

The purpose of this brief is to advocate for reforms of SSNs in Egypt by providing a strong-based evidence for a better informed public dialogue on subsidies and social safety nets - one of the key long-awaited reforms

# Subsidies and the Social Safety Net in Egypt

Egypt Network for Integrated Development

---

**Policy Brief 012**

## **Subsidies and the Social Safety Net in Egypt**

### **Introduction**

Social safety nets (SSN) are a crucial component of a well-functioning economy. SSN are non-contributory transfer programs seeking to prevent the poor or those vulnerable to shocks and poverty from falling below a certain poverty level (Grosh et. Al. 2008). They play an important role in sustaining social cohesion and promoting a more equitable development in all modern-day welfare states.

Egypt spends large amounts on untargeted subsidy programs, with little resources allocated for a number of other fragmented SSN programs. Effectiveness of these programs in managing household risks and reducing poverty has proved to be limited. Also, progress in human development outcomes is still disappointing given Egypt's level of income. The recent political changes have further underscored these vulnerabilities, renewing attention to the need to address human development challenges in Egypt through effective and productive SSN.

The purpose of this brief is to advocate for reforms of SSNs in Egypt by providing a strong-based evidence for a better informed public dialogue on subsidies and social safety nets (SSNs)- one of the key long-awaited reforms. The brief thus summarizes the results of the stock of research which has looked at social safety nets in Egypt, their poverty and inequality impact, the long-run potential payoff from reforming the current subsidy system and shifting it into a substantially strengthened and expanded assistance program.

### **SSN in Egypt and Subsidies**

SSNs can be formal or informal. Formal programs can be provided by the public sector (Governments, Donors) or by the private sector (mainly NGOs). Informal SSNs constitute mainly of household transfers. Publicly financed safety nets cover additional cash or income transfers (such as pensions, child allowances, unemployment benefits, or microfinance); in-kind transfer programs (such as food subsidies, housing subsidies, or energy subsidies); labor-intensive public works programs, and fee waivers to ensure access to essential public services (health, education and utilities).

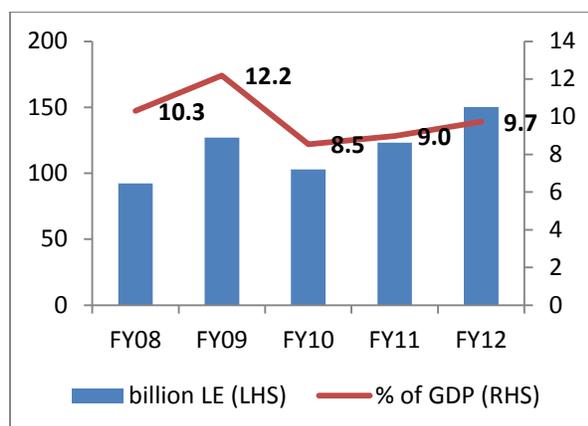
In Egypt, the public safety net comprises basically in-kind subsidies (energy and food) and tiny programs of cash transfers and other various subsidies. There are also off-budget larger but fragmented programs of public works and microfinance provided by the Social Fund for Development and in-kind and cash assistance programs by Nasser Social Bank. This does not conform to the structure of well-functioning SSNs as other countries' experience shows. The

present brief focuses on the part of Egypt’s public social safety net as reported in the fiscal budget.

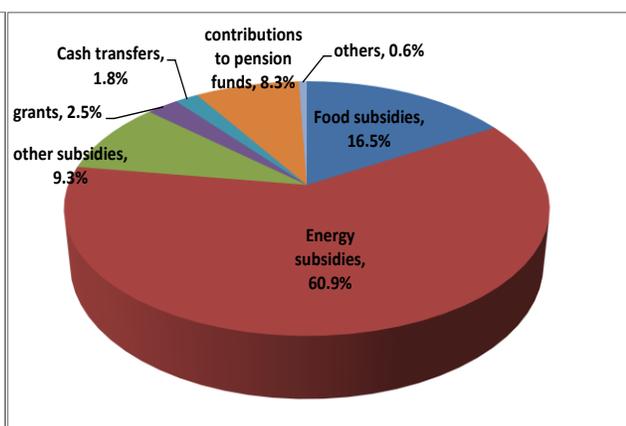
### Importance of Subsidies in Egypt

Public spending on SSN in Egypt has been consistently high since 2006<sup>1</sup> averaging 9 percent of GDP (See Figure1). This is much higher than the average of MENA (2.2 percent of GDP), Europe (1.7 percent) and Central Asia (1.3 percent of GDP). As Figure 2 shows, Egypt’s spending is almost fully devoted to food and energysubsidies (LE170.8 billion or 9.9 percent of GDP in 2013), with only tiny amounts going to cash transfer programs (LE3.8 billion or 0.22 percent of GDP in 2013). Moreover, spending on subsidies is unbalanced too. In 2013, (i) universal energy subsidies still account for 72.2 percent of total subsidies<sup>2</sup>; (ii) dieselaaccount for almost half of the energy subsidies; and (iv) universal baladi bread subsidies account for almost 61 percent of food subsidies (down from almost 80 percent in 2008).

**Figure 1: Trend of Subsidies, Grants and Social Benefits in Egypt 2012/2013**



**Figure 2: Structure of Subsidies, and Social Benefits in**



Source: Calculated by the author from the Ministry of Finance data.

### Energy subsidies

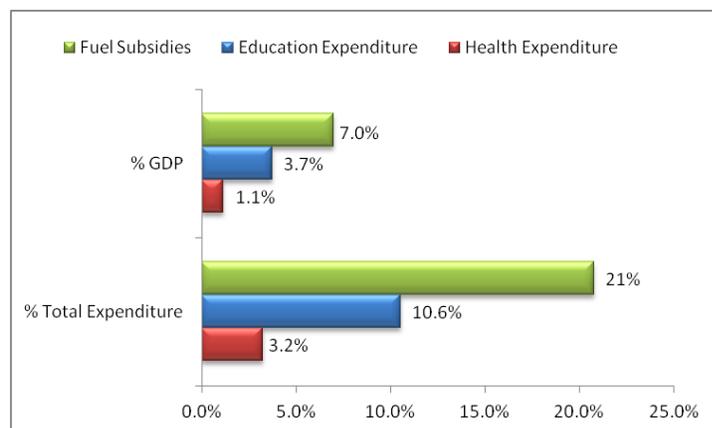
In 2012/2013 fiscal budget, Egypt’s energy subsidy system covers subsidies of diesel (44.2% of total energy subsidies); gasoline (21.7%); butane (15.5%); fuel oil (10.9%) and natural gas (7.8%). Energy subsidies are not only a drain on fiscal resources, particularly in periods of high oil prices, but also they have high indirect costs on the economy. First, they cause significant fiscal imbalances, crowding out public investment in priority sectors such as education, health etc. (See Figure 3) while jeopardizing fiscal sustainability. Second, when energy prices are kept artificially low – subsidized energy prices range between 80% and almost 400% of the benchmark prices- price signals that drives energy efficiency are subdued. Energy intensity has

<sup>1</sup> In 2006, energy subsidies were first introduced in an explicit line in Egypt’s fiscal budget.

<sup>2</sup> Region-wide, only Yemen and Syria have a higher energy subsidy burden as a ratio to GDP. (World Bank, 2011)

remained unchanged during the last 15 years in Egypt, while it has dropped nearly everywhere in the world (World Bank, 2009 a). Third, energy subsidies distorted Egypt’s choice of industrial policy, for instance the excessive investment in energy intensive sectors would have not been economically feasible in the absence of high energy subsidies. Fourth, they increased tendency to smuggle fuel across Egypt’s borders (50% of the diesel supply in the Egyptian market was smuggled in 2012/13, announced the Minister of Petroleum in November 2013. And finally, energy subsidies increase pollution and deteriorate the environment.

**Figure 3 Fuel Energy Subsidies Crowd out Social Expenditures**



Source: World Bank Staff calculations based on Egypt Arab Republic’s Ministry of Finance data

### Food subsidies

The Egyptian food subsidies consist of two programs: Baladi bread and ration cards. Baladi bread, available for purchase by all Egyptians, is the most important bread consumed in Egypt and accounts for over 70 percent of the cost of Egyptian food subsidies. In contrast, ration cards provide fixed monthly quotas of basic and additional subsidized foods (sugar, cooking oil and rice) to households. While Egypt’s spending on food subsidies is similar to that in other MENA countries, it is much higher than in developing countries in general. (World Bank 2010). Price distortionary effects are not significant in the case of food subsidies, since there is no similar bread produced in the free market, and the limited share of ration cards quantities in the total household consumption. However, leakages in the system are very high: 31 percent of the wheat flour supplied to bakeries and 26 percent of ration cards’ subsidies do not reach intended consumers. This represents a high cost on Egypt’s already burdened budget.(World Bank, 2010).

### Cash Transfers (Social Solidarity Pension)

In recent years there has been a marked movement away from generalized, universal food subsidies toward more targeted programs, and from the use of food toward the use of cash.<sup>3</sup> A

<sup>3</sup> For example, universal food distribution programs were prevalent in North Africa, South Asia, and sub-Saharan Africa until the early 1990s when they were proven to be far too expensive and ineffective in reaching the poor, especially in rural areas (see

recent innovation is conditional cash transfer programs, which provide income support to families while requiring them to invest in their children's health and education (Grosh et. al., 2008). However, in Egypt cash transfers targeted to the poor and vulnerable has hardly reached 0.2% of GDP in 2012/2013. This was because of the increase in the number of beneficiary households by around 300 thousands, making the pension of social solidarity covering 1.4 million households (almost 28% of Egyptian poor households). In spite of the declared increase in the cash payments to LE215/month, the calculated average from the budget figures is around LE155/month.

### **Targeting and Poverty Impact of Egypt's subsidies**

Universal energy subsidies are typically regressive, with rich households receiving disproportionately higher benefits than poor households, and often excluding large sections of the poor. An IMF study (Coady et al., 2006) found that the bottom 40% of the population typically receive only 15-25% of the value of energy subsidies. Another IMF study<sup>4</sup> found that the top income quintile captures six times more in fuel subsidies than the bottom quintile. The last study that calculated the benefit incidence of energy subsidies shows that 34% of these subsidies goes to the top quintile while 17% only goes to the poorest quintile (World Bank, 2005)

Also, as Table 1 shows, while subsidized baladi bread and ration-card foods covered 96.9% of the poor in 2008/2009, social solidarity pension covered only 12.1% of the poor, and all forms of private networks covered 17%. Also, the increase in coverage of targeted cash assistance programs between 2004/05 and 2008/09, from 3% to 12.1% of the poor was much higher than the increase in coverage of the non-poor (from 4.7% to 5.6%), indicating an improvement in targeting. The increase in the coverage of the poor was also relatively higher than of the non-poor for ration cards: for each new non-poor household that received a ration card, there were 6 new poor beneficiary households.

---

Alderman and Lindert 1998 and Tuck and Lindert 1996 on the reform process in Africa; and Dev et al. 2004 and Mooij 1999 on India).

<sup>4</sup> IMF Fiscal Affairs Department, 2010, The Unequal Benefits of Fuel Subsidies: A Review of Evidence for Developing Countries. Working Paper 10/202.

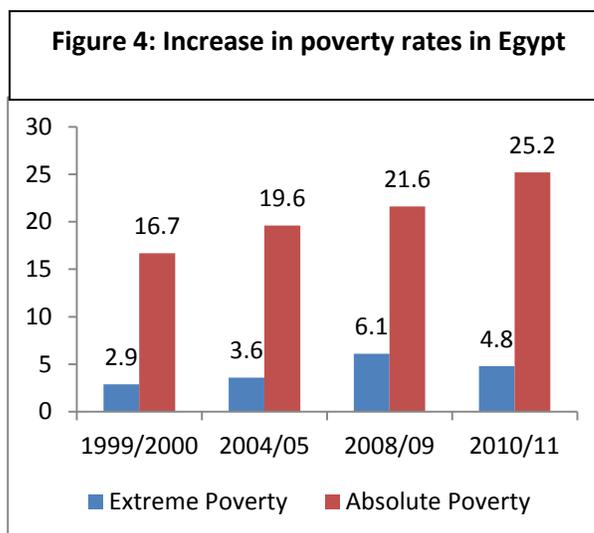
Table 3. 1. Coverage (%) of Poor and Non-poor by Social Protection, 2004/5-2008/9

	2004-005			2008-09			Change in coverage	
	All families	Poor	Non-poor	All families	Poor	Non-poor	for the poor	for the non-poor
<b>All food subsidy programs</b>	<b>91.0</b>	<b>92.4</b>	<b>74.8</b>	<b>94.1</b>	<b>96.9</b>	<b>93.3</b>	<b>+4.5</b>	<b>+18.5</b>
subsidies for ration cards (food)	58.5	62.7	57.8	67.6	76	66.2	+13.0	8.4
subsidies for baladi bread	75.6	71.7	76.6	80.9	77.2	81.9	+0.8	+16.4
<b>All social assistance</b>	<b>3.9</b>	<b>3.8</b>	<b>4.7</b>	<b>7.0</b>	<b>12.1</b>	<b>5.6</b>	<b>+8.3</b>	<b>+0.9</b>
Social Solidarity pensions	2.7	2.6	3.5	4.3	7.2	3.4	+4.6	-0.1
social assistance transfers	0.8	0.8	0.6	2.4	4.6	1.7	+3.8	+1.1
other government transfers	0.4	0.4	0.7	0.5	0.5	0.5	+0.1	-0.2

Source: World Bank, 2011 using HIECS 2004/5-2008/9.

Note: Energy subsidies are excluded, as they are not regarded as a social program.

However, the impact of food subsidies and cash transfers on the poor's welfare is a less inspiring story. The cash transfers programs have a very marginal poverty-reduction impact (only 0.7 percent of the population would have been poorer without the social solidarity pension in 2008/09. This is probably because of the miniscule budget devoted to targeted social assistance and the small fraction of the poor it covers. On the other hand, food subsidies lifted about 9 percent of the Egyptian population out of poverty in the same year, with the baladi bread accounting for 2/3 of this impact. But the increase in poverty rates (See Figure 4)



highlights the fact that food subsidies may dampen but do not prevent poverty increases, and only at huge cost.

### The Need for Subsidy Reform

Though politically sensitive, energy and food subsidy systems reform is urgently needed. Mobilizing such large fiscal resources to food and energy subsidies may be justified if the poverty impact and benefits to human development are sufficiently effective and no alternative use of resources could bring greater benefits. Yet, the benefits from this pattern of spending are limited and could be vastly increased through reforms.

Energy subsidy reform is essential for Egypt not only because the country is no longer the plentiful oil and gas producer, but also because Egypt is facing an unsustainable fiscal

deficit. This is of course besides all the other above mentioned negative implications. Also the poverty impact of food subsidies has an unnecessarily high cost in terms of high leakages outside the system and large portions going to well-off Egyptians.

Given the far-reaching coverage and long-standing nature of the existing subsidy systems, the nature and timing of reforms are critical to ensure their sustainability. In the short term, some of the needed reforms may be politically and socially difficult, especially at times of political and social fluidity, but some others can be implemented with no public resistance, such as reducing food subsidy leakages away from the intended uses, apply smart cards in rationalizing gasoline subsidies, etc.... Reforming subsidies should go hand-in-hand with reforming Egypt's social safety nets. The current social safety net system has many weaknesses, including fragmentation and poor coordination; low coverage of the poor; weak links to promotion of human capital; low poverty impact; and social and economic inefficiency. An introduction of well-targeted temporary interventions (cash transfers, school feeding, etc.), limited to affected poor and vulnerable populations, can be useful.

In the medium term, the Government should strengthen the fragmented social safety nets. The safety nets could be strengthened by (i) gradually eliminating the non-needy (the richest 20 or 40 percent of the population) from the system, using various targeting methods (geographic, income-based, self-selection), thus enabling the poor to receive more benefits without increasing the burden on the fiscal budget; and (ii) improving the targeting, delivery, and monitoring and evaluation of existing cash transfer programs. The first step in this reform process is to develop a database of the poor and vulnerable. This would start by combining existing databases, such as the social solidarity database, the database of the Ministry of Social Solidarity on the poor in the poorest villages, the databases of various NGOs on the poor they assist, etc... Also, databases on cars ownership, electricity bills, etc... can be used to eliminate non-poor and ineligible households from benefiting from existing subsidy systems. The process of reform will face many obstacles, and finding the right path and achieving social buy-in will require that key agencies and the public develop a shared vision of what problems need to be solved. A well-planned communication strategy will be an important part of that effort.

## References

- Alderman, H., and Kathy Lindert. 1998. "The Potential and Limitations of Self-Targeted Food Subsidies." *World Bank Research Observer* 13 (2): 213–29.
- Coady et. Al. Coady, David, Moataz El-Said, Robert Gillingham, Roland Kpodar, Paulo Medas, and David Newhouse. 2006. "The Fiscal and Social Costs of Fuel Subsidies: Evidence from Bolivia, Ghana, Jordan, Mali and Sri Lanka." Review paper. Washington, DC: International Monetary Fund.
- Dev, S. Mahendra, C. Ravi, Brinda Viswanathan, Ashok Gulati, and Sangamitra Ramachander. 2004. "Economic Liberalisation, Targeted Programmes and Household Food Security: A Case Study of India." Markets, Trade, and Institutions Division Discussion Paper 68. Washington, DC: International Food Policy Research Institute.
- Grosh, M.; C. Ninno; E. Tesliuc; A. Ouerghi. 2008 "For Protection and Promotion: the design and implementation of effective safety nets"; World Bank, Washington DC.
- IMF Fiscal Affairs Department. 2010. "The Unequal Benefits of Fuel Subsidies: A Review of Evidence for Developing Countries". IMF Working Paper 10/202.
- Mooij, Jos. 1999a. *Food Policy and the Indian State: The Public Distribution System in South India*. New Delhi: Oxford University Press.
- Tuck, Laura, and Kathy Lindert. 1996. "From Universal Food Subsidies to a Self-Targeted Program: A Case Study of Tunisian Reform." Discussion Paper 351. Washington, DC: World Bank.
- World Bank. 2011. *Poverty in Egypt 2008-09: Withstanding the Global Economic Crisis*.
- \_\_\_\_\_. 2010. *Egypt's Food Subsidies: Benefit Incidence and Leakages*. Washington, DC: World Bank.
- \_\_\_\_\_. 2009. *Tapping a Hidden Resource: Energy Efficiency in the Middle East and North Africa*. Washington, DC: World Bank.
- \_\_\_\_\_. 2005. *Egypt - Toward a More Effective Social Policy: Subsidies and Social Safety Net*.