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# Egypt's Armed Forces Cement Economic Power

Military Business Expansion Impedes Structural Reforms

Jessica Noll

Since toppling President Mohamed Morsi in July 2013, the Egyptian military has successively expanded its civil economic activities. This development has attracted growing criticism, above all in the private sector. The government responded in October 2016 by announcing that the armed forces would diminish their economic role over the coming two to three years. But strong market positions, established privileges and historically ingrained structures make it unlikely that this will actually occur. Instead the economic activities of the armed forces, for example in the food, energy and construction sectors, will continue to shape the Egyptian economy. Realisation of the structural reforms Cairo agreed with the IMF in November 2016 is more than doubtful under these circumstances. Not least on those grounds, international donors should urge Egypt's leaders to curb the army's privileges.

In early September 2016 a group of Egyptian mothers took to the streets of Cairo, protesting over a shortage of subsidised baby milk. While the police acted quickly to stop the protests spreading, the military leadership addressed the problem. The armed forces supplied additional "discounted" formula, according to an official spokesman, in line with its duty to poorer citizens.

Whereas state media celebrated the intervention, there were dissenting voices too. Especially representatives of the private sector, which accounts for about 65 percent of the total labour force (2014 figures), criticised the economic influence of the armed forces. The increasingly broad product spec-

trum of the military enterprises – everything from arms and electrical goods to pasta – is regarded as a competitive threat. Besides Prime Minister Sherif Ismail, who announced that the military would wind down its economic involvement, President Abdel Fattah al-Sisi also made a conciliatory statement, claiming that military enterprises represent no more than 2 percent of Egyptian GDP. The figure seems rather implausible, considering the historic role of the armed forces in the economy and their unprecedented expansion in recent years. Experts believe the true figure to be at least ten times higher, although the lack of solid data makes reliable estimates impossible.

## **Expansion into the Civilian Economy**

The economic role of the Egyptian army dates back to the era following the coup of 1952 and the subsequent presidency of Gamal Abdel Nasser (1956–1970), when the armed forces began to see themselves spearheading national development. Alongside land reform, nationalisation lay at the heart of their policies. The old elites were disempowered, while the military secured long-term sway over land use and public enterprises. The doctrines of industrialisation through import substitution and development through large-scale projects also originate from that era – and remain current to this day. This centrally planned approach typified the construction of the Aswan High Dam in the 1960s and 1970s and the expansion of the Suez Canal in 2014/2015.

Nasser's successor Anwar al-Sadat (1970–1981) initiated a policy of economic and political opening, under which the number of military men in high positions of state decreased. The peace agreement with Israel in 1979, which secured US military aid for Cairo, represented another watershed. As well as developing Egypt's defence industries, the army's business activities were subsequently expanded under the defence ministers Abdel Halim Abu Ghazala (1981–1989) and Mohammed Tantawi (1991–2012). Here the military relied on a multitude of conglomerates, which remain to this day under the control of the Ministries of Defence and Military Production and are managed by retired generals. Within the military economy the lines between civil and military production are blurred. The National Service Projects Organisation (NSPO) founded in 1979 operates primarily in the civil sphere and concentrates on food production, while the Arab Organisation of Industrialisation (AOI, established 1975) and the enterprises of the Ministry of Military Production produce both military and civilian goods.

Under President Hosni Mubarak (1981–2011) Cairo pursued a course of economic

liberalisation. From the 1990s, and above all in the 2000s, this led to growing competition between civilian and military enterprises, where the latter succeeded in expanding both their product ranges and their international cooperation (for example with the Arab Gulf states). The armed forces justified this expansion above all on the grounds that their control over products and prices benefited both the state and consumers.

After playing a less salient political role during the Mubarak years, the military returned to prominence after the 2011 uprising and the toppling of Mubarak. The Supreme Council of the Armed Forces (SCAF) assumed power, and essentially retained it after Mohamed Morsi was elected president in June 2012. As well as opening the way for then Defence Minister Sisi (Tantawi's successor) to take over as president, Morsi's removal in summer 2013 also gave another boost to the economic expansion of the armed forces. General Mohammed al-Assar in particular has played a central role. He had served as assistant defence minister under Tantawi, and was responsible for external relations in SCAF from 2011. Since President Sisi appointed Assar as minister of state in 2015, the Ministry of Military Production has been increasingly visibly expanding its portfolio. Most recently it launched a "Made in Egypt" campaign promoting local (military) production as a means to reduce import dependency.

President Sisi also actively promotes reliance on the armed forces as a motor of national development. Under his presidency the civil economic activities of the armed forces have seen successive expansion at the expense of both the state-owned and private sectors. This has been possible in the first place because the armed forces have leveraged political power to further legalise their privileges. Military figures have also filled more political posts while the armed forces have expanded and consolidated cooperation with other ministries and broadened their responsibilities. In order to generate support for their efforts, they also promote

their business activities much more prominently than before 2011, asserting that they are working for the public good. Three central sectors will be analysed in the following.

### **Production and Supply of Food and Basic Goods**

In recent years, lack of foreign currency and mismanagement have regularly led to shortages of basic commodities, which the military has been able to leverage for publicity and expansion of its own businesses. Most recently, in January 2017, the Egyptian government reacted to months-long drug shortages and price rises for those that remained available by granting the armed forces a license to form a pharmaceutical company. Earlier, in November 2016, soldiers supplied the population with millions of food parcels after devaluation of the Egyptian pound by about 130 percent against the US dollar caused prices to spike – in some cases by more than 40 percent in 2016 alone. Subsidised food parcels have repeatedly been offered whenever the supply situation tightened; many of the products they contained came from military sources. The army has also expanded its own supermarket chain across the country, in particular in order to supply those living below the national poverty line. According to official figures, that represents almost 28 percent of the Egyptian population of more than 90 million.

Supplying the population with food produced by the military is nothing new. In response to the so-called bread riots of 1977, which broke out after President Sadat cut subsidies and were ended by the military, the NSPO sold surplus goods to the civilian population. This approach has also been used to cushion price fluctuations in the international wheat markets, which have immediate repercussions because Egypt remains reliant on wheat imports. In 2008 President Mubarak called on the armed forces to tackle a particularly severe bread shortage by increasing production in military bakeries.

The military has recently also expanded its political influence in the field of food supply. In September 2016 Major-General Mohammed Ali al-Sheikh took charge of the Ministry of Supply, which is also responsible for Egypt's crucial wheat imports. As in other cases, the appointment of a military officer to a civilian post was presented not only as a service to the common good, but also as a means to curtail rampant corruption. The previous minister of supply faced – contested – accusations of corruption in connection with the disappearance of wheat stocks. And al-Sheikh's successor, appointed in the February 2017 cabinet reshuffle, also has career-related ties to the military.

In the course of the transition, responsibility for the smart card subsidy system passed to the Ministry of Military Production. Since November 2016 the influential Minister of State Assar has therefore also been responsible for the rationing system that permits almost 90 percent of Egyptians to purchase subsidised food.

### **Energy**

During the years following the 2011 uprising Egypt was plagued by energy shortages. In response, a vigorous electricity generation expansion programme has been pursued. Despite reforms to facilitate private investment, the state remains the most important actor – offering the armed forces opportunities to expand their business operations in the energy sector too. In 2016 the Ministry of Military Production announced the establishment, in cooperation with the Ministries of Petroleum and Electricity, of a company to conduct the maintenance of state-owned power stations. The armed forces also appear to have acquired a veto over oil and gas production, with exploration and other ventures requiring their prior approval. The military itself also holds stakes in state-owned energy companies, such as Tharwa Petroleum Company. And it is also involved as a general contractor in the expansion of coal- and gas-fired power stations, which is being ramped up

to meet rapidly rising demand. One example of this is the conversion of two power stations by the Egyptian company Orascom in 2016.

Military enterprises are also involved in the production and installation of wind and solar power equipment. Despite its outstanding geographical prerequisites, renewable energy still plays a very marginal role in Egypt's energy mix. That could well change, however. In July 2013 the Arab Organisation of Industrialisation founded a company to manufacture components for wind and solar power. And in summer 2015, in a joint venture with an Emirati firm, it opened a factory producing photovoltaic modules. The AOI could face internal competition within the military complex from the Ministry of Military Production, which in 2016 announced plans to build a solar panel manufacturing plant in cooperation with the Ministry of Electricity and Renewable Energy and the Ministry of International Cooperation; Chinese investors are reportedly also involved.

But above all, the military is decisively backing the push to bring nuclear power to Egypt. Despite experts' concerns over safety and profitability, Sisi's government has been negotiating with Russia since 2015 over construction of its first nuclear power. The armed forces were involved in talks over an (as yet unfinalised) agreement under which Russia would supply technical assistance and a loan of \$25 billion. The military would also supply components.

### **Construction and Infrastructure Projects**

Participation in major development projects is especially prestigious for the armed forces. In recent years these are likely to have generated considerable – and absolutely opaque – additional revenues. Since 2013 the Armed Forces Engineering Authority has completed hundreds of government projects to the tune of several billion Egyptian pounds: as well as roads and bridges, these encompass social housing, hospitals and slum redevelop-

ment. The government is also relying on military participation in its ambitious plans to build a new capital east of Cairo by 2022.

The largest project of recent years was the Suez Canal expansion. Within the space of just one year a second shipping lane was created and a stretch of the original channel was deepened. Although numerous civilian firms participated in the project, it was led by the military. The armed forces are also involved in developing the Suez Canal Economic Zone into an international logistics hub, including the creation of industrial parks and port expansions. From the beginning, the project has also been overseen by the Suez Canal Authority, which is usually headed by a former naval commander.

Here and in other projects, the armed forces have ensured that their influence and financial returns are not restricted to the construction phase. Under Article 204 of the 2014 constitution, military facilities and infrastructure are subject to military jurisdiction, whose scope has been steadily expanded in recent years. For example, President Sisi decreed in 2016 that roads built by the army were security-relevant, along with the adjacent land. This de facto gave the armed forces permanent control of the land. The possibilities to generate revenue had already become obvious in 2015, when private companies came into conflict with the Defence Ministry over the distribution of advertising revenues from hoardings installed beside the Cairo Ring Road on land claimed by the armed forces. Sisi's decree could also secure the military lucrative locations for its petrol stations.

### **Political Calculations**

In general the expansion of the military economy can be regarded as an ongoing strategy to justify the size of the army. Given that economically hard-pressed Egypt faces no acute external threats, it is hard to justify maintaining the world's tenth-largest army with a strength of about 440,000. The armed forces' economic activities are there-

fore presented in the context of “national security”. Given that popular unrest, for example in response to shortages, certainly has the potential to turn against it, the military has good reason to worry about internal security and an interest of its own in providing affordable everyday needs such as food and electricity.

Expanding its business operations also offers the military possibilities to strengthen its control over the population. Via the smart card system for subsidised food, whose data is now gathered by the Ministry of Military Production, the armed forces can ultimately decide who is to receive subsidies. In recent years, moreover, the legal possibilities for prosecuting civilians before military tribunals have been expanded. These now have the authority to prosecute any violation touching on to the military or its facilities. In future this could also apply to offences relating to smart cards for subsidised food.

Intensified cooperation between the army and the private sector also creates structures of dependency. It has become harder for private companies to win public contracts, as they can be underbid by the expanding military enterprises. If they want to survive economically, firms are increasingly forced to cooperate with the armed forces, with the latter clearly in the driving seat.

### **Economic Self-interest**

As has been the case in the past, military actors justify their business activities on the basis of supposed benefits to society as a whole – for example asserting that low prices for their products and projects benefit both the population and the state budget. Ultimately, however, they are likely pursuing their own economic interests. It is impossible to make any serious estimate of their profit margins, or judge whether the low prices actually benefit the state budget. Given that such prices are only possible because of extensive privileges, this represents an extreme distortion of competition.

For example, the armed forces are able to draw on recruits for cheap labour. No reliable figures exist for the numbers of conscripts working in the army’s factories, nor what they earn. But one indication of low wage costs is found in a decree issued in summer 2013, increasing monthly pay for recruits to about 250 Egyptian pounds (about \$36 at the 2013 exchange rate).

Control of construction land must also generate substantial profits. A law of 1981 grants the Defence Ministry authority to designate state-owned desert land for construction projects. Other ministries and agencies also share this task, but enjoy lesser status than the Defence Ministry or are required to coordinate with it – as in the case of the National Centre for Planning State Land Uses. In 1997 then President Mubarak also decreed that the armed forces may administer undeveloped non-agricultural land. As a result, investors planning projects such as solar and wind power require additional permits from the military.

Fiscal exemptions represent yet another competitive advantage. Military enterprises pay no income, sales or import taxes. In June 2015, Defence Minister Sedki Sobhi also exempted numerous military-owned properties – including hotels and supermarkets, as well as housing – from property tax. Concurrently, in 2016 a 13 percent value-added tax was imposed on transactions in the civilian sector, and at the same time the import tax on hundreds of products was increased, in some cases by up to 60 percent.

Across the board the army’s revenues are likely boosted by its ability to cover most of its running costs out of the defence budget. Neither parliament nor the public is informed in any detail about how the defence budget breaks down. According to newspaper reports, it increased by \$1 billion between fiscal years 2013/2014 and 2015/2016, to reach \$5.4 billion – despite the country’s financial troubles. This further underlines the political power of the military.

Moreover, annual US military aid of \$1.3 billion is estimated to cover up to 80 per-

cent of Egyptian weapons procurement. This has allowed the military to accumulate immense financial reserves over the decades. Sources close to the army put the sums involved in the low tens of billions. Such assumptions are not unrealistic, given that the armed forces lent the Egyptian central bank \$1 billion in 2011.

### **No Civilian Controls**

Historically, there has always been a lack of civilian control over the military enterprises. Since 2011 that situation has increasingly been codified in law. First and foremost, the constitution of 2014 stipulates that only the National Defence Council – whose members are largely military – may debate the defence budget.

This means that the parliament elected at the end of 2015 lacks any constitutional authority to operate as an instance of control. Moreover, for the first time in decades, parliament again includes numerous members whose background is in the security apparatus. For example, the chair of the Defence and National Security Committee comes from the military intelligence service. In this function he participates in sessions of the National Defence Council discussing budget matters. Thus, another channel for civilian oversight is closed. At the same time, despite the fragmented party landscape, pro-regime forces secured a majority in parliament, which has passed pro-army legislation. For example, military pensions were raised in 2016, after they had already been increased repeatedly since 2014.

Neither the judiciary nor other civilian organs possess the authority to investigate transgressions committed by the military. At the latest since 2011 serving and retired military personnel have been immune from prosecution in the civilian justice system, and may only be tried by military tribunals. This protection also applies to the business activities of military actors, which on account of their classification as “security-relevant” are already completely opaque

and encourage mismanagement, if not even corruption. The Administrative Control Authority, which is officially responsible for fighting corruption in the administration, is itself traditionally headed by a former army officer.

In fact, given that members of the armed forces also enjoy exclusive access to lucrative posts in the administration and various state authorities, they actually control the civil sphere, rather than vice versa. For decades, former officers have occupied governorships and top administrative posts, for example in the aforementioned Suez Canal Authority and the port and transport authorities. The number of such functionaries with military backgrounds has increased yet further since President Sisi took office.

The fact that there is no significant discernible resistance to the army’s activities underlines its predominance in the state’s institutional structures. Egyptian civil society is powerless to change that. NGOs seeking to improve transparency and rule of law have been systematically persecuted and impeded in their work since Sisi took office. Nor can the media offer any correction. Freedom of the press is heavily curtailed, and critical reporting on the military subject to state censorship.

### **Outlook and Recommendations**

Despite the government’s insistence that the military is doing no more than crisis management, the armed forces are unlikely to withdraw from the Egyptian economy in the foreseeable future. Examples like China and Argentina demonstrate that pruning back military involvement in business demands political willpower. President Sisi will continue to support his generals’ course of business expansion because he is heavily reliant on their backing due to a lack of democratic legitimacy.

In fact, the influence of the armed forces in the Egyptian economy could increase further, contrary to the interests of international donors. In November 2016 Cairo agreed a comprehensive economic package

with the IMF, in the context of a budget deficit of 12.1 percent and state debt reaching almost 100 percent of GDP in fiscal year 2015/2016. An IMF loan of \$12 billion and funds from other donors including Germany are designed to create space for reforms in the coming years and thus boost economic growth. The goals include increasing competition and improving the climate for investors – and hence also strengthening the private sector.

Yet the economic expansionism of the armed forces threatens to keep Egypt's public sector contribution to GDP at its existing level, if not to increase it. Other planned reforms are also at risk: the IMF programme seeks to liberalise the energy market, but military interests in this sector (described above) are likely to hamper implementation. Efforts to create new jobs could also be undermined, along with hopes of promoting the private sector by reducing bureaucracy, new investment legislation, more transparent allocation of land and greater competition. Given that the armed forces draw primarily on their own personnel to realise their projects, wide-ranging military business activities will not necessarily create the new jobs the country urgently needs, with official unemployment at 27 percent among the under-30s. Moreover a reduction in military-related bureaucracy cannot be expected in the coming years. Complicated military approval processes will continue to create costly delays in private investment projects. And the appointment of military officers to political offices is unlikely to contribute to reducing corruption or improving transparency, as demanded by international donors.

The options for external donors to bring about a reduction in the economic power of the Egyptian military appear limited. But that does not mean that the matter should be ignored. Even if donors make their aid conditional, the army cannot be expected to withdraw completely from the Egyptian economy. However, in talks over financial aid they should still demand at least a reduction in the economic activities and

privileges of the Egyptian armed forces. Otherwise support designed to encourage economic development will be fruitless. Germany and the European Union should also put more thought into ways to assist the few civil society actors in Egypt, which could potentially initiate a national discussion about civil-military relations and push for a shift towards greater transparency. The current climate of repression of critical civil society makes this extremely difficult. Especially in that context, concessions to the Egyptian armed forces should only be made when they in return contribute to improving the human rights situation and the treatment of civil society.

### Further Reading

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