Egyptian Initiative
for Personal Rights

Eye on the Debt II

The second report monitoring the economic and social impact of the IMF loan

April - December 2017

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Summary:

- Under the terms of the IMF program and the first review report issued by IMF experts in September 2017, the Egyptian government was obligated to carry out 17 measures to address economic problems in the period from April to December 2017.
- The EIPR believes eight of these measures (47 percent) are inappropriate given their socioeconomic impact.
- The government carried out only 8 of the scheduled 17 measures in the second review period.
- Of the socially detrimental measures, the government carried out four of these, or one-third of the mandated harmful actions.
- The government failed to carry out four measures with an overall positive socioeconomic impact.

The IMF visits, designed to assess the performance of the Egyptian government, take place every six months and determine the disbursement of the next tranche of the loan. The next visit is scheduled for April–May 2018. Thus far Egyptian has obtained $4.13 billion from the IMF as part of the program.

The objectives which the government failed to meet in the second review period include:

1. Attaining the target reduction of the primary deficit. The primary deficit (which excludes interest payments on public debt) came in at 1.8 percent instead of 0.8 percent at the end of fiscal year 2016–17.
2. Providing a comprehensive picture of all government loans of all types.
3. Drafting a medium-term strategic plan for public spending and resources.

The EIPR has reservations about several of the measures required by the IMF that may have deleterious effects on the economy and social stability with no tangible economic benefit, most significantly:

1. Raising the interest rate despite its failure to contain the inflation set off by the floating of the pound. To reduce the pressure on the price of the pound, it would be better to address the causes of dollar outflows abroad while rescheduling the public debt with a lower interest rate.
2. Increasing fuel prices on the household sector alone. It would be preferable to not exempt energy-intensive industries and services from the price increases and require these sectors to obtain energy at market prices.
3. The decision to institute a VAT on its own. The VAT should have been coupled with a package of progressive taxes on income and profits to provide additional revenues to defray the deficit while achieving tax justice. In its recently released second review report, the IMF advocated a package of fairer taxes.

This is the second in a series of shadow reports, issued to coincide with each visit by the team of experts from the International Monetary Fund. The first report noted the IMF's failure to anticipate the magnitude of the depreciation of the Egyptian pound, as a result of which inflation increased to about double the projected rate. The first report also criticized the increase in the interest rate and its marginal effect on inflation, correctly predicting an increase in the deficit.

"An Eye on Debt," issued by the Egyptian Initiative for Personal Rights, seeks to monitor the economic measures imposed by the IMF loan program and their impact, positive and negative, on the economy and citizens. It also identifies the measures the government failed to carry out and attempts to offer alternatives that are less onerous for the public, especially low-income groups.

	Objective	Is it economically or socially appropriate?	Measures required under the IMF program	Were they carried out by government or CBE?	Economic and social impact according to EIPR	Observations and alternatives
General outlook						
1. Risks, according to IMF	Completion of the program	No	1. Compliance with program policies 2. Maintenance of free-floating currency price 3. Continued political support at highest level	Yes	The IMF warns of the following risks: 1. Monetary stability is still precarious (the Central Bank may covertly attempt to rein in any increase in the value of the local currency, even by psychological impact and rumors). 2. The difficulty of required reform measures (corruption and stakeholders may hinder it, while increasing wages endangers the budget deficit target). 3. Potential for deteriorating security conditions. 4. Macroeconomic stability is under threat if inflation continues to rise, if weak demand among firms continues and tourism bans continue, and if social protests spread.	The IMF prioritizes a floating currency over improved conditions for citizens. Alternatives: 1. Recognize that the pound will further devalue against the dollar in the coming period; the alternative is moving to a managed currency price. 2. Reduce wages of senior civil servants and use the savings to improve public services. 3. Boost government revenues by levying a wealth tax and a capital gains tax, and increase tax collection on real-estate wealth. 4. Introduce an unemployment benefits system and a minimum wage in the private and informal sector; reduce working hours; and examine the government's commitment to conditional tax reduction, advised by the IMF and not carried out by the government.

	Achieve 3.5 percent growth in June 2017 and 4.8 percent in June 2018	No	The program described no steps for the period of April–December 2017 to stimulate the economy in order to spur growth and employment.	No	1. The IMF downgraded growth projections slightly due to slower than expected growth in the second half of fiscal year 2016, according to the IMF's first review report. 2. The EIPR anticipates decreased growth for the second half of 2017 based on the following indicators: according to the Business Barometer, issued by the Egyptian Center for Economic Studies for the period April - June 2017, both the production and local sales indicator declined due to a sharp spike in the prices of production inputs and finished goods; indicators for exploitation of production energies, investment, employment, and wages declined due to a slowdown in local sales and higher prices for production inputs; and investment and employment indices are both down. 3. The growth rate is expected to increase due to inventory accumulation (unsold goods are assessed as part of GDP but are a sign of recession, not growth). 4. The Purchasing Managers Index (PMI) put out by Markit and Abu Dhabi Bank fell by two points in the last quarter of fiscal year 2017, indicating a contraction in the non-petroleum private sector and a decline in local and foreign investment. The decline is due to the increased price of finished goods. 5. Projections from the Business Barometer for the July-September quarter of 2017: continued decline in production and sales rates in the local market and the rate of productive energy use; continued increase in the price of inputs and finished goods; and a slight dip in investment and employment indicators.	The Finance Ministry projects economic growth of 5.6 percent at the end of the current fiscal year, while the World Bank projects a rate of 4.9 percent. Despite attempts by the Finance Ministry and Planning Ministry to improve the accuracy of their projections, we nevertheless lack transparently published figures for projected growth in Egypt. A report from the Gallup Institute on the relationship between GDP growth and prosperity (which reflects individual happiness and life satisfaction) found that despite improved per capita GDP in Egypt since 2007, individual life satisfaction and happiness are down. The same is true of India. In Russia, despite a weak increase in per capita GDP, indicators for happiness and life satisfaction were up. The root is development, not growth. As such, the goal should be sustainable development that achieves social justice. This requires following through on institutional, structural, political, and social reforms, and for the process of economic transition to be transparent and democratic. The EIPR thus recommends: 1. Stimulating local demand by putting more money in the hands of the poorest classes (cash assistance, reduced work hours, tax breaks linked to family spending on education and health). 2. Training and temporary employment programs in local government enterprises, with a minimum wage for low-skilled or inexperienced workers, particularly in agriculture and construction.

2- Monetary policy (CBE measures)

1. Exchange Rate	1. By June 30, 2017: Lift restrictions on transfers abroad	No	Lift restrictions on transfers of $100,000 to individuals abroad (for commercial transactions) and $50,000 for the import of non-primary goods	Yes. The government went even further by lifting all restrictions on dollar deposits and withdrawals for the import of non-essential goods.	This measure leads to increased demand for dollars for non-essential purposes, even as demand for the dollar is increasing in order to meet foreign debts (principal and interest) absent any increase in dollar resources. The anticipated result is further devaluation of the pound and a concomitant increase in inflation.	This measure is premature and should be postponed until the dollar shortage crisis is resolved and genuine currency stability is achieved, not formal or temporary (the current increase in the dollar supply is primarily the result of a large increase in dollar-denominated borrowing).
	2. Tighten management of international reserves.	Yes	Set medium-term plan to eliminate Central Bank Foreign deposits at branches of Egyptian banks abroad, while refraining from making any new deposits at these branches and maintaining no more than their size as of April, $5.4 billion	Uncertain	The measure is appropriate to promote transparency but the IMF is demanding the elimination of one method of defense of the pound against speculation on the dollar, without providing reasons. The maintenance of bank deposits was one method used by the CBE under Farouq al-Oqda in 2007 to protect the value of the pound from collapse. This measure sought by the IMF may result in a return of the black market and a devaluation of the pound, which could increase inflation, especially for the poorest groups.	The current management of reserves is based on foreign borrowing to maintain a relatively large reserve of foreign currency (about 7.7 months of imports). EIPR recommendations are: 1. Maintain dollar reserves and increase the value if possible, while announcing the value of reserves. 2. Return to a managed currency system to allow the CBE to play a bigger role in maintaining the price of pound against collapse. 3. Levy progressive taxes on hot money in dollars, according to how long it stays in the country.

	3. By December 21, 2017: Improve governance and transparency at the CBE	Yes	Develop the management structure; increase transparency; set rules for the distribution of bonuses for CBE employees; recapitalize the CBE; settle relations between the government and commercial banks; separate emergency financing measures for banks (the responsibility of the CBE) from the bank-rescue framework (the responsibility of the government); and upgrade disclosure of outcomes of CBE enterprises pursuant to best global practice (IFRS), especially recourse to foreign financial sources	Yes. A bill was drafted; it is not yet approved by the Cabinet and has not been put to the House of Representatives.	This IMF condition has a positive impact on oversight of public finance.	Some articles in the section on the CBE will circumscribe the oversight of the Central Accounting Agency and could lead to a conflict of interest in its management board.
	4. By September 2017: Increase transparency in monetary policy	Yes	Release 2016 report on stability of monetary policy	Yes		
2. Inflation	Inflation reduction must be an objective of the CBE	Yes	- Rely on increase of interest rate. - The IMF is projecting an average inflation rate of 21% over the FY 2017-18, according the second review report.	Yes	1- The CBE did not cut the interest rate, which stands at 19 percent, although annual inflation fell to 30.53 percent in October 2017 from 33.26 percent in September 2017, due to higher monthly inflation spurred by an increase in school fees and costs and mobile phone cards. 2- The IMF is projecting a 5 percentage point increase in inflation triggered by a rise in energy prices in June-July 2018.	Monetary policy (increasing interest rates) is not enough alone to combat inflation. Fiscal policy must also play a role by reducing public debt, i.e., restructuring public debt to extend the term of the debt while writing off some domestic debt. This will reduce the deficit, which in turn will contain inflation. It will also redistribute income toward low-income groups, which slows down the increase in the numbers of poor people and mitigates social anger.

Fiscal policy (measures related to the Finance Ministry and other competent ministries)						
1. Wages	Gradual reduction in wage share over three years to reach target of 5 percent of GDP by program end	No	Reduce government wages as a percentage of GDP by 0.1 percent in fiscal year 2017–18; the government reduced it by 0.5 percent.	No	Lower wages coupled with high inflation and the state's withdrawal from subsidy programs and other developmental roles on which citizens rely means increased poverty and an erosion in the real value of wages.	Wages in the current public budget were cut even more than demanded by the IMF, to 5.9 percent of GDP instead of 6.3 percent, down from 6.4 percent of GDP in the last fiscal year. Perpetuating this austerity at this pace has an impact on inclusive growth and threatens to entrench poor social conditions. The EIPR believes it is necessary to set a maximum wage and benefits scale for senior civil servants, who account for the largest part of the wages in the budget, instead of cutting junior civil servants' salaries.
2. Taxes	By July 2017: Increase VAT from 13 percent to 14 percent	No	Increase tax revenue by at least 1 percent of GDP by the end of fiscal year 2017–18 and an additional 1 percent in 2018–19 to bring tax revenue to 14.5 percent of GDP by program end	Yes	According to the first review report (p. 9), the government did not meet the target for tax revenue, despite imposing the VAT. The IMF recommends addressing the shortfall in targeted revenue with additional cuts to spending on wages and the purchase of goods and services.	Tax policy in its current form is unequal and unfair. While revenues are not enough to meet the needs for expenditure on public services, half of all targeted revenues this fiscal year come from consumers by way of the VAT. There is no trend to increase the tax burden of corporations or taxes on wealth and higher incomes. The EIPR reiterates its recommendations to impose fairer taxes, such as a tax on real-estate wealth, a tax on unused apartments, a progressive income tax, a capital gains tax (on the sale of land and property, mergers, and acquisitions), and an estate tax.
3. Insurance and pensions	Draft law to reform social insurance and pension system	Yes	A bill to reform the social insurance system was drafted.	No	Support for the Insurance Fund in the current fiscal year is LE62.5 billion, according to public budget data, allocated to cover the current deficit in pensions.	

4. Mitigate burden on citizenry resulting from IMF program	Spend the equivalent of 1 percent of GDP on package of protective policies	Yes	1. Increase individual cash subsidies on energy supply cards from LE15 to LE21 in 2016 and to LE50 in 2017. 2. Increase insurance pensions by 15 percent. 3. Increase monthly benefits for beneficiaries of Takaful and Karama programs by LE100 per month.	Yes	This measure aims to reduce inflationary pressure on the poorest groups, but we are unable to ascertain whether these supplements are sufficient to save everyone harmed by austerity policies. The head of CAPMAS in July 2017 raised the possibility increasing the poverty line to nearly LE1,000 per month (instead of the LE482 set in 2015). Raising the poverty line could put more citizens under it.	1. A reliance solely on cash and in-kind subsidies is not enough to lift nearly 30 percent of the population out of poverty. 2. More people are harmed by the IMF program than benefit from the network of cash subsidies and pensions. 3. Is it useful to compare which is greater: the increase or the inflation rate? The social insurance pension has increased 35 percent, the equivalent of the highest rate of inflation seen.
5. Energy subsidies	By July 2017: Increase fuel and electricity prices	No	Reduce fuel subsidies by 1.4 percent of GDP by the end of fiscal year 2016–17; it was agreed to postpone this measure to the end of fiscal year 2017–18.	Yes	Despite price hikes, the government failed to cut energy subsidies. Allocations for subsidies on petroleum products increased threefold in fiscal year 2017–18 due to the float of the pound. This erased the impact of three years of fuel price increases. Despite the injustice of this type of public subsidy, abandoning it without adequate protection policies in place would spark an unprecedented wave of inflation.	1. Fuel subsidies are divided into subsidies for individuals and subsidies for corporations. Firms receive anywhere from two-thirds to three-fourths of the subsidy bill (the figures are not disclosed; these are estimates based on World Bank reports and independent studies). The secretary of the parliamentary energy committee said in a conference at Akhbar al-Yom al-Iqtisadi in November 2017 that the government subsidizes energy-intensive industries at the rate of $2 per million btus. Thus far, the IMF has agreed to exclude energy-intensive industries and service firms from any price increases. Energy price increases have so far been shouldered solely by individuals. 2. The IMF also agreed not to include natural gas (though most of it goes to politically connected monopolies) in its list of subsidized fuels in the loan program document (and also in the public budget data).

6. Budget Deficit	By July 2017: Reduce overall deficit to 10 percent of GDP.	No ✖	- The government failed to commit to the projected budget deficit, according to the second IMF review. The overall deficit reached 10.9 at the end of FY 2017. - the IMF failed for the second time to project the overall balance. In 2017-18 the IMF modified the projected budget deficit at the end of the fiscal year to 9.2% up from 8.5%. - Primary deficit (Overall deficit excluding interest payments on public debt) achieved was 1.8 percent instead of projected 1 percent. According to the report (p. 9), failure to meet the objective is partly due to poor VAT revenues as a result of the delayed implementation of the tax. A large part is due to the higher cost of fuel subsidies as a result of the float of the pound and higher global oil prices. The program aims to address this failure in the new fiscal year with further austerity measures in wages and the purchase of goods and services. - As a result to the rise in budget deficit, the public debt witnessed an increase to 103% of the GDP compared to a projected 93.8%, According the second IMF review.	No ✖	The IMF altered its projected budget deficit for the end of fiscal year 2017-18 to 8.5 percent from 8.3 percent and to 6.7 percent from 5.9 percent for the following year.	The EIPR recommends: 1. Addressing spending inefficiencies in a way that does not affect poor and vulnerable groups. 2. Focusing on revenues by imposing fairer taxation, such as a real-estate wealth tax, a progressive income tax, and taxes on wealth and estates. 3. Cutting public spending by reducing the interest rate on public debt, currently at 18.5 percent according to the CBE. Every 1 percent cut to the interest rate will reduce the deficit by LE16 billion, according to the Prime Investment Bank.

7. Transparency	By March 2017: Prepare report on state guarantees postponed to November 2017 and not issued	Yes	The aim of the report is to identify all obligations arising from foreign debt carried by government bodies other than the central government. The purpose is to obtain a precise picture of the external debt burden. This measure was postponed from the first review period, and the government still has not implemented it.	No	"The end-September structural benchmarks (SB) on developing a system to evaluate and decide on new state guarantees was missed. The authorities need more time to flesh out a comprehensive framework on state guarantees", reads the second IMF review.	- The Government does not publish the budget in accordance to the IMF manual of 2001 in violation of its commitment as shown in the debt document. As a result: 1- there are no complete information on external debts and the terms of reimbursement. 2- The budget does not display data on subsidies allocated to corporates vs subsidies allocated to households. - The EIPR requests that the IMF compels the government to fulfill its commitments to transparence.
Investment climate and other reforms	By June 2017: Facilitate women's integration into the labor market	Yes	Establish kindergartens and provide safe transit to encourage women to join the labor market, funded with LE250 million by the end of 2016-2017.	No; delayed to June 2018 and doubled to 500 million, According to the second review		

	Privatization	No	Put petroleum companies and public sector banks up for IPO	No	1. The privatization program agreed upon is not disclosed in either IMF or Egyptian government documents. 2. A government investment bank, NI Capital, managed through private investment, announced its responsibility for identifying and preparing 30 government companies for IPOs in the next two years. In principle, the EIPR objects to the sale of state assets to attract foreign capital in order to improve the balance the payments. It would be preferable to attract foreign investment in greenfield projects. We also have reservations about privatization to reduce the budget deficit, since this is an ad-hoc treatment for a structural problem, i.e., exceptional revenues. However, in the current situation of the unprecedented explosion of foreign debt, privatization may temporarily offset foreign borrowing by supplying the government with dollars. On the negative side, the workforce at these companies could be cut, along with the government's share in important, profitable sectors. This would affect general revenues and increase the deficit.	
	By June 2017: Facilitate exit from the market for investors	Yes	No	The law was not debated in parliament.		