Impact of IMF Austerity Policies on Social Protection

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The International Monetary Fund (IMF) plays an influential role in formulating the economic and social policies of member countries, often with direct consequences on the livelihood of their populations, particularly limited-income and poor segments. Although this role was on the decline in the 2000s, the IMF has been regaining influence and dominance on the global level, exploiting the urgent situation caused by the deep structural crisis in global capital continuing to cast its shadow on the entire world.

This time, the IMF's strong return could be seen in its direct intervention in the Eurozone, where it imposed strict austerity measures to the great detriment of the region's people, without leading to a significant improvement in economic indicators, such as growth rates, budget deficit, or public debt levels. With the intensification of the global economic crisis, the geographical scope of this intervention started to expand, especially in the global South. As a result, the IMF is beginning to acquire a powerful impact on economic and social policy-making in several Arab countries, where the features of austerity are blatant, with its attendant negative consequences on the social question in general and social protection and subsidies on basic goods in particular.

The first section of this paper will be dedicated to the critical role carried out by the IMF, with a focus on its interventions in the Arab region. The second section will review austerity policies imposed by the IMF on Arab countries and their negative consequences on economic growth and the social question in general. The third section will address the impact of austerity, highlighting the problem of subsidies on basic goods and weaknesses in the related solutions proposed by the IMF.

Section One: IMF Responsibilities and their Impact on the Economic and Social situation in the Arab Region

1. Evolution of IMF Responsibilities

To understand its ability in influencing public policies of member states, it is worth recalling how the tasks entrusted to the IMF had evolved over time and how it became a major player in this arena, imposing the will of major contributors on countries, especially those planning to receive its loans. This will be followed by an assessment of IMF interventions in the Arab region.

1.1. The IMF was created in 1944 to maintain favorable financial conditions for successful investment in the global economy and exchange rate stability. Article I of the Bretton Woods Agreement set the purpose of the IMF as follows:

A. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

B. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

C. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

D. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions, which hamper the growth of world trade.

E. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

F. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

Financial resources and mechanisms are provided to the IMF to conduct its role. Based on Article IV of it's establishing agreement, the Fund exercises direct surveillance over broad public policies, including state budgets, financial, credit, exchange systems, and government financial policies related to control over the banks or other financial institutions. Furthermore, the Fund looks into structural policies underpinning overall economic performance, such as gross national income, consumption, investment, and financial credit.

The IMF issues recommendations to this effect, imposing specific conditions on member states wishing to obtain the loan, in the aim of stabilizing its balance of payments and the rate of the national currency. These conditions often include forcing countries to adopt policies to convince the IMF of the possibility of repaying the loan within a maximum of five years. Other channels are also available to the IMF to influence public policies, such as the "advice" it gives to policy-makers on the international and national levels.

1.2. The beginning of the 1970s saw a deep downturn in the global economy. The foundations of the Bretton Woods system (the gold standard and fixed exchange rates) were scrapped and replaced with floating exchange rates and the free movement of capital from the control previously imposed by nation states, in addition to the tremendous increase in oil prices and the worsening debt crisis in many Third World countries. This led to the "rebirth" of the IMF as a dominant supranational institution, run on different grounds, but more powerful and influential.

The IMF was transformed from a tool to meet the needs of European and North American countries in tackling problems caused by currency exchange rates (the price of one currency compared to the price of another) and the balance of payments, into a "gatekeeper", in concert with the World Bank, of deep structural reforms of the economic and social structures of Third World countries, especially those falling into the debt cycle, in order to conform to the needs of the global economy. Hence, the IMF started to impose harsher conditions and controls over those countries, issuing new "Conditionality Guidelines" in 1979, giving it stricter authorities and where benefiting from the Fund's loans were subject to the application of its long term structural policies and programs.

Moreover, radical transformations in the economic rationale framing the IMF's recommendations and interventions took place on the national and international levels. After a period of partially adopting Keynesian economic theories–which entailed controlling market mechanisms through supranational institutions like the IMF, it turned into an ardent defender of neoliberalism, which consecrates the freedom of markets, the priority to private initiative, and state retreat from the economy. This took place following the rise of the conservative right to power in the UK and US.

Along with the World Bank, the IMF started promoting this economic model in the early 1980s throughout the Global South, under what was termed the Washington Consensus, which stood on three pillars: economic liberalization, privatization, and austerity in public spending.

However, the bank's recipes failed to achieve the promised results as the countries of the South failed to register any mentionable results, whether in growth rates, investments, or creation of decent jobs. Moreover, IMF recommendations to East Asian countries to open up financial markets to foreign investment directly and manifestly contributed to the 1979 Asian financial crisis.

The exorbitant social cost imposed on the peoples of the Third World through Structural Adjustment Programs (SAPs) was even worse. It prioritized the achievement of financial balance (reducing budget deficits, limiting inflation, and controlling the balance of payments), which led to reducing public spending and decreasing budgets allocated to social sectors, to the significant detriment of public services.

Moreover, lifting subsidies on basic goods, partially or fully, removing price controls, and raising the cost of public services, hand in hand with frozen wages and a devalued currency, prompted a significant decline in the purchasing power of middle-income and poor segments.

In such a situation, the eruption of social protests and popular uprisings against international institutions and governments in the Global South should not come as a surprise, due to the thousands of victims they will leave behind.

2. IMF Intervention in the Arab Region

International financial institutions (IFIs) intervention in the Arab region–particularly the IMF–is characterized by the unique entanglement of the economic with the strategic and political. Empirical studies show that granting loans and subsidies is subject to economic determinants, such as deteriorating macroeconomic indicators, worsening disparities in the balance of payments, and depleting hard currency reserves during the 1980s. These factors led to the considerable impact on many Arab countries, especially Egypt, Jordan, Morocco, Tunisia, and Algeria, by political (closeness and friendship with the West, position with regards to the Arab-Israeli conflict) and strategic (to provide the West with oil, problems of immigration and terrorism) interests of donor countries, which control the decision-making process within IFIs, which are dominated by the G7 and the US in particular.

As indicated by Harrigan, et. al. (2006), in Arab countries, chances for profiting from IMF programs are contingent on economic and political factors, the latter in particular: “Signing a peace treaty with Israel improves a country’s chance of a loan as does improving democracy.” Moreover, “economic need alone does not really explain the timing of IMF loans. However, political liberalization, which often sees the incumbent regimes challenged by Islamic opposition, seems to have an influence as shown by the significance of the democracy and election variables. Likewise, a change in foreign policy stance represented by signing a peace treaty with Israel is a good predictor of IMF loans.”

With the exception of this feature, indebted Arab States share the same traits with Third World countries in their dealings with the IMF and the World Bank and submit to the same conditionalities of the Washington Consensus. Gradually, foreign trade and the economy were liberalized, national currencies were devalued, privatization and price liberalization was set in motion, and priority was given to reducing the budget deficit by public spending cuts and increases in indirect tax, in addition to freezing wages and employment in the public sector.

The impact of IMF recipes on the economy had been detrimental, failing to push forward investments or create jobs, opposite to was preached. One of many examples are contained in ESCWA’s annual survey of economic and social developments in the region, which said that rising unemployment was the cumulative result of two decades of contraction. From the early 1980s until 2004, all ESCWA economies without exception performed lower than their potential. Although per capita share of the real GDP had been rising at acceptable annual rates in the 1970s (4.33%), it dropped to 3.43% in the 1980s and registered lower than 0.34% in the 1990s.

Chronically high unemployment rates are associated with a protracted contraction in economic activity, with unemployment rates higher than in any other region of the world (estimated at 16%).

On the other hand, the social cost of alleged economic reform programs were on the rise. Worsening unemployment was fed by additional numbers of active population entering the labor market and not finding jobs, due to an almost complete stagnation of the economy, contractions in the sector, and growing mass layoffs due to the closure of production units or declining activity. This was in addition to the widening scope of vulnerability and poverty and the significant expansion in the informal sector since the 1980s.

While poverty rates in the Arab region are low by international standards, overall poverty, which is defined as the share of the population under the national poverty line, is higher than the lower poverty levels resulting from the use of the international poverty line of two dollars a day. Thus, poverty in Arab countries is more prominent and blatant than assumed. Social sectors, especially education and health suffered from the pressures on public spending and the removal or reduction of subsidies on basic goods remains one of the direct reasons for the decline in the purchasing powers of large segments of the population, in addition to the spread of poverty and vulnerability. The deteriorating situation led to growing anger in Arab streets and the eruption of hunger uprisings in several Arab countries, including Egypt, Tunisia, Morocco, and Jordan.

Social safety nets aiming to avoid the negative repercussions of SAPs failed to reduce the harm incurred by the poor, due to several factors, including the lack of financial means allocated, the multiplicity of programs, and weak management capacity.

Finally, manifestations of social exclusion had been aggravated in the 1980s and 1990s and there is evidence that suggests that wealth inequality exacerbated at a higher rate than the decline in income.

Section Two: Impact of Current IMF Austerity Measures on the Social Question in the Arab Region

The IMF treated the repercussions of the crisis in global capital with a great amount of vacillation. During 2009-2010, the IMF encouraged Member States to adopt clearly Kinseyan fiscal and monetary policies to revive the economic cycle. However, it later drastically changed its approach, insisting on the need to give priority to confront the issue of public debt and budget deficit, which had been exacerbated by government intervention to rescue their economies from recession. This section will focus on demonstrating the clear negative impact of austerity measures imposed by the IMF in the Arab region, especially following the Arab Spring, on the social question, in general, and social protection, in particular. The last section of the paper will be devoted to discuss the impact of removing subsidies on basic goods.

Austerity Policies as a Solution to Macroeconomic Imbalances According to the IMF

After Europe, the IMF opened a new front in the Arab World, exploiting the deteriorating economic situation in countries witnessing revolutions due to political instability and the aggravating consequences of the crisis in globalized capital, especially in the Eurozone, on the Arab region.

A) IMF Views on Confronting Macroeconomic Imbalances
The theory of austerity and its shortcomings (Krigman, Ortiz, Toussaint)

Growing fiscal and balance of payments deficits are considered by the IMF to be direct reasons for widening debt and that public authorities should focus their efforts on fighting such imbalances through harsh austerity policies, such as reduced public spending and pressures on wages and prices, in an effort to help the economies of countries suffering from macroeconomic imbalances to recover and compete. Such austerity measures should enable the private sector to regain confidence in the economic climate. Reducing state expenditures is an indicator of its abandonment of competition with the private sector over loans, as the state had previously done by resorting to monetary and financial markets to finance its expansionary fiscal policy. On the other hand, lower public debt is considered an indication of reduced tax pressure in the medium term and would encourage consumers and producers alike to increase their consumption and investment, leading to a positive impact on the economic cycle and creating jobs.

IMF optimism about the positive reaction of markets to austerity policies does not stand up to sober analysis. On one hand, it is not certain that all social groups would regain their consumption and investment power, as the more consumer-oriented middle and lower classes who often rely on public services will face the brunt of cuts in public spending and pressures on wages. On the other hand, it is difficult to imagine the average consumer like acting rationally towards shrinking public expenditure. Citizens threatened with losing their jobs and source of livelihood will have reduced confidence in their country's economy and will hesitate before consuming more, in fear of an uncertain future. Furthermore, the simultaneous adoption of austerity policies on highly interdependent economies, such as the Eurozone, could lead to neutralizing the impact of such policies on growth, due to the decline in demand by the other partners.

B) Impact of Austerity Policies on the Economy and Society in the Eurozone

Several common denominators make the comparison between the situation in the Eurozone and the Arab region worthy of study and analysis. Public indebtedness and fiscal deficit rose significantly in recent years, resulting in major economic problems. Macroeconomic imbalances also led to the IMF's strong comeback in those areas, especially the Eurozone, which it had left thirty years ago. The two regions have become an open arena, with ample room to apply austerity policies advocated by the Fund. It is critical to focus in this regard at the impact of those policies on social protection. Furthermore, fiscal and monetary austerity policies in the Eurozone are expected to have a negative impact on many Arab economies subservient to EU countries.

Contrary to IMF expectations, austerity policies implemented by Eurozone countries – especially those under challenge by the financial markets due to the magnitude of their sovereign debt, such as Greece, Italy, Portugal, Spain, and Cyprus – did not witness significant improvements in the level of economic operators' confidence. Austerity policies, nonetheless, led to slowing down economic activity, rising unemployment, and declining purchasing power of citizens. At the same time, these policies have led to a real social crisis, whose channels and mechanisms will be described first, before moving to their dominant features.

A key measure adopted to put austerity policies into practice in Europe had been the reduction or elimination of subsidies on goods such as fuel, electricity, food, and farming tools, in addition to freezing or cutting back the wage bill in public administrations, higher general sales taxes and VAT, reforming pensions, additional rationalizing and/or rationing of social safety nets, reforming the health system, and adapting the job market to become more flexible in hiring and firing employees.

Added to that was the privatization of public facilities in countries such as Greece, Portugal, Spain, and Italy (selling national water and electrical distribution companies, public transportation companies, and several healthcare facilities).

In the UK alone, 1.1 administrative jobs were scrapped and wages in the same sector were shrunk in Italy and Ireland, while being mostly frozen in the UK. It should be noted that at least three of the above austerity measures are linked directly to social protection. In addition to eliminating or reducing subsidies on basic goods, considered a mechanism of social assistance, Eurozone countries seem to have appreciably reduced budgets allocated to social security (the budgets of Greece, Lithuania, and Portugal saw a 5% decrease behind Romania, which registered more than 5% in 2011). This meant a decrease in the nominal value of family and housing allowances, as well as disability benefits. It is also highly expected that women will be even more affected by these measures, considering their role in child and elderly care inside households.

The impact of austerity was also apparent in health budgets, through measures to cut back costs in public health facilities and adapting costs of medicines to be closer to that of generic medication, in addition to citizens paying a higher share of medical and treatment costs.

Retirement plans were also changed drastically through raising the contribution of wage earners, increasing the duration of subscription to benefit from pensions, postponing retirement age, and reducing the value of pensions.

The adoption of "labor market flexibility" led to a reassessment of the minimum wage and the relative abandonment of progressive wages and prices. It also led to decentralizing collective bargaining, weakening the bargaining power of wage earners (this occurred in Greece, Portugal, Italy, and Spain). Easing restrictions on firing workers, however, was not accompanied with measures to protect those who lost their jobs from falling into poverty and vulnerability.

The devastating effects of the social crisis caused by the austerity policies imposed on Eurozone countries are clearly visible; unemployment reached unprecedented rates in that region, especially among young people and the long-term unemployed (one instance, the unemployment rate rose almost three times in Spain and Greece, from 8.3% in 2007 to 24% in 2012.

Increased prices and lower real values for wages exacerbated the presence of "poor workers" (the UK, Portugal, Italy, Spain, Ireland, and Greece). In general, it could be said that poverty in the EU is growing. In 2001, it rose by 5% in Austria, 4.7% in Belgium, 8.6% in Greece, 6.5% in Italy, 11.7% in Spain, and 5.2% in Sweden.

Social and class differences grew deeper, threatening the harmony and cohesion of the community, diminishing citizen trust, and leading to increased crime and decreased school graduation rates.

C) Impact of Austerity Policies on Arab Countries

<u>IMF's Approach to Arab Spring Countries</u>

The IMF's neoliberal approach to Arab economies remained the same post-Arab Spring. IFIs (IMF, WB) still believe in the validity of economic reforms adopted previously in Arab countries and that they had not been properly applied, witnessing a retreat with the reduced confidence in the state, weak public participation, lack of accountability, and rampant corruption and nepotism. However, the prevailing impression was that such reforms are only deepening inequalities and benefiting an elite associated with the regime.

As one of the main architects of the Deauville Partnership, IMF analysis of Arab economies post-Arab Spring is based on the impact of external and internal factors and the magnitude of the challenges ahead. On the external level, there are conflicting indicators related to slow global economic growth and recession in the Eurozone, in addition to rising food and fuel prices and the spillover of the Syrian crisis in neighboring countries. Internal situations, on the other hand, are characterized by uncertainty and faltering political reforms, with the tendency of governments to increase support for basic goods, despite the great need for financing.

According to the IMF, these factors combined led to slow growth and rising unemployment, in addition to wider imbalances in fiscal balances and external accounts, with the depletion of protective margins available through economic policy (For more details, see Masood Ahmed, "Regional Economic Outlook: Middle East and North Africa," International Monetary Fund, November 2012). To break out of the situation, the IMF wants to give priority to foreign financial sustainability and reducing public debt.

Thus, fiscal and monetary policies should be set in motion to provide condition for comprehensive growth for all sectors of society. On one hand, fiscal consolidation should be put in place and the quality of public investment improved, while strengthening social safety nets for the poor. On the other hand, monetary policies should be vigilant about the subsequent inflationary effects, enhance exchange rate flexibility, and expand policy tools in the medium term.

In parallel, structural reforms must continue through reviewing labor market regulations and reforming education systems, along with the organization of work and governance (treating businesses on the basis of transparency, equality, and reducing barriers to entry and exit of business), as well as improving access to funding.

This presentation of IMF's views demonstrates its continued adoption of the described approach. In short, it calls for controlling fiscal deficits through austerity measures capable of bringing back the confidence of the private sector, which is relied upon as the engine of economic growth (Box 1 presents key commitments by Arab countries towards the IMF).

The remainder of this section will discuss the effects IMF austerity recommendations might have on the social situation in some Arab countries, including the question of social protection.

<u>Potential Impact of Austerity Policies on the Social Question</u>

Looking at austerity measures in the social sphere recommended by the IMF to the Arab region reveals that they closely resemble the situation in the EU. Once again, this demonstrates the dogmatism of that institution and its inability to devise solutions or mechanisms, which could be applied to the variety of local conditions in different countries.

The package of measures being implemented by several Arab countries is the same as the one discussed earlier in this paper, as illustrated in Table 1. Hence, the most common austerity measures in the Arab world had been to reduce subsidies on basic goods (applied in nine out of ten surveyed countries), reduce or freeze the public sector wage bill (seven out of ten countries), and increase taxes on consumption (seven countries out of ten). It also included reforming pensions and creating social safety nets (five countries out of ten).

The remainder of this section will discuss the potential impact of wage freezes, labor flexibility, and additional taxes on consumption. The effects of the reduction of support for basic materials and the creation of social safety nets will be discussed in some detail in the final section.

Box 1: Adjustment Measures in the Middle East and North Africa 2010-2013

Country	Limiting Subsides	Wage bill cuts/caps	Increasing consumption taxes	Pension reform	Rationalizing and targeting safety nets	Health reform	Labor reforms
Algeria	X	X			X		
Djibouti	X	X	X				
Egypt	X		X	X	X	X	
Iran	X		X				
Iraq	X						
Jordan	X	X	X	X	X	X	
Lebanon		X	X	X	X	X	
Morocco	X	X		X	X		X
Tunisia	X	X	X	X			
Yemen	X	X	X				
Total	9	7	7	5	5	3	1

Source: Author's analysis of 314 IMF country reports published from January 2010 to February 2013

Freeze or reducing the wage bill in the public sector will have negative repercussions on human development levels in several Arab countries suffering from a significant lack of available human resources, such as teachers, doctors, nurses, and social workers. For example, a country like Morocco needs to hire more than 7,000 doctors and 9,000 nurses to meet minimum needs in the health sector and improve services provided to the population, especially in villages. The wage freeze and lack of adjustment to inflation rates will hurt the purchasing power of workers in the public sector, especially in the vital social sectors, which could increase instances of absence from work, growing employment in the informal sector, and a heavier brain and skill drain. Combined, this would lead to a significant decline in public services, especially in popular neighborhoods in cities and in villages.

As for labor flexibility through measures like facilitating individual and collective layoffs, reducing compensations, and encouragement of fixed-term contracts, it is uncertain that they would increase the competitiveness of production units linked to other, more influential factors, such as productivity levels, administrative efficiency, and innovation. However, it would lead to greater vulnerability for workers and low wages during a contraction of the economic cycle.

Raising indirect taxes, on the other hand, will reduce consumption. Rising prices will weaken the purchasing power of large segments of society, especially the poor, who allocate the largest part of their income to the consumption of basic materials. This reflects the unfair nature of taxes on consumption, compared to direct corporate taxes or income or wealth.

Box 1: Austerity Measures in Selected Arab Countries (IMF Approach)

Morocco: “Program Note”, 5 April 2013, IMF website.
Issue: Worsening budget deficit due to rising cost of subsidizing basic goods and high wage bill.

Priorities:

1. Adopting austerity measures to rebuild fiscal buffers, ensuring medium-term fiscal sustainability, through developing alternative targeted social protection schemes to replace high-cost universal subsidies and reforming pensions.
2. Rebuilding external buffers and strengthening competitiveness, through structural reforms and greater exchange rate flexibility.
3. Fostering higher and more inclusive growth through improving economic governance and strengthening the business environment.
4. Maintaining adequate monetary conditions and preserving the stability of the financial sector.

Egypt, “IMF Reaches Staff-Level Agreement with Egypt on a US$4.8 Billion Stand-By Arrangement”, IMF Press Statement, 20 November 2012.

1. Supporting a government program where fiscal reforms are a key pillar to:
   - Reduce wasteful expenditures, including by reforming energy subsidies and better targeting them to vulnerable groups;
   - Raise revenues through tax reforms, including by increasing the progressivity of income taxation and by broadening the general sales tax (GST). This would reduce the large public sector deficit and the generated resources would be used to boost social spending and growth of the private sector.
2. Improving public sector management.
3. Gearing monetary and exchange rate policies toward ensuring declining inflation over the medium term.
4. Strengthening competitiveness.
5. Ensuring fair and competitive environment for the business community.

The Egyptian government did not comply with the IMF’s austerity conditions, choosing instead a voluntary policy to stimulate the economic cycle.

(See for example, The Daily Star, “Egypt’s new finance minister plans stimulus, not austerity”, July 27, 2013.

Jordan, “Program Note”, IMF, 3 August 2012

Priorities: Socially acceptable austerity (fiscal consolidation) program and 36-month Stand-By Arrangement (SBA) in the amount of $2 billion.

Main challenges:

1. Reducing vulnerabilities in public finances through fiscal consolidation on the short and medium terms, supported by reforms in spending and taxes and the protection of low income population segments.
2. Achieve cost recovery in the national electricity company.
3. Sustain structural reforms to improve the business environment, enhance transparency, and improve skills in the job market, to attain high inclusive growth.

Section Three: The IMF and Basic Subsidies

IMF's approach reduces social protection to its social assistance component and providing subsidies to the needy, ignoring the key aspects of social insurance as a tool to mitigate risks associated with the life cycle, such as illness, unemployment, old age, and injury. This narrow view is mainly due to the IMF's lack of interest in social protection, except its impact on the budget deficit, since an essential part of social assistance is provided in the form of direct support for basic goods from the state budget. IMF sees this type of support as a heavy burden on the state budget and considers it a major factor in increasing the fiscal deficit of the state. This last section of the paper will critique the IMF approach to social protection, through demonstrating the limitations of reforming subsidies on basic goods it promotes, underlining its negative impact on the economy and society.

A) Subsidies: Definition and Socio-Economic Functions

Subsidies are defined as "measures to keep the prices for consumers at less than market level or to keep the prices for producers above market levels or reducing the costs for consumers and producers through direct and indirect assistance." The size of the subsidy is measured through the "price gap" index, comparing the recorded price of a product or service to a standard or baseline price. For energy, for example, international organizations estimate the size of available subsidies, based on the different between the price of fuel in international markets and locally.

Subsidies on basic goods perform several functions – social and economic. Subsidies on energy use mainly aim to expand access to a vital and strategic product, through reducing the cost of fuel used by households for cooking and heating or for electricity production, for example. It is also used to assist in the expansion of necessary infrastructure, such as electricity networks in rural areas, through direct support to producers or consumers through, reducing the initial costs of household connections to networks. The second factor in subsidizing energy costs is to protect limited income households from high fuel prices. But instead of targeting them directly, some countries prefer to keep the prices of all petroleum products at less than international, regardless of whether the user is rich or poor. Energy subsidies also aim to encourage local industries and to stimulate companies to provide goods and services to consumers at reasonable prices, helping to protect them from foreign competition, enhancing their export competitiveness, and protecting the local workforce. Fourth, governments work on encouraging consumption in the face of energy price fluctuations, through subsidizing local prices when they get high in international markets, and increase taxes when global prices are low. Government intervention also tires to avoid inflationary pressures generated by global increases in the prices of key commodities.

The focus on energy subsidies in Arab countries is due to the weight of this sector, which reached $237 billion in 2011, or 8.6% of the Arab world's GDP, compared to 0.7% for food subsidies.[1] However, food subsidies are no less critical, given their social and economic role. More than half a century of food subsidies in countries like Egypt is an example of political and social commitment by public authorities to provide basic goods to citizens at affordable prices, despite starting to reduce the cost of subsidizing food products due to budgetary and IFI pressures since the mid-1980s. In general, food subsidies play an economic and social role, to reduce poverty, attain social justice, and redistribution. The incentive for such policies ranges from crisis or disaster or to get political support and develop loyalty, within the framework of some type of social contract between the ruler and the community.

B) World Bank Vision on Energy Subsidy Reform in the Arab World

In its analysis of the energy subsidy system in the Arab world, the IMF focuses on the following negative aspects. ("Energy Subsidies in the Middle East and North Africa: Lessons for Reform", IMF, 2013.)

1- IMF, "Energy Subsidies in the Middle East and North Africa: Lessons for Reform," March 2014.

First, IMF considers that subsidies are a costly endeavor, estimating pre-tax energy subsidies – that is subsidies measured as the difference between the value of consumption at world and domestic prices – in the region as whole to be equivalent to almost 22% percent of government revenue, accounting for more than half of global energy subsidies.

Second, energy subsidies do not provide effective support to the purchasing power of deprived segments and they weigh on public finances and the balance of payments. They also create distortions in price structures, which are harmful for the economy and the allocation of resources. Energy subsidies benefit households directly, through lower prices for energy used for cooking, heating, lighting, and personal transport, but also indirectly by reducing production costs for other goods and services that use energy as an input. However, energy subsidies are highly inequitable as they mostly benefit upper income groups, compared to middle and low income segments. For instance, the IMF study mentions the example of Sudan, where the poorest 20% of the population receives only about 3% of fuel subsidies, whereas the richest 20% receives more than 50%.

Third, energy subsidies also divert public resources away from spending on other sectors, such as infrastructure, education, and health. In Egypt, for example, total energy subsidies were three times the spending on education and seven times health expenditures.

Fourth, energy subsidies cause over-consumption, aggravating pollution and traffic congestion, and does not encourage investments in efficient energy, public transportation, or renewable energy.

Despite barriers to reform, such as opposition from specific groups benefiting from the status quo, lack of information regarding the magnitude and shortcomings of subsidies, lack of government credibility and administrative capacity, the IMF believes that subsidy reforms will have several positive consequences, boosting growth, reducing the budget deficit and interest rates, stimulating private-sector investment and reinforcing economic growth.

The main reform components suggested are: appropriately phased and sequenced price increases; well-targeted measures to mitigate the impact of energy price increases on the poor, through cash transfers or vouchers. Alternatively, other initiatives, such as public works programs, can be expanded while capacity is developed. A comprehensive communications strategy to help generate broad political and public support for reform must also be reached.

C. Critiquing the IMF Approach

Before addressing the main criticisms directed against the IMF approach to the question of social protection, it is important to note that the term “energy subsidy reform” is misleading, since the issue is actually related to the gradual removal of these subsidies, with the introduction of social safety nets aimed at the most vulnerable groups due to this policy.

Negative impact on growth and prices:

Raising the costs of basic goods will have an adverse effect on domestic demand, growth, and employment, at least in the short term. For example, a recent study by the Moroccan High Planning Commission indicated that energy price increases implemented by the Moroccan government in September 2014 would have the following impact on socio-economic indicators:

The rate of growth will drop by 0.15% in 2013 and 0.48% in 2014, as a result of declining domestic demand, while local domestic consumption prices will increase by 0.37% and 1.1% respectively and the budget deficit will drop by 0.18% in 2013 and 0.58% in 2014.

Limits of Social Safety Nets:

Despite several mitigating measures, such as targeted energy subsidies, the use of existing social safety nets, and public works programs, targeted cash transfers remains the most ambitious mitigating measure and the action most favored by the IMF. This measure, which eliminates all support for the use of energy, is based on the use of savings in the budget to finance cash transfers programs geared toward the poor.

Such transfers may be conditional on beneficiary families sending their children to school and access to public health services. But despite the various advantages of cash transfers, they are not without flaws, which limit their effectiveness in the fight against poverty, with overhead costs that could reach up to 30% of resources allocated to the program. It also poses problems in assessing income levels and identification of beneficiaries, resulting in incomplete coverage as well as social stigma.

These barriers are particularly important in some Arab countries, given the weakness of administration and rampant corruption, bribery, and nepotism. On the other hand, several studies have delineated the limitations related to cash transfers targeted at addressing poverty. Despite the relative improvement registered in the field of schooling, health, and nutrition, the impact in terms of cutting down poverty remains weak in the short term. Long-term results in education, human capital formation, and poverty reduction are not guaranteed as well.

Targeted cash transfers in Arab countries are limited further by their lack of institutions and mechanisms of protection in many cases. The proportion of the population profiting from social protection remains low, since it only covers workers with permanent contracts, which are only possible in the public sector. This is added to the prevalence of work in the informal sector and high unemployment rates, as well as weak women's participation in the labor market.

Impoverishment of the Middle Classes

Addressing the poorest segments through targeted and direct cash transfer mechanisms will inevitably lead several groups currently suffering from vulnerability, as well as large sections of the middle classes, to impoverishment and deteriorating living conditions. Thus, "subsidy reform" will lose the political support necessary for its success and will raise the political cost of its implementation, as in the recent situation in Sudan, where around 200 people were killed in campaign to suppress protests against the increase in energy prices.

So-called subsidy reform policies suffer from narrow economism, which focuses on macroeconomic financial balances to the detriment of social balances. According to IMF experts, priority must be given to regaining investor confidence and debt repayment, even if at the expense of economic and social rights of citizens. Narrow economism, which underpins the work of IFIs, remains immune to the values of justice, solidarity, collaboration, and non-discrimination. This doctrine only sees individuals as economic actors looking to maximize their pleasures and profits in the context of competitive markets, based on the trio of liberalization, privatization, and fiscal austerity at the level of the general budget.

General Conclusion

IMF's role in the global economy changed significantly since its inception in 1944 as a guardian of global financial stability necessary for the development of global trade, supporting economic growth, and expanding job opportunities. Today, it plays the role of policing the integration of the world's economies in the global market and restructuring them according to the requirements of globalized capitalist economy, taking advantage of the debt trap in which many of the countries of the South have fallen. Severe conditions were imposed, especially on countries resorting to the IMF for loans, through the adoption of the Washington Consensus based on the liberalization of the economy, privatization, and austerity in public finances. Many countries were entangled in the web of IFIs. Moreover, the strategic geopolitical location of Arab countries increases the influence of political considerations and interests of the great powers in directing interventions in the region.

Although many Arab countries had been loyal to IMF prescriptions, they witnessed a decline in economic growth, rising unemployment, and exacerbating class inequalities and social exclusion. While IMF's role in the global economy saw some retreat during the 2000s, it was able to regain its his power and influence by exploiting the structural crisis in globalized capitalism. The IMF imposed strict austerity policies on many European countries, especially in Southern Europe. To the contrary of the Fund's forecasts, however, their economies did not recover. Rather, the policies led to an intolerable social situation, of varying intensity, for people living in the Eurozone.

Despite the winds of the Arab Spring, IFIs failed to change their approach to the deep economic problems in the Arab world. They retained the same neoliberal recipes, despite their revision and some good governance. Due to the global crisis, in addition to social and internal pressures, macroeconomic indicators in several Arab countries deteriorated. This forced them to seek recourse at the IMF, which imposed tough conditions, similar, to a large extent, to those promoted in Europe. Thus, maximum priority was given to controlling fiscal deficit, through the adoption of austerity measures as a prerequisite to regain the trust of the private sector and, thereby, raise the pace of investment and growth to create jobs needed by the region's people.

While it is still early to predict the economic consequences of this approach, it is expected that lower subsidies on basic goods, decreased or frozen wages, and increased taxation on consumption will have a negative impact on human development and the purchasing power of the middle class, leading to fragile working conditions.

The IMF limits its approach on the question of social protection to the support provided by the state to its citizens through subsidies on basic goods, which it believes to be the main contributor to deficits in the public budget and balance of payment. Consequently, the IMF is pressuring Arab countries to reduce subsidies with the prospect of their ultimate cancellation. To mitigate the effects higher prices on basic goods, the IMF proposes social safety nets in the form of targeted cash transfers to the poor. However, the political and social impact of such reforms is not guaranteed, considering the difficulties in applying them in the Arab environment and high administrative costs. It will also lead to the impoverishment of the middle classes.

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