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ENERGY SUBSIDY COUNTRY UPDATE

Assessing Egypt's Energy Subsidy Reforms

Egypt's Recent Subsidy Reforms | Kieran Clarke | IISD-GSI

In early July 2014 the Egyptian government announced sweeping measures to increase energy prices paid by businesses and households. Large increases in the prices of diesel (+64 per cent), gasoline 80 (+78 per cent) and gasoline 92 (+40 per cent) were widely reported by the media; however, prices were also increased, often significantly, for gasoline 95, for residential and commercial users of natural gas (with, for example, six-fold increases in prices for the largest residential users of natural gas), for heavy fuel oil and for all residential and commercial electricity tariff classes. A complete summary of the recent price reforms is given in Table 1. "Big bang" reform of this kind is a bold break from the past; energy prices in Egypt have changed little over several decades. According to the government, the reforms represent a decisive first step in reducing the burden of energy subsidies on Egypt's public finances.

1. The Context for Reform

Until now, expenditure on fuel subsidies in Egypt has increased dramatically, growing at a compound annual growth rate of 26 per cent between 2002 and 2013.[1] A number of marginal pricing reform efforts for various fuels have been implemented in post-revolutionary era—most notably: a 220 per cent increase in the price of liquid petroleum gasoline (LPG) (previously frozen for 21 years) and a move to full cost recovery for gasoline 95 in April 2013; various natural gas price increases for residential, commercial and industrial consumers beginning in 2012; and several small ad hoc revisions to gasoline 80/92, diesel and end-user electricity prices. These did not, however, arrest soaring subsidy costs. In fact, the prices for all refined products have declined in real terms since 2008. As a result, the share of fuel subsidies in the Egyptian government's budget increased from 9 per cent in 2002 to 22 per cent in 2013, and when electricity subsidies (for both inputs and end-user prices) are included, this share is well above 30 per cent. In the same period, expenditure on fuel subsidies increased from 3 per cent to 7 per cent of Egypt's gross domestic product (GDP). Currently, Egypt spends more on fuel subsides (not including electricity subsidies) than on health, education and infrastructure combined.

The rapidly expanding subsidy burden has been compounded by stalled growth, lower incomes and declining government revenue since the revolution. Since 2011 average growth has fluctuated between 1 and 2 per cent per year, markedly lower than the 5 per cent growth rate recorded in 2010, prior to the 2011 revolution. The slowdown has resulted in significant economic hardship for individuals and businesses and contributed to an increase in both unemployment and poverty rates. Unemployment increased from 8.9 per cent in December 2010 to 13.4 per cent in September 2013, while poverty rates have increased significantly, from 21.6 per cent in 2009 prior to the revolution to 26.3 per cent in 2013, and remains particularly high among women (25 per cent) and the youth (42 per cent).

The combination of soaring subsidy costs and economic stagnation has resulted in significant fiscal instability in Egypt. In fiscal year 2013 (FY13), the fiscal deficit and public debt reached 14 per cent and 100 per cent of GDP respectively, although improvements are anticipated in FY14 as a result of Gulf-country aid packages. In 2013 the Egyptian government spent EGP120 billion, or 7 per cent of GDP, on fuel subsidies, compared to combined expenditures on health and education of around 5 per cent of GDP. Because of the significant costs of current energy pricing policy, an informal coalition of businesses, industry, academics and commentators have for some time encouraged Egyptian political leaders to undertake meaningful energy subsidy reform, despite industry and business often benefiting significantly from the status quo (Fick, 2014).

2. Details of the Reform Package

The subsidy reforms introduced in July form part of a broader attempt to reduce Egypt's budget deficit to 10 per cent of GDP in the next fiscal year (through revenue enhancements as well as cost cutting), from an expected deficit of around 14 per cent in FY13, with slow year-on-year reduction in the size of the budget deficit thereafter (Saleh, 2014). The recent budget handed down by Finance Minister Hany Kadri Dimian aims to cut fuel subsidies to 13 per cent of total government spending in this fiscal year, a decrease of about 10 per cent in total expenditure. Altogether, savings from the current reforms are estimated at LE51 billion (El-Tablawy & El Wardany, 2014). Ministers have stressed that the current reforms are only the first step in a longer process of energy subsidy reduction and reform, without giving clarity on the timing and nature of future price rises. In terms of electricity, the government indicated that top-end tariffs will double over five years, with the introduction over time of a more graduated block tariff system in which larger consumers increasingly cross-subsidize smaller consumers. In the same way, the government indicated that, following the current price increases, refined product prices will move to cost-recovery over a period of 5–7 years (Saleh, 2014).

Certain measures were put in place to dampen the immediate effect of higher energy prices on consumers, particularly the poor. In order to ensure that energy price increases did not translate into higher prices for staple goods, the government has frozen the prices of publicly distributed bread, rice, sugar, tea, flour and oil. Further, in anticipation of reduced energy subsidies, in June 2014 the government expanded the food subsidy system, discounting the price of 20 new products, including meat, chicken, fish, detergents, pasta, certain staple vegetables, dairy products and butter. Immediately following the announcement of higher energy prices, various government spokespeople, including Egypt's newly-elected President Abdel-Fattah El-Sisi, assured the public that transport fares for private minibuses (the main form of transport for Egyptian commuters) would likely increase only marginally (Rizk, 2014). In practice, however, minibus fares in Cairo doubled in the days following the announcement, with small transport operators arguing they had little choice but to pass on the 64 per cent increase in diesel prices as well as the additional cost of higher engine oil prices (Rashwan, 2014). Since the implementation of higher fuel prices, Prime Minister Ibrahim Mahlab and President El-Sisi have focussed much of their attention on quelling discontent among transport operators, consulting with the industry's representatives and urging operators "on word of honour" not to resort to predatory pricing in the current context of uncertain fare levels (Zayed, 2014).

3. Reaction to Reform

Compared with experiences in other countries, mass public protest against the decision to raise energy prices has been relatively muted (Fahim, 2014; El-Tablawy & El Wardany, 2014; Rizk, 2014). Reports from Egypt suggest a mood of significant frustration, and often despair, among Egypt's poor regarding higher costs of living (Rashwan, 2014). This mood has not, however, not translated into mass protests and civil unrest. Although transport operators undertook strikes and protests in Cairo, Sinai and Alexandria, and small protests were organized in Cairo's Tahrir Square, large-scale demonstration of the kind experienced during and since the revolution of January 2011 has been absent (Zayed, 2014). While anecdotal evidence suggests that there is a proportion of Egyptians that understand the motivation for the reforms, there is little doubt from recent reports that the price rises have been highly unpopular among a majority of poor and lower-middle-class Egyptians, likely compromising, at least to some extent, President El-Sisi's previously strong popularity with this group (Rashwan, 2014). Presumably, the violent crackdown on the Muslim Brotherhood and the banning of public protest in the last year have been significant in discouraging demonstrations (Fahim, 2014).

While those political parties tied strongly into President El-Sisi's ruling coalition tended to support price reforms, many leftist parties (including some of those that supported El-Sisi's presidential campaign) have been critical of the decision. For example, while the Egyptian Social Democratic Party generally supported the reduction in subsidies, a spokesperson for the closely aligned leftist National Progressive Unionist Party, Nabil Zaki, criticized the reforms for their impact on the poor in a time of general economic hardship. The leftist Socialist Popular Alliance Party released a statement supporting the reforms but criticizing the decision to increase the prices of natural gas and electricity for households rather than solely for industry and big business. The Nour Party argued, somewhat spuriously, that although price increases were aimed at reducing Egypt's sizable budget deficit, no practical mechanisms to achieve this had been announced. The Strong Egypt Party also issued a statement saying that the rise in fuel and electricity prices contradicts the government's previous pledges to not cut subsidies before making efforts to improve living conditions and to alleviate the current burdens on the poor, in terms of income loss and unemployment (see Al Ahram, 2014).

In the media, most reporting on the reforms focused on the likely effects of higher energy prices for households. "The hour of suffering has struck," read a headline on the popular Al-Masry Al-Youm newspaper, while Al-Shorouk, an independent newspaper, claimed "the fire of fuel lights the street" in another headline (Loveluck, 2014). In general, however, coverage has been balance—some media outlets argued against the reform because of the inflationary effect on prices and criticized the government, somewhat incorrectly, for failing to provide additional protection for the poor before undertaking reform. Meanwhile, others explicitly supported the decision, stressing that the government should work to cushion the impact of higher prices on the poor going forward. Anecdotal evidence suggests that the response on social media was equally balanced, with a natural mix of commenters for and against reform. There was very little coverage in both traditional and social media on the effects of higher energy prices on industry and on investment in energy-intensive industries (Wahish, 2014).

The government made significant efforts to communicate the rationale for reforms immediately before and after the event, beginning with a media offensive on the energy subsidy problem during the budget negotiations in late June 2014 (Zayed, 2014). Senior ministers, the prime minister and President El-Sisi have since conducted an intensive public relations campaign in support of the reforms, speaking on the issue (at least initially) on a daily basis and publicly engaging with aggrieved stakeholders (most notably, small transport operators) (Zayed, 2014). In general, the various government statements, the most important of which was a lengthy national televised address given by President El-Sisi on July 7, have been consistent in messaging and have adequately explained the necessity and rationale for subsidy reform to a wide audience (Hamza, 2014). Communications should continue to be a focus of the ongoing reform process, particularly given that subsidy reform will likely continue to take place in the context of economic hardship for large parts of Egyptian society.

4. Ongoing Challenges

Further reform: The current reform represents only a first step in the process of reducing the burden of subsidies on the Egyptian budget and economy. In order for Egypt's subsidy burden to become more manageable, further price appreciation will be necessary. For example, the price of LPG—the most highly subsidized of energy products in Egypt, which is used extensively by poorer households—was not revised in early July. From a political perspective, ongoing price increases will be difficult given current economic circumstances, and given consumers have already expressed considerable frustration at the recent price increases. Effective communications will be important in providing a rationale and enhancing support for ongoing price reforms.

Social protection: Of crucial importance is the development and implementation of targeted mechanisms that protect poor and vulnerable consumers from higher energy prices as they rise. Egypt lacks a well-designed non-subsidy social safety net that can provide an effective mechanism for the protection of the poor, be scaled up during economic shocks or provide mitigation against adverse impacts of subsidy reform. The current (non-subsidy) targeted safety net programs are inadequate to protect the poor and to be used as a mechanism for price mitigation. They have many weaknesses, including fragmentation and poor coordination, poor targeting performance and low poverty impact. In order to protect the poor in the context of rising energy prices, and to make ongoing reforms more publically palatable, the Egyptian Government will need to enhance welfare mechanisms, either through targeted cash transfers or through targeted fuel subsidy rationing. At this point, the systems needed to successfully roll out these two welfare mechanisms—such as a unified registry of poor households or sophisticated electronic smart card systems—are lacking.

Delivering on promises: The Egyptian government will also need to deliver tangible results in terms of improved public service provision. The often-repeated rationale for energy subsidy reform is that it will provide the fiscal space to deliver better public services, including investment in education, health and infrastructure, all of which are sorely needed. Indeed, Prime Minister Mahlab has stated that EGP21 billion of the total saving of EGP51 billion from the current reforms will be channelled directly into health and education. Egyptian

consumers who have been affected by higher energy prices will demand that their sacrifices result in tangible change in the way government provides essential services for them. Delivering noticeable, timely improvements in service provision, in the context of general fiscal consolidation, should therefore be a key priority of Egypt's macroeconomic policy in the short to medium term. Again, communications and transparency will be key to the achievement of this objective. To ensure the public is aware of tangible new investments in health, education and other the services, the Egyptian government should publicise audited records of new expenditure in these areas that has followed energy subsidy reform.

Notes

1 All figures in paragraphs 2-4 are sourced from official Ministry of Finance (http://www.mof.gov.eg/english/pages/ home.aspx) and Ministry of Petroleum (http://www.petroleum.gov.eg/en/Pages/default.aspx) data.

Table 1: Schedule of Egyptian energy price changes, July 2014

Previously				As of July 2014,			
Consumer	**Price**		**Ministerial Decree**	**Consumer**	**Price**		**Ministerial Decree**
Cement	6	US Dollars/ million BTU	1162/2014	Cement	8	US Dollars/ million BTU	1162/2014
Bricks	6	US Dollars/ million BTU	1162/2014	Bricks	5	US Dollars/ million BTU	1162/2014
Iron and steel - Aluminum - copper	3	US Dollars/ million BTU	1162/2014	Iron and steel - Aluminum - copper	7	US Dollars/ million BTU	1162/2014
Fertilisers and petrochemicals	3	US Dollars/ million BTU	1162/2014	Fertilisers and petrochemicals	4.5*	US Dollars/ million BTU	1162/2014
Float glass , ceramic and porcelain industries	2.3	US Dollars/ million BTU	1162/2014	Float glass , ceramic and porcelain industries	7	US Dollars/ million BTU	1162/2014
Other	2	US Dollars/ million BTU	1162/2014	Other	5	US Dollars/ million BTU	1162/2014
Electicity Generation	1.77	US Dollars/ million BTU	1162/2014	Electicity Generation	3	US Dollars/ million BTU	1162/2014
Residential	20 p.t./m³ ($0.8/MMBTU)		Ministry of Petroleum	Residential	40 p.t./m³ ($1.7/MMBTU) for less than 25 m³ consumption		1162/2014
					100 p.t./m³ ($4/MMBTU) for consumption between 25 m³ and 50 m³		
					150 p.t./m³ ($6/MMBTU) for more than 50 m³		
CNG for cars	0.45	LE/M3	120/1995	CNG for cars	1.1	LE/M3	1162/2014

*Or in accordance with the pricing equation mentioned in the contracts.

Diesel

Previously			As of July 2014,		
Consumer	**Price**	**Ministerial Decree**	**Consumer**	**Price**	**Ministerial Decree**
Bricks and Cement	1.5 LE/liter	110/2013	Electricity Generation	1.8 LE/liter	1162/2014
Other users	1.1 LE/liter	Ministry of Petroleum	Vehicles	1.8 LE/liter	1162/2014
			Other users	1.8 LE/liter	1162/2014

Kerosene

Previously			As of July 2014,		
Consumer	**Price**	**Ministerial Decree**	**Consumer**	**Price**	**Ministerial Decree**
All users	1.1 LE/liter	Ministry of Petroleum	All users	1.8 LE/liter	1162/2014

Heavy Fuel Oil

Previously			As of July 2014,		
Consumer	**Price**	**Ministerial Decree**	**Consumer**	**Price**	**Ministerial Decree**
Bakeries and food industries	1,000 LE/ton	110/2013	Food industries	1,400 LE/ton	1159/2014
Electricity Generation	2,300 LE/ton	110/2013	Electricity Generation	2,300 LE/ton	1159/2014
Cement	1,500 LE/ton	110/2013	Cement	2,250 LE/ton	1159/2014
Bricks	1,500 LE/ton	110/2013	Bricks	1,950 LE/ton	1159/2014
Other users	1,500 LE/ton	110/2013	Other users	1,950 LE/ton	1159/2014

Vehicle Fuels

Previously			As of July 2014,		
Fuel Type	**Price**	**Ministerial Decree**	**Fuel Type**	**Price**	
Gasoline 80	0.9 LE/liter	Ministry of Petroleum	Gasoline 80	1.6 LE/liter	
Gasoline 92	1.85 LE/liter	Ministry of Petroleum	Gasoline 92	2.6 LE/liter	
Gasoline 95	5.85 LE/liter	1236/2012	Gasoline 95	6.25 LE/liter	

Electricity

User Type	Previously			Cost of generation based on $1.77/ MMBTU NG, 2300 LE/ton HFO and 110 pt./liter Diesel	Previously			
	Demand Charge (LE/kWh)	Off-peak (pt/kWh)	Peak (pt/kWh)		Consumption Tiers (kWh/month)	Demand Charge (LE/kWh)	Off-peak (pt/kWh)	Peak (pt/kWh)
UHV (132,220 kV)								
Chema*		4.7				-	4.7	
Underground Metro*		6.8		28.51		-	14.5	
EII**	12.1	27.7	41.5			10	34.1	51.1
Other users**	11.1	15.4				10	22.6	
Glass, ceramic, porcelain**	11.6	25.2						
HV(66,33 kV)								
Underground Metro*		11.3				-	16.3	
EII**	12.1	30.0	45.0	32.65		20	35.8	53.7
Other users**	11.1	18.6				20	27.5	
Glass, ceramic, porcelain**	11.6	28.6						
MV (11,12 kV)								
EII**	12.1	35.8	53.7			30	38.3	57.5
Glass, ceramic, porcelain**	11.6	32.7				30	41.5	
Other users**	11.1	25.5				30	36.5	
LV (380 V)								
Irrigation**		11.2				-	17.0	
Other users**		29.0				-	36.6	
Public lighting**		47.5		46.82		-	56.6	
Residential Users**								
0 -50 kWh		5.0			0-50 kWh	7.5		
51 - 200 kWh		12.0			51 -100 kWh	14.5		
					0 -200 kWh	16.0		
201 - 350 kWh		19.0		44.2	201 - 350 kWh	24.0		
351 - 650 kWh		29.0			351 - 650 kWh	34.0		
651 - 1000 kWh		53.0			651 - 1000 kWh	60.0		
1000 kWh +		67.0			1000 kWh +	74.0		
Commercial Users**								
0-100		27.0			0 - 100	30.0		
101-250		41.0		44.11	0 - 250	44.0		
251-600		53.0			251-600	59.0		
601-1000		67.0			601-1000	78.0		
1000 +		72.0			1000 +	83.0		

*MOEE Annual Report 2011/2012
**PM Decree 37/11/11/4 year 2011

EII: fertilisers, petrochemicals, SUMED, Steel , cement, Aluminum

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International Institute for Sustainable Development
Global Subsidies Initiative
International Environment House 2
9 chemin de Balexert, 1219 Châtelaine,
Geneva, Switzerland

Tel: +41 22 917-8373
Fax: +41 22 917-8054

http://www.iisd.org/gsi/