Fiscal Reforms for a Low Carbon Energy Transition:
The Experience of Egypt

Macro Fiscal Policy Unit
October 2018
Energy Products in Egypt Long Suffered from Underpricing ...

Which Created the Wrong Incentives for the Market, in terms of:

Over consumption:

And Under investment:

Energy Use per Capita (Kg Oil Equivilant) (2014)

Investments in Energy Sector (% of GDP)
Resulting in Misallocation of Resources, by:

**Contributing to a large fiscal deficit**

- Overall Deficit Excluding Grants (% of GDP)
- Energy Subsidies (% of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Overall Deficit</th>
<th>Energy Subsidies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009/10</td>
<td>5.5%</td>
<td>5.0%</td>
</tr>
<tr>
<td>2010/11</td>
<td>10.0%</td>
<td>5.8%</td>
</tr>
<tr>
<td>2011/12</td>
<td>10.7%</td>
<td>7.0%</td>
</tr>
<tr>
<td>2012/13</td>
<td>13.3%</td>
<td>6.6%</td>
</tr>
<tr>
<td>2013/14</td>
<td>16.7%</td>
<td>4.0%</td>
</tr>
<tr>
<td>2014/15</td>
<td>12.5%</td>
<td>-0.9%</td>
</tr>
</tbody>
</table>

**Turning from an Energy Exporter to Importer**

Petroleum Trade balance (US$ Billion)

- 2009/10: 8.5%
- 2010/11: 10.0%
- 2011/12: 10.7%
- 2012/13: 13.3%
- 2013/14: 16.7%
- 2014/15: 12.5%

**Leading to decline in output**

Natural Gas Production (MMCFD)

- 2011/2012: 5,911
- 2012/2013: 5,688
- 2013/14: 5,050
- 2014/15: 4,526
- 2015/16: 4,016

**Accumulating Arrears to our Energy Partners**

- Foreign Partners arrears:
  - 2009/2010: 5.1
  - 2010/11: 2.9
  - 2011/12: 0.9
  - 2012/13: -0.5
  - 2013/14: -0.9
  - 2014/15: -3.5

**Overall Deficit Excluding Grants (% of GDP)**

- 2009/10: 8.5%
- 2010/11: 10.0%
- 2011/12: 10.7%
- 2012/13: 13.3%
- 2013/14: 16.7%
- 2014/15: 12.5%

**Energy Subsidies (% of GDP)**

- 2009/10: 5.5%
- 2010/11: 5.0%
- 2011/12: 5.8%
- 2012/13: 7.0%
- 2013/14: 6.6%
- 2014/15: 4.0%

**Contributing to a large fiscal deficit**

- Overall Deficit Excluding Grants (% of GDP)
- Energy Subsidies (% of GDP)

**Turning from an Energy Exporter to Importer**

Petroleum Trade balance (US$ Billion)

- 2009/10: 8.5%
- 2010/11: 10.0%
- 2011/12: 10.7%
- 2012/13: 13.3%
- 2013/14: 16.7%
- 2014/15: 12.5%

**Leading to decline in output**

Natural Gas Production (MMCFD)

- 2011/2012: 5,911
- 2012/2013: 5,688
- 2013/14: 5,050
- 2014/15: 4,526
- 2015/16: 4,016

**Accumulating Arrears to our Energy Partners**

- Foreign Partners arrears:
  - 2009/2010: 5.1
  - 2010/11: 2.9
  - 2011/12: 0.9
  - 2012/13: -0.5
  - 2013/14: -0.9
  - 2014/15: -3.5

**Overall Deficit Excluding Grants (% of GDP)**

- 2009/10: 8.5%
- 2010/11: 10.0%
- 2011/12: 10.7%
- 2012/13: 13.3%
- 2013/14: 16.7%
- 2014/15: 12.5%

**Energy Subsidies (% of GDP)**

- 2009/10: 5.5%
- 2010/11: 5.0%
- 2011/12: 5.8%
- 2012/13: 7.0%
- 2013/14: 6.6%
- 2014/15: 4.0%
Until Policies Were Proven Unsustainable …
Debt ballooned

Total Budget Sector Debt (% of GDP)

Reserves dropped to a minimum

Net International Reserves

- US$ Billion
- Months of Imports
A Comprehensive Economic Reform Program was designed and implemented

**Pillar 1: Macroeconomic Stabilization**
- Job-rich Growth
- Growth friendly fiscal consolidation
- Inflation Targeting
- Flexible ER regime

**Pillar 2: Social Inclusion**
- Cash transfer programs
- Food Subsidies and School Nutrition Programs
- Social Housing and Slum Development
- Better Health and Education Services
- Universal Health Insurance Coverage

**Pillar 3: Structural Reforms**
- Ease of Doing Business
- Infrastructure development with expanding private sector role
- Expanding the manufacturing base
- Promoting exports
- Supporting SMEs and Entrepreneurship
Within this program, energy price distortions are being addressed.

**Fuel Products Price Reforms (LE/liter)**

- **DIESEL**
  - May 2014: 1.1 LE/liter
  - June 2018: 5.5 LE/liter
  - A cumulative increase of 400% between May 2014 and June 2018

- **GASOLINE 80**
  - May 2014: 0.9 LE/liter
  - June 2018: 5.5 LE/liter
  - A cumulative increase of 511% between May 2014 and June 2018

- **GASOLINE 92**
  - May 2014: 1.85 LE/liter
  - June 2018: 6.75 LE/liter
  - A cumulative increase of 265% between May 2014 and June 2018

**Electricity Price Reform**

- Average increase of around 306% in prices across brackets over 5 years

**Cost Recovery Ratio For Petroleum Products**

- Nov-16: 44%
- Dec-16: 56%
- Sep-17: 68%
- Jun-18: 73%
- Jun-19 (Target): 100%

**Fuel Products Price Reforms (LE/liter) as of June 2018**

- **DIESEL**
  - 0.75 LE per KWH
- **GASOLINE 80**
  - 7.5 LE/liter
- **GASOLINE 92**
  - 1.2 LE/liter

**Electricity Price Reform**

- 0.28 LE per KWH
- 0.75 LE per KWH

**Average increase of around 306% in prices across brackets over 5 years**
Under the right Incentives, Consumption is being rationalized while production is picking up.

Supporting Egypt’s Macroeconomic Stabilization

Overall Deficit and Energy Subsidies (% of GDP)

Natural Gas Production (MMCFD)

Petroleum Trade balance (US$ Billion)
Recipe for Policy Sustainability

- Clear and pre-announced strategy and plan to set expectations
- Stressing on the inefficiency and regressively of energy subsidies
- Illustrating the opportunity cost of energy subsidies in terms of more spending on Health and Education

- MoF championing the reform
- Engaging with cabinet and other decision makers regarding opportunity cost of energy subsidies in light of limited fiscal space

- Gradual implementation taking into consideration social aspects
- Designing social measures to offset short-term negative impact of low income households

Socially Responsible, Politically Feasible and Economically Sustainable Policies
Accompanying and Offsetting Social Measures Packages

- Wage increases by 21% for civil servants and 30% for special cadres between FY16/17 & FY18/19, in addition to a nominal (lump-sum amount) bonuses

- Pension Increases by 30% between FY16/17 & FY18/19 for nearly 10 million pensioners

- Cash transfer (Takaful and Karama) increases by LE 100 per month for each of the 1.7 million households

- Food Subsidies: Increase in monthly cash transfer on ration cards from 21 to 50 pounds, increasing the amount of goods that can be purchased by 140%

- The Tax Exemption Bracket was raised from 6500 to 8000 pounds, other brackets were revised upwards as well

- Temporary Exemption from Tax on Agricultural Land for three years
Accompanying and Offsetting Social Measures Packages

Expenditure on Energy Subsidies (Petroleum and Electricity) exceeds Expenditure on Health and Education in FY13/14

- Expenditure on Health, 30.8 LE Billion
- Expenditure on Education, 84.1 LE Billion
- Petroleum Subsidies, 126.2 LE Billion
- Electricity Subsidies, 13.3 LE Billion

Expenditure on Health and Education Exceeds Energy Subsidies (Petroleum and Electricity) in FY18/19 Budget

- Expenditure on Health, 61.8 LE Billion
- Expenditure on Education, 115.7 LE Billion
- Petroleum Subsidies, 89.1 LE Billion
- Electricity Subsidies, 16.0 LE Billion
Managing Fiscal Risks From Energy Price Fluctuations ...

Objectives

- Fiscal Risk Management
- Smooth and manageable price shocks
- Confidence in ability to meet targets
- Financial Sustainability

Automatic Price Adjustment

- Quarterly adjustment of petroleum product prices in the domestic market
- Pre-set and communicated formula for the change in prices incorporating impact of international oil prices and exchange rate
- Smoothing mechanism through a cap on magnitude of quarterly adjustment

Hedging

- Tool to avoid deviations from budget assumptions
- Planned for application on other commodities where Egypt has a large exposure
- Synergy with the Automatic Price Adjustment for further smoothing
Opening the Energy markets to the private sector ...

Objectives and Foreseen Gains from Market Liberalization

- Significant flow of investments into these markets despite limited fiscal space
- Competition with the private sector will create more incentives for efficiency

Progress so far:
- Electricity and Natural Gas laws already modified
- Electricity Regulator established
- Natural Gas regulator under establishment
- Petroleum products liberalization is in the works
Thank You

Questions?