December, 1981

PRIVATE SECTOR INDUSTRIAL DEVELOPMENT STRATEGY

Paul G. Clark

This is one of a set of studies of Egypt's industrial development strategy undertaken by economic consultants participating in a Boston University project for the U.S. Agency for International Development, Cairo.

Private Sector Industrial Development Strategy: Contents

Private Sector Industrial Development Strategy: Executive Summary

I. General Private Sector Strategy

The expanding role of the private sector has been a key feature of Egypt's economic experience since the strategy of El Infitah was adopted. Its share in production, although still modest, has been growing. Its rising share in investment implies increasing momentum in the future.

The Law 43 companies have been the leading edge of the response to successive steps in liberalization of the economy. Manufacturing projects have about half of the LE 4200 million of total investment in inland non-financial projects approved by end-1980. Egyptian owned companies have about 40% of total capital. Two problem areas, however, are that exports by Law 43 companies have been less than expected, and that the experience with Free Zones has been disappointing.

We interviewed 46 private companies -- selected from four industries and including Law 43 and other Egyptian companies. Most of the companies are expanding production by at least 20-30% per year, and many more rapidly than that. They sell in domestic markets on the basis of product quality and service to customers, and feel they can readily out-compete public sector rivals. There are many stories of enterprising responses by individual companies to market opportunities.

The government has adopted or is considering three major policy initiatives that would further stimulate the private sector.

1. The new Company Law will remove or relax for all private companies many restrictive provisions that were lifted earlier for Law 43 companies.

2. The revised income tax law will reduce decisively the extra tax burden previously imposed on income from distributed profits vs. income from interest. It would lower the tax rate on retained profits to 20-32% (as well as cutting all other rates).

3. A variety of ideas for developing the domestic financial markets include inducing more Law 43 companies to raise funds through public share issues, and continuing to raise nominal interest rates to positive real levels.

Although one may reasonably criticize some aspects of these proposals (notably reducing taxes across the board), taken together they seem likely to give an impetus to private sector development comparable to Law 43.

External donors should be supportive of these three initiatives, particularly in the form of program or sector assistance to cushion initial costs in the balance of payments or (especially) the budget.

II. Industrial Export Strategy

Rapid expansion of industrial exports is probably the key to an appropriate development strategy for the eighties. (a) Export expansion is needed to maintain availability of foreign exchange as remittances, petroleum earnings, and external aid rise more slowly. (b) An export oriented industrial sector is needed to generate sufficient employment; exports permit output to grow more rapidly and tend to be more labor intensive. (c) Industries that export must have comparatively low real costs, so their growth increases the overall efficiency of the industrial sector.

An industrial experts strategy must be launched now in order to yield benefits by the latter eighties, when they will be most needed.

Among the companies we interviewed, substantial exporters were more frequent in textiles than other industries, and among Law 43 companies than other companies, but much depends on the strategy of individual owners. Predominantly negative comments about the existing customs drawback scheme indicate that a basic change is needed. There are many indications that companies are sensitive to factors affecting the relative profitability of exports and domestic sales; export prices were generally reported to be lower.

Egypt faces some underlying economic obstacles to expanding industrial exports. (a) Abundant foreign exchange earnings in the near future will lead to a lower exchange rate than is needed to stimulate exports for later in the decade. (b) Domestic inflation at rates above international inflation will reduce the profitability of exports. (c) Protection and import substitution policies create unintended biases against exports.

Industrial export policies must therefore aim to raise substantially the profitability of exports vis-a-vis domestic sales.

1. The two-market exchange system should be retained, in order to give all industrial exports the more favorable rate in their own exchange market, and the official rate should be kept closer to equilibrium.
2. A new tax rebate system, to replace customs drawbacks, should provide a prompt, standard rebate for each kind of product, adequate to cover all customs duties and taxes that directly or indirectly raise the input costs of exporters.
3. An export credit system with preferential interest rates should be established.

4. Institutions that now control exports should be transformed into export promotion agencies.

External donors should support such innovative policies for industrial export expansion, either through program or sector assistance, or through project support for the tax rebate system or the export credit system.

III. Industrial Financing Strategy

Industrial financing is an area for both permissive and incentive policies to encourage private industrial investment.

The main institutions financing private industry fall into three groups. The Development Industrial Bank is much the largest, is relending concessional loans from external donors, and gives considerable attention to small scale companies. Misr Iran and the Arab Investment Bank are publicly owned Law 43 investment banks, obtain most of their funds from deposits, and aim at larger projects. Although the Law 43 banks mainly take short term deposits and make short term trade loans, their medium term project lending is significant in aggregate, and varies among bank managements.

We supplemented our 46 company interviews with interviews of 14 banks of different kinds. There has not been any problem with equity funds, largely because most companies prefer to be family affairs. Three-fifths of the companies had had medium term foreign exchange loans, often more than one for successive investments. The others either did not need to borrow or were averse to it. Company experiences and bank comments suggest that overall supply and demand of medium term funds are about in balance. There are more disputes about lending terms; jumps in eurocurrency interest rates have raised companies' costs under existing loans with variable interest charges.

Industrial financing policies should be improved in two main ways -- by modifying terms of financing and by broadening channels for lending to small scale companies.

1. Industrial projects must face major business risks during their gestation process -- more serious than in trade and services. Exchange rate and interest rate risks, however, are financial risks which most companies are not well suited to bear. The government can assume these risks if it is effectively managing the balance of payments and debt servicing capacity of the whole economy.
2. The preferred terms for foreign exchange loans would be repayment in pounds at the exchange rate when the loan was made, and a fixed interest rate for the term of each individual loan. The government could authorize such terms on loans from special funds channeled through financial institutions.
3. The DIB already offers nearly these terms, using concessional funds from external donors; the government would need only to assume the exchange risk. Misr Iran and the AIB could offer similar terms on part of their loans, by obtaining concessional funds through the government from external donors. The Law 43 banks could do so, if an Industrial Financing Fund with external donor support (similar to the new Private Investment Encouragement Fund) were set up to share in individual banks' loans.
4. Additional channels should be set up to finance projects of small scale industrial companies; only the DIB has substantial activity now. The basic problem is that such lending is more costly to lenders, so must have outside support. A Small Industry Fund with

external donor support could first help Misr Iran, the AIB, and a few active Law 43 banks build up their small scale capability, and then share in their lending to small companies.

External donors should support such improvements in private sector industrial financing, by providing concessional funding for Misr Iran and the AIB to expand lending at improved terms; for the suggested Industrial Financing Fund to share with Law 43 banks in improving terms; and for the suggested Small Industry Fund to build up additional channels dealing with small scale industrial companies.

PRIVATE SECTOR INDUSTRIAL DEVELOPMENT STRATEGY

Paul G. Clark[1]

I. General Private Sector Strategy

The expanding role of the private sector has been a key feature of Egypt's economic experience during the seventies, since the strategy of El-Infitah (the opening) was adopted late in 1973. The private sector has been the leading edge in the response of producers to successive steps in liberalization of the economic system.

A principal objective of El-Infitah has been a broader and more active private sector, within Egypt's mixed system of public and private enterprises. We can distinguish two main elements in a purely economic rationale for this objective. First, private companies are likely to have comparative advantages in carrying out some of the economic adjustments needed for more rapid development. For example, they seem to be comparatively effective in searching out foreign markets for expanding industrial exports. Second, by being especially responsive to market incentives, private companies are likely to increase competition in domestic markets. More competitive markets, in turn, ought to stimulate both the public and the private sectors to become more progressive. We should

---

[1]My colleagues throughout this study have been Prof. Sultan Abu Aly of Zagazig University and Prof. John Stewart of American University in Cairo. We have worked together in defining procedures, carrying out the research, and discussing findings and implications. Ultimately, however, I must accept responsibility for the judgments in this report.

keep these two considerations in mind as we examine the actual experience with private sector development.

A. The momentum of private sector expansion

The private sector enters the eighties with a great deal of momentum. Its share in production, although still modest, has been growing, and its rising investment share implies continuing output growth in the future.

Last year the Ministry of Planning revised the national accounts estimates for the years 1975 through 1979. Adjustments were made particularly in sectors in which private activities are prominent, and in which revised sample bases and new data permitted fuller coverage of them.[1] For 1979, trade and finance was raised 35% in 1975 prices and 86% in current prices; housing, 73% and 78%; construction, 8% and 63%. The combined effect of these and other adjustments was to raise GDP at factor cost in 1975 prices by 7%, GDP at factor cost in current prices by 19%, and the implicit GDP deflator by 11%. Thus the revised national accounts show a significantly different picture of the present sector structure of the economy. Over the 1975-79 period, they also indicate a marginally higher real growth rate of the aggregate economy (8.7% vs. 8.5%), a notably higher growth rate at current prices (24% vs. 20%), and a notably higher implicit inflation rate (14% vs. 11%).

Within the industrial sector, private sector activities are still relatively large in certain industries and quite small in others. A 1977 breakdown between public sector and private sector value added for 18 industries within manufacturing (excluding petroleum refining) indicates

---

[1] See IMF, Arab Republic of Egypt - Recent Economic Developments, January 1981. Adjustments are calculated by comparing the revised figures with previously available figures for 1975 to 1979.

an overall 33% share for the private companies. (See Table 1.) The industries with higher private shares (in order of amount of private value added) were foods (65%), clothing (87%), wood products (90%), metallic products (38%), printing (55%), and leather products (82%). The six largest industries with private shares under 20% (in order of total value added) were spinning & weaving (18%), chemicals (20%), basic metals (8%), other manufacturing (11%), transport equipment (9%), and electric machinery (8%). This general pattern of private sector or public sector concentration in particular industries is likely to change only gradually.

The trends over time, however, generally indicate relatively more rapid expansion of the private companies within a given industry. In those industries under the supervision of the Ministry of Industry, the recorded value of output from 1976 to 1980 increased by about 24% per year for the private companies, as against about 19% for the public companies. (See Table 2.) There were differentials in favor of the private companies in all four of the large industries -- spinning and weaving, foodstuffs, chemicals, and engineering and metal products. Moreover, as ministry officials indicate, coverage of the newer Law 43 companies in these data is incomplete, and trends of private sector expansion are probably understated.

The share of the private sector in aggregate investment has also been rising, with significant implications for the future. From 1975 to 1979, the share of the private sector in gross fixed investment for the economy as a whole rose from about a fifth to about a fourth, while the share of the new Law 43 companies in total private investment rose from about a tenth to about half. (See Table 3. These figures are part of the revised national accounts.) Within the industrial sector, Law 43 investment alone had risen to 22% of the total by 1979; within services, to 25% (largely tourism); and within agriculture, to 14%. Since production necessarily lags behind investment, the rising private share in investment implies that the private share in production is likely to continue to increase in the future.

B. Experience under Law 43

The most dramatic element of the new economic policies of Al-Infitah was to welcome Arab and foreign investment in Egypt. The arrangements for foreign investment, however, have actually worked out as the key channel for a much broader process of expanding the role of the private sector in the Egyptian economy.

The revised investment policies are reflected in Law 43 of 1974, as clarified in certain respects by Law 32 of 1977. Investment projects subject to Law 43 must be approved and registered by the Investment Authority. The criteria for approval are quite broad, however. Projects involving Arab or foreign investors are generally expected to be joint ventures with Egyptian investors. The Egyptian partners may be private individuals or companies, or they may be public sector companies, which treat their participation in the joint venture as a private sector subsidiary. Moreover, projects which are entirely Egyptian owned are eligible for Law 43 status, and a substantial fraction of the projects undertaken are indeed wholly Egyptian.

The most significant incentives under Law 43 are that approved projects are exempted from many restrictive laws which would otherwise apply to private sector companies. These exemptions permit greater discretion in many important areas -- hiring workers without going through the employment offices, amount of any distribution of profits to workers, nature of worker participation in management, composition of shareholders and boards of directors, rentals which can be charged in new buildings, importing and exporting without licenses. Thus the new private sector ventures under Law 43 have an unprecedented scope for operating commercially in response to market conditions.

Law 43 projects are eligible for a number of financial incentives. Profits are exempt from the commercial and industrial profits tax for a tax holiday period -- typically five years, although in special cases longer. Interest on foreign loans is exempt from both the relevant schedular income tax and the general income tax during the tax holiday, and distributed profits up to 5% of investment are exempt from the general income tax indefinitely. The Investment Authority may grant some projects exemption from customs duties and import taxes on their imported capital equipment and construction materials. After being approved many projects do obtain at least some exemptions.

There are some special provisions for banks in the law. Joint venture commercial banks, operating both in local currency and foreign exchange, are authorized, with a minimum of 50% Egyptian equity. Joint venture investment banks are also authorized, operating only in foreign exchange, but free to finance foreign trade as well as investment. Finally, wholly foreign branch banks are authorized, operating only in foreign exchange. The Law 43 banks are subject to Central Bank regulations in their foreign exchange transactions, but in practice have operated quite freely.

The law also establishes Free Zones in which manufacturing, storage, and services may locate. Projects in free zones can import goods from abroad or export goods to abroad, free of customs duties and with simplified clearance procedures. Local goods entering a zone pay any applicable export duties, however, and goods moving from a zone into the domestic economy are subject to customs duties (adjusted in the case of manufactured products for the percentage of local costs). In lieu of any profits tax, free zone projects pay the Investment Authority an annual fee of 1% of the value of goods entering the zone (for storage projects) or leaving it (for manufacturing projects).

What can be said about the economic effects to date of the new investment projects formed under Law 43?[1]

First, the Law 43 program is broad and diverse. There were about 1,300 approved projects, as of Dec. 31, 1980, with total authorized investment of about LE 6,800 million. (See Table 4.) It is helpful for analysis to separate the free zone, banking, and petroleum projects, which operate under quite distinctive circumstances. The remaining "inland non-financial" projects have an investment value of about LE 4,200 million. The sector composition of this investment was about 50% in manufacturing, 20% in tourism, and 10% each in agriculture, housing, and services. Within manufacturing, the industry with largest authorized investment was building materials (33%), followed by engineering products and textiles (17-18% each), and then foods and chemicals (13% each).

Projects are typically joint ventures, as expected. More projects are wholly or essentially Egyptian owned, however, than are wholly or essentially foreign owned. About 40% of authorized capital in the inland non-financial sectors is in companies with nine-tenths or more Egyptian capital, about 10% is in companies with nine-tenths or more Arab or foreign capital,

---

[1]The analysis here draws on a Study on Law 43 Investment Policies, carried out by a working group under Abdel Galeel El Emary, former Central Bank governor, and published by the Ministry of Economy in December 1979. Some of the statistics have been updated to Dec. 31, 1980.

and about 50% is in other joint ventures.

In the second place, the Law 43 program has built up a considerable pipeline of approved investment projects which are under execution or still being organized, and not yet in production. As of Dec. 31, 1980, only about 17% of the LE 4,200 of inland non-financial investment had reached the production stage; about 44% was under execution, and the remaining 39% had only been approved. (See Tables 5 and 6.) Some such pipeline is an inherent feature of any investment process, but its size in this case probably reflects in part remediable delays in the implementation of Law 43 projects. The El Emary report inferred that the most important problem causing delays was finding a suitable location, with adequate land, infrastructures, and telephone and utility connections. There was evidently a strong unsatisfied demand for locations in planned industrial areas.

At the same time, it is significant that the movement of projects from the pipeline into production has recently been accelerating. Between end-1978 and end-1980, the value of inland non-financial projects in production rose from LE 329 to LE 699 million (for manufacturing, from LE 64 to LE 277 million). The value of new approvals during the two-year period, however, was LE 1736 million (for manufacturing, LE 1036 million). Thus the pipeline of projects under execution actually increased by LE 524 million (for manufacturing, LE 263 million), while the pipeline of projects only approved also increased by LE 743 million (for manufacturing, LE 559 million). In view of the size of the present pipeline, and the recent trend in projects entering production, it seems evident that the value of Law 43 investment coming into production will continue to increase rapidly during the next few years.

In the third place, one of the aims of Law 43 has been to accelerate innovation in products or techniques of production. The El Emary study inferred that a considerable fraction of inland non-financial projects are introducing new or better products (e.g. many projects making plastic products or engineering products), and that a substantial majority are making innovations in productive techniques (typically through more modern machinery) or management (e.g. in tourism or housing construction).

Another aim of the program has been to expand employment opportunities. Although employment effects will increase as more projects come into production, their magnitude will be limited by the fact that the average capital per job in Law 43 projects is about double the overall average for the economy.

Fourth, probably the most important effect of the Law 43 program is that the new investment projects are the leaders in the expansion of the private sector. The 1,300 approved projects involve formation of a large number of new private companies. These companies are permitted to operate much more responsively to market forces than could the older private companies, and they also benefit from initial financial incentives. The 40% of projects which are wholly or essentially Egyptian-owned are the key channel through which private individuals (including returned emigrants) are investing. In addition, the 50% of projects which are essentially joint ventures include many in which the Arab or foreign partners can contribute improved product designs, production techniques, or management experience. Thus the private companies operating under Law 43, though still only a small part of the economy, are a significant source of competitive market pressures in a more liberalized economy.

Moreover, the Law 43 program is affecting the dominant public sector of the economy. About a fifth of inland non-financial investment under Law 43 is in projects in which public companies are partners. Such projects are most prominent in tourism, agriculture, textiles, and building materials. Public sector managers typically seek joint ventures in order to avoid the many constraints on managerial discretion under which they have chafed. Entering joint ventures poses certain problems for the vigor of the parent companies, and raises broader policy issues.[1] But the point here is that Law 43 enables some public companies, through new private subsidiaries, to become more responsive to market forces in part of their activities. In addition, public sector companies will increasingly have to react to competitive pressures from the private sector.

The Law 43 banks also appear to be playing a significant role in modernizing the banking sector of the economy. (The new banks' activities in financing trade and investment are analyzed in Part III.) The El Emary report observed that they have been a significant channel for repatriation of Egyptian foreign exchange holdings, provided banking services need by other Law 43 projects, helped create an active inter-bank market in Egypt, contributed to lowering interest premiums over London inter-bank offering rates which Egypt pays in financing exports and imports, and begun to stimulate the four public sector Egyptian banks to become more competitive. At the same time the report concluded that the existing number of banks was already sufficient for these purposes, and suggested ways in which the four public sector commercial banks could respond more

---

[1]See Leroy Jones, Improving the Operational Efficiency of Public Industrial Enterprises in Egypt, (another study in this project).

actively to competition and to new banking opportunities.

Thus the experience under Law 43 is predominantly one of momentum and achievement. There have been two problem areas, however, which are particularly relevant for private sector industrial development strategy.

One problem is that exports by Law 43 companies have often been less than originally expected. The law emphasized exports as an objective, and many projects projected significant exports when they were approved. Among inland manufacturing projects that were in production by end-1978, projects proposing to export over a third of output had 52% of authorized investment, and projects proposing to export smaller proportions had 12% of investment. Our company interviews in Part II show that there is actually an impressive range of export activity among Law 43 companies, yet at the same time a number of companies which expected to export are not doing so. There seem to be two general reasons -- apart from simply over-optimistic goals set during the approval process. The economy has been expanding rapidly and having considerable inflation, so that domestic sales have been easier and more profitable. The liberalization of foreign exchange availability, particularly through the own exchange market, has reduced pressure to obtain foreign exchange through exports. To address this export problem, the El Emary report emphasized general export promotion policies to raise the profitability of exports relative to domestic sales for the whole economy.

Another problem is that the experience with the Free Zones has been disappointing. One would expect Egyptian free zones to attract significant export oriented manufacturing, in view of Egypt's location near Europe and at the center of the Arab world, and its experience as the most industrialized large Arab country. Approved free zone projects actually amount to about a fifth of total authorized investment under Law 43, with manufacturing projects about half of the free zone total, storage projects somewhat over a quarter, and service projects somewhat under a quarter. But most of the manufacturing investment was not under execution by end-1978, so about 85% of the investment actually in production was in storage or services projects. The difficulty is partly that infrastructure investments in the organized public free zones have lagged, so many projects have located temporarily in areas designated as private free zones, or have simply been delayed. Unwillingness of Arab Common Market countries to consider free zone exporters eligible for tariff preferences, and the political estrangement between Egypt and other Arab countries, have been obstacles.

The early prominence of storage projects in the free zones poses problems. They yield less employment and lower returns to the economy than manufacturing, have rent and tax advantages in competing with storage and wholesale trading companies located inland, and occupy a large fraction of the limited land area in the existing zones. They also require more difficult controls against smuggling. The El Emary report proposed that the Authority should not approve additional storage projects, and should raise rentals and seek to release space within the zones for manufacturing. It also suggested that the Authority should schedule construction to speed completion of those areas within zones which are furthest advanced, and should operate some areas within the larger zones as industrial areas for inland industrial projects.

Despite these problem areas, the general experience under Law 43 seems to demonstrate how responsive to market opportunities private sector companies are, when the legal and economic environment enables them to be so. The momentum built up by the new Law 43 companies during the seventies provides the foundation for further progress in private sector industrial development during the eighties.

C. The private sector other than Law 43

Private companies other than those formed under Law 43 fall into two groups.[1] One group are companies formed under Law 26 of 1954. These are companies with a legal existence independent of the persons of their owners, and may be organized either as joint stock companies or as one of two forms of limited liability companies. They are subject to the Companies Administration of the Ministry of Trade. The other group are partnerships formed under the general commercial code. They are considered legally as extensions of the persons of their partners, and may be organized either as limited or as general partnerships. These companies are simply registered in the Commercial Registry.

As of the end of 1979, the Investment Authority indicated that there were 724 Law 43 companies, of which 396 were joint stock companies The Companies Administration indicated that there were 308 Law 26 companies, of which only 47 were joint stock companies. The Commercial Registry indicated that there were 82,000 partnerships, predominantly of the general (unlimited liability) type. Although the data are not fully comparable, it appears that the Law 26 companies have only a modest fraction of the investment and the employment of the Law 43 companies,

---

[1] See Hafez Ghanem and Dina Dakroury, "A Review of the Economic Effects of Changes in the Companies Law," unpublished paper, April 1980.

and also much less than all the partnerships taken together. Over the three years 1977 to 1979, while about 500 companies were being formed under Law 43, about 100 were formed under Law 26.

D. Indications of growth and competitiveness from company interviews

As one important part of this study we have interviewed owners or executives of 46 private sector companies about their domestic growth and competition (see Part I), export sales and problems (see Part II), and investment financing sources and problems (see Part III). The companies were chosen from four industries -- textiles (13), chemical products (11), engineering and metal products (15), and foods (7). They included three kinds of companies -- Law 43 joint ventures (21), Law 43 Egyptian companies (11), and other Egyptian companies (14). The interviews pursued the same general questions, in a flexible style that permitted pursuing interesting experiences, and were conducted by one or more of the three principal participants in the study.

The 46 companies are not intended to be a representative sample of all private sector industrial companies. Rather, our sample is designed to reveal reasonably representative experiences -- in domestic production, exports, and investment financing -- that the three kinds of companies in four interesting industries have had.

The Law 43 companies were selected from the records of the Investment Authority, and most of the non-Law 43 Egyptian companies had been borrowers from the Development Industrial Bank. The selection of individual companies sought to exclude ones that had not been in production for two years, and to include a significant number that were thought to be exporting. The companies turned out to have equity capital mainly in the range

LE 200 thousand to LE 5 million, and employment mainly in the range 25 to 1000.

The general picture of expansion of production and sales is impressive. A third of the companies in our sample are expanding production and sales by 20-30% per year, and half are expanding at rates higher than that. A sixth are growing relatively slowly or not expanding, and a few face real difficulties. Although these figures usually refer to values, the rates of volume increase probably average only moderately less, since many companies had only recently started production. Very rapid growth seems to be most frequent in the textile industry, and least frequent in the foods industry. Very rapid growth seems to be more frequent among Law 43 companies (whether they are joint ventures or wholly Egyptian), but is also found among the non-Law 43 Egyptian companies.

In discussing their competition in the domestic market, the competitive advantage most frequently cited by the companies was quality of product. Quality referred variously to material used, technology embodied in the product, quality control, and style. The other commonly cited advantage was marketing effort and service to customers. This referred variously to prompt and frequent deliveries, dealing directly with customers, providing maintenance service, and adapting products to customers' needs. It may also be noted, as an indicator of competitiveness, that among the companies with rapid or very rapid sales growth, four were selling primarily in export markets and five were making substantial export sales.

The interviews did not obtain information from which firm estimates could be made of the levels of protection against import competition which companies are receiving. (In principle we would like to calculate an effective rate of protection, or ERP, which measures the effect of tariffs or subsidies, on both inputs and outputs, upon the profits and wages earned by domestic producers.) However, we can make some suggestive guesses about whether protection is high, medium, or low -- based on percentages of imports in value of product, tariff rates reported on some products and inputs, comments about import competition, and extent of export sales. In textiles, many companies are capable of exporting -- particularly cotton products, but also some products of other materials. At the same time, some companies seem to have high protection (e.g., ERP perhaps 250%) on domestic sales of clothing of synthetic materials. This apparently results from much higher nominal tariffs on products considered luxuries than on imported materials used to produce them. In chemical products and engineering and metal products, many companies seem to have medium protection (e.g., ERP perhaps 40-60%). This apparently results from nominal tariffs of perhaps 40-60% on the products, which are often intermediate goods or construction inputs, and similar tariff rates on the imported materials. At the same time, some companies in these sectors can export, some seem to have low protection, and some high. In food products, many companies seem to have medium or low protection.

To get the foreign exchange needed for imported inputs to their production process, the great majority of companies in our sample purchase dollars in the own exchange market. Another significant group meet their foreign exchange needs from their own exports, while two obtain partial payments from some customers in dollars. A third group get foreign exchange allocations from the official pool, but since the allocations are insufficient or delayed, they also draw on the own exchange market.

Thus the general picture is that most of the private sector companies interviewed are expanding production rapidly or very rapidly, that they are competing in domestic markets on the basis of product quality and especially service to customers, that a significant fraction are capable of exporting, that many can operate with a medium or low level of tariff protection, and that most rely on the own exchange market to meet their operating needs for foreign exchange. We will examine other aspects of these companies' experiences in Parts II and III, with respect to exports and to investment financing.

Underlying the general picture there are many interesting stories about the responsiveness of individual companies to market opportunities, as they arise in current operations. One company is shifting a step in the production process from a European factory to the Egyptian factory. One company showed a customer how he could cut inventory costs by relying on the company's readiness to make frequent deliveries of any varieties ordered. Several companies are phasing out a low profit product in order to focus on higher profit products. One company, which has had difficulties reaching its sales objectives, is devoting part of its capacity to supplying a single customer, and shifting other capacity into a new product. One company is building a factory to expand from its present stage of producing its product into an earlier stage. Other instances of companies' enterprising actions will be noted when we consider exports and investment financing.

The private companies in our sample often had dealings with public sector companies as suppliers or customers, although they tended to prefer dealing with private companies. A complaint about public sector suppliers was infrequent and unreliable deliveries; some textile companies rewound yarn from public sector mills to remove flaws. A complaint about public sector customers was that the tendering procedures let small price differences dominate quality considerations. The companies interviewed also often had public sector competitors, but very few seemed to feel significant pressure from them. Most indicated that they could readily outcompete public rivals because of product quality and especially customer service. This suggests that continuing expansion of the private sector, with a competitive edge in responsiveness to customers' needs, is likely to exert more and more pressure for reforms to improve the competitiveness of public sector companies too.

E. Current policy proposals for encouraging the private sector

It happens that at the time this study was being made, the Egyptian government was considering three important policy proposals for further encouraging the growth of the private sector. The first is a new Company Law, revising and replacing Law 26 of 1954, which would enable all private companies to operate in a more flexible market oriented style, similar to that now permitted only for Law 43 companies. The second is a revision of company and individual income taxes, which would make the taxation of income from profits more equivalent to the taxation of income from interest and from other sources, and would lower tax rates. The third is a broader range of ideas for development of financial markets, as crucial intermediaries between private savers and private investors.

The company law and the income tax revision were passed by the People's Assembly in August, 1981, and the third group of proposals are being considered in the new Capital Markets Authority and other concerned agencies. These three policy initiatives may have impacts on private sector development as significant as the major policy redirection under Law 43.

The new Company Law is first of all a modern law, designed to facilitate formation of private companies and to enable them to operate flexibly. For example, it simplifies procedures for forming a company, permits companies to have authorized capital larger than issued capital, authorizes mergers and allows companies as well as persons to be partners in limited liability companies, sharpens requirements for independent auditors, and strengthens rights of individual shareholders.

Most importantly, the new law eliminates or modifies greatly the restrictive provisions of Law 26 which were introduced during the sixties. These provisions have surely inhibited private sector activities in many ways. In particular, as implied in section C above, they have apparently led private investors to prefer to remain as partnerships rather than companies, and whenever possible to make investments under the Law 43 rather than the standard arrangements.

Law 26 now requires, in the case of joint stock companies, that at least four members of the board of directors be elected by the workers. The new law permits (via executive regulations) other forms of worker participation in the management of a company, e.g. making board membership contingent on the union having the necessary ownership of shares. Moreover, the new law clearly gives to the board of directors full authority to manage the company. It also eliminates for all companies the present LE 5000 limit on annual compensation for any officer, director, or employee.

Law 26 now requires that 25% of distributed net profits be allocated directly or indirectly to the workers. The new law changes this to 10% of distributed profits (or 100% of the wage bill, whichever is smaller), for companies with more than LE 20 thousand of capital. Naturally this issue has been controversial, but from the standpoint of unions it is reportedly acceptable, and from the standpoint of owners it seems to be a reasonable accommodation to tradition and to a broadly-stated article in the constitution. The new law also drops a mandatory allocation of 5% of distributed profits for purchase of government bonds.

The Shura Council added to the draft law a broad provision granting to companies formed under it all of the benefits of Law 43 companies except repatriation of capital and profits. Depending on how it is interpreted and implemented, this could have two distinct kinds of effects. First, it could extend to all companies some very important Law 43 exemptions from restrictive features of other laws -- from having to hire new employees through the employment offices, from being subject to rent controls on new buildings, and from having to obtain licenses for imports and exports. Second, it could extend five year tax holidays to all companies that invest in the broad fields listed in Law 43, with the approval of the Investment Authority.

From the standpoint of private sector development, the first group of effects seem clearly desirable. Indeed they are necessary to enable new companies to operate as competitively as Law 43 companies. The second effect -- generalizing the five year tax holidays -- seems undesirable. The government's large fiscal deficits, and the serious inflation to which they are contributing, imply that no proposal for tax reductions should be accepted unless it can be justified by large benefits to the economy as a whole. Where tax holidays make economic sense, the case for them is that they can be focused on some kinds of investments, for which the real profitability to the whole economy is notably higher than the financial profitability to the company. They should not be given to other more "average" investments. An argument of "treating everybody the same" is not adequate. (An amusing feature of the debate in the Assembly is that this argument was used by spokesmen for companies in trade and services to contend that the holidays should not be limited even to the broad fields listed in Law 43.)

Turning to the law revising income taxes, there are three aspects of it which call for comment.

One basic difficulty with the present system is that it consists of five schedular taxes on different sources of income -- wages and salaries, commercial and industrial profits, the professions, movable property (i.e., distributed profits, dividends, and interest) and real estate. Both the tax on profits and the tax on distributed profits or dividends are collected at the company level, although in principle the company is liable on the retained profits and the owners or shareholders on the distributed profits. Combined income after the schedular taxes is then subject to a general income tax, which has very progressive rates, but in practice yields little revenue.

This kind of system leads to differences in marginal tax rates upon different forms of income, and distorts incentives, since the various schedules have different rate schedules and exemptions. It also leads to horizontal inequities between taxpayers with the same total incomes, but getting their income from different sources. The income tax revision retains the schedular system, however, and (as in the interim tax law of 1978) patches it up to address the most urgent problems.

From the standpoint of private sector industrial development, the most urgent problem in the present system is that the tax burden on income from profits has been higher than on income from interest. In the early seventies, the schedular tax rates both on commercial and industrial profits and on distributed profits, dividends, and interest were at flat rates, carried over from the past, of about 40%. Then at various times in the late seventies, partly in order to avoid conspicuous increases in nominal interest rates, interest from almost all forms of financial assets has been made tax exempt. The exemptions apply to time deposits, savings deposits, term deposits, investment certificates, development bonds, and dollar deposits -- essentially everything except government bonds purchased compulsorily. Private savers therefore now have a clear, large tax incentive to prefer interest income over income in the form of distributed profits or dividends.

The tax burden on income from profits has also been higher than on income from wages and salaries and from new real estate ventures. The schedular tax on wages and salaries has an exemption and a sequence of lower to higher bracket rates, which hold down the average tax burden. The schedular tax on real estate has percentage rates on assessed values of land and of buildings, which for new ventures not subject to rent control typically work out considerably less than 40% of income. The most worrisome tax differential, however, is between income from interest and income from profits.

The income tax revision has an ingenious device to reduce this tax discrimination against profit income. A reduced tax rate on distributed profits or dividends is to be set below the standard tax rate, which applies to retained profits, by an absolute percentage rate equal to the highest tax-free interest rate on deposits authorized by the Central Bank in a given year. In principle both retained profits and distributed profits of companies are to be taxed under a new schedular corporation tax, rather than under the former profits and movable property schedules. But the effect is still that the company is liable on the retained profits, and the owners or shareholders on the distributed profits, at the new reduced rate. In addition, under the general income tax, there is a rough allowance for the taxes on profits paid at the company level -- in the form of deducting from total taxable income half of the dividends or distributed profits received.

A reasonable tax policy argument can be made that a better way to narrow the tax differential between profits and interest would be to reduce the tax exemption given to interest. This approach would be more consistent with facing the government's fiscal deficits. But one way or the other, cutting substantially the tax differential between profit income and interest income is a constructive step. It should provide a significant stimulus to the flow of savings into private sector investment. It also has the effect of reducing the tax differential between profit income and income from wages and salaries or real estate.

A third aspect of the tax bill is that it lowers tax rates in all the schedules and in the general income tax. It does this mainly by canceling the defense, security, and jihad surcharges on the basic income tax rates, and setting new income tax rates between the present basic rates and the present rates plus surcharges. Under the new corporation tax on profits of companies, the standard rate becomes 32%, compared to the present schedular rate of 42% on commercial and industrial profits. Partnerships and individuals have new rates, under the schedular tax on commercial and industrial profits, that range from 20% to 32%, depending on the amount of profits. Somewhat similar reductions are made in all the other schedules. The general income tax is to have an exemption of LE 2000, and rates from 8% up to 50%, compared to the present top bracket rate of 80%.

Given the government's basic fiscal problems, and the inflationary tensions to which they are contributing, it is hard to avoid the conclusion that these across-the-board tax reductions are too widespread and too deep. As a silver lining, however, a cut of this size in the taxes on company profits ought to have a demonstrable positive impact on the amount of retained profits used for reinvestment by private companies and partnerships.

The policies for development of financial markets are not yet specific draft laws, but a range of ideas for ways to encourage flows of financial savings from private savers to private investors. They are being considered in the Capital Markets Authority, the Central Bank, and other agencies and the International Finance Corporation of the World Bank has been drawn upon as a consultant.[1]

Policies for financial development need to encourage both the demand for and the supply of publicly held shares in joint stock companies. On the demand side, the new income tax law will already raise significantly the attractiveness of shares relative to interest yielding financial assets. In addition, extending the existing tax credit for initial investment in Law 43 shares to subsequent public issues by Law 43 companies, and to initial investment and subsequent public issues by joint stock companies

---

[1] See IFC, Report and Recommendations on Development of Capital Markets in Egypt, January 1981.

formed under the revised Company Law, would be reasonable steps. Longer run institutional improvements, such as strengthening of auditing procedures and of the stock exchanges, would help. But probably the most important impact on demand would be a succession of public issues by established profitable companies during the next few years, which are priced to sell and subsequently receive continuing dividend increases.

On the supply side, policies must recognize that the great majority of private companies will continue to be family enterprises, and will typically operate either as limited liability companies or as closely held joint stock companies. Thus the companies most likely to be induced to make public share issues are Law 43 joint stock companies which want to expand their initial projects, and older companies which, under the new Company Law, reorganize as joint stock companies and then expand their investment. The policies needed are various forms of suasion (a term intended to embrace informal pressures, CMA regulations linked to company size, and if necessary some tax sweetening) both to induce more private companies to adopt the joint stock form, and to induce more established companies to finance expansions through public share issues.

Selected public sector companies are also suitable for issuing shares to draw on private savings for expansion.[1] The main criteria are that they be profitable without high subsidies or protection, be engaged in activities for which commercial principles are appropriate, have a substantial private share in ownership and the board of directors, and be permitted to operate as private companies free of government controls. Law 111 of 1975,

[1]See Ministry of Economy, "Policy Study in Issuing Shares of Public Sector Companies," March 1979.

which prohibits any reductions in the existing percentages of public ownership in public sector companies, would of course have to be revised. Over time, the proposed general reforms of the public sector, if adopted, would increase greatly the number of public sector companies suitable for issuing shares.

The bulk of private savings in financial forms will continue to flow into interest paying deposits and other claims on financial institutions, however, and here there are other promising policies. Probably the most important is to continue the gradual process of raising nominal interest rates on pound-denominated assets until they offer substantial positive real interest rates (corrected for inflation) -- that is, until they approach levels which are clearly competitive with alternative uses of private saving. Nominal deposit rates now range from 5% to 11.5%, and normal lending rates from 13% to 15%, whereas the general rate of domestic inflation is at least 15%, and longer-term dollar deposits yield about 17%. When and if domestic inflation drops closer to international inflation, or international interest rates drop closer to domestic rates, these occasions should be seized as opportunities to let real interest rates continue to rise toward competitive levels, not as occasions to cut nominal rates again. Another constructive policy would be for the Central Bank to encourage Law 43 banks, public sector banks, and insurance companies (suasion again) to expand their portfolio investments in private companies' shares. A role for some banks as channels for distributing new share issues to the public, on a best-efforts basis, might help stimulate interest in this use of their own funds.

We would judge that passage of the new Company Law and the revised income tax law, and then introduction over several years of a series of policy measures to develop the financial markets, would constitute a watershed in private sector development comparable to that of adopting Law 43 in the early days of El-Infitah. In particular, there is probably a backlog of company reorganizations and expansion investments which have been held up during the extended discussions of the two proposed laws. Although one may reasonably criticize some specifics, and urge further actions not now proposed, these three initiatives taken together are a constructive and important advance in private sector development strategy.

F. Possible contributions of external donors

The principal aim of external donors, with respect to general policies for private sector development, should be to be supportive of the three interrelated initiatives which the government is pursuing. The most effective aid instrument for this purpose would be program or sector assistance, to cushion the incremental costs in the balance of payments or (especially) the government budget of adjustments to these new policies. Readiness to provide such assistance may also help encourage the government to move ahead with some of the promising ideas on the agenda for financial market development over the next two or three years.

One specific possibility for project assistance also emerges from the analysis so far. It is project support for constructing planned industrial areas for inland industrial investments, which have land ready for use, adequate basic infrastructures, and utility connections. Although the benefits from prepared areas in free zones have been limited, prepared inland areas would ease what seems to be a serious bottleneck in prompt implementation of industrial projects. A project for such areas could also help in addressing some basic issues of geographical location for Egyptian industry.

II. Industrial Export Strategy

A. The key role of industrial exports in development strategy

Rapid expansion of industrial exports is probably the key component of an overall development strategy for Egypt appropriate for the eighties. There are three main reasons for the priority of industrial exports.

First, rapid growth of industrial exports is needed to maintain the ready availability of foreign exchange upon which continuing overall progress in an open economy depends. The expansion of foreign exchange availability in the seventies has depended mainly upon remittances, external aid, tourism, the Suez Canal, and petroleum. Receipts from remittances and petroleum will probably at best be rising much more slowly in the latter eighties, and there is a political risk that remittances might actually fall. It is probably undesirable, as well as infeasible, for Egypt to rely on higher flows of external concessional financing than at present. Thus a central objective of development strategy must be to carry through during the eighties a transition to greater self reliance in obtaining foreign exchange.[1]

Of the main possible sources of additional foreign exchange, industrial exports seem much the most promising. Although improved policies may yield modest increases in agricultural exports, rising domestic demands for foodstuffs and industrial inputs are a fundamental constraint. Although continuing industrial development will lead automatically to some import substitution and foreign exchange savings, a policy of encouraging further import

---

[1]See World Bank, Domestic Resource Mobilization and Growth Prospects for the 1980s: Arab Republic of Egypt, December 1980. Also Henry J. Bruton, "Egypt's Development in the Seventies", Economic Development and Cultural Change, forthcoming.

substitution by even more protective measures than at present would have high real economic costs per dollar saved. Expansion of industrial exports, on the other hand, would take advantage of Egypt's location close to European and Arab markets, and her capacity and experience as the leading industrial power in the Arab world. With well designed policies, industrial exports should be capable of elastic expansion at comparatively low real economic costs per dollar earned.

Second, rapidly increasing industrial exports are needed in order for the economy to generate a sufficient growth of employment during the eighties. Since the labor force is likely to increase more rapidly than in the past, and since such important sectors of employment as emigrants abroad and the government will probably not be expanding as they did in the past, the two principal sectors for future employment expansion must be industry, first of all, and trade and services.[1] Moreover, expansion of industrial exports is likely to be essential if the industrial sector is to contribute sufficiently to employment growth, for two reasons. On the one hand, industrial exports offer elastic markets which would permit industry to expand its output more rapidly than domestic demand. On the other hand, the industrial products most competitive in export markets tend to be more labor intensive than the rest (though not in all cases). Thus an increasingly export oriented industrial sector would both expand output faster and generate more employment per unit of output than otherwise. In addition, employment in the trade and services sector, which is comparatively labor intensive, would

---

[1] See Bruce Vermeulen and Gustav Papanek, Labor and Industrial Promotion in Egypt, (another study in this project). Also ILO, Employment Opportunities and Poverty in a Changing Economy: Egypt in the 1980s, forthcoming.

be stimulated indirectly by more rapid growth of industrial output and employment, as well as directly by export and import transactions.

Third, rapid expansion of industrial exports can contribute greatly to making the industrial sector increasingly efficient as the sector grows. Those industries within the sector which are capable of exporting significant percentages of their output must sell competitively at international prices. They must therefore have comparatively low real costs, in terms of the amount of domestic capital and labor used to produce a given value of output. Those industries which cannot export, and must sell virtually all their output at home, typically have comparatively high real costs. That is, they use much more domestic capital and labor to produce an equivalent value of output for the economy. Such industries are able to pay for the extra capital and labor they use only because they typically get some form of protection, which permits them to raise their domestic prices above the international prices. Clearly, rapid expansion of the exporting industries, by shifting the industry mix toward those with comparatively low real costs, will increase the overall efficiency of the industrial sector as it grows. Rising efficiency, in turn, is the basis for rising real incomes of the capital and labor employed.

What is involved in a development strategy emphasizing rapid expansion of industrial exports? We will explore various aspects of this question in the following sections. But one point should be emphasized immediately: industrial exports cannot be turned on abruptly when needed, like water from a tap. It takes time for the government to adopt and implement energetic export promotion policies, for companies already exporting to widen their sales channels and adapt additional products to export markets, for companies not now exporting to recognize new profit opportunities and make investments to break into export markets, and for all these actions to cumulate into a substantial impact on the economy. An industrial exports strategy must be launched now in order to yield substantial foreign exchange, employment, and industrial efficiency benefits by the latter eighties, when they will be most needed.

B. Indications of export capability from company interviews

Our interviews with private companies revealed a number of suggestive points about export potential in the industrial sector.

Export activity was more widespread among the companies interviewed then we expected. Nearly a third of the companies were either exporting the bulk of their output or exporting a substantial fraction (like a third). About another quarter were either exporting small amounts of their output or had plans to export that had some concreteness. This left about half which were selling only domestically, and either not intending to export or expressing only vague interest in future exporting. The substantial exporters were most frequent in the textile sector, but were also found in engineering and metal products, chemicals, and foods. Indeed, one inference we draw from the interviews is that the principal factor determining whether a company is export oriented is often the enterprise of individual owners, rather than more general sector circumstances.

The exporters were drawn mainly from the Law 43 companies -- both the joint ventures and the Egyptian owned companies -- and were rare among the non-Law 43 Egyptian companies, except in the textile industry. Although in some of the joint ventures the Arab or foreign link seemed to contribute to exporting, the main advantages of the Law 43 companies as a group over the non-Law 43 companies were presumably their freedom to operate flexibly and their interest in considering exports. On the other hand, although most of the Law 43 companies had proposed to export when they were approved, only half of those that had proposed to do so were actually exporting.

The principal export markets were in Europe, particularly for companies exporting textiles and engineering products. Arab markets were nearly as important, particularly for companies exporting products used in construction and foodstuffs. Although many non-exporting companies referred to the Arab boycott as a reason, only one had had a sharp fall in exports to Arab countries, which it attributed to the boycott. A modest number of companies were selling to the U.S., often commenting that it is harder to break in there than in Europe. In discussing how they marketed exports, many companies stressed that they exported directly through their own agents or to visiting buyers, and some described very energetic investigations and sales efforts.

One area explored in the interviews was experiences with government regulations affecting exports. Here a distinction must be drawn between the textile industry, where the Cotton Textile Consolidation Fund has a central role in everything involving cotton, and the other industries.

The CTCF allocates raw cotton and cotton yarn to users, grants export licenses, approves product quality and design, and sets minimum export prices. Textile companies working only with synthetics are little affected by the CTCF. Some companies indicate that their working relations with the CTCF go smoothly; they tend to be older companies whose operations are also linked with the public sector. Other companies complain greatly about CTCF controls, particularly minimum export prices which they say do not recognize specific competitive circumstances, or pricing tactics needed to make initial sales. These companies tend to be newer and more assertively private. The extensive controls of the CTCF over cotton textile exports do seem to be an anomalous carryover from the past.

In industries other than textiles, the General Organization for Exports and Imports grants export and import licenses, and oversees minimum export prices and quality controls. Among the companies we interviewed, only a few non-Law 43 exporters reported difficulties with "red tape" in the Customs and the Export-Import Organization.

Many exporters were asked about their experience with the customs drawback scheme, which permits exporters to obtain refunds of customs duties paid on their imported inputs. Only two indicated that the scheme worked satisfactorily for them -- and both were cases in which the imported inputs were components of considerable value and customs duties were waived in advance. Other companies either complained about extremely long delays in obtaining drawbacks, or said they didn't even apply for drawbacks because the complications were too great. The existing drawback scheme seems to be almost a complete failure as a policy to facilitate exports.

Probably the most significant results of the interviews were indications of the sensitivity of companies to the relative profitability of export sales and domestic sales. A large majority of the companies that obtained different prices for their exports and their domestic sales stated that their export price was lower. (Only some food companies were the exceptions.) Why then did these companies export? Some companies said that larger export orders and production runs lowered costs to offset lower prices. Several companies noted that their export earnings enabled them to finance import needs without paying the higher exchange rate required to purchase own exchange. Some non-Law 43 exporters of cotton textiles received an export subsidy from the Cotton Textile Consolidation Fund. For non-exporters, on the other hand, the standard reason given for not exporting was that the domestic market readily -- and profitably -- absorbs their output. These indications of companies' sensitivity to comparative prices and to other influences on export profitability suggest that any policies which effectively raise returns on exports vis-a-vis returns on domestic sales could lead to significant reactions.

There were several indications of the sensitivity of companies to exchange rates, as well. The keenest complaints about exchange rates came from cotton textile exporters, who were required to convert their export proceeds at the 70 piaster rate, although they typically had to purchase in the own exchange market at least part of the foreign exchange for their imported inputs, at rates rising into the 85-90 piaster range. The fact that about half the companies imported between 35% and 75% of the value of their material inputs, and that most use the own exchange market to finance them, indicates that the own exchange rate is a key factor in their cost and profit calculations. The fact that a prominent motive for exporting is to earn foreign exchange instead of buying it at the own exchange rate suggests that offering this rate to exporters who now get only lower rates could significantly affect export incentives.

The interviews also bring out a number of revealing stories about individual export experiences. One company's exports are coordinated with the operations of an associated European company, so that production schedules in both Egypt and Europe may be adjusted as the companies expand.

One company, as part of an imaginative marketing effort to enter the U.S. market, had adapted its product in design, color, and size to meet American tastes. One owner travels extensively to Arab and African countries each year, to keep in touch personally with the markets and to establish new outlets in additional countries. One company, producing high technology products used in construction, stresses direct sales to contractors abroad who will recognize the technical advantages that warrant relatively high prices.

These individual experiences illustrate the kinds of enterprising activities that may be required for expanding industrial exports. They also suggest that private sector companies are likely to have some natural advantages in exporting. Responsiveness to changing market opportunities and readiness to adapt production to customers' needs are presumably their greatest strengths. (In considering reforms of the public sector, a specific focus on changes to stimulate export competitiveness would nevertheless be a promising approach.) Thus policies for expanding exports and policies for developing the private sector are likely to reinforce each other.

C. Export trends and policies

Industrial exports have not contributed significantly to the overall expansion of foreign exchange availability in the seventies. That depended predominately on receipts of remittances and external aid, and on exports of tourism services, Suez Canal services, and recently petroleum. Nevertheless there have been some significant changes in the level and composition of industrial exports, which suggest that they could be more dynamic in the future.

The total value of industrial exports increased about 20% per year from 1977 to 1980. (See Table 7.) Exports for convertible currency increased more rapidly (about 23%) and exports through bilateral accounts more slowly (about 13%), as some bilateral argreements ended and as a larger part of exports were sold in Western Europe. The value of private sector exports expanded somewhat faster than public sector exports (23% vs. 19% in the data, which probably understate the private sector trend). For the private sector, convertible currency exports expanded about 37% per year, while bilateral account exports remained constant. For the public sector, exports to the two currency areas expanded at more similar rates. Thus Egypt's industrial exports, although limited in amount, have been able to expand in the more competitive convertible currency markets, and private sector exports in particular have been increasingly focused on these markets.

Nearly half of the value of 22 principal manufactured exports in 1979 was cotton yarn, about a quarter was 7 other textile products, and about a quarter was 14 other products from fruit juices to aluminum bars. (See Table 8.) Among the textile exports, cotton yarn, cotton fabrics, cotton waste, carpets, and made-up textiles increased considerably in value (over a third) from 1976 to 1979, although only yarn and fabrics expanded in quantity, as contracting sales to Eastern Europe offset rising sales elsewhere. Among the 14 other export products, fruit juices, cigarettes, essential oils, pharmaceuticals, and aluminum bars increased considerably in value from 1976 to 1979; alcoholic beverages, perfumes & cosmetics, leather clothing, footwear, printed books, and wooden furniture increased or decreased only marginally; and leather bags, cement, and iron & steel sheets decreased markedly. Only 3 or these 14 expanded in quantity -- aluminum bars, cigarettes, and footwear. If the data extended through 1980 (a good export year) some of these trends would be higher, but the general picture is that only about half of the principal manufactured exports have been expanding.

Analyses of the economic profitability (at international prices) of producing some 50 individual manufactured products suggest that a number of the 22 principal exports, as well as other manufactures not on this list, ought to be capable of selling competitively in export markets.[1] Products among the 22 in which Egypt probably has a comparative advantage include carpets, knitted undergarments, clothing, cotton fabrics (fine fabrics from long-staple yarn or ordinary fabrics from short staple yarn), fruit juices, cigarettes, essential oils, perfumes & cosmetics, leather clothing, leather bags, and wooden furniture. Other products not now among the 22 principal exports, for which Egypt probably has a comparative advantage, include several food products (jams, biscuits, confectionary, starch, preserved beans); some textile materials (rayon filament and polyester fibres); several chemical products (phosphate fertilizer, PVC & plastic products, synthetic leather, paints); some building materials (tiles, sanitary ware); rubber tires; and several engineering products (bicycles, televisions, refrigerators, washing machines, room air conditioners, sewing machines, enamel ware, batteries, electric cables). On the other hand, existing exports of cotton yarn (relatively coarse yarn spun from long-staple cotton), aluminum bars, and iron & steel sheets do not appear to be economically profitable at international prices, but are exportable because of underpriced inputs.

---

[1] See Robert Lucas, Future Directions for Investment in Egyptian Manufacturing: Comparative Advantage; and Hanaa Kheir-El-Din and Robert Lucas, Comparative Advantage in Egyptian Manufacturing, (other studies in this project).

External markets are quite open to Egyptian manufactured exports. The Cooperation Agreement of 1977 between Egypt and the European Economic Community provides that all manufactured exports to the EEC are free of customs duties and other similar charges.[1] They are also free of quantitative restrictions or quotas, except that cotton yarn and cotton fabrics (not other textile products) have quotas under separate arrangements. These quotas have been increased 5% annually, but they are broken down by individual EEC countries, and the overall quota has often not been fully used. Manufactured exports to the United States, again except for some textile products, benefit from the Generalized System of Preferences for exports from developing countries. Since Egypt is a very small supplier, the risk that large and rapidly expanding suppliers may lose GSP privileges in U.S. markets is not relevant for Egypt.

During the latter seventies Egypt has been one of the least active developing countries in adopting policies designed to stimulate manufactured exports. In part, Egypt's inactivity seems to be due to the past tradition that industrial policy aims to supply domestic demands and avoid imports, and that only surpluses are exported. This tradition is reinforced by the carryover of past institutions. In textiles, the Cotton Textile Consolidation Fund grants export licenses, sets minimum export prices that differ among markets, inspects and controls quality, oversees the operation of quota systems, and compensates exporters for the additional cost of using high quality Egyptian yarn rather than the low quality yarn

[1] See Ministry of Economy, "Effects on Egypt of the Second Enlargement of the European Economic Community," September 1979.

that foreign exporters use. For other products, the General Organization for Exports and Imports has similar licensing, price control, and quality control functions.

In 1979 a Presidential Decree did establish the Egyptian Export Promotion Center. Its chairman is the Minister of Economy, and its deputy chairman is Advisor to the Deputy Prime Minister on Export Promotion. It undertakes studies on export markets for particular products, assists exporters with their problems, and makes proposals on such policies as the customs drawbacks. But it is a staff organization, does not have operating responsibilities like the CTCF and the GOEI, and appears to be having little impact compared to these line organizations.

Egypt's inactivity in export policy also seems to be due partly to limited awareness among policy makers of the importance of economic factors in depressing or stimulating exports. Our analysis in the previous section suggests that private exporters are quite sensitive to the prices of exports, the own exchange rate, and anything that alters the relative profitability of selling abroad or at home. Public sector reforms will presumably make public sector managers more sensitive in the future. For the 1980s, export policies focused on economic incentives are likely to be the key to improving the mediocre export experience of the past, and taking advantage of the export opportunities now being missed.

D. Industrial export policies for a new stage of development strategy

The central aim of industrial export policies appropriate for the eighties should be to raise substantially the profitability of export sales relative to domestic sales. The analysis in the last two sections has shown that there is considerable dynamism and potential among industrial exporters, and that private companies can be counted on to be responsive to changes in export returns. What, specifically, can be done?

We must recognize at the beginning that, in the circumstances of the eighties, Egypt must overcome some basic economic obstacles to expanding her industrial exports.

The prospect that foreign exchange earnings from petroleum and other impermanent sources will be much more abundant in the earlier years of the decade than later means that market forces will result in too low an exchange rate. A well designed export expansion strategy should be focused on the higher future exchange rate which can be expected when foreign exchange becomes less abundant. But the lower actual exchange rate will not be giving potential exporters the right incentives to begin immediately the time consuming market development and investment activities required for substantial export expansion.

Moreover, the prospect is that Egypt will continue to experience domestic inflation that is more rapid than international inflation. A continuing high rate of investment will maintain pressure on domestic resources, even though foreign exchange will be abundant. Even if domestic fiscal and monetary policies were to be made less inflationary than they have been, structural adjustments in prices and wages would continue to put upward pressure on the overall price level. But domestic inflation at a higher rate than international inflation will reduce the profitability of exports vis-a-vis domestic sales -- the opposite of what is needed for export expansion.

A third basic obstacle is that Egypt, like virtually all countries, has in place a wide range of import substitution policies, which have the effect of establishing an unintended bias against companies that export. Countries stress import substitution mainly because the policy instruments to restrict imports, and thereby to raise the profitability of replacing imports (at higher prices), can be easily implemented. The bias results because companies producing import replacements for the domestic market receive a substantial implicit subsidy from their customers, whereas there is no comparable subsidy for companies selling their products in export markets. They must sell without protection, while their costs have been raised by protection for others. Moreover, a further bias against exporting companies results from the fact that extensive import restrictions lead, through market forces, to a lower exchange rate than otherwise, which also reduces the profitability of exports.

Effective industrial export policies for the eighties must overcome these basic economic obstacles, and raise substantially the profitability of exports relative to domestic sales. Government administrative improvements and campaigns, although desirable, are inadequate.

Exchange rate policies are the first promising area for actions to stimulate exports. In August, 1981 (when it happens that the first draft of this study was just completed), the government raised the official exchange rage from 70 to 84 piasters per dollar. However, it seems quite probable that further adjustments in the exchange rate system will become necessary in the future. The continuing gap between the free (own exchange) rate and the official (unified) rate suggests that the official rate is still not in equilibrium. Continuing domestic inflation at higher rates than international inflation suggests that an official rate which is viable in 1981 will become increasingly out of equilibrium as time passes.

Moreover, as the gap between the free and the official rates widens, it will get more difficult to collect sufficient foreign exchange for the official pool, which has led in the past to disruptive patchwork changes in foreign exchange rules, and unannounced public sector transactions at higher than official rates.

When further adjustments in the exchange rate system become necessary, the aim should be to use the occasion to introduce changes that are explicitly designed to raise the profitability of exports relative to domestic sales. The most effective way would be to retain a two-market foreign exchange system, and to give all industrial exports the higher exchange rate in the free (own exchange) market. In practice the Law 43 companies can already convert export proceeds through the free market, so the relevant action would be to extend an assured legal right to do so to all private companies that export industrial products. (The foreign exchange arrangements for public sector companies must be considered as part of broader public sector reform, but it may well be desirable to provide special treatment for their foreign exchange earnings from industrial exports, including the higher free exchange rate.)

We recognize that a reasonable argument can be made for a different modification of the present exchange rate system -- to merge the own exchange and official markets into a single market, to establish a unified exchange rate at a level high enough to be close to equilibrium, and to initiate a practice of adjusting this rate frequently in small steps. The general argument for this alternative is that it would permit more efficient allocation of foreign exchange among uses and more uniform incentives to larger initial rise in the exchange rate would tend to push up prices more, particularly in the public sector, and make it harder to manage inflation pressures. Our argument here, however, does not address these difficult macro issues. Our argument is simply that, from the standpoint of an effective industrial export strategy, exports need a higher preferential rate in order to help offset the three intrinsic obstacles to exporting discussed above.

The second promising idea for export policy is to establish a new tax rebate system for exports, to replace the utterly inadequate customs drawback scheme.[1] The aim is to assure industrial exporters that, in spite of domestic protection, their costs of material inputs used in producing their exports (net of rebates) will be approximately the same as costs at international prices. Since the new scheme would both increase the size of the tax rebate for a typical recipient, and assure that virtually all industrial exporters receive rebates promptly, it would increase significantly the returns from exports relative to domestic sales.

The principle for determining the amount of tax rebate due for an exported product has three elements. The rebate should include both customs duties (and associated import taxes) and domestic excise taxes (and similar indirect taxes) that are embodied in the costs of inputs. It should refer both to imported inputs used directly by the producer and to the indirect import content of domestically supplied inputs. The amount of direct and indirect imports should be calculated marginally, recognizing that for

---

[1]See Ministry of Economy, "Policy Study on Incentives for Manufactured Exports: Duty Drawback on Exports," March 1980.

many materials that are partly imported and partly produced domestically, the marginal source is imports. Moreover, the new scheme should estimate a standard tax rebate for each kind of product, using information about the typical composition of inputs and the marginal share of imports. It is not necessary to estimate or justify the rebate for each individual company. The aim, after all, is to define a soundly based export incentive.

The administrative aspects of the scheme are as important as the size of the tax rebate. With a standard rebate for each kind of product, stated as a percentage of its value, an exporter would simply have to demonstrate the kind of product he is shipping, to become eligible for the rebate. The application procedure could be simple, and payment of the rebate could be immediate -- thus greatly increasing the incentive effects.

The third promising area for export policy is low cost export credit. This type of export incentive is quite widely accepted internationally, and can be provided through the banking system rather than as a cost in the government budget. Like the other two proposed incentives, export credit at a preferential interest rate would help to offset the bias against exports and in favor of import replacement that now exists.

A clearly focused and simply administered form of export credit could just finance, at a preferential interest rate, the time lag between shipment of exports and receipt of payment from foreign customers. This kind of scheme provides benefits only for actual export sales, and could be supported simply by a special fund or discount window at the Central Bank. The implicit benefit is modest. (For example, a three month export credit at 6%, compared to a commercial credit at 18%, would be approximately equivalent to 3% of the value of the shipment.) But this kind of export credit may have more leverage than appears, because competing suppliers from other countries often have similar facilities, and it would enable an Egyptian exporter to compete in sales terms if necessary.

Other more ambitious programs of low cost credit for exporting companies might provide working capital loans at preferential interest rates, or even medium term credits for investment. But such programs are fuzzier and riskier, because working capital and plant are used for both export and non-export production, and companies that propose to export may in the event export less than expected. A narrow and simple scheme might be preferable, at least at the beginning.

Government export promotion activities are of course a fourth important policy area. Indeed, new export incentives like broad tax rebates or low cost export credit could also have significant promotional side effects, by demonstrating conspicuously that the government is serious about stimulating industrial exports.

Probably the most significant institutional improvements would be to transform the General Organization for Exports and Imports and the Cotton Textile Consolidation Fund from regulatory to export promotion institutions. This would involve removing their authority to control prices and designs and quality of exports, and instead mandating them to offer product quality analysis and marketing information as consulting services to exporting companies -- both private sector and public sector. The Egyptian Export Promotion Board should probably be given a more functional role as staff agency for the Ministry of Economy's foreign trade branch, with a mandate to focus its policy analyses on measures intended to raise the profitability of exports relative to domestic sales.

E. Possible contributions of external donors

Innovative policies for industrial export expansion, we have argued here, should have a central role in a new stage of Egypt's development strategy appropriate for the eighties. Probably the most constructive form of external assistance in this respect would be program or sector assistance, to assure the government that any initial foreign exchange or government revenue costs of innovative policies would be sustainable.

Two possible external assistance projects are also suggested by our analysis. One is a project of technical and equipment assistance to help design and then implement a new scheme for rebating the costs of customs duties and indirect taxes that are embodied in industrial exports. The other is a project for similar assistance to help design and then implement a new export credit scheme. This project could also involve a grant or loan to establish a revolving fund of foreign exchange from which the export credits would be drawn.

Another important contribution of donor countries is to be receptive to the expanding industrial exports from Egypt which the new export policies are designed to achieve. As noted in section C, the European Community's association agreement and the United States' general system of preferences are at present quite open to increasing Egypt's industrial exports. Since Egypt is now a small exporter, future resistance to larger export sales may not arise. But it is essential that it not arise, and that external donors recognize and welcome the key role of expanding exports in Egypt's overall development.

III. Industrial Financing Strategy

A. The role of private sector industrial financing in development strategy

An overall development strategy that is appropriate for the eighties will surely include efforts to encourage expansion of private companies in the industrial sector of the economy. Private companies can be expected to be particularly responsive to customers' demands and to strengthen competitive forces within domestic markets, as suggested by our analysis in Part I. They can be expected to be particularly effective in penetrating export markets for industrial products, as suggested in Part II. Given Egypt's mixed enterprise system, encouragement of private companies and management reforms for public sector companies should go hand in hand.

We can distinguish two general kinds of policies to encourage private industrial companies. One kind is permissive policies, which seek to permit private initiatives to pursue market opportunities, particularly by reducing previous government restraints on the private sector. Such policies include, for example, the new Company Law for non-Law 43 companies, the reduction of income taxes on profits relative to interest income, and proposals to drop government controls on exports. Another kind is incentive policies, which seek to stimulate selected industrial activities that are judged to have higher economic profitability than private financial profitability. Measures to stimulate industrial exports, such as a higher exchange rate than the official rate, and a system of broad and prompt rebates of taxes that raise input costs, illustrate this kind of policies.

Industrial financing policies, which seek to provide suitable channels and suitable terms for financing industrial investments by private companies, have both permissive and incentive aspects. To some extent they are intended to overcome the market imperfections in financing arrangements for private investment that typically prevail in developing countries, and inhibit private initiatives. To some extent they are intended to stimulate industrial investment in particular, because risks are judged to be especially high for projects in industry, relative to trade and services.

B. The structure of financing institutions

The financial institutions that have the most important roles in financing private sector industrial projects can be divided for analytical purposes into three groups -- the Development Industrial Bank by itself, the Misr Iran Development Bank and the Arab Investment Bank, and the new Law 43 banks. In addition, the public sector commercial banks and the public sector insurance companies have specialized roles.

The Development Industrial Bank is an established public sector investment bank (under the Central Bank) with a definite mission to promote private sector industrial investment.[1] Its total loans and investments as of Dec. 31, 1980, were half again as large as the MIDB and the AIB combined. Since it makes hardly any equity and securities investments, the DIB's medium and long term loans were about three times those of the other two banks. (See Table 9.)

The DIB has been expanding rapidly by obtaining, through the government, concessional loans from many external donors -- World Bank, A.I.D., African Development Bank, OPEC Special Fund, European Investment Bank, and the Swiss government. Thus it is able to lend at comparatively favorable

---

[1]See Coopers & Lybrand, Evaluation of AID/DIB Loan Program and Assessment of Future AID Assistance for Industrial Private Sector Development, May 1981. See World Bank, Development Industrial Bank, Egypt: Staff Appraisal Report, February 1980.

terms, and still operate with respectable financial profits. It is the main institution lending to the older non-Law 43 private companies, and has been active with Law 43 companies as well. As a public sector company, it has had some difficulties in building a suitably professional staff and applying modern investment banking techniques, although the consensus is that it has become an increasingly effective organization. Our company interviews turned up a number of critical comments about the DIB, notably for slow and bureaucratic procedures. But the interviews also provided some very positive comments, particularly from companies that had had successive loans from the DIB as they grew.

The DIB gives considerable emphasis to lending to small scale industries. This is partly because most of the older private companies have been small, and partly because several external donors (World Bank, OPEC, African Development Bank) have provided funds intended to assist smaller companies. Of loans approved in 1980, 13% of the foreign exchange loans, 54% of the pound loans, and 67% of the short term loans -- 37% combined -- went to small companies by the World Bank definition (less than LE 200,000 of fixed assets other than land and buildings at 1980 prices). An interesting recent project is a $3.6 million loan to about a hundred very small weaving companies in a district of Cairo, through a private cooperative, in order to purchase about a thousand new looms plus accessory equipment. The scheme took two years to arrange, including negotiating through the cooperative, finding a suitable low-cost loom from Taiwan, arranging for minor product adaptations, and assuring that the supplier would set up a service and spares center. In view of the administrative costs of lending to small borrowers, it is not surprising that our interviews with other banks did not reveal much interest in pressing into the small company field .

The Misr Iran Development Bank and the Arab Investment Bank are Law 43 investment banks in which the Egyptian government has a dominant fraction of the capital.[1] They obtain the bulk of their funds from foreign exchange deposits, however. Like the DIB, they have a definite mission to promote private sector industrial investment. In doing so, they frequently take equity participation in projects, in addition to making loans. (See Table 9.)

Misr Iran and the AIB are aiming at projects from $1-2 million on up, and lend almost entirely to Law 43 companies. They give a great deal of emphasis to promotion of projects, seeking out projects that will meet an emerging market opportunity through an appropriate technological advance, and using modern project investigation and evaluation techniques. One interesting aspect of Misr Iran's approach is that it has taken the lead in organizing several syndicated loans, involving public sector banks, Law 43 banks, and foreign banks as well as itself. The syndicates have helped very large projects to obtain financing at a lower margin over LIBOR, and to get export credits from foreign government agencies at especially attractive rates. The AIB has sponsored a new joint venture company, with participation by Arthur D. Little and Societe de Traction e Electricite, to emphasize economic and financial (in addition to the usual engineering) analysis of projects.

The Law 43 banks have three different forms. The commercial banks can be wholly Egyptian, or joint ventures with at least 50% Egyptian equity,

---

[1] See World Bank, Loan to Misr Iran Development Bank, Egypt: Staff Appraisal Report, April 1980.

and they can accept deposits and make loans in both pounds and foreign exchange. The investment banks can be joint ventures with majority foreign or Arab ownership, but they can operate only in foreign exchange. The branch (or merchant) banks are entirely foreign or Arab companies, are simply authorized to operate in Egypt, and must also make all transactions in foreign exchange. All three forms, however, can make loans for any purposes and any maturity.

Although all three forms of Law 43 banks mainly accept short term deposits and make short term trade loans, they also engage in medium term project lending which in aggregate value is a significant third component of private sector investment financing. The aggregated balance sheets as of Dec. 31, 1980, show that the Law 43 investment banks had made 14% of their loans with a maturity greater than a year, and the Law 43 commercial banks 8%. Since the commercial banks had larger total assets, however, the value of such loans was similar for the two kinds of banks. (See Table 10.)

Our study includes interviews with banks, as explained in the next section. The interviews suggest that differences among Law 43 banks in their investment financing depend mainly on their individual strategies, not their legal forms. Among the two investment banks and the branch bank in the sample, there were notably different percentages of medium term loans within total loans, and of industrial projects within medium term loans. Management interest in project lending also varied in less measurable ways. Among the four commercial banks interviewed, the joint ventures seemed more concerned with project lending than the Egyptian owned banks, but individual differences were again notable. The range was from active interest, comparable to an active investment bank, through reluctant response to government suasion and bank competition, to virtually no interest.

The public sector commercial banks, of course, have much larger net assets -- four times as large -- as the Law 43 banks. But they do very little lending with maturity longer than a year -- only about 1% of total loans. Their investments are over three-fourths in government securities, and the balance are mainly in public sector companies or joint ventures involving public sector companies. (See Table 10.)

The public sector insurance companies also have a specialized role in investment financing. The two insurance companies we interviewed had invested 20-25% ot their total investments in equity or long term loans to Law 43 companies. A majority of the Law 43 companies, however, were companies that had other public sector participation, or had been formed to carry out prominent government aims like food security. Although a significant channel of public sector funds to Law 43 projects, the insurance companies had evidently not been bold.

These different groups of financial institutions, with different approaches to private sector lending, need to be kept in mind in considering investment financing policies.

C. Indications of financing needs from company and bank interviews

Our interviews for this study provide a variety of revealing indications about how present industrial financing arrangements for private companies are functioning, and about problems that suggest new policy actions.

The nature of the 46 company interviews has been described in Part I. In addition, we interviewed top officials in 14 banks or other financial institutions. The bank interviews were intended to look at industrial financing experiences also from the lenders' viewpoint, and to provide indications of any differences among different kinds of institutions. The banks included the Development Industrial Bank; the Misr Iran Development Bank and the Arab Investment Bank; two Law 43 investment banks, one branch bank, and four commercial banks, with various ownerships; one public sector commercial bank; two public sector insurance companies; and the new Private Investment Encouragement Fund.

Some of our questions were about companies' experiences in raising equity capital, both in the formation of the company and for expansion. The responses do not suggest that there has been shortage of equity funds. The bulk of the companies, including many of the Law 43 joint ventures, are still essentially family or closely held enterprises. The owners of such companies want to have and to keep close control over their activities. For expansion they want to put in some more equity and borrow the rest, then pay off the loan while building up their equity further. Some of the larger joint ventures (some wholly private, some with public sector participation) had to assemble initial capital, but indicated no difficulties.

Moreover, about two-fifths of the companies interviewed had already substantially increased or multiplied their initial capital or their fixed assets, through retained profits plus borrowing. Only 10-15% seemed not to be expanding their equity at all, and in some of these cases the owners had other business activities on which they preferred to concentrate. A future need to raise outside equity funds seems most likely to arise for larger joint ventures as they continue to expand, and for very successful family companies whose investment needs in time outrun their retained profits.

The extent of equity participation by the banks is correspondingly limited. Only Misr Iran and the AIB take equity shares in a significant fraction of the projects they finance, typically just to fill out a nearly complete package.

Thus companies' actual experience with investment financing has been mainly with medium term loans of 3 to 7 years. About three-fifths of the companies had obtained medium term loans, usually to finance the foreign exchange costs of investment in equipment. Moreover, they had often had more than one such loan, for successive additional investments, and sometimes from different sources. As a group, the borrowers drew on all the different kinds of banks, including in a few cases offshore banks and foreign banks. Only two companies interviewed had had long term loans, in both cases projects with which the government was clearly sympathetic.

We were surprised that as many as two-fifths had not had medium term loans, and that there were non-borrowers among all three kinds of companies in our sample. The larger part of the non-borrowers seemed to be so because they did not need to borrow; their investment needs could be covered by their own capital and retained profits. The smaller part said they did not like to borrow, some for explicitly Islamic reasons and others perhaps just to keep business simple.

The general view of the banks seems to be that the supply of funds for medium term lending is quite adequate to meet the demands of private companies that have sound investment projects. The DIB, Misr Iran, and AIB devote considerable effort to promoting projects. They also tend to emphasize the importance of companies' making thorough project analyses, and to be expanding their assistance in this area. Those Law 43 banks that have relatively more interest in medium term lending than the others typically say they are searching for borrowers, and prepared to bend lending criteria as far as they prudently can.

The companies' experiences in obtaining medium term loans described above seem to be consistent with the banks' interpretation that the supply of medium term funds is adequate. An overall supply-demand balance is not really surprising, since investment projects have an inherent gestation process, while domestic money and credit and (more recently) foreign exchange revenues and deposits have been increasing rapidly.

Terms of the foreign exchange loans raise more intricate questions. Reasonably standard terms from all lenders include a minimum company contribution to the investment of 30-40%, and a mortgage on the company's assets as collateral. The DIB, Misr Iran, and AIB tend to offer somewhat longer maturities than the Law 43 banks, in some cases ten years. The DIB can extend foreign exchange loans repayable in pounds, although borrowers have an exchange rate risk. Misr Iran and the AIB and the Law 43 banks lend and are repaid in foreign exchange; thus the exchange risk rests on the borrowers. The DIB, using concessional funds from external donors, can charge fixed interest rates a little below the lending rates for pound loans authorized by the Central Bank. Misr Iran can do the same for the part of its lending based on a World Bank loan signed at the end of 1980. These interest rates are thus considerably more favorable than recent eurocurrency rates. The Law 43 banks lend at variable eurocurrency rates, in the order of 2% over LIBOR. All lenders have various other charges or costs which raise effective rates above nominal rates.

The companies interviewed did not seem to be having serious difficulties as a result of these terms. Only a few reported liquidity problems, and the reasons were usually standard commercial matters. The banks reported very few bad loans, and usually attributed them to company management problems. A number of companies complained about mortgage collateral requirements, or reported disputes with banks about collateral. A few companies had actually obtained loans on their general credit, on the other hand. Others argued that their size and past success ought to permit them to do so now. The availability of loans secured by a company's general credit may be increasing, and ought to do so as the momentum of private sector development continues.

Many companies complained about too high interest rates. To some extent this was presumably just a lagging reaction to the Central Bank's recent successive raises in pound lending rates toward positive real levels. Moving both deposit rates and lending rates up to positive real levels, however, is a crucial policy for improving the effectiveness of the whole financial system, in an era of world and domestic inflation.

More importantly, the complaints about high interest rates reflected the shock of sharp increases in eurocurrency interest rates in 1980 and again in 1981, which have raised payments on all past foreign exchange loans subject to variable interest charges. The Law 43 banks, Misr Iran, and the AIB, in so far as they are lending their foreign exchange deposits, which must be paid competitive eurocurrency interest rates, can hardly do other than adjust their medium term loan rates as their deposit rates vary.

Nevertheless there is a basic question whether the present pattern of interest rates and exchange rate risks on foreign exchange loans is appropriate for private sector industrial investment projects. A number of both companies and banks stressed that such industrial projects have lengthy gestation periods. The risks of interest rate fluctuation and exchange rate changes add to the intrinsic commercial risks of investment.

The companies interviewed, taken all together, had had experiences in obtaining or discussing medium term loans with all kinds of banks. Much the most widespread experience (18 companies) had been with the DIB; they included 12 which were initially chosen for the sample from DIB lists, and 6 others. There were 10 companies with experience with Law 43 banks, 8 with public sector banks, 4 with Misr Iran, and 4 with offshore or foreign banks.

The pattern of flows of medium term industrial financing appears to be somewhat segmented. The wholly private Law 43 companies, both joint ventures and Egyptian owned, tended to deal with the Law 43 banks. The few Law 43 companies with public sector participation had mainly dealt with Misr Iran and the public sector banks. The non-Law 43 Egyptian companies tended to deal with the DIB (even though this tendency was probably exaggerated in our sample) and the public sector banks.

On the other hand, individual companies were able to arrange to meet their medium term needs in a variety of ways. One company, wanting to expand its equipment quickly to fulfill a large contract, had the enterprise to put together a package including a loan from a Law 43 branch bank, a European export credit, a loan from an Egyptian Law 43 commercial bank, and some personal capital. A considerable number of companies obtained medium term financing from different kinds of sources -- e.g., DIB and a Law 43 branch bank, a Law 43 investment bank and a public sector bank. In their short term borrowing, moreover, many companies borrowed from both a

Law 43 bank and a public sector bank, presumably for dollar and for pound credits. Individual companies seem to search out flexibility within the system.

D. Financing policies for the eighties

Our analysis in the last two sections suggests that the present system for financing private industrial investment is active, evolving, and functioning reasonably well. But there seem to be two significant needs for policy improvements. One important improvement would be to modify financing terms to fit better the intrinsic risks in the gestation process of private industrial investments. The other important improvement would be to broaden the channels for financing investment by small scale industrial companies.

The intrinsic gestation process of industrial investment projects involves major business risks and takes at least several years. A new project must accept major uncertainties about the snags that arise during investment, the technological shakedown and management adjustments in starting production, and the customers' response and profit margins achievable in the market. The gestation process is typically longer and the uncertainties greater in industry than in trade and services. In our interviews, both banks and companies pointed out that many companies have been taking longer than expected to go through this gestation process. Expansion projects face somewhat smaller uncertainties and may resolve them sooner, but are essentially similar. It is economically desirable that companies bear these major business risks, and individual companies have the knowledge and power to manage them.

Investments financed with foreign exchange loans face financial risks too. In particular, there is the risk of exchange rate changes and the risk of interest rate changes under loans with variable rates. Individual companies typically lack the knowledge and the power to manage these risks. Policy measures to modify financing terms, however, can at least reduce the financial risks associated with investment, so that companies can focus on their intrinsic business risks.

One significant risk during the eighties is bound to be the risk of exchange rate changes. Although this risk is less important for exporters than for other companies, it is relevant for all because unpredictable exchange rate increases can reduce abruptly the profitability of any project undertaken with a loan commitment. Under an earlier A.I.D. loan to the DIB, when the official rate was raised from 40 to 70 piasters, the fracas that broke out among borrowers, the DIB, the government, and A.I.D. illustrates the impact of this risk.

At present, on DIB pound loans supported by external donors, the government takes part of the exchange risk (for changes between the dollar and the currency of the donor's loan), but the private borrowers must accept the risk of changes between the pound and the dollar. There is no economic obstacle to the government taking the whole exchange risk from the borrowers, provided that it is managing the balance of payments and the reserves so as to maintain the debt servicing capacity of the whole economy. The present DIB terms would simply have to be modified, to permit borrowers to repay their pound loans at the exchange rate prevailing when the loan was made. Possible arrangements with other financial institutions than the DIB are discussed below.

In opposition to this proposal, it might be argued that the main reason for future devaluations of the pound is likely to be a higher rate of Egyptian inflation than of world inflation, that during such inflation borrowers will experience both higher pound revenues and higher pound costs, and that borrowers will therefore be quite able to bear higher pound costs of loan service following devaluations. But the amount and timing of future devaluations will probably be affected also by impulses from specific items in the balance of payments, and by discretionary government decisions. Moreover, trends in individual borrowers' pound revenues and costs during inflation are likely to differ from average trends, and variations in the amount and timing of devaluations due to other influences are likely to affect individual borrowers quite differently. Thus the exchange risk in loans remains a significant consideration for investment decisions of individual private firms. Our approach here urges that loan terms should press firms to focus on the intrinsic business risks of their industrial investments, and relieve them from the financing risks that they are ill equipped to manage.

Another significant risk during the eighties is unpredictable changes in eurocurrency interest rates, and therefore in variable interest charges linked to LIBOR in foreign exchange loans from Misr Iran, AIB and the Law 43 banks. For a project already financed, this means that if eurocurrency rates rise, the company's committed financing costs are raised unexpectedly, and its profits reduced. Of course if eurocurrency rates fall, the company's profits unexpectedly benefit. But for each individual company, the risk of running into the wrong interest rate trend, rather than its original terms, is serious.

In order to address this problem, an arrangement is needed by which financing institutions could offer some proportion of their medium and long term loans at fixed interest rates, while the government accepted the risk of fluctuations in eurocurrency interest rates. Such an arrangement is discussed below. Note that the fixed interest rates could change from year to year, and the aim could be to adjust them to reasonable estimates of average short term market rates over the next five year period. The fixed rates would move sluggishly -- perhaps initially below short term rates but in the future sometimes above them. Note also that over a period of years the government could offset gains (when eurocurrency rates fell) against losses (when eurocurrency rates rose).

In opposition to this proposal, it might be argued that, in an inflationary world with more active use of monetary policy, fluctuations in eurocurrency interest rates are a risk to which firms everywhere must become accustomed. We recognize the force of this argument, as it applies to short term borrowing for less risky activities in trade and services. But for medium and long term borrowing to finance industrial investment projects with their major business risks, the further risk of an unlucky rise in eurocurrency interest rates is more serious for individual firms. Again we feel that relieving firms of a financing risk which they are ill equipped to manage would contribute to encouraging sound industrial investments.

Thus the preferred financing terms, for medium to long term foreign exchange loans to finance private sector industrial investment projects, would be repayment in pounds at the exchange rate prevailing when the loan was made, and a fixed interest rate for the term of each particular loan. Such terms would reduce the financing risks which now add to the intrinsic business risks of industrial projects -- already more difficult than trade and services projects. Such terms should be recognized as a policy that is explicitly intended to stimulate private sector industrial investment.

These improved terms would not be practicable for all loans by financial institutions, since they obtain most of their funds as short term deposits denominated in foreign exchange and at interest rates which must vary with eurocurrency rates. These terms could be offered, however, for additional sources of funds channeled by the government through financial institutions. How could such additional channels be arranged for different kinds of institutions?

It is easy to provide such terms for loans through the DIB. The DIB is a public sector bank, concerned with positive but not maximum profits, obtaining its funds from the Central Bank and external donors. The concessional loans from external donors, through the government, already permit it to offer borrowers fixed interest rates at levels somewhat below the standard indicated above. Since the DIB operates under the Central Bank, it can already permit repayment of foreign exchange loans in pounds. In order to relieve borrowers from the exchange risk they now bear, the government could simply permit borrowers to repay at the exchange rate as of the date of the loan, rather than as of the date of the payment. The relending provisions in the government's own loans from external donors would also have to specify that the government bears the full exchange risk.

Achieving more suitable terms for loans through Misr Iran and the AIB is somewhat more complicated. Although their capital is public, they obtain the bulk of their funds from foreign exchange deposits, on which they must be capable of paying short term market interest rates. Nevertheless, practicable arrangements could enable them to offer borrowers the same terms as the DIB's, in at least part of their lending activities. External donors could similarly make concessional loans to them, through the government (as the World Bank has recently done for Misr Iran). Then, for loans drawing on these funds, fixed interest rates could be offered at the indicated levels. The government could similarly remove the exchange risk from borrowers, and permit borrowers to repay their loans in pounds, while maintaining its commitment to repay external donors in foreign exchange.

Achieving more suitable terms for loans through the Law 43 banks is considerably more complicated. But it is essential, in order to make suitable terms widely available. A significant share of private sector industrial financing is being provided by the Law 43 banks, and they introduce flexibility and competitiveness into the system. The extensive recourse to them by private companies, despite more costly terms than the DIB, is an indication of their value. The complications arise because they are definitely profit maximizing firms, make medium term project loans as only part of their activities, and get virtually all of their funds from deposits in foreign exchange that must pay market interest rates.

A promising arrangement would be for the government to establish an Industrial Financing Fund, which would operate as an intermediary between external donors, on the one hand, and the many Law 43 banks plus public sector banks, on the other. The IFF would offer to share with individual banks in financing individual private industrial projects, and to set terms for its loans which would result in satisfactory combined terms for the package. The individual banks would continue to deal with borrowers, to screen projects, to set terms on their loans, and to assume normal lender's risks. The government would obtain concessional funds for the IFF from external donors, and agree to accept the exchange risk and permit repayment in pounds. The borrowers would end up with a loan package, including a bank loan and an IFF loan, with combined terms more appropriate for industrial investments.

A model for this kind of arrangement already exists: the Private Investment Encouragement Fund, which was established last year within the Investment Authority, and initially funded by an A.I.D. grant of $33 million.[1] Borrowers can repay the PIEF loans in pounds at the exchange rate as of the date of the loan, i.e., without exchange risk. The interest rate will be fixed for the term of the loan, and will be set simply at the current Central Bank rate for pound loans.

Of course the PIEF also has some particular features which are not inherent in the approach. The various limits on the size of the PIEF's loans, its share in the package with the participating bank, and its share in a given project imply that projects are likely to range from about $700,000 to $10 million. The bulk of the grant ($30 million) can only be used for purchase of goods and services from the U.S. Since the A.I.D. support is a grant, the PIEF is likely to be quite profitable, and the profits plus the repayments should cumulate substantially in the future. The first PIEF loan proposals were considered only in June, so it is too early to reach any judgments about how useful it will prove to be.

In any event, the main point here is that an intermediary Industrial Financing Fund similar to the PIEF could be the key to extending improved financing terms for private industrial projects quite widely through the banking system.

---

[1] See Robert R. Nathan Associates, A Study of the Feasibility of a Private Investment Encouragement Fund for the Egyptian Private Sector, September 1979.

The second important area for policy improvements is to develop more channels, with more funds, to finance projects of small scale industrial companies. At present the DIB is the only institution with substantial activity in the small scale field.

By small scale we mean industrial companies with such characteristics as LE 200-300 thousand pounds of fixed assets (similar to the World Bank's definition in its DIB loans) and a labor force in the order of 25-100. (Very small companies, operating in workshops with much less fixed assets and labor forces of five or ten, are a quite different group with different needs.) Such small scale companies correspond to the smaller non-Law 43 Egyptian companies in our interviews, and to many of the existing Law 26 companies likely to be affected by the new Company Law. These small scale companies are strategically placed to expand into larger industrial firms in the future, to respond to export incentives, and to make effective use of improved availability and terms of financing.

The basic problem is that lending to a larger number of small companies is more costly for any financial institution than lending to fewer larger companies. The administrative problems are likely to be different as well as greater, and the risk of bad loans is likely to be higher. Thus appropriate channels for financing small scale industrial companies must have significant government or external donor support.

The DIB is clearly an appropriate institution. It is a public sector bank, already has a special department for small scale industry, and (with funds from particularly interested external donors) has been expanding its lending to smaller companies. It should press ahead.

But an adequate outreach to small scale industry must have more than a single public sector channel. And in order for Misr Iran, the AIB, and a few of the more active Law 43 banks to enter this field in a serious way, they would need to build up staff and procedures for special small borrowers' departments. Accordingly, they would need to get outside financial support to cover the additional costs of the build up, and then to help support the extra costs of continuing operations.

A promising approach again seems to be for the government to establish a financial intermediary. A Small Industry Fund could channel concessional funds from external donors to the modest number of banks that can be induced to enter the small scale field in a committed way. The first phase, providing support to the banks as they build up their capability, would resemble a conventional external assistance project. The second phase, sharing in the banks' lending to small borrowers while bearing most of the extra costs, would be more novel. Although the Small Industry Fund would be more complicated than the Industrial Financing Fund, devising its specifics should not be beyond the wit of man.

In conclusion, we wish to emphasize that the policy measures to improve financing terms for industrial projects and to broaden financing for small scale companies should be meshed with the broader efforts to develop Egypt's financial markets discussed in Part I. In particular, the policies should mesh with efforts to assure positive real interest rates for widely held financial assets, and to induce larger private companies to finance part of their future investment through share issues.

E. Possible contributions of external donors

External donors could contribute in three main ways to improving Egypt's arrangements for financing private industrial investment. First, they could make concessional loans for use by the Misr Iran Development Bank and the Arab Investment Bank. The government could then enable these two publicly owned Law 43 banks, as well as the Development Industrial Bank, to do part of their lending at terms especially suitable for industrial projects. Specifically, Misr Iran and the AIB could offer some medium to long term loans repayable in pounds without exchange rate risk, and with interest rates fixed for the term of each loan. Second, external donors could provide concessional funding for an Industrial Financing Fund. The IFF would share with any of the Law 43 banks and public sector banks in financing private industrial projects, and thereby permit combined terms for the loan package to approach those just described. The IFF would be similar to the recently established Private Investment Encouragement Fund. Third, external donors could provide concessional funding for a Small Industry Fund. The SIF would help a limited number of interested banks, besides the DIB, to build up their capability for dealing with small companies, despite the extra costs of such lending. The SIF would then share in expanding these banks' loans to small borrowers.

External assistance for these three initiatives would have the function of program support for innovative government policy measures, designed to stimulate private industrial investment. Support for any of them, however, could take the form of project loans or grants.

Table 1 Industrial Value Added in 1977: Public Sector and Private Sector (LE 000)

Industry	Total	Public Sector	Private Sector	% Private
Foodstuffs	172,600	60,000	112,600	65
Beverages	16,800	14,300	2,500	15
Tobacco	33,600	31,400	2,200	7
Spinning, Weaving	220,500	180,500	40,000	18
Clothing, footwear	86,300	11,400	74,900	87
Wood products	36,700	3,500	33,200	90
Paper products	22,900	22,400	500	2
Printing	20,500	9,200	11,300	55
Leather products	8,900	1,600	7,300	82
Rubber products	9,100	8,500	600	7
Chemicals	126,200	100,500	25,700	20
Non-metallic prod.	45,900	34,600	11,300	25
Basic Metals	75,100	69,400	5,700	8
Metallic products	33,200	20,500	12,700	38
Non-electric mach.	12,400	10,700	1,700	14
Electric Machinery	43,400	39,900	3,500	8
Transport Equipment	54,600	49,900	4,700	9
Other manufacturing	57,400	50,900	6,500	11
Total Manufacturing	1,076,100	719,200	356,900	33

Source: Development Research and Technological Planning Center, Cairo University. Data from many official sources have been used in preparing the 1977 input-output table and social accounting matrix.

Table 2 Industrial Production 1976-80: Public Sector and Private Sector

(gross value of output at current prices, LE million)

	1976	1977	1978	1979	1980 est.	1976-80 Annual % Increase
inning, weaving	755.8	836.5	1,097.5	1,163.3	1,382.8	
Public sector	563.1	641.1	798.3	838.7	1,015.9	15.9%
Private sector	192.7	195.4	299.2	324.6	366.9	17.5%
odstuffs	774.8	845.9	958.1	1,190.4	1,459.7	
Public sector	591.7	667.3	755.9	894.7	1,027.2	14.8%
Private sector	183.1	178.6	202.2	295.7	432.5	24.0%
Chemicals	232.3	279.2	313.5	413.7	552.4	
Public sector	180.4	202.4	235.0	297.1	414.1	23.1%
Private sector	51.9	76.8	78.5	116.6	138.3	27.8%
Engineering, metals	446.2	541.4	653.8	836.5	1,129.7	
Public sector	381.2	471.2	569.1	723.1	940.9	25.3%
Private sector	65.0	70.2	84.7	113.4	188.8	30.5%
ining, refractory	27.9	35.2	60.3	83.6	100.9	
Public sector	7.7)		33.6	42.4	51.7	61.0%
Private sector	20.2)	35.2	26.7	41.2	49.2	24.9%
ood products						
Private sector	60.4	75.0	99.9	107.6	119.2	18.5%
eather products						
Private sector	162.2	170.5	248.9	362.5	413.7	26.4%
otal	2,459.6	2,783.7	3,432.2	4,157.6	5,158.4	20.3%
Public sector	1,724.1	1,990.3	2,391.9	2,796.0	3,449.8	18.9%
Private sector	735.5	793.4	1,040.3	1,361.6	1,708.6	23.5%
% Private	29.9%	28.5%	30.3%	32.7%	33.1%	

Source: Ministry of Industry, as reported by the IMF. Estimates for 1980 are projected from January-June figures for 1979 and 1980. The figures cover only industries under the Ministry's supervision. Ministry officials indicate that coverage of Law 43 companies is incomplete, and that private sector trends are probably understated.

(LE million)

	1975	1976	1977	1978	1979	1979 % of GFI
Gross fixed invest.	1265	1450	1838	2618	3346	
Public sector	1064	1153	1477	2179	2547	
Private sector	201	297	361	439	799	24%
Law 43 (less land)	22.5	102.8	177.6	256.8	356.6	11%
GFI by sector						% of sector
Agriculture	95	98	146	191	268	
Law 43		0.1	1.1	21.8	36.6	14%
Industry	287	379	561	765	817	
Law 43	13.8	30.0	70.8	106.2	179.1	22%
Petroleum	122	186	206	201	450	
Law 43	4.3	5.9	6.6	7.1	8.0	2%
Construction	31	80	48	132	76	
Law 43	0.4	1.5	1.7	5.5	9.2	12%
Transport, etc. (incl. Suez)	383	373	443	692	882	
L 43 marine etc.	0.9	19.3	36.6	47.0	28.5	5%
L 43 storage		14.7	21.8	11.0	18.6	
Housing	177	128	125	136	142	
Law 43		0.1	3.8	4.7	8.1	6%
Services	73	97	138	212	307	
L 43 tourism	2.1	31.2	33.6	53.9	65.0	25%
L 43 health etc.		0.1	3.8	4.7	10.4	
Electricity	53	59	109	203	229	-
Utilities	46	45	66	96	160	-
Trade, finance	16	26	30	37	70	-
Less: land	-17	-21	-35	-47	-56	

Source: Ministry of Planning, as reported by the IMF.

Table 4 Approved Law 43 Investment Projects, as of 12/31/78 and 12/31/79

(Authorized capital plus loans, LE thousand)

SECTOR	DEC. 31, 1978		DEC. 31, 1980	
	Investment (LE 000)	% of Inland or FZ Total	Investment (LE 000)	% of Inland or FZ Total
Inland:-				
Tourism	570,282	21	770,979	14
Transport	60,706	2	86,318	2
Agriculture	251,219	9	345,684	6
Manufacturing	1,047,837	38	2,083,395	38
Textiles	295,097	11	346,081	6
Foods	67,271	2	275,392	5
Chemicals	112,437	4	271,835	5
Engineering	282,108	10	388,489	7
Building	221,739	8	694,800	13
Metals	36,208	1	46,912	1
Pharmaceuticals	16,731	0.6	32,550	0.6
Wood	16,246	0.6	27,336	0.5
Housing	243,248	9	415,107	8
Services	247,339	9	455,594	8
Contractors	56,759	2	158,062	3
Health	51,509	2	81,122	1
Other	139,061	5	216,410	4
Non-Financial Total	2,420,631	88	4,157,007	77
Banking	129,467	5	496,700	9
Investment Cos.	194,526	7	661,321	12
Petrol/Mining	9,378	0.3	105,484	2
Inland Total	2,754,002	100	5,420,582	100
Free Zones:-				
Agriculture	54	0	n.a.	
Manufacturing	334,613	48		
Storage	175,797	25		
Services	137,436	20		
Non-Financial Total	647,900	93		
Banks	6,250	1		
Petrol/Mining	42,241	6		
Free Zone Total	696,391	100	1,370,526	100
Inland + Free Zones:-				
Non-Financial Total	3,068,531			
Grand Total	3,450,393		6,791,108	

Investment Authority.

Source: /The Authority's figures for the inland textiles sector have been adjusted by reducing the Ameria project from LE 530 to LE 212 million, to represent approximately the rephasing which has been agreed. The Ameria project is under execution.

Table 5 Proportions of Projects in Production, Under Execution, and Only Approved, as of 12/31/78 and 12/31/80
(Authorized capital plus loans, and per cent of sector total)

	Dec. 31, 1978						Dec. 31, 1980					
	Production		Execution		Only Approved		Production		Execution		Only Approved	
	LE 000	%	LE 000	%	LE 000	%	LE 000	%	LE 000	%	LE 000	%
Inland:-												
Tourism	83,768	15	327,313	57	159,201	28	78,939	10	447,231	58	244,809	32
Transport	7,665	13	26,582	44	26,189	43	71,016	82	597	1	14,705	17
Agriculture	36,731	15	165,026	66	49,462	20	134,617	39	78,118	23	132,949	38
Manufacturing	64,080	6	614,071	59	369,686	35	276,927	13	877,288	42	929,180	45
Housing	124,346	51	82,572	34	36,330	15	65,757	16	298,656	72	50,694	12
Services	12,747	5	86,241	35	148,351	60	71,382	16	124,010	27	260,202	57
Non-Financial Total	329,337	14	1,302,075	54	789,219	33	698,638	17	1,825,900	44	1,632,539	39
Banks	90,467	70	32,000	24	7,000	24	227,300	46	32,400	7	237,000	48
Investment Cos.	53,200	27	98,976	51	42,350	22	324,569	49	121,087	18	215,665	33
Petrol/Mining	6,289	67	1,329	14	1,760	19	15,722	15	19,454	18	70,308	67
Inland Total	479,293	17	1,434,380	52	840,329	31	1,266,229	23	1,998,841	37	2,155,512	40
Free Zones:-												
Agriculture	54	100	-	-	-	-	n.a.		n.a.		n.a.	
Manufacturing	27,687	8	34,334	10	272,592	81						
Storage	103,896	59	55,243	31	16,658	10						
Services	92,914	68	9,343	7	35,179	26						
Non-Financial Total	224,551	35	99,920	15	324,429	50						
Banks	6,250	100	-	-	-	-						
Petrol/Mining	37,012	88	2,391	6	2,838	7						
Free Zone Total	267,813	38	101,311	15	327,267	47	350,615	26	751,559	55	268,352	20
Inland + Free Zones:-												
Non-Financial Total	553,338	18	1,401,294	46	1,113,899	36						
Grand Total	747,106	22	1,535,691	45	1,167,596	34	1,616,844	24	2,750,400	40	2,423,864	36

Table 6 Manufacturing Projects (by Industry) In Production, Under Execution, and Only Approved, as of 12/31/78 and 12/31/80
(Authorized capital plus loans, and per cent of sector total)

	Dec. 31, 1978						Dec. 31, 1980					
	Production		Execution		Only Approved		Production		Execution		Only Approved	
	LE 000	%	LE 000	%	LE 000	%	LE 000	%	LE 000	%	LE 000	%
Inland:-												
Manufacturing	64,080	6	614,071	59	369,686	35	276,927	13	877,288	42	929,180	45
Textiles	6,091	2	284,983	97	4,023	1	22,614	7	292,614	85	30,853	9
Foods	5,451	8	25,639	38	36,181	54	63,731	23	70,114	25	141,547	51
Chemicals	26,519	24	49,957	44	35,961	32	76,942	28	122,551	45	72,342	27
Engineering	5,175	2	20,024	7	256,909	91	30,741	8	107,319	28	250,429	64
Building Mat.	754	0.3	199,838	90	21,147	10	35,072	5	249,789	36	409,939	59
Metals	19,137	53	15,672	43	1,399	4	33,805	72	11,822	25	1,235	3
Pharmaceuticals	240	1	5,779	35	10,712	64	4,521	14	6,534	20	21,495	66
Wood	713	4	12,179	75	3,354	21	9,501	35	16,545	61	1,290	5
Free Zones												
Manufacturing	27,687	8	34,334	10	272,592	81	n.a.		n.a.		n.a.	
Textiles	11,708	16	14,210	19	48,440	65						
Foods	5,953	49	78	1	6,093	50						
Chemicals	9,399	33	6,701	24	12,299	43						
Engineering	452	2	3,782	13	24,510	85						
Building Mat.	–	–	822	1	152,537	99						
Metals	175	1	3,141	10	26,720	89						
Pharmaceuticals	–	–	5,600	74	1,993	26						

Table 7 Industrial Exports: Public Sector and Private Sector (LE million[a])

	1976	1977	1978	1979	1980 est.	1980 %	1977-80 annual % increase
xports	207.1	360.2	477.3	458.5	619.8	100%	19.8%
Convertible currency	103.4	249.0	370.5	337.3	459.9	74%	22.7%
Public secto	90.5	218.9	338.3	298.5	382.3	62%	20.4%
Textiles	(34.9)	(63.2)	(134.6)	(110.1)	(157.3)		
Other	(55.6)	(155.7)	(203.7)	(188.4)	(225.0)		
Private sector	12.9	30.1	18.0	38.8	77.6	13%	37.1%
Textiles	(4.7)	(3.8)	(4.1)	(7.0)	(14.0)		
Other	(8.2)	(26.3)	(13.9)	(31.8)	(63.6)		
Bilateral accounts	103.7	111.2	106.8	121.2	159.9	26%	12.9%
Public sector	72.3	85.1	80.6	98.2	133.2	21%	16.1%
Textiles	(62.0)	(79.4)	(75.0)	(91.9)	126.9		
Other	(10.3)	(5.7)	(5.6)	(6.3)	6.3		
Private sector	31.4	26.1	26.2	23.0	26.7	4%	0.8%
Textiles	(3.9)	(5.5)	(3.9)	(1.8)	0.5		
Other	(27.5)	(20.6)	(22.3)	(21.2)	26.2		
Total exports	207.1	360.2	477.3	458.5	619.8		
Public sector	162.8	304.0	418.9	396.7	515.5	83%	19.2%
Private sector	44.3	56.2	58.4	61.8	104.3	17%	22.9%

Source: Ministry of Industry, as reported by the IMF. The figures cover only industries under the Ministry's supervision. Ministry officials indicate that coverage of Law 43 companies is incomplete, and that private sector trends are probably understated.

a. The 1976 data are at the official exchange rate of LE 1 = US$2.5556. Beginning in 1977 convertible currency exports and parallel market imports are at the parallel exchange rate of LE 1 = US$1.4286; bilateral accounts exports and imports are at the rate of LE 1 = US$2.5556.

Table 8 22 Principal Manufactured Exports: Value in 1979, Value Index 1976-79, Quantity Index 1976-79

	Value in 1979 (LE mil.)	Value Index (1976 = 100)				Quantity Index (1976 = 100)			
		1976	1977	1978	1979	1976	1977	1978	1979
Cotton yarn	130.1	100	118	154	224	100	87	96	122
(excl. East Europe)	(45.5)	(100)			(282)				
Cotton fabrics	41.0	100	140	155	234	100	103	113	116
(excl. East Europe)	(34.0)	(100)			(263)				
Cotton waste	10.5	100	113	157	226	100	93	130	90
Carpets, etc.	5.1	100	151	151	164	100	143	98	101
Undergarments, knitted	3.2	100	97	102	95	100	92	84	57
(excl. East Europe)	(2.6)	(100)			(441)				
Outergarments, knitted	4.4	100	71	87	82	100	71	79	65
Clothing	5.7	100	72	70	73	100	81	82	79
(excl. East Europe)	(2.0)	(100)			(704)				
Made-up textiles	4.8	100	157	93	134	100	150	91	94
(excl. East Europe)	(4.5)	(100)			(496)				
Fruit juices	3.9	100	70	117	182	100	62	99	83
Alcoholic beverages	3.5	100	201	158	121	100	138	66	61
Cigarettes	0.5	100	495	86	343	100	347	120	133
Perfumes, cosmetics	7.1	100	122	97	88	100	104	56	35
Essential oils	6.9	100	135	149	136	100	74	68	64
Pharmaceuticals	1.4	100	150	87	137	100	114	76	47
Leather bags, etc.	0.6	100	47	40	27	100	62	48	35
Leather clothing	2.4	100	91	77	93	100	125	61	73
Footwear	3.2	100	123	125	75	100	115	210	252
Printed books	3.8	100	132	83	107	100	143	90	82
Wooden furniture	2.6	100	68	45	85	100	55	35	59
Cement	0.07	100	62	29	12	100	50	21	7
Iron & steel sheets, etc.	7.0	100	39	26	49	100	36	23	38
Aluminum bars, etc.	31.0	100	192	60	475	100	149	42	144
Total	278.8								

Source: Calculated from value and quantity data in CAPMAS, Monthly Bulletin for Trade Statistics, January-December issues. The figures excluding exports to Eastern Europe are from the Cotton Textile Consolidation Fund.

Table 9 Loans and Investments of Development Industrial Bank, Misr-Iran Development Bank, and Arab Investment Bank, Dec. 31, 1980

(LE million and %)

	DIB		MIDB		AIB	
	LE mil.	(% of 3)	LE mil.[a]	(% of 3)	LE mil.[a]	(% of 3)
Total loans and investments	121.8	(59)	62.3	(30)	23.7	(11)
Loans, med./long	104.5	(75)	16.2	(12)	18.3[b]	(13)
Local currency	(63.0)					
Foreign curr.	(41.5)					
Loans, short	17.3		21.2		b	
Local currency	(17.3)					
Foreign curr.						
Investments, securities			20.3			
Equity investments			4.6		5.4	
Cash & other assets, net			43.9		35.4	
Assets = Liabilities			106.2		59.1	
Deposits			68.2		43.6	
Capital & reserves	c		32.2		12.5	
Other liabilities	c		5.8		3.0	

Sources: DIB, MIDB, and AIB

a. MIDB and AIB figures are converted from dollars at LE.7 = $1.

b. AIB loans and advances include a small amount of short-term.

DIB capital accounts as of 9/30/80 were LE24.8, liabilities to the Central Bank were LE38.6, and liabilities to foreign sources were LE37.3 million.

Table 10 Assets and Liabilities of Law 43 Investment Banks, Law 43 Commercial Banks, and Public Sector Commercial Banks, Dec. 31, 1980
(LE million and %)

	L43 Investment		L43 Commercial		Public Commercial		Law 43 as % of Total
	LE million	%	LE million	%	LE million	%	
1. Total assets	1616.7		1942.0		10,369.3		
. Assets, net[a]	887.7	100	1459.1	100	8910.5	100	21
3. Cash + domes. bal., net[a]	-66.1	-7	216.6	15	1156.1	13	12
. Balances abroad, net[a]	421.3	47	397.7	27	670.8	8	55
5. Loans < 1 year	383.0	43	671.3	46	5825.5	65	15
. Loans > 1 year	60.0	7	54.8	4	77.0	0.9	60
7. Government securities	4.2	0.5	7.5	0.5	506.7	6	
. Investments	31.2	4	8.9	0.6	150.7	2	21
. Fixed & other assets	54.1	6	102.3	7	523.7	6	
. Liabilities, net[a]	887.7	100	1459.1	100	8910.5	100	
11. Deposits	669.6	75	1151.1	79	5754.3	65	24
. Capital & reserves	144.8	16	192.3	13	214.4	2	
. Other liabilities	73.3	8	115.7	8	2941.8	33	
. Contingent liabilities	755.0	85	920.0	6	6527.3	20	
	%		%		%		
5+6 ans > year/all loans	14		8		1		
6+8/6+7+8 on-gov./medium + long	96		89		31		
/11 bal. abroad/deposits	63		35		12		
5+6+7+8/11 ans + invest./deposits	71		65		114		

urce: Central Bank

a. Net cash + domestic balances are net of balances due to domestic banks (418.4, 295.0, 296.4, respectively). Net balances abroad are net of balances due to banks abroad (310.6, 187.9, 296.4). Net assets and net liabilities are net of balances due both domestically and abroad.