

# Developing Human Capital in Egypt through Energy Subsidy Reforms: Delivery Note

## Introduction

Like many emerging market economies, Egypt has struggled to keep pace with growing domestic demand for energy. After decades as an energy exporter, Egypt became an energy importer in 2014 due to rising domestic consumption among its fast-growing population of roughly 100 million (ESMAP 2019). Egypt has Africa's highest consumption of oil and natural gas despite being one of Africa's top producers of both fossil fuels (EIA 2018).

This energy market imbalance has made it harder for Egypt to achieve economic growth, energy security, and climate resilience. It has also made energy subsidies one of the heaviest burdens in Egypt's national budget, exacerbating its chronic deficit and crowding out social investment.

In 2013, spending on fuel and electricity subsidies comprised 21.9 percent of Egypt's budget expenditures and amounted to 6.0 percent of Egypt's GDP (Breisinger et al. 2019). In contrast, combined expenditures on health and education totaled only 5 percent of GDP (ESMAP 2019). To unlock the potential of its human capital, Egypt would require new funding sources for costly programs in areas like healthcare, social insurance, and education.<sup>1</sup>

Egypt's energy policies also had social, environmental, and economic costs. Egypt's subsidized gasoline prices were among the world's lowest in 2014, which encouraged waste and inefficiency, distorted local markets, and disproportionately benefited wealthier citizens who owned private vehicles (Fahim 2014). Severe power disruptions could be life-threatening in Egypt's summer heat and led to increased usage of wasteful private generators. Energy instability jeopardized Egypt's economic recovery after its 2011 uprising, which depressed tourism and other domestic markets (Khan and Miller 2016). The subsidies also discouraged private sector investment by obscuring the financial viability of public utilities (ESMAP 2019).

In 2014, Egyptian policymakers decided to tie energy reforms to new social programs, addressing all these issues together. Reforming wasteful energy subsidies would free up new funding for human capital development, while investing in human capital would make energy reform more politically palatable. New social programs would provide support to the poor and vulnerable citizens who were most acutely affected by subsidy cuts.

This plan had to be carefully managed to minimize potential risks. Like their regional peers, Egyptians who already struggled with difficult economic conditions staunchly resisted subsidy cuts (Sdravovich et al. 2014). In Jordan, for example, energy subsidy cuts in 2012 led to multiple days of heated protests.



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<sup>1</sup> Human capital can be defined as the knowledge, skills, and health that people accumulate throughout their lives, enabling them to realize their potential to become productive members of society. Investing in human capital increases productivity, economic growth, and progress toward the Sustainable Development Goals adopted by the United Nations General Assembly in 2015.

Nevertheless, the Egyptian government saw a window for reform, opened by a timely global downswing in energy prices. Loan facilities provided by the World Bank helped the Egyptian government manage this policy shift. The Egyptian government managed to reduce energy subsidies with minimal social disruption and to channel more investment into human capital sectors like health, education, and social protection. These policies supported macroeconomic stability while securing funding for popular new social programs that provided a crucial lifeline to citizens vulnerable to price fluctuations.

In tying subsidy cuts to human capital investments, Egypt demonstrated a “whole of government” approach that the World Bank’s Human Capital Project has found to be effective to overcome the challenges of human capital development. The three elements of this approach are: continuity (sustaining effort across political cycles), coordination (ensuring that sectoral programs and agencies work together), and evidence (expanding and using the evidence base to improve and update human capital strategies) (Human Capital Project 2019).

## Development Challenge:

To meet the challenges of its growing population and energy use, Egypt needed to redirect resources from wasteful, regressive, and environmentally unsustainable fuel subsidies to human capital development priorities.

## Delivery Challenges:

To mitigate the social impact of a cut to energy subsidies and free up new resources for investment in human capital development priorities, Egypt had to overcome three main delivery challenges:

- **Communications:** To cut subsidies without provoking major public backlash, Egypt had to manage public expectations and hear and address citizen concerns. Ensuring that vulnerable and marginalized populations could participate in new social programs also required public outreach.

- **Beneficiary Targeting:** Egypt had to design and create programs to pass cost savings from subsidy cuts to the neediest citizens, who were vulnerable to price increases for basic goods for which energy is a critical input, like food and transportation.

- **Financing:** Egypt had to develop sustainable funding mechanisms for new social programs without straining its tax base or expanding its deficit.

## Intervention:

In 2014, the Egyptian government developed a gradual, transparent plan to cut energy subsidies over five years, based on a comprehensive energy policy study as well as an analysis of mitigating social protection mechanisms. To facilitate the plan, the government developed public communications materials and modernized population information databases to better target social spending. The plan was later extended by three years to ease the transition.

In 2015, Egypt began a conditional cash transfer program entitled *Takaful w Karama* (“Solidarity and Dignity”). The *Takaful* program provides income support to households with children below the age of 18 who meet certain conditions related to education and healthcare, such as regular school attendance and periodic health check-ups. The *Karama* program provides unconditional cash transfers to vulnerable beneficiary populations including the elderly poor, orphans, and people with severe disabilities. These twin programs provide a safety net for citizens in need while making beneficiaries co-partners in human capital investment.

## Addressing Delivery Challenges:

### Communications

The Egyptian government did not want citizens to feel surprised or misled by subsidy reductions, or to feel unsure of how funds were reallocated. Thus, the government emphasized transparency from the start. In a series of decrees, the Egyptian Cabinet specified a gradual increase over five years in the selling price of electricity, as well as increases in prices for solar power and other fuel types like gasoline, natural gas, and kerosene.

With help from the World Bank’s Energy Sector Management Assistance Program (ESMAP), Egypt developed a comprehensive communications strategy to manage public expectations. Based on stakeholder analysis, the communications fully explained the necessity of reform and contributed to positive public narratives about the necessity and purpose of the reforms (ESMAP 2019).

The communication campaign covered a range of media, including video clips for social media, radio and television advertisements, and roadside billboards. Different materials were targeted to different population segments. For example, a message like “I am against wasteful subsidies, I am for improvement and development” could be deployed in channels popular among educated workers, while a message like “Targeting the subsidies in the right way equals good education” might appeal more to parents of young children.

Altogether, these messages reinforced the connection between potentially unpopular subsidy cuts and desirable social programs in public opinion and media discourses.

## Beneficiary Targeting

Under the *Takaful* program, Egypt targeted conditional cash transfers to young families who met conditions beneficial to human capital development, like immunization, clinical visits, and regular school attendance. These programs provided a dignified way for young families to take a greater role in improving healthcare and educational outcomes and ensuring maternal and child health and wellbeing. They also facilitated periodic monitoring and recordkeeping by medical and educational personnel.

In contrast, Karama cash transfers to vulnerable populations like the elderly poor and people with disabilities were unconditional. They were intended to support those with limited capacity to cope with price increases for basic goods. Unlike past support programs for people with disabilities that assessed eligibility using a purely medical approach, Karama based eligibility on a more rights-based model called ‘functional disability assessment’.

## Financing

Egyptian energy sector reforms and social programming drew on a mix of financial sources including international support, private sector financing, and public-private partnerships.

The government took complementary efforts to restructure the electricity sector and promote private sector investment in renewable energy to put competing providers on more equal footing and incentivize investments in energy efficiency. These efforts helped jumpstart solar and wind energy production, newly competitive as international oil prices rose (ESMAP 2019). Promoting energy efficiency and renewable energy production would help Egypt meet its goals for climate resilience and climate change mitigation.<sup>2</sup>

Regulatory reforms in the energy sector encouraged private sector investment, particularly in renewable energy. The government introduced new renewable energy laws and established regulations for competitive bidding for independent power producers (ESMAP 2019).

## Outcomes:

Energy subsidies composed 28 percent of the budget deficit in 2017, down from 57 percent six years earlier, reducing the burden of all subsidies from 90 percent of the deficit to 76 percent, even as the share of other subsidies remained constant. Energy subsidies dropped from 6.5 percent of Egypt’s GDP in 2014 to 3.4 percent in 2018 and merely 0.3 percent by 2020. This decline exceeded the savings from the global dip in energy prices and persisted after energy prices rose again.

The effects of Egypt’s economic reform program, especially on the poor, including the gradual energy subsidy removal, did not spark social unrest or public outcry, unlike previous attempts to cut food subsidies, which faced vocal resistance and public discontent.

More resources went to health and education as energy subsidies decreased. Public spending doubled in the health sector and rose 30 percent in the education sector by 2019, although their shares of expenditures did not increase relative to total public expenditures or to Egypt’s GDP.

<sup>2</sup> Egypt is currently not a major contributor to global emissions but is extremely vulnerable to climate change. For more, see Objective 5 under Egypt Vision 2030, available at: <https://mped.gov.eg/EgyptVision?lang=en>.

Public opinion surveys by the Egyptian Center for Public Opinion Research (Baseera) found highly positive public perceptions of subsidized services in energy and transportation, rising from 2017-2019 as blackouts and fuel shortages decreased. Public satisfaction with electricity services rose by 12.5 percentage points to 83.6 percent, while it rose roughly ten percentage points for satisfaction about fuel and transportation (to 84.7 percent and 71.6 percent respectively). Although public opinion of public services related to education and health was less favorable, perceptions rose by more than ten percentage points on both issues.

Altogether, *Takaful w Karama* has reached roughly 3.4 million households encompassing 12 million individuals, 75% of whom are women. Roughly two-thirds of program funds have been disbursed in the economically distressed region of Upper Egypt.

An independent evaluation of the *Takaful w Karama* program found that it had positively impacted the consumption of beneficiary households, increasing their consumption by 8.4% compared with non-beneficiary households, despite rising prices (IFPRI 2018). The evaluation found beneficiary households increased spending on nutrition, school supplies, and transportation to school, resulting in lower rates of youth stunting and wasting. The evaluation found 68 percent of program beneficiaries to be very satisfied with the program, with an additional 21 percent somewhat satisfied. While the evaluation found the program to perform well in international comparison on measures of increased consumption and participant satisfaction, it had only a minor impact on poverty alleviation.

Information collected for the *Takaful w Karama* program database proved useful to launch other “cash plus” interventions, many of which promote human capital accumulation. Examples include: FORSA (to build self-reliance); Two is Enough (to encourage family planning); First 1000 days (for early childhood development); and No Illiteracy with Takaful (to incentivize literacy).

Beside *Takaful w Karama*, new social spending by the Egyptian government also included programs for housing and sanitation, as well as technical training and job opportunities for young people and persons with disabilities.

## Lessons Learned:

### **Clear, transparent, value-driven communications encouraged positive perceptions of reform.**

Anticipating public concerns over energy subsidy cuts, the Egyptian Government conducted a targeted public communications campaign across multiple channels to explain the necessity of reform, link subsidy cuts to public benefits, and appeal to civic values like fairness and shared responsibility for national development. These messages alerted citizens to the change and gave them time to adjust. They also explained its positive impacts, so that citizens were less likely to feel the loss of an entitlement.

### **Opportunistic timing of reforms helped ease the pain of transition.**

With international support, the Egyptian Government rapidly responded to a transient global drop in energy prices to cut subsidies at a time when prices were relatively low. Seizing this window of opportunity made costs more manageable for most citizens, while cash transfer programs supported the poorest and most vulnerable, who were most negatively affected by price increases. Increased social spending made possible by energy subsidy cuts built political will for future reforms. Liberalizing energy markets also encouraged investment in energy efficiency and renewable energy.

### **Combining conditional and unconditional cash transfer programs can serve a range of beneficiaries.**

Egypt’s *Takaful w Karama* program provides both conditional cash transfers to low-income families with children and unconditional cash transfers to the elderly poor, orphans, and people with severe disabilities. The conditional transfers incentivize beneficiary families to invest in their children’s education and healthcare, augmented through additional programs promoting literacy, family planning, and other socially beneficial outcomes. Meanwhile, unconditional transfers provide a social safety net for vulnerable and marginalized citizens. Cash transfer programs were accompanied by new public investment in housing, sanitation, job training, and other sectors.

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