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REFORMING THE SUBSIDY SYSTEM IN EGYPT

by

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To the tourist who breaks away from the obligatory stops at Cairo's numerous must-see places and walks across the 26th of July Bridge into Zamalek, the contrast between this burrough and the rest of the city is readily visible. There are few monuments here. Even the usually enthusiastic Blue Guide of Egypt admits that not much of historical value is to be found among the Edwardian architecture and the more recent skyscrapers. There is another, more contemporary kind of richness to Zamalek, however, one easily discerned in the hustle and bustle of the downtown area.

Its main thoroughfare, the 26th of July street, is lined with numerous shops, many of them touting imported European, Japanese and American items. Fruit stalls and fish shops are in abundance here, and the pace a tiny bit slower than in the rest of the city. Early in the morning the fishmongers are pounding great slabs of ice into nugget size chunks to preserve the day's catch. Butchers in white aprons are chopping and carving slabs of meat marbled with fat. Occassionally they venture out of their shops, cutting pieces of meat from whole carcasses of lamb and beef that are hung on sidewalk racks. Little boys armed with long sticks try to keep the flies at bay, to the delight of the tourist in search of the picturesque.

The clientele on this part of 26th of July street dresses better than the average Egyptian. Ladies in impeccable western-style hairdos and Hermes scarves sally forth from stores filled with the latest in consumer durables. Prices often make even the expatriate population wince.

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Occasionally women drive up to butchershops and grocery stores and order directly from the recess of air-conditioned cars while café-owners shuttle back and forth to provide them with tea and coffee while their errands are taken care off.

It is perhaps surprising then for the visitor to chance across a dirty and ill-kept bakery as soon as the bridge is crossed. But he'll have a hard time avoiding it, for lack of space - the quintessential Cairene condition - forces the bakers to store their wares in the middle of the sidewalk. Dodging between sesame-encrusted loaves and plain baguettes in huge blackened trays - all the while careful not to kick up too much dust - one is unlikely to see a line of cars here, or a carefully manicured finger picking up a loaf of bread. The invisible line below which no self-respecting middle-class Zamalek housewife ventures is drawn at the Mobil station a hundred yards north of the bakery.

For this is a no-frills bakery and its clientele is more likely to wear old galabiyas and scruffy shoes than the latest Parisian creations displayed further up the street. Customers will not get the customary plastic bag here to wrap their purchases in, but more often than not will find their bread rolled up - if at all - in a page of yesterday's Al-Ahram. Those familiar with the city might have guessed; the shop is one of Cairo's cooperative bakeries, providing bread to the urban poor at highly subsidized prices. A loaf of bread here costs only a few piasters, even less as the day wears on.

The reader might also remember that in my first report I mentioned the low cost of butagaz, a paltry 75 piasters. I'm returning to the butagaz bottle and to the bread situation temporarily in order to write some more about the problem of subsidies in Egypt - in particular wheat and flour subsidies - and about the most current battles that are taking place to eliminate some of them in the face of determined political opposition.

The container of gas, according to Prime Minister Ali Lutfi, costs 3 pounds to produce (300 piasters), or roughly 4.5 times what the consumer pays. Not only is there an enormous economic cost to this subsidizing of gas - approximately 100 million pounds per year - but there are some related difficulties as well. As Lutfi remarked in a recent interview to a local publication, a poor family using one bottle of gas per month receives a subsidy of 2.25 pounds. But a rich family in Zamalek or Heliopolis uses perhaps five times that amount - in effect getting subsidized to the tune of 11.25 pounds per month.

The problem is of course one readily recognized by economists. Subsidies, unless carefully controlled, often end up profiting those who don't need them more than those who do. The difficult problem is to discover ways to make sure that subsidies only benefit those who are in need of them. And this of course is where the difficulties start, for few countries have ever devised an adequate system. Two additional problems in Egypt are the highly political context in which subsidy policies have been formulated, and the fact that few statistics exist on which a possibly improved system could be based.

Egypt's system of subsidies took shape during World War II when shortages prompted the monarchy to implement some measures that would protect the country's poor from suffering unduly under the shortages that existed. But as I pointed out in my first report, it was not until the

Nasser period - and more particularly after 1960 - that the welfare state as it now exists in Egypt, came into being. Nasser's decision that no Egyptian should suffer for the sake of future generations carried a strong ideological commitment. It was a legacy that grew into a considerable burden around the Egyptian economy's neck, and one that by the time of Sadat's assassination had grown into a nightmare for the government's political leaders and for Egypt's economic planners alike who stood by helplessly as increasing amounts of badly needed foreign exchange were devoted to them. Subsidies quickly became the sacred cow of Egypt. From an initial outlay of only 9 million pounds in 1960 they soared to two billion by 1981.

DIRECT SUBSIDIES IN EGYPT 1960-61 TO 1985-86
(Egyptian pounds mil. current)

1960	9.0
1965	45.0
1970	51.0
1975	420.0
1980	1,279.0
1985	2,000.0
1986	1,700.0 ¹

Subsidies in Egypt fall into two main categories: direct and indirect. Direct subsidies are provided for wheat, flour, and lentils and, in the case of these three commodities, are not subject to rationing. Some commodities with direct subsidies do have fixed monthly quotas, however, and are determined by household size. They include sugar, edible fats, and frozen meat. All goods with direct subsidies are provided to the population at fixed prices.

Indirect subsidies exist on items as rice, electricity, irrigation water, petroleum, and natural gas. The government subsidizes the difference between the domestic cost of production of the commodity and the price at which it is sold to the consumers - whether they are individuals or the public sector. (It is very hard to obtain figures on indirect subsidies to the public sector since they are not covered in official reports. It is estimated, however, that their value equals if not supercedes that of the direct subsidies. A recent issue of The Middle East

¹ Sources: John Waterbury. The Egypt of Nasser and Sadat, p. 214; numbers for 1985 and 1986 gathered from diverse issues of Al-Ahram and Al-Ahram al-Iqtisadi. Actual outlays in most years were substantially above planned ones. In 1980, for example, actual outlays were estimated to have surpassed the two billion pound mark.

Times estimated them as high as 4 billion pounds annually).² The cost for education and services, another legacy of the Nasser era, can also be considered an indirect subsidy.

I am particularly concerned with the direct subsidies in this report, particularly the wheat and flour subsidies, since they are politically the most sensitive. Over the last fifteen years they have on average absorbed in excess of 75% of all total direct subsidies. Of this amount, wheat alone accounts for 50%. In 25 years, from 1960 to 1985, the per capita share of imported wheat has increased from 100 to an estimated 300-350 pounds. Between 2/3 and 3/4 of this comes from the United States. The annual bill for these direct subsidies is now in the 2 billion pound range (app. \$1.5 billion), 15% of total budget expenditure in 1985-86 and almost 10% of GDP.

For all of Sadat's professed interest in a more efficient economy that would eliminate all possible distortions from the Egyptian economy in the 1970s, the amount spent on welfare programs - and consequently on consumption - actually increased dramatically during his term in office. Even education and social services that had been neglected during the lean seven years were resuscitated. Trying to explain how this gargantuan subsidies system was sustained during all these years takes us away in part from the realm of economics and into the political arena.

The persistence of the whole subsidies debacle stems in part from the social context within which it arose. From the beginning, food subsidies were aimed largely at the urban poor, and remain so today. Wheat subsidies for example were traditionally of little importance to the rural population since maize was their staple.³ Subsidies on milled flour also have little importance to the rural population who grind their own, nor are they of great importance to the urban middle and upper classes whose diet no longer depends overwhelmingly on carbohydrates.

For the urban poor however, bread remains a vital commodity. Government subsidies often literally spell the difference between an adequate and an inadequate diet. During the Nasser regime per capita private consumption increased by almost 50%. But the urban population lagged far behind. This situation only marginally improved under Sadat, and in some ways was exacerbated even further. For Egypt's urban poor

² Karima Korayem in Distributing Disposable Income and the Impact of Eliminating Food Subsidies in Egypt (Cairo: American University in Cairo, Cairo Papers in Social Science, April 1982) includes a third category of "disguised" subsidies, such as petroleum products and cotton who could be sold internationally. The subsidy here is the difference between the export price of the commodity and the price it is sold to local consumers.

³ It is interesting to note, however, that wheat has gradually replaced maize as the staple of Egypt's rural population. The only explanation seems to be the availability of cheap wheat. A recent editorial in al-Gumhuriya suggested the possibility of once again making bread in part with maize flour. So far the suggestion has not met with any response.

throughout the 1970s had little choice but to bear the brunt of expensive city life. They also spent - and continue to spend - an inordinate amount of their income on subsidized food, often as much as 50% of their income. At the same time their real wages continued to decline under the impact of a high inflation, induced in part by infifah.

Subsidies then have often been seen by many analysts as a pay-off to these urban poor, a type of social contract between the government and those among Egypt's poor who have not profited the growth of the economy or from infifah. Although many of the Egyptian policy-makers I have talked to deny this, there is little doubt that subsidies are in part being used to keep that volatile part of the population in check. Neither Nasser nor Sadat have always successfully managed to do so, and recent Egyptian history has been punctuated by often violent conflagrations between the government and workers: in 1968 and 1972 riots took place at Helwan and in 1972 at Shubra al-Khayma, large industrial suburbs in Cairo. In 1975 and 1976 more violence occurred at Muhalla al-Kubra, and in January 1976 Cairo itself was partly occupied by striking public sector workers.

Despite this, the first serious attempts to reduce subsidies took place that year, in part under pressure from the International Monetary Fund. Sadat dismissed his Ministers of Economy and Finance and appointed as Deputy Prime Minister Abd al-Munim al-Qaysuni, an economist of impeccable liberal credentials who had once served as the IMF's Middle East Director. Qaysuni pointed out that Egypt simply could no longer afford the massive welfare system it had created. His observation that subsidies no longer reached those for whom they were originally intended undoubtedly rang true to most poor Egyptians. Black marketeering and greedy middlemen had become an almost accepted way of life in Egypt, the subject of innumerable newspaper articles, and the butt of many jokes and even more newspaper cartoons. It was common knowledge that some of the cheap, subsidized bread was being fed to cattle, and certain Cairo bakeries extended their profit margins by buying back old bread from restaurants at highly reduced prices, to be sold to feedlot owners. Why then were the urban poor asked to make sacrifices?

As Qaysuni and Sadat perceived the situation, only four ways could reasonably cut the budget to meet the IMF requirements and to bring the economy under some semblance of control: cuts in public sector investment, in servicing Egypt's debt, in defense, and in subsidies. Debt repayment to the Soviet Union was suspended and provided some breathing space. But in the absence of any further alternative, Sadat and Qaysuni seized upon the weakest link - the constituency that had few links and could seemingly be contained without major repercussions - and lifted subsidies on selected food items.

Popular reaction was uncommonly strong and violent. For the first time since the 1952 revolution the Egyptian army was called upon to restore order. Sadat himself was whisked away from his rest house near Aswan when riots spread throughout the city.⁴ Well over one hundred people were

⁴ Muhammad Haykal recounts in his Autumn of Fury (London: Andre Deutsch, 1983) that Sadat's plane stood ready at Abu Suwayr airport to take him and his family into exile to Tehran. No one I have talked to until now has verified this.

killed, and with them died any serious chance at refashioning the subsidies system. Throughout the remainder of the 1970s Egypt pledged to cut back on subsidies in agreements with international creditors, but it was clear that subsidies were too sensitive an issue to seriously consider reductions. On the contrary, a series of further popular measures were taken that included the raising of minimum wages and tax cuts for the poor. The food subsidies bill reached the two billion pound mark by 1981, and no further systematic effort was made to curtail subsidies until 1985.

It seems clear that the infitah policies were indirectly connected to the subsidies dilemma. By the end of the 1970s when some of the adverse consequences of liberalization were becoming visible - particularly in terms of income distribution and rapid inflation - criticism of infitah ranged more or less across the political spectrum. Even ardent pro-infitah supporters were urging some sort of "cleaning up" operation. Lutfi 'Abd al-'Azim, editor of Egypt's leading economic journal al-Ahram al-Iqtisadi, wrote about "economic apartheid" that pitted rich against poor, and Sadat himself several times denounced those who were profiting excessively from infitah at the expense of the poor.

To those who have followed Egypt's plight in the last two decades there is thus a strong sense of déjà vu to the by now almost ritualistic effort to reduce subsidies. Sadat, in his last interview, mentioned the possibility of moving in the direction of an "American food stamps" system. The euphemism used these last years to make the intended policy a bit more palatable is "rationalization." This use of words, however, has fooled no one. In As-Shaab, one of the workers' newspapers, even the obviously uneducated cartoon characters now use and misuse "rationalization" in their everyday language, to the readership's delight.

That the whole subsidy debate has taken on some ominous undertones since the death of Sadat, and particularly this last year, is perhaps not so surprising. The Egyptian economy, still committed to infitah under Mubarak, has come under even greater strains. The remittances from Egyptians working abroad, once estimated at up to \$3 billion per year, are now declining as increasing numbers return home. Income from the Suez canal has been steadily levelling off. Drastically lowered oil prices and stagnating oil production add further to the difficulties. And to make matters even worse, tourism has been at an all-time low after the spate of terrorist accidents in the region over the last year.⁵

⁵ The absence of tourists is plainly visible throughout the country. From the horse carriage drivers along Zamalek's nightclub strip to small shopkeepers in the tourist places in Upper Egypt that I talked to, all are complaining about the downturn. Particularly Upper Egypt - where the major temples and tombs are located - seems to be suffering. A guide on a recent trip in the area told us that weather reports on national television have repeatedly used lower than actual temperature readings for the south, in order not to scare more tourists away. The Reagan administration's attitude toward travelling in Egypt has until now been a cautious one. But, in a seeming attempt to bolster the confidence of the American public, vice-president George Bush is visiting Luxor this coming August. To anyone

Egypt's deficit this year is projected at over five billion pounds. The West will undoubtedly find it in its interest to fill the gap once again. But there is a point at which largesse, even if based on tangible interests, becomes absurd and self-defeating. With an additional million people every nine or ten months, the task of simply maintaining subsidies at the same level requires ever larger financial commitments. At present rates of growth Egypt may well surpass the seventy million people mark by the year 2,000. Assuming unchanging per capita consumption, it would then need 10,000,000 tons of wheat to feed its population. The cost of subsidies, if continued at present levels, would be staggering.

While this may sound alarming to many readers of this report - particularly since wheat production has widely been predicted to fall substantially short of demand by the year 2,000 - most poor Egyptians are unlikely to take much interest in these depressing statistics. Beyond 'aysh and ful, bread and beans, there is little to ruminate about in daily life.

But it is against these statistics and attitudes that Mubarak and Prime Minister Ali Lutfi must come up with a coherent strategy. Until now they have attempted to put forward the whole subsidy debate in purely economic terms. It is obvious from their public statements nevertheless that they remain extremely aware of the political and social issues that surround the whole subsidy question. Undoubtedly amidst the current debates both are reminded of the 1977 bread riots. More recently, and although this has no direct relation to subsidies per se, the rioting of Central Security Force conscripts in February refreshed the leadership's memory of how little is needed - in this case nothing but a rumor - to provoke violence.*

There seems little doubt this time, however, that the Lutfi government will go ahead and impose some kind of "rationalization". The real issue, however, will be the final shape of the new subsidies policy. And, as you might expect by now, this will have relatively little to do with economics, but a lot with political compromise in which lessons of the past will once again be reviewed.

who has ever been in Luxor at that time of the year - when temperatures routinely hover around 110-115 degrees - his visit seems inspired by more than an interest in pharaonic remains.

* The february riots were triggered by a rumor that the conscription period for Central Security Force soldiers would be extended from two to three years. The CSF conscripts are mostly drafted from villages and farms in the Delta and Upper Egypt. They are usually the least educated of Egypt's 280,000 man strong militia, and are often brought into the major cities to guard embassies, public places, and even private businesses. This is no coincidence since they are considered to be the least politicized and more apathetic than many of their fellow conscripts. Their salary is incredibly low - 6 pounds per month, about \$4 - and their military service time usually means a considerable loss of income to their rural families. It is against this background that the riots must be understood.

As usual in the midst of all these serious debates, Cairenes have found an escape by dreaming up innumerable jokes about Prime Minister Ali Lutfi, his government, and the "rationalization" measures. One that has been de rigueur at any self-respecting party lately centers on a dessert called Umm Ali (mother of Ali), an exceedingly rich concoction of cream, filo dough and nuts, introduced to Egypt during the Ottoman period.⁷ This year, however, the government has forbidden the import of the nuts (called yameesh) which are traditionally consumed in great amounts during the holy month of Ramadan - for an estimated savings of 75 million pounds.

In the joke a patron at a restaurant asks for an Umm Ali, after having finished his meal. The waiter returns a few minutes later and slaps in front of him an Umm Ali that is a pale reflection (of course, without the nuts!!) of what it should be. "You call that an Umm Ali?" asks the bewildered client, to which the waiter sarcastically responds "I call that an Umm Ali Lutfi."

There are two central questions to the now raging debate - who should receive subsidies under any new system, and how will eligibility for the subsidies be determined? Although all political parties have initially supported the idea of eliminating at least part of the subsidies, they have lately been going through politically inspired volte-faces and pyrotechnics meant to assuage their respective audiences.

President Mubarak has charged Lutfi with consulting all parties before any further changes are made. He has been anxious to point out that the government will announce its decision only after full consultations. Samir Tobar, chairman of the economic committee of Mubarak's National Democratic Party has even been talking about a poll to find out the opinions of the people (!) and Youssef Wali, Secretary General of the party, has proposed meeting with all the parties' leaders.

Despite this, several of them have been accusing the government of proceeding unilaterally, and continue to see government attempts as a way of giving in to the IMF and the World Bank. The Unionist Progressive Party in particular has argued along these lines. Mustafa Kamal Murad, head of Al Ahrar party has charged that the government has already made up its mind. According to Murad, the government should tackle government waste and mismanagement of appropriations before taking on subsidies, but he remains nevertheless in support of a gradual implementation of a new system.

Ahmed Abu Ismail, chairman of the economic committee of the New Wafd (the main opposition party) charges that the new system now being debated will destabilize prices of commodities and services even further. In his opinion a drastic overhaul of the entire economy is needed before any

⁷ As far as I was able to find out, the name of the dessert does not get its name from the mother of the caliph Ali, as John Kifner reported in the New York Times.

alternative can be considered.⁸

Politics makes for strange bedfellows and, as on several other occasions in the past few years, Ahmed Sabahi (head of the Umma Islamic Party) and Ibrahim Shukry of the Labour Party have found themselves in agreement. Both insist on full food, educational and health subsidies for all those working in the public sector, for laborers outside the public sector, and for some of the poorer farmers. Sabahi has also come out in support of a proposed cash subsidy system that would add specified amounts to the poor's paychecks, in effect eliminating middlemen - and hopefully corruption. The Unionist Progressive Nationalist Party has for the time being withdrawn from any negotiations, claiming that the government is unwilling to take its proposals into consideration. These would have included a straight subsidy tax to be imposed on the rich, and heavy taxes on luxury goods such as air conditioners, gasoline, and large automobiles.

But even if the different parties can reach an agreement on the two central questions, actual implementation of any measure may still be a long way off. There are first of all a couple of practical problems: How do you measure income levels in an economy where a substantial part of economic activity takes place on the black market and where few reliable statistics are available? Several practical solutions have been proffered on which to base eligibility. They include monitoring electricity consumption, ownership of cars, ownership of houses, or owning more than 10 acres of land.

But beside the conceptual problems with any such scheme (Does a poor taxidriver who owns two taxis lose eligibility? Is the owner of two slum houses excluded?) there is the even greater difficulty of determining who will collect this type of information? To anyone familiar with Egypt's bureaucracy, an enterprise of this size and potential impact immediately conjures up visions of bribery on a scale perhaps never before witnessed in a country already known for its adept and skillful use of bakshish - not to mention visions of mile-long lines at the government ministries if any such plan should ever be implemented.

My personal estimation is that the Lutfi government will slowly chisel away at the subsidy edifice. In what it considers small matters, such as raising the bus fares from 5 to 10 piasters a little while ago, it will likely do so without advance warning to the population. One government official in the Ministry of Planning told me bluntly that a fait accompli might avoid some of the difficulties earlier experienced. At the same time

⁸ Ismail has been particularly worried about the ration card system. An estimated 10 million families in Egypt now own (green) ration cards with which they can purchase items on which quotas exist (sugar, edible fats and oils, frozen meat, among others). It is generally accepted that the whole system to administer the system is rife with corruption and completely infiltrated by black market merchants. At one point the government attempted to introduce partially subsidized red ration cards. An estimated 250,000 were distributed but, because of the relatively easy availability of the green cards, quickly vanished into oblivion. I have yet to see the first one.

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consultation with the political parties will undoubtedly continue, but I find myself in agreement with those opposition leaders who maintain that the government only negotiates to lengthen the process of implementation, hoping to contain serious opposition meanwhile.

I remain optimistic that the direct subsidy bill can be reduced substantially, but the direct subsidies are only the tip of a badly balanced economic iceberg. The government, for example, is seriously considering reducing the direct subsidies in favor of higher wages. But if no gains in productivity are achieved, production costs and ultimately the prices of commodities will rise again, destroying much of the impact of the initial wage increases.

Although for now the question is whether or not the government can proceed with its measures within a reasonable time limit, there are several problems of even greater magnitude beyond the direct subsidies debate. It is those the government needs to urgently tackle (or rededicate itself to) if the long-term reductions now being considered are to be maintained: the problem of the indirect subsidies, the dismal performance of the agricultural sector, the bureaucracy and, last but certainly not least, the alarming population growth.

All the best,

Dankwa

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