Rationalising public transfer spending in the Middle East and North Africa:
Strategic options to deal with challenges

Markus Loewe, German Development Institute (DIE) and
Georgeta Auktor Vidican, Nuremberg Institute of Technology

Spending for social policies in MENA is high...

MENA countries spend much more on social protection and health than other countries

Source: Silva, Levin & Morgandi (2012)
Spending for social policies in MENA is high... but inefficient!

MENA countries spend much more on social protection and health than other countries but the bulk of their spending is on subsidies rather than direct social transfers.

Source: Silva, Levin & Morgandi (2012)
MENA accounts for almost half of global energy subsidy spending

Source: Sdralevich et al. (2014)
This pattern produces manifold problems such as for example:
Problem 1: Huge fiscal burden

Costs and opportunity costs of petrol subsidies, 2012

- Pretax
- Posttax

Middle East and North Africa posttax weighted average subsidy

Middle East and North Africa pretax weighted average subsidy

Source: Sdralevich et al. (2014)
Problem 2: Poor targeting efficiency

Share of energy subsidies benefitting the bottom 40% of the population, 2011

Source: Sдраlevich et al. (2014)
Problem 3: Limited effectiveness

Poverty Impact of Subsidies

Source: Silva, Levin & Morgandi (2012)
Problem 4: Adverse effects

% annual change in energy intensity of GDP 2000-10
(kg of oil equivalent/ PPP GDP)

Source: Sdralevich et al. (2014)
These issues raise questions:

1. Why do MENA countries spend so much on subsidies?

2. What can be done about it?

3. How are MENA countries actually dealing with the problem?

4. And why are they going different ways?
Our research starts with four hypotheses:

Questions:

1. Why do MENA countries spend so much on subsidies?
2. What can be done about it?
3. How are MENA countries actually dealing with the problem?
4. And why are they going different ways?

Hypotheses:

1. MENA countries are still coined by a very specific form of populist-authoritarian social contract that prevailed in the 1950s-1980s in all countries in the region
2. MENA countries could replace subsidies by direct cash transfers
3. Many MENA countries are in fact taking action to reduce subsidies – but not all are setting up direct transfer schemes instead
4. MENA countries are developing different new social contracts
“set of explicit and implicit, agreements of the various groups of society

- with each other
- and with the government (or any other actor in power)
defining rights and obligations towards each other.”

Every country with government has a social contract
- but these are all quite different

Source: Loewe / Zintl (forthcoming)
What are the deliverables?

Society gives recognition of legitimacy (instead of fear of repression) possibly taxes and/or military or civil service

Government gives one or more of the three:

- protection (collective and individual security)
- provision (infrastructure, social benefits…)
- participation (in political decision making)

Source: Loewe / Zintl (forthcoming)
What was the social contract in MENA?

MENA countries 1960s-1970s: populist-authoritarian social contracts

- little political participation
- ideological or religious legitimisation combined with “material legitimisation”: sharing of external rents with society
What was the social contract in MENA?

Source: Loewe / Zintl (forthcoming)

**government** gives one or more of the three:

- **protection** (collective and individual security)
- **provision** (infrastructure, social benefits…)
- **participation** (in political decision making)

**recognition of legitimacy** (instead of fear of repression)

possibly taxes and/or military or civil service

**Society** gives
Why did they set up subsidy schemes?

- Reduce poverty and income inequality
- Enable / incentivise purchase of certain commodities
- Enable local industries to compete on world markets
- Create rents for cronies
But today:

Subsidy programmes:

- constitute **huge fiscal burdens** (are no longer affordable)
- have **low effectiveness**
- have even **regressive effects** on income distribution
- have **multiple adverse effects:**
  - e.g. **over-consumption and waste**
What is the dilemma of reform?

Reforms constitute a severe challenge:

- regimes are afraid to delegitimise themselves
- **lock-in**: large parts of society benefit from subsidies today, not only the poor – and no group wants to give away a benefit once it has got it
- many citizens are not even aware of subsidies’ negative effects
- administrative difficulties to replace subsidies by direct transfer schemes

So: What can governments do to overcome the challenges?

- **communication**: explain problems and need to reform to the public
- **dialogue & participation** work out reform strategy with representatives of society
- **compensate losers of reform**, e.g. with direct cash transfers (go for universal transfers if targeting is too difficult)
- **make proof of government’s commitment** in order to discourage possible protestors
- repress opposition
<table>
<thead>
<tr>
<th></th>
<th>Egypt</th>
<th>Morocco</th>
<th>Iran</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Per-capita income</strong></td>
<td>13000</td>
<td>9000</td>
<td>20000</td>
</tr>
<tr>
<td>(USD in PPP 2017)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Pre-reform subsidies</strong></td>
<td>10-14% of GDP</td>
<td>5-7% of GDP</td>
<td>10-14% of GDP</td>
</tr>
<tr>
<td><strong>Subsidy reduction</strong></td>
<td>2-5% of GDP:</td>
<td></td>
<td>1-2% of GDP:</td>
</tr>
<tr>
<td></td>
<td>all energy,</td>
<td></td>
<td>energy and food,</td>
</tr>
<tr>
<td></td>
<td>most food</td>
<td></td>
<td>but excluding the</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>key commodities</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>of the poor</td>
</tr>
<tr>
<td><strong>Information</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>on rational, goal and strategy</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Dialogue</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>with citizens</strong></td>
<td>Information always</td>
<td>Information always</td>
<td></td>
</tr>
<tr>
<td></td>
<td>late / s.t. wrong</td>
<td>++</td>
<td>++</td>
</tr>
<tr>
<td></td>
<td>or revoked little</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>late</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Intimidation</strong></td>
<td>+++</td>
<td>0</td>
<td>+</td>
</tr>
<tr>
<td>of possible reform opponents</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Compensation of losers:</strong></td>
<td>1% of GDP /</td>
<td>1% of GDP /</td>
<td>1% of GDP/</td>
</tr>
<tr>
<td>(direct transfers pre/post reform)</td>
<td>1.5% of GDP</td>
<td>2% of GDP</td>
<td>7% of GDP</td>
</tr>
<tr>
<td>(targeting)</td>
<td>means-tested</td>
<td>means-tested /</td>
<td>quasi-universal</td>
</tr>
<tr>
<td></td>
<td></td>
<td>categorical</td>
<td></td>
</tr>
<tr>
<td><strong>New social contract?</strong></td>
<td>build “stability”</td>
<td>attempt to</td>
<td>make “old” social</td>
</tr>
<tr>
<td></td>
<td>contract” instead</td>
<td>preserve ‘old’</td>
<td>contract more</td>
</tr>
<tr>
<td></td>
<td></td>
<td>contract</td>
<td>inclusive</td>
</tr>
</tbody>
</table>

**Source:** Auktor / Loewe (forthcoming)
reconstructed social contract (Jordan? Morocco?)

no country-wide social contract / state failure (Libya, Yemen, Iraq, Syria)

"stability contract“ (e.g. Egypt)

more participatory / liberal social contract (Tunisia)

reinvented, more inclusive populist provision contract? (Iran)

anything else? (still in flux) (i: Saudi-Arabia, Qatar, Bahrain) (ii: Algeria) (iii: Sudan)

Source: Loewe / Zintl (forthcoming)

"old", populist-authoritarian social contracts

post-populist, "un-social" contracts

ARAB SPRING
Thank you very much for your attention!

www.die-gdi.de/mena/