arab revolts, however, these objectives remain as distant as ever. In fact, the economic challenges facing the Arab Spring countries have become even more pressing. Unemployment has nearly doubled in both Tunisia and Egypt. Foreign investment has dried up, and tourism revenues, while relatively resilient, remain endangered. Fiscal challenges remain at large: Egypt's fiscal deficit will exceed 11% of GDP this year. While the problems are urgent and present, the policy response is either absent or painfully slow. Both Egypt and Tunisia are governed by coalitions led by Islamic parties: the Brotherhood in Egypt and Ennahda in Tunisia. This brief note will revisit the economic ideology of these parties and their approach to dealing with their countries' respective economic challenges.

Economic Ideology

In matters of economic governance, as in politics, the ruling Islamic parties in Egypt and Tunisia seek their inspiration in Islam. Islam is typically viewed as providing answers to all social and economic ills. Specifically, both parties seek to establish an Islamic economic system based on a judicious middle path

between laissez-faire capitalism and a socialist economic order. This narrative, based on the ideas of a body of literature known as Islamic economics, gives primacy to both markets and social justice. Islamic economics purports to offer an alternative – a middle ground of sorts – to the two prevailing economic systems of the time, capitalism and socialism. Although the core insights of Islamic economics are not new, having found expression in many earlier writings, in the 1980s, Islamic economics aimed to bring them together under a single consolidated critique of the mainstream economic order. Practically speaking, Islamic economics advocates the need to marry free markets with social justice. Unnecessary restrictions on economic exchange are viewed as anathema to the spirit of Islam. At the same time, both the State and markets should be tailored towards serving the wider public good. However, possible tensions between markets and social justice are not typically well-analysed; nor are the challenges of dealing with the resulting trade-offs.

From Ideas to Practice

Islamic parties in Egypt and Tunisia subscribe to the ideas of Islamic economics. While Islamic economics offers a strong critique of the capitalist system, the mapping from ideas to practice remains weak. Apart from broad guidelines, few concrete alternatives or possible solutions are offered. This is also manifested in the economic discourse of Islamic parties. Beyond the rhetoric in favour of free markets and social justice, the economic narrative of the Muslim Brotherhood and the Ennahda Party remains vacuous. Both parties have criticised crony capitalism, emphasised the need for fiscal reform, and advocated support for a stronger private sector, espe-

cially small and medium enterprises. A large-scale reform of the subsidy system – an essential element of fiscal reforms – is also mentioned in the party manifestos of ruling Islamic parties. Promises have likewise been made to mainstream Islamic finance in national economies.

While Islamic economics offers a strong critique of the capitalist system, the mapping from ideas to practice remains weak. Apart from broad guidelines, few concrete alternatives or possible solutions are offered

While the goals and objectives are clearly laid out in speeches and public documents, the instruments for achieving them are not well spelled out. There is little clarity on the concrete steps required to address pressing economic challenges. Islamic parties in Egypt and Tunisia have largely failed to inspire a new economic discourse or to issue a fresh blueprint for economic revival. Most items on these parties' economic agendas are practically indistinguishable from those on the agendas of other mainstream parties. A radical agenda to shift the distribution of economic power is missing from their narrative. In fact, for all practical purposes, their economic programme is consistent with neo-liberal economic reforms associated with the IMF and the World Bank.

Policy Response to Economic Challenges

The economic record of the post-revolution Islamic governments has been mostly disappointing. Genuine economic reform is stalled, while the absence of political stability has worsened the investment climate. At least four aspects of economic management are worth highlighting at the outset:

- Economic reform has been both slow and insufficient. Last year, to qualify for an IMF programme, subsidies on high-end fuel were reduced in Egypt, but this was not followed by

subsequent reforms. A planned tax increase was delayed soon after it was announced by President Morsi. There is widespread recognition amongst political stakeholders that a stronger tax effort and a reformed subsidy regime are essential for fiscal sustainability. But neither the people on the street nor the rulers seem ready to bear the social and political costs of fiscal reform. The politics of public finance is admittedly complicated, but Islamic parties have avoided initiating a serious discussion of reform, as well as building coalitions to address complicated economic challenges. The politics of division dominates the politics of consensus. Economic reform continues to be delayed due to political exigencies.

- Public policy for addressing economic problems has been more reactive than proactive. Government efforts are largely directed at dealing with short-term economic problems. Medium to long-term economic priorities have received scant attention. Given their transitional nature, Islamic governments also have fewer incentives to undertake genuine reforms that may undercut their populist base.
- Economic policy has been more geared towards provision than production. Consequently, maintenance of the subsidy regime has taken precedence over structural economic reforms that dismantle monopolistic concessions and open the markets to fair competition. Despite the avowed support for small enterprises, the basic incentive structure facing young and aspiring new firms has not changed for the better.
- Apart from being fiscally unsustainable, the subsidy regime has been seriously challenged by mismanagement and thriving black markets, resulting in acute fuel shortages in Egypt.

In addition to the above, three related aspects of governance have impacted economic management. First, economics has not received the priority it deserves. Islamic governments in both countries have chosen the wrong battles in the transitional period. The narrow struggle for power and the ensuing political instability bode ill for the business environment. Second, the most pressing economic challenges – for instance, revamping the social contract that sustains a precarious subsidy regime – requires

the politics of consensus. Rather than building coalitions, the ruling Islamic parties have deepened their political divisions. Third, where foreign economic support is available (e.g., Egypt), it has intensified the problem of moral hazard by offering free cash and weakening the resolve for economic reform.

Some of these issues are discussed in more detail below.

Stuck in the Politics of Transition

The region is stuck in a difficult politics of economic transition, a transition made more difficult by continuing political uncertainty in Egypt and Tunisia. In this charged political climate, in which governments are fire-fighting on a daily basis, it is unsurprising that the business of economic reform has not even started. Slashing public expenditures on subsidies is unlikely to win favour with a jittery electorate that is no longer afraid to protest. Leaders realise that macro-economic stability and social cohesion can be irreconcilable in the short run. The current impasse on economic reform therefore illustrates a larger point: it is difficult to reform the region's subsidy and tax regimes without redefining the underlying social contract that has long exchanged welfare distribution for political acquiescence.

The economic record of the post-revolution Islamic governments has been mostly disappointing. Genuine economic reform is stalled, while the absence of political stability has worsened the investment climate

Therein lies the contradiction. Politics will not solve the challenges of public finance. At the same time, traditional IMF recipes, such as a narrow insistence on subsidy reform, are unlikely to solve the political problem in a country like Egypt, where 40% of average per capita income is allocated to food. Politics is thus a binding constraint. Redefining the social contract is far too risky for any single political leader, or even single country, especially in the absence of economic growth and a favourable investment climate. Global evidence suggests that it is easier to

bite the subsidy bullet in an expanding economy, where citizens feel compensated for the loss of public entitlements.

Problems of Moral Hazard

It is also relevant to consider the international context that has influenced the incentives for reform. Repeatedly over the past two years, transitional governments have been saved from economic collapse by blank cheques written by rich Gulf neighbours. Saudi Arabia has extended more than US\$3 billion to Yemen; Egypt has received around US\$6 billion from Saudi Arabia and Qatar. The UAE has recently pledged a grant of US\$2.5 billion to Bahrain. The rich Gulf countries are effectively subsidising public services not only for their own citizens, but also for citizens in neighbouring countries.

Typically, the resource-rich Arab governments have tried to resolve problems by throwing money at them. But cash that does not commit governments to reform is unlikely to solve problems; it only postpones them. An unconditional aid effort can do more harm than good by loosening budget constraints, reducing pressure for economic reform, and exacerbating the issue of moral hazard. Ruling Islamic parties have limited incentive to reform when they know from past experience that they will be bailed out in times of distress. The persistence of adverse incentives for reform underscores the need for fresh thinking on regional development that redefines the relationship not just between citizens and the State, but also between Arab countries themselves. The Arab world needs to revamp its development effort in the face of emerging challenges. This calls not just for a quantitative leap in development spending, but also for streamlining the existing aid effort. While there is no dearth of Arab regional development banks, they have largely failed to act as coordination and commitment devices.

A New Regional Bargain

Large-scale economic revival in Tunisia and Algeria is difficult without a new regional vision that helps national governments bypass their immediate political constraints. In other words, transitional govern-

ments need a regional bargain that buys the political space for economic reform. This requires regional powers to underwrite a growth pact – a Marshall Plan of sorts – that facilitates major new investments for reviving economic activity before serious subsidy reforms are introduced. But, while growth can be ignited through such resource injections, it cannot be sustained without actively contested markets. This requires a dismantling of regional trade barriers, which are more pervasive in North Africa than even sub-Saharan Africa. The growth pact should commit Arab countries to a gradual reform of the subsidy system and a reduction of barriers to cross-border economic exchange.

The most pressing economic challenges – for instance, revamping the social contract that sustains a precarious subsidy regime – requires the politics of consensus

The regional dimension to prosperity has long been ignored in the Middle East. Weak regional linkages restrict the entry and growth of small firms, making existing firms more dependent on state patronage. There is little hope for Egyptian or Tunisian econo-

mies without such regional linkages. For one, unemployment is difficult to tackle without re-opening Libya's labour market, which has historically absorbed migrants from Tunisia and Egypt. Tunisia, arguably the most hopeful case for reform, is suffering from a crippling investment shortfall that is unlikely to be met by Europe, which is mired in its own fiscal troubles. Capital flows from resource-rich Arab neighbours offer a viable alternative. But, rather than offering blank cheques, the oil-rich Arab countries should channel their financial support through a well-structured programme implemented by a new (or significantly reformed) development institution organised on the lines of the European Bank for Reconstruction and Development (EBRD). Such an institution could underwrite the costs of economic transition and, in conjunction with new investment vehicles, such as sovereign wealth funds or Islamic finance, provide funds to credit-starved firms.

Both Ennahda and the Muslim Brotherhood seek inspiration from the Turkish model. After coming to power, both parties have forged closer economic ties with Turkish business associations. They have been less successful in heeding the key lesson from the Turkish experiment, which is the importance of cultivating regional synergies built on linkages and complementarities in production processes.