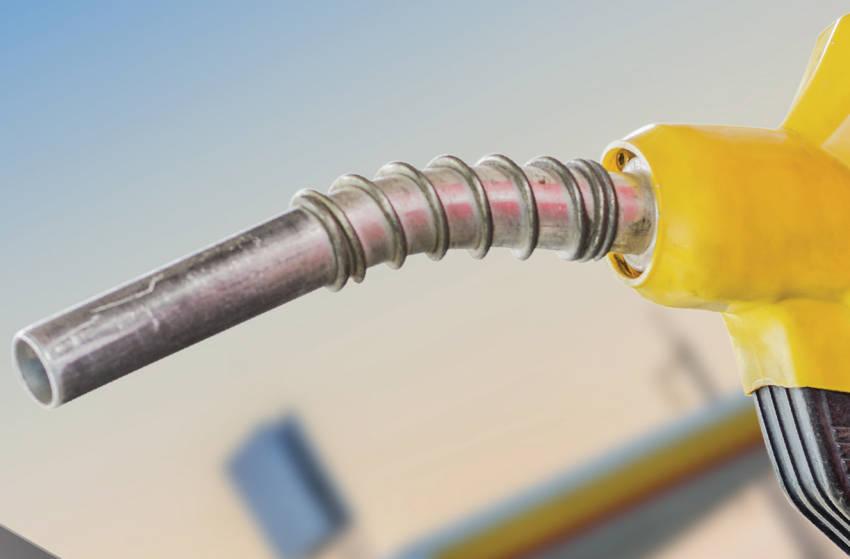


EGYPT'S FUEL SUBSIDY

REFORM DEVELOPMENT



EGYPT'S FUEL SUBSIDY REFORM DEVELOPMENT

BY JOLLY MONSEF, MARIAM AHMED & MAHA BALBAA



Recognizing the importance of fuel subsidy and its structural reforming are always crucial in Egypt. Fuel subsidies aim to support particular social and economic objectives through ensuring affordable access to energy. However, it has been imposing a stressful burden on the budget. Thus, reforming the fuel subsidy system has become a strategic priority in efficiently managing the budget and reallocating the deficit incurred to more efficient recipients.

Therefore, in fiscal year (FY) 2014/2015, the government launched an energy subsidy reform program that included gradually cutting subsidies and increasing fuel prices in the budget. Furthermore, Egypt adopted a \$12 billion economic reform program backed by the International Monetary Fund (IMF) that included specific measures to improve Egypt's fiscal performance and alleviate heavy burdens on the state's budget, including phasing out fuel subsidies. In addition, in December 2022, a \$3 billion loan backed by an IMF agreement was signed, concerning a new economic reform program on structural policies and reforms.

Egypt's petroleum sector has committed its vision to work on switching to low-carbon sources of energy and decarbonization. Accordingly, Egypt's decarbonization strategy focused on six main pillars, including improving energy efficiency and ensuring a well-reformed energy subsidy system. Hence, this report analytically gauges the development of Egypt's fuel subsidy reform over the period from FY 2019/20 to FY 2022/23.

Flashbacks

Energy subsidies have existed for a long time in Egypt to ensure affordable energy services to lower-income households. Historically, there were several attempts to reform fuel subsidies in Egypt, that have been met with failure, perhaps the most popular one is Sadat's 1977 attempt to cancel subsidies on a number of commodities. Yet, the insufficiency of domestic oil and gas production, the increase in energy costs, and the deterioration in the budget deficit have pushed the government to launch the energy subsidy reform program in 2004.

Regarding reforming fuel subsidies, the program targeted raising the gasoline and diesel oil prices until reaching full cost recovery by 2014. Since 2014, the program committed to lifting energy subsidies gradually over five years. In November 2016, the government reduced fuel subsidies by about 50%. It is noteworthy that fuel prices reached the breakeven point in June 2019, according to the Ministry of Petroleum and Mineral Resources (MoPMR).

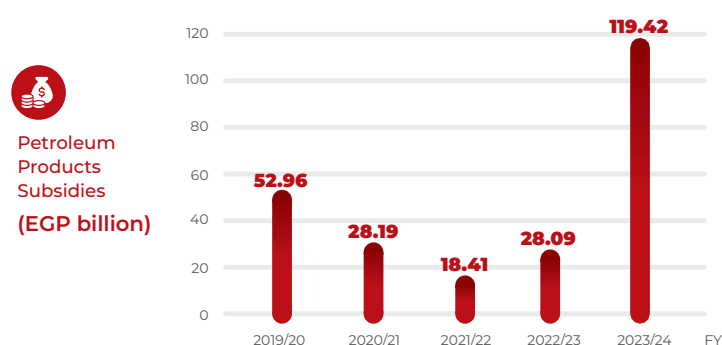
DEVELOPMENT OF THE PETROLEUM PRODUCTS SUBSIDIES

Petroleum products subsidies constitute an essential part of total subsidies in Egypt's state budget. The average of petroleum products subsidies in the period from FYs 2019/20 until 2023/24 are recorded at EGP 49.4 billion. The Egyptian government has embraced the fuel subsidy reform program to address the deep-seated challenges of the fuel subsidies paid by the government. Therefore, the petroleum products subsidies declined in FYs 2020/21 and 2021/22 by 46.8 % and 34.7%, respectively. This decline was also a result of the stability in exchange rates as recorded on average at \$15.78 and \$16.51 in FYs 2020/21 and 2021/22 respectively.

After a continuous decline in stability of exchange rates, the government slowed down the pace of phasing out fuel subsidies as the petroleum products subsidies witnessed an increase in FY 2022/23 driven by the huge increase in global petroleum prices, as well as, the exchange rates instability which jumped to \$30 during the FY.

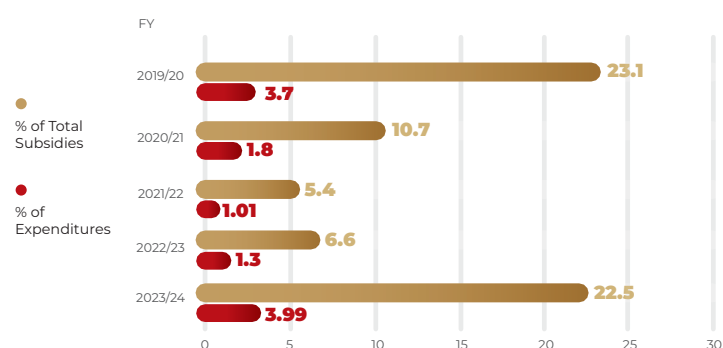
Then in light of the global inflationary wave and high exchange rates, the government allocated EGP 119.42 billion, the highest allocation during the period, for petroleum products subsidies in the FY 2023/24 state budget which represents 22.5% of total subsidies and 3.99% of total expenditures, according to the Ministry of Finance (MoF).

ANNUAL PETROLEUM PRODUCTS SUBSIDIES



Source: MoF

SHARE OF PETROLEUM PRODUCTS SUBSIDIES

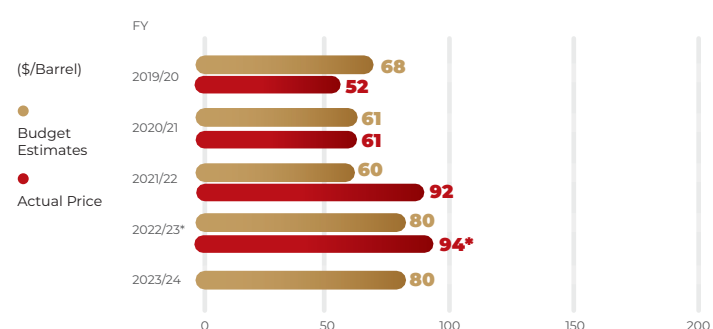


Source: MoF

DEVELOPMENT OF OIL PRICES IN EGYPT

Within the government's efforts to limit the effect of rising Brent prices globally, it estimates prices in its budget. The average actual price of FY 2019/20 was \$52 per Brent barrel, which is down by 23% from the estimated price in the budget, due to covid lockdown and the global economic slowdown. In FY 2020/21, the projected oil barrel price in the budget was in parallel with the global market price at that time. After that, the Russian war in Ukraine made oil prices rapidly grow as it blocked key Russian supply to markets. In FY 2021/22, the actual price of Brent barrel surpassed its estimate in the budget by about 52%. The preliminary budget estimates for the FY 2022/23 budget show that the actual price of the Brent barrel exceeds the estimated price by 17.5%, according to the MoF.

THE PRICE OF BRENT OIL BARREL IN THE BUDGET



*Preliminary estimates

Source: MoF

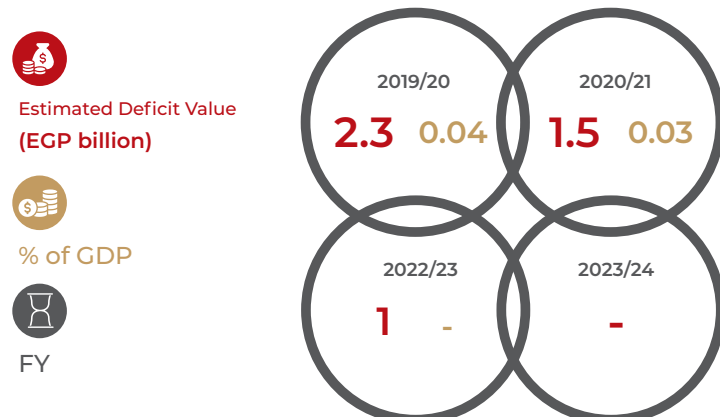
THE BUDGET DEFICIT AND CHANGES IN GLOBAL OIL PRICES

Recent hikes in global oil prices have induced pressure on Egypt's budget, as a \$1 rise in the global price of oil barrel to exceed the estimations, leads to a deterioration in the treasury's net relationship with the Egyptian General Petroleum Corporation (EGPC) and thus the targeted total deficit.

Over FYs 2019/20 to 2021/22 the fuel subsidies declined, lifting the load on the budget deficit. Yet, due to the global inflation pressures on

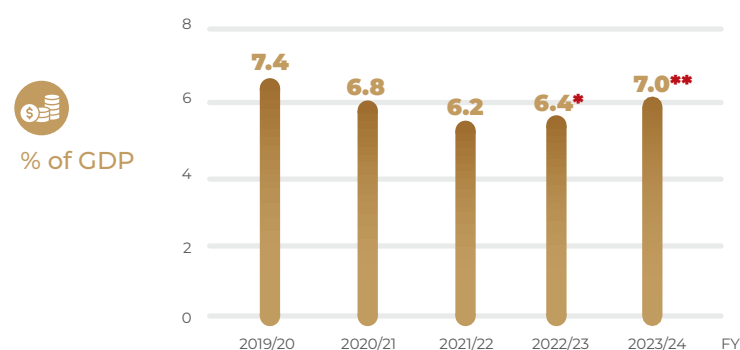
the economy and hikes in global oil prices, the Egyptian government has started to raise fuel subsidies again in FY 2022/23, putting some pressure on the budget. Besides, the sharp devaluation of the Egyptian pound in March 2022, taking place after the Russian-Ukrainian war, further affected the budget. Consequently, the budget deficit is estimated at 6.4% of the gross domestic product (GDP) in FY 2022/23 and is projected to be at 7% of the GDP in FY 2023/24, according to the MoF.

IMPACT OF A \$1 INCREASE IN THE OIL BARREL PRICE ON THE DEFICIT



Source: MoF

BUDGET DEFICIT



*Preliminary estimates

**Budget

Source: MoF

FUEL PRICES & INFLATION

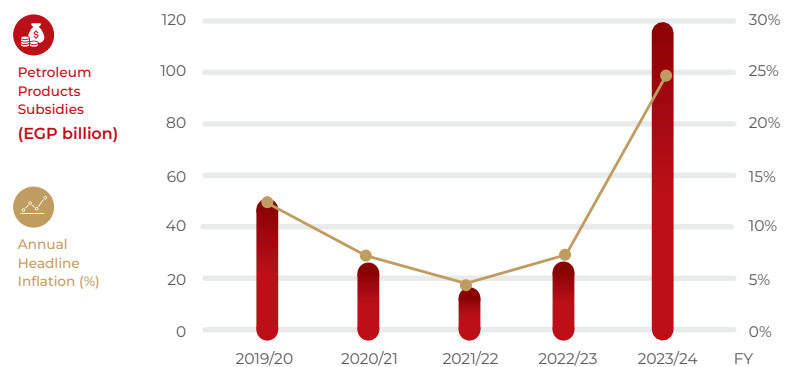
Fuel subsidies usually react similarly with inflation. Hence, fuel subsidy cuts trigger intensive inflationary pressures. Accordingly, the government embarked on a fuel subsidy reform by cutting fuel subsidies gradually to reflect the changes in global prices.

The annual headline inflation, calculated from the CPI data, started to decline over the FYs 2019/20 and 2020/21 as the petroleum subsidies' cut started to be applied. This was ever since energy costs edged higher, imposing extra burdens on the budget within the framework of reforming the fuel subsidies, according to the Central Agency for Public Mobilization and Statistics (CAPMAS)'s CPI data.

However, during the two FYs 2022/23 and 2023/24, petroleum products subsidies witnessed an exponential increase of 52.6% and 325.1% respectively, owing to the global inflationary pressures after the COVID-19 pandemic, followed by the Russian-Ukrainian Conflict,

according to the MoF. This is in parallel to an annual headline inflation recording 7.26% over the FY 2022/23 as well as a 25.8% forecast for the FY 2023/24, according to CAPMAS's CPI data.

ANNUAL PETROLEUM PRODUCTS SUBSIDIES VS. ANNUAL HEADLINE INFLATION



Source: MoF & CAPMAS

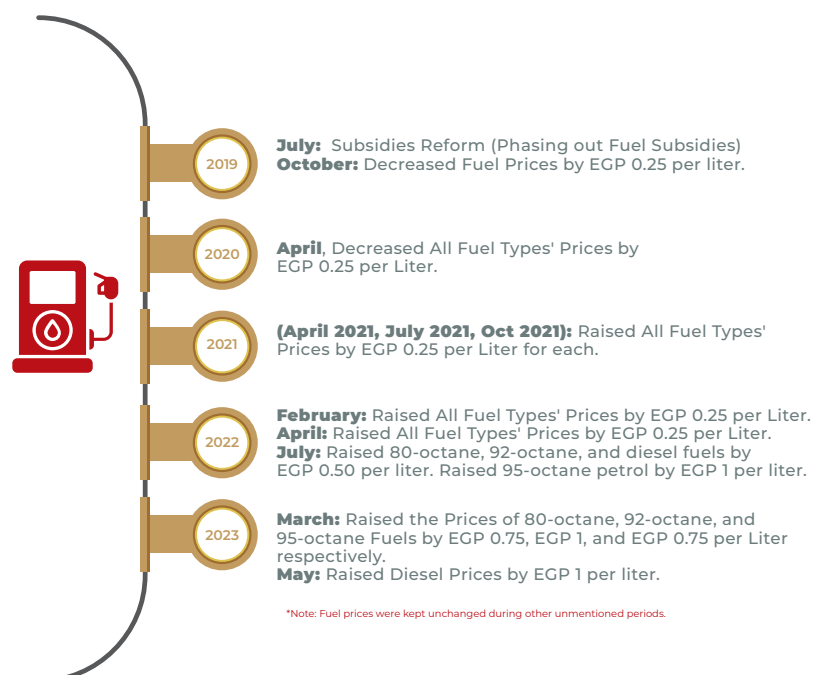
AUTOMATIC PRICING MECHANISM DECISIONS

The fuel pricing indexation mechanism was first implemented in June 2018, within the framework of the \$12 billion IMF loan agreement to efficiently regulate the fuel market in Egypt. Basically, emerging countries adopt automatic fuel pricing mechanisms for key objectives including protecting fuel tax revenues, ensuring full pass-through of international fuel prices to domestic prices, as well as to put governments under control. Furthermore, it represents the initial stage of the transition to a fully liberalized pricing and supply regime, which has been a more effective approach to reforming subsidies and protecting the budget, according to the IMF.

This mechanism determines fuel domestic prices based on a formula of the summation of the global import price of fuel products, domestic wholesale and retail distribution margins, and fuel taxes. Hence, domestic prices will change regularly to fully reflect the changing waves in global fuel prices, according to the IMF.

Accordingly, the fuel pricing mechanism committee convenes on a quarterly basis to assess the prices of petroleum products and propose changes in line with the international price of Brent crude oil and the price of the dollar against the Egyptian pound. Accordingly, the MoPMR initially selected a 10% price cap, as a ceiling and floor, for the fuel prices' change, and accordingly, price adjustments will occur quarterly with a 10% cap on each adjustment, according to the IMF.

FUEL AUTOMATIC PRICING COMMITTEE'S (FAPC) DECISION



Energy subsidies are essential in improving energy efficiency, reducing inequality in income distribution, and achieving social justice. Egypt realized the importance of the fuel subsidy reform program, in which the subsidies were directed to vulnerable groups. The government is moving forward in its subsidy reform to ensure that subsidies for petroleum products are balanced between easing the citizens amid global changes and not putting pressure on the performance of the petroleum sector. This is in addition to ensuring a more sustainable pathway for fuel pricing.

