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Liberals warn of increasing authoritarianism under President Abdel Fattah Al-Sisi's (2014-present) government as the Criminal Court finds against human rights activists and Sisi appoints former senior military officials governors. The government begins the implementation of the 13% value added tax (VAT) to replace the 10% general sales tax. The government and the International Monetary Fund (IMF) hope it will help bridge the budget deficit, but implementation risks are high. Egypt's three incumbent mobile operators fail to meet the 22 September deadline to acquire 4G service licences, due to objections about their terms, with the National Telecom Regulatory Authority (NTRA) considering an international tender.

Sisi continues to pressure human rights activists as military retains influence

The **Cairo Criminal Court** on 17 September upheld an asset freeze on five prominent human rights activists.¹ The ruling is indicative of increased authoritarianism under President **Abdel Fattah Al-Sisi** (2014-present). The most prominent of the activists is **Hossam Bahgat**, founder of the **Egyptian Initiative for Personal Rights**.² The other activists are **Gamal Eid**, founder of the **Arabic Network for Human Rights Information**, **Bahey eldin Hassan**, founder of the **Cairo Institute for Human Rights Studies (CIHRS)**, **Mustafa el-Hassan**, founder of the **Hisham Mubarak Law Center (HMLC)** and **Abdel-Hafiz Tayel**, founder of the **Egyptian Center on the Right to Education (ECRE)**.³ The court also froze the assets of the CIHRS, the HMLC, and the ECRE.⁴ The activists face charges of using foreign funds to undermine national security.⁵ They face 25-year prison sentences if the court pursues prosecutions against them.

The case began in 2011, but then justice minister **Ahmed El-Zind** revived it in March 2015.⁶ Liberal groups allege that the government is using the threat of legal action to curb criticism. International non-governmental organisations (NGO) including **Amnesty International** immediately criticised the ruling.⁷ The cabinet on 9 September approved a draft law to regulate the activities of NGOs in **Egypt**.⁸ However, it did not publish details of the draft law, which the state council and parliament must still approve.

Increased repression of liberal activists and students is undermining Sisi's support amongst the middle classes who felt more secure under former president **Hosni Mubarak** (1981-2011).⁹

"The professional elite – the lawyers and doctors – who earned their wealth under Mubarak are concerned about their and their children's security. Previously, under Mubarak, the lines were clear between what you could and couldn't say. There was some limited space to criticise the

¹ MENA, 17 Sept 2016.

² Aswat Masriya, 17 Sept 2016.

³ Aswat Masriya, 17 Sept 2016.

⁴ MENA, 17 Sept 2016.

⁵ Aswat Masriya, 17 Sept 2016.

⁶ Aswat Masriya, 17 Sept 2016.

⁷ Amnesty International press release, 17 Sept 2016.

⁸ Daily News Egypt, 9 Sept 2016.

⁹ Source, business consultant, Egypt

*government. Now, the lines are blurred. It's entirely arbitrary when you get a knock on the door from **Homeland Security**. The elite are sending their children to international universities out of a fear a single social media posting will see them locked up."*¹⁰

The **Alexandria Military Court** on 18 September delayed a final ruling in a case involving 27 workers at the military-owned **Alexandria Shipyard Co.**¹¹ Similar labour action at politically and economically sensitive sites may possibly deter potential investors in the government's planned part-privatisation of state-owned enterprises. It was the third time that the military court had failed to deliver a verdict in the case.¹² The military detained the workers in May after 2,500 workers staged a sit-in over wages, profit shares, and safety measures.¹³ The defence ministry acquired the Alexandria Shipyard Co in 2007, and deployed soldiers in response to the May strike.¹⁴ Legally, military courts can try any offences within a military zone, even if the alleged perpetrator is a civilian. The court offered no explanation for delaying the ruling, but said it would issue a final ruling on 18 October.

Sisi has ensured the continuation of the military's political influence by appointing six provincial governors, five of whom have held senior positions within either the **Homeland Security** domestic security agency or the military.¹⁵ Previously, civilians held three of the six governorships. The six governors are:

- **Atef Abdel Hamid, Cairo.**¹⁶ Hamid is a former **Egyptian Armed Forces (EAF)** officer and transport minister. Hamid is a controversial appointment, as the **Illicit Gains Authority** previously investigated him for abuse of public funds while at the state-owned **Egyptian Aviation Services Co.**¹⁷ Hamid replaces major-general **Ahmed Taymour** who had held the post on an interim basis since the appointment of his predecessor **Galal Saeed** as transport minister in March 2016.
- Major-general **Amr Abdel-Moneim, Qalyubia.** Abdel-Moneim is the current cabinet secretary and former EAF officer.¹⁸
- EAF major-general **Reda Farhat, Alexandria.**¹⁹ Farhat's predecessor, **Mohamed Abdel Zahar**, was involved in a dispute with national development minister **Ahmed Zaki Badr** over alleged national government interference in the governorate.
- **Essam El-Din El-Bedawai, Minya.** El-Bedawai is a former **Egyptian National Police** governor.²⁰
- Major-general **Ahmed Mohamed Hamed, Suez.** Hamed is a former senior officer in the **Egyptian Air Force.**²¹
- **Gamal Sami, Fayoum.** The only new governor without a military background is a university professor.²²

With the new appointments, only eight of **Egypt's** 27 governors have civilian backgrounds.

Sisi has also proved unwilling to curb the business interests of the military, which gives it an undue advantage over other investors, and remains a politically sensitive issue.

*"Sisi has not challenged the military business model, where it benefits from cheap land, cheap power and cheap transport."*²³

¹⁰ Source, business consultant, Egypt

¹¹ Daily News Egypt, 18 Sept 2016.

¹² Daily News Egypt, 18 Sept 2016.

¹³ Daily News Egypt, 18 Sept 2016.

¹⁴ Daily News Egypt, 18 Sept 2016.

¹⁵ Daily News Egypt, 10 Sept 2016.

¹⁶ Daily News Egypt, 10 Sept 2016.

¹⁷ Daily News Egypt, 10 Sept 2016.

¹⁸ Daily News Egypt, 10 Sept 2016.

¹⁹ Daily News Egypt, 10 Sept 2016.

²⁰ Daily News Egypt, 10 Sept 2016.

²¹ Daily News Egypt, 10 Sept 2016.

²² Daily News Egypt, 10 Sept 2016.

²³ Source, business consultant, Egypt

VAT comes into force

The government on 9 September began the implementation of the 13% value added tax (VAT) to replace the 10% general sales tax.²⁴ The effective implementation of VAT and its smooth passage of the legislation through the house of representatives bodes well for other economic reform efforts as the government looks to increase fiscal revenue to address the budget deficit. VAT is now applicable to a specified list of goods and services. Under the previous system, general sales tax was only applied at the final point of sale.²⁵ VAT will now be collected throughout the supply tax, streamlining tax collection and reducing the risk of evasion.²⁶

*“Those who oppose the VAT law argue that it will contribute to inflation and further burden poor Egyptians, while those in favour argue that this form of taxation has the potential to streamline tax collection and to tackle the informal economy, thus providing Egypt with a much-needed increase in revenue. The VAT is symbolically important too, in that previous governments have made little effort to introduce reforms, fearing a situation like the bread riots of the president **Muhammad Anwar el-Sadat** (1970-1981) era would ensue. That this government is doing so, signals movement on these issues to market and to potential foreign investors.”²⁷*

Parliament approved the VAT legislation on 28 August.²⁸ The pro-government **Coalition to Support Egypt (CSE)** voted in favour of the bill, while members of the **Al Nour** party and the **25-30 Alliance** voted against. The house of representatives made insubstantial changes to the draft legislation that the finance ministry proposed (see *ARC Briefing Egypt August 2016*). The most notable change is that the VAT rate will stand at 13% in the first year of implementation before rising to 14% in the second year onwards.²⁹ The government had originally proposed the immediate implementation of 14% VAT.³⁰ Some members of parliament (MPs) had in response sought to lower the VAT rate to 10%, but finance minister **Amr El-Garhy** proposed 13% and the incremental increase to 14% as a compromise to secure the bill’s passage. The finance ministry claims that the compromise will cost the government EGP 12 billion (\$1.4 billion) in lost revenue in 2016/2017.³¹

The VAT legislation also increased penalties for tax evasion. The law provides for three- to five-year prison sentences and fines of up to EGP 50,000 (\$5,631) for tax evaders.³² It also allows for the finance minister to resolve tax evasion disputes out of court.³³ MPs had requested that tax evasion penalties be a percentage of taxes due, but Abdel-Al rejected this as unconstitutional.³⁴

The **International Monetary Fund (IMF)** has welcomed the enactment of VAT. The IMF board included the implementation of VAT amongst conditions for approving Egypt’s request for a \$12 billion three-year extended fund facility (EFF) (see *ARC Briefing Egypt August 2016*). IMF mission chief to Egypt **Chris Jarvis** on 30 August described the passage of the legislation as an *“historical achievement”* and the bill itself as a *“good”* law.³⁵

However, there are significant implementation risks. Egypt has a track record of failing to meet its tax revenue targets due to weak institutional capacity and poor growth. This increases the uncertainty about whether VAT will allow Egypt to substantially decrease the budget deficit.

²⁴ Enterprise, 29 Aug 2016.

²⁵ Enterprise, 29 Aug 2016.

²⁶ Enterprise, 29 Aug 2016.

²⁷ Source, journalist, Cairo

²⁸ Enterprise, 29 Aug 2016.

²⁹ Enterprise, 29 Aug 2016.

³⁰ Mubasher, 29 Aug 2016.

³¹ Mubasher, 29 Aug 2016.

³² Enterprise, 29 Aug 2016.

³³ Enterprise, 29 Aug 2016.

³⁴ Enterprise, 29 Aug 2016.

³⁵ Jarvis quoted in Al Shorouk, 30 Aug 2016.

“Given the scope of Egypt’s vast informal economy, this is a tall project, how are you going to formalise and enforce? What thought has the government given to this? And will they be enforcing across the board? Or will it be a kickbacks kind of system where they quietly make exceptions for some?”³⁶

Various administrations had proposed replacing the general sales tax with VAT since the mid-2000s. However, concerns about correlated inflationary pressures on poor households made the subject politically sensitive. According to the government **Central Agency for Public Mobilization and Statistics (CAPMAS)** data published in July, 27.8% of Egyptians live under the poverty line compared to 26.3% in 2012/2013.³⁷ Inflation reached 15.5% in August.³⁸ The August figure was the highest since 2008, and a 200 basis points increase on July.³⁹

*“Inflation and price hikes are the big concerns; with prices already at an all-time high, people are worried what the VAT will mean for them. The government has been at pains to say that vulnerable Egyptians will be protected. It seems more than inflation: what will happen is that business will exploit the VAT as an opportunity to put their prices up. Just as the banks have exploited the currency situation to impose new conditions that benefit them, under the guise that such new conditions come from the **Central Bank of Egypt**.”⁴⁰*

The IMF’s insistence on the implementation of VAT has given Sisi political coverage to introduce an unpopular measure.⁴¹ However, it appears that Sisi is concerned about the impact of economic reforms on the poorest communities. At the opening of a housing project in **Alexandria** on 26 September, Sisi said the government is working to control inflation through increasing the supply of goods “regardless of the price of dollars”.⁴² This was possibly a signal that a currency devaluation is imminent. It also indicates that the government will probably have to increase social spending to avoid additional unrest if VAT contributes to increasing poverty levels. Egyptians are sceptical about the government’s intentions and capacity to meet their needs.

“With the economy in bad shape Egyptians are being increasingly critical of the government. They are feeling that once again they are being taken advantage of by leaders who are not capable of making choices that are in the best interests of the majority.... With both the VAT and fuel subsidy reduction on the table, and the impending devaluation, it remains to be seen how Egyptians will ultimately react to the reform package.”⁴³

A general lack of confidence in government public financial management increases implementation risks around VAT.

“Sisi gave a speech recently in which he asked Egyptians to give their spare change to the government for development projects. It’s not the first time he invokes such an idea to receive universal mocking across the country. People took to social media to mostly say they he can’t have their change because who knows where it will go. And this will be the determining factor with VAT. Enforcement and trust. People are reluctant to pay money when they don’t know where it will go. It remains to be seen, but I expect at some point not only difficulties with enforcement, but a general backlash about the reforms coming, especially with VAT in regard to where exactly these revenues are going.”⁴⁴

³⁶ Source, political commentator, Cairo

³⁷ www.arabfinance.com

³⁸ Reuters, 9 Sept 2016.

³⁹ Bloomberg, 9 Sept 2016.

⁴⁰ Source, financial journalist, Cairo

⁴¹ Source, journalist, Cairo

⁴² Daily News Egypt, 26 Sept 2016.

⁴³ Source, political commentator, Cairo

⁴⁴ Source, financial journalist, Cairo

Telecommunication operators reject 4G licence

Egypt's three incumbent mobile operators failed to meet the 22 September deadline to acquire 4G service licences.⁴⁵ Despite concerns about currency volatility, the size of the Egyptian market will prove attractive to new market entrants. **Vodafone Group Plc** subsidiary **Vodafone Egypt Telecommunications SAW**, **Orange SA** subsidiary **Orange Egypt** and **Emirates Telecommunications Corp** subsidiary **Etisalat Misr** all declined to acquire 4G licences due to objections about their terms.⁴⁶ Both Orange and Vodafone said the quantity of spectrum offered would not allow it to offer 4G services up to international standards.⁴⁷ The three carriers also objected to the licence provision that required them to pay half the fee in dollars.⁴⁸ The licences are valid for 15 years with a possible five-year renewal, and require services to come online within six months of agreement.⁴⁹ It is unclear if the operators will seek a compromise solution with the Egyptian government.

State-owned landline monopoly **Telecom Egypt** on 1 September did secure a 4G mobile licence.⁵⁰ The licence is not conditional on Telecom Egypt disposing its 45% stake in Vodafone Egypt, raising concerns about market competition.⁵¹ Telecom Egypt paid EGP7.08 billion (\$878m) to secure its licence.⁵² Telecom Egypt will need to pay EGP 5.2 billion (\$585.6m) immediately, and the remainder in instalments over a four-year period.⁵³ Telecom Egypt is in advanced negotiations to secure bank finance overdraft facilities to fund the upfront cost of the licence.⁵⁴

The **National Telecom Regulatory Authority (NTRA)** board will convene on 10 October to discuss launching an international tender.⁵⁵ The NTRA has said that it will offer market entrants different terms to existing domestic operators.⁵⁶ **China** state-owned **China Telecommunications Corp**, **Kuwait**-based **Zain Group**, **Saudi Arabia**-based **Saudi Telecom Co**, and **Lebara KSA** have all reportedly expressed an interest in securing a licence.⁵⁷

Implications

The Sisi administration has succeeded in weakening all organised political opposition, including NGOs. With opposition leaders either in prison or afraid to act, there is little capacity to coordinate protests despite growing public discontent over living costs. The lack of formal political opportunities for opponents of the Sisi administration will encourage militancy. The military is perhaps the only political actor with the necessary authority to act as a check on Sisi. However, by not challenging its economic role, Sisi is not giving the military any reason to intercede.

The government will have to continue its high level of social spending to assuage concerns that public discontent over living costs and distrust of the government's public financial management results in protests. This will delay efforts to meet the budget deficit. Fiscal reform will be more politically palatable if the government introduces it gradually and alongside efforts to improve effective and transparent revenue collection and broader public financial management. Until government tax revenue increases, investors are at greater risk of payment demands.

⁴⁵ www.AlArabiya.net

⁴⁶ www.AlArabiya.net

⁴⁷ Bloomberg, 22 Sept 2016.

⁴⁸ Reuters, 22 Sept 2016.

⁴⁹ Gulf News, 1 Sept 2016.

⁵⁰ Gulf News, 1 Sept 2016.

⁵¹ Gulf News, 1 Sept 2016.

⁵² Gulf News, 1 Sept 2016.

⁵³ Gulf News, 1 Sept 2016.

⁵⁴ Reuters, 1 Sept 2016.

⁵⁵ www.AlArabiya.net

⁵⁶ www.AlArabiya.net

⁵⁷ Gulf News, 19 Jul 2016.

The similar language that the mobile companies used in explaining why they rejected the 4G licence suggests a degree of coordination. This united stance will increase pressure on the government to reach a compromise with them to accelerate the development of the information communication technology (ICT) sector. Further, Telecom Egypt's licence is useless if it is unable to reach a local roaming agreement with the mobile companies, suggesting that it is in the government's interests to compromise. However, the government may be tempted to launch an international tender process as it could then receive dollars for the total value of the licence. If the government wants to secure the maximum amount of hard currency, it may offer a combined mobile, landline and 4G package.

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