

History Capstone (Integrative)

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Development of Authoritarian Kleptocracy in Russia and Egypt

Introduction

The story of neoliberalism in action is a dismal one. In all places where neoliberal policies have been implemented, it seems the majority populations are worse off while the rich get richer. And we see a trend develop among these small elite groups – those that are well-connected with politics seem to be advancing much faster than the economies themselves. The initial theory of neoliberalism as a socially utopian idea has unfortunately given policymakers the necessary fuel to push these ideas through in undemocratic fashion—a concept Naomi Klein dubs “shock therapy.” Klein states a theory that neoliberal reform policies intended to create high sustainable economic growth in countries and prioritize the free market above the state are only able to pass in an undemocratic fashion, because people would never vote for it. She expands that although the neoliberal “economic model is capable of being partially imposed under democracy, authoritarian conditions are required for the implementation of its true vision.”¹

David Harvey defines neoliberalism as a theory “that proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free

¹ Naomi Klein, *The Shock Doctrine* (New York: Metropolitan Books, 2007), 11.

trade.”² This concept is also inextricable from globalism, and the development of increasingly intertwined economies across nations. International finance institutions (IFIs) form the connective tissue for global neoliberalism; bodies like the International Monetary Fund (IMF) and World Bank simultaneously support neoliberal policies and enforce them within states. This deployment of policy often has little or no regard for the poorer populations of countries and makes no effort to observe other economic factors that have pertinence to the effect of policies such as the business climate of a state and the likelihood of foreign investment.

Two cases can be brought in conversation with one another: that of Russia and its rapid privatization scheme and Egypt’s economic reform movement, both occurring from the early 1990s but having implications up to present day. There are some obvious similarities between the two, and important distinctions. Neoliberal policy reforms were forced upon both states: in 1991 Egypt signed the Economic Restructuring and Structural Adjustment Programme (ERSAP) under pressure from IFIs and in the same year Russia’s mass privatization project started.³ Both these states developed what can be termed authoritarian kleptocracies, in which a small, elite, well-protected segment of the population profited from privatization policies and a majority faced additional burdens as a result of government austerity and corruption. What effect did the grand plans of neoliberalism have on the ground, and how were the majority populations of these nations affected? The theory behind implementing radical free-marketism was the same in Russia and Egypt but the makeup of their economies at the time was different. Russia is a natural resource rich country that had already-formed valuable firms that needed to be divorced from the state and laid in private hands. Egypt, however, is not as resource-rich and the neoliberal hustle of the 90s was focused instead on converting the economy from its statist model to spark larger

² David Harvey, *A Brief History of Neoliberalism* (Oxford: Oxford University Press, 2005), 2.

³ Bessma Momani, *IMF-Egyptian Debt Negotiations* (Cairo: American University in Cairo Press, 2000), 40–41.

revenues and economic growth. So, while Russia already had substantial market value that needed to be transitioned and was offered substantial aid packages, Egypt had to create more value in their market for aid to keep funneling in.

In the case of both Russia and Egypt, the implementation of neoliberal policies in the 1990s resulted in a move towards stronger nationalism and a security state, and significant economic reform or revolution has proven evasive. Although faced with similar problems and events in the 1990s, namely the dirty privatization of economic capital and austerity regarding public spending, in Russia this has led to a popular demand for the state to reclaim private enterprises while the 2011 mass protest in Egypt called for an end to the neoliberal policies furthering income inequality. Putting the events of Russia and Egypt in conversation with one another helps examine how global neoliberalism becomes deeply rooted in political systems, and how the policies of these authoritarian kleptocracies that disproportionately target poorer populations are paradoxically self-reproducing and unsustainable for long-term economic growth.

This paper will first examine fiscal policies implemented in Russia and Egypt in the 1990s and how these affected the growth of public revenue and the private sector. Then moving to economic measures often overlooked such as patience and trust that have profound impacts on economic growth and the relationship between politics and economics. Finally, it will examine the social costs resulting from neoliberalism as an ideology, and how they differ between Russia and Egypt. This paper focuses mostly on the economic and social costs that neoliberalism incurs, rather than monetary policies such as changes to the exchange rate and national reserves. While these are also measures to consider and have import regarding IFI policies, they are not as relevant to the actual development and perpetuation of authoritarian kleptocracy.

Fiscal Policy: Budget Cuts and Tax Reform

Some of the common policies advocated by the IMF and World Bank for countries transitioning to more open markets are reducing public spending to cut down the budget deficit and implementing more comprehensive taxation laws for increased public revenue. In theory this would mean after state cuts subsidies to producers and corporations alike, the free market will thrive under rational agents and produce output that increases the overall national income level, dispelling the need for subsidies. Raising and implementing better regulations and tax laws also should theoretically lead to reductions in the budget deficit without hampering market growth and national welfare. Clearly, the attempted implementation of these policies was poorly planned and corruptly done in Egypt, Russia, and many other states in a similar position. Beyond that, however, the policies are flawed in themselves as they do not account for the conflation of business and government that is allowed to take place under neoliberal conditions, or for the automatic reproduction of those conditions once the system is set in place.

By 1991, Egypt owed a significant amount to other countries and international finance organizations and had begun to default on its loans as early as 1983.⁴ Negotiations with the IMF were stalled until Egypt accepted their conditions in the late 1980s, and this conflict led to other lending institutions halting their loans as well.⁵ The deadlock continued as the IMF rejected reform programs Egypt suggested from 1989-90 and other creditors grew increasingly weary of lending to Egypt without affirmations from the IMF.⁶ By 1991 Egypt was essentially forced to accept IMF conditions for a larger loan to pay off interest on outstanding debts and avoid a

⁴ Timothy Mitchell, "Dreamland," in *Rule of Experts: Egypt, Techno-Politics, Modernity* (Berkeley and Los Angeles: University of California Press, 2002), 276.

⁵ Momani, *IMF-Egyptian Debt Negotiations*, 27.

⁶ Momani, 37-38.

financial collapse. After signing the ERSAP agreement, Egypt launched into an array of reforms that were intended to increase public revenue. Cutting subsidies and implementing taxation reform were just two of the conditions required by the IMF. Russia's situation was somewhat different in 1991. International organizations and Western states enthusiastically offered to help transition Russia's economy into a free market after the collapse of the Soviet Union.⁷ Aid was liberally gifted to Russia in hopes of developing a democratic, capitalist state, and those in managing the aid were also responsible for creating the policies to reach this ideal. The goal of these changes was the same as with Egypt: a strong free market that increases national income levels and has sustainable growth potential, and a small budget deficit with significantly reduced public spending.

The first element to examine of the reform policies was the reduction of public spending, which took place in Egypt primarily by cutting subsidies on consumer goods. Before the reforms Egypt subsidized necessary household items and smaller businesses, but their most important subsidies were on energy services like electricity and gasoline. The state continually refused to cut the subsidies on energy in fear of popular unrest, but by 1991 was forced to implement those reforms to continue receiving IMF support.⁸ These budget cuts affected the poorer populations unfairly, meaning consumers bore most of the cost burden. The state was also vague and often dismissive of announcing the policy changes to the people; when subsidies on household goods were initially cut the government did not publicly announce the changes.⁹ The process of the public spending cuts was corrupt and observed as "a multilayered political readjustment of rents,

⁷ Janine R Wedel, "Tainted Transactions: Harvard, the Chubais Clan, and Russia's Ruin," *The National Interest*, no. 59 (Spring 2000): 23.

⁸ Momani, *IMF-Egyptian Debt Negotiations*, 43–44.

⁹ Momani, 45–46.

subsidies, and the control of resources,”¹⁰ defeating the purpose of a privatization movement intended to return capital to citizens. The military is one such example: as the state budget was reduced, this meant the military’s defense budget also shrunk. In fear of resistance from the vast military apparatus, however, the government allowed the generals to convert their military production largely to consumer production under the guise of privatization.¹¹ This was not uncommon – many states that implemented similar reforms, almost always because of IFI pressure, saw a diversion of funds to capitalist enterprises under the politically advantaged rather than a serious cut of spending. Part of the purpose of state spending cuts was to grow the private sector by selling off public companies, but this growth was largely hampered by the profit-driven elite that acquired enterprises unfairly. The growth of these enterprises might have been high, but the profits were often diverted and consolidated to a very small group of elites instead of reinvested. Despite these factors, Egypt was lauded as an IMF success story by the end of the 1990s as a neoliberal state that saw consistently high GDP growth around 5 percent per year.¹²

Russia’s privatization movement was unique – policymakers’ goal was to convert many state-owned companies but also drastically cut down on state employment, pension funds, and public benefits. This process was therefore wider in scope than that of Egypt, but equally as corrupt. The agents responsible for implementing policy were mostly private: the American Harvard economists and the Russian group that came to be known as the “Chubais clan” were the ones responsible for pushing through reforms.¹³ These groups were given unfettered access to aid packages from USAID and IFIs, with the promise of using them to further the privatization

¹⁰ Mitchell, “Dreamland,” 277.

¹¹ Zeinab Abul-Magd, *Militarizing the Nation: The Army, Business, and Revolution in Egypt* (New York: Columbia University Press, 2017), 116.

¹² Mitchell, “Dreamland,” 272.

¹³ Wedel, “Tainted Transactions: Harvard, the Chubais Clan, and Russia’s Ruin,” 24–25.

process. The amounts they were given are staggering: the Russian Privatization Center in Moscow managed around \$4 billion of Western aid funds during the project.¹⁴ The priority of the opening process in Russia was to first privatize state companies rather than make explicit cuts. Voucher privatization was a program deployed by these ‘reformers’ wherein citizens were given vouchers that represented shares in private companies (of their choosing). As many citizens did not fully understand the value of the vouchers and prioritized more necessary goods, a small circle of elite businessmen (later known as the oligarchs) often bought these shares en masse for cheap and worked to gain ownership of mid to large companies. The theory fueling rapid privatization was that any privatization is good privatization, whether it was corrupt or not.¹⁵ Those in charge of implementing economic reform and deciding the privatization agenda were notoriously as corrupt as the politicians, using their position to receive personal profits either from diverting aid directly or simply self-dealing.¹⁶ The approach of rapid privatization assumed the tax reform policies would be passed around the same time the private sector grew, and this would be followed by stronger institutions to regulate private business. Yet a high degree of insider dealing that directly involved government agents precluded any meaningful change from being enacted.¹⁷ Tax law enforcement remained low, and practically nonexistent for the elite classes that hid their stolen profits offshore.

Thus, those responsible for Russian institutional reform had vested business interests themselves, entrenching the corruption of privatization into the state’s infrastructure. Egypt’s government developed an entrenched system of business and politics too, but the military held a

¹⁴ Wedel, 26.

¹⁵ Bernard Black, Reinier Kraakman, and Anna Tarassova, “Russian Privatization and Corporate Governance: What Went Wrong?,” *William Davidson Institute at University of Michigan Business School*, n.d., 10.

¹⁶ Wedel, “Tainted Transactions: Harvard, the Chubais Clan, and Russia’s Ruin,” 30–31.

¹⁷ Black, Kraakman, and Tarassova, “Russian Privatization and Corporate Governance: What Went Wrong?,” 25–28.

stronger position than the security forces of Russia. The liberties afforded to the Egyptian military extended as far as passing a law “authorizing the military to decide on its own tax exemptions.”¹⁸ Defense conversion was also present in Russia, but the lasting implications were different because public image of the military in Egypt held more weight. During the Nasser era of the 1960s when Egypt developed a socialist model the government image was one of a military state, and the lasting social implications were general public support and trust of the military image.¹⁹ Even as support for the military waned due to their part in authoritarian suppression over subsequent years, as late as 2011 the people of Egypt welcomed state ownership by the military over Mubarak and his private cronies.²⁰ Over the 1990s, as the Egyptian military budget was reduced from 20 percent to 9 percent, the generals enjoyed more insider privileges and benefits from privatization programs.²¹ The military specifically was able to secure land rights contracts for much less than they were worth, expand their factories to produce consumer goods, and evade significant taxation within the process. The glaring issue with this process, besides from the corruption, is that the public spending cuts and low enforcement of taxing the new private enterprises and land rents only led to small public revenues. The rest of the tax revenue needed to keep the public budget afloat had to come from those without as many privileges, and those came in the form of regressive sales and income taxes.

As a result of dirty privatization, subsidy cuts, price increases, and regressive taxation, both Russia and Egypt have developed massive shadow economies that parallel the official one.

¹⁸ Abul-Magd, *Militarizing the Nation: The Army, Business, and Revolution in Egypt*, 123.

¹⁹ Walter Armbrust, “The Revolution Against Neoliberalism,” in *The Dawn of the Arab Uprisings: End of an Old Order?*, ed. Bassam Haddad, Rosie Bsheer, and Ziad Abu-Rish (Pluto Press, 2011), 118.

²⁰ Armbrust, 113.

²¹ Abul-Magd, *Militarizing the Nation: The Army, Business, and Revolution in Egypt*, 123.

The widespread knowledge of the government's direct involvement in business ventures and failure to tax corporations or the rich properly has increased the appeal of operating in the informal economy. The social networks that dictate organization in the informal economy are distinct in Russia and Egypt though. The Russian economy of favors—*blat*—is well-known and an informal system of calling upon social connections for goods and services that are otherwise unattainable. Under the Soviet Union the black market and existence of *blat* was engaged upon typically to get around the state restrictions, but the social networking economy is still in working order today, with slightly different applications. The Russian informal economy has grown in parallel to the official economy largely to evade taxes, corruption, and crime rather than to bend state rules. In Egypt there are other social connections that facilitate and help organize the shadow economy—particularly the networking opportunities afforded by Islamist movements and NGOs. These connections do not neatly organize the informal economy, but they are strong threads that allow more mobilization of the urban poor. This economy has been built on survival needs; the informal housing situation in Egypt offers a vivid example: “Greater Cairo contains more than 111 spontaneous settlements (*ashwaiyyat*) housing more than six million people who have subdivided agricultural lands and put up shelters unlawfully.”²² These populations also steal public services like running water or electricity illegally, but because the settlements are so large and continue to build despite any government opposition, the state has little control over the network.

As for the scope of these informal networks, economists estimated the shadow economy of Russia in the late 1990s-early 2000s to be around 50 percent of GDP per year but has been

²² Asef Bayat, *Life as Politics: How Ordinary People Change the Middle East* (Stanford, California: Stanford University Press, 2013), 81.

steadily decreasing to around 40 percent in 2020.²³ They found economic factors such as tax revenues and production subsidies to be the most significant variables regarding the growth of the shadow economy.²⁴ These are not surprising results, but they affirm that the tax policies and public budget cuts do contribute to the massive growth of a shadow economy. When tax revenues are not high enough to provide public goods like education and healthcare, these markets tend to be reproduced in parallel to the official system as a way to avoid taxation and simultaneously consume the services. In Egypt the informal economy is arguably larger, not only because of the percentage of GDP it occupies but the breadth of it—the shadow economy accounted for more than 40 percent of GDP in the mid-2000s and was considered the largest source of jobs in the overall economy.²⁵ The downsides to such a large informal economy are that the state does not provide resources to workers or citizens operating solely in this sphere, including healthcare and education. Yet the informal economies continue to grow because the state continues to cut public benefits that aid lower classes and to levy taxes disproportionately on the poorer. This trend can be expected to continue as long as these conservative fiscal policies continue.

The piece of the story that is left out of the IFI progress reports and Western rhetoric is the lack of supervision over what the public spending cuts or tax reform look like and what industries or populations they target. The IFIs that pushed through neoliberal policies in the developing private sectors of both Russia and Egypt either did not account for, or care about, the ease with which the governments could engage in insider dealing, and how inextricable the two

²³ Olga Lizina et al., “The Informal Sector in The Structure of The National Economy: Simulation and Evaluation,” *Journal of Eastern European and Central Asian Research* 7, no. 3 (2020): 300.

²⁴ Lizina et al., 298.

²⁵ Mohammed Soliman, “Egypt’s Informal Economy: An Ongoing Cause of Unrest,” JIA SIPA, October 29, 2020, <https://jia.sipa.columbia.edu/egypts-informal-economy-ongoing-cause-unrest>.

systems would become. Rather than using the diversion of public funds to grow the private sector or significantly reduce the budget deficit, in Egypt those with political power tended to earn large profits from the reforms. Most of the GDP growth seen from Egypt in the 90s comes from the reinvestment and growth of capital from a very small circle, while most of the population struggle to survive. This is a far cry from the 'trickle-down' theory of economic growth that the IFIs hoped to see, wherein the private sector's rapid growth would inevitably lead to higher national income levels for all. In Russia, the theory was similar: after the priority of privatization was complete, stronger institutions to regulate the economy and collect taxes would emerge naturally and most citizens would reap the profits of a capitalist market structure. In reality, the informal economies of both these states thrived in the light of public spending cuts and taxation reform because the outcomes of these policy changes unfairly burdened the lower classes. These fiscal policy changes made in the 1990s have proven hard to reform in subsequent years though. Because the current system rewards the politically well-connected, the likelihood of taxation reform that targets the rich is low.

Patience, Trust, and Business Climate

Classic macroeconomic indicators such as GDP, public revenue, capital outflows and inflows, inflation, and the unemployment rate are not sufficient markers of social wellbeing in most countries. Measures such as GDP and capital inflows are calculated as an aggregated number across the entire nation and do not reflect wealth inequalities or the underground market. Inflation and price markers also omit how much of the burden consumers take on compared to producers. This is not to say that these classic macroeconomic measures are outdated, but rather that they do not fully reflect the state of the economy and the impact on different populations

from policy changes. Recently, economists have investigated other measures that help provide a deeper analysis of economies that can be added to the list of classic macroeconomic indicators. The main three I am concerned with here are patience, trust, and the business climate.

Economic theory is based on the assumptions of rationality and profit maximization. Patience, however, complicates this theory by acknowledging there is a difference in a present versus future payoff: if agents will choose a strategy that maximizes their payoff, one must consider how patient they are to receive gains to predict their behavior. Often this is referred to as a discount rate – or how much a future payoff is discounted as compared to a present one. Trust is another interesting measure that weighs how much people trust one another during transactions, and this can be extended to civilians trusting governments or firms trusting regulators. Economists have found that trust within societies can have profound impacts on their growth. Trust can be examined as a factor regarding single transactions or between civilians and a government. Zak and Knack found that when the institutions to punish “cheaters” are weak, the likelihood of lower trust is increased and low growth will follow.²⁶ The business climate of an economy is an idea that puts together patience, trust, and other factors regarding the beliefs and values of a society. Managers often choose their business strategy under consideration of how other businesses are conducting themselves and what protections they have from government regulators. The business climate can also be affected by the society’s morale and values, so if there is a history of cheating rather than good management, it is likely that more cheating will continue.

Returning to the case studies, the most apparent difference between Russia and Egypt in the 1990s is that Egypt already had some free market structures in place and sectors needed to be

²⁶ Paul J. Zak and Stephen Knack, “Trust and Growth,” *The Economic Journal* 111 (2001): 196.

reformed, whereas Russia needed to restructure and privatize their whole economy. The inherent value of Russia's state companies was also higher than Egypt's, simply due to the nature of the firms: there was strong demand for natural gas and oil, whereas Egypt was still working on developing a diverse economy with larger revenue potential. Some of Russia's biggest firms had astronomical market capitalization estimates: Gazprom, the natural gas giant, was conservatively estimated to be worth \$600 billion, with more liberal estimates capping it at \$2 trillion in 1999.²⁷ Companies like Yukos, who had an estimated market capitalization of \$170 billion at the time of privatization, were initially acquired for a fraction of its true value and subsequently gutted of profits. Some major state-owned Egyptian companies had high value, but their industries were still developing overall, and the conversion from military production to consumer products was a major shift that resulted in the loss of some foreign business.

Black et al. suggest two interrelated strategies facing managers that acquired firms in Russia: the "value creating" strategy and the "self-dealing" strategy.²⁸ They explain that these strategies are not independent; if a manager chooses to steal value from the company by asset stripping, then they face the risk of inhibiting the growth and future value of a company.²⁹ In perfect theory analyzing rational actors, the more profitable decision for new managers who acquired a valuable firm was to grow it and reap the profits from a successful enterprise for years to come. Voucher privatization was "inherently dangerous" because it offered managers ownership of the company through shares but separated them from facing any official accountability for cheating, so skimming profits became both easier and more appealing.³⁰ Many

²⁷ Black, Kraakman, and Tarassova, "Russian Privatization and Corporate Governance: What Went Wrong?," 39. For reference, in 2022 USD Alphabet Inc. (the parent company of Google) has a market capitalization of \$1.7 trillion.

²⁸ Bernard Black, Reinier Kraakman, and Anna Tarassova, "Russian Privatization and Corporate Governance: What Went Wrong?," *William Davidson Institute at University of Michigan Business School*, n.d., 21.

²⁹ Black, Kraakman, and Tarassova, 23.

³⁰ Black, Kraakman, and Tarassova, 25.

new owners observed that running a company honestly, even if it had inherent value, would take time to restructure and grow, likely leading to small losses in the beginning. Instead, most managers were impatient for gains and often chose to steal the value which already existed in their firms and forget about growth altogether.

These companies did not have a single owner per se, but voucher privatization made it possible for insiders to acquire a majority of shares, along with minority shares of a firm's subsidiaries. In the case of Yukos, Mikhail Khodorkovski acquired ownership of the parent company and large minority shares of its subsidiaries. He was able to first to skim profits to the point where Yukos reported low profits, evading state taxes. The second step was for Yukos to buy oil from its subsidiaries at astonishingly low prices, leading those companies to also report low or negative profits. The skimmed revenue likely ended up in Khodorkovski's offshore accounts. The economic cost of this behavior to Russia was a lack of reinvestment in companies that were inherently profitable, low tax revenues for the state, and major social costs to employees who they often neglected to pay.³¹ There are many examples of this behavior by managers – it became the standard more than the exception. As bad managers continued to gain ownership of companies and voucher privatization became increasingly corrupt, citizens and potential good managers were less trusting of the government and its ability to effectively regulate the new free market.

Distrust compounded the effects of low patience and corruption, leading to the downward spiral of managers choosing the self-dealing strategy, making it more difficult for regulating institutions to hold them accountable. The growth of the Mafia and the government's lack of policing was also a factor that drove the shadow economy further underground, as citizens and

³¹ Black, Kraakman, and Tarassova, 40–44.

smaller business owners did not trust the government.³² The business climate of Russia in the 90s was therefore corrupt, untrustworthy, full of bad management and a growing shadow economy. The government's image as weak regarding institutions and policy also negatively affected the business climate. A large part of the blame for these issues lies with the private reformers – they clearly did not account for these factors and pushed their privatization policies through anyways, each of them making large profits as well. Trust in Egypt was also exceptionally low, with good reason. Most of the cronies that profited from the 1990s reforms were directly connected to the authoritarian government, and the military also made major profits on producing consumer goods while simultaneously cutting wages and suppressing unionism. Big companies like Eastern Tobacco and Arab Contractors were state-owned, but the owners of their private subsidiaries were often the family members of those running the parent companies.³³ The conversion of the military production was also hasty, indicating a high discount rate for generals that wanted to be compensated for financial losses due to budget cuts. The shift was poorly planned, as many of the consumer products that military factories started to make were duplicated by other factories, leading to overall inefficiency and a surplus of unnecessary household goods.³⁴ The generals entering the private market did not choose strategies to maximize the long-term growth of their companies, like reinvesting in capital equipment to make higher quality goods, but instead just converted what resources they already owned and skimmed the profits.

Foreign capital is difficult to raise in low-trust societies, and many under-developed states are hoping for foreign investment to help jumpstart domestic growth. In Egypt, the 1990s

³² Black, Kraakman, and Tarassova, 24.

³³ Mitchell, "Dreamland," 280.

³⁴ Abul-Magd, *Militarizing the Nation: The Army, Business, and Revolution in Egypt*, 120–21.

reforms had the opposite effect: “The country’s openness index, which measures the value of exports and imports of goods and services as a proportion of GDP, collapsed from 88 percent in 1985 to 47 percent in 1996-97.”³⁵ The head of the General Authority for Investment and Free Zones from 1999-2004, Muhammad al-Ghamrawi, offers an example of how trust affected foreign investment. He was an officer that previously held the post of minister of military production, and when he assumed office at the head of GAFI, foreign direct investment dropped from \$1 billion to \$646.9 million in 2002.³⁶ He consistently lied to the public about how much foreign investment was truly coming in, and over the years he was the head of GAFI foreign investment continued to drop. After he was replaced, however, foreign investment increased again. Global investors and lenders are weary of figures like al-Ghamrawi who they see as less trustworthy and more corrupt. In Russia the aid packages and foreign investment fervor was initially high when privatization started, but USAID and other lending institutions started to pull back on their loans when the development of the kleptocracies became too apparent to ignore.³⁷ The national savings rate of countries is also positively related to domestic capital investment. Less domestic capital overall means less reinvested in the national economy, and most of the current capital is owned by the small group of elites that invest in themselves and their own small grouping of companies. Thus, the banks in Egypt tended to only lend large sums of money to corporations that already had lots of capital, instead of opening any new investment opportunities by way of small businesses or petty loans.³⁸

These domestic cases and factors do not even consider how the patience and trust of global financial institutions like the IMF and World Bank also contributed to this disastrous

³⁵ Mitchell, “Dreamland,” 275.

³⁶ Abul-Magd, *Militarizing the Nation: The Army, Business, and Revolution in Egypt*, 171.

³⁷ Wedel, “Tainted Transactions: Harvard, the Chubais Clan, and Russia’s Ruin,” 29–30.

³⁸ Mitchell, “Dreamland,” 279–80.

conversion. The immediacy of returns they demanded did not leave time for Egypt or Russia to properly implement reforms to their state regulation laws and institutions. The rhetoric was consistently one of immediate, rushed reforms—or “shock therapy” as Naomi Klein dubs it. By threatening to cease aid packages these economic transformations were rushed, and oftentimes the IFIs enforced the neoliberal policies generally but failed to oversee the government’s involvement with the growing private sector. For instance, Egypt in the late 1980s consistently referred to the potential unrest that could develop as a result of cutting subsidies so drastically and enforcing a higher sales tax, but the IMF and other Western creditors refused to loan more money unless they guaranteed faster changes.³⁹ The idea was that the enforcement of the policies would develop after tax reforms were in place and subsidies cut. Once the corruption of the state and business sectors was established, however, any changes proved incredibly difficult.

This is not to wholly discount the idea of empirical macroeconomic analysis as a valid form of identifying development levels of an economy, but rather an introduction to a more nuanced way of looking at economic development. To instill widespread reform and truly grow economies, not just on a large scale but a more equitable and opportunistic one, these conditions must be understood and accounted for. Economic restructuring takes time, but also speculation. If the trust of a society is low, even if reforms are implemented that does not mean trust will automatically increase. The game is more long-form because cosmetic changes under the aggressively conservative neoliberal ideology are unlikely to lead to sustainable success and growth. If factors like patience and the business climate are taken into consideration and policies and reform movements target raising these factors alongside explicit fiscal reform, the changes have a higher potential for successfully rooting themselves into a society.

³⁹ Momani, *IMF-Egyptian Debt Negotiations*, 41–43.

Social Costs of Neoliberalism

There are large social costs inherently present in neoliberal policies, many of which contributed to social unrest and continued growth of the shadow economies of Russia and Egypt. Fiscal reforms disproportionately levied taxes on the lower classes and cut subsidies that directly benefited most citizens, while the negligence of IFIs to curb corruption led to less capital, wage stagnation, and a growing income inequality. The development of informal economies alongside the official ones were due to this corruption and the inability of a majority part of the state to have economic and political agency. This informal system, however, has proven difficult to dismantle because there is no state-funded alternative to provide many of the same goods and services to the majority populations. Costs that people incur by being in the informal economy rather than official are the lack of public benefits like healthcare and education. Thus, the informal economies have found ways to facilitate programs that compensate somewhat for the losses. Asef Bayat terms this a “quiet encroachment” in Egypt, arguing this is “a prevalent strategy that gives the urban grass roots some power over their own lives and influence over state policy.”⁴⁰ Although not sustainable for growing populations, these systems have become necessary and enmeshed into the fabric of the state’s overall economy. Just as conservative fiscal policies are deeply rooted and hard to reform, the informal economic systems are also integral to the state’s overall economy. More conservative policies—higher spending cuts and higher regressive taxes—only serve to drive a market further underground rather than adjust people’s behavior. The shadow economies are not sustainable and totally self-sufficient, but they do indicate a necessary shift in policy for markets to function correctly. Russia and Egypt could also be described as security states, as they rely heavily on military and security forces to survey

⁴⁰ Bayat, *Life as Politics: How Ordinary People Change the Middle East*, 58.

citizens and limit resistance to the government. The development of a security state has many social costs—civil power in the political and economic spheres is seriously crippled.

Specifically, unionism and resistance measures like labor strikes are discouraged and the people have very little say in political matters, including policy.

Conclusion

There is a divide looking at Russia and Egypt together in the past decade: one saw a mass protest erupt in 2011, largely as a response to neoliberal policies implemented in Egypt. The grievances that protesters brought up were of corrupt politicians, high unemployment, little public benefits, and regressive taxes.⁴¹ The “quiet encroachment” of the informal society was quickly mobilized, and they succeeded in some of their goals. Mubarak stepped down, and some of the cronies from his political circle were held accountable. The military and its vast commercial empire remained largely untouched though, and Egypt again seems to be trending toward conservative neoliberal policies. While Russian citizens had many of the same grievances, the fervor ran instead to supporting a stronger statist model. People still distrusted the privatization process and the neoliberal policies that came with it, but they used what political agency they had to advocate for state reforms. In 2000, Vladimir Putin ran for presidency under a campaign that argued for an end to the oligarchs that had purged Russia’s companies of their value.⁴² He was a popular candidate because of these claims, and once in office he started some legislative measures to reverse some of the corrupt privatization transactions. A majority of Russian wealth is still consolidated within a very small group, but the state has begun to play a larger role again, so the market is not left to its own forces entirely. The costs of continuing to

⁴¹ Armbrust, “The Revolution Against Neoliberalism,” 113.

⁴² William Tompson, “Putin and the ‘Oligarchs’: A Two-Sided Commitment Problem,” 2004, 1–2.

pass neoliberal policies, including the development of shadow economies, increasing social unrest, and limitation of human capital participation in the state are not insignificant. Even though neoliberalism roots itself deeply within a government structure, making it easy for cronyism to take place and hard for progressive tax reform, developments have been made in the past two decades to get away from that system. In the long-run, neoliberalism is inefficient and unsustainable: the growth of informal economies that make up over half of GDP for a state means the state is losing out on public revenue and domestic capital, social wellbeing is significantly lower than potential, and future growth prospects such as foreign investment and long-term value creation are unlikely to develop. Reforming from neoliberal policies requires more than just surface level changes – social costs and strategy preferences have to be considered as much as revenue and tax levels.

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