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**THE POLITICAL ECONOMY OF FOOD SUBSIDY  
REFORM IN EGYPT**

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**ABSTRACT**

Egypt has a large food subsidy program that has created a relatively effective social safety net, but it has also drained budgetary resources and proved to be poorly targeted toward the poor. Discussions about reforming the system to improve its effectiveness have run into extreme political sensitivities surrounding the issue of food subsidies. Egypt, therefore, well illustrates the quandaries that policymakers and others contemplating food subsidy reform face in developing countries. This study examines the political economy of food subsidy reform in Egypt and discusses the economic and political advantages and disadvantages of nine possible reforms. The study concludes that the reforms that have the greatest chance of success are those that reduce the access of the wealthy while increasing the access of the truly needy, but the timing, sequence, and trade-offs of such reforms have to be taken into account before they are implemented.

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## 1. INTRODUCTION

It is common knowledge among policymakers in developing countries that expanding consumer subsidy programs is always politically easier than reducing them. This has been particularly salient in the case of food subsidy reform, since in the past 25 years there are numerous examples of government attempts to reduce food subsidies that have ignited violent protests, often seen by policymakers as politically destabilizing.<sup>1</sup> Yet despite the political benefits of food subsidy programs, they often perform poorly at their ostensible task of providing a safety net for the truly needy, while they also tend to be costly, presenting a significant drain on government expenditures. External donor actors, such as the International Monetary Fund (IMF), are often one of the main sources of pressure for food subsidy reform, proposed within broader structural adjustment programs. The dilemma facing policymakers with large food subsidy programs is whether, when, and how these programs can be reformed without sparking political unrest. It is also a question of interest to donors looking to encourage food subsidy reform in recipient countries, as well as scholars seeking to better understand the political and economic factors that contribute to the success or failure of policy reform in developing countries.

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<sup>1</sup> Increases in food prices have resulted in violent protests in countries including Dominican Republic (1994), Egypt (1977), Indonesia (1998), Jordan (1989, 1996), Liberia (1979), Morocco (1981, 1984), Peru (1978), Sudan (1979, 1982), Tunisia (1984), Yemen (1998), Zambia (1986), and Zimbabwe (1988).

This paper examines the political economy of food subsidy reform efforts in Egypt. Egypt provides a case of a country with a large food subsidy program that has been relatively effective as a social safety net, but a program that is also expensive and poorly targeted to the poor. Policy discussions about reform strategies to improve the system's performance run into the extreme political sensitivity of the issue of food subsidies in Egypt. Egypt is therefore a country that well illustrates the dilemmas facing policymakers and others contemplating food subsidy reform in developing countries.

The food subsidy system in Egypt currently covers four staples: the flat *baladi* bread, *baladi* flour, cooking oil, and sugar.<sup>2</sup> The problems besetting the current system include high absolute costs, which stood at LE 3.7 billion in 1996/97 in current prices, roughly corresponding to total earnings from tourism (Ahmed, Bouis, and Gutner 1999); poor targeting vis-à-vis the needy; evidence of considerable leakage of subsidized foods before they reach consumers; and distortions to domestic wheat and milling sectors caused by the subsidized bread and flour programs. Although there is widespread agreement among policymakers, donors, and other political actors that the subsidy program should be reformed to function more efficiently and better target the poor, the political sensitivity of food subsidy policy in Egypt has challenged the government to find strategies of reform that are perceived to be politically feasible.

Why is food subsidy policy so politically sensitive in Egypt? First, and most important, since the Nasser era, the state has made explicit its mandate to ensure basic

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<sup>2</sup> Wheat is the foundation of the Egyptian diet. *Baladi* bread and flour are 82 percent extraction.

food supplies for all Egyptians (Khouri-Dager 1996). Over time, Egypt's provision of subsidized bread in particular has become a powerful symbol of the broader social contract between the government and the population, in a political system where political participation is highly limited. As Singerman (1995) has noted, "The Egyptian Government's policies of political exclusion have gone hand in hand with their public commitment to provide for the basic needs of the population....(T)he government maintains its legitimacy by providing goods and services to the population." As a result, food subsidies in Egypt, especially those for bread and flour, are perceived to be important in promoting political stability. Indeed, sharp increases in the price of food staples and other products in 1977 ignited riots in Egypt that were seen as regime threatening. The riots left a legacy of government caution and gradualism on strategies not only for food policy reform, but economic reform more broadly.

Second, the provision of subsidized wheat and wheat flour, major components of Egypt's food subsidy system, has been a particular challenge to the government. Historically, Egypt's self-sufficiency in wheat has been low, leaving Egyptian food security vulnerable to swings in international wheat prices. Indeed, currently, Egypt is one of the world's top wheat importers.<sup>3</sup> Finally, Egypt is in the midst of a far-reaching process of economic reform and structural adjustment that has heightened the importance of food subsidies as a component of the social safety net. Indicators of political unrest—such as

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<sup>3</sup> According to U.S. Department of Agriculture (USDA) data, Egypt was the world's top importer of wheat and wheat flour in 1997/98, and was the second largest importer in 1996/97 (USDA 1999). Currently, Egypt imports just under 50 percent of total wheat consumption.

illegal strikes—have also increased since the reform process began, contributing to government caution about tinkering with the food subsidy system.

Egypt has, in fact, quietly reformed its food subsidy system over the past 20 years from one that was economically unsustainable to one that poses a more modest drain on government expenditures. Food subsidy costs have declined to around 5 percent of government expenditures in recent years, from a high of 14 percent in 1981-82. Egyptian food subsidies are also widely credited with guaranteeing affordable staples to the population and helping to reduce infant mortality and malnutrition (World Bank 1995). Yet, there is clearly scope for more reform.

This paper suggests that there is a "pool" of politically feasible policy options that can meet the twin goals of reforming Egypt's food subsidy system so that it better targets the poor while functioning more efficiently. This "pool" of options can be nested in a broader set of options that have been proposed or discussed by policymakers, researchers, and other actors, which include more economically efficient options that are seen as having low political acceptability, as well as politically acceptable options that may also increase the program's costs. Different combinations of these options can be designed to reflect the ways that policy goals are prioritized, in terms of whether the emphasis is political feasibility or cost savings.

The remainder of this paper is divided into five sections. It begins by examining the broader issue of the political economy of food subsidy reform. Turning to the case of Egypt, it reviews the economic and political context of food subsidy reform in Egypt



since World War II, in order to highlight the factors that have shaped past and current reform issues and options. Section 4 examines the political dynamics of subsidy reform in Egypt, before turning in Section 5 to the description and evaluation of a number of food policy reform options.

## **2. THE POLITICAL ECONOMY OF FOOD SUBSIDY REFORM**

The relationship between subsidy cuts and other economic reform policies on political stability is complex, and depends greatly on the specific economic and political climate a country faces when its government is considering and implementing policy reform. Different actors hurt by economic reforms can disrupt the process in a number of ways, some of which can be more harmful than others. Labor can strike, low-income groups and students can riot, private-sector actors can move their capital out of the country, and public-sector actors can hoard (Waterbury 1989). Unfortunately, it is difficult for anyone to know exactly what the thresholds are at which disruptive actions are triggered, or intensify. Existing studies tend to be stronger in highlighting the challenges governments face in attempting policy reforms, and identifying factors and actors that influence political responses to reforms, versus specifying the relative strength of different causal mechanisms that may shape these responses.

## SUBSIDY CUTS AND VIOLENCE

To date, little research has been undertaken that seeks to determine the relationship between consumer subsidy cuts and political stability in developing countries. One existing study that compared cases where subsidy cuts resulted in violence argued that riots tended to be inconsequential for political stability, mainly because most riots were spontaneous, and therefore difficult to sustain (Bienen and Gersovitz 1986).<sup>4</sup> The authors found that in cases of violent responses to subsidy cuts, protesters rarely had an agenda beyond annulling the price increases. At the same time, and not surprisingly, protests often revealed broader resentment toward the government.

More recent events like the demise of the Suharto regime in Indonesia call this argument into question. It may be the case that regime change is rarely a direct result of consumer subsidy cuts, but this does not explain why negative public response to subsidy cuts can sometimes explode into something more destabilizing. In the Indonesian case, sudden increases in the prices of fuel and electricity by up to 70 percent incensed Indonesians, and was the match that ignited deeper discontent about the regime. Student protests quickly spread to include other interest groups, which together called for ousting the old regime (*Economist*, May 1998).

In addition, in most cases where subsidy cuts result in violence, the subsidy cuts are rescinded, which may explain why such protests are rarely regime-threatening. Empirical

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<sup>4</sup> The authors examined nine major cases where subsidy cuts resulted in violence in the period 1976-84, as well as other cases where subsidy cuts did not result in violence.

evidence showing the opaqueness of a direct link between subsidy protests and regime changes also does not account for the extent to which such protests play a role in weakening a government, and making it more vulnerable to other challenges to its survival.

Despite their weak argument, Bienen and Gersovitz provide useful data on common factors shared by almost all cases where food price increases resulted in riots. First, the authors found that in almost all of the cases where food price increases resulted in riots, the price increases were large (over 25 percent), immediate, and above rates of inflation. In the cases they analyzed, there were no examples of government officials killed during the riots, nor of rioters being armed. In most of the cases of violent protest, subsidy reductions were rescinded, but more moderate price increases were ultimately implemented within months of the riots, and usually without protest. Violent protests lasted anywhere from a few days to more than two weeks, and began in both capital cities and provincial cities. The authors also found that major violence over food issues occurred relatively more in the North Africa region, while protests in Latin America have focused more on fuel products and transport costs, and often reflect general opposition to increases in the cost of living. They posit that this occurs for two reasons. First, many Latin American countries do not have extensive food subsidy systems, which means there are fewer opportunities for discontent over food subsidy cuts. Second, they argue that Latin American urban and working classes tend to be better organized and developed than

their North African counterparts, and thus more able to respond to issues like increased transport or fuel costs (Bienen and Gersovitz 1986).

Finally, the only case in the Middle East and North Africa region where violent protests directly resulted in regime change is the case of the Sudan in 1985, when President Nimeiry was forced out by a coup that followed wide protests sparked by an austerity package that included subsidy cuts. In this case, Nimeiry announced a 33 percent increase in bread prices, 66 percent increase in gasoline prices, and price increases in soap, edible oils, and textiles as well. Spontaneous reactions from youth were soon augmented by more sizable crowds, demonstrations, and strikes, which led to demands for Nimeiry's removal. While subsidy cuts were not the main cause of instability, they were a trigger that reflected much deeper dissatisfaction with the president, and the country's economic policies. As a result, while subsidy cuts alone may rarely topple regimes, such cuts may be the critical factor in potentially explosive situations.

#### **POLITICAL FACTORS CONTRIBUTING TO SUCCESSFUL POLICY REFORM**

Analysts examining both the politics of subsidy reform and the politics of broader economic adjustment policies often highlight government commitment to reform and public perception toward reform as two particularly important variables that explain success or failure of policy changes. A third key variable includes the tactics and strategies used by committed governments to try and shape public support and reduce public opposition to reform.

In terms of government commitment to reform, clearly economic reform efforts have been most successful in countries where leaders were strongly committed to major change, and where there was widespread public acceptance or demand for such change. Stated differently, people are more willing to accept economic hardship if they are confident in the government (Graham 1994). In a study of a number of countries adopting widespread structural adjustment policies mainly in the 1980s, Nelson argued that they shared a "reform syndrome" (Nelson 1989). This was characterized by new governments taking office with strong public support for major changes, even though there was often disagreement about the specifics of the reforms. Analyzing successful food subsidy reforms, Alderman (1991) also observed that policy shifts were often made possible following elections in Jamaica, Sri Lanka, and Zimbabwe, as well as shifts from military to civilian government in Turkey.

State commitment, however, appears to be a necessary but not sufficient condition for successful reform. In many cases, political leadership may agree on the necessity of a particular policy reform, but remain divided about the timing and scope of the policy changes. Political leaders may also alienate important interest groups and supporters when undertaking structural adjustment and other economic reform policies, which can thwart the success of reforms. Bureaucratic interests can play a pivotal role in terms of whether reform efforts are implemented well or sabotaged (Waterbury 1989). As a result, the tactics and strategies used by political leadership, discussed below, are critical with respect to how reforms are implemented and received by the public.

Public perception of the fairness of a policy change is also critical in determining public response. Governments undertaking economic reform are more likely to push through austerity measures such as food subsidies or wage freezes when people believe such policy changes are legitimate solutions to the country's economic problems, even if they cannot see the benefits right away. Continued public support for policy changes, however, is dependent on people eventually noticing some tangible improvements in their lives. It is therefore incumbent upon the political leadership to organize constituencies that support their policy actions. Alderman and Seddon have both noted that so-called "food" riots—such as those that took place in Egypt, Morocco, Tunisia, Zambia, and Jordan—were in fact "equity" riots, where the underlying issues had more to do with a perception that the policy changes were unfair, than the actual policy change (Alderman 1991; Seddon 1986). While many governments have sought to blame "food" riots on highly-organized small groups of agitators, existing research shows this is rarely the case.

Even in cases where governments are strongly committed to change, the strategies and tactics they adopt to implement new policies can make the difference between success and failure. These tactics and strategies give the political leadership maneuvering room to compensate potential losers, avoid alienating too many political groups at the same time, reduce opposition to policy reform, and to help to influence public opinion. Timing, targeting, and transmission strategies appear to be particularly important in ensuring the success of food subsidy reform.

The timing of a reform has to do with how different policy reforms are sequenced. Since every government regime consists of different allied interests, governments undertaking economic adjustment policies must calculate the impact of policy changes on members of the ruling coalition. Successful policy change is then more likely where the leadership avoids simultaneously hurting the interests of all coalition members. In the case of Egypt, the dominant coalition includes organized labor, public-sector managers, private importers, import-substituting manufacturing interests, and the military. Subsistence farmers are absent from the ruling coalition, and capitalist farmers and the civil service are neutral actors (Waterbury 1989).

In a broader process of economic adjustment, strategies can include sequencing reforms, so that not all powerful supporting interest groups are hurt at the same time. In addition, the political leadership may also make concessions to some of these groups, as a means of encouraging their support. Violence in the wake of policy reforms is less likely to be self-sustaining if a wide variety of social groups do not have strong incentives to join on board. Implicit in Waterbury's argument is the idea that the reduction of consumer subsidies is a secondary priority in phasing in a broader set of structural adjustment policies. Often IMF-supported adjustment programs begin with devaluation and domestic budget cuts. This phase tends to increase the cost of living, which consumer subsidies help to offset. In addition, the austerity resulting from initial policy adjustments also enhances the importance of consumer subsidies as social safety nets. The phasing in of various policy reforms, then, helps to spread the burden of adjustment.

Joan Nelson argues that governments moving from general subsidies to targeted subsidies must set targets widely as a means of reducing the political risk associated with policy changes (Nelson et al. 1989). General subsidies can benefit the nonpoor as well as the poor, and therefore better-targeted subsidies can help governments transfer more resources to the truly needy, while at the same time enjoying cost savings. However, a change from general to targeted subsidies risks alienating some nonpoor who benefit from general subsidies. Protests over food price increases, she notes, rarely consist of the poor alone. Instead, such protests mobilize students, workers, and even middle-class and upper-class groups. Targeting that includes broad portions of the middle income groups, as well as the poor, will reduce the political opposition associated with moving from a general to a targeted system. It is therefore a relatively more risk-averse approach than a policy of directly targeting the needy.

Compensation is also a common approach by governments who seek to reduce opposition from interest groups who lose in the wake of policy changes. In the area of food subsidy reform, one example of this is the case of Pakistan. When Pakistan ended its flour rationing system, it added a compensation program that initially totaled 80 percent of the costs of the previous system. Pakistan as well as Sri Lanka also increased salaries of some government workers while reducing subsidies, while in Turkey changes in food prices have been linked to tax benefits (Alderman 1991). Often, governments have more incentive to compensate the well-organized, vocal, and politically powerful groups, even though these may not be the most needy. At the same time, governments can also use



compensation techniques to create what Graham (1994) has called "new political space" for the poor, which can give them a stake in the reform process. For example, governments that invite NGOs to help implement safety net programs for the poor are also creating more channels of access to the government, which can increase political support from the poor, and therefore enhance the political acceptance of economic reform.<sup>5</sup> An example of this in the area of food policy might be creating a program of food-for-education that is directly targeted to vulnerable and needy groups. The danger with compensation programs, however, is when their costs erase any economic savings from reducing subsidies, or have other negative economic side effects.<sup>6</sup>

Political scientists and other analysts disagree on effectiveness of government dialogue and explanation as a means to cushion the effect of subsidy cuts and other economic adjustment policies. Some argue that careful explanation and dialogue with middle-class groups is essential when benefits such as subsidies are being withdrawn from them (Nelson et al. 1989; Alderman 1991). The argument here is that if, in fact, food riots are equity riots, then negative public reactions can be reduced through public explanation and discussion. There are numerous cases where riots over food subsidy reduction or removal occurred when price increases were sudden and unannounced. Stated differently,

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<sup>5</sup> Graham's arguments are based on her analysis of case studies of sources of failure and success in the implementation of market-based reforms and safety net programs in Chile, Bolivia, Peru, Senegal, Zambia, and Poland.

<sup>6</sup> For example, wage increases can be inflationary.

governments can increase public support for painful policy actions if they present a clear vision of how today's pain will translate into future benefits (Ibrahim and Lofgren 1996).<sup>7</sup>

Yet, there is also an argument that declarations of policy goals, along with timetables, may give opposition more time to organize and react, and reduce the room for maneuvering available to the leadership. Obfuscation of policy intentions can be important in cases where public announcement may cause these policies to be aborted, as in the case of future exchange rate devaluations, for example (Roe, Roy, and Sengupta 1989). As discussed below, Egypt is an example of a country that has made significant reforms in its food subsidy policy without public announcements. The following section reviews the economic and political context of Egypt's food subsidy system, and shows how government policy since the 1977 riots reflects many of the lessons suggested above.

### **3. REVIEW OF THE POLITICAL AND ECONOMIC CONTEXT OF FOOD SUBSIDY REFORM IN EGYPT**

The Egyptian government's involvement in consumer food subsidies started as early as the years following World War I, when the government responded to rising food prices by importing large quantities of wheat and flour from Australia, and selling it at a loss in government-owned shops in 1919-1920 (Scobie 1981). Since World War II, there have been two main phases in the history of Egypt's food subsidy system: the growth of the system to unsustainable levels by the early 1980s, and since then, the gradual contraction

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<sup>7</sup> Ibrahim and Lofgren refer specifically to the case of Egypt in their study.

of the system to its current levels. This contraction has been undertaken quietly and gradually, to reduce prospects for political unrest.

## HISTORICAL BACKGROUND

Food rationing began as a temporary measure in Egypt in 1941, with a goal of helping Egyptians cope with scarcity and inflation resulting from World War II. The initial system was not targeted to the poor, but was instead set up to provide necessities such as sugar, kerosene, edible oil, and tea (Ali and Adams 1996). Wheat, in turn, was not rationed, but was subsidized in the years following the war, particularly at times when local shortage increased domestic wheat prices, such as in the late 1940s and early 1950s<sup>8</sup> (Alderman, von Braun, and Sakr 1982; Scobie 1981). Following President Gamal Abdel Nasser's "July Revolution" in 1952, agrarian reforms marked the beginning of extensive government involvement in the production, marketing, and distribution of most agricultural products, which lasted until the start of liberalization of state agriculture in 1987 (Badiane, Kherallah, and Abdel-Latif 1998).

The food subsidy system expanded in the 1960s and 1970s, becoming part of a broader set of consumer welfare programs that also subsidized transport, housing, energy, and some nonfood consumer products, such as soap and cigarettes. These policies helped to hold consumer prices down in the face of urbanization and rapid population growth.

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<sup>8</sup> Scobie notes that soil fertility was poor after the war, due to the scarcity of fertilizer.

In the mid-1960s, ration cards were introduced for a small number of goods, in response to rising domestic prices, which were influenced in part by the discontinuance of U.S. food aid at the time of the 1967 Arab-Israeli War (Alderman, von Braun, and Sakr 1982). The United States curtailed its P.L. 480 food aid program in 1965, amid deteriorating U.S.-Egyptian relations, and used short extensions until aid was stopped in February 1967.<sup>9</sup> As a result, Egypt was forced to use foreign exchange reserves to pay for grain imports, and consequently fell into arrears in making payments on its foreign debt. Wheat and flour imports in 1965-66 totaled LE 55 million, which was greater than all Egyptian exports to the West (at LE 52 million) in the same period (Waterbury 1983).

The ration cards initially did not always involve price subsidies, and were designed as a quantity-rationing system to shield people against shortages. In general, under Nasser, spending on food subsidies remained a modest percentage of the government's budget, and the role of food subsidy policies was primarily to ensure the supply of essential food items.

Egypt's self-sufficiency in wheat, however, began to decline in the 1960s. Wheat imports began exceeding domestic production in 1963, and at its nadir in 1983, Egypt produced less than 20 percent of its wheat needs (Scobie 1981; Badiane, Kherallah, and Abdel-Latif 1998). The result of declining self-sufficiency in wheat and increasing demand

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<sup>9</sup> U.S. relations with Egypt deteriorated during Lyndon Johnson's presidency. Johnson was concerned with Nasser's moves to support "revolutionaries" fighting in Yemen, his dependence on Soviet arms, and his growing hostility toward the U.S. (Johnson 1971). Egypt, in turn, saw demonstrations against U.S. policy at the time, and Nasser was concerned about U.S. interference in Egypt's internal politics. When Johnson ignored Nasser's request for wheat assistance in 1964, Nasser launched a strong attack against U.S. policy. U.S. aid, including P.L. 480 grain imports, resumed in 1973 after Egypt realigned itself with the U.S.

for wheat meant that Egypt became increasingly dependent on wheat imports from the mid-1960s onward. Wheat imports had become the government's responsibility in 1961, when it nationalized all foreign trade, and growing wheat imports used scarce foreign exchange reserves, leaving the country vulnerable to swings in international wheat prices and stocks.

#### EXPANSION OF THE SUBSIDY SYSTEM

The food subsidy system grew significantly, in scope and cost, under President Anwar Sadat, who took power in 1970. A broader set of foods were brought under the subsidy umbrella, including beans, lentils, frozen fish, meat and chicken, as well as rice and yellow maize. At its peak, the subsidy system included 18 foods.

Food security became a major policy issue in Egypt in 1972, as world wheat prices skyrocketed from \$60 a ton to \$250 a ton by 1973, and Egypt's wheat imports surged from \$147 million to \$400 million (Sadowski 1991). Overall, expenditures on food subsidies jumped from LE 3 million in 1970/71 (only 0.2 percent of total government expenditure) to LE 1.4 billion in 1980/81, which accounted for 14 percent of total government expenditure (Alderman, von Braun, and Sakr 1982; Ahmed, Bouis, and Ali 1998).

#### THE 1977 RIOTS

The infamous 1977 riots deeply unnerved Egyptian policymakers and left a legacy of government caution not only toward food policy reform, but economic reform more broadly. The riots illustrate all of the strategies policymakers should avoid in reforming food subsidy policy: that is, high, sharp, price increases in a political context where the public perceives the changes to be inequitable. Although the riots are commonly termed "food riots," as noted above, they were in fact "equity riots" since the underlying issues had more to do with the perception that the policy change was unfair, rather than the actual policy change itself. Indeed, the price increases announced in January 1977 did *not* include increases in a number of subsidized staples, such as *baladi* bread, beans, lentils, rationed sugar, or cooking oil. Price increases were announced for *fino* bread (50 percent), 72 percent extraction (refined) flour (67 percent), regulated sugar (4 percent), rationed rice (20 percent), tea (subsidy canceled), cooking oil (46 percent), gasoline (26–31 percent), and cigarettes (different amounts) (Alderman 1986).

The subsidy cuts stemmed from negotiations between the government and the IMF in 1976 over a package of economic reforms for the economy. Subsidy cuts were part of the package, although the actual policies that sparked the riots were more modest than those the IMF initially proposed (Sadowski 1991). Indeed, Deputy Premier for Financial and Economic Affairs Abd al-Munaim Qaissuni, who announced the subsidy cuts, felt he was lifting subsidies from a list of "luxury" goods that included commodities like macaroni and *fino* bread, and estimated that the price increases would cost very little to the average Egyptian family (Waterbury 1983). Egyptians, however, were shocked and angry about

the LE 277 million subsidy cuts, given unfulfilled government promises of prosperity under Sadat's Open Door Policy.

Those who rioted were neither communists, as portrayed by some, nor starving masses portrayed by others. Rather, they were industrial workers, students and public-sector employees who felt the subsidy cuts were unfair, and were soon joined by others as well, including lower income people (Sadowski 1991). Rioting flared up on January 18, 1977, in various places along the Nile Valley, but mainly in Cairo and in Alexandria. In Cairo, workers, students, and others smashed windows and attacked trolleys and police stations, and protesters throughout the country attacked government offices and government officials' homes. Police fired into the crowds and the military was called in to try to restore order. The violence only ended when the government backed down and rescinded the subsidy cuts on January 20.

Sadat's response to the riots was to expand the subsidy system further, in an effort to placate the public and counter widespread public criticism that his government was not doing enough to promote social equity. Food subsidies came to be seen as both a safety net to protect the poor, as well as an important tool in the promotion of social equity. For example, the 1978-82 Five-Year Plan listed as two of the government's five most important tasks "to protect the consumer from price increases," and "to make available to the public necessary food items" (Sadowski 1991).

#### SUBSIDY REDUCTION PHASE

The costs of the expanding system continued to grow and the subsidy system was becoming increasingly unsustainable by the time President Hosni Mubarak took office in 1981. Mubarak was faced with the daunting task of easing the acute economic burden it imposed. Government data at the time showed food subsidies in 1980/81 accounted for almost 20 percent of total current expenditure, which contributed to persistent budget deficits (Alderman, von Braun, and Sakr 1982).<sup>10</sup> By 1981/82, 99 percent of the population had ration cards, of which 97 percent were the more highly subsidized green ration cards (Abdel-Latif and El-Laithy 1996). The strain of paying for growing wheat and flour imports with scarce foreign exchange became even more pressing during the 1980s, as Egypt's foreign debt and debt service obligations grew. By 1989, for example, Egypt's foreign debt totaled \$46 billion, and its debt service ratio (total debt as a percentage of current account receipts) was 46 percent (IMF 1991).

In 1982, Mubarak initiated a process of reforming the food subsidy system, which he launched by holding a seminar on national economic issues to seek the advice of prominent Egyptian officials, businessmen, and intellectuals (Sadowski 1991). There was agreement at this conference that Egypt's persistent budget deficits must be tackled in order to reduce inflation and high levels of foreign borrowing. In addition, rising subsidy costs were seen as a key contributor to the deficit problem.

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<sup>10</sup> Recent, revised estimates derived by IFPRI, by contrast, indicate that food subsidies were only 13.9 percent of total government expenditure in 1980/81 (Ahmed, Bouis, and Ali 1998).



During this period, and over the next decade, Mubarak's advisers developed several strategies to gradually reform the subsidy system. The broad approach they adopted was a slow transformation of the system as a means to avoid political protest. This approach, according to senior Egyptian officials involved in its development, was based on the assumption that the most important obstacle to subsidy reduction was public perception, and a gradual strategy would not lead people to worry that their living standards were being sharply reduced (Sadowski 1991). The government's specific strategies since the early 1980s have included

1. Attempts to better target the ration card system by introducing in 1981 the red ration cards, which offered a lower subsidy on goods such as sugar, cooking oil, tea, and rice than the existing green card. The red cards are intended for people in higher income professions.
2. A reduction in the number of subsidized foods. Meat, chicken, fish, and other foods mainly consumed by higher income groups were removed from the subsidy program. Subsidies on meat were removed in 1990/91, those on fish and tea in 1991/92, and those on rice in 1992.
3. Reductions in the number of people on the ration card system. These were cut back from 99 percent in the early 1980s to around 70 percent in 1998, as a result of reductions in 1981, 1994, and 1997. This was accomplished in part by canceling

cards owned by people who had died or were abroad. In 1989, the Ministry of Trade and Supply stopped adding newborns to the ration card system.

4. A slow reduction in subsidies through various techniques, such as gradually reducing the quantity of the particular subsidized good, in some cases gradually replacing it by a more expensive version. An example of this is the increase in the price of bread from 1 piaster to 2 piasters in 1985, without protest. The government's strategy was to introduce a higher quality 2 piaster loaf alongside the 1 piaster loaf. Over time, the old loaf became harder to find, and its quality had deteriorated. Finally, the 1 piaster loaf was no longer produced, and most people had switched over to the widely available 2 piaster version without complaint (Sadowski 1991). Bread prices were further increased by the same strategy to 5 piasters in 1988-89, also without protest.

Other examples of this quiet reform process for *baladi* bread include decreases in loaf size, changes in extraction rates, and more recently, the addition of maize flour in some selected areas. In addition, in 1996 the government introduced larger, unsubsidized versions of *fino* bread and 72 percent extraction flour and of *shami* bread and its related 76 percent extraction flour.

#### CURRENT CONTEXT: FOOD SUBSIDY POLICIES

The result of these small but frequent policy steps has been, between 1981/82 and 1996/97, a significant reduction in the number of subsidized foods to the current four, a

decline in real subsidy costs from a peak of LE 6.0 billion to just under LE 2.5 billion (in constant 1991/92 prices), and a decline from 14 percent to 5.5 percent of total government expenditures (Ahmed, Bouis, and Ali 1998). Egypt's food security has also been aided by the gradual liberalization of wheat input and output markets since 1987, which has resulted in a dramatic tripling of domestic wheat production between the early 1980s and 1995 (Badiane, Kherallah, and Abdel-Latif 1998).

Despite these improvements, there is still significant scope for further improvement in the food subsidy system. Recent research undertaken by the International Food Policy Research Institute (IFPRI), in collaboration with Egypt's Ministry of Agriculture and Land Reclamation (MALR) and Ministry of Trade and Supply (MOTS) shows that the subsidy system is poorly targeted to the needy, and that there is considerable leakage of subsidized foods before they reach the consumer. These were among the conclusions derived from an integrated household survey (Egypt Integrated Household Survey, or EIHS) carried out by IFPRI in March-May 1997. This was a single-round, nationally representative survey in which questionnaires were administered to 2,500 rural and urban households from 20 governorates, using a two-stage, stratified selection process. It collected information on a wide range of topics, including income, expenditures, food consumption, nutrition and health status, employment, farming, housing, and the use of food subsidies by households.<sup>11</sup>

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<sup>11</sup> For more detailed results, see Ahmed, Bouis, and Ali (1998).

### *Poor Targeting*

*Baladi* bread and flour subsidies were not designed to serve the poor alone, since these foods are available to any consumer. While there is a widespread perception that self-targeting has resulted in *baladi* bread and flour being relatively more consumed by the poor, in fact, the EIHS survey results showed that a high percentage of bread and flour subsidies goes to the nonpoor. The better-off 40 percent of the Egyptian population receive 37 percent of benefits from *baladi* bread, 40 percent of benefits from *baladi* flour, 42 percent of subsidized sugar, and 42 percent of subsidized oil (Ahmed, Bouis, and Ali 1998). A variety of recent studies identify between 25-50 percent of the Egyptian population as living below the poverty line; the fact that the distribution of subsidy benefits is not skewed toward a particular income group suggests that there is scope to improve the amount of benefits received by the poor.<sup>12</sup>

In contrast to bread and flour subsidies, sugar and oil subsidies are explicitly designed to be targeted, with the less highly subsidized red cards meant for the richest Egyptians and the more highly subsidized green cards for others. Holders of red cards include investors, owners of estates, shops, automobiles and more than 10 feddans, and

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<sup>12</sup> There are numerous ways to define and measure poverty levels. There is also disagreement among economists on which methodologies and definitions are most accurate. In a study for the Ford Foundation, Assaad and Rouchdy (1998) analyze the conclusions of several recent studies that seek to estimate poverty levels in Egypt, and conclude that by whatever standard used, at least 25 percent of Egypt's population is considered to be poor. The report notes that research on poverty in Egypt is relatively weak compared with similar work in other countries, particularly on trends over time. This is mainly due to the political sensitivity of the topic.

Egyptians working in embassies or joint venture companies. Around 70 percent of the population benefits from the ration card system.

However, available data show that the card system is also poorly targeted in a number of ways. First, despite a general assumption that the 25 percent not covered by the ration cards system consists of high income citizens, there is evidence that even poor households do not hold any ration cards. One obstacle has been the pervasive long-term problem the government has had in identifying the poor. Studies have also shown that poor families sometimes find the bureaucratic steps to apply for a ration card to be a large obstacle (Salmi 1991). Data from the EIHS survey show that 11 out of 100 of the poorest quintile of the population do not carry a ration card, while 15 out of 100 of the second quintile also do not. Furthermore, over 10 percent of these two lowest quintiles hold red cards.

Second, the wealthiest 40 percent of the population actually hold more green cards than red cards. Over 60 percent of both the top 4<sup>th</sup> and 5<sup>th</sup> expenditure quintile hold green cards, compared with less than 12 percent that hold red cards. The remaining 20-30 percent (of the upper 4<sup>th</sup> and 5<sup>th</sup> quintile, respectively) hold no cards. Ultimately, poor targeting of the food subsidy system reduces the amount of benefits that would otherwise be available to the poor (Ahmed, Bouis, and Ali 1998).

### *Leakage and Waste*

Leakage is defined here as the amount of subsidized foods that do not reach the consumer; that is, subsidized food that disappears at the wholesale level. Leakage can be

caused by factors such as the diversion of subsidized flour into production of nonsubsidized bread and pastries, the sale of subsidized or rationed goods at nonsubsidized prices, and other forms of corruption, as well as losses from transport or storage. IFPRI data show that leakage is highest in the *baladi* flour system, where estimates put leakage at 30 percent of the total flour entering the system.<sup>13</sup> Leakage in *baladi* bread, by contrast, is much lower, estimated at 12 percent of total supply for Egypt. Leakage for sugar was estimated at a national average of 25 percent, and for subsidized oil, the figure was 28 percent (Ahmed, Bouis, and Ali 1998). These levels of leakage suggest scope for policy improvements to ensure more of the benefits of subsidized food reach the consumer.

#### *Wheat Market Distortions*

The Egyptian government has made great strides in liberalizing the wheat sector, which has resulted in sharply higher levels of wheat production and higher self-sufficiency rates. However, consumer subsidies on *baladi* bread and flour reduce the performance of the wheat market, particularly by making it difficult for local markets to become more integrated and function more efficiently. For example, some governorates impose transportation restrictions on wheat and flour, largely to ensure their required wheat

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<sup>13</sup> Ahmed, Bouis, and Ali (1998) estimate leakage by subtracting the total amount of each subsidized food purchased by consumers during the 1997 household survey from the quantities of these foods placed into the system during the same period by the Ministry of Trade and Supply. Leakage, then, is the difference between supply and purchases.

deliveries to the government for the production of *baladi* flour and bread. These transportation restrictions increase price instability and discourage stockholding (Badiane, Kherallah, and Abdel-Latif 1998).

#### CURRENT CONTEXT: THE STATE OF POLICY REFORM

Egypt began a substantive process of economic reform and structural adjustment in 1991, backed by agreements with the World Bank and IMF. President Mubarak supported the IMF and World Bank programs policies for economic reform to counter the economic slump Egypt experienced in the late 1980s, due in part to the sharp fall in oil prices in 1986. By the late 1980s, the economy faced increasing levels of unemployment, inflation and foreign debt, and falling levels of real income.

The timing of the government's acceptance of the IMF and World Bank programs was also linked to significant debt reduction strategies provided by donors in 1990 during the Gulf War, which helped to make economic reform policies more politically acceptable. The U.S. and Arab Gulf state creditors canceled \$14 billion of debt in late 1990, followed in 1991 by an agreement from the Paris Club of creditor countries to cancel an additional \$10 billion over time, while rescheduling a remaining \$10 billion (IMF 1991; Ibrahim and Lofgren 1996). Egypt's external debt was reduced from \$47.6 billion in June 1990 to around \$34 billion in February 1991, and declined to \$31 billion by mid-1991 (Amin 1995). The significant reduction in its external debt allowed Egypt to avoid a rapid

devaluation of its currency when embarking on its structural adjustment process in 1991, while increasing its creditworthiness.

The goal of the economic reform and structural adjustment program was to promote economic growth by creating a market-based, export-oriented economy. The program included measures to promote fiscal and financial-sector reform, trade and price liberalization, privatization, and deregulation. The result has been a significant improvement in Egypt's macroeconomic performance. Egypt's budget deficit declined to 1.2 percent of GDP by 1996, well below levels of 17 percent of GDP in 1991. Inflation declined to 4.6 percent in 1997 from over 22 percent in 1991 (World Bank 1997c; World Bank 1999). Real GDP has grown since 1993, achieving a rate of 5.0 percent in 1996/97 (Subramanian 1997). The reform efforts have also resulted in a more stable currency, significant foreign exchange reserves, and a stronger banking system (Lane 1998). Privatization, while moving at a slow pace, has resulted in the government selling or reducing its stake in many nonfinancial institutions, as well as in the banking and insurance sectors.

Despite the positive economic results brought about by the economic reform process, domestic support for the process among various political parties and social groups has been mixed. Sociopolitical unrest—reflected in visible indicators such as demonstrations, strikes, and riots—did increase sharply in the early 1990s, compared to previous years, coinciding with the implementation of the structural adjustment and economic reform programs (Ibrahim and Lofgren 1996). The implementation of a new



law on liberalizing agricultural rents, which took effect in September 1997, also sparked unrest in the countryside, including mass rallies in Beni Suief, Gharbia, and Menoufia. The law ended tenancy contracts based on rent controls and perpetual leases that were created during the Nasser era, giving landlords the right to increase rents, or regain control over the land of almost 1 million affected tenant farmers (*Economist* 1997).

In addition, the number of violent attacks by Islamic militants increased since 1990, claiming the lives of leading politicians, intellectuals, and media figures, as well as hundreds of others (Clarke 1997). While Islamic activists have been weakened by the government's security policies, their existence reflects increased frustration with the regime's limited channels of political expression and highlights the government's need to gain support for its reform efforts from various constituencies of social groups (Weiss and Wurzel 1998). A number of scholars have argued that the government has been weak in its efforts to build such support and has not sought sufficient participation from civil society (Cassandra 1995; Clarke 1997; Ibrahim and Lofgren 1996; Weiss and Wurzel 1998).

Ultimately, the existence of sociopolitical unrest in the wake of economic reform has heightened the government's interest in keeping the reform process gradual, and increasing spending for social services. To help protect vulnerable groups and maintain political and social stability, in 1991, the government created the Social Fund for Development (with funding from the World Bank's International Development Association

[IDA] and other donors) to help finance labor-intensive public works, microenterprise development, and community services, among other activities.

Government concern about the social effects of the larger economic reform process also reduces any pressing need for significant and far-reaching reform of the food subsidy system, such as the abolishment of subsidies, or a move from the untargeted *baladi* bread and flour system to an administratively targeted system that would involve food stamps or coupons. Food subsidies, as stated above, have been an important component of the safety net to help protect the vulnerable and poor. Indeed, under the IMF agreements, prices for numerous other goods and services have risen in recent years, further heightening the importance of cheap food staples to the nonrich.<sup>14</sup> Government officials, including President Mubarak, have made statements in the past that stressed that bread subsidies would not be removed (Deutsche Press-Agentur 1996).<sup>15</sup>

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<sup>14</sup> Price increases have affected everything from train tickets (up 40 percent) to electrical batteries (up 12 percent), as well as a variety of nonsubsidized foods (Weiss and Wurzel 1998). Other forms of social assistance provided by the government include a contribution-based social insurance program for mainly public-sector employees; a social security program covering people not included in the former, such as small artisans, temporary agricultural workers, and domestic servants; the Sadat Pensions, which provides pensions of between LE 50 and LE 60 per month to people reaching 65 years of age who are incapacitated, or to families of people who die before receiving social insurance. The latter, however, has not taken new beneficiaries since 1980. There is also a monthly pension or short-term assistance, called the *Ma-ash Damani*, which targets the poorest of the poor (including orphans and divorcees) who are not eligible for other social security programs. See Assaad and Rouchdy (1998).

<sup>15</sup> This particular comment was made following unrest in Jordan after bread prices were increased there in August 1996.

#### **4. POLITICAL DYNAMICS OF FOOD SUBSIDY REFORM IN EGYPT**

Egypt's "quasi-democratic" political system is characterized by a powerful presidency and a weak legislature dominated by the ruling National Democratic Party (NPD) (Weiss and Wurzel 1998). The key political decisionmaker in Egypt is Mubarak, who has stressed numerous times that bread subsidies will not be removed, while at the same time playing a leading role in initiating the cautious process of reforming the subsidy system that began in the early 1980s. This fits in well with his main concern of maintaining political stability in Egypt (Weiss and Wurzel 1998).

The NPD, reflected Mubarak's strategy, has called for better targeting of food subsidies since the late 1980s. While political participation in Egypt is highly limited, Egypt's other political parties do contribute to the formulation of public opinion, and most have argued that subsidies should be better targeted and used more cost effectively, to alleviate burdens on the state budget, particularly in the midst of the current economic reform process. However, most party opinions are expressed in broad terms, such as the importance of "rationalizing" the subsidy system to address issues of leakage and waste, without more specific or technical ideas in terms of how exactly subsidies could be better targeted to the needy (Nasser and Gomaa 1998).

The most powerful ministries involved in the food subsidy issue are the MALR, concerned with agricultural production, and MOTS, which administers the food subsidy program. The MALR has traditionally been strongly in favor of reductions in food

subsidies, because of the negative impact of subsidies on domestic agricultural production. Yet senior officials at MOTS are also interested in modifying the food subsidy system in order to better increase its ability to reach the poor with less leakage and inefficiency. According to MOTS officials, trade minister Ahmed Goweili favors some reform in the subsidy system, but is cautious due to the political sensitivity of the issue.<sup>16</sup>

At the same time, currently there is little external pressure on Egypt to undertake a dramatic reform of its food subsidy system. This conclusion, based on interviews with Egypt's major donors and analysis of policy documents (often confidential) highlighting donors' strategies in the country, is somewhat counterintuitive, in the sense that there is a perception among many domestic stakeholders that external pressure for subsidy reform is prevalent (Gutner, Gomaa, and Nasser 1999).

In terms of the politically sensitive issue of *baladi* bread and flour, no major donors are calling for the abolishment of subsidies, or an increase in prices. Donors do support measures to better target the system to the poor, while reducing its cost, which are in line with the interests of the MALR and MOTS. They are also aware that while Egypt's macroeconomic climate is healthier, unemployment has increased, contributing to the widespread belief that social conditions must be improved.

At the same time, donors have pushed for food subsidy reform in the past, and may reexamine the issue in the future. However, donor leverage has historically been mixed in Egypt; that is, what donors want and what they are able to achieve are not always the

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<sup>16</sup> Author interviews with MALR and MOTS officials, April 15 and May 5, 1998.

same (Zimmerman 1993; Clarke 1997; Cassandra 1995). This reflects the fact that the United States is by far Egypt's largest donor, and its aid to Egypt is driven by the broader U.S. desire to secure Egypt's support for the 1979 Camp David peace accords with Israel and to ensure a strategic relationship with Egypt and the U.S. This geopolitical context gives Egypt relatively more leeway vis-à-vis donors than it might otherwise have. Egypt is the second largest recipient of U.S. aid, after Israel. Since the mid-1980s, Egypt received around \$2.1 billion a year in U.S. aid, of which \$1.3 billion was military aid, and \$815 million was economic aid, under the Economic Support Fund, provided through the U.S. Agency for International Development (USAID). In 1998, economic aid was reduced to \$775 million, although military aid is unchanged.<sup>17</sup> Despite this reduction, U.S. aid to Egypt dwarfs other sources of assistance. For example, it compares with around \$2.5 billion in aid currently provided by the rest of the donor community combined, which includes the IMF, World Bank, the European Union, France, Germany, and the African Development Bank Fund (USAID 1998).

Of the major donors, USAID has been one of the more active in promoting better-targeted food subsidies, as a component of its Agricultural Policy Reform Program (APRP). One of APRP's goals was to target food subsidies to the poorest households. USAID officials in Cairo acknowledged that while there was donor pressure on Egypt to cut back on food subsidies in the early 1990s, by the mid-1990s the issue was less

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<sup>17</sup> The reduction in aid was related to the fact that Israel proposed U.S. economic aid be gradually phased out over 10-12 years, with half the money added to military aid.

pressing, given the improving health of the Egyptian economy.<sup>18</sup> In addition, in the early 1990s USAID was keen on the idea of encouraging Egypt to set up a targeted food subsidy system—such as one using food stamps or coupons. Yet, this idea also lost some of its urgency a few years later, given the perception that such a policy reform was politically unacceptable.<sup>19</sup> USAID's view evolved so that by the late 1990s it was seeking ways to assist Egypt in improving the efficiency of its food subsidy program in ways that safeguarded the poor but were also more cost-effective.<sup>20</sup>

The IMF is also a highly influential donor institution in Egypt, in part because its standby agreements have been necessary for Egypt to receive World Bank loans, and more recently, compliance with IMF and World Bank stabilization measures was necessary for the 1992 and 1994 reductions in debt owed to the Paris Club group of Western creditor countries (Amin 1995).<sup>21</sup> Food subsidy reform appeared as a component of the 1991 IMF program, as one of many measures to help reduce the government budget deficit. However, the necessity of removing food subsidies declined in importance, and the most recent standby agreement—from the period October 1996-September 1998—did not mention food subsidy reform.

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<sup>18</sup> Author interviews with USAID officials, Cairo, Egypt, May 3 and 5 1998.

<sup>19</sup> Author interviews with USAID officials, Cairo, Egypt, May 3 and 5 1998.

<sup>20</sup> Author interviews with USAID officials, Cairo, Egypt, May 3 and 5 1998.

<sup>21</sup> Egyptian debt to Paris Club countries was cut by 15 percent immediately after a May 1991 agreement, with a second cut of 15 percent occurring after 18 months (November 1992), and a final cut of 20 percent 18 months later (May 1994). The last two cuts were linked to Egypt's economic performance.

A third major donor in Egypt is the World Bank. While its judgment on Egypt's structural adjustment reforms has been linked to IMF disbursements and the Paris Club's relief program (Weiss and Wurzel 1998), in many ways its strategies have been more modest vis-à-vis the United States or IMF. World Bank lending to Egypt has declined in recent years, due to the government's decision to reduce its borrowing as part of its debt management strategy, as well as the availability of high levels of grant and concessional resources from other donors—particularly the United States. World Bank average annual lending commitments to Egypt in the period FY95-97 averaged \$110 million, down from \$375 million in 1992. In addition, Egypt's access to IDA, the Bank's soft-lending arm, is being phased out after 1999, due to the country's access to other forms of external financing, and its per capita income of around \$1,060.<sup>22</sup> Because the World Bank's leverage, based on financial contributions, is "severely limited" in Egypt, the Bank has emphasized its contribution to Egypt's development through its nonlending services, such as analytical assistance and policy advice (World Bank 1997b).

The Bank's focus in Egypt is to help support the government's goal of reducing unemployment and increasing living standards. Food subsidy issues in Egypt are not a direct area of World Bank work, but it has noted that improvements in Egypt's social safety net are important in the country's war on poverty.

## **5. OPTIONS FOR FOOD SUBSIDY POLICY REFORM**

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<sup>22</sup> IDA provides assistance to countries with per capita income of \$785, or less (constant 1996 dollars).

The political sensitivity of food subsidies in Egypt increases the likelihood that, at least in the near-term, the government will choose to tinker with the system at the margins, versus embarking on any sweeping reform effort. However, given the inefficiencies of the system, there is considerable room for reforms that increase subsidy resources to the needy, while improving the subsidy program's performance. This section describes and evaluates a number of possible policy options for further reforming Egypt's food subsidy system. The options emerge from the various weaknesses of the system mentioned in this paper, ideas discussed among Egyptian policymakers and donors, and options that have been used in the past. These particular options are those that have the joint goals of tightening the targeting of the food subsidy system to better reach the poor without adding significant costs. While it is impossible to precisely rank options in terms of political feasibility, there is a widespread perception in Egypt that policy reforms affecting the price of subsidized *baladi* bread and wheat flour are more politically sensitive than those affecting subsidized sugar and oil. Appendix Table 1 highlights the major features of each option, which are loosely presented according to their perceived political acceptability, from high to low.

## OIL AND SUGAR SUBSIDIES



The first three options focus on reforming the oil and sugar subsidy, since these are widely perceived to be less politically sensitive than many options affecting *baladi* bread and flour, and can still result in cost savings and better targeting.

*Option 1: Convert High-Income-Household Holders of Green Cards to Red Cards*

A two-phase policy reform might first seek to transfer some percentage of the highest-income consumers from the green card to the red card, and later remove the red-card subsidy. In the longer-run, the red card itself may be eliminated, although this step may be somewhat more politically sensitive, since people prefer the security of holding a ration card (whether or not they use it) in case of emergency.

The major disadvantage of a policy reform that attempts to move people from green cards to red cards, and to eventually remove the subsidy from the latter is the fact that members of lower income groups also hold red cards, and could be adversely affected by such a policy reform. This can be avoided if poor people who happen to hold red cards can be transferred over to the green card system. The major challenge facing policymakers, as always, is to determine who exactly the poor and nonpoor are, in order to avoid reducing subsidies to the needy.

*Option 2: Bring Lower-Income Households into the Ration Card System*

The political feasibility of policy options to increase the number of people receiving the less-subsidized red card can be enhanced by additional policies to bring lower income people who do not receive ration cards into the ration card system. Such policies show the government's desire to provide a ration-card safety net to the poorer people who currently have slipped through the system. Again, it is not always clear who these people are. It is clear, however, that the current policy of excluding newborns from the ration card system hurts lower income groups relative to higher income groups, since poorer households tend to be relatively larger than nonpoor households (Datt, Jolliffe, and Sharma 1998). Policy reform in this area requires some type of method to better locate the poorer people, such as proxy means testing<sup>23</sup> as well as improvements in the capacity of the bureaucracies who run these programs to find ways of helping people to complete the bureaucratic procedures required to procure a green card. Taken alone, this option results in greater targeting, but an increase in subsidy costs. Costs savings would come into play if the option is used in conjunction with another option that removes some of the wealthier population from the ration card system.

### *Option 3: Increase Price or Reduce Quantity of Goods Bought with Green Card*

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<sup>23</sup> Proxy means testing is a relatively new and low cost approach that seeks to identify indicators of household income, and uses regression equations to determine the strength of association between indicators and household incomes (Ahmed and Bouis 1998).

Cost savings in the ration card system can also be achieved by increasing the price of items bought with the green card, or reducing the amount available for a given price. The cost savings resulting from such a move clearly depends on the level of price increase. This option reduces government expenditures for subsidized oil and sugar. Another advantage is that higher prices for ration goods will reduce the price differential between rationed goods and free-market goods, and may encourage wealthier consumers to switch to the latter, if the quality is higher. The downside of such a policy is that it will hurt the poorer cardholders more than the rich cardholders. The government has increased the price of rationed oil and sugar in the past, without any political unrest. The price for rationed sugar was increased in 1992/93, and that of rationed oil was increased in 1991/92, in 1992/93, and 1993/94 (Ali and Adams 1996).

#### *BALADI* BREAD AND FLOUR

In terms of *baladi* bread and flour, direct price increases are seen as the most politically difficult of all policy options. Nonetheless, the government has successfully raised the price of subsidized bread from 1 to 5 piasters over the past 13 years.<sup>24</sup> It has also undertaken a variety of other gradual reforms, although not all of these are repeatable. For example, while shrinking the size of the *baladi* loaf has been one way to reduce costs in recent years, there may be limited scope for further shrinkage, since the

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<sup>24</sup> Five piasters is approximately 1 U.S. Cent.

loaf now weighs 130 grams. The following five options evaluate other possibilities, a few of which are already being attempted by the government.

*Option 4: Mix Maize Flour into Subsidized Wheat Flour*

The strategy of mixing maize flour into subsidized wheat flour for delivery to *baladi* bread bakeries and warehouses has the dual advantages of reducing leakage and the cost of wheat imports, since maize flour is relatively cheaper than wheat flour. Leakage is reduced, because the mixed flour cannot be sifted into a higher quality, more refined wheat flour for sale (as flour or baked goods) at unsubsidized prices. This option may also improve targeting, since the mixed flour loaf may be less attractive to the nonpoor. This is a strategy that the government began to implement in selected Cairo bakeries in late 1996. More recently, it extended this policy to subsidized flour sold to consumers through warehouses.

The downside of such a policy move is the fact that a greater reliance on maize imports may not result in a significant decrease in cereal imports, since maize prices on the world market are not significantly lower than wheat prices. A senior Ministry of Agriculture official has noted that maize yields are higher, per acre, than wheat yields, which could encourage an increase in domestic maize production, allowing the government to buy a larger quantity of maize in domestic markets for the subsidy system.<sup>25</sup>

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<sup>25</sup> Interview with a senior Ministry of Agriculture official, Cairo, April 15, 1998.

However, to date, domestic maize production is not sufficient to expand this initiative throughout the country (Ahmed, Bouis, and Gutner 1999).

*Option 5: Increase Extraction Rate of Subsidized Wheat Flour*

An increase in the flour extraction rate has the advantage of better targeting *baladi* bread to the poor. Egyptians tend to perceive the higher extraction breads as less attractive, which may reduce the demand for this bread by wealthier consumers. Self-targeting is a preferred way to improve the performance of the subsidy system, because it focuses on the incentives facing consumers, and does not require any bureaucratic apparatus to implement. There is further scope for an increase in the extraction rate, which currently stands at 82 percent. The cost involved in this includes a one-time cost of reconfiguring flour mills. In addition, a higher extraction rate could also result in higher government costs, because it reduces the amount of bran that the government can sell separately, and the selling price of bran (over LE 400 per metric ton) is higher than the price of subsidized flour for *baladi* bread (LE 290 per metric ton) (Ahmed, Bouis, and Gutner 1999).

*Option 6: Introduce Higher Quality Subsidized Bread at a Higher Price*

This option also works through self-targeting. A higher quality, subsidized loaf would be more attractive to those that can afford it. Such a move is likely to reduce wastage, and can also be a first step in a longer-term strategy to replace the 5-piaster loaf

with the new, more highly-priced loaf. This is the technique used by the government in the past, to gradually increase the price of *baladi* bread. The act of introducing a new loaf with no change in the price of the existing subsidized loaf would have no negative political effects in itself. An open question is how quality can be increased without also increasing the cost of production. In some cases, this may require bakeries producing bread as instructed. For example, the government has in the past urged bakeries to reduce moisture levels in the bread, and to avoid undercooking it to lower energy costs.

*Option 7: Target Baladi Bread Bakeries to Poor Neighborhoods in Urban Areas*

This option calls for a greater concentration of *baladi* bread bakeries and distribution outlets in poor neighborhoods, in part by reducing their numbers in higher income communities. Again, this works by increasing self-targeting. Richer people need not lose subsidy benefits if they choose not to. They can continue to buy the 5-piaster bread at other bakeries where it is available, but will be more discouraged from doing so because of the greater time and effort that may be involved. The difficulty in implementing this is in determining exactly where the boundaries are between "wealthier" and "poorer" neighborhoods; such boundaries are unclear in rural areas, and in many cases are also difficult to determine in urban areas.

*Option 8: Develop an Administratively Targeted System*

Perhaps the most politically sensitive option, but possibly the most efficient, is the idea of replacing the current subsidy system for *baladi* bread and wheat flour with an administratively targeted system that would work by giving poor people food stamps, coupons, tokens, or plastic cards to use when purchasing subsidized bread or flour. Such a system could be an effective way to target subsidies, and by removing subsidies at the wholesale level, it could reduce leakage and help the wheat market to function more efficiently. This idea has been discussed from time to time among policymakers and donors. However, policymakers and other social actors are uneasy about this option, reflecting concerns about whether such a move would create social unrest. While the losers, in theory, would not be the poor, there are concerns that the move could be interpreted as showing a reduced government concern for social welfare. Many experts and policymakers are also skeptical about the government's ability to specifically target those who should receive the coupons or cards under a new system.<sup>26</sup> In addition, officials are uncertain about whether the increased costs posed by such a system would outweigh the economic savings, particularly in the absence of widespread political support for such an option.

## OTHER OPTIONS

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<sup>26</sup> Interviews with officials from MALR, MOTS, and various donors, March, May, and June 1998.

*Option 9: Reallocate Subsidy Supply Among Governorates*

The idea here is that a better regional allocation of subsidies can provide a stronger link between total benefits and total poverty rates. This option stems from EIHS survey results that show allocations are not sensitive to poverty rates in different governorates. Some governorates, such as Cairo and Giza, account for greater subsidy benefits vis-à-vis their percentage of total poverty, while others, such as Behera, Beni-Suef, Fayoum, Menia, Assyout, Suhag, and Quena, account for 55.7 percent of poverty but receive just under 30 percent of total food subsidies. There may be scope for revisions in the distribution of these benefits across governorates, which would better target the poor (Ahmed, Bouis, and Ali 1998). In fact, with the exception of Behera, the other governorates where subsidies are underprovided relative to poverty levels are in Upper Egypt, where extremist political groups are concentrated. A policy to increase the level of total subsidies to these regions can play a role in dampening discontent by providing more social benefits to the poor, while it has the added benefit of not involving any additional bureaucratic procedures or creating new institutions. The difficulty with this option lies in determining how to overcome political obstacles with implementing it, given the likely opposition to such a plan from governorates who stand to lose some share of their subsidy benefits, assuming the total level of subsidy benefits remains unchanged.



## 6. CONCLUSIONS

While major reforms of the food subsidy system are not currently a high priority to the Egyptian government, there is significant interest both inside and outside the government for the food subsidy system to perform in a more cost-effective and efficient manner that better targets subsidies to the needy. The government therefore has time to devise programs with long-term impact.

While the options in Table 1 are listed separately, policymakers can combine some of them to create a number of alternative bundles of policy choices. The most politically acceptable options—in terms of public perception—are clearly those that expand the scope of the system to better target the needy without removing benefits from the rich. These are also options that will tend to increase costs, such as finding lower income households missed by the ration card system and enrolling them. The least politically acceptable options, in turn, are those that remove large numbers of people from the subsidy system, including some who are not truly poor but depend on subsidies. In between these two extremes are the other options discussed above, of which the majority work by influencing individual consumer's incentives systems.

Perhaps the most acceptable options are those that combine moves to reduce the access of the wealthy to the subsidy system while at the same time increase the system's ability to reach the truly needy. Taking into account the discussion in Section 2 on the efficacy of targeting widely, removing the wealthiest beneficiaries of subsidies is less likely

to mobilize protests, particularly when combined with measures that emphasize the government's commitment to protecting the poor. Loose targeting can mean retaining the subsidy benefits for some people who may not fall below the official poverty line (e.g., reduce benefits of the upper 20 or 30 percent of the wealthiest, rather than the upper 50-60 percent of the population). These are the packages that combine measures reducing the benefits available to higher income groups with measures that increase the benefits available to lower income groups. Moves to combine and implement these policy options should be sensitive to other issues addressed in Section 2, namely sequencing the policy changes so that all members of the ruling coalition are not simultaneously hurt by a reduction in subsidy benefits; and to consider policies to compensate the most vocal losers and to directly increase the living standards of the poor.

The choice of options also depends on how goals are prioritized. Options chosen for their political feasibility do not necessarily coincide with those that are most cost-effective. Options to expand the social safety net, for example, can result in increased costs, but they can also result in reduced costs if they are taken in conjunction with other measures to make the subsidy system work more efficiently. In addition, policymakers may have different sets of short-term goals versus long-term goals. A long-term goal, for example, may be to replace the universal subsidy system for *baladi* bread and flour with an administratively targeted food stamp or coupon system, even if such a system is not seen as politically feasible in the short run. Short-term goals, in turn, must be placed within the context of Egypt's far-reaching economic adjustment and reform process, and the

important role that social safety nets such as food subsidy policies play during this process.

Ultimately, the government is in a comfortable position of being able to address ways of increasing the efficacy of the system without having to do so as a result of intense economic or external political pressure. Food subsidy reduction is often politically difficult for developing countries; however, even in the case of Egypt, where the issue is highly politicized, numerous options exist that can simultaneously strengthen the social safety net, while reforming the system so that it more effectively reaches the poor and has a reduced impact on government expenditures.



**Table 1—Comparison of policy options for food subsidy reform**

Option Number	Goal	Pros	Cons	Tried Before?	Political Acceptability	Administrative Feasibility	Open Issues
1	a. Transfer some number of wealthiest from green card to red card	Better targets subsidy to poor Cost savings	None	Yes	High for (a); difficult for rich to complain about loss of subsidies intended for poor	Proven	How to identify the wealthy How many to move How to administer Whether to publicize
	b. Then, in a second phase, remove subsidy on the red	Better targets remaining subsidy Cost savings card	Can impact poor people who have red cards	No	Mixed for (b) since some poor will also be affected. To avoid this, transfer poor from red to green cards	Should be no problem	Level of price increase Timing of policy change Whether and how to publicize
2	Bring lower income households into ration card system	Captures some of the poorer people who do not receive green cards Strengthens social safety net	May increase costs of system (depending on whether higher income people are removed from green cards)	Yes	High; shows government concern for subsidies as safety net; may cushion political impact of other measures	Depends on level of government efforts to target	How to find the poor currently outside of system
3	Increase price of goods bought with green card	Cost savings May discourage some wealthier from using card	May hurt poorer cardholders	Yes	Depends on amount of price increases and timing	Should be no problem	Level of price increase Timing of policy change Whether to publicize
4	Mix maize flour with wheat flour for subsidized <i>baladi</i> bread and subsidized wheat flour	Reduces leakage at bakery and warehouse levels Decreases wheat imports Cost savings	Currently limited scope for higher maize procurement from domestic production	Yes, to a limited degree	High	Proven	Requires more maize procurement from domestic production Needs research on farmers' maize marketing decisions

(continued)

**Table 1** (continued)

Option Number	Goal	Pros	Cons	Tried Before?	Political Acceptability	Administrative Feasibility	Open Issues
5	Increase extraction rate of subsidized flour	Better targets subsidy	One-time cost of reconfiguring flour mills Could slightly increase government costs by reducing the amount of bran it can sell separately	Yes	High	Proven	Determining extraction rate How to reconfigure mills
6	Introduce higher quality 82% subsidized loaf at price above 5 piasters	Improves self-targeting of 5-piaster loaf Reduces wastage Cost savings Creates option of eventually phasing out 5 piaster loaf	None	Yes, in transition from 1-2 piaster loaf and 2-5 piaster loaf	Neutral	Proven	Timing Whether to publicize
7	Target <i>baladi</i> bread subsidies to poor neighborhoods in poor	Better targets subsidy Cost savings	Politically sensitive? urban areas	Yes	Medium	Easy, if boundaries determined	How to determine where the boundaries are between can be and wealthy neighborhoods
8	Replace general bread subsidy system with targeted system, giving poor coupons, tokens, or plastic cards	Best way to target subsidy Cost savings Removes leakage at wholesale level Helps wheat market to function more efficiently	Politically sensitive Additional administrative costs	No	Low	Difficult	Many: costs, identifying poor, distributing coupons, how to reimburse bakers, etc.
9	Better regional allocation of subsidies so total benefits better reflect total poverty rates	Better targets to poor Can improve government popularity in areas that see increase in benefits rates				Depends on capacity of areas to receive higher benefits	Whether to add benefits or reallocate benefits How to increase capacity where it is weak
	a. Adding new benefits for governorates where benefits are much lower than poverty rates;		None		High		
	b. Reallocating benefits from governorates where benefits are much higher than poverty rates to those where they are much lower		Politically sensitive		Medium/low		



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