Paul Rivlin and Shmuel Even

Political Stability in Arab States:

Economic Causes and Consequences

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Preface

The two papers in this memorandum analyze some of the strengths and weaknesses of Arab states from an economic perspective. Specifically, they look at the way in which Arab regimes have responded to serious economic and socio-economic problems. The spiraling population and the rapid growth of the labor force against a background of weakening economic performance have continuously heightened anxieties about social stability. Arab regimes have survived even though the economic reforms they implemented were only partial. Somehow, the reforms have been sufficient to keep the regimes in power despite internal and external threats.

Part I, by Paul Rivlin, provides an overview of the economic structure of the Arab state. It shows how rental incomes, mainly from oil, have enabled the state to dominate society through huge bureaucracies and armed forces, and therefore the state in turn has been able to limit economic liberalization. Rivlin suggests that the state has proven much stronger than the society in which it existed. The lack of organized, powerful, and independent groups in society meant that governments went unchallenged, except by Islamic fundamentalist forces. Because of the state's monopoly of force as well as international opposition to Islamic fundamentalism, governments prevailed and crushed the fundamentalists – in Egypt and Algeria, for example – who in effect comprised the only viable opposition.

Rivlin shows that the sources of stability were themselves those factors causing economic malaise. Huge rental incomes earned directly or indirectly from oil reduced or delayed the need for economic reforms. They also created a situation in which large shares of income were generated with very little employment, and governments became income-redistributing mechanisms. Foreign aid, from within the region and from outside, reinforced this. Arab governments avoided radical reforms because they were afraid of the consequences, and of these, two in particular. The first was that smaller bureaucracies and reduced public sector employment would result in higher rates of unemployment. The second consequence was that an enhanced role for the private sector might make the state less dominant and thus weaken its political power. The regimes preferred to muddle through and did so quite successfully for many years.

Part II, by Shmuel Even, explores the ramifications of the economic balance on the stability of Arab regimes in three instances: Syria, Jordan, and Egypt. Even studies two phenomena: the threat of economic difficulties to the internal stability of these Arab states, which at times culminated in popular riots against the regime; and the means whereby Arab rulers grappled with socio-economic pressures through a redistribution of economic resources. His analysis shows that in times of economic crisis, there emerges a red line of sorts to popular limits of tolerance for a decline in the standard of living, a line the population is unwilling to cross. Hence, for example, violence in response to price hikes of subsidized commodities, which signals the population's refusal to shoulder more economic burdens at the time. The consequent threat to internal stability prompts the regime to increase, at least temporarily, the resources allocated to increasing the standard of living at the expense of resources that would otherwise be directed to military and future investments.

Even examines how this makeshift economic approach played out in Syria, Jordan, and Egypt. The process was punctuated by serious unrest in Syria in 1986-87; riots in Jordan in 1989 and 1996; and riots in Egypt in 1977 and 1986. Other Arab states had similar experiences. Even shows that poor economic performance in these countries in the 1970s and 1980s resulted in financial crises. The resolution of these problems, or more precisely, their alleviation, took years and was in large part made possible by increases in oil incomes or foreign aid that were largely exogenous resources. At the same time, important shifts in regime policy occurred that were dictated by economic motives. Diplomatic measures that encouraged reconciliation with Israel seem to have been motivated at least as much by economic considerations as by ideological issues, if not more: the need to reduce expenditures for military buildup and the fear of domestic unrest were among the important factors that propelled Arab regimes to engage in negotiations with Israel. Thus, in 1987 Syria abandoned the strategic arms race with Israel, mainly because of financing difficulties and the threat presented to the stability of the Syrian regime by the economic crisis. Similarly, one of President Sadat's aims in signing a peace treaty with Israel was to obtain US economic aid.

The two papers show that Arab states have succeeded in what might be thought of as a dangerous strategy: delay and react rather than initiate and reform. This strategy has, however, served their own interests well, and Arab regimes have been far more stable since the 1970s than they were before. If regime survival is the raison d'être of all policies, then even the regimes'economic policy, which perforce became a subordinate objective, can be judged to have been successful. Nonetheless, it is impossible to ignore the high price that Arab societies have paid due to the lack of effective economic policy.

Part I

Arab Economies and Political Stability

Paul Rivlin

Introduction

The Middle East is dotted with several Arab regimes that have retained their power despite poor economic performance. Significantly, different kinds of regimes with quite different economies have operated in similar ways.

Since independence, the institution of the state has been the most successful enterprise in the Arab world. It has controlled instability – the large number of coups of the 1950s has dropped to almost zero – and has maintained its power despite an almost total lack of democratic representation. Violent, internal opposition in Algeria, Egypt, and elsewhere has been suppressed, and most leaders die in office. Arab states of very different kinds – monarchies and military dictatorships, socialist and non-socialist regimes – have developed similar supporting institutions, including large armies, security forces, and civilian bureaucracies. Since they gained independence, these have been used to maintain and extend state control over society and the economy.

Rental incomes play a key role throughout the region. These are mainly derived from oil, gas, and related products, as well as from the sale of minerals. In the poorer, more diversified economies, rental incomes comprise the remittances of migrants who have left the country to work abroad and foreign aid. These sources of income have declined over the years but have generally remained significant. In all Arab states, revenues from the sale of oil have gone to the state. In addition, countries such as Egypt, Jordan, and Syria were able, with varying degrees of success, to extract strategic rents from powers outside the region. During the period of superpower rivalry that ended in the late 1980s, they gained backing from the United States or the Soviet Union. After the collapse of the Soviet Union, Egypt, Jordan, and the Palestinian Authority received Western aid in order to advance the peace process with Israel. Total rents have fallen and there is little prospect that they will increase significantly in the near future. The effects of this on political behavior and on economic structures, which might be called political and economic rental psychology, remain.

When rents declined in the mid-1980s and 1990s, Arab states found it harder and harder to provide employment and subsidies to their populations. Reforms were introduced at varying paces in different countries, but they were seldom comprehensive. Governments could not cope with the consequences of the privatization of major state-owned assets, since large-scale privatization would have further increased already high unemployment levels. The result of partial rather than complete reform was that economic growth or potential growth was sacrificed. Trading the future for the present and ensuring social and political stability became a primary objective, and drove the Arab states to refuse the economic medicine prescribed by many Western and Arab economists, or at least the dose recommended. It is also the reason why economic conditions have not improved as they otherwise might have.

Rents

The Arab world is exceptional in the volume of rental income that it has earned, and it is the rental income that has largely funded the expansion of the state. The most important source of rental income has been the sale of oil and related products, followed by aid received from outside the region and aid given by richer to poorer states within the region. In addition, migrant workers from poorer Arab states in the oil-rich states remitted huge amounts of money home. Likewise, migrants from North Africa working in Europe sent home significant volumes of funds.

Traditionally the definition of rent was payment for the use of land or for the production of natural resources, such as minerals.[1] This also applies to income from oil sales because oil is drilled out of the land. At the same time, this definition has been extended to cover legal and illegal competitive seeking of profits from the sale of services that are in short or fixed supply.[2] It has widespread application in countries that have controlled or partly controlled economies, such as many of the Arab states.

In the Arab world, the growth of the capitalist class (often referred to as the "new middle class") has largely been a function of government initiative. As state-owned sectors of the economy buckled under the strains of over-employment and low productivity, governments had to find other ways to generate revenues. Many turned to the private sector and encouraged its expansion within strict limits. This included permission to operate with or within sectors run by the state.

Rent-seeking inside an economy was, therefore, the search for privilege in domestic markets. This was usually made available by the state to those that it favored through the issuance of licenses to produce, import, or sell. When competition is limited by the state, those who sell or supply make higher profits (in other words, rents) than they would if there was free competition. Where there are restrictions or shortages that are under state control or influence, individuals or groups will act to obtain privileges. If they are significant politically and/or economically – and the two usually run together – they can be called interest groups, lobbies, or vested interests. Another term with the same meaning that has become increasingly popular is crony capitalism. The activity of the Palestinian Authority in this regard has been notorious.

Sadowski analyzed the role of interest groups in the liberalization of Egyptian agriculture in the 1980s. He showed how a relationship developed between businessmen in agriculture and bureaucrats in government, wherein both sides felt that the other was indispensable. Businessmen gained influence through political parties and lobbies to such an extent that they could not be ignored.[3] Overall, the rise of the middle class has been a result of changes in state policy, most notably the shift away from public sector domination of the economy towards a liberalized system. Both Marxists and liberals have claimed that these new forces have captured the state. An alternative view was that new forces were created by the changes in economic policy.[4] Meantime, relations such as those described above are somewhat veiled. The negotiations take place behind closed doors; they are not subject to public scrutiny and their conclusions are not documented or recorded.

Arab countries have experienced both aspects of the culture of rent. The oil-rich states have lived off the income of a natural resource that is pumped out of the land. In those countries and in the diversified economies, governments have also been occupied with the allocation of licenses to produce, import, and trade that provide rental incomes. These favors, granted to private sector groups or individuals, in turn brought rewards to public sector officials. The scale of these favors had profoundly negative effects on work and other incentives, thus discouraging investment, production, and exports.[5]

Oil

In 2002, the Arab countries had 61 percent of the world oil's reserves but accounted for only 29 percent of production.[6] The world's largest reserves are in Saudi Arabia, which is also the world's largest oil producer. Oil is sold primarily outside the region and so export revenues depend, at least in part, on external conditions, both in consuming countries and in other oil-producing states, inside and outside OPEC. Oil dominates the economies of Saudi Arabia, Kuwait, the UAE, Qatar, Bahrain, and

Oman, as well as Iraq and Libya. Oil and gas also play a key role in the economies of Algeria, Egypt, and Syria. All these states, in varying degrees, obtain large foreign currency revenues for a natural resource that is drilled, piped, shipped, and sometimes refined in their territory. Employment in this sector is limited and this helps governments keep revenues and other sensitive information secret. The revenues accrue to governments or directly to rulers who therefore have a source of income unrelated to taxation. This has profound implications for their economies and political systems.

Between 1980 and 2000, the Arab members of OPEC (Algeria, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, and the UAE) had a total income from oil exports of about $2,150 billion, equal to 33 percent of their GDP.[7] This is the largest rental income ever received by a group of countries. Other Arab countries, most notably Egypt and Syria, had oil export earnings exceeding $100 billion during that period. Total Arab oil income between 1980 and 2000 therefore came to about $2,250 billion.

The oil export revenues of the Arab members of OPEC fell from $446 billion in 1980 to $163 billion in 2003 (table 1.1)

Table 1.1. **Arab OPEC Oil Export Revenues, 1972-2003 ($ billion, 2000 prices)**

	1972	1980	1986	2000	2003
Algeria	5.5	27.5	7.2	11.0	16.7
Iraq	6.0	57.8	9.1	19.3	9.0
Kuwait	11.5	40.1	10.0	17.7	17.9
Libya	12.2	47.6	7.4	12.9	12.6
Qatar	1.8	11.4	2.3	6.7	8.7
Saudi Arabia	19.3	223.2	31.2	66.0	75.7
UAE	4.3	38.9	10.5	20.7	22.7
Total	60.6	446.5	77.7	154.3	163.3

Source: EIA, OPEC Revenues Factsheet, March 2001 and January 2004; and author's calculations.

Between 1980 and 2003, oil export revenues per capita in Arab OPEC member states fell sharply, on a constant price basis. As the population of these countries nearly doubled, from 47 million in 1980 to 91 million in 2003, per capita oil income fell sharply from an average of $9,500 to $1,800, a decline of 81 percent. In 2003 Saudi Arabian oil export revenues per capita were only 12 percent of their 1980 levels; in Kuwait they were 23 percent; in Iraq, 10 percent; and in Libya, 6 percent.

Political Rents

Some Arab states have received large flows of money from abroad that have been essential for their survival. These have come from other Arab states, typically from the rich to the poor, and from outside the region. The classic "rentier state" is Jordan; other significant recipients have been Egypt and Syria. Aid has been bilateral and multilateral, civilian and military. It has taken the form of loans, grants, and debt write-offs. Between 1973 and 1989, poorer states in the Arab world received $55 billion of aid from Arab countries and multinational bodies, made possible by the huge rise in oil income in the region.[8] Political rents were paid to help maintain the state and the regime. Often the two were the same, but with the rise of fundamentalist challenges within Arab states, aid has been provided to governments in order to help them stay in power.

Foreign aid has fallen in value since the 1980s for several reasons. First, Arab oil wealth has declined and so there was less to give. Second, the direct investments made by the oil-rich states in the industrial and agricultural sectors of the poorer Arab states such as Egypt and Sudan did not yield profits as expected. Third, the decline of pan-Arabism led countries to go their own way and be less interested in inter-Arab relations. Fourth, Western countries and multilateral bodies tied aid to economic reforms, which if successful reduced the need for external assistance. Finally, with the end of the Cold War, the Arab states could no longer play the US and the USSR off against each other: they would no longer be rewarded for changing sides, as Sadat was in 1973-74.

Aid given on a concessional basis (i.e., at below market interest rates and/or with long grace periods during which repayments are not required) was a higher share of total aid in the Middle East and North Africa than anywhere else in the developing world. In 1999, 38 percent of long-term debt in the Middle East and North Africa was concessional, compared to 19 percent on the average for developing countries.[9] This was an indication of political favor. In addition, the region failed to attract the private sector capital that played a huge role in the industrial development of East Asia in the 1980s and 1990s. In 1999, 57 percent of long-term net resource flows to the Middle East and North Africa were from public sector bodies, compared with 17 percent for all developing countries. In 1999, the Middle East and North Africa attracted only $1.0 billion in foreign direct investment, equal to 0.5% of the total invested in all developing countries.[10]

The rescheduling or cancellation of foreign debt can be considered a form of rental income as well. It is often a reward for the misdeeds of a ruler.[11] Between 1979 and 1999, about $60 billion of Arab foreign debt was rescheduled or written off. This included nearly $28 billion of Egyptian foreign debt, including debt owed to the US for military equipment.[12]

Remittances

The growth of oil income prompted the movement of workers from poorer to richer Arab states. In the period 1973-89, the remittances of these workers that were registered in balance of payments data came to about $60 billion. In addition, Morocco and Tunisia received about $24 billion from emigrants in Western Europe.[13] These funds helped to cover part of the large deficits on trade in goods and services. In 1990-98, remittances to Egypt, Jordan, Yemen, and Oman (the latter were minimal) came to about $58 billion. Those to Morocco and Tunisia totaled $23 billion. Given the growth of these economies, remittances declined in their relative importance but remained a large absolute source of income that was not earned inside the economy.

Table 1.2 shows that rental incomes played a very important role in the economies of recipient states during the 1970s and 1980s. These money transfers had many effects, chief of which was the fact that they made it possible to import without the pressure to export that would otherwise have applied. As a result of rental incomes, many countries in the region had very weak non-oil export sectors and failed to develop the culture of competitiveness that applies to those who sell on international markets. Of course the same applied to the oil-rich states: they had an easy source of foreign revenue with which to fund imports, and so pressure to export manufactured goods, agricultural products, or services was very limited. Until rents fell, none of these states had to undergo the painful processes of structural change to which competitive economies are continuously subjected.

Table 1.2. **Arab Aid and Remittances, 1973-89**

	$ billion	Percentage of GNP	Percentage of Imports
Algeria	5.3	0.9	3.9
Egypt	48.2	13.4	40.3
Jordan	19.0	38.1	54.7
Lebanon	1.2	2.5	2.8
Morocco	19.0	7.8	31.1
Sudan	6.7	4.7	37.3
Syria	16.9	8.2	33.9
Tunisia	5.7	4.8	12.5

Source: Pierre van den Boogaerde, *Financial Assistance from Arab Countries and Arab Regional Institutions* (Washington DC: IMF Occasional Paper no. 87, 1991).

Table 1.3 indicates the scale of rents in the region. The first three items were flows of income. The fourth was a reduction in the stock of debt and cannot, strictly speaking, be added to the former.

Table 1.3. **Total rents 1980-2000***

Source	$ billion
Oil	2,250
Remittances	165
Arab aid	55
Debt write-offs	60
Total	2,530

*excludes gas exports, non-Arab aid, and remittances in cash
Source: Author's calculations based on sources cited in the text.

The Military

The phenomenon of coups that characterized Arab regimes in the 1950s has essentially ended, and stability has increased significantly. One of the most important reasons underlying this stability was the expansion of the armed forces, so that staging a military coup has become a much bigger and more complex matter. Table 1.4 charts the growth of Arab armies and security forces since 1966. Between 1966 and 2002, the number of soldiers in the regular armed forces more than quadrupled; those in paramilitary forces increased almost nine-fold, and the total, more than five-fold. The figures for 1984-94 were affected by the massive increase in Iraqi power during the Iran-Iraq war of the 1980s, but the overall Arab increase preceded that conflict. Even if Iraq is removed from the total, the number has still grown dramatically.

Table 1.4. **Arab Army Personnel, 1966-2002**

	1966	1975	1984	1994	2002
Regular	553,000	940,200	2,191,650	2,150,000	2,328,100
Paramilitary	156,000	235,500	1,051,500	1,294,300	1,387,000
Total	708,000	1,175,700	3,243,150	3,444,300	3,715,100
Total (excluding Iraq)	609,000	1,013,400	1,940,650	2,571,800	3,282,600

Source: Roger Owen, *State, Power and Politics in the Making of the Modern Middle East* (London: Routledge, 1992); Ephraim Kam (ed.), *The Middle East Military Balance 1994-95* (Tel Aviv: Jaffee Center for Strategic Studies at Tel Aviv University and Jerusalem Post); and Ephraim Kam and Yiftah Shapir (eds.), *The Middle East Military Balance 2002-2003* (Tel Aviv: Jaffee Center for Strategic Studies at Tel Aviv University, 2003).

Large armed forces provide employment in a region that suffers from widespread unemployment. They provide control systems and intelligence and encourage loyalty. The large size of militaries and security forces means that the state has an overwhelming monopoly of force, which clearly contributes to the lack of opposition to regimes in the Arab world.

Military Spending

Relative to other states, the Arab states spend a disproportionate share of their income on the military. In 2000, Arab states spent $46 billion on the military, nearly 6 percent of world military spending, though with only an estimated 1.9 percent of the world GDP.

In 1980-89, Arab states, excluding Iraq, spent an annual average of $55 billion measured in 2002 prices on defense. In 1991-2000, they spent an annual average of $48 billion, also in 2002 prices, excluding Iraqi spending.[14] These large sums can be explained by two sets of factors: the need for defense against foreign attack, and defense of the regime against internal threats, for example, Islamic fundamentalists in Algeria and Egypt. The regimes also bought loyalty by providing employment for hundreds of thousands of soldiers and officers and by providing other benefits for the military and security forces. The decline in military spending between the 1980s and the 1990s was due to the fall in oil revenues and the deteriorating financial state of the biggest spenders, most notably Saudi Arabia.

Arab countries are distinguished by the central role of the state in political and economic life. The military, which was often synonymous with the state, was powerful if not dominant in nearly every Arab country. Many of the regimes that now rule came to power in coups d'état staged by the army. Since then, a separation of government and military has developed. The latter was rewarded for its loyalty with foreign arms, jobs, access to economic benefits in the civilian sector (and in Syria, control over trade with Lebanon), and political functions (for example, the late President Sadat appointed an air force general, Husni Mubarak, as his vice-president). The military plays a key role in maintaining political order, not only through the use of force but also by keeping millions off the unemployment register.[15] In Egypt a large military industry has been created with very close connections to the army; in Syria a military construction company, Milihouse, provides benefits to the military and employment to ex-military officers and others.

Bureaucracy and State Control

The period since independence has seen a massive increase in public sector activity and employment, especially in the civil service. Part of this was due to the Arab socialist movement, which began in the 1950s in Egypt, Syria, Iraq, and Yemen, and in the 1960s in Algeria. Using the Soviet model, these countries nationalized economic assets and employed central planning and control to develop their economies. The creation of employment by the public sector was a key policy designed to increase welfare. Non-socialist countries such as Jordan, Morocco, and the Gulf Cooperation Council (GCC) members (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE) also used the public sector to drive economic development forward.

Since the 1980s most countries in the region have moved away from the socialist model towards free markets and many have privatized assets. This has not, however, reduced public sector employment. The Egyptian bureaucracy, for example, expanded rapidly since independence: from 350,000 in 1952 to 4 million in 1992.[16] In the period 1988-98, despite reforms, the civil service (employment in government ministries) grew rapidly, providing 1.82 million more jobs while 306,000 others went elsewhere in the public sector, which includes public corporations and other bodies (tables 1.5 and 1.6). In Egypt in 1990-98, despite the implementation of structural adjustment programs and a reduction of the share of government in the economy, the civil service was the fastest growing sector of employment. In 1988 it accounted for 19 percent of total employment, and in 1998 was at almost 24 percent.

Table 1.5**. Egypt: Government Employment, 1969-98**

Year	Millions
1969-70	1.187
1978	2.065
1988	2.974
1998	4.794

Sources: Paul Rivlin, *The Dynamics of Economic Policy Making in Egypt* (New York: Praeger, 1985), p. 21; and Ragui Assaad, "The Transformation of the Egyptian Labor market, 1988-1998," Economic Research Forum for the Arab Countries, Iran and Turkey, August 2000, Table A11.

Table 1.6. **Egypt: Employment in State-Owned Enterprises, 1976-99**

Year	Millions
1976	1.109
1984	1.347
1988	1.349*
1999	1.043

* or 1.742 million if 450,000 working in public authorities are included
Source: Ragui Assaad, Table A11.

Algeria is an example of a country that gained its independence with a very small bureaucracy. When the French left in 1962, they withdrew their civil servants, who were largely responsible for the administration. Algeria was thus left with fewer than 30,000 civil servants, all of low rank. By the late 1980s over 800,000 were employed in twenty-six ministries and about thirty-nine public organizations.[17] In 1995, there were 1.2 million civil servants and a further 1.2 million were employed in public sector enterprises, equal to about 32 percent of the labor force.[18]

What of states that did not experience Arab socialism? In 1962 there were 37,000 civil servants in Saudi Arabia; in 1981 there were 232,000.[19] In 1999 the Saudi government employed 900,000 people or 12.8 percent of the labor force. Of these, 716,500 were Saudi citizens and constituted almost 22 percent of the labor force of Saudi citizens.[20] In Kuwait, the civil service expanded from 22,000 in 1963 to 146,000 in 1980 to 160,294 in 1987.[21] The number of Kuwaiti nationals thus employed increased from 25,000 in 1966 to 58,000 in 1987, equal to about one third of all Kuwaiti citizens in employment during that period.[22] In Jordan in 1998, 69,000 or 16.4 percent of the labor force was employed in public administration and defense, and another 10.3 percent were employed in education and health. Together these categories accounted for 27 percent of the labor force, but the share of the public sector was much higher if workers in public sector industries were included.

Government in the Arab world is big: in Egypt, Algeria, Saudi Arabia, and Jordan, the total size of the bureaucracy came to almost 7 million employees in the late 1990s. If Syria, Morocco, and Iraq are included, then the figure is at least 8 million and possibly as high as 10 million. This does not include those in public sector industries or organizations. The huge numbers of civil servants form a vested interest group that is hard to dislodge. Its business is governing and this inevitably comes into conflict with liberalizing trends.

Taxation and Subsidies in the GCC

Five of the GCC member states – Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates – are oil and gas-rich. The sixth, Bahrain, has more limited hydrocarbon resources. With the exception of Saudi Arabia, they all have relatively small populations. Oil wealth has therefore meant high average per capita incomes. Since the dramatic rise in oil prices in 1973 and 1979, the GCC states have provided Western levels of welfare and developed the economy without the need to rely on taxation. The established if tacit cost was public acquiescence to the ruler's decisions with no debate. The slogan for most GCC member states was "no taxation and no representation" or, at most, "very little taxation and almost no representation."

The provision of free or heavily subsidized services by the state reduced pressures for political freedom during periods of economic growth and prosperity. The state and/or the ruler were seen by many to be successful in providing most of their populations with rising standards of living. Problems arose when economic growth slowed or went into reverse. In economies that were dominated by one sector this was an ever-present danger, and the lack of democratic freedoms meant that responsibility for making painful economic adjustments was essentially the ruler's, who was solely responsible for the implementation of these changes. He could not announce tax increases or subsidy cuts with the same ease as the finance minister of a democratically elected government. The lack of public debate about economic and social issues meant that little could be expected from the public in terms of solidarity with the ruler during hard times. The personal responsibility of the ruler and his family was reinforced by the extensive involvement of the royal family in government and in the economy. Princes were ministers and in some of these states they were also businessmen operating in the public and private sectors and in the large areas where the two overlapped.

In the GCC states, oil resources were considered the personal property of the ruler, a perception reinforced by international recognition. It had its origin in the agreements that created these states, namely, the oil concessions that were allocated by the colonial power as a result of negotiations with the ruler, who became the link between the international oil companies, powerful foreign governments (particularly the UK and US), and the domestic economy. In this way the British founded these states. Foreigners bought oil from the king or the emir and he allocated oil wealth at home. None of the GCC states have ever disclosed in any detail how much they earn from oil, because this is considered the personal income of the ruler.[23]

The most significant impact that oil has had on the economic structure and development in the Gulf is the fact that it has enabled these states to preempt the need for high taxation. Table 1.7 shows the share of taxation in total government revenues.

Table 1.7. **Tax revenues as a share of GDP, 1994-2000 (in percent)**

	1994	1996	1998	2000
Oil-rich economies				
Bahrain	7.4	7.8	8.8	8.9
Kuwait	1.2	1.1	1.4	1.1
Oman	7.1	7.5	8.8	10.1
Saudi Arabia	4.2	3.4	3.6	3.7
UAE	1.2	1.5	1.8	2.0
Diversified economies				
Egypt	22.6	17.5	17.6	19.4
Jordan	20.7	21.4	19.6	22.6
Morocco	23.8	23.8	29.1	31.5
Syria	17.5	15.6	16.7	18.0

Sources: M. Nagy Eltony, "The Determinants of Tax Effort in Arab Countries," Arab Planning Institute, Kuwait, September 2002 (www.arab-api.org).

Table 1.7 shows that taxation was a much more important source of revenue in the non-oil states than in the oil states. Income tax on individuals accounted for a very small share of total revenues in the former. In the latter it was non-existent.[24]

The oil states were able to rely almost entirely on oil as a source of revenue. In Bahrain, Kuwait, and to a lesser extent Oman, tax revenues were important in 1975, the beginning of the period of high oil revenues. By 1980, the impact of high oil revenues was felt in those three states as elsewhere in the Gulf, and the share of taxation in total revenues fell. Bahrain's oil revenues were relatively small and declined in the 1980s; in response, the government made an attempt to diversify the economy and raise taxes. From 1985, the share of tax revenues in the Saudi and Kuwaiti budgets rose, mainly because oil revenues had fallen. Only in the 1990s were attempts made to increase taxes in those states when the effects of lower oil revenues were felt.

In Saudi Arabia, the entry into the business world of the royal family, which numbers thousands, occurred during the reign of the late King Faisal, who ruled from 1964 to 1975. This reduced the need for the state to support the royal family directly, or at least reduced the level of direct support required. During the early stages of economic development, in the late 1960s and early 1970s, members of the royal family were involved in setting up manufacturing industries, which was considered a patriotic duty. Others then became involved in international contract negotiations and attracted international attention and criticism for the intermediation fees they charged. This was made possible by the greater tolerance of the regime toward the activities of the princes since the death of the relatively austere King Faisal in March 1975. The entry of the princes into business also enabled the royal family to maintain large-scale involvement and very strong influence over the private sector. The royal family, through its control of oil resources, the public sector, and its integration into the business elite, could block any attempt by commoners or by another identifiable group to dominate any sector of the economy and thus gain excessive economic or political influence.

There has been a close relationship between rulers and merchants in the Gulf. Rulers have made land available to those who collected debts for them. The buying and selling of land for public development projects at inflated prices has been an important way of allocating resources.[25] The king or a member of the royal family was often lobbied in order to receive business contracts from the government, licenses for production, and imports, or to ensure a domestic monopoly. Another method was to make him the chairman or director of the company.

Economic Liberalization

During the 1960s and 1970s, Egypt, Jordan, Morocco, Syria, Tunisia, and other Arab countries followed import substitution policies in order to industrialize. Imports were restricted to protect local producers and the government set up public sector firms to push forward industrialization. The state allocated credit and land, licensed private sector activities, took control of foreign trade, and nationalized many sectors of the economy. After the initial phase of industrialization, much of this activity came to rely on aid from abroad, workers' remittances, and revenues from exports of oil and minerals. All of these sources of income depended on economic and political conditions abroad and were generally unstable.

Although they were small producers by international standards, Egypt and Syria had significant oil resources, and oil sales constituted a large share of their exports. Morocco and Jordan were major producers of phosphates, the price of which increased five-fold after 1973. These countries, like others in the region, were able in the 1970s to increase investment and thus boost their rate of growth. They were also able to attract foreign capital because the rise in oil prices drove the developed economies in the Organization for Economic Cooperation and Development (OECD) into recession. Banks in the OECD purview were flooded with funds, mainly from the Gulf, but the local demands for funds were limited. Western banks were therefore eager to lend to the rapidly growing oil-rich countries in the Middle East. These states thus benefited from an increase in incomes that were largely unconnected with developments in their domestic economies and that depended on changes in international markets.

During the 1980s much of this pattern was reversed; 1979-82 was a period of recession for non-oil-producing states. Oil prices fell sharply after 1981 and the volume of funds that were sent to Western banks by Gulf oil producers declined significantly.[26] Real interest rates in the OECD rose, borrowing became more expensive, and Western bankers were less keen on lending to Middle Eastern countries because their economies looked less attractive after the oil price decline.[27] Aid from the rich to the poor in the Arab world fell, as did oil income in Egypt and phosphate income in Morocco.

As a result of these developments, the diversified economies in the region began to experience balance of payments and budget difficulties. These became so severe that during the 1980s, Egypt, Jordan, and Morocco applied to the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank) for assistance. In 1983, Morocco began to implement economic reforms in cooperation with the IMF and the World Bank. Tunisia followed in 1986. In 1987, Egypt reached an agreement with the IMF that it did not implement, but in 1991, it carried out radical changes in accordance with a new agreement it had reached. Jordan began to implement major reforms in 1989.

Following the collapse of oil prices in the early 1980s, aid extended by oil-rich Arab states to the poorer ones declined. From 1973 to 1981, these inflows, together with remittances of workers, had exceeded the value of exports, goods, and services in the poorer Arab states (they reached 27 percent of the GNP in Egypt in 1975). In Morocco, official assistance from Arab countries and agencies, as a share of the GNP, fell from a peak of 12 percent in 1981 to a low of 6 percent in 1989. In Tunisia, it fell from a peak of 5 percent in 1981 to nearly 4 percent in 1985. In Egypt the peak in the 1980s was in 1984 at 14 percent, with a low of 8 percent in 1986. Most dramatic was the fall in Jordan, from 55 percent in 1986 to 15 percent in 1989.

During the early 1980s, the prices of Arab exports fell and import prices rose, causing a deterioration of the trade balance. Between 1980 and 1985, as a result of the trade imbalance and the reduction of aid and remittance inflows, the foreign debt of Egypt, Morocco, and Tunisia rose from $34 billion to $67 billion. In 1989, it reached a peak of $82 billion. Furthermore, the rates of interest paid on foreign borrowing rose in real terms and the burden of financing and servicing the foreign debt escalated. In

1980, it accounted for 13 percent of exports in Egypt, 11 percent in Jordan, 33 percent in Morocco, 11 percent in Syria, and 14 percent in Tunisia. In 1990, it reached 22 percent in Egypt, 20 percent in Jordan, 22 percent in Morocco, 23 percent in Syria, and 25 percent in Tunisia. By 1999, the burden had fallen to 9 percent in Egypt, 12 percent in Jordan, 6 percent in Syria, and 16 percent in Tunisia, but had increased to 24 percent in Morocco.[28] The declines in the debt servicing ratios were in part due to agreements signed with lending countries that resulted in the cancellation of some debts, lowering of interest rates, and a lengthening of debt repayment periods. The implementation of IMF stabilization and World Bank structural change measures were conditions for debt restructuring packages.

As Arab states began the process of economic liberalization they were constrained by two main factors. The first was the state itself, defined as the central government and all the bodies that it directly controlled. These include local government, public sector companies and other groups supplying services, and the military. When proposals for economic liberalization were put forward, a major consideration was whether the state would lose power to the private sector. Insofar as a shift in the distribution of power was the likely outcome, it reduced the willingness of governments to make reforms. A thriving private sector, especially one linked to the international economy through the mechanisms of globalization, would reduce the power, status, and relative importance of the state. Rulers would have to share power to a greater extent with the domestic and foreign business community.

The second was the fear of the social consequences of reform. In 1994, unemployment in the Arab world was estimated by a Western source at 10 million, about 10 percent of the labor force.[29] The Arab Labor Organization estimated unemployment at 15 million (about 15 percent of the labor force) and stated that 2.5 million new workers join the labor force each year.[30] Unemployment in 2003 was estimated at between 15 and 20 million.

Between 1988 and 1998, unemployment in Egypt rose by 830,000, from 5.4 percent to 7.9 percent. This was two and a half times the rate of growth of either the labor force or the working age population. Among urban males aged 15-19, a politically sensitive group, unemployment increased from 173,000 (14.6 percent) in 1988 to 335,000 (21.8 percent) in 1998. In absolute terms the number almost doubled, and this took place during a period of relatively rapid economic growth.[31] As a result, the Egyptian government was unwilling to lose jobs in the public sector even if that would, through the implementation of economic reforms, eventually lead to the creation of new jobs. The same considerations applied throughout the region.

In all, therefore, Arab governments have been very hesitant about privatization programs that would require firing large numbers of surplus workers in the bloated public sector. Reductions in food and other subsidies resulted in riots, but they were contained and political stability was not undermined: because the Arab states maintained massive public sector employment, both civilian and non-civilian, they were able to retain the loyalty of those so employed. The second factor was that the states maintained large police, paramilitary, military, and other security forces that were used against their own populations when necessary. Examples of social reaction to economic policy changes appear in Part II of this study.

The Middle Class

The weakness of the middle class in economic and political terms has been a key feature in the economic and political development of the Arab world. Particularly significant is that regimes that came to power with the end of Western colonialism in the middle of the twentieth century often made the political and economic position of the middle classes even weaker.[32] This was true in all the countries that experienced Arab socialism and nationalized assets. Insofar as entrepreneurship was associated with the middle class, the weakness of the latter had negative effects on the economy. In political terms it meant that one of the forces that might have challenged the regime did not exist on a scale that would provide a threat or alternative source of leadership. In many respects the regimes that rule in the Arab world today continue a tradition of centralization that has existed in the region for hundreds if not thousands of years.

Easterly's comments on the role of the middle class are relevant here:

> One way to summarize the conditions favorable for growth is that pro-growth policies are likely when the two most common forms of social polarization, class conflict and ethnic tensions, are absent. Let's call a situation of high share of income for the middle class and a high degree of ethnic harmony a middle class consensus. Societies with a middle class consensus are more likely to have good economic policies, good institutions and high economic growth.….Just as a middle class consensus explained the difference in North and South America's development, it helps to explain development successes and failures around the world.[33]

He concludes with some pertinent remarks about Egypt:

> Why is Egypt so poor four millennia after building the pyramids? Why didn't an industrial revolution happen under the pharaohs? Some quick back-of-the-envelope analysis provides an answer: income distribution. The

> pharaohs had everything, and the oppressed masses had nothing. Rich elites can do a fine job erecting monuments to themselves, with the help of labor from the masses. As in other oligarchical (sic) societies, the rich elite in Egypt chose to keep the masses poor and uneducated. So prosperity for the few has lasted for millennia, but prosperity for the many remains elusive in Cairo today.[34]

Little that has happened since independence has increased pluralism, decentralization of political power, and free expression. All governments make mistakes, but in an undemocratic environment the opportunity to criticize and suggest alternatives is limited. The incentives to make corrections are also lacking.

Foreign Interests

The most important force pushing for economic liberalization has been the international community, led by the World Bank and the International Monetary Fund. Their role in the Arab world increased when economic crises hit parts of the region in the 1970s and 1980s. Their power lay in the fact that they controlled the purse strings and they usually laid down strict conditions in exchange for aid. The United States government and more recently the European Union have played a similar role on a bilateral basis.

With the exception of foreign donors, no interest group has been able to stop the state from adopting its chosen path. It should be noted that in Egypt, strategic rents eased the conditions imposed by the IMF: the United States intervened to soften IMF decisions regarding conditions for aid. In Syria, foreign loans were not taken, and the speed of liberalization has been slow and its direction and content unclear.

Oil plays a crucial role in determining the Arab world's international relations. Consuming countries have vital interests in getting energy resources. The US sent 500,000 troops half way around the world in 1991 (albeit with the costs paid by Saudi Arabia and Kuwait) to liberate Kuwait, out of fear that Iraq would gain control of Saudi as well as Kuwaiti oil fields. Alliances between Western powers and Gulf rulers go back to the creation of the latter states between the 1920s and 1960s. Today those regimes and many others in the region receive explicit or implicit Western support to help them deal with Islamic fundamentalist forces. Thus while the West advocates economic and political decentralization, or a weakening of the state vis-à-vis society in Arab states, it reinforces the state by providing military aid or sales of defense equipment and buys oil.

Conclusion

The very sources of stability in Arab countries were also those of economic malaise. The first was the role of rents. During 1980-2000, the region earned about $2.5 trillion in rents, 90 percent from oil. This was possible with very limited economic activity within the region: fewer than one million people were employed in the oil, refining, and petrochemical industries. Oil revenues along with foreign aid went to the state or to the ruler. The second primary source of stability was the political system, which operates with few checks and balances. Dictatorships of various kinds, from the "bunker states" of Algeria, Iraq, Libya, Sudan, and Syria, to the "bully praetorian states" of Egypt and Tunisia and the monarchies of Jordan, the GCC states, and Morocco all survive by force or the threat of force against their own citizens.[35] One reason for this was the lack of a strong middle class.

Egypt is one of the more open societies in the region. Despite this, all major decisions about the allocation of resources are made by the government with only very narrow consultation or democratic decision-making. This was the situation under Nasser and Sadat, and it remains true under Mubarak.[36] This is the ideal environment for rental agreements. The leaders' aim is not to produce economic growth but to survive. If growth is the only way for the system to survive then attempts will be made to encourage economic growth, but if those steps threaten the system through a loss of power by the government, then they will be avoided. This is how economic policy has muddled through in Egypt and elsewhere in the Arab world.

Ayubi called the Arab state "fierce" rather than strong.[37] It is stronger than other institutions in society but its attempts to mobilize the society around development objectives have been weak. Because of its undemocratic nature it has relied on force to obtain resources (nationalization, expropriation) rather than on taxation, which requires a greater degree of representation. The prevalence of rents has helped to sustain the lack of accountability of the state. Forces pushing for reform have therefore been relatively weak, and the state, while not short of power, has been unable and unwilling to use it as a galvanizing force in the development process. For the Arab leader the issue is simple: the system works in terms of ensuring political stability defined as regime continuity. If it works, why fix it? The decision not to undertake fundamental economic and political reforms is from the viewpoint of the regime quite rational. For the economy and the society, the same is not true. Given the lack of incentives to institute reforms, or to put it more accurately, the presence of incentives for leaders *not* to make changes, Arab states remain trapped in what economists call a low-level equilibrium.

Part II

Arab Regime Stability and the Allocation of National Economic Resources: Three Case Studies

Shmuel Even

Introduction

It may be assumed that authoritarian leaders such as those in Arab states strive to exploit the national resources at their disposal in order to maximize their long-term survival and strength. Thus, increasing the resources allocated to civilian consumption is intended to improve the standard of living and in turn enhance the regime's chances of survival inside the country. Increasing defense consumption is intended to enhance the capability of withstanding military threats from outside, and increasing investments is intended to augment future resources and hence bolster the regime's chances of survival in the face of subsequent external and internal threats.

When economic resources are sufficient and certainly if they are growing, there is no problem in meeting all these objectives, but the dilemma a regime faces becomes acute when resources are depleted and the population suffers a sharp decline in its standard of living. Such conditions often lead to outbreaks of violence, and indeed, several incidents of this sort have erupted in Arab countries since the middle of the 1970s. These include the riots in Egypt in January 1977 caused by the sharp increase in bread prices in the wake of reduced subsidies; riots within the central security forces in Egypt in February 1986; expressions of grave discontent in Syria in the period 1986-87; the food riots in Algeria in October 1988; riots in Jordan in April 1989 following a rise in fuel prices; and violent demonstrations in Jordan in August 1996 following the hike in bread prices. It is also clear that the outbreak of the intifada in the territories in December 1987 was similarly influenced by the sharp drop in the standard of living of Palestinians who suffered from the economic crises in the Arab world and in Israel, even though the root cause of the violence was nationalistic in nature.

The proliferation of events of this sort in the second half of the 1980s was not a chance occurrence. Those years saw the Arab economies hit by sharp decreases in the demand for oil and reduced oil prices. Major oil-producing countries such as Saudi Arabia suffered from a reduction of their oil incomes, while others, such as Syria, Jordan, and Egypt, were affected by the drop in money transferred by their citizens employed in the oil-producing countries. Syria and Jordan were also affected by the decline in the financial aid they had previously enjoyed from Arab countries. These factors joined others to create the severe financial shortages within several Arab regimes.

Economic crises endanger internal stability, since reduction of the standard of living generates resentment and public dissatisfaction with the regime. Increased prices, lowered incomes, unemployment, shortages of essential commodities, and other reduced economic indicators heighten the readiness to rebel and strengthen the opposition organizations. This essay studies the connection between economic parameters and the effect of economic crises on the welfare and behavior of the population. It examines how regimes cope with this problem, by analyzing both the leaders' rhetoric and their action regarding the allocation of resources.

Specifically, the chapter examines how the regimes in Syria, Jordan, and Egypt confronted the problem of internal stability by diverting and reassigning national economic resources. The essay addresses the most significant events that took place over the last thirty years as indicators of regime policy. For example, in 1987 Syria abandoned the strategic arms race with Israel, mainly because of financing difficulties and the threat presented to the stability of the Syrian regime by the economic crisis. Overall, the major socio-political events of the decades fostered the economic crises and were in turn influenced by the regimes' responses to the economic challenges that arose.

The Analytical Model

Regime policies are expressed in part by the way in which the leaders allocate the economic resources of the country – gross national product (GNP) and surplus imports – to three purposes: civilian consumption, i.e., private consumption and public civilian consumption; military consumption; and investments, both private and public. The basic assumption is that the regime is capable of influencing changes in these distributions, not only by determining the composition of the state budget, but also by influencing private consumption and investments through various means, for example, taxation and encouragement of private investment.

The civilian and the military spending together comprise the consumption required to maintain the regime in the present. Military consumption is intended to enable the regime to combat threats presented by external bodies, such as foreign armies and underground organizations, while civilian consumption is intended to supply necessary services and combat internal dangers that originate in public dissatisfaction with economic conditions. Investment is supposed to determine the size of the GNP in the future, that is, the regime's future capability to allocate resources to security and to the general standard of living.

The regime strives to divide the economic resources between the country's present and future needs in an optimal manner, in order to maximize its long-term survival and strength. Since these uses benefit the regime over varying periods of time, the optimal distribution should be determined as a simultaneous resolution to the following two challenges:

i) How should the regime divide the economic resources between the present needs and the future needs, in order to maximize the state's survival and strength over a period of time? In other words, how should economic resources be divided between current consumption (civilian and military) and investments? When a strong feeling of internal stability exists, the proportion of investments likely increases, and when the degree of uncertainty increases, this proportion decreases, because the regime is uncertain of the future.

ii) How should the regime divide the resources allocated to current consumption between military and civilian consumption, in order to maximize its survival and strength in the present? It may be assumed that when the dangers to the regime's survival increase within the country, the proportion of civilian consumption increases, and when the security dangers increase, the proportion of the military consumption increases.

Based on this model, when the threat to internal stability increases as a result of reduced public welfare, the regime will be more ready to divert resources to improve the standard of living of the population at the cost of compromising on other national objectives, such as in defense and foreign affairs. In centralized regimes, such as in Syria, Jordan, and Egypt, the army is also used for internal security tasks and is, along with the internal security organizations, capable of suppressing signs of dissatisfaction among the population. However, this is a short-term solution only. When the economic situation deteriorates, more and more strata of the population are affected, including those loyal to the regime and who may be among those who rebel. This was the case in the riots of the internal security forces in Egypt in February 1986, and the riots in April 1989 and August 1996 among the Bedouin population in Jordan, loyal to the Hashemite regime. Diversion of economic resources to civilian consumption is also a major tool of the regime in order to halt the strengthening of Islamic opposition, such as the Muslim Brotherhood in Egypt and Jordan, which attempts to garner support by exploiting the economic plight of the population and offering economic aid, medicine, legal assistance, and other social welfare services.

Political rhetoric is an additional tool that indicates how the leader explains what led him to redirect the allocation of resources. Leaders' statements on economic issues may also reflect the gap between their awareness and the gravity of the actual economic situation.

When resources decrease sharply and the regimes encounter difficulties in diverting additional resources, they are forced to change their policy substantively in directions that will improve their economic capabilities. One example is Syria's decision to halt its military growth in 1987 or to modify foreign policy in order to gain economic rewards that would increase the resources and/or slow down the arms race with Israel. Egypt's peace advances toward Israel and the policy change toward the US in 1977 form a similar instance of foreign policy change in response to economic crisis.

Before proceeding to the case studies, one proviso is in order regarding the data for military expenditure. Syria, Jordan, and Egypt publish their military budgets without including the costs of military purchases. In many cases they do not publish updated data regarding their actual expenditure, but only for planned budgets. Moreover, in Syria and Egypt there is no continuous correlation between the exchange rate and inflation, so that no great significance can be attached to the presentation of the defense budgets in dollar terms. Despite these difficulties, it is definitely possible to mark trends and to draw important conclusions by evaluating the real changes that occurred in the defense costs of the countries and their relative proportion of the resources, while making use of reliable information regarding the influence of the economic constraints on defense costs. The real changes to local military consumption have been calculated using the public consumption index in the various countries. Purchasing expenditure data are estimates made by international research institutions (SIPRI and ACDA). They are of limited importance regarding the issue in question, since in many cases the purchases were financed by external bodies and the financing was not an alternative to internal resources. Consequently, the variables of the decision were mainly the defense costs in local currency.

Syria: Economic Crisis and Arresting the Strategic Arms Race with Israel

The Economic Decline of 1983-1986

After the Peace for the Galilee War in 1982, Syria accelerated its rearmament program against Israel. Defense Minister Mustafa Talas said: "Syria is taking great steps on the way to building up its own strength and achieving a strategic balance."[1]

In 1983 the proportion of military expenditure, together with purchasing, reached a height of about 30 percent of the total economic resources, although Syria did not pay the Soviet Union for a significant part of these purchases. The local defense costs without purchasing peaked in 1984. They were 17 percent greater in real terms than in 1981 and represented about 15 percent of the total economic resources, compared with 12 percent in 1981. The increase in defense costs was complemented by an increase of tens of thousands of soldiers, and the number of divisions increased from six to nine.[2]

Syria could not shoulder the economic burden of the arms race that it had imposed upon itself, and in 1983-84 an economic crisis began to develop. In 1984 the GNP decreased by 4 percent in real terms compared to 1983, after seven consecutive years of growth. Furthermore, a severe drought damaged the agriculture and the industrial sectors connected to it. The yield of wheat in 1984 was 40 percent less than in 1981.[3] At the same time there was also a decrease of hundreds of millions of dollars of Western aid and of money transferred by Syrians working in the Gulf states. The deficit in the current account of the balance of payments in 1984 reached $852 million, compared to $275 million in 1981, and the Syrian foreign currency balance, without gold, dropped to a low of $52 million in 1983, versus $300 million in 1981.[4] As a result the population suffered a drastic decrease in its standard of living, and industry was hit with a shortage of imported raw materials and fuel. This caused disruptions in various sectors of the economy and price increases of tens of percents.[5] The civilian per capita consumption in Syria was 21 percent lower in real terms in 1984 compared to 1981.

The economic situation deteriorated further during 1985-86. The budgetary deficit increased, foreign aid to Syria decreased from $1.8 billion in 1981 to $759 million in 1986, and the deficit in the balance of payments account reached $952 million in 1985, despite a sharp reduction in imports of merchandise.[6] The Syrian external debt totaled $10.8 billion in 1985, compared to $3.5 billion in 1980.[7]

In 1986, following the exposure of Syria's involvement in terrorism, sanctions were imposed, which worsened the economic situation. Syria also began to suffer from Moscow's change of attitude after Gorbachev's rise to power in 1985. The new Russian president gave priority to dealing with the ailing Soviet economy over subsidizing arms sales to its allies. The Syrian economic crisis in 1986 took the form of a grave shortage of basic commodities, the blossoming of a black market, daily electricity and water cuts, and an annual rate of inflation of tens of percent in an economy lacking linkage mechanisms. Because of uncertainty regarding the economic situation the Syrians did not prepare the sixth Five Year Plan for the period 1986-90.

A cut in real terms was actually made in the 1985 Syrian budget, but only at the beginning of 1986, at the peak of the economic crisis, did the regime publicly admit that the situation was grave. In a speech made on February 27, 1986, at the opening session of the Syrian People's Council, Assad enumerated the reasons for the crisis. He distinguished between objective factors, such as the effect of the world economic crisis on Third World countries, and internal ones, such as the imbalance between income and expenditure. He also emphasized the rapid population increase, 3.3 percent annually, which magnified the difficulties.[8] On March 8, 1986, in a speech given to mark the anniversary of the Ba'ath revolution, Assad admitted that there was a shortage of "essential and important items," i.e., basic commodities.[9]

The Shift in National Priorities

Because of the grave economic crisis the regime was forced to adopt a policy of restraint, which included drastically cutting in real terms the government budgets in 1986-87, curtailing imports, and encouraging exports by fixing attractive rates of exchange. The aim of the move was to halt inflation and reduce the deficit in the balance of payments. Despite the sharp cuts, allocations for the development of water and electricity infrastructures were increased in 1987, in order to provide a solution for the disruptions in water and electricity supply throughout the country.

Analysis of the distribution of funds indicates a dramatic change in Syria's national priorities: resources were moved from defense and investments to maintaining the standard of living of the population. Within this framework, the proportion of civilian consumption of the total resources increased from 64 percent in 1984 to 74 percent in 1987, resulting in increased salaries in the public sector. During 1985-87 there were two progressive salary increases, at a rate ranging from 10 percent to 35 percent. During the period 1984-87 the proportion of investments decreased from 21 percent of the total resources to 16 percent. The share of local defense consumption decreased from 15 percent to 10 percent, while the local defense budget in 1987 was lower in real terms by between 30 percent and 40 percent of the 1984 budget. The share of the defense consumption together with purchasing fell from 25 percent to 15 percent of the total resources. Defense budget cuts were reflected in reduction of the size of the regular army and significant cost-saving measures in the army.[10] After this cut the Syrian defense budget in 1987 was in real terms close to that of 1978, before the beginning of the strategic balance process.

In a January 1987 interview with the Kuwaiti newspaper *al-Qabas*, Assad explained the effects of the economic situation on the strategic balance with Israel. He said that Syria was obligated to exploit its natural and human resources as a condition for improving the strategic balance with Israel, and that in this regard it was as yet in early stages. In a speech on the occasion of Revolution Day, on March 8, 1987, Assad explained that "the economic situation was on the leadership's agenda,"[11] or in other words, it had been awarded top priority. For the first time Assad emphasized clearly the change in national priorities: "The citizen is the starting point, the aim, and the center of interest," an avowal reflected in the economic policy.

As well as relocation of resources in order to raise the standard of living, crisis management included efforts to increase efficiency, particularly in a war against corruption and smuggling. At first, from 1986 to the middle of 1987, an accusing finger was pointed at the smugglers, those who were stealing the merchandise from the market and creating shortages and price increases. The Syrian press contained many references to the struggle waged by the regime against these bodies, such as the arrest of speculators and persons charging exorbitant prices; the arrest of smugglers of domestic electrical goods; the capture of smuggled building materials; and the confiscation of smuggled iron and medicines.[12] Concurrently, reports also appeared of more severe court sentences for economic offences.

During the course of 1987 the economic crises worsened. In addition to the shortage of basic food products, unemployment of production workers whose factories had been shut down because of a lack of electricity and raw materials rose. The press suggested that the Syrian economy was totally paralyzed, the foundations of the state were in chaos, and the Syrian regime would be unable to overcome the crisis without a structural change. It reported that senior army officers had been brought to trial because of their involvement in smuggling and in a failed coup attempt.[13]

The French news agency reported on October 14, 1987 that there was a shortage in the Syrian markets of dairy products, eggs, chickens, and electrical batteries, and occasionally of coffee, sugar, rice, and meat. Likewise, food prices had increased drastically. For example, in the first ten months of 1987 the price of chicken rose from 60 to 115 Syrian pounds per kilo, and after severe criticism in the Syrian press the price was reduced to 100 Syrian pounds. Accounts circulated of long lines for food products, a shortage of medicines and animal fodder, and serious damage to the infrastructure of the regional Ba'ath party. It was reported that "there are long queues at the entrance to a bakery in Damascus; people have to wait hours, and not everyone manages to buy a loaf of bread in the end."[14] It was also reported that the Syrian security forces had been put on a high state of alert in most Syrian cities because of the fear of unrest produced by the long lines.[15]

As the situation deteriorated, an accusing finger was pointed at government ministers. Members of the Syrian People's Council attacked the Ministry of Supply and claimed that the sharp rise in food prices was a result of poor management and corruption on the part of ministry officials.[16] The ministers of housing and agriculture were dismissed; the latter was also jailed.[17] The Kuwait newspaper *al-Siyassa* reported that several ministers (tourism, finance, industry, supply, and electricity) wished to submit their resignations.[18] At the end of October 1987 the ministers of supply and of industry were dismissed and brought to trial on charges of corruption and causing economic damage.[19]

The End of the Economic Crisis

Syria's economic situation improved during 1988-90, mainly due to the development of the oil industry and the partial success of the economic policy. In 1988, for the first time since 1975, Syria achieved a surplus in its balance of payments account and a renewal of economic growth. Oil production reached a total of 300,000 barrels per day in 1988 and 400,000 in 1990. Forecasts indicated an increase of production to a figure of 550,000 barrels per day over the next two years.[20] This improvement was significant, particularly since in 1988 the Arab aid ("Baghdad aid"[21]) was totally discontinued, and the Soviet Union toughened the terms of supply of purchasing. The Soviet ambassador in Damascus explained that the USSR was examining Syria's requests, with the intention of making cuts because of Syria's inability to pay.[22] The Syrian external debt came to $16.4 billion in 1988, compared to $10.8 billion in 1985 and $3.5 billion in 1980, and represented a debt Syria was unable to remit.[23]

The Syrian leadership displayed optimism regarding Syria's capability of extricating itself from the economic crisis. In a speech given on March 8, 1988, the twenty-fifth anniversary of the Ba'ath revolution, Assad said: "We have taken steps to improve the state of the economy and reduce the difficulties, and the situation is now improved." He announced that new oil and gas fields had been discovered in Syria and a good agricultural season had begun.[24] Exactly one year later, on the twenty-sixth anniversary of the revolution, Assad said: "Despite the ongoing economic difficulties, Syria has made great progress in overcoming them, and without doubt the current situation is far better. Within not too long a time the economic situation will improve even further."[25]

During 1988-90 the new trend of redistributing economic resources continued. The relative share of the total resources used in civilian consumption continued to grow until it reached a peak of 79 percent in 1988, while the share of investments and defense consumption continued to decrease. In real terms, in the period 1987-90 Syrian civilian consumption increased by 20 percent, double the rate of increase of the population. Some of the increase in the proportion of civilian consumption was associated with 25 percent salary increases to civil servants.[26] This was the third salary increase in the period 1985-89. In contrast to the earlier, progressive salary increases, this raise was the same for all income levels. The lower income groups were compensated by reducing the price of flour, in order to prevent an increase in bread prices resulting from the increased prices of energy products. It is possible that the timing of this salary increase was influenced by the riots in Jordan in 1989 that broke out because of rising prices and reduced salaries (in real terms).

Table 2.1 charts the shifts in the distribution of Syrian economic resources in the 1980s.

Table 2.1**. Distribution of allocations as a percentage of Syrian economic resources, 1981-90**

Year	Percentage of civilian consumption	Percentage of defense consumption (local currency)	Percentage of investments
1981	67.7	12.5	19.8
1982	64.7	14.0	21.3
1983	65.6	13.6	20.8
1984	63.7	15.0	21.3
1985	65.0	13.8	21.2
1986 Economic crisis at its peak	66.8	13.0	20.2
1987	74.0	9.9	16.1
1988	79.0	8.2	12.8
1989	75.5	8.5	16.0
1990	77.5	7.8	14.7

Source: Data processing based on IFS (IMF) and SIPRI.

Jordan: Economic Crisis and the Palestinian Political Front

The Economic Decline

During the 1980s the state of the Jordanian economy deteriorated, taking the form of arrested GNP growth, increase of the external debt, and decrease of the standard of living. In 1989 the per capita consumption was 30 percent lower in real terms than at the beginning of the 1980s. Unemployment increased from 3 percent at the beginning of the 1980s to 20 percent in 1989. It increased to 30 percent in 1990, following Iraq's invasion of Kuwait.[27]

The economic deterioration in Jordan was partially due to objective factors: the few natural resources in the country; the structure of the economy (65 percent of which were service sectors); demographic developments (immigration to Jordan, rapid population growth, and increased urbanization); a reversal of the trend in the world oil market; and failure by the Arab oil-producing countries to meet their financial obligations to Jordan. In 1988 the Arab oil-producing countries ceased transferring money as part of the Baghdad aid, and the Gulf states did not agree to complete their commitments to the kingdom: Jordan received half of the $12.5 billion commitments it was due.

At the same time, however, the Jordanian government was largely responsible for the crisis. At least in the first years of the economic deterioration Jordan estimated that the shortage in resources was temporary, and consequently made insufficient adjustments between the reduction of resources and allocations. In this period Jordan increased its debts to a tremendous extent. During the years 1981-88 Jordan obtained loans totaling about $4 billion, almost the size of its GNP. As a result Jordan's external debt rose from about $2 billion in 1980 to $6.7 billion in 1988. The loan servicing payments reached a record figure of $1 billion in 1988.[28] At the same time Jordan used up all the foreign currency reserves at its disposal, and they decreased from $1.1 billion in 1981 to only $50 million in the middle of 1988.[29] As a result Jordan lost its financial credibility, which had previously been relatively high for the region. In parallel, Jordan also reduced its investments, thus impairing its chances of extricating itself from the crisis. The investments' proportion of the total resources decreased from 31.2 percent in 1981 to 17.6 percent in 1986, while the allocation for civilian consumption increased from 61.4 percent to 72.5 percent, respectively.

The Regime's Efforts to Manage the Crisis

In its efforts to overcome the economic crisis, in 1988 Jordan formulated a program for economic recovery. In an interview with the Jordanian newspaper *al-Ra'i*, the

Jordanian prime minister, Rifa'i, said that the government was aware that the austerity stage was liable to be difficult, but in the end it would strengthen the Jordanian economy. He emphasized that the government was determined to look after the needs of the citizens, supervising the prices of the basic commodities and the cost of the basic services. He expressed his hope that the Arab countries that had not met their obligations to aid Jordan would finally do so. He related Jordan's large debt to the absence of this aid.[30]

On July 31, 1988, Jordan decided to disengage from the Israeli-occupied territories. This decision came in the wake of the intifada, the deterioration of Jordan's economic situation, and the failure of the Jordanian development program for the territories. Jordan accordingly separated from the West Bank, and the percentage of Jordanian citizens who were of Palestinian origin thus decreased, although they remained a majority even after the separation. Prime Minister Rifa'i explained in an interview to the Kuwaiti newspaper *al-Anba'a* that Jordan's step had put an end to the Jordanian option and only the Palestinian one remained to resolve the problem of the Palestinians. He made it clear that Jordan was the antagonist with the longest border with Israel and that the decision to disengage from the territories did not mean that Jordan was no longer involved in the conflict.[31] Following the separation, traders and investors in the territories withdrew their money from Jordan, Palestinian workers in the Gulf hesitated to send their money to Jordan, and the residents of the territories lost faith in the Jordanian dinar. All these factors accelerated the drop in the rate of exchange of the dinar and harmed investments.[32]

In February 1989 Jordan applied to the International Monetary Fund (IMF) and together with it formulated a new recovery program. Jordan hoped that the program would enable it to receive additional loans under easy terms and to redistribute its external debts. In accordance with the requirements of the IMF, Jordan hurriedly implemented a policy of restraint in order to come to an agreement with it regarding a long-term reform program. Among other measures, this policy included a reduction of subsidies, an adjustment of the exchange rate, an imposition of VAT, and a freeze of the development program. These steps were required for the economy but were implemented too drastically and without sufficient preparation of the population.

The two decisions announced by Jordan – the economic austerity plan and the separation decision – were intended to strengthen the East Bank in the long term, even at the price of entirely conceding Judea and Samaria and the readiness to undergo a difficult period of austerity. This took the form of an increase in the relative proportion allocated to investments, from 18.6 percent in 1988 to 20.7 percent in 1989, at the expense of a reduction of the relative proportion allocated to the standard of living and to defense. In 1989 there was a real decrease of 20 percent in the per capita civilian consumption, compared to 1988. In 1989 the per capita consumption was estimated at about $1400 compared to $2000 in 1982-84 (in 1980 prices). Thus, the per capita civilian consumption dropped to its value of twelve years earlier.

The April 1989 Riots

The steps taken by Jordan as part of the IMF program began on April 10, 1989, and took the form of price increases of between 10 and 50 percent for numerous products, including fuel and cigarettes, mainly because of the reduction of subsidies.

Over April 19-22, 1989, bloody rioting raged in Jordan as a result of the price increases. Eight people were killed and about 100 injured. The riots erupted in Ma'an in southern Jordan by drivers who protested against the increased fuel prices. They quickly turned into a violent protest against the government, in the form of attacks on shops, banks, and government institutions, and spread to other regions in Jordan. King Hussein was abroad at the time and Crown Prince Hassan failed to halt the rioting before the king returned.

The rioting was started by Bedouin tribes in southern Jordan loyal to the regime. The results of a survey published in Jordan the following year indicated a large difference in income levels between the south and the rest of the country, thus explaining the high sensitivity of the population there to the decline of the economic situation. According to the survey, the average expenditure of a family living in the Amman was 405 dinars per month, compared to 235 dinars per month in the town of Irbid in the northern region and 199 dinars per month in the town of Ma'an, the capital of the southern region. The survey indicated a sharp decline in the standard of living throughout the entire kingdom in the period 1986-90.[33]

As a result of the rioting the regime realized that it had crossed the threshold of risks to its stability based on the population's standard of living. It consequently moderated the rate of implementation of the reform, and made cuts in defense costs and investments in order to divert the money to civilian consumption. The reform was halted as far as drastic increases in prices were concerned, but the kingdom still attempted to implement other elements of the IMF program. In July 1989 Finance Minister Jardana reported that the aims of the economic program were as follows: to achieve a growth rate of 4 percent in 1991, to reduce the budgetary deficit from 24 percent of the GNP in 1988 to 6 percent in 1993, and to accumulate foreign currency, so that in 1993 Jordan would have at its disposal reserves for an entire year's spending.[34] It rapidly became apparent to the Jordanians that this program could not be implemented in light of Jordan's economic and political situation.

Analysis of the distribution of resources indicates a change in the national priorities. The portion allocated to the cost of living (civilian consumption) reached 77 percent of the total resources in 1990, compared to 71.6 percent in 1988. This was done at the expense of investment, which dropped from 18.6 percent to 15 percent in the corresponding period, and local defense consumption (without purchasing), that decreased from 9.8 to 7.8 percent. As a result Jordan's local defense costs in 1990 were lower, in real terms, by 20 percent over 1988.

Because of the gravity of the crisis King Hussein made a rare, emotional appeal to the Arab countries in an interview with the United Arab Emirates television.[35] Hussein stated:

> The economic situation represents the tax incurred by Jordan given its location and its responsibility for the Palestinian issue and the entire Arab nation in military and other aspects. In the beginning the scope of the aid supplied us matched that which we expected from our brethren, as part of the first Baghdad summit, which proffered aid for building up our military strength and coping with the danger confronting us. This was aid intended to prepare people to fulfill their role in the confrontation [with Israel], in terms of knowledge, action, and progress. The circumstances that developed in the region and in the world caused considerable reduction in the aid we expected from our brethren. We lived in hope and continued to act in an attempt to achieve the goals that we had set for ourselves using our human resources, until the crisis began that affected everyone in this country and continues to affect them. . . We are trying, as we tried in the past, to reach a situation in which we can stand on our feet and rely on ourselves and on our resources. However, the question again arises if the problem is Jordan's only, or if the problems facing the Jordanian economy are part of a larger problem – a problem of the geographic location, a problem of the suffering on the conquered land, a problem of strongly defending this nation. I have real hopes that we will be given what world Jewry and the Zionist movement gives to Israel, or on a similar scale, and then others may ask us what we are ourselves giving. You can be sure that we are giving everything we have and, mainly, our lives, in order to defend our nation and its right to live.

The quantitative economic data supporting the king's statement were supplied by Prince Hassan, who said:

> For Jordan, a country with a population of barely three million, to spend $600 million a year on defense, or 16 percent of the GNP, is an impossible situation. The drastic reduction of aid from the oil-producing countries, from $1.2 billion in 1981 to less than $400 million today, has caused Jordan, which has few resources, to enter deeply into debt. Furthermore, the drop in prices of merchandise, despite our efforts to promote the phosphate industry, also contributed to our economic problems. As a result of the reduced income of our oil-producing neighbors, the income of Jordanian citizens working in the Gulf states, one of our important sources of foreign currency from the private sector, dropped by more than 30 percent over the last three years, to about $800 million. At the same time, Jordan's overall external debt increased from $3.5 billion in 1984 to almost $8 billion at the present time. We have done our best to implement the recovery program presented to us by the IMF, but there is a limit to the amount of pain and deprivation we can impose on our people, who are suffering so much. The intifada reduced the capital reserves of the Jordanian banks by a sum of dinars equal to more than $250 million. The money was withdrawn by residents of the territories and without doubt was good for the Israeli economy, but Jordan suffered considerably from this.[36]

Table 2.2 charts the shifts in the distribution of Jordanian economic resources over 1981-90.

At the end of this period Jordan became involved in the Gulf crisis as a result of the Iraqi invasion of Kuwait in August 1990. This had far-reaching effects on the Jordanian economy, including the numerous Jordanian workers who returned from Iraq and Kuwait, the blow to tourism, and reduced income from commercial transit to the Gulf via Aqaba. In 1991 Jordan participated in the Madrid Conference and on October 26, 1994 signed a peace agreement with Israel, in part in the hope that this would bring about an improvement to its economic situation.

Peace did not resolve all of Jordan's economic woes. From August 16 to 18, 1996, violent demonstrations took place in the country following the government's decision to increase the prices of several basic commodities (for example, the April 13 decision to raise the price of bread) as part of economic reform. Similar to the events of April 1989, violence erupted in the southern part of the kingdom and spread rapidly to Amman and to northern Jordan. The demonstrators attacked public property, burned tires, set fire to banks, damaged vehicles, and wrote slogans against the leaders of the regime. This time King Hussein was in the kingdom and put down the rioting with a combination of determination and a relative degree of restraint.

Table 2.2. **Distribution of allocations as a percentage of Jordanian economic resources, 1981-90**

Year	Percentage of civilian consumption	Percentage of defense consumption (local currency)	Percentage of investments
1981	61.4	7.4	31.2
1982	63.0	7.5	29.5
1983	68.4	7.9	23.7
1984	70.8	7.7	21.5
1985	72.0	8.9	19.1
1986	72.5	9.9	17.6
1987	71.7	10.0	18.3
1988	71.6	9.8	18.6
1989 Rioting in April 1989	70.3	9.0	20.7
1990	77.1	7.8	15.1

Source: Data processed in accordance with data of the IFS (IMF) and the Jordanian Central Bank.

Egypt: Riots and their Diplomatic Ramifications

The Food Riots of January 1977

After the Yom Kippur War President Anwar Sadat adopted a policy of economic openness. Although this policy improved the economic situation, it increased the gaps between the strata of the population by encouraging those better off to increase their income by investments in Egypt. The increase in the number of Egyptian workers abroad and the income transferred to Egypt also increased the income gaps in a country where the standard of living was lower than in the neighboring Arab countries. According to 1977 data, Jordan's per capita civilian consumption was 260 percent higher than Egypt's, while Syria's was 145 percent higher.

In an interview with the *Washington Post* on December 30, 1976, President Sadat said it was true that Egypt had economic problems, but this did not mean that Egypt was in a desperate situation. At the time Sadat was concentrating on the problems of food and housing: he explained that these were problems that had accumulated since the 1960s, and were produced in part by Egypt's heavy defense costs since the Six Day War.[37]

On January 18 and 19, 1977, bloody rioting erupted in Egypt involving workers and students, in the course of which some fifty people were killed and about 600 injured. The cause of the rioting was the government's attempt to reduce subsidies, accompanied by drastic increases in the prices of basic commodities. The cut in subsidies was made under pressure from the IMF, which pointed to the increasing proportion of the subsidies in the Egyptian budget. Indeed, the subsidies have generally represented the social mechanism of the regime. A considerable proportion of them were provided in the form of coupons for purchasing basic food commodities. Others were given indirectly by subsidizing energy products and water and maintaining price control over many items (electrical products, pharmaceuticals, building materials, and others) manufactured in the public sector or imported by the government and sold at a lower cost than their real price. After three days the regime was forced to abandon the plan.[38]

Not only were the subsidies not reduced; they continued to increase. By 1979 the expenditure on subsidies reached the sum of 1.27 billion Egyptian pounds (about $1.85 billion), or a fifth of the national budget for that year. Of this total, about a billion Egyptian pounds were allocated for food subsidies. This compared with 690 million Egyptian pounds for subsidies in 1978 (480 million Egyptian pounds for food), 435 million in 1974, and 255 million in 1973.[39]

In a speech delivered on May 1, 1977 Sadat admitted that he had been surprised by the rioting. "I did not expect that the resentment would cause sons of Egypt to rise up and set it alight."[40] In parallel, Sadat quickly reported on efforts to raise funds in the Persian Gulf and on plans to widen the Suez Canal in cooperation with Japanese agencies. Sadat stated that in the coming three years the government would place emphasis on food and housing, as well as employment and increasing production. He added that he had agreed to most of the demands of the chairman of the workers union, but warned against the need for loans, and stated that this situation must be halted soon. Sadat expressed the hope that in 1980 Egypt's economic difficulties would be at an end and the country would "begin to breathe."

In a speech delivered in July 1977 to the Central Committee of the Arab Socialist Union, Sadat said that the rioting in January 1977 had been "an uprising of thieves," and that the regime had been mistaken in not beating them down at the beginning. "I have never been as angry as in the matter of January 18-19."[41] On this occasion the president became involved in an argument with the delegates of the committee, one of whom charged, "The economic openness that you support does not serve the cause of the workers. It has become openness of consumption. Economic openness is producing an economic situation in which new economic forces are arising, having interests. This will return us to the old situation [before the July 1952 Free Officers coup] of political parties." Sadat revealed that the Soviet Union wished to cancel contracts and demand cash payment for armaments, and that a dispute had arisen between the two countries regarding military needs and contracts for repairs and spare parts, for which the Soviets also demanded cash, and regarding the question of the debts.

In November 1977 Sadat made his famous visit to Jerusalem, which paved the way for the peace agreement between Israel and Egypt. On the economic front, by October 1978 Sadat also sounded more optimistic. He emphasized the achievements of the Egyptian economy in overcoming the economic difficulties, and stated that this was achieved with Arab, American, and West European aid.[42] During the negotiations with Israel, the Egyptian propaganda organization launched a campaign to convince the population of the vital need for the peace agreement and pointed out its economic benefits. For example, it was stated that "a survey about the oil and natural resources in the Sinai Peninsula confirmed that reclaiming the peninsula would contribute significantly to the development and strengthening of the Egyptian economy."[43]

After the signing of the peace agreement with Israel in March 1979, the turnaround in Egyptian foreign policy was completed, without the blessing of the Arab countries. At the conference of Arab Foreign and Finance Ministers in Baghdad at the end of March 1979, it was decided to levy a series of sanctions on Egypt. These included halting all forms of Arab aid to the Egyptian government and its institutions, applying the laws of the Arab boycott to government and private bodies in Egypt that maintained direct or indirect relations with Israel, and refusing to supply Egypt with refined oil products or to purchase Egyptian government bonds. Despite the gravity of these decisions, they were not of crucial importance for the Egyptian economy, since Arab aid was already reduced, and trading between Egypt and Arab countries was relatively minor: in 1978 imports from Arab countries represented about 3 percent of total Egyptian imports, and exports represented about 12 percent of total Egyptian exports. Furthermore, the Arab countries decided not to harm the Egyptian workers in the Gulf and to maintain their rights.

Once Egypt was isolated in the Arab world after the signing of the peace agreement, Sadat said, "We have achieved by peace more than we achieved by war," a clear reference to economic gains as well as the political and diplomatic progress.[44]

Despite the food riots, the period 1974-79 was characterized by very rapid growth. Specifically:

i) The proportion of investments of total resources increased from 12 percent in 1974 to 28 percent in 1979. The real increase in investments since 1973 was 280 percent, and this contributed to the real growth in the Egyptian GNP, which increased by 66 percent in the period from 1973 to 1979.
ii) The proportion of local defense costs decreased from a peak value of 25 percent (32 percent including military purchasing) in 1973 to 7.4 percent (9.8 percent including military purchasing) in 1979. In real terms, during this period there was a decrease of 58 percent in the local defense costs and 56 percent in total defense costs (including purchasing).
iii) The relative proportion allocated to the standard of living fluctuated during the period. In 1975 and 1977 there was a decrease to less than 60 percent of the total allocations, followed by an increase to 64.4 percent in 1979. During the entire period 1973-79, there was a real increase of 36 percent of civilian per capita consumption, but the income gaps between strata of Egyptian population also increased.

The factors that permitted an increase in investments and in the standard of living were the cuts in defense expenditure and the increase of unilateral transfers to Egypt:

i) Unilateral transfers by private individuals increased from $123 million in 1973 to $2.8 billion in the fiscal year 1979-80.[45]
ii) Arab aid increased from about $700 million in 1973 to a peak of 2.5 billion in 1975. It subsequently decreased to $1.4 billion in 1978, and ceased altogether in 1979, after the signing of the Egyptian-Israeli peace agreement.[46]
iii) Western aid to Egypt also increased, including American aid, which increased from $110 million in 1974 to about $1 billion in 1979.

Additional important factors that contributed to Egypt's foreign currency income and to the increase in its GNP were the opening of the Suez Canal in 1975 following the intermediate agreements; increased tourism to Egypt; and increases in oil production and export. At the same time an increase in trade with the West was recorded. Trade with the US, for example, increased from $400 million in 1974 to $1.35 billion in 1978.[47] However, Egypt's external debt increased in the period 1973-80 from $3.5 billion to $16.6 billion.[48]

In 1980-81, the first years of the peace treaty with Israel, the trends that had characterized the previous years continued. Defense consumption continued to decrease, the standard of living increased, and investments maintained their high proportion of the total resources. In the first year the regime tried to prompt a sharp increase in the standard of living. Per capita consumption increased in real terms by

8 percent, and the share of civilian consumption of the total resources reached an unprecedented high of 70 percent. At the same time there was a certain reduction in the share of investments and defense in favor of civilian consumption. It is possible that in this way the regime wished to show to the Egyptian citizens that the peace agreement with Israel was worthwhile. The prominent development in the economy was the continued increase in oil production, which reached 600,000 barrels a day. Income from oil exports represented 58 percent of the total export of merchandise.[49]

After the assassination of Sadat on October 6, 1981, his successor, Husni Mubarak, continued in his footsteps, but implemented a more conservative policy, including in the economic field.

Table 2.3 charts the shifts in the distribution of Egyptian economic resources over 1973-81.

Table 2.3. **Distribution of allocations as a percentage of Egyptian resources, 1973-81**

Year	Percentage of civilian consumption	Percentage of defense consumption (local currency)	Percentage of investments
1973	65.0	25.0	10.0
1974	62.5	25.5	12.0
1975	58.6	22.8	18.6
1976	61.8	19.0	19.2
1977 Riots of January	59.7	17.6	22.7
1978	64.1	10.7	25.2
1979	64.4	7.8	27.8
1980	70.0	6.2	23.8
1981	67.3	5.6	27.1

Source: Processing of data based on data from IFS (IMF) and SIPRI.

Riots of the Central Security Forces in February 1986

In 1983 the Egyptian economy dropped sharply to a serious low point, mainly because of the decline in oil prices and the decrease in money remitted by Egyptians working in the Gulf. In 1986 there was additional serious economic deterioration. The export of goods decreased from $3.8 billion in 1985 to $2.6 billion in 1986, and in that period the transfer of money by Egyptian workers abroad decreased from $3.2 billion to $2.5 billion. At the same time there was a significant increase in Egypt's external debts, which reached $46 billion in 1986, compared to $21 billion in 1980. The servicing of Egyptian debts exceeded $4 billion per year, and Egypt could not repay its debts.[50] At the same time there was an increase in the government budget deficit, and inflation (customer price index) increased by 12 percent in 1985 and by 24 percent in 1986, in an economy lacking linkage mechanisms.[51]

Acknowledging Egypt's economic problems, Mubarak explained: "Over a period of more than thirty years of wars we have drained all our resources and spilled the blood of our soldiers. In this way we remained without an infrastructure. However, now that the wars are over and we embarked on the path of peace, we must alleviate the suffering of the citizens."[52] Recognizing the influence of the economic constraint on flexibility in foreign policy, Mubarak remarked vis-à-vis the Egyptian subsidies policy: "Wheat is important strategic merchandise and if we don't slow down consumption, within a few years Egypt will be subjected to pressures liable to harm its independence and free will." He said that the consumption of wheat increased from 84 kg/head per year in 1979 to 200 kg in 1984, because bread was used as animal fodder. He called for an increase in bread prices in well-off neighborhoods only.[53] Egyptian prime minister Ali Latfi added: "The roots of the economic problem lie in four wars that Egypt waged in the past, in past mistakes in economic policy, in imbalance between income and expenditure, and in imbalance between the amount of agricultural land and the size of the population."[54]

Despite the regime's public awareness of the grave economic situation and its public addresses on the subject, on February 25, 1986 riots erupted that were more severe than any since the food riots in 1977. The riots were initiated by soldiers of the Central Defense Units in Cairo, and they spread rapidly to other regions in Egypt, to the Delta, and to Assiut in southern Egypt. The rioters attacked shops, banks, and other economic targets until they were halted by military forces.

The deputy Egyptian minister of the interior, Abdel Karim Darwish, explained that the major problem of the internal security personnel was their low salaries, and said that the riots caused damage estimated at about a billion Egyptian pounds.[55] Other political figures added that the members of the Central Security Organization came from backward strata of Egyptian society, and that they rebelled because of the poverty and living conditions, earning only six Egyptian pounds a month.[56] The column "A Café on Political Street" in *al-Ahram* reported that the cause of the riots was the economic situation in Egypt, reflected in a minority of the rich and a majority of the poor, and that the riots were started by soldiers suffering from bitter resentment who were joined by a large group of poor citizens harboring similar sentiments.[57]

The events in Egypt aroused considerable apprehension in Western countries, and Egypt embarked on a propaganda campaign to project its ongoing stability. It emphasized the need to promote economic cooperation with the EEC and eliminate fears regarding tourism in Egypt.[58] The US was also recruited to Egypt's aid via economic agreements, such as the agreement for insurance of investments.[59]

Similarly, the unrest in Egypt was a source of anxiety for the Arab oil-producing countries, which had broken off their relations with Egypt following the peace agreement with Israel. The head of the office for representation of Egyptian interests in Kuwait said that "a number of Arab leaders, who do not maintain diplomatic relations with Egypt" informed Mubarak that their country was prepared to aid in repairing the damage caused by the riots, and that he had instructions for improving relations between Kuwait and Egypt.[60] In 1986, for the first time since the peace agreement, Arab aid to Egypt reached a significant figure and totaled $54 million.[61]

Following the riots Mubarak delivered a speech in which he criticized the Egyptian government for its slow handling of the economic crisis. Mubarak gave his government a number of tasks: to reduce its expenditure significantly; to remove obstacles from enhancing the private sector and investments and to raise confidence among investors; to strengthen the public sector while reducing bureaucracy and introducing advanced technology; to formulate policy regarding tourism; to shorten civilian bureaucratic processes; and to reassess agricultural output. The prime minister added that economic difficulties must be confronted without harming the weak segments of society.[62] Several months later, Mubarak defined the priorities of the regime: "We are making every effort to improve the standard of living of the masses." He cast the blame for the gravity of the crisis on external factors: "Our resources were harmed by external reasons (oil, the Canal, tourism), but with the spirit of October we shall not surrender to the difficulties and we shall not halt."[63]

Following the deterioration of the economic situation, from 1986 Egypt made efforts to reschedule the repayment of its debts. In April 1987 it reached an agreement with the IMF that had deepened its involvement in the Egyptian economy as part of the rehabilitation programs. These programs required Egypt to reduce its budgetary deficit, fix realistic prices for imported products (such as wheat) by devaluation of the rate of exchange, and reduce subsidies for these products. Egypt was also required to carry out reforms in the capital market and to fix realistic rates of interest. For this purpose a new five year plan was prepared for the period 1987/88–1991/92, which drafted far-reaching objectives, including: increase of the agricultural sector in order to reduce the dependence on imported food; increase of industrial output (a target annual growth rate of 7.2 percent was set); increase of the gas sector; improvement of the water economy; and development of the tourism industry.[64]

Egypt failed to meet most of the requirements of the IMF. Although many steps were taken in accordance with the program, it avoided any significant raise in the prices of basic commodities, as demanded by the IMF, because of a fear of harming the poor population. This generated a severe rift between the regime and the IMF, reflected in Mubarak's statement: "I support the economic reforms [of the IMF] but only to an extent bearable by the citizens. It is possible that from a purely technical and economic aspect it is good for the economy, but I don't want to correct the economy overnight and kill the citizen while doing so."[65] As a result Egypt did not succeed in repaying its debts and its situation deteriorated. At the end of 1990 Egypt agreed to join the US-led coalition to liberate Kuwait, and in January 1991 sent a large expeditionary force as part of this effort. In return, the US together with several European countries wrote off Egyptian debts of $25 billion, out of a total of more than $50 billion. In addition Egypt received economic aid totaling several billion dollars from Saudi Arabia and Kuwait.

Table 2.4 charts the shifts in the distribution of Egyptian economic resources over 1982-90.

Table 2.4: **Distribution of allocations as a percentage of Egyptian resources, 1982-90**

Year	Percentage of civilian consumption	Percentage of defense consumption (local currency)	Percentage of investments
1982	69.9	6.3	23.8
1983	69.1	6.5	24.4
1984	70.1	7.9	22.0
1985	71.5	7.8	20.7
1986 Riots in February	73.2	7.9	18.9
1987	76.8	7.0	16.2
1988	74.1	5.1	20.8
1989	76.3	3.9	19.8
1990	78.4	2.9	18.7

Source: Processing of data based on data from the IMF, SIPRI, and the Egyptian Central Bank.

Conclusion

In times of economic crisis, the limits of tolerance for a decline in the standard of living are tested and assume new importance while under heavy pressure. Faced with a significant drop in their economic stature, a state's population is likely to experience severe anti-regime sentiments that may even lead to violence against the regime. Against this domestic threat, a regime will increase its domestic allocations so as to improve the population's standard of living, at the expense of military expenditures and investments for future development. This in turn impacts on the foreign policy of centralized regimes and motivates them to reduce the military threats before them and obtain economic assistance through various potential channels.

The regimes in Syria, Jordan, and Egypt encountered similar economic constraints and acted in a similar manner. Once the economic situation deteriorated and presented a threat to internal stability, all three regimes reduced the relative proportion of defense costs and investments of their total national economic resources to improve the standard of living. Rioting by the populations indicated to the regimes that they had reached a red line from which they had to retreat. In the three regimes there were clear declarations by the leader that indicated his recognition of the influence of the economic constraints on his political or military freedom of maneuver. The changes in distribution of the resources – between defense costs, civilian costs, and investments – give quantitative expression of the efforts of each of the regimes to allocate the resources so as to maintain their rule in the long term.

The inability to support the economic burden and its influence on internal stability were among the major factors that led the leaders of the countries to the recognition that they were incapable of achieving their aims by military means and encouraged them to participate in peace processes as a strategy to achieve their objectives from Israel. In other words, it seems that reduction of the defense burden and adoption of diplomatic processes in the three countries did not result from ideological considerations, rather because the regimes could not bear the price they paid for military rearmament from the economic, social, and political aspects, and feared for their survival. Additional reasons were the collapse of the USSR and the results of the 1991 Gulf War, which also diminished the Arab estimate of their chances of achieving a military solution.

In concrete terms, although Egyptian President Anwar Sadat formulated his position for a diplomatic solution with Israel several years earlier, it is reasonable to assume that not by chance did he decide to come to Israel in November 1977 after the bread riots. Syrian President Hafez Assad and Jordan's King Hussein also joined the peace process in October 1991, after they experienced grave economic crises that threatened the stability of their countries and forced them to reduce their defense budgets. Additional factors were the cessation of financial aid from Arab oil-producing countries to Syria and Jordan; the collapse of the USSR, which had supplied arms to Syria under special financing terms; and the desire to receive financial aid from the West. Finally, the entry by the PLO to the Oslo process in 1993 was preceded by a grave economic crisis, which threatened the survival of the organization and its capability of fighting against Israel.

Thus, the events in Syria, Jordan, and Egypt and the regimes' responses to the economic pressures they confronted validates the research model analyzed in this work.

Notes

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