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Cairo Partially Lifts Energy Subsidies: Deepening the Crisis or a Step Towards a Solution?

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Introduction

Egyptians started Ramadan this year with the introduction of new austerity measures. Taking effect on July 1, these measures aim to reduce Egypt's deficit by partially lifting fuel and electricity subsidies, and by increasing taxes on a number of commodities.¹ The decisions announced by Prime Minister Mahlab were a shock to Egyptians, especially coming at a time when their impact is felt most strongly. Mahlab's government insisted that such drastic measures are inevitable and represent a necessary evil in solving the chronic budget deficit in Egypt. The time has come, he claimed, to take harsh measures to deal with the fiscal imbalances afflicting Egypt's economy.² Mahlab stated that the revenue collected from tax increases and fuel and electricity price hikes will be earmarked for public services, especially health and education. Egypt's government, however, has yet to disclose the steps it intends to take to confront the expected economic downturn resulting from the subsidy cuts, to regulate markets, or to compensate Egypt's poor for the impact the new austerity measures are likely to have on them.³

The Controversy Over Subsidies

Few deny that a fiscal imbalance is afflicting Egypt and threatening to push the economy over the brink. Disagreement arises on how to confront a crisis that dates from Anwar al-Sadat's reign, that further worsened under Mubarak, and that has become even more severe during the political instability crippling Egypt since 2011. Economists have long warned of a looming crisis in Egypt and most would agree that the subsidy system should be reworked. However, opinions are divided about the

¹ For the text of the decision to increase fuel prices, see *Al Masry Al Youm*, in the *Official Gazette*: <http://www.almasryalyoum.com/news/details/476424> and Tarek Tablawy and Salma al-Wardany, 'El-Sisi says Price Rises to Save Egypt from Debt Drowning', *Ahram Online*, July 6, 2014: <http://bit.ly/XLxy8u>

² For an interview with the Minister for Planning that reveals important aspects of the government's vision, see <http://www.almasryalyoum.com/news/details/478186>.

³ For more information on energy subsidy cuts, including figures and data, see Azza Maghazi and Ahmad Rajab, 'Energy Subsidies: Wasted Money- A special report, *Al Masry Al Youm*, March 25, 2014: <http://www.almasryalyoum.com/news/details/417087>.

solutions that should be adopted. The current government and the business elite, who heavily influence Egypt's economic policy, believe that rapid austerity measures and a fiscal stimulation program are needed.⁴ Many opposition parties and think tank experts have come out against these ideas, arguing that they simply reproduce past measures with a poor record of saving the Egyptian economy. What they would like to see is an economic development program based on fighting poverty, creating jobs and fostering a balanced economy that does not favor businessmen and investors and does not produce monopolies. Their main concern is rampant poverty and the heavy impact these measures are likely to have on the livelihoods of large segments of Egyptian society, who live below or just above the poverty line. Many fear that Egypt's current government will renege on the constitutional right to implement a socially-oriented economic policy, and to provide safeguards against economic exclusion and impoverishment.

Under Mubarak, several administrations—Ahmad Nazif's in particular—were criticized for their neoliberal economic approach, which brought nearly half of Egypt's population below the poverty line. Combined with high levels of corruption and a widespread plundering of the public purse, Egypt's economic policies enacted a predatory capitalist model in which the poor bear the brunt of the economic crisis. During the revolution, strong demands were made for social justice and inclusion of the poor. The governments after the January 25 revolution thus found themselves in a bind. The fiscal crisis inherited from Mubarak could not be ignored, and threatened to make it impossible to meet such demands. It thus came as no surprise that the solution should focus upon the factor which had long exacerbated the crisis: public debt.

Reactions to the Rise in Fuel Prices

In an attempt to pre-empt public outrage, Prime Minister Mahlab justified the subsidy cuts by saying that they would serve the poorest sections of society. He stated that “the

⁴ Ahmed al-Sayyid al-Naggar ‘Egypt's budget: beginning cautiously to exit the Mubarak box’, *Ahram Online*, July 29, 2014: <http://bit.ly/VKlNw>. Ironically, al-Naggar also wrote on the subject from an opposite perspective during Morsi's presidency: <http://www.ahram.org.eg/NewsQ/133211.aspx>.

partial removal of energy, fuel, and gasoline subsidies will save the state LE 51 billion,” and “the surplus from the removed subsidies will go toward the most pressing problems [...] in the following manner: LE 22 billion for health and education, LE 10 billion for the minimum wage, LE 12 billion for pension increases, and LE 5.7 billion for social welfare.”⁵

Official figures indicate that with the reform package, the budget will have a deficit of LE 288 billion, or 12.6 percent, a slight improvement over the previous budget deficit of over 14 percent. Domestic and foreign debt has reached a total of approximately LE 1.9 trillion. The inflation rate stands at 10.6 percent, which is undermining purchasing power and pushing the Egyptian pound toward collapse.⁶

The public anger that has ensued from the subsidy cuts was inevitable, and has been accompanied by harsh criticism from political parties and movements, regardless of their ideological leanings, many of whom view these austerity measures as a continuation of Mubarak’s policies.⁷ At the forefront of critics of Mahlab’s austerity budget are the new parties formed after the revolution. The Free Egyptians Party stated that it generally supported a reform of the subsidy system, provided that subsidies for the wealthy be cut as well. The party has warned of dire economic consequences and worsening inflation that will affect the poorest groups as a result of the government’s decisions.

Even the Egyptian Patriotic Movement, a party which is close to the regime, considers the recent decisions to be a mistake and a heavy burden on ordinary Egyptians. The party feels that the measures neglect national security considerations. “We have been turned into a Mamluk state: whenever the government senses a crisis, it imposes new taxes” claimed one of the party’s leading figures, warning that popular anger would be

⁵ Press Conference of the Prime Minister, Television Channel 1, July 5, 2014: <http://www.youtube.com/watch?v=Fnwd2jyIIjc>.

⁶ Ahmed al-Sayyid al-Naggar ‘Egypt’s budget: beginning cautiously to exit the Mubarak box’, *Ahram Online*, July 29, 2014: <http://bit.ly/VKINxw>.

⁷ Summer Said, ‘Egyptians Fume Over Fuel Subsidy Cuts’, *Wall Street Journal*, July 6, 2014 : <http://on.wsj.com/1vejaU3>.

sparked by these decisions. He called on al-Sisi to resolve the crisis by holding the prime minister accountable for the recent price increases.

The Constitution Party, one of the main parties of the secular revolutionary forces, condemned the measures, saying that they represent a strong bias for the higher income brackets of Egyptian society at the expense of the poor when handling subsidies. According to the party's spokesman, the party's position is that any measures to reform subsidies must not adversely affect the poor. He stressed that the decision-making process raised serious concerns, and that it was impossible to raise fuel prices without a parallel rise in the price of other commodities.

The Salafist Nour Party has been equally critical of the measures, and condemned the government for taking such decisions without embarking on non-inflationary economic reforms or development projects. The Socialist Popular Alliance Party has gone so far as to call for a peaceful protest against the government following the decisions that it described as biased and damaging to the working classes. Unsurprisingly, the regime-friendly Congress Party has backed the decisions but warned that the price hike of diesel fuel in particular would affect both the middle class and the working classes.

The oldest of the traditional liberal opposition parties, Wafd, has stated that new budget's problem is its timing rather than the measures in themselves. The way it was handled, the party complained, lacked transparency and was marred by misleading statements, for example when the petroleum minister denied there would be any price increases during Ramadan. Despite this, the government went ahead with decisions that "do not respect the people." An even harsher tone has been taken by the Muslim Brotherhood-aligned National Alliance in Support of Legitimacy, which described the new set of austerity measures as aiming to starve the Egyptian people, in particular the poorest classes. They have called on all Egyptians to reject the oppressive measures which serve only the interests of the business elite, especially the supporters of the coup against the elected president.⁸

For their part, Egypt's businessmen are more than satisfied with the move to cut state subsidies. Naguib Sawiris, a powerful business tycoon and spokesman for the Sawiris family, which has large investments in many industries including cement,

⁸ "Pro - Democracy Alliance Calls for a week of 'The Coup Crushes the Poor'," *Rassd*, July 10, 2014: <http://goo.gl/n3Fw4f>.

telecommunications, construction, and tourism, has asked the government to deregulate the prices of cement and other subsidized, energy-intensive industrial products, allowing them to match global prices. He has also called for expediting cash subsidy programs to rescue the poor.⁹

Among the dissatisfied are Egypt's taxi and microbus drivers, who have threatened to call a strike. Microbus drivers complain that the government has abandoned them to face an angry public. The government implemented a ten percent fare increase, but this has not made up for their losses, given that not only fuel prices have risen but also those of other staple goods. Egypt's taxi drivers' association, already in tense relations with the government over the white taxi project—a government program aiming to replace the capital's aging taxi fleet—has threatened to step up their protests. These could include taxi convoys demonstrating against the insufficient tariff increase enacted by the governor of Cairo.

Risk of Deepening Poverty and Economic Marginalization

A general consensus has appeared among economic commentators: Egypt's subsidy system is unfair and economically unstable, as it targets the commodity rather than the consumer.¹⁰ Even those who are not against cutting subsidies on petroleum products find such reforms acceptable only if they form part of a comprehensive and long-term economic program that will not increase the burden of the middle class and the poor. Many believe it necessary to hasten new anti-poverty measures, most importantly by amending the subsidy distribution policy, preventing waste, and investing in infrastructure, especially Egypt's transportation system. Investment in transportation would counteract the inefficient alternative private system that has developed in recent years, known for using excessive energy, wasting subsidies, and burdening the poor with its corruption and inefficiency.

⁹ Marwa Hussein, 'Egyptian businessmen in Twitter spat', *Ahram Online*, April 6, 2014: <http://bit.ly/1ws4vpJ>

¹⁰ The Egyptian Initiative for Personal Rights has made an important report on the imbalance in energy subsidies as a major form of social injustice in Egypt, with a commentary on subsidized items. Prepared by political economist Amr Adli, the report uses pre-revolution data: <http://bit.ly/1vf8m83>

Egypt's current subsidy regime developed in the 1960s as an attempt to fight poverty and inequality. Its design did not take into account differences in income, which were not as pronounced at the time as they are today. It failed to ensure that allocations went to those who needed them rather than to the wealthy.¹¹ The subsequent waste and outright theft of subsidies continue to prevent the development of a fair system of income distribution, while the gap between the rich and poor is growing wider. Egypt's subsidy system has remained unchanged until now, and little has been done to proactively limit waste or to direct subsidies only toward those who need them.¹²

Given recent events, the memory of the bread uprisings of the 1970's is fresh in Egyptians' minds. The most notable bread riot took place January 17-19, 1977. Sadat violently quashed it after it threatened his presidency, and thereafter referred to it as the "thieves uprising." These uprisings were a response to gasoline price increases introduced by the government of Mamdouh Salem, causing price hikes in a number of staple goods. The effects of these uprisings continue to form public perceptions of what has become known as the "revolution of the hungry," a term that reemerged during the 2011 revolution and has been used recently in statements condemning the decision to remove subsidies.¹³ The term is a stark reminder of the worst case scenario involving unrest during economic crises that deeply affect the poor. The 1977 uprising pays testament to the critical role played by the price of energy and its ramifying effect on inflation, sparking unrest. It also highlights how angry masses react when they are overburdened and when patience starts wearing thin.

The 1977 uprising deeply affected Hosni Mubarak, discouraging him from taking such drastic measures—with the exception of the period of Gamal Mubarak's influence over the economy—a reluctance that prevented mass unrest linked to inflation. The tight

¹¹ With the cut in energy subsidies, a legal challenge has been raised to force the government to remove energy subsidies for factories. See http://www.eipr.org/sites/default/files/pressreleases/pdf/energy_.pdf.

¹² It is noteworthy that the Egyptian subsidy regime has been adopted by several Arab states, yet continues to experience such problems. The issue of lifting fuel subsidies is also a heated one in the current economic and political scene in Yemen, Sudan, and Tunisia, which have witnessed mass disturbances. Even some Gulf countries have debated the issue, including Bahrain which intended to remove subsidies despite a large fiscal surplus.

¹³ On the bread uprising and the expression "revolution of the hungry," see Patrick Kingsley, 'Egypt 'suffering worst economic crisis since 1930s'', *The Guardian*, May 16, 2014: <http://bit.ly/1tBBF1K>

grip of the security apparatus along with the fragmentation of social actors and political forces no doubt diminished the possibility for protests. In recent years, however, with the shortage of cooking gas cylinders, the deaths of those queuing up for them, the end of 80-grade gasoline, and the diesel fuel shortage, unrest over price hikes has resurfaced, and were among the precursors to the January 25 revolution.

Following the fall of Mubarak, and throughout Egypt's transitional period, certain periods appeared to herald a new wave of unrest and protests. It seemed that a "revolution of the hungry" linked to fuel crises was about to be triggered by Egypt's poor. During the rule of the Supreme Council of the Armed Forces (SCAF), a crisis erupted in parallel with the Muhammad Mahmoud events at the end of 2011. The authorities tried to pull the wool over people's eyes by attributing the crisis to simple unrest and instability, and by manipulating the media to further incite those opposing the revolution using the pressure of the fuel crisis. The crisis was also blamed on disruption of industrial activity and high levels of smuggling of subsidized fuel, in the context of a breakdown of law and order.

Under Mohammed Morsi's rule, fuel supplies were hit by a severe crisis, worse than during the reign of the SCAF. The crisis intensified in the run up to summer 2013 and Egypt's harvest season. Observers suggested that a large part of the crisis was manufactured. Supporters of President Morsi accused certain businessmen and former military men of provoking the crisis—a prime example, they said, of the workings of the deep state. Observers do not dispute the fact that it was the fuel crisis at the end of Morsi's term that largely contributed to the street demonstrations against him, a fact which was exploited by the forces behind the coup as providing a popular cover to their movement. Rumors referred to the alleged large-scale smuggling of fuel to Gaza, and what the press termed the "fuel mafia." They failed to mention that the crisis was long-standing and structural in nature, and like the smuggling did not originate under Morsi.¹⁴

¹⁴ Before Morsi came to power, there was a tense atmosphere with Hamas given the increasing unrest in the Sinai and the escalation of violence by Islamist groups in the area between El Arish and Rafah. Several stories concerning the Gazan fuel mafia made the rounds. See: for example Abdel Halim Salim, "The Gaza Smuggling Mafia behind the Gasoline and Diesel Crisis," *Al-Youm Al-Sabia*, April 12, 2012: www1.youm7.com/News.asp?NewsID=651137. This long-standing campaign was exploited in the media and linked to the Muslim Brotherhood's rise to power. It escalated in the final days of Morsi's presidency.

Today, queues have reappeared at the pumps and severe power cuts have taken place, which had lessened in the past year thanks to the gasoline and gas aid shipments that were part of the Saudi and Emirate package of support for Sisi. Stories about a manufactured crisis have disappeared. The radical nature of the crisis has become evident, alongside its link to a real deficit in production of petroleum products, the instability of the subsidy system, and the link with an imbalanced economic model that generates inequality.

Fix the Fiscal Imbalances or Reform the Economic Model?

Subsidy reform cannot be discussed without a serious and far-reaching analysis of the rampant economic inequality at the heart of the Egyptian system. The subsidies form part of a fiscal model involving significant expenditures and a highly inefficient taxation system with a small base. This notoriously weak tax regime has unfair rules for assessment, insufficient collection, and unfair distribution. It is unfit for the financing of the state, and lacks mechanisms to bring an end to the rampant tax evasion among Egypt's business elite.

Egypt's social security system cannot be relied upon to soften the blow of the subsidy cuts on the poor. This is a major reason for the widespread criticism of the subsidy reform, despite the clear necessity to rework it. Ultimately, it should not have taken the form it did, and should have been preceded by a series of economic measures that guarantee an improvement in the circumstances of the poor, particularly with respect to income. They should be compensated for the rapid changes and protected from inflationary effects. Closing the income gap by the imposition of minimum and maximum wage levels is part of the solution. Although a maximum wage level has been set, the minimum wage remains problematic since it is not enforced, except in the public sector. Furthermore, the minimum wage is not indexed to inflation; prices rises swallow up any wage raises.

The government may want to implement austerity measures, but scant attention has been given to curtailing excessive government spending, for example by limiting expenditure on special advisers, promotional activities, and perks such as car purchases or fitting out buildings and offices of senior officials. No strategy exists to boost spending on services by establishing a fair distribution of resources between the basic public service budgets and those of so-called sovereign agencies. These agencies have

not seen their budgets shrink—they have in fact frighteningly ballooned—giving the lie to the government’s complaint that it lacks resources.¹⁵

Overall, the deep distortion in the structure of the Egyptian economy will continue. Violations of workers’ rights, particularly their right to decent wages, are becoming more severe in the absence of any structure for healthy labor relations that would allow a better distribution of production profits.

The government is thus shying away from real radical solutions to the issue of economic inequality. This reflects its short-term thinking as it lifts subsidies while disregarding the need for swift action in a parallel and equivalent adjustment to wages. Economic policy inherited from Mubarak continues to ignore the role of the fair wage as a stimulus to the economy. It rejects various models of worker participation, adopted in states whose economic conditions are similar to Egypt’s, such as Argentina, which have led to growth and ensured equality of distribution.

A fiscal policy focused on solutions that lower spending by reducing subsidies to the poor while aiming for high growth neglects the fair distribution of the returns of growth and the right of the poor to social welfare, health care and education. This will remain one of the reasons why growth will not translate into a real improvement in the living standards of the poor.

Will Sisi Find a Solution or Face Another Bread Riot?

The chances of al-Sisi and Mahlab succeeding in pushing through these harsh measures depends on the ability of their support base to gauge popular anger, absorb the shock, and close the gap between the poorest and richest segments of society. This would entail a courageous stance which confronts the greed of the business elite, limits the concessions they receive, directs public investment toward essential services without aggravating chronic fiscal issues, and acts quickly on comprehensive tax reform. All of these solutions would help redistribute the burden of financing the state and solve the fiscal crisis in a manner that does not put all the weight on the poor.

¹⁵ At the same time that the government cut the deficit by LE 50 billion by slashing subsidies, justifying this by saying that the funds would be directed to health, education, and pensions, it seems that one third of that amount was added to the already large military budget. Budget figures indicate a real reduction in health insurance.

Confrontation between the government and either the poor, standing up for their right to a livelihood, or the businessmen, unwilling to make concessions and aiming to keep their privileges, is inevitable if the Gulf “Marshall Plan” being prepared by Saudi Arabia and the Emirates in support of the Sisi regime does not succeed. The poor cannot continue to be squeezed, and the government cannot rely on oppression if another wave of popular anger breaks, unless a large social bribe is offered to the poor and the wealthy are confronted.

As long as the Egyptian government and international funding institutions continue to insist that poverty should be solved through pro-growth policies and stimuli, then the success of the proposed strategies and plans to tackle poverty will remain extremely limited. It is misdirected to stimulate economic growth without reinforcing the channels that ensure that this growth is equitable and its returns fairly distributed. Most of the solutions proposed for tackling poverty in Egypt, whether they stem from the government, the business class, or international organizations—including the decision to lift fuel subsidies—are based on improving the targeting of subsidy programs toward aiding only the poor.¹⁶ However, these solutions do not confront the need to change the existing distorted development model imposed by rapacious neo-liberalism. That model will only exacerbate the crisis, increase the inequality gap, and lead inevitably to further social unrest and instability.¹⁷

Any post-revolution development policy in Egypt that does not make radically fighting poverty a top priority is doomed to failure in the long term, even if it survives direct popular attack. The only way to confront poverty is through fair development, which is the only way to ensure economic stability and to overcome the crisis.

¹⁶ For the role of international economic organizations, see the International Monetary Fund’s recommendations as to removing subsidies on fossil fuels: <http://bit.ly/1zBc1xN>

¹⁷ For an excellent analysis of the relation of inequality to the current neo-liberal development model, which forms the overall framework of the crisis of inflation resulting from cuts in energy subsidies and tax increases on basic commodities in Egypt, see the report by Reem Abdel Halim: http://eipr.org/sites/default/files/reports/pdf/growth_and_poverty_nexus-cps2.pdf.