منصة العدالة الاجتماعية
Social Justice Platform

The Price of Deficit

Analysis of the 20182019/ Budget

Written by

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When we embark on analyzing and commenting on the government's policies, we find out only a sense of repetition with each new budget proposal. Every year, the budget comes with more severe and harsh austerity measures, and this year's budget is no different from its predecessor, except in the magnitude of its austerity. The proposed budget for the fiscal year 2018/2019 came under a package of the harshest austerity measures in the country. Perhaps the most important measure is the hike of Cairo metro fares- a means of transportation on which 5.7 million citizens depend daily to traverse Cairo[1]- by between 200 and 600% in the past three months. The latest hike in metro fares was followed by announcing a new increase in electricity prices, starting from the new fiscal year. This increase ranges between 10 piasters per kWh for the highest segment, an increase of 7.4%, and 9 piasters for the lowest segment with an increase of 69.2%[2]. Then, the final blow came by announcing the hike in fuel prices within the penultimate phase of the government's program to completely lift subsidies on fuel, which is expected to be completed in full next year in accordance with the requirements of the International Monetary Fund (IMF). All of these increases and austerity measures came at the heels of one of the country's biggest inflation trends, if not the largest; whereas the inflation had been hovering at more than 20% for a full year; during seven months of which, the inflation rate exceeded 30%. As all these austerity resolutions came in order to reduce the budget deficit and fiscal discipline[3], which adopt reducing the deficit and inflation as the government's most important economic duties, we have to raise two questions. First, if the primary objective of this austerity is to achieve these two goals, has the government considered the inflationary effects of these price hikes? We can imagine that this increase in prices and necessities of life will not be translated immediately into higher inflation - which the government brags about reducing it to 13%[4].

The second and most important question is: Does the government realize what its purpose from those policies is? The main aim of reducing the deficit, even for the followers of neo-classical economics[5], is that the government reduces the basic financial burden on citizens to encourage consumer and investment spending, but when the attempt to reduce the deficit does quite the opposite, so, does the deficit reduction have a value? However, we, here, do not mean that the high deficit is not a problem, but what we mean is that the deficit reduction is a means to an end. If the means yields counterproductive results, then we must reconsider for a moment what we do.

In the coming lines, we will analyze some aspects of the financial statement to provide everyone interested in the Egyptian economic affairs with a simplified elaboration of the most important financial and social policies of the Egyptian government for the fiscal year 2018/2019, and its impact on the ordinary citizen in his daily life.

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[1] http://cairometro.gov.eg/uipages/Statistics.aspx

[2] Based on the stated figures in the ministerial resolution no. 57 of 2018 issued by the Ministry of Electricity and Renewable Energy.

[3] Fiscal Discipline

[4] Page no. 27 of the financial statement 2018\2019

[5] Regardless of our disagreement with its theoretical assumptions and applications

Most Highlighted Features of the Financial Statement for FY 2018/2019

The statement reflects the government's vision of the Egyptian economy eloquently. It repeatedly praises the financial reforms of the government, pushing aside the hard price paid by the citizen for the deficit indicators progress. Hence, the reader finds the financial statement closer to a shareholder's financial statement than a statement of a state's budget that has obligations to its citizens. Instead of increasing the public sector wages and stimulating the private sector wages to cushion the effects of a spike in inflation that has made Egyptians' purchasing power eroding by more than 50 percent[6] since the exchange rate was liberalized, the Finance Ministry boasts about successfully containing the wages bill this year, continuing a real downturn over the past three years, at the time that debt services continue to rise, remaining at the top of expenditure items.

As for the risks facing this economic program, the government continued in the same line as last year in its financial statement by singling out the external risks of the UK's exit from the EU, the risks of the EU debt burden, the rise in interest rates in the United States and the possibility of adopting protectionist or austerity policies in the countries mentioned above. We do not say that these factors do not pose a risk to the Egyptian economy. However, singling out these factors indicates that the government clears itself of any negative impact on the Egyptian economy. Also, we witness the absence of discussing the government's precautions to confront these obstacles or any alternative plans for maneuvering these global circumstances.

It is important, when we read this report, to bear in mind the distinction between the approved budget for the FY 2017/2018 and the expected revisions to it that were mentioned in the financial statement for 2018-2019; whereas the available revised forecasts were taken into account whenever possible, in our attempt to present the closest image of reality. The following is a comparison of the most important items and indicators expected for the FY 2017-2018 budget as reflected in the financial statement for the FY 2018-2019.

First: Functional Classification of Expenditures[7]

The budget is functionally classified into 10 sectors covering the arms of government spending, and the public services sector that includes the Executive and Legislative bodies beside the public services topped them with the highest government spending rate; whereas this sector's budget is greater than 674 billion in the draft budget,

[6] Based on the general figures of inflation issued by the Central Bank of Egypt.

[7] To calculate the real growth, the general figure of consumer prices in April 2018 is used. The annual figure is from the Central Bank's website; it is 13.124%.

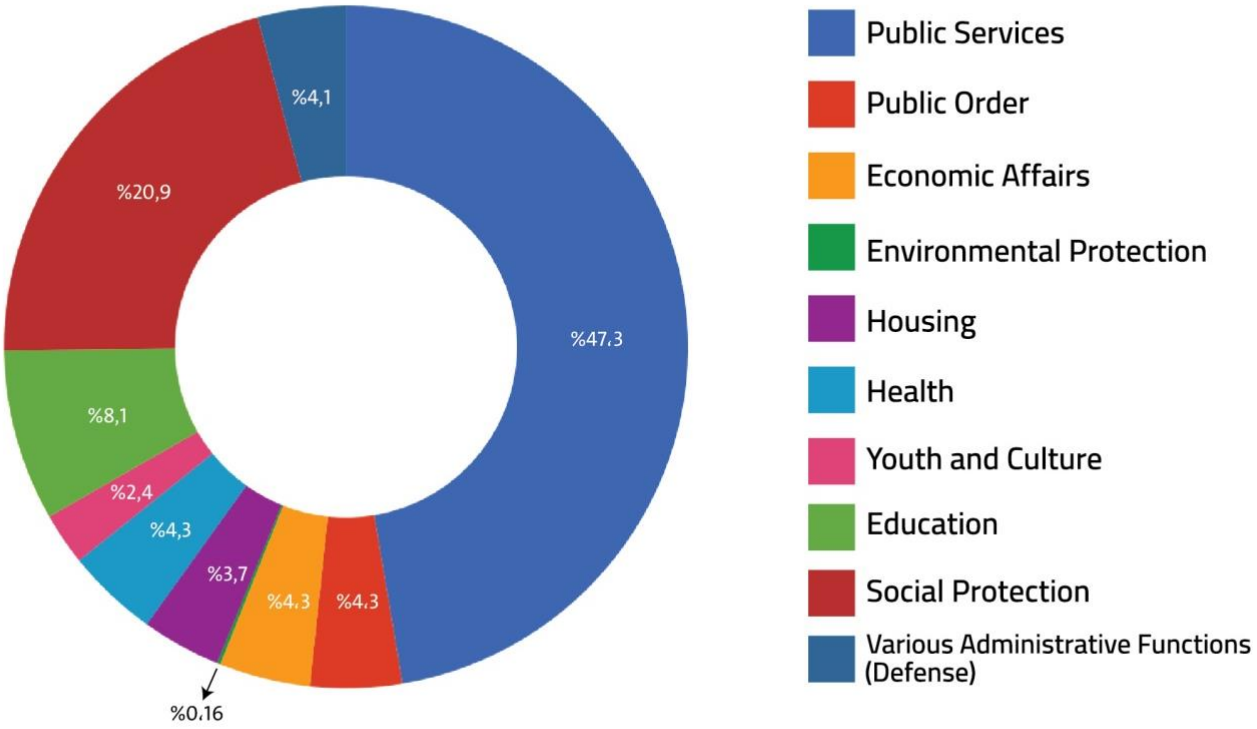
accounting for 47.36% of the budget; a huge increase from last year's 40% only. The importance of the sector was not only reflected in its relative importance in the functional classification, but also it recorded nominal growth[8] of over 36.5% and real growth of 20.65%.

In 6 constituting sections- out of 10- the functional classification witnessed a real contraction ranging between 0.51% in health sector to more than 12% in social protection and support sector. This general contraction showcases the government's austerity policies and recent decisions to lift subsidies. With regard to the four sectors that witnessed a real increase (economic affairs, youth and culture, defense, and public services), they witnessed very uneven growth rates: while the economic affairs, youth and culture, and defense recorded real growth rates of 0.84%, 0.55%, and 1.18% respectively, the public services sector increased by more than 20.65%, to be the main propellant for growth in the expenditure bill according to the functional classification, estimated at 17.97% nominal rates, compared to 4.28% actual rates.

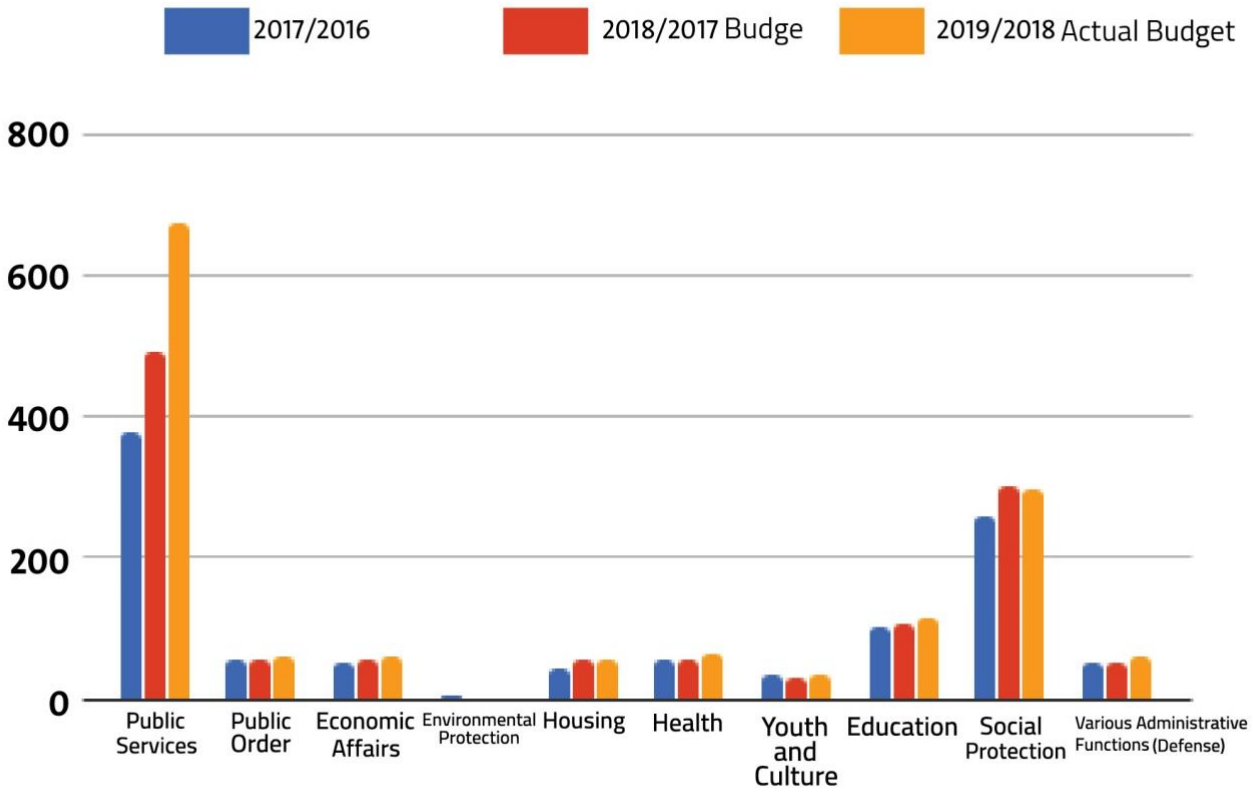
One of the significant changes mentioned in the financial statement without explanation is the adjustment of the expected allocations to farmers subsidies in the fiscal year 2017/2018 to only EGP 65 million, out of EGP 1.65 billion approved in the budget of the same year, representing a decrease of over 93.9% than what is allocated in the budget. Astonishingly, the allocations expected for the health insurance subsidy for last year is "zero" out of EGP 2 billion that were allocated in the budget. Has this allocation been transferred to another item, without explanation? Or has the government decided to cut spending on the basic rights of the poorest and the neediest citizens?

[8] The nominal growth is growth without calculating the inflation effect. It does not reflect the purchasing power of growth and contraction on the quality of services provision, compared to the previous year.

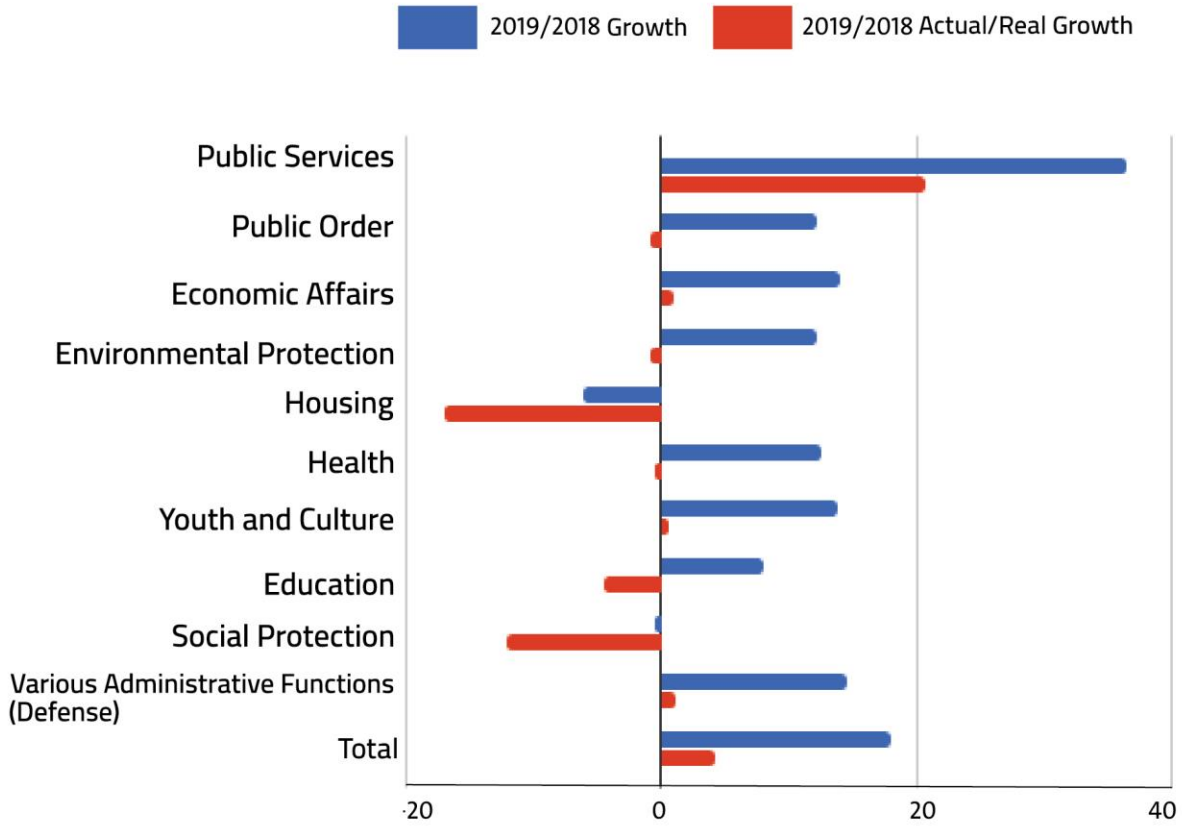
Draft Budget 2018\19 in the Functional Classification



A comparison between the actual budget and the expected budget 2018\2019- functional



A comparison between the percentage of growth in
the approved and actual budgets 2018\2019 - functional classification



Second: Economic Classification of Expenditures[9]

The economic classification presents expenditures in terms of their economic objective. The economic classification is organized into eight major chapters, they are: 1. Wages and compensation of employees. 2. Purchase of goods and services. 3. Interest. 4. Subsidies, grants, and social benefits. 5. Other expenditures. 6. Purchase of nonfinancial assets (investments). 7. Acquisition of financial assets. 8. Loans repayment.

The first 6 chapters are grouped under the name of "expenditures", which will be discussed in this section. If we measure the changes in the economic classification of the draft budget, we will find out the total expenditures increased by 15.36% than the previous year to reach EGP 1424.02 billion, compared to 1234.41 expected for FY 2017-2018, and by taking into account the inflation, it has sustained a growth of 1.98%.

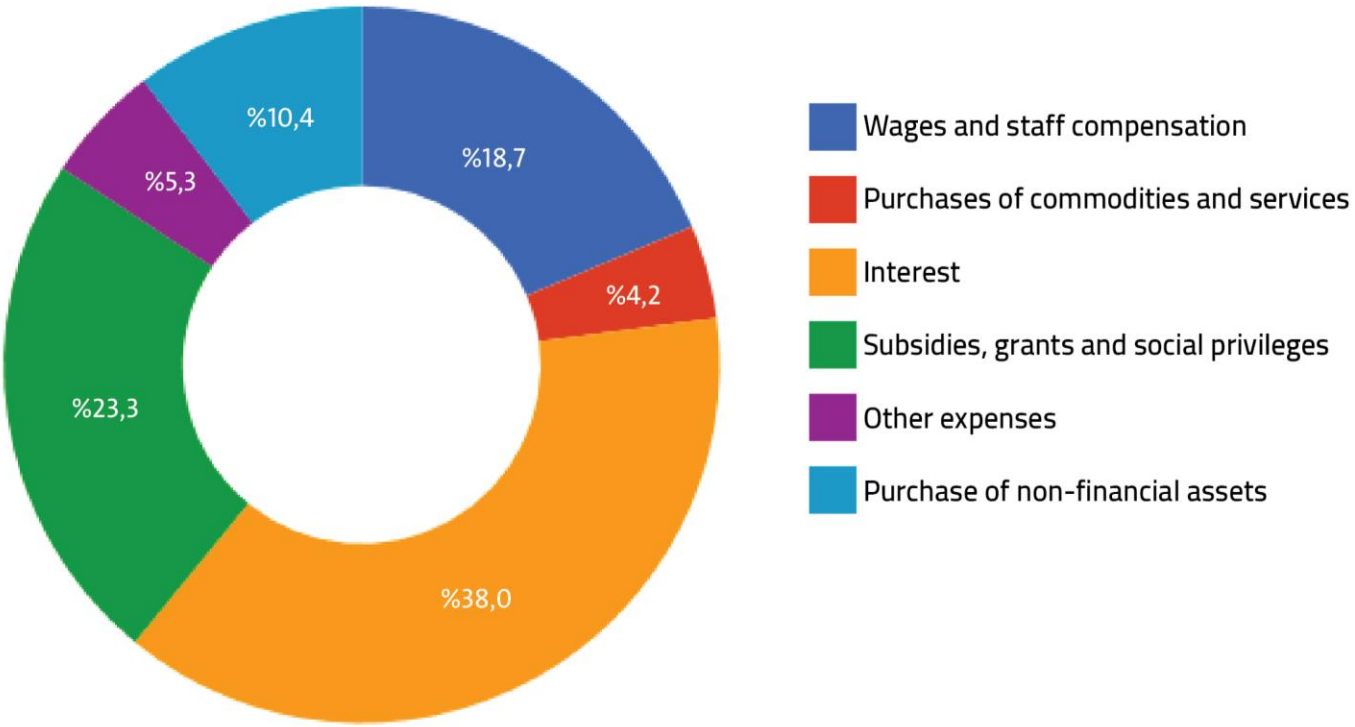
The largest increase is in the nonfinancial assets item for the third year in a row. This item increased from EGP 111.32 billion last year to EGP 148.51 billion in the proposed budget, an increase of more than 33.41%, achieving a real growth rate in the government spending on investments; exceeding 17.93%; in continuation of the government's focus on investments it has undertaken since two years.

As for the largest item, it is interest, which eats up nearly 38% of expenditures, going up by more than 23.61% and attaining a real growth of nearly 9.27%, after it recorded a temporary real contraction last year. The majority of this increase comes from the interest on the treasury bills and bonds of the Central Bank, which- together- witnessed increases of more than EGP 92.8 billion and EGP 42.1 respectively to form more than 58.3% of total interest paid; about EGP 315 billion. This accelerating rise is the result of government resolutions to raise the interest rate, which leads the government to pay- even if from the public money - the price of the failure to manage the inflation crisis.

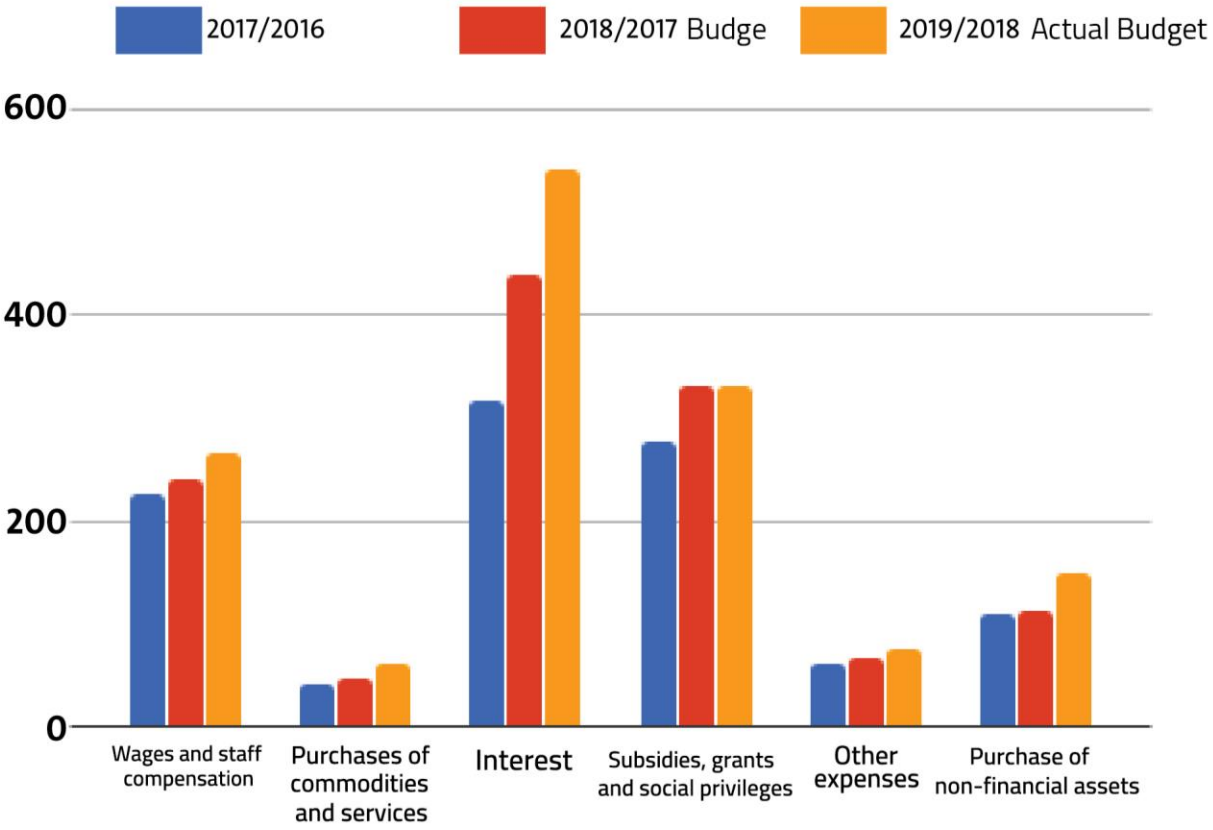
Noteworthy, the rise of interest on debt[10] ate up more than 73.92% of the increase in total expenditures this year. This sudden increase came after a temporary drop last year, whereas the interest ate up almost 38.3% of the last year increase, 67.77% in the penultimate year, and 59.93% in FY 2015\2016[11]. It is a completely expected increase under the maturity of the new debt as well as the rise of interest rates; even the progress- even if it is slight- that we achieved to reducing the debt burden went with the wind.

[9] When referring to the FY 2017-2018 in this chapter, the reference is to the forecast mentioned in the financial statement and not in the approved budget for the same year.
[10] When the debt is mentioned unspecified (external/internal), we mean the total debt, internally and externally.
[11] These estimates are calculated on the basis of budget linkage figures for each year.

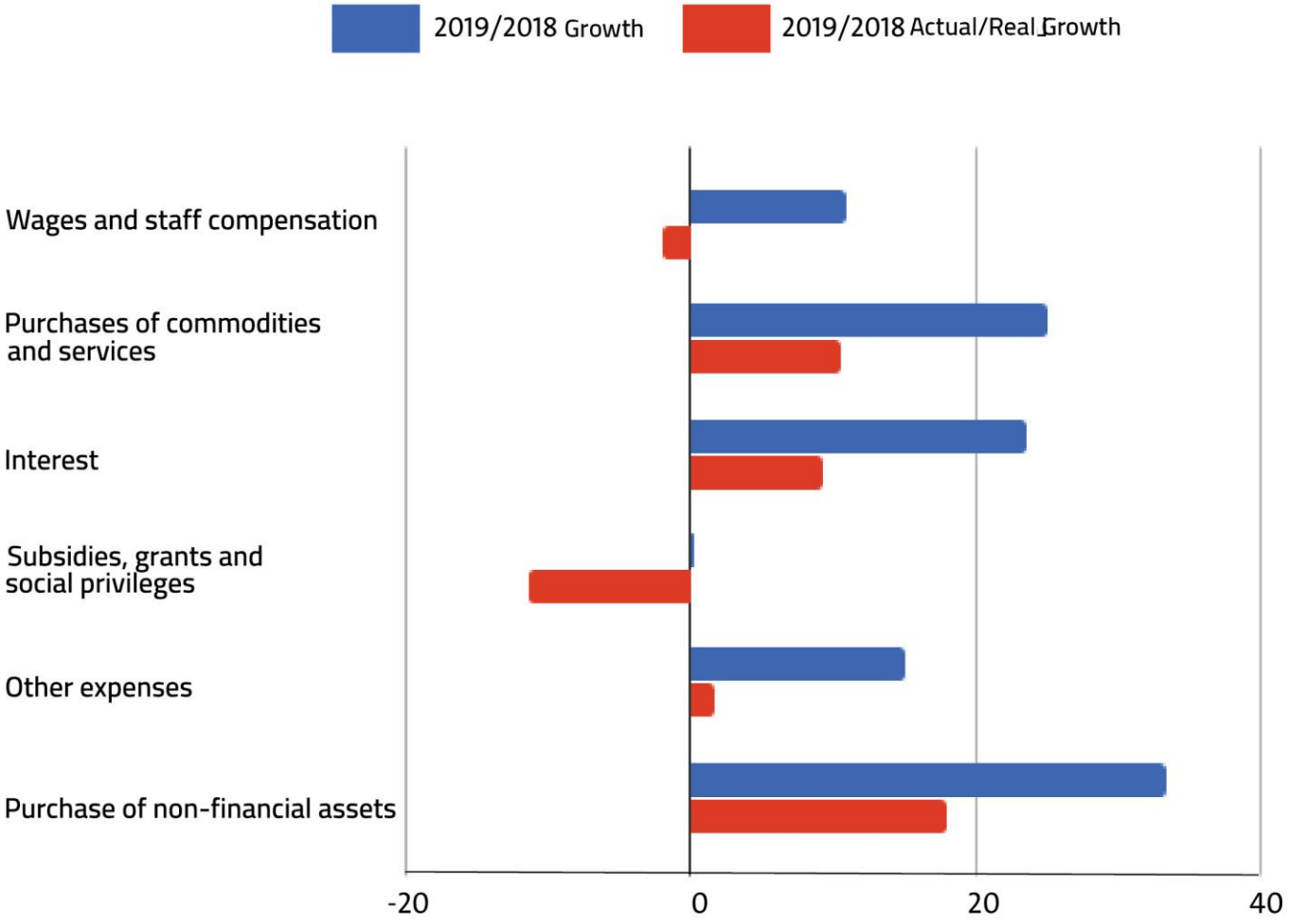
Expenditures in the draft budget 2018\2019 - the economic classification



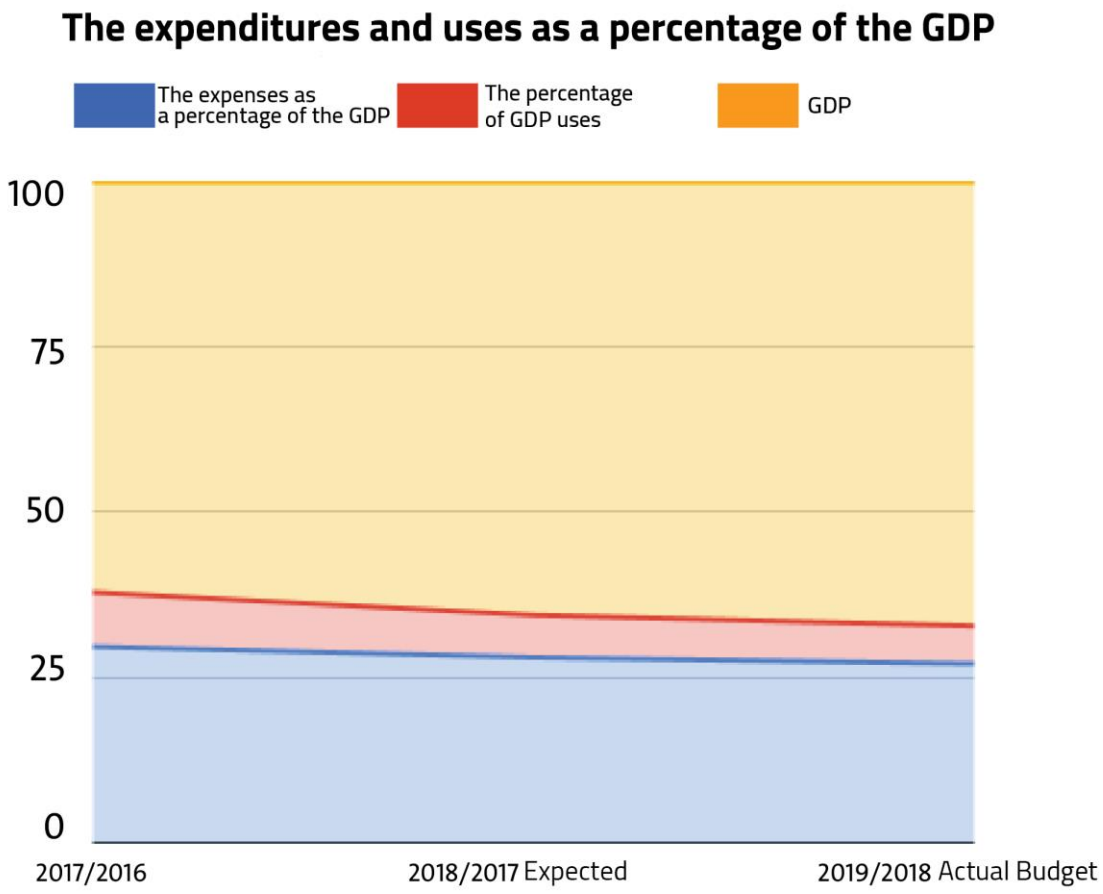
Expenditures from the 2017\18 budget to the 2018\19 draft budget- economic



The percentage of expected growth in 2018\19 versus the real growth



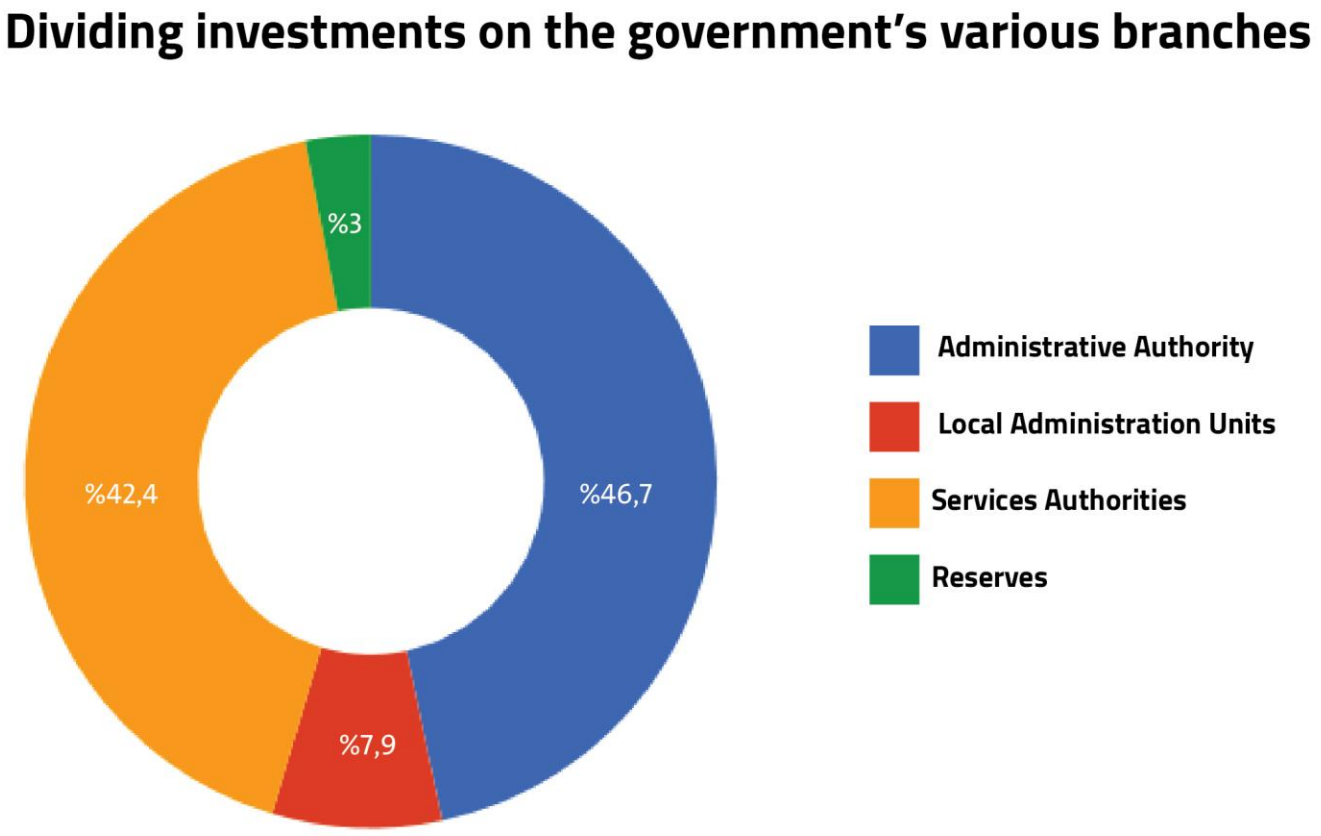
In regards to wages, they went up by EGP 26.1 billion to reach 266.09 billion Egyptian pounds, an increase of 10.89%, but after adjusting for inflation, we find that the wages bill has recorded a real contraction of 1.98%. This contraction comes in the aftermath of the last year contraction of 18.19%, perpetuating the large decrease in the purchasing power of the state institutions' workers[12], which pushed some of them under the poverty line, reinforcing the reasons for the economic recession, weakening the consumption capacity of one of the largest consumptive segments in Egypt. The subsidy section hit the least increase- less than EGP 0.9 billion- recording a nominal rise of 0.27%, and the largest real contraction this year of more than 11.36%. The fall-off in subsidies and wages comes as a continuation of the government's policy of narrowing the deficit at the expense of wages and subsidies under the governmentally-adopted neoliberal policies, and to which it is committed to in exchange for a rescue package of international financial institutions so as to reduce the actual government spending by not keeping pace with inflation, and focusing on the nominal value of allocations instead of their actual capacity to meet the desired services.



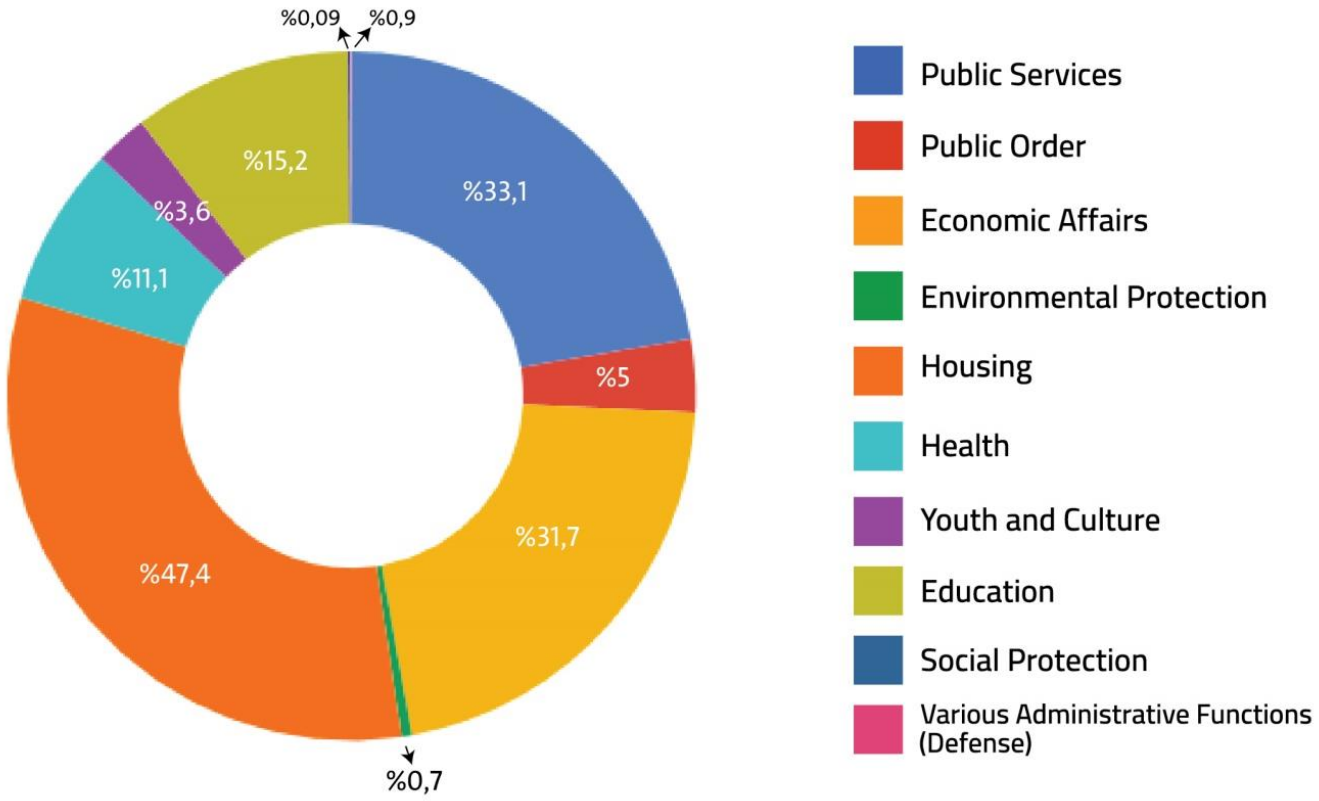
[12] Noteworthy, the employees in the public and public business sectors receives wages higher than their counterparts in the private sector by more than 60%.

Purchase of Nonfinancial Assets (Investments):

Starting 2 years ago, the government continued its plan of financing investments in the fixed assets, which is one of the few policies in the budget that received wide acclaim from different factions for its role in stimulating the economic growth and improving the dilapidated infrastructure across the republic. The new budget, however, has not brought in any radical changes, as the allocations distributed on the various functional sectors by following the same pattern of last year. The vast increase in investment allocations is surprising, whereas we found that the revised figures in this statement showing the actual spending on investments is lower than what was allocated in the previous year budget by over EGP 24 billion. Such a pattern was repeated in the last two years, where the government did not spend EGP 16 billion. Nevertheless, the current statement has not elaborated why the government retreated from spending these allocations, and will their fate be the same of the current year allocations increase?



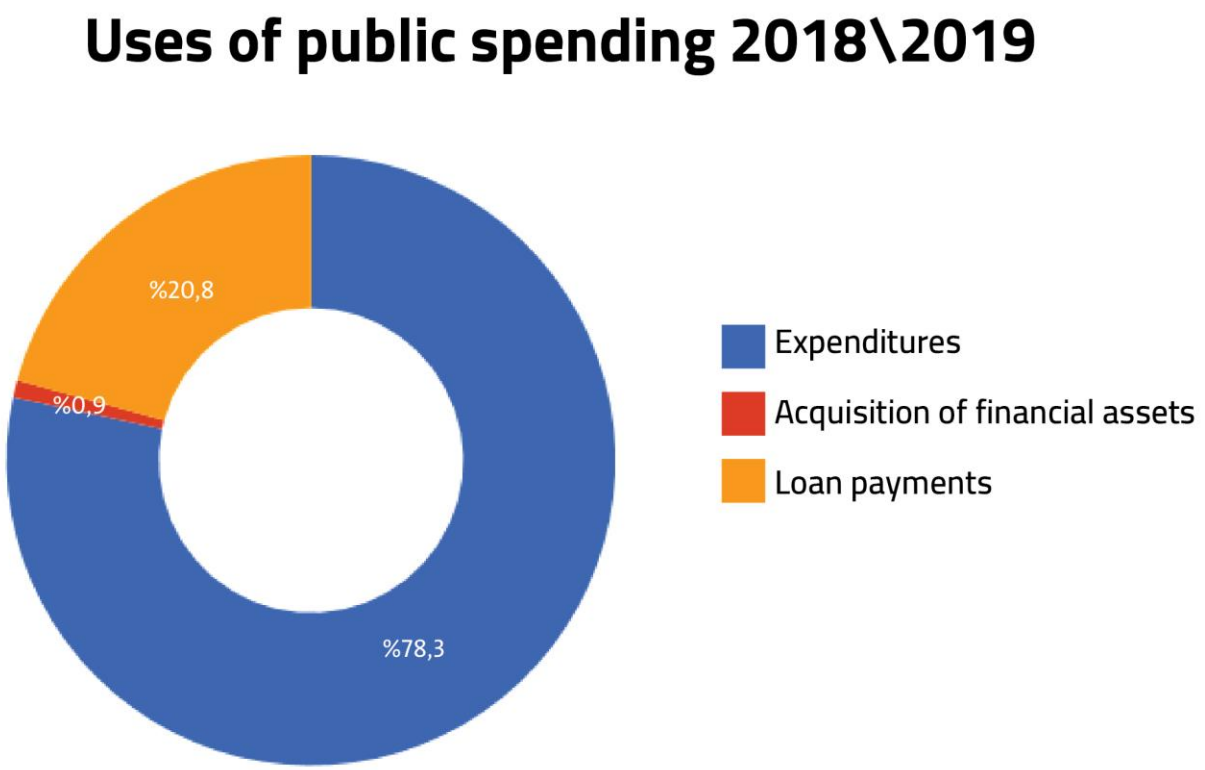
Investments in the functional classification



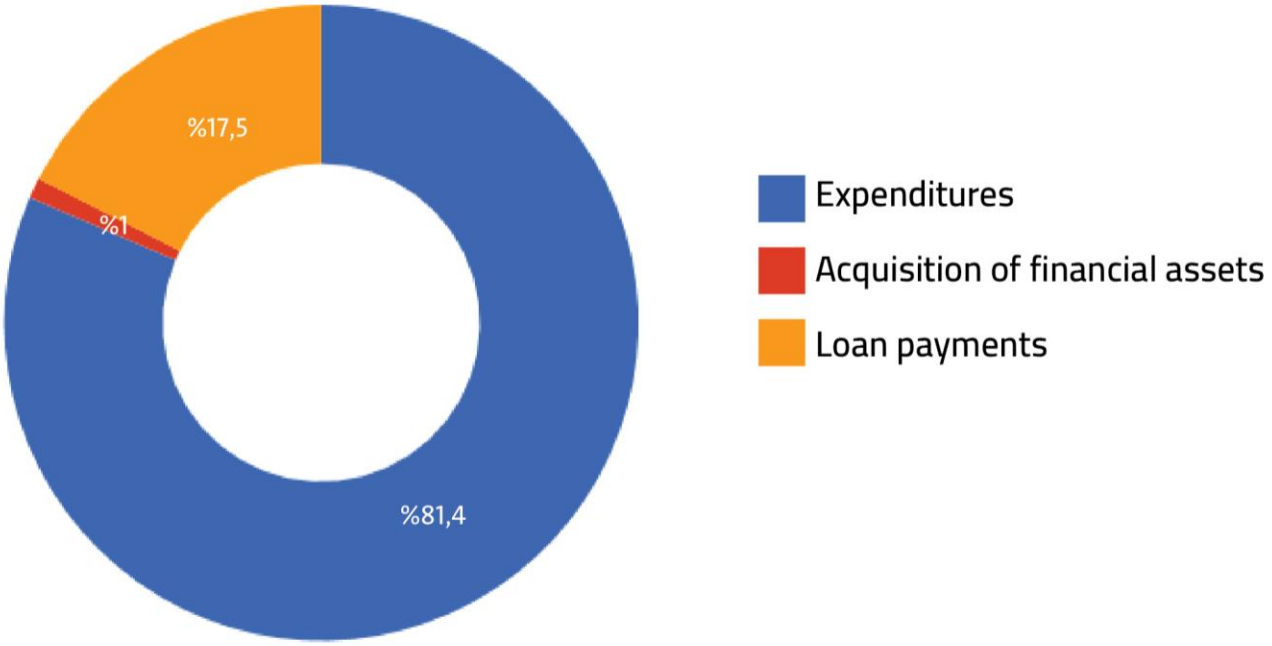
Third: General Picture of Uses

After taking the most important points of the expenditure items and their change ups, we must point out that expenditures alone do not cover the entire government spending, as they do not include two items: acquisition of financial assets and loans repayment. The loans repayment is the third largest budget item overall, with an estimated value exceeding EGP 276.04 billion; an increase of about EGP 11 billion than what was expected for the last year. After calculating the inflation effects, this section witnesses a real contraction of about 8.05%.

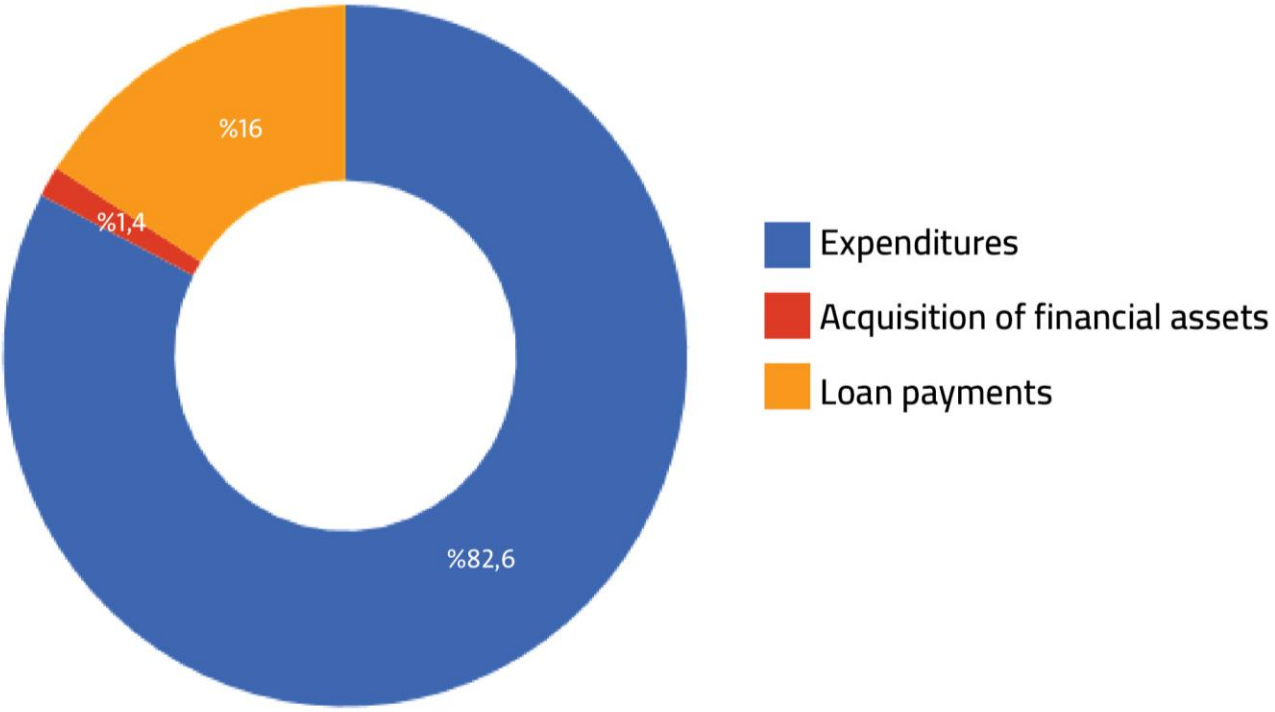
Both of debt services items represented in interest and loans repayment- together- constitute 57.4% of total government spending, compared to 43.44% last year. This is a catastrophic percentage that reflects the worsening debt crisis that uses up the government resources' day by day. This rapid rise in the debt services items comes as a consequence of the maturity of many loans that the country received throughout the past years and the necessity of paying them and their interest back. This rise in the debt services' payments menaces the country's economic growth and negatively affects the government policies as it becomes debt-dependent; in addition to threatening the stability of its entire economy. Consequently, it makes the economy more vulnerable to crises.



Uses of expected public spending 2018\2019

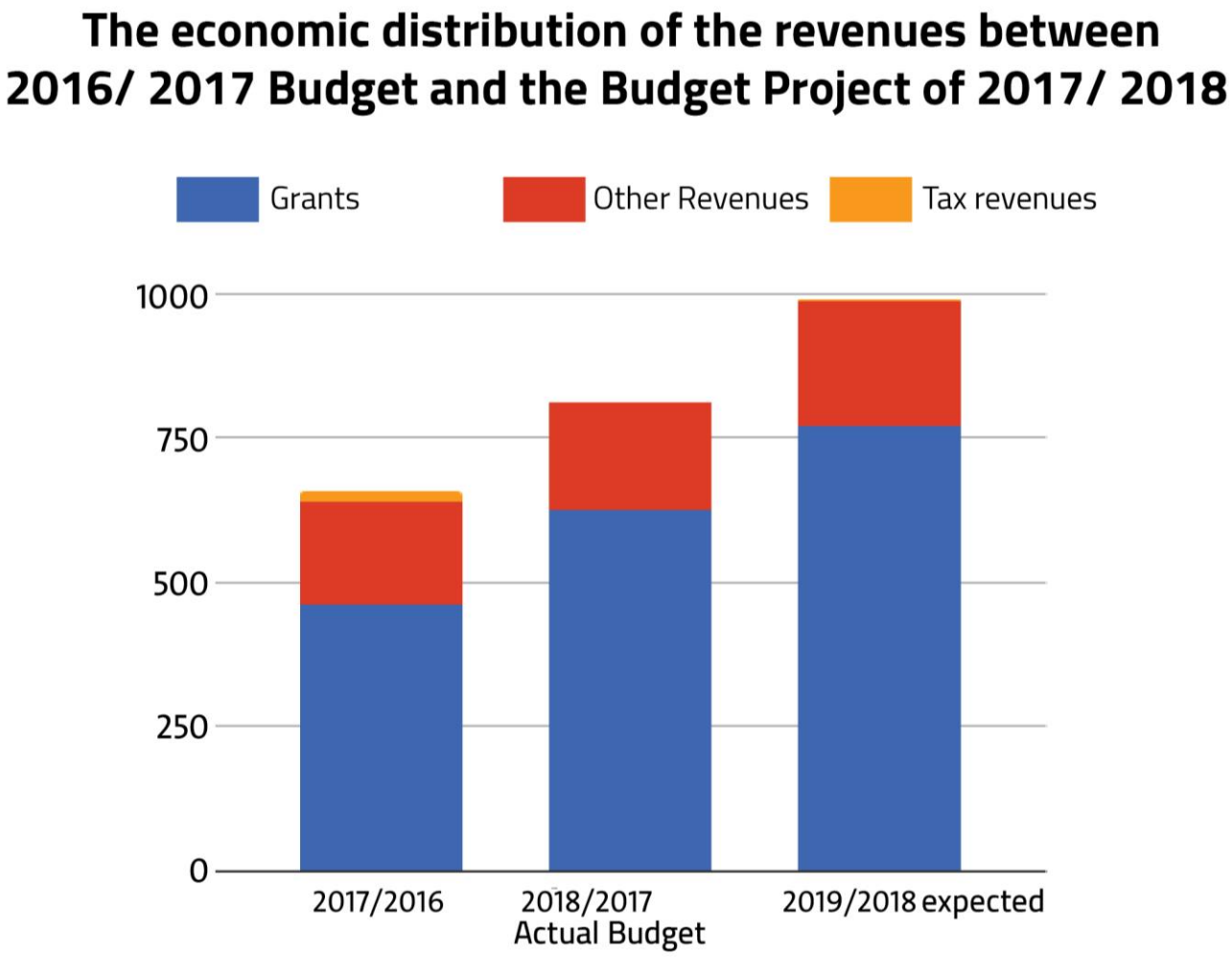


Uses of public spending in the draft budget 2018\2019



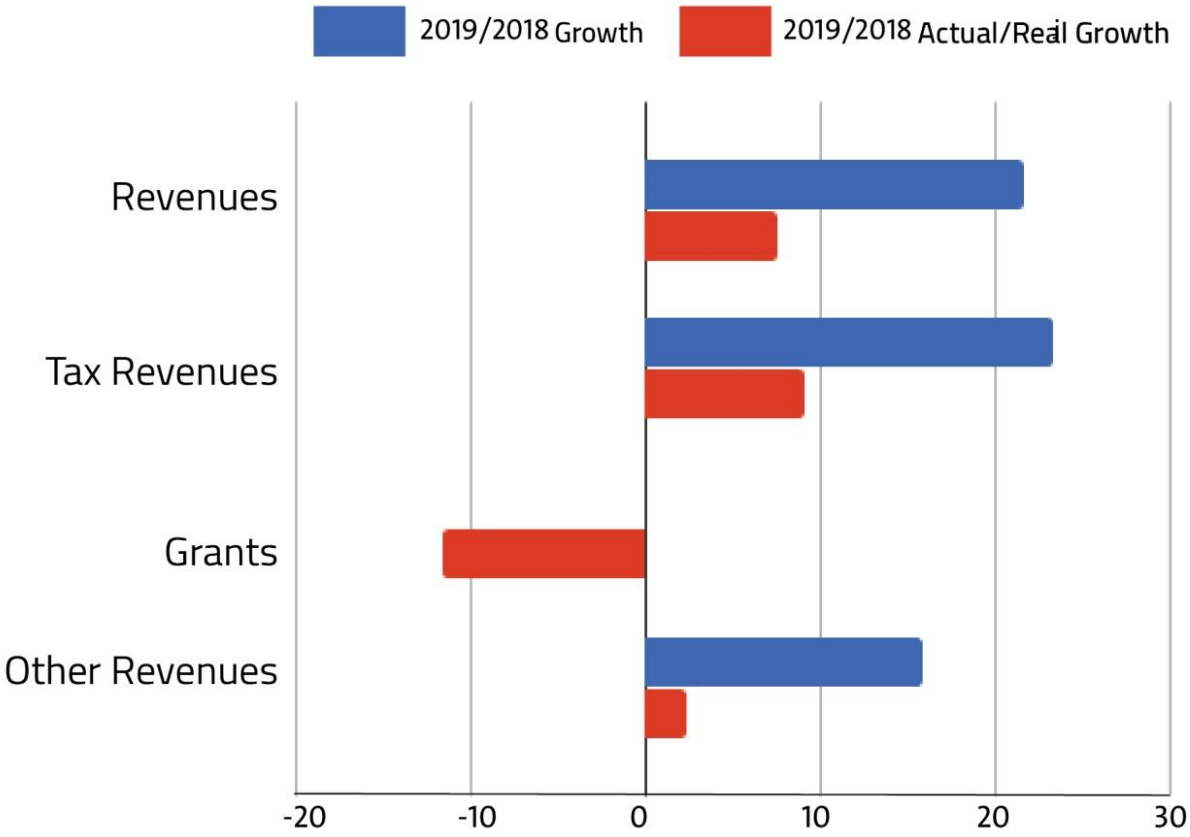
Fourth: Economic Classification of Revenues[13]

The revenues in the 2018-2019 draft budget amounted to EGP 989.19 billion, an increase of over EGP 175 billion than the expected amount last year that reached EGP 813 billion, representing a growth rate of 21.61%, and a 7.5% real growth.



[13] When referring to FY 2017-2018 in this chapter, the reference is to the forecast mentioned in the financial statement and not in the approved budget for the same year, unless otherwise stated.

A comparison between the rates of growth and the real growth for revenues in 2018\2019



Tax Revenue:

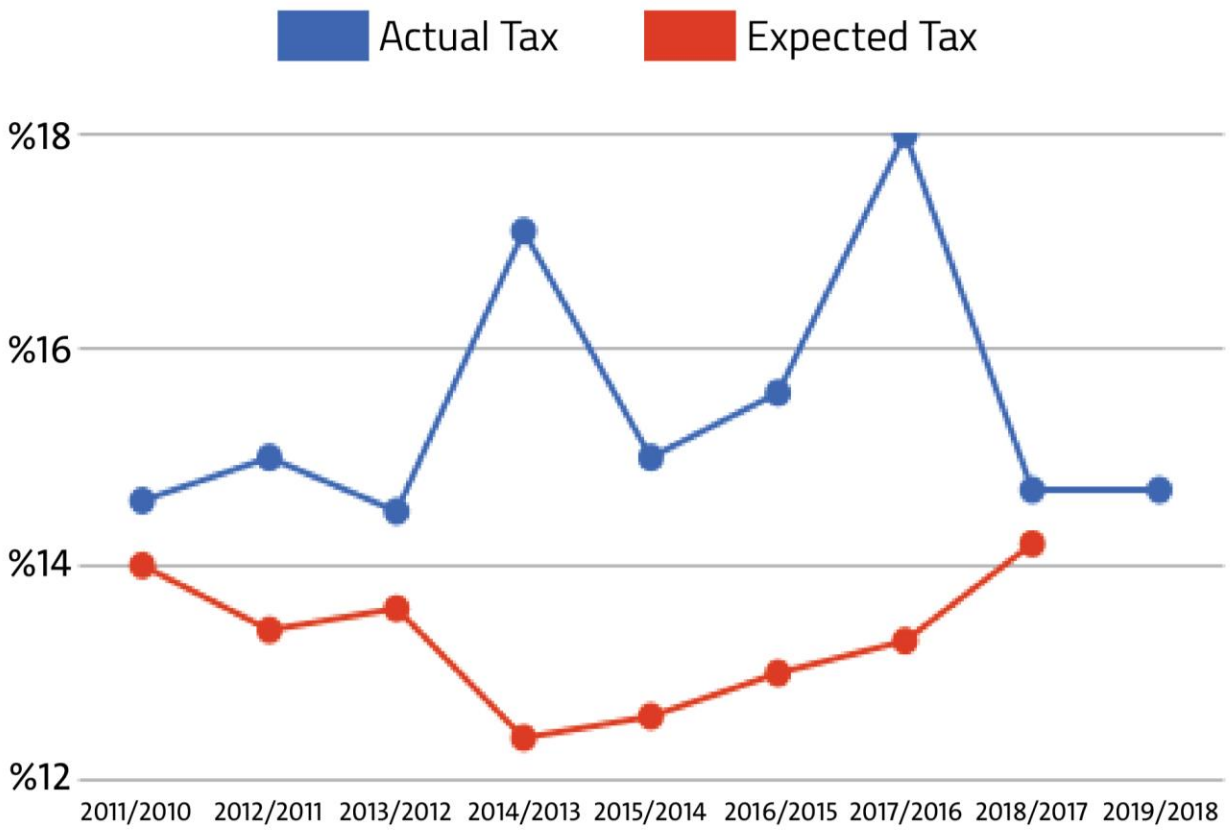
More than 72.36% of this increase is from tax revenues, which witnessed a rise of EGP145.08 billion (23.4%). This increase, however, shrinks after the impact of inflation, recording a real growth of 9.09%. .

More than the half of this increase is from the indirect taxes section after imposing VAT, value-added tax, which increased by 1% in the last fiscal year to reach 14%. It is a regressive levy that contradicts the principles of tax justice for its disproportionate burden on poorer consumers. In addition, it is a consumption tax that contributed to the inflation crisis, although the government has repeatedly promised that it will stave off this effect. Also, the expansion of consumption tax has a negative effect on consumption indicators; weakening the purchasing power of the citizen; and consequently, it weakens the economic growth in the final personal consumption-driven economies, such as Egypt. Hence, the country loses what it has gained. Moreover, the tax imposed on the treasury bills and bonds' returns increased by EGP 20 billion to hit EGP 59.57 billion. Among the promising signs in the statement is the increase of corporate tax to EGP 86.89 billion, from EGP 65.17 billion last year; it is a nominal growth of 33.33%, and reaches 17.86% after calculating the inflation rates.

It is also commendable that the Egyptian government, for the first time in nine years, has successfully collected the tax expected for the past year; whereas the government usually fails to meet its tax targets. We hope that the government continues its efforts. The biggest remaining problem is the very low tax effort[14] in Egypt. Despite its increase to 14.7%, it is still very low compared to the rest of the countries, even those in the classification of the low middle-income countries to which Egypt belongs, where the average is 26.4%.

[14] The tax effort is the ratio of the tax collected in the GDP by the state during the fiscal year. It is an important indicator showcases the ability and efficiency of the government's tax collection as well as its reliance on the internal resources to finance the needs of the state.

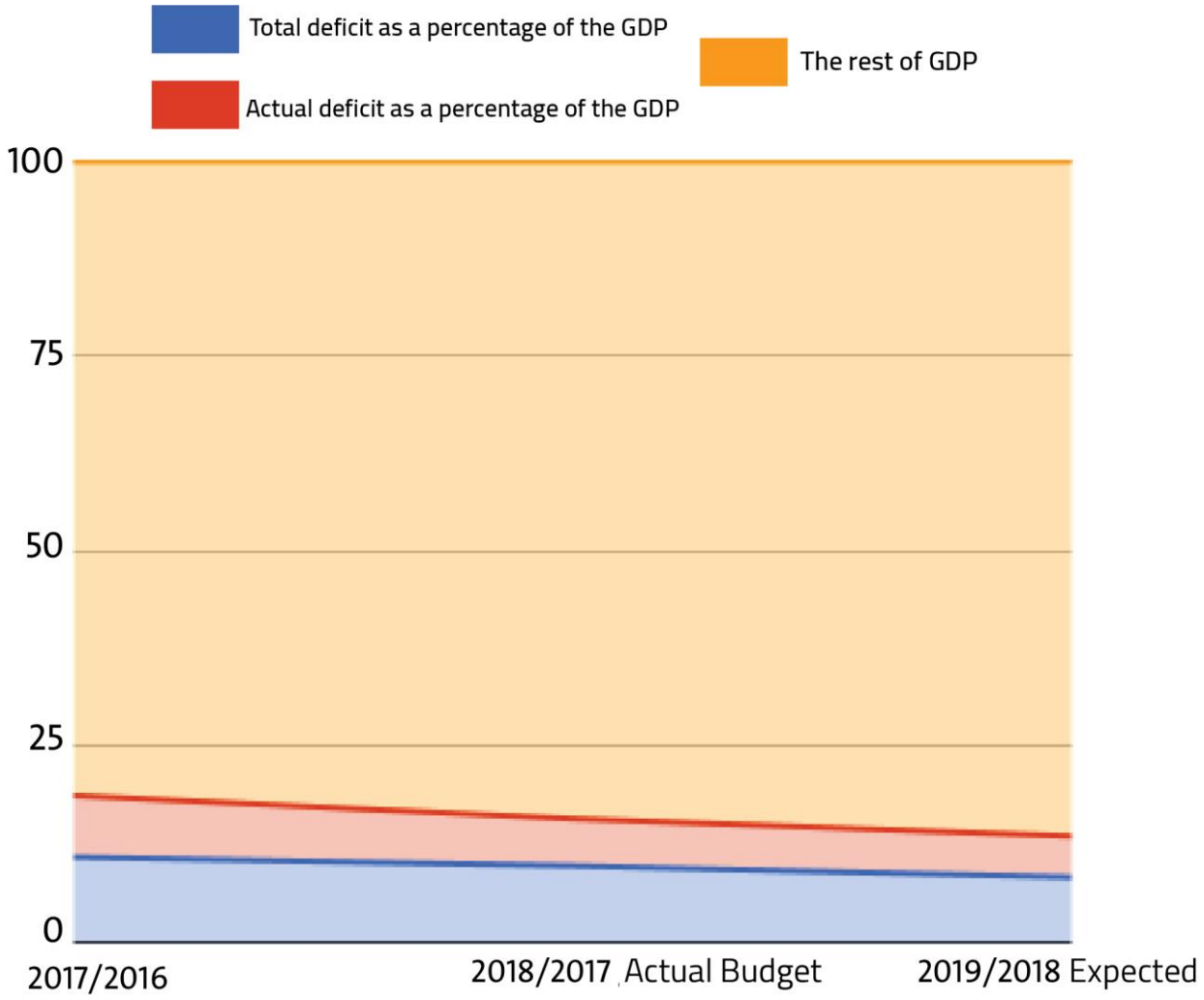
The percentage of expected tax from GDP vs actual tax



Fifth: Deficit

Deficit is the variance between the state's expenditure and its available financial resources. It is financed by borrowing from domestic and foreign resources, and issuing securities other than shares. There are several types of deficit, each of which reflects a different extent of the state's capability to finance its spending. To explain this budget, two types of deficit were selected. The first type is the "total deficit", which means the difference between the first seven chapters in uses and the first four chapters in resources, and indicates the extent to which the state can cover its various activities. The second is the "actual deficit"; it is the total deficit plus the eighth chapter of uses-loan repayments, which is used as an indicator of the total real needs of the state.

The draft budget 2017\18 ,The expected budget 2018\19, 2016/ 2017

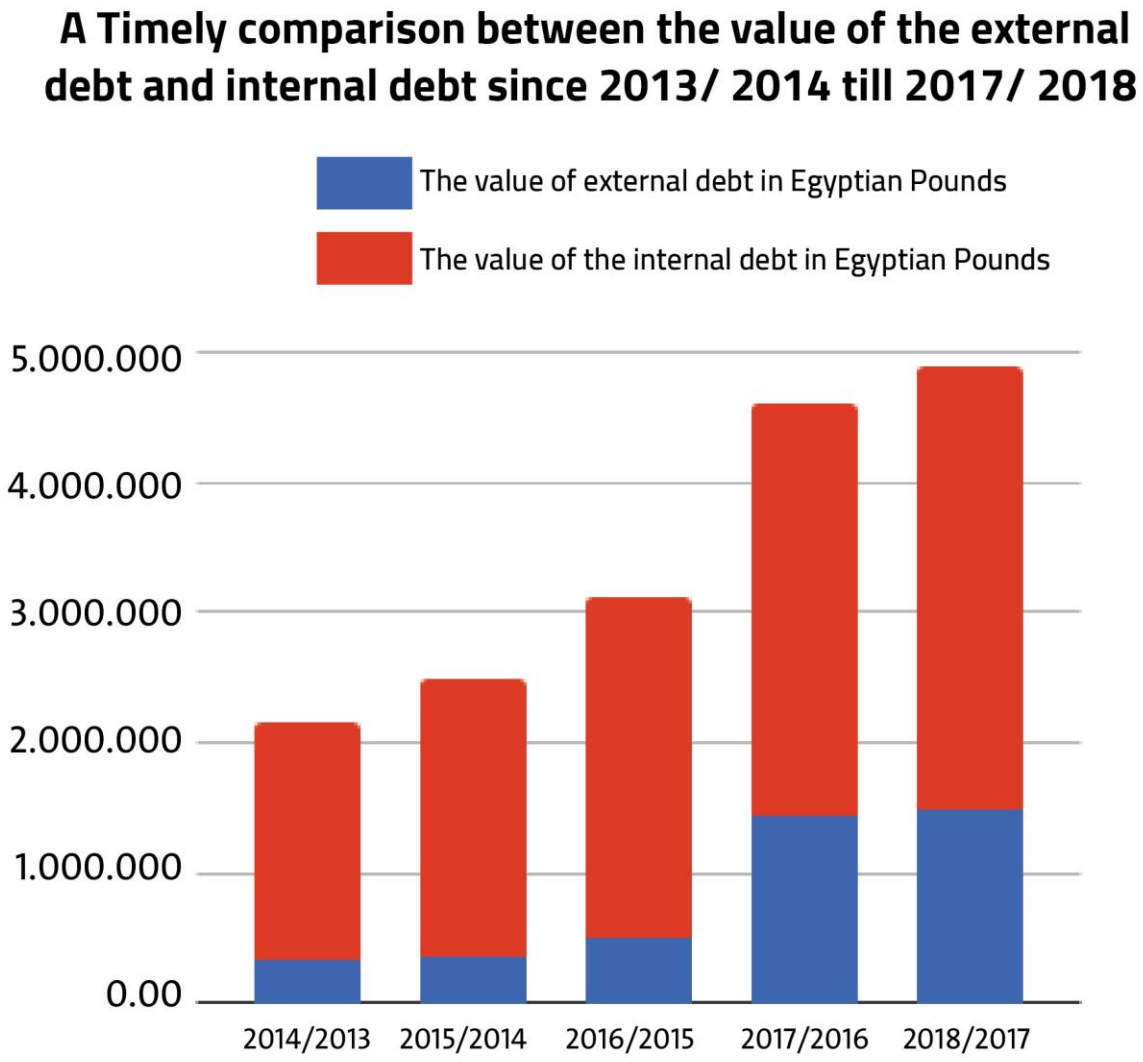


As shown in the chart, the deficit is still increasing. However, the pace of its growth has begun to decline compared to previous years. The total deficit is expected to increase by less than EGP 8 billion and the actual deficit only by EGP 18 billion. It is an auspicious sign that it is possible to control the permanent deficit crisis, which remains the biggest crisis facing the general budget, making our future dependant on our present and creating a snowball of debt that is increasing year after year. In turn, it increases the burden of debt service on the budget, hiking the deficit again and threatening the stability of the macro economy and making the economy more vulnerable to shocks. Moreover, it drives away investors from the Egyptian market and attracts only predatory creditors, as the rest fear what may be caused by this terrible deficit.

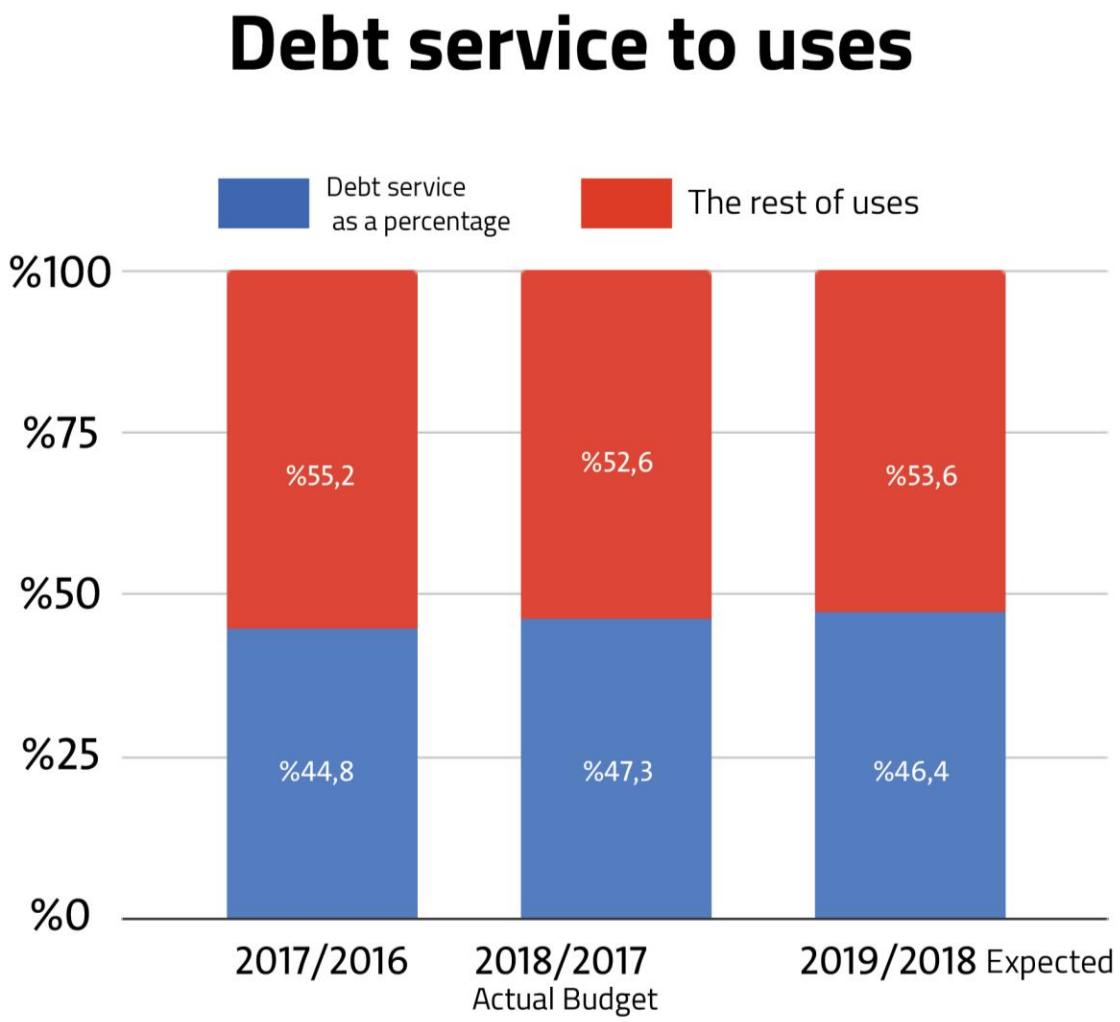
In terms of credit rating, Egypt is still at the bottom of the extreme speculative package (B / B3) and is threatened by a drop to the high risk package, particularly if the crisis led to any default in the payment of increased debt services, which may turn away investors from investing in the Egyptian economy. Moreover, the process of leveraging becomes more difficult and puts us back on the brink of IMF conditionality.

Sixth: Public Debt

The external debt in the financial statement is estimated at EGP 740.86 billion, which reflects only the government's external debt (the statement did not provide how that figure was calculated), and not the external public debt, which is estimated by the Central Bank in to be more than US$ 82.88 billion (more than EGP 1485 billion)[15]. Above all, the statement has not provided any false information, but it just focuses on the general budget bodies[16]. Hence, to provide a full picture of the debt in Egypt, we have recourse to the monthly statistical bulletin of the Egyptian Central Bank; April 2018 issue.



[15] The Egyptian pound value was estimated according to the exchange rate of the Central Bank of the dollar at 17.91 Egyptian pounds.
[16] Noteworthy, there are also differences between the estimates of the statement of internal public debt and the data provided by the Central Bank and the Ministry of Finance. However, these are relatively-small differences; assuming good faith, it may be due to expectations or methods of calculation with minor differences.



As shown in our calculations that are based on the agreed estimates of the above CBE bulletin and the data issued by the Ministry of Finance, the real indebtedness rate calculated on the GDP revised for 2016-2017 exceeds 111.4%. By assuming the debt consistency and achieving the growth rate shown in the budget (they are two targets not expected to be achieved); it is a very high percentage, although it represented hopes of a decline from the 132.38% achieved last year, and extends its negative impact to cover all indicators and financial and economic policies. The deficit crisis, which is directly related to the debt crisis, remains the biggest problem facing the Egyptian economy; particularly as the debt service swallows more than 57.4% of public spending.

Conclusion:

After reviewing the most important components of the financial statement and its main indicators, we can glean some important points. We witness success in curbing the deficit, but at what price? We agree with the government over its goal of reducing the deficit as well as the public indebtedness, but we completely disagree with its method of reaching this goal. The main aim of reducing the deficit is to ensure that it will not jeopardize the future of the country, not to make its future dependant on its present, and not to burden its citizens with debt and impoverishment. Therefore, when the deficit is being reduced on the account of decisions in which the government abandons its social duty, leaving the citizens with little protection to face a massive wave of inflation that they cannot afford, we have to ask: Has the “means” distracted the government from the "goal"? Or has the government abandoned the "goal" itself?

The VAT law, lifting subsidies on fuel, metro fare hikes, cutting electricity subsidies and boasting about scaling back spending on wages and subsidies, all these decisions came to embody the government's class preferences, and its vision of the Egyptian society as it desires; a society in which the government has no obligations and the citizen has no rights. It sees the citizen as a financer to consumption tax in every move s\he has, instead of a worker entitled to a fair wage that provides them with food, clothes and housing. All these decisions were also made in response to the dictates of lenders[17], recalling what Thomas Sankara said: "Who feeds you, governs you." Prostrating to lenders, surrendering to economic programs that do more harm than good, and wasting the interest of the citizen in favor for investors are so serious because they came in the wake of the debt crisis. The debt is due to the deficit; the deficit came because of the tax failure, while the latter is a result of the policies dictated by the lenders. There is no solution for this crisis except getting out of this vicious cycle, and building an efficient and fair "tax structure" that achieves the hope of development, and does not jeopardize the hopes of our future with the failure of our present. The citizen’s rights must be considered first before the lenders' benefits.

[17] Or at least that's what the government has said, although some statements said that the government has set itself these goals.