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## **Global Forum on Competition**

### **COMPETITION, STATE AIDS AND SUBSIDIES**

#### **Contribution from Egypt**

-- Session I --

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Contact: H el ene CHADZYNSKA, Programme Manager of the Global Forum on Competition  
Tel: +33 1 45 24 91 05; email: helene.chadzynska@oecd.org

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## COMPETITION, STATE AIDS AND SUBSIDIES

### -- Egypt --

#### 1. Introduction

1. State aid policy has a part to play in the transformation of a planned economy into an open market economy with free competition. However, a state aid policy is not a stand-alone regulatory too, it certainly has its impact on competition policy. The intensity of this impact depends on the level of the state intervention, the benefitting sector where the undertaking concerned is functioning and other factors. Reflections on the interface between state aid, competition law and policy have been drawn worldwide. Nonetheless, the awakening in this field of research has not been accompanied by much thinking in Egypt. Studies investigating into the consequences and impacts of state aid on the implementation of competition law in Egypt have lagged behind, and no single work can be mentioned. It is both because the literature on competition law and policy has taken little attention in Egypt; and the Egyptian competition law<sup>1</sup> in 2005 and its Executive Regulations do not contain prohibition on state aid, which distorts or may distort competition in the market. Moreover, the obligations on the government to adopt state aid policy that does not distort competition as mentioned in the Egypt-EU trade agreement<sup>2</sup> as well as its Action Plan,<sup>3</sup> were expected to be implemented on June 2009. Nothing materialised in this regard until today.

2. Egypt's state aid or subsidies policy has not been formulated in the general economic framework. In other words, there is no concrete definition of what qualifies a certain practice by the government as a state aid. No mechanism for identifying or controlling such practices exists. There are no laws that regulate or define state aid in Egypt.<sup>4</sup> Therefore the term employed in most of the literature on aid focussed on subsidies and not state aid.

3. Egypt has used subsidies as an active policy choice since the World War II. Subsidies and other artificial supports were a necessary part of industrial policy in Egypt, however, laws were neither promulgated to define such a policy nor to prohibit it when it is harmful to competition policy, as will be shown below.

#### 2. Characteristics of Subsidies

4. The financial transfers and other forms of direct and indirect aid to entire sectors or individual enterprises were very frequently employed to boost economic development and to promote employment in

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<sup>1</sup> Law No. 3 of 2005 promulgating the law on the protection of competition and the prohibition of monopolistic practices.

<sup>2</sup> O.J L.345, 31/12/2003, paragraph 0115-0116. The Agreement is replacing the 1977 Co-operation agreement.

<sup>3</sup> O.J.L 230/19, "Recommendation No.1/2007 of the EU-Egypt Association Council of 6 March 2007".

<sup>4</sup> Only the law of the State Budget No. 87 of the year 2005 defines subsidies as the transfer from the government to support producers or consumers to enhance the standard of living.

the more backward regions of the country as well as for the achievement of industrial policy objectives.<sup>5</sup> The responsibility for supervising and monitoring the subsidies in Egypt is under the competence of the Ministry of Finance. The Ministry of Finance grants subsidies directly to firms where the value of the aid and the recipient are known, as it is recorded in the State Budget. It can also grant subsidies indirectly through other Ministries. For instance, it could allocate a certain fund from the State Budget to the Ministry for Trade and Industry, which in its turn transfers the fund to the Egyptian Export Promotion Centre to grant aid to a given company or a group of companies. In the latter case only the value of the aid is known, but not the recipient.

5. The aid could take the traditional forms such as direct financial transfers, tax breaks, granting of government-owned inputs below market prices, government purchases above market prices, or the provision of loans below market rates. The aid could also take another form such as preferential treatment including regulations or enforcements. For example, the Egyptian Civil Aviation Law and its Executive Regulations explicitly mandate that no airline can be licensed to operate on internal routes that compete with the itineraries of currently operating Egyptian companies.

6. The term used by the government for the transfer of public resources from the state to economic entities or the general public is “Subsidies, Grants, and Social Advantages”. The official figures data are usually reported in Chapter 4 of the State Budget. Some items can also be traced in Chapter 7 of the State Budget. The subsidies in Egypt are divided into two forms. A substantial part of the subsidies granted by the government is explicitly stated in the State Budget. These subsidies are mainly a tool to achieve social objectives, e.g. helping consumers with low income, encouraging economic activity for a certain area, or preventing the decline of an industry. The other form of subsidies does not appear explicitly in the State Budget.<sup>6</sup> A good example is some transfer granted by the Ministry of Finance to settle debts of some public sectors banks including Bank of Alexandria in the year 2005/2006.<sup>7</sup> This transfer is estimated at 1.27 billion Euros. Another example of aid granted by the Minister of Finance after the Prime Minister’s approval to banks to retain the government share of profits for provisioning and improving these banks’ financial viability. These voluntary retained earnings are estimated at 127 million to 381 million Euros for the past three years. The beneficiaries of subsidies in Egypt could be government-owned enterprises or private firms. The latter could include foreign owned companies.

### 3. The Allocation of Subsidies

7. The main component of subsidies granted by the Egyptian government target food and petroleum sectors. The programme of food subsidies had its beginning in the effort to cope with inflation after World War II. Since then food subsidies have increasingly become a crucial element in state aid and an important means to ensure political stability. Since the 1952 Coup d’état the government took major steps to support an equitable distribution of food and income in Egypt.<sup>8</sup> Since the appointment of the new cabinet of 2004,

<sup>5</sup> It is worth noting that a study conducted by the World Bank in 2005 “*Egypt-Towards a More Effective Social Policy: Subsidies and Social Net*” notes that the public social safety net in Egypt does not follow the typical programmes in many countries. It is devoted to consumer subsidies on food; energy subsidies to producers and consumers, which serves as important state aid; income-generation programmes that provide financial credit and in-kind support to the disadvantaged to foster entrepreneurship and business development; social insurance reflected in the pension scheme; Social Fund of Development programmes; and social assistance cash transfer from The Ministry of Insurance and Social Affairs.

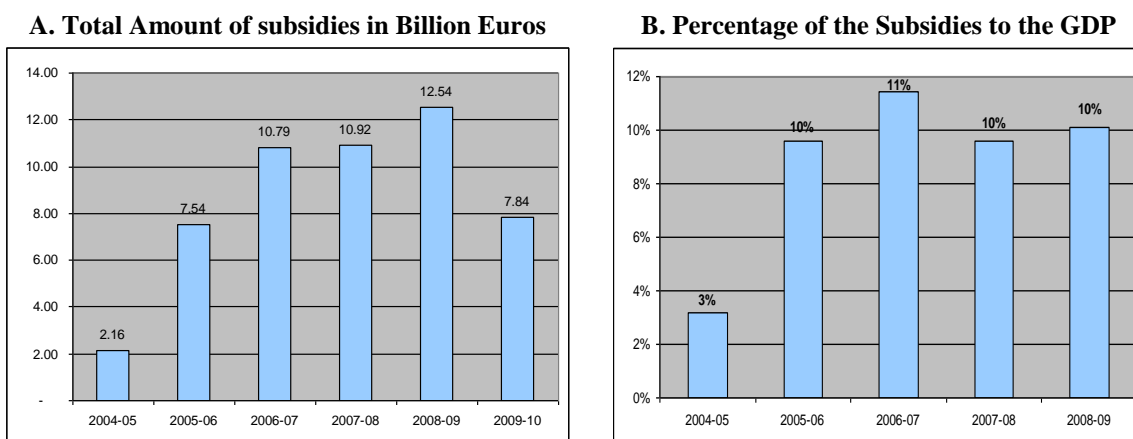
<sup>6</sup> The value of such subsidies does not show explicitly in the State Budget, however, it is issued by ministerial decrees or Prime Minister decisions to target certain sectors or industries.

<sup>7</sup> Minister of Finance, “the Fiscal Policy Statement” (2006) approved by the Parliament.

<sup>8</sup> See above note 3, World Bank (2005), “*Egypt-Towards a More Effective Social Policy: Subsidies and Social Net*”, 41.

the government expanded food subsidies. In 2008-09 its financial cost reached 2.2 percent of the GDP. The same pattern can be witnessed in the energy subsidies, which increased dramatically in recent years. This was largely because of the growing gap between the rapidly increasing international prices and the slowly increase of domestic prices. The recent devaluation of the currency has further contributed to the increase in these subsidies. The petroleum subsidies are substantial with their economic cost reaching 6.4 percent of the GDP in 2008-09.

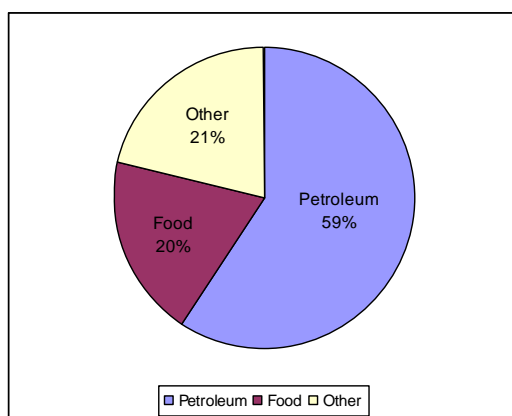
**Table 1: Trend of Subsidies according to the State Budget from 2004 to 2009**



Source: Ministry of Finance. The above figures are calculated as a percentage from the GDP from the State Budget years 2004 until 2009.

8. As shown in Table 1.A, the subsidies in Egypt reached its highest level in 2008-09 to be 12.5 billion Euros. This increase could be justified by the global financial crisis of 2008 to adjust its negative impact Table 1.B shows that the allocated subsidised in Egypt reached an average of 9 percent of the GDP from 2004 until 2009 (see Table 1.B above).

**Figure 1: The Average of the Distribution of Subsidies by Sectors [years 2004 to 2009]**



Source: Ministry of Finance' State Budget.

9. In addition, Figure 1 below illustrates that the gap between subsidies to the petroleum sector and the other sectors in the economy is quite large. Petroleum products receive 59 percent of the subsidies. Some of the aid to petroleum products is considered to serve energy-intensive industries (excluding the food and textile industries) but includes industries such as cement, steel, chemicals, fertilisers, aluminium.

As shown the food subsidies represent 20 percent. The remaining 21 percent of annual subsidies is directed to soft loans, employee training, and subsidies for farmers.

#### 4. Interplay between State Aid and Competition Law and Policy

10. Although the introduction of competition law and policy in Egypt is without a doubt a significant economic phenomenon, it does not prohibit state aid, which distorts or may distort competition in the market. Therefore, the Egyptian competition authority (ECA) has not been involved in any occasions since its establishment with complaints from enterprises denouncing competition distortion effects of state subsidies being granted to the complainants' competitors. Saying that, Article 1 of the competition law sets the main objective as follows: "Economics activities shall be undertaken in a manner that does not prevent, restrict or harm competition in accordance with the provisions of the law." The broad sweep claimed by Article 1 in relation to the goal of the law begs the question on why subsidies or aids that have anticompetitive effects occurring in the market, or in other contiguous or unrelated markets through cross subsidisation practices, are not prohibited by the law.

11. Since the ECA started its activities in 2006, the ECA has conducted studies covering various sectors, food (e.g. sugar, meat, dairy products and edible oil), construction sector (e.g. cement, glass and steel), and chemicals (e.g. fertilisers). By reviewing these studies, the dynamics of different markets in Egypt, as well as the issue of setting forth the concept of subsidies and distortion of competition, the following issues seem to deserve further consideration.

12. First, subsidies are usually associated with the government intervention by fixing prices of the subsidised goods. This intervention creates a segment of the market that does not fall under the jurisdiction of the Egyptian competition law. As a consequence, the ECA investigates only the segment of the market that is free from government's regulations and subsidies. In the edible oil market study, the ECA only investigated 22 percent of such a market as the remaining 78 percent was subsidised. In this case as well as in other similar cases, the narrow analysis of the market may not reflect its real dynamics. Even worse, it could mislead the decisions on anticompetitive practices, and/or impede the implementation and enforcement of the law.

13. Second, the Egyptian economy is characterised by a high level of concentration. This concentration was revealed in the cement industry, where only three firms held more than 63 percent of such a market. Another example is the fertiliser market, where two companies control more than 90 percent. Garcia and Neven demonstrate that the significance of competition distortion resulting from a state aid is likely to increase in the presence of market concentration.<sup>9</sup> Thus, sustaining the current high level of subsidies in Egypt could greatly weaken the level of competition in the market. Moreover, it may reduce the attractiveness of the market to investors and hinder the growth of emerging sectors.<sup>10</sup>

14. Third, informal sector is considerably large in Egypt. This can be exemplified by the high ratio of the informal enterprises to the total small and medium enterprises, which approximately amounts to 82 percent. However, it is worth noting that some Egyptian firms operate simultaneously in both the formal and informal sector (by having underground activities). In that sense, these firms could reap all the benefits of operating formally such as subsidies. Busato, Chiarini, and De Angelis noted that subsidising such

<sup>9</sup> J. Garcia and D. Neven, "State Aid and Distortion of Competition: a Benchmark Model", 6 HEI Working Paper (2005), Graduate Institute of International Studies.

<sup>10</sup> For example, subsidising petroleum products could adversely provide people with no incentive to buy more fuel-efficient cars or switch to cleaner fuels.

enterprises may encourage them to increase their underground activities, as they will have less incentive to increase their reported capital and risk a reduction in the level of aid received.<sup>11</sup>

15. From the above one can deduce that subsidy policy, which is often reflected in public intervention as a tool to correct market failure and/or to achieve social objectives, is far from being a sufficient condition. It is hence required on policy grounds, at the national level, to show when the subsidy is not distorting competition and when it is necessary and proportionate to its objectives.

16. Finally, besides the requirements of defining and preventing state aid that distort competition at the national level, there is the requirements of the Egypt-EU association agreement signed in 2004 of the adoption of a clear definition of state aid and a national mechanism for collecting information on state aid in order to ensure the implementation of the competition Article (34.3) of the agreement. The reason is to ensure the prohibition of state aid that distorts competition according to Article 34. As stated in the EU-Egypt Action Plan, this mechanism for collecting information on state aid should be realised by exchanging with the EU an annual report on the total amount and distribution of state aid, as well as exchange of knowhow and experience in regard to state aid control regime.<sup>12</sup> Furthermore, the adoption of a state aid control regime and legislation was one of the requirements of the EU in the context of the approximation of Egyptian national law to that of the EU *acquis*, including a system of an *ex-ante* control of state aids, which distorts trade between the EU and Egypt.<sup>13</sup> This is to prepare Egypt's participation in the EU internal market.

## 5. A Step Ahead for Harmful State Aid and Distortion of Competition

17. This is the first encounter for Egypt with the subject of state aid and distortion of competition. As has been discussed, too much attention has sometimes been paid in the past to aid, and as seen the ratio of subsidies in Egypt to GDP has roughly tripled. Two main obstacles may result from this high state aid ratio and the lack of rules to regulate it in order to prevent aid that may distort competition. The first relates to bolstering vested interest by some producers to unproductive subsidy. The second obstacle is reducing the competitive playing field to favour firms in certain sectors that receive state aid whether directly or indirectly.

18. The law and its Executive Regulations are very much a work in progress and will, in all likelihood, be amended several times down the road, which will necessitate a reform in order to establish a precise definition of what constitutes state aid. This in turn will necessitate that the ECA should be equipped to investigate and control the aid that may be considered distorting competition and hence infringing the law. Therefore, the authority should take the appropriate measures regarding this issue one of which is the training of its employees for such aid rules. Therefore, more can be done at the competition authority level, such as developing competition scrutiny of state aid in order to reform the law to have provisions on this issue. This is to effectively deter and prevent the aid that is likely to distort competition. Criteria for intervention within competition policy against competition-distorting subsidies need to be developed and wider policy ground principles of good subsidy design need to be created. Moreover, the ECA should consider studying empirical evidence from other developing countries such as the Central and Eastern countries when preparing for their accession to the EU, to draw the relevant lessons in regard to the adoption of provisions on state aid that are in full convergence with the EU *acquis*.

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<sup>11</sup> F Busato, B. Chiarini and P. De Angelis “*State Aid Policies and Underground Activities*”, Discussion Paper (2007), Department of Economic studies, University of Naples, Parthenope, Italy.

<sup>12</sup> O.J.L 230/19, “Recommendation No.1/2007 of the EU-Egypt Association Council of 6 March 2007”.

<sup>13</sup> Ibid.

19. At the government level, new state aid mechanism has to substantially be initiated. The old policy towards state aid from the government has to be sharpened further by including competition aspects inside the remit of such a policy. This is to ensure dynamism, productivity and competitiveness. In order to apply this, greater transparency about state aid and creating rules and processes that apply to it are needed. This is not to say that all subsidies to firms are bad but those that distort competition certainly are.

20. It remains to be seen whether the Ministry of Finance of Egypt would be entrusted with the supervision of state aid or should it be dealt with in the ECA, which, unlike the Ministry of finance, does not provide aid and as such is fully independent in its decision-making.