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## Opinion: It's the Egyptian Economy, Stupid

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*By Richard W. Rahn*

On Monday, Egypt's military rulers announced plans to have a constitutional referendum later this month. That's welcome news to those fretting over whether a stable, transparent democracy can emerge from the ashes of the Mubarak regime in Egypt.

But in order for democracy to sprout along the Nile, transitional leaders should focus as much on Egypt's future economics as its future politics.

As in every other country in the world, prospects for successful democracy in Egypt are dim unless it sustains a healthy rate of economic growth. This is, in fact, readily doable. One of the major frustrations with the Mubarak regime was the slow rate of improvement in the standard of living for most Egyptians. Egypt's per capita income has roughly doubled since 1980. Yet, during the same time period, India's per capita income has increased more than three times and China's has increased more than 12 times.

The Egyptian revolution should be taken as an opportunity by the U.S. and other major aid donors to require, as a condition of continued aid, the additional economic reforms necessary for Egypt to grow at a 7 to 10 percent annual rate.

Achieving this rate of growth shouldn't be all that difficult, because Egypt has much going for it. It has a reasonably good transportation infrastructure, and as the world observed over the last couple of weeks, the majority of the population has cell phones and access to the Internet. Egypt's tax rates are moderate, with both top corporate and individual tax rates of 20 percent. It produces roughly as much oil and gas as it consumes, and it has other natural resources, including gold.

But economic development is highly correlated with economic freedom, and on this score Egypt doesn't rank very well. It comes in 80th out of 141 countries in the "Economic Freedom of the World" report, and 96th out of 179 countries in the "Index of Economic Freedom." The World Bank index of the cost of "Doing Business" ranks Egypt 94 out of the 183 countries graded.

Among the country's economic handicaps:

**Foreign aid:** Egypt is one of the world's largest recipients of foreign aid and receives remittances from Egyptians who are working and living elsewhere. There is considerable economic literature to show that foreign aid tends to promote dependency rather than development, and there is ample evidence of this in Egypt's case.

**Red tape:** Egypt is also hobbled by a suffocating and costly bureaucracy that adds unnecessary cost and delay to many business activities. The judicial system tends to be slow, arbitrary and at times corrupt, which means property rights are not adequately protected.

**Trade barriers:** Tariffs and nontariff barriers are too high to allow the full potential of businesses. Given Egypt's strategic trade location with the Suez Canal, it would have much to gain by becoming a totally free-trade state, becoming a great center for both distribution and transshipment.

**Government ownership:** The Egyptian government still owns too many enterprises that would be much more efficiently run if they were in private hands. Given its location, telecommunications infrastructure and a large number of educated English speakers, for example, Egypt is a logical place to create a large financial center to better serve both the local and international community. But that's unlikely to happen so long as Egypt's banks remain under government ownership.

**Deficits:** Like all too many other countries, government spending is too high in relation to revenues. The result is a deficit of about 8 percent of gross domestic product in 2010 and a debt-to-GDP ratio of about 80 percent, both uncomfortably high. More rapid economic growth is the only cure for this problem.

**Inflation:** Egypt has had persistent low-double-digit inflation, which causes resource misallocation and adds to economic uncertainty. Rather than pursue a more responsible monetary policy, Egypt has given in to the temptation of certain price controls, which, as always, cause black markets and shortages.

The good news for Egypt is that the economic reforms needed are all very doable, and many could be done in a matter of months with adequate political will.

If a democratic system is established in Egypt, it should be given a fighting chance of success.

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