

**Economic
Reports**

31 JULY 2018



**المعهد المصري للدراسات
EGYPTIAN INSTITUTE FOR STUDIES**

**Reduction of Subsidy &
Egypt's Financial Situation**

Abdelhafez Alsawy



WWW.EIPSS-EG.ORG

 Eipss.EG  Eis_EG

TURKEY- ISTANBUL

Bahçelievler, Yenibosna Mh 29 Ekim Cad. No: 7 A2 Blok 3. Plaza D: 64
Tel/Fax: +90 212 227 2262 E-Mail: info@eis-eg.org

Reduction of Subsidy and Egypt's Financial Situation

Abdel-Hafez Al-Sawi

Subsidy in Egypt, a thorny issue, is usually addressed in light of government decisions to reduce it, which accordingly leads to raising the prices of goods and services. But subsidy is not new in many economies, even those of developed countries. Because subsidy addresses certain social circumstances, it is not wise to eliminate it completely on the pretext that some of the rich benefit from it.

For example, the United States and the European Union continue to support the agricultural sector there, despite their pledge to phase it out when the World Trade Organization was established in January 1995. But this has not happened in more than two decades, arguing that the abolition of subsidies will have a negative social impact on farmers and workers in the agricultural sector.

The decision to cut fuel subsidy and reduce subsidies on electricity and drinking water comes in an economically unfavorable environment in Egypt where wages are still the same. Moreover, reducing fuel subsidies usually leads to a significant increase in the prices of goods and services. This is what actually happened: The first reaction by the government after raising fuel prices was to increase public transport fees between 10% and 20%; and in some municipalities 25%.

In fact, the reduction of fuel subsidy is linked to the agreement of the International Monetary Fund (IMF) that calls for the complete cancellation of fuel subsidies. The Minister of Finance has recently announced that Egypt would receive the fourth tranche of the IMF loan by the end of July by about 2 billion dollars. However, the Finance Minister added that part of the \$ 2 billion would be used to support the budget and the rest would back the foreign exchange reserves - without employing these loans in any development projects.

The surge in prices will continue in many goods and services in Egypt over the next six months. After government inflation fell to 12% by the end of May 2018, it is expected to rise again to over 20% in the next six months, by the end of 2018.

However, the various governments that came after the coup d'état (against Egypt's first elected president on 4 July 2013) have always justified their decisions to cut subsidies by claiming that such move would help achieve social justice; so that the rich would not benefit from subsidies, or that such decisions would have a positive impact on the state budget .

This paper will discuss these arguments through the official figures and statistics of the Egyptian government, and even from the data of the financial and analytical statements of the Egyptian budgets in the past years, as well as the fiscal year 2018/2019:

First: Reduction of subsidy and its impact on the budget

According to government officials in Egypt, the reduction of subsidies has a positive impact on the budget, but we have to read the budget figures since the fiscal year 2014/2015, in which the government announced its position on subsidy, and took the first steps to reduce it – so that we could understand the financial implications of such moves, and find out whether they are positive or negative.

1- Reduction of subsidy and increased debt

“The government is moving towards reducing energy subsidies and ending this over 3-5 years with providing necessary protection for the poor, low-income and the middle-class,” reads the Financial Statement of the 2014-2015 Budget – P. 86. The government has already taken the first steps to reduce fuel subsidies in early July 2014, resulting in an increase in fuel prices by more than 75%.

However, the crisis of the collapse of oil prices in the international market since mid-2014 helped the government to postpone completion of its policy of lifting subsidies on fuel, especially as the government had not entered into its agreement with the IMF at the time. Fuel subsidies continued to be reduced in 2016, 2017 and, most recently, in June 2018.

What about Egypt's financial situation through its budget data?

We note that the fuel subsidies in the years 2014-2018 witnessed a reduction from 130 billion pounds in 2013-2014 to 89 billion pounds in 2018/2019, taking into account that fuel subsidies were at the lowest estimates in 2015/2016 due to low oil prices in the international market, where the actual fuel subsidies in that year reached 51 billion pounds. However, the decline in the exchange rate of the Egyptian pound at the end of 2016 led to raising the fuel subsidies in the budget again in 2016/2017 to 115 billion pounds; but the reason was due to the decline in the pound exchange rate by about 100%. Then, fuel subsidies fell to 110 billion pounds in 2017/2018, in addition to the last reduction in the budget 2018/2019, where the budget aims to reduce fuel subsidies to 89 billion pounds.

It is assumed, as government officials say, that the reduction of subsidy allocations will ease the budgetary burden, especially in debts and their interest, however the same source says that the burdens of the debt service during the period 2014-2018 jumped from 193 billion pounds in 2014/2015 to 541 billion pounds in 2018/2019. The debt also jumped from \$ 46 billion in 2014 to \$ 82 billion by the end of 2017. The domestic debt also jumped from 1.8 trillion pounds in 2014 to 3.16 trillion at the end of July 2017.

2- Subsidy reduction and tax increase

With the reduction of subsidy allocations during the period 2014-2018, as mentioned earlier, this decrease has not eased the burdens of citizens. Instead, the government raised the value of taxes and imposed new taxes, which led to raising tax revenues during the same period from 305.9 billion pounds in 2014/2015 to 770 billion pounds in 2018/2011. In other words, taxes have increased more than 100%. Despite the huge funds that were provided, the government never moved to use them for mitigating the reduction of fuel subsidies and any other subsidies.

3- Reduction of fuel subsidy and social justice

One of the misguided statements made by governments that came after July 3, 2013, is that the rich benefit more than the poor from subsidy and that the government move to eliminate it for achieving social justice. In fact, this is a way to evade responsibility, regardless of the resulting negative economic and social consequences. The fact that the rich benefit from subsidy does not mean depriving the poor of benefiting from it, especially since social protection programs do not meet the needs of the poor who have been affected by the economic measures imposed by the IMF agreement. The government could have provided a strong and flexible database covering all segments of society to move from the in-kind support to cash support, thus sustaining subsidy, and preventing the rich from benefiting from it.

4- Reduction of subsidy and expenditure on education and health

Data of the Ministry of Finance indicate that the allocations of the health sector rose from LE 37.2 billion in 2014-2015 to LE 61.8 billion, and the education sector increased during the same period from 92 billion pounds to 115 billion pounds. The increase in the allocations of the health sector amounted to approximately LE 24 billion during the

period. In the education sector, the increase amounted to LE 23 billion. The total increase in the allocations of the two sectors during the period amounted to LE 47 billion, while the subsidies decreased by LE 41 billion during the same period – as it was 130 billion pounds in 2013/2014 and fell in 2018/2019 to 89 billion pounds. If this is the case, why was the public debt (domestic and external) doubled, despite the increase in tax revenues for more than 100% during the same period?

5- Reduction of subsidy and budget deficit

It is normal that a rent-dependent economy that does not have a self-development project maintains a permanent budget deficit. Egypt imports tools, machinery, production inputs, as well as consumer and entertainment goods. Consequently, the budget does not have sustainable resources to rely on for bridging the gap between expenditure and income.

The percentage of total deficit to GDP is increasing continuously. After the deficit was 279.4 billion pounds in 2014/2015, the total deficit in the budget of 2018/2019 jumped to 438.5 billion pounds. In other words, the total deficit in the budget witnessed an increase of approximately 159.1 billion pounds. It is assumed that in light of the government's statements, the decrease in subsidies will lead to a decrease in the deficit. This means that the deficit was supposed to be lower than that deficit of 2014-2015 (lower than 279.4 billion pounds), but this did not happen.

Second: Warped logic

According to Minister of Petroleum Tariq al-Mulla, Egypt provides 70% of its fuel needs through its domestic resources, and imports 30%. However, the government relies in calculation of the value of subsidizing fuel on world prices, as if it imports its full fuel

needs from abroad. Hence, fuel subsidies have been rising since 2006, where the International Monetary Fund (IMF) conditions in this regard were met.

What is the logic that a people should be treated in the consumption of its domestic resources in light of world prices? Should not they enjoy their resources and feel that their resources help them to a better standard of living? Unfortunately, the government restricts people's standard of living instead of improving it through the country's domestic resources.

The government has not sought to have an energy management system, despite the announcement of programs and projects to invest in clean energy, or to rationalize energy consumption. The Egyptian government continues to rely on traditional sources (oil and gas) to provide its energy needs. Even in light of the repeated announcement of increasing the production of Egyptian natural gas fields, no positive effect to this increase has been observed on the Egyptian citizens, neither in the general budget resources nor in raising people's standard of living.

Conclusion

The post-coup governments as well as the Mubarak governments have taken uncalculated economic steps, leading to the spread of underdevelopment, disease, poverty and ignorance, as well as destruction of human beings, and instilling the spirit of despair among large segments of young people, in light of the expected increases in inflation due to decisions on reduction of fuel subsidies.