Recent Developments in Egypt’s Fuel Subsidy Reform Process

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1.0 Introduction

In July 2014, Egypt introduced long-awaited energy subsidy cuts. These had been in the pipeline for over five years, but repeatedly delayed by political instability. Their announcement was therefore seen as a sign of consolidation by the new President, Abdel-Fattah al-Sisi, as well as a positive signal to external investors. With energy subsidies habitually driving a large, structural fiscal deficit, and constant problems of shortages, low fuel and electricity prices were widely seen as a luxury that Egypt could no longer afford. The most significant step was the 64 per cent hike in diesel prices, but similar increases affected electricity and a wide range of refined products—the most notable exclusion being heavily subsidized liquefied petroleum gas (LPG). Moreover, the subsidy reductions were set out as the first step in a five-year program to eliminate energy subsidies entirely (again, excluding LPG).

This paper seeks to outline the background to Egypt’s move, assess its implementation and the public response, and to analyze future probabilities. It concludes by drawing out lessons for other countries facing similar pressures.
2.0 Context

2.1 Political Developments

Egypt in 2014 was emerging from three years of political instability, following the toppling in February 2011 of long-term President Hosni Mubarak by a popular revolution. Relatively organized demonstrations by workers and the pro-democracy movement were joined by large numbers of more dispersed citizen protesters, as well as Islamist groups (Abdelrahman, 2012). The fall of Mubarak was followed a period of uncertainty. The army, which had been a backbone of the previous regime but had stood aside rather than shoot protesters, was widely seen as the guardian of stability, and the Supreme Council of the Armed Forces (SCAF) enforced a road map towards elections. At the same time, Islamist movements, especially the Muslim Brotherhood, which had been incompletely suppressed under Mubarak, gained ground against the secular and leftist “revolutionary” forces, in part because of their superior internal organization. The winner of the presidential election in mid-2012 was Mohammed Morsi, the Brotherhood’s nominated representative, with 51.7 per cent of the vote. However, his popularity rapidly declined, with increased polarization between Islamists and secularists, especially over the strongly Islamic constitution passed at the end of the year, as well as a continually worsening economic situation.

The crisis came to a head in July 2013, when the Minister of Defence, General Abdel-Fattah al-Sisi, stepped in to remove President Morsi in response to mass protests, sparked in part by persistent energy shortages. Thousands of Muslim Brotherhood supporters were arrested and the movement was pushed back underground. The military, backed by key religious and secular leaders, put in place a new interim government, largely made up of liberal technocrats. A new constitution was drafted, together with a new road map to elections, in which General Sisi decided to stand as a presidential candidate. He was elected in May 2014 with more than 90 per cent of the vote (Kingsley, 2014). In general, overt political tensions seem to have subsided since 2012, although Islamists remain discontented and often imprisoned, with a number of terror attacks taking place, particularly in the Sinai Peninsula. Secular liberals also complain of a broader crackdown on political freedoms.

2.2 Economic Developments

In the later years of the Mubarak regime, neoliberal technocrats held most of the cabinet’s economic portfolios, and took significant steps to reform the moribund, state-centred economy (Butter, 2013). Combined with a sharp increase in petroleum revenue, this resulted in a period of sustained GDP growth in the first decade of the 21st century (World Bank, 2014a). However, the reform process seems to have been flawed, resulting in corruption allegations, especially as regards the sell-off of state enterprises, and the perceived enrichment of major businessmen with little trickledown to most of the fast-growing population.1 The middle class shrank from just over 50 per cent of the population in 2009 to 44 per cent in 2011, while the number counted as poor increased over the decade, especially in urban areas (Abu-Ismail & Sarangi, 2013). Plans were drawn up for the reform of the increasingly expensive and poorly targeted subsidy system, but awareness of rising social tensions meant that these had not been implemented before the regime fell.

The core slogan of the 2011 Revolution was “Bread, Freedom and Social Justice”, and poor service provision by the government was a key mobilizing factor. However, the subsequent years of political instability had a negative impact on the economy, not least from a sharp decline in tourism revenue and non-oil investment. At the same time, further reform, including of energy subsidies, remained politically difficult—President Morsi pulled back from agreements with

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1 There is a lively debate over the extent to which inequality actually increased, and the extent to which it was merely the perception of inequality. World Bank (2014a); Alvaredo & Piketty (2014).
the IMF in late 2012 and early 2013, fearing further unrest (Butter, 2013). As a result, the budget deficit widened sharply, from under 8 per cent of GDP in 2010 to 14 per cent in 2013, while government debt rose from 73 per cent of GDP to 89 per cent over the same period. Although inflation and the current account deficit remained relatively under control, real GDP growth fell from over 5 per cent in 2010 to an average of 2 per cent in 2011-13. Driven by the slowdown, unemployment increased from 9.2 per cent in 2010 to 13 per cent in 2013 (IMF, 2014a). At the same time poverty rates rose significantly, from 21.6 per cent in 2009 to 26.3 per cent in 2013, remaining particularly high among women (25 per cent) and youth (42 per cent). 4.4 per cent of the population (4 million people) are suffering from extreme poverty, living on less than US$1.25/day (Egypt Business Directory, 2014).

FIGURE 1. FISCAL DEFICIT (% GDP)
Source: IMF World Economic Outlook database (October 2014).

FIGURE 2. GROSS PUBLIC DEBT (% GDP)
Source: IMF World Economic Outlook database (October 2014).
The new military-backed government in 2013 therefore faced an immediate economic crisis, with extremely low foreign exchange reserves and endemic shortages of bread, electricity and other consumer goods, including some fuels. This was driven in part by the subsidy system, with recent global reports by the Overseas Development Institute (ODI) and others highlighting Egypt as a key example of a country where energy subsidies have created huge fiscal problems (Whitley, 2013). In the short term, the government was supported, however, by a large economic package worth US$16 billion (including $2.5 billion in fuel supplies) from allies in the Gulf Arab countries (notably, Saudi Arabia, Kuwait and the UAE), who were concerned about the influence of the Brotherhood in the region. There was thus some recovery in business and investor confidence in late 2013 and early 2014.

2.3 Government Policy

The consistent policy of recent Sisi-appointed, largely technocratic governments, has been to revive economic growth, contain inflation and reduce the budget deficit (International Monetary Fund [IMF], 2014b). The aim has been to achieve this recovery through further support from the Gulf states, energy subsidy reforms and increased foreign investment, including in “mega-projects” (Abaza, 2014). These three policies are interrelated: Gulf allies would have hesitated to continue to transfer funds into the ever-expanding black hole of subsidy spending, while potential investors were looking for energy subsidy reforms as an indicator that the administration was serious about improved economic management (Saleh, 2013).

Some progress had already been made in preparing for energy subsidy reform. Even before the revolution, the IMF, the Egyptian Center for Economic Studies (ECES) and others had begun making the case. They pointed out that the richest 20 per cent of the population got 46 per cent of the benefit from petroleum subsidies, while the poorest 20 per cent received just 9 per cent. In urban areas, the top quintile received eight times as much benefit as the bottom one (Abouleinen, 2009; IMF, 2010; Rohac, 2013). The economists in the Mubarak government had also begun drawing up plans and readying IT systems for reform (D. Butter, personal communication, December 5, 2014). This progress was stalled by the 2011 upheaval, and the situation worsened in the intervening years—Egypt’s spending on energy subsidies peaked at 6.8 per cent of GDP in 2012 (IMF, 2014c). Even so, there were some steps taken under the Morsi regime. For example, an electronic tracking system for fuel supplies from refineries and stores to petrol stations was established, to reduce black market losses. This exposed hundreds of “phantom” petrol stations, and cut smuggling of subsidized products to Gaza and Turkey. In early 2013 the government also increased prices of natural gas for some businesses and electricity for households (Hussein, 2013). However, plans for a comprehensive reform discussed with the IMF in November 2012 and May 2013 were scotched for fear of provoking dissent (Butter, 2013).

After the fall of Morsi, the military-backed interim government also strongly indicated its intention of implementing subsidy reform. It began a pilot scheme to give “smart cards” to drivers, which they present when buying petrol or diesel at petrol stations—at first for tracking rather than cost-control purposes (Farid, 2013; Fick, 2013). The interim government also distributed coupons for butane cooking gas cylinders to holders of ration cards, beginning in January 2014, limiting the number available at the existing, heavily subsidized price (IRIN, 2013). Nevertheless, despite all these tweaks, the prices for all refined products had continued to decline in real terms, pushing the subsidies’ cost as a proportion of budget spending up to 22 per cent by 2013—over 30 per cent if the electricity sector is included (International Institute for Sustainable Development [IISD], 2014b). Once President Sisi had secured election in mid-2014, the fuel subsidies (still relatively easier to address than bread subsidies) were the first target in his government’s sights, with comprehensive cuts announced in July 2014 (Goyder, 2014). These were part of a broader effort to reduce the budget deficit from around 14 per cent of GDP currently to less than 10 per cent of GDP (or 13 per cent of total government spending) in the 2014/15 fiscal year, through increased revenue and cost cutting (Ministry of Finance, 2014a).
2.4 Political Process

In some respects, the decision to reduce energy subsidies was not politically complex: it was made by President Sisi, who, prior to the holding of new parliamentary elections according to the new roadmap, held both executive and legislative power. Legal opposition parties, which had just been soundly defeated in the presidential election, were neither consulted nor vocal in their opinions. Moreover, the outlawed Muslim Brotherhood (which had, in any case, itself previously attempted subsidy reform) remained firmly suppressed. The President’s decision was certainly in line with the views, and taken based on the advice, of his technocratic cabinet, including the uncontroversial Prime Minister, Ibrahim Mehleb; newly appointed Finance Minister, Hany Kadry Dimian, a former senior ministry official who was close to the IMF; and the oil minister, Sherif Ismail, also a long-term insider (Anonymous Egyptian oil executive, personal communication, December 8, 2014). Indeed, President Sisi even requested deeper cuts than had originally been planned, to reduce the deficit further in the draft 2014/15 budget, below 10 per cent of GDP (Gad, 2014; Esterman, 2014).

It may be speculated that, rather than taking place in the context of cabinet or parliament, the key political process is likely to have been the behind-the-scenes discussions with other key members of the military/security establishment, which has not always supported subsidy reform—for example, vetoing the May 2013 deal with the IMF. This is at least in part because many of the legal distortions in the Egyptian economy are to the benefit of military-owned businesses. On the illegal side, there are apparent links between the security sector and the black market in subsidized fuel. However, although military intelligence was President Sisi’s original constituency, these relationships have been in the process of redefinition since he became President, and the degree of the remaining influence of the military-security apparatus is likely only to become clear over time. President Sisi is also reported to be evolving a network of consultation with top business leaders, academics and others (D. Butter, personal communication, December 5, 2014; Anonymous Egyptian oil executive, personal communication, December 8, 2014). Overall, though, the major driver for the decision seems to have been the fact that by 2014 there was a very widespread acknowledgement within Egypt—including business and industry leaders, as well as various academics and pundits—that the existing system of subsidies was unsustainable (Fick, 2014a). Businesses were concerned that the subsidies were a key driver of frequent power cuts and shortages, with some leaders extremely vocal in their support for reform (Citadel Capital, 2012). At the same time, socially concerned commentators noted that the subsidies disproportionately affect people in higher income brackets. The military leadership is also part of the same general consensus among those with a stake in power. External support for reform may also have influenced the political process to some extent. Arab Gulf allies were providing significant diesel, petrol, fuel oil and LPG, but are likely to have been concerned about subsidy-inflated demand (Butter, 2013). Similarly, the IMF had long been a strong advocate of subsidy cuts, which were among the conditions for the future provision of concessional funding. Nonetheless, in general it seems to have been the widespread domestic acknowledgement that “something must be done” which was the government’s principal motivation for reform, with a representative asserting strongly that they were “homegrown” (Wahish, 2014).
3.0 Pricing

3.1 Details of the Subsidy Reform

The reforms announced on July 4, 2014 were designed to reduce energy subsidy spending by 44 billion Egyptian pounds (LE) (US$6.2 billion) in the 2014/15 fiscal year, according to the Finance Minister (Middle East Monitor, 2014a). The budget allocation was brought down to just over LE100 billion (US$14 billion), compared with spending of LE145bn (US$20 billion) in 2013/14, although the actual allocation in that year was in fact slightly lower, at LE99 billion (US$14 billion). Budgeted electricity subsidies were halved, from LE27 billion (US$3.8 billion) to LE13 billion (US$1.8 billion) (Ministry of Finance, 2014b; Esterman, 2014). While these reforms were significant, and even criticized by some for being too steep and sudden, they still kept petrol prices comfortably below one quarter of the world price—with gasoline 92, for example, at around one third of the comparable U.S. price (Shawky & Salah-Ahmed, 2014; El Wardany, 2014; Khan & Milbert, 2014).

![FIGURE 3. FUEL PRICES, LE/LITRE](Source: Ministry of Petroleum (2014).)
With diesel representing almost half of the total subsidy bill, its 64 per cent price rise to LE1.8 (US$0.25)/litre was probably the most significant step (Ministry of Petroleum, 2014; Attalah, 2014). Diesel is used for public transport and haulage, as well as electricity production and industrial purposes. The sharpest single increase was for gasoline 80 (78 per cent), to LE1.6 (US$0.22)/litre, which is the most common fuel for the older taxis largely used in Egypt; however, the lower middle classes were also affected by the rise in gasoline 92, for most domestic vehicles, which went up by 41 per cent, and kerosene by a steep 64 per cent (Ministry of Petroleum, 2014; Attalah, 2014; AP, 2014; Shawky & Salah-Ahmed, 2014). The price of gasoline 95 for luxury, diplomatic and high-level government vehicles rose by 7 per cent, but it had already seen a sharp price rise eliminating most of the subsidy in November 2012, causing consumption to fall by 88 per cent year-on-year even before the July 2014 subsidy cuts (Adel, 2014a).

Prices of heavy fuel also rose, depending on usage, with the 50 per cent hike for cement production bringing it up to the existing price level for electricity generation, while other industrial uses remained slightly cheaper. Natural gas prices were also raised on a complex usage-dependent scale. Differential prices were introduced for residential users, with high-consumption users (more than 50 cubic metres) seeing prices rise by a factor of 7.5, and medium-consumption by a factor of five. However, even for low-consumption users (less than 25 cubic metres), prices more than doubled, to the equivalent of US$1.7/MMBtu (Ministry of Petroleum, 2014).²

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³ Consumption was replaced by gasoline 92, with an imported booster.
⁴ At the time of the reforms, the U.S. spot price (Henry Hub) was US$4/MMBtu, according to the EIA. Residential prices are set in Egyptian pounds, but the exchange rate since end-May 2014 has been largely constant at around EGP7.15:US$1.
For industrial users, there was also varying treatment: natural gas for cement production remained the highest, rising by one third, while the price for brick production actually fell. Prices of natural gas for other purposes rose by anywhere between 50 per cent (for fertilizers) to 204 per cent (glass and ceramics). However, the cost of gas for electricity production remained relatively low, rising by just 69 per cent to US$3/MMBtu—below even the medium-tier residential cost. Thus, while electricity prices also increased across the board, they remained relatively restrained, with the steepest rise of 50 per cent, affecting the lowest residential users, bringing the price up to just 7.5 piasters (1 US cent)/kWh. Other residential and commercial increases averaged 17 per cent (Ministry of Petroleum, 2014).5

5 This compared with an estimated cost of generation of 44 piasters (6 US cents)/KWh. It does not apply to certain key industrial users such as Chema, the Metro, Ell, glass ceramic producers, and users of LV for electricity and irrigation. These also saw increases, but on their more complex on-peak/ off-peak scales, which also saw the introduction of a voltage-dependent aspect.
The notable gap in the July 2014 subsidy reforms was liquefied petroleum gas (LPG), with the published price remaining at a 95 per cent-subsidized LE8/cylinder. Although there have been pilot projects in several governorates to lay the groundwork for a rationed distribution system at a subsidized price, nothing has yet been attempted on a larger scale. Most of the transport and distribution network is privately owned, and there seems to be significant profiteering in the form of diversion to the black market. There is, moreover, a strong lobby group against reform, with military/security connections (D. Butter, personal communication, December 5, 2014; Anonymous Egyptian oil executive, personal communication, December 8, 2014).

3.2 Pricing System

The energy subsidy reforms raised the prices of various energy products, but did not alter the fixed basis on which they are set in local currency, which is a key aspect of existing supply chains, including a mix of state-owned and private companies (see Figure 7). This has a tendency to limit the potential profits of distributors such as petrol station owners, except in cases of corruption (IISD, 2014a). There is still no automatic link to international prices; although the facts that the Egyptian pound is currently relatively stable against the U.S. dollar, and that oil prices have been falling in U.S. dollar terms, mean that this does not present a short-term problem for the stability of the system. In the longer term, however, the government is clear that it does plan to eliminate the subsidies altogether (except in cases of specific poverty targeting). For electricity, top-end tariffs are supposed to double over five years, as a more graduated block tariff system supporting smaller consumers is gradually introduced. Refined product prices are intended to move to cost increase-recovery over the next five to seven years (IISD, 2014b; Saleh, 2013). Potential investors and international partners will be watching for evidence of forward momentum on this agenda (Rohac, 2014).

FIGURE 7. FUEL SUPPLY CHAIN
4.0 Impacts and compensation measures

4.1 Analysis of Compensation Measures

Compensation measures to offset the impact of the subsidy cuts put in place by the government have so far been extremely limited. The food subsidy system was expanded in June 2014, with 20 further staple products including certain meats, vegetables and dairy products. This was in addition to government distributions of bread, rice, sugar, tea, flour and oil (IISD, 2014b). Prices were kept fixed in order to limit the pass-through of the subsidy reforms on food prices in the form of rising transport costs. There has also been a deliberate decision not to touch food subsidies as yet, particularly the politically sensitive subsidized bread—although in some cases loaf sizes have become smaller and distribution has been tightened up (D. Butter, personal communication, December 5, 2014).

The government also made some efforts to support the poor and lower middle classes by attempting to restrain public transport costs, with President Sisi stating that minibus fares should only increase slightly. The Prime Minister engaged in debate with representatives of transport operators in an attempt to persuade them not to take the opportunity to raise prices to unnecessarily high levels (IISD, 2014b; Zayed, 2014). Some free transport in army buses was provided (Fick, 2014b). In general, however, this is a largely privatized sector over which the government has relatively little control, and independent minibus operators doubled prices immediately following the subsidy cuts—arguably a reasonable response to the sharp increase in costs of diesel and engine oil (Rashwan, 2014).

Nevertheless, these were essentially ad hoc measures, far removed from the more comprehensive and targeted social safety nets advocated by international interlocutors such as the World Bank and the IMF (El Wardany, 2014). It seems likely that significant additional progress would need to be made in this area before the government would move forward with further energy subsidy reform. The government has announced plans for two new cash benefit programs, one targeting poor working families and the other those who are elderly or disabled, due to begin in early 2015. These will deploy LE2.5bn in rural Upper Egypt in the first six months of 2015, after which the government will re-evaluate (Kalin & Noueihed, 2014a).

There is significant room for progress beyond the existing benefit scheme covering 1.5 million people nationwide—a 2012 study showed that spending on social safety nets was significantly lower as a percentage of GDP in Egypt than other MENA countries, and far below comparable regions, reaching just 15 per cent of the poorest quintile. This is in a context where the poverty rate has been rising sharply (from 16.7 per cent in 2000 to 26.3 per cent in 2013) and youth unemployment is over 30 per cent (IMF, 2014c). However, there are ongoing concerns over targeting and corruption risks, despite complex plans for new databases, distribution through post offices and monitoring of children’s compulsory attendance at schools and health centres (Reuters, 2014a).

4.2 Initial Impact

Following a strong immediate reaction, the impact of the fuel subsidy cuts seems to have been relatively muted. Fuel consumption surged in late June and early July, as people stockpiled petrol (up 25 per cent from the average) and diesel (up 8 per cent) in anticipation of the price increases (Middle East Monitor, 2014a). No consumption data is yet available to show the longer-term impact of the fuel subsidy cuts, but they are unlikely to have been steep enough to contain the long-term rising trend of energy usage in Egypt (see Figure 8).
Inevitably, there was an initial rise in inflation following the energy price increases, as transport costs went up by 11.2 per cent in July (Gad, 2014). Diesel is the most consumed oil product, and 80–85 per cent is used by the goods and services sector (Attalah, 2014). Headline consumer price index (CPI) increased from 8.2 per cent year-on-year in June to 11.8 per cent in October (Central Bank of Egypt, 2014). Some women complained that they were not sure how they would be able to feed their families as a result of rising food prices, with a sharp boost to vegetable prices coming from higher input costs for farmers and more expensive distribution (Accorsi & Piazzese, 2014). However, the IMF reported that “swift interest rate action by the Central Bank... has helped to contain the second-round impact” (IMF, 2014b). Core inflation was swiftly brought under control, falling steadily from 10.1 per cent in August to 7.8 per cent in November, when headline inflation also subsided to 7.8 per cent (although this may in part be due also to a base effect, compared with the sharp price rises, especially for fruit and vegetables, seen in November 2013). This seems to have anchored inflation expectations, offsetting the fact that annual inflation in the prices of regulated items (including fuel) has averaged 17 per cent since July, compared with 8 per cent over the equivalent period a year earlier.
At the same time, the broader economy improved in the period following the subsidy cuts. This is partly because of an easing of the fiscal pressure—the government reported that energy subsidy spending in July-September 2014 fell by 29 per cent to LE22 billion (US$ 3.1 billion) (Mourad, 2014). However, there was also a broader economic improvement, as a result of wider reforms. The Minister of Planning estimated that government investment quadrupled in the first quarter of the 2014/15 fiscal year (Daily News Egypt, 2014). Although business activity suffered in July, by September, there was significant growth in output, with a business index showing a rise in new jobs and new orders, despite higher input prices as a result of the change in subsidy regime (Kalin & Noueihed, 2014b; Reuters, 2014b). GDP growth in July-September 2014 was estimated by the Prime Minister at 6.8 per cent year-on-year, sharply up from the 3.7 per cent recorded in April-June—although this was in part driven by a base effect, with a poor performance over the same period in 2013 (Bushra, 2014; D. Butter, personal communication, December 5, 2014). Moody's Ratings Agency changed their outlook for Egypt from negative to stable (Moody’s, 2014). As a result, consumer confidence improved, with more optimism reported on not only on “local job prospects” but also, notably, regarding the “state of personal finances”—an unusual trend, so soon after significant price increases (Aggour, 2014b).

4.3 Anticipated Impacts

Most forecasters expect that the inflationary impact of the subsidy cuts has already passed, and that the trend of economic improvement will continue into the medium term. This is based on the Finance Minister’s stated intention to carry on reducing the budget deficit, to around 8–8.5 per cent of GDP within five years, compared with a current target of 10.5 per cent of GDP (Noueihed & Georgy, 2014). This may be a difficult target to achieve: the government is also committed to almost double health and education spending, and the increases in corporate tax and VAT planned for next year may hit economic activity (D. Butter, personal communication, December 5, 2014). In many respects, the energy subsidy cuts have merely stopped things from getting worse: in July–September 2014, there was a 27.5 per cent year-on-year increase in overall subsidy spending, and the budget deficit rose in absolute terms. Although it decreased from 3 per cent to 2.7 per cent of GDP, this was driven by a rise in revenue as a proportion of GDP rather than by the spending cuts.

![Figure 10. Brent Spot Price (US$/Barrel, FOB)](source: U.S. Energy Information Administration (n.d.))

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6 Although spending data for Q1 2014/15 have been published by the Finance Ministry, as is usual at this stage of the fiscal year these do not yet include revenue or spending data for EGPC, hindering fuller analysis.
Nevertheless, the government will be significantly assisted in its efforts to control the fiscal deficit by the recent fall in oil prices. The price of dated Brent Blend dropped from over US$110/barrel in July 2014 to US$60/barrel in December. As a result, spending on fuel subsidies was reported to be down 29 per cent year-on-year in July–September (Aswat Masriya, 2014). If those levels are sustained, given that the budgeted price is US$105/barrel, analysts suggest that energy subsidy spending could be at least 40 per cent below budget, saving LE40bn in the current fiscal year. On the other hand, the risk factor is that Gulf allies suffering from low oil prices may reduce their grants (for example, the US$13 billion of fuel grants provided in 2013/14) more rapidly than planned (Adel, 2014b). Overall, the IMF estimates that Egypt’s spending on energy subsidies will be down to 6.6 per cent of GDP in 2014, compared with a peak of 6.8 per cent in 2012. As a result, it forecasts a narrowing fiscal deficit, and a current account remaining largely in balance, contributing to a recovery of growth (albeit coupled with reviving inflation). Even so, with fiscal deficits remaining substantial, government debt is still expected to rise, exceeding 90 per cent of GDP within two years (IMF, 2014c).
5.0 Perceptions and communications

5.1 Government Communications Strategy

The energy subsidy cuts were telegraphed in advance by the government. A media campaign in late June put forward the rationale for the price increases, and people seem to have understood that the leadership was serious about reform (Zayed 2014; IISD 2014b, Anonymous Egyptian oil executive, personal communication, December 8, 2014). There was consequently a hike in consumption in advance of the reforms, but it does not seem to have led to panic or created shortages, suggesting that the message was nuanced (Middle East Monitor, 2014a). The relatively short time period of preparation may also have been a factor in the muted response (Khan & Milbert, 2014). After the announcement, there was an ongoing public relations campaign by the President and cabinet, including meetings with relevant stakeholders. President Sisi gave a national address on television on July 7, which explained the energy price changes as a necessary “bitter pill” (Hamza, 2014; Al Jazeera, 2014). Two days earlier, the Prime Minister, Ibrahim Mehleb, had also given a press conference explaining that the decision had been taken after “delicate studies,” outlining how much would be saved in the budget, and emphasizing that almost half would be allocated to education and health care (Shawky & Salah-Ahmed, 2014; Nasralla & Saleh, 2014a).

The constant message was that these reforms were long-overdue, that their delay had led to shortages and other difficulties, and that they would contribute to the reduction of poverty in the longer term. President Sisi’s speech also presented a context of Egypt as at “war” to rebuild, thus pleading for cooperation in the national interest (Al Jazeera, 2014). The rhetoric thus reinforced public perceptions and aligned well with public priorities. At the same time, a predictable five-year plan for further reductions, and improved targeting, was also laid out. Even so, an IMF report published on July 9 on subsidy reform in the MENA region argued that Egypt still needed to do more on its consensus building and communications strategy (IMF, 2014d). Other analysts advocated for more detail and transparency in the long-term planning on this issue (Khan & Milbert, 2014).

5.2 Views of Outspoken Groups

There was little organized protest in response to the energy subsidy cuts. The leftist revolutionary activists and trade union leaders who were prominent in the January 2011 revolution constitute the political force most suspicious of the liberal economic elite, in whom they perceive significant continuity with the corrupt Mubarak era (Abdelrahman, 2012; Butter, 2013). This hostility to free markets was to some extent reflected in their standard revolutionary slogan, “bread, freedom and social justice.” However, a crackdown on dissent by the current regime has meant that the activists are wary of involvement in public demonstrations (Anonymous Egyptian academic looking at labour movements, personal communication, April 11, 2014). Although the April 6 Youth Movement did call for protests, their focus was as much on political repression (particularly the November 2013 law heavily limiting the right to protest) as on fuel prices, and in any case the public response was muted (Shoureap, 2014). One April 6 activist, who held a banner in Tahrir Square reading “You [meaning President Sisi] promised not to remove the subsidy, but you turned out to be a liar”, was promptly arrested (Al Jazeera, 2014).

Related dynamics silenced the Muslim Brotherhood even more strongly. Formerly the main opposition force in the country, the Brotherhood might have been expected to take any opportunity to promote popular resistance—even though, when in government, it advocated similar subsidy-cutting policies. Since it has been forced entirely underground, however, it was not in a position to raise public objections.
The Consumer Protection Agency (CPA) did object publicly to the subsidy reform, with its head, Zeinab Awadallah, calling the decision “random”, and likely to push prices up by as much as 200 per cent, angering the people. Other economists, including a representative of the Egyptian Institute for Personal Rights (EIPR), were less critical of the reforms themselves, but complained of the lack of dialogue with the poor, and argued that social safety nets meant that the burden was falling most heavily on the poorest (Abdel Halim, 2014; Shawky & Salah-Ahmed, 2014; Gad, 2014). A similar case was put forward by representatives of the National Progressive Unionist Party and the Strong Egypt Party, while the Socialist Popular Alliance Party and the Nour were more vaguely critical of the practicalities rather than the principle of the reforms (IISD, 2014b; Ahram, 2014).

Business leaders, however, were generally supportive. Wael Ziada, the head of research at EFG Hermes, said the step “needed to be done a while back” (Shawky & Salah-Ahmed, 2014). Ahmed Heikal of Qalaa Holdings, who had argued strongly for the subsidy cuts, said that his company was poised to take advantage of the energy investment opportunities (Saleh, 2014a). The exceptions were, unsurprisingly, energy-intensive industries: the CEO of Egyptian Steel complained that the move would cause Egyptian industry to lose a key comparative advantage (Nasralla, 2014). The general approbation of business, nevertheless, was echoed internationally, with the IMF Managing Director, Christine Lagarde, calling them “a good start towards restoring fiscal sustainability” (Fitch, 2014; Qudsi, 2014).

5.3 Public Reactions

There was significant public discontent as a result of the energy price rises, especially between poorer and lower middle class groups (Nasralla & Saleh, 2014; Rashwan, 2014). The high cost of living presents major difficulties for Egypt’s poorest. However, partly because of the lack of mobilization by opposition groups, there were no strong protests. While some newspapers were overtly hostile to the news, most presented a more balanced approach. Taxi drivers and minibus operators were very hard-hit, and organized immediate ad hoc protests in various districts of Cairo, Alexandria, Suez, Ismailiya and Sinai, which were dispersed by tear gas in some cases, but these failed to gain momentum (Zayed, 2014; Nasralla, 2014; Loveluck, 2014; Nasralla & Saleh, 2014). A couple of months later, in September, protests led by the Anti-Coup Alliance in the Maadi and Helwan areas of Cairo, among other locations, which focused on both political freedoms and the rejection of subsidy cuts, also fizzled out (Middle East Monitor, 2014b).

The limited public reaction is remarkable given the relative steepness of the cuts and the Egyptian population’s recent repeated experience of mobilization in massive public demonstrations. As a result, the IMF concluded that in Egypt, “there seems to be a consensus around reforms, evidenced by public acceptance of the recent cuts in energy subsidies” (IMF, 2014e). Overall, it does seem that people have adjusted to the fuel price increases rather than protesting them: car-pooling and bus-pooling are reported to be on the rise (Worldcrunch, 2014). This might be because the link has been made in the public mind between subsidies and the costly power cuts experienced by a population that is 97 per cent electrified—although severe power cuts have continued since the price increases, and in any case survey data gathered shortly before the reforms suggested that 52 per cent of households would prefer lower prices to more reliable supply (Accorsi & Piazzese, 2014; Daragahi, 2014; IISD, 2014a). An alternative possibility is that significant latent dissent and tensions are being repressed because of fear of the consequences of protest—which could suggest a longer-term risk of political instability if the current trajectory of economic improvement does not trickle down soon (Middle East Eye, 2014).
5.4 Government Response

The relative success of the energy subsidy reforms has meant that, after the initial public relations campaign, the government has had little to respond to. There have been some suggestions from government figures, including President Sisi, that commodity sellers and taxi drivers might be profiteering by raising prices more steeply than necessary, and measures were announced to counteract this (Accorsi & Piazzese, 2014). There have also been calls for households to rationalize energy consumption in homes and factories in order to reduce the pressure on supply—for example, by the trade and industry minister in November 2014 (State Information Service [SIS], 2014b). But the main questions around government policy come in the context of its plans for future price rises.
6.0 Looking Forward

The government has put forward a medium-term macroeconomic policy framework, covering the fiscal years from 2014/15 to 2018/19, according to which it plans to reduce the fiscal deficit from 12.6 per cent to 8.5 per cent of GDP, and its public debt burden from 97 per cent to within 80 to 85 per cent of GDP, in five years. This is an ambitious fiscal consolidation, and the framework states that “reform of energy subsidies will account for the lion’s share of the planned fiscal adjustment, with subsidies on all fuel products (other than LPG for needy households) and electricity to be phased out over the medium-term.” It also says that vulnerable households will be compensated through an expanded cash transfer program, and some of the savings will be redirected towards health and education in line with constitutional requirements (Ministry of Finance, 2014a). The commitment was reiterated by President Sisi at an investor conference in September (Petroleum Africa, 2014). The electricity minister also said in September that electricity subsidies would also be removed over the same five-year period, rather than over three years, as previously stated (Aggour, 2014a).

The latest IMF Article IV mission report expresses broad approval of this program and ongoing reforms, but emphasizes the need for ongoing commitment to further subsidy reform, beginning in 2015/16, to “keep expenditure in check,” “reduce energy supply bottlenecks” and “raise potential growth.” It also underlines the need for stronger social protection (IMF, 2014b). There are indications that Egypt may seek to resume regular relations—including a lending program—with the IMF in the coming fiscal year, which would provide a more specific agreed framework for ongoing reform, and would be welcomed as additional security by Gulf allies also providing financial assistance (D. Butter, personal communication, December 5, 2014). Businesses and potential investors will also be looking for evidence of continued commitment, including at the high-profile economic summit planned for mid-March 2015 (Ridge, 2014; SIS, 2014a). Continued reform will be critical to addressing Egypt’s pressing energy supply constraints (Setouhy, 2014). This is likely to provide an ongoing source of motivation, as the government seeks to restore EGPC to financial viability, enabling it to repay its debts to international energy companies and sign new contracts (Saleh, 2014b).

Some additional progress has already been made since the first round of reforms, with the government announcing in October that it would go ahead with the second and third phases of the reform of the petrol distribution system (the delivery of smartcards to registered users, and the registration of all fuel purchasers, respectively). A national consumption database is being established that could ultimately be used as a basis for selective pro-poor pricing (Ayyad, 2014a). The smartcard distribution is expected to begin in January 2015, and become comprehensive nationwide by April (Mada Masr, 2014; Awsat Masriya, 2014).

While the government commitment to further reform is very clear, there are still significant risk factors. The most important is that ongoing low international oil prices may reduce the sense of urgency and make it more difficult to build internal coalitions for another round of reforms at the start of the next fiscal year (Adel, 2014b; El Wardany, 2014; D. Butter, personal communication, December 5, 2014; Anonymous Egyptian oil executive, personal communication, December 8, 2014). Moreover, the fact that the first round of prices rises was achieved without significant social unrest does not mean that subsequent rounds will proceed as smoothly (Kalin, 2014). There is substantial latent discontent, as well as limited understanding of the real structure of subsidies, especially in the lower income brackets. If the political conditions change or growth does not trickle down fast enough, there might well be much larger demonstrations against reform, which would compound the government’s temptation to delay. According to the planning minister, the next step on subsidy reform will not be taken by the current cabinet:
the plan would be to move forward in July 2015, by which time a new parliament will have been elected and a new
government appointed (Ayyad, 2014b). While substantial continuity is expected, this would nonetheless present
an opening for policy change.

In order to move forward, then, much faster and more comprehensive progress on social safety nets will be
vital. Positive interaction with the equally important and difficult question of food subsidy reform is also likely
to be a critical success factor (Fick, 2014b; Shahine, 2014). Finally, there is also the difficult question of how the
government will address the highly controversial and political LPG problem. While this is Egypt’s most heavily
subsidized energy product, and the sector is in urgent need of reform, it was not touched in the first round of cuts,
and—at least for needy households—is excluded from the five-year plan for full energy subsidy removal. Severe
market distortions may therefore remain in place.
7.0 Lessons Learned

7.1 Pricing
   a. While there is still no automatic linkage to international prices, significant distortions will remain in place. This should therefore be an important focus for future reform. Current low international oil prices may represent a unique opportunity, if the technical capacity can be achieved.
   b. Certain sectors, such as LPG, may remain difficult to reform even when blockages are removed elsewhere. Sector-specific analysis and policy discussions may be required to identify possible ways forward.

7.2 Mitigating Impact
   c. An effective and comprehensive social protection, based on improved databases of households across the country, is urgently needed if further subsidy cuts are to be successful. So far, mitigation has been limited, and at some point, given high poverty levels, this must present a serious blockage to future reform.
   d. There are complex interrelations, particularly from the viewpoint of the consumer, between food and energy subsidies, necessitating coordination in reform efforts.
   e. Well-planned and timely action by the Central Bank can contain the inflationary impact of even relatively steep energy price increases, within a few months.

7.3 Building Public Support
   f. Political volatility can prevent subsidy reforms even when these are universally acknowledged to be necessary—governments therefore need to seize windows of opportunity when they arise.
   g. External partners (including donors and investors) can be a significant part of critical coalitions supporting reform, but they are unlikely to be decisive.
   h. As long as the economy is improving in other respects, the public can show surprising resilience in the face of subsidy cuts. In the longer term, however, perceived corruption or lack of trickle down will remain risk factors.
   i. The lack of popular outcry at the first round of subsidy cuts does not necessarily mean that the public has internalized the case for reform: indications are that there is very limited public understanding in Egypt, and a much more thorough outreach program will be required if the rest of the planned subsidy removal is to go smoothly.
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