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Country Development Strategy Statement

FY 1984
Annex

Policy Issues Facing Egypt

Egypt

February 1982

Agency for International Development
Washington, D.C. 20523

BEST AVAILABLE

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1984 CDSS ANNEX

CDSS POLICY ISSUES FACING EGYPT

USAID/Cairo

February 1982

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CDSS: POLICY ISSUES FACING EGYPT

I. SUMMARY

1.01 The bottom line for any aid program is how to allocate aid resources in an effective manner. The questions at least are clear. What are the problems that need to be addressed? What realistically can be addressed? What should we do, should not do and why? None of these questions can be addressed in a vacuum. Following a brief introduction designed to establish the contextual framework of the Egyptian economy, the critical policy issues facing Egypt are cast in the context of how they relate to the allocation of aid resources in the sense of the bottom line questions noted above.

II. RECENT ECONOMIC PERFORMANCE

2.01 For the last seven years, and more specifically since 1978, Egypt has been riding the crest of unprecedented growth in foreign exchange availability. Part of this growth derives directly from Egyptian economic policies: the introduction of the Open Door Policy in 1974, the decision to widen and deepen the Suez Canal, the petroleum concessions negotiated by the government and the liberalization of the foreign exchange regime are but a few of the explicit Egyptian policies which have underlain this boom in foreign exchange availability. Part also has been due to factors exogenous to domestic Egyptian policies. These principally include the massive growth since 1974 in remittances from Egyptian workers abroad and the fortuitous coincidence of the 1979 OPEC price increases with the bringing into production of new Egyptian petroleum fields. Finally, part has been due to the growth in assistance flows, principally from the U.S. but also from other bilateral and multilateral donors.

2.02 The boom in resource availability has fueled impressive macro economic performance. Real GNP growth has averaged around 8% per annum over the past seven years. The ratio of gross investment to GNP has exceeded 25% in each year. Real consumption growth has exceeded population growth rates. Unemployment trends have been contained within socially acceptable bounds in the face of population growth rates currently averaging almost 3% per annum. More importantly, and as presented in detail in another of these annexes, the benefits of growth have been broadly distributed. People are substantially better off in both the public and private sectors. The less skilled workers in the private sector and those in the lower financial grades in the public sector have not only improved their position absolutely, they have also improved their position relative to professional and managerial occupational classes.

III. BENEATH THE SURFACE OF RECENT ECONOMIC PERFORMANCE

3.01 The boom in resource availability has also had a negative side. It has papered over, veiled and permitted a postponement in addressing an array of complex problems which both are and have been adversely affecting the ability of the economy to allocate resources in a manner which will sustain favorable performance. Moreover, these problems have mounted as a result of the postponements in addressing them.

3.02 Many of these problems have been identified in this and last year's CDSS. While they are discussed in more detail in the following pages, it will be useful to summarize them concisely at this point:

- a price structure facing the agricultural, industrial and household sectors that has become increasingly divorced from signaling consumption, investment and production decisions that are consistent with Egypt's comparative advantages;

- the large and growing volume of resources that are being misallocated on the basis of these price distortions;

- the effect these price distortions have had over time in creating a capital stock, a structure of production in the agricultural and industrial sectors and a system of price-based income transfer payments for households that have made maintenance of this price structure a self-fulfilling argument for preserving the status quo;

- the bases of these distortions in an orientation toward resource allocation that gives heavy weight to national self-sufficiency in production and that gives equally heavy weight to using the price structure rather than the fiscal system as a means to distribute real income gains to consumers, tax agricultural income at highly discriminatory rates and support public sector industrial development;

- as illustrated by the current tightening in the foreign exchange situation, the effect this price structure and orientation toward national self-sufficiency have had in elevating import requirements, both directly and through reducing potential export earnings, to levels that can no longer be sustained on the basis of foreign exchange availabilities from traditional sources;

- the need now to alter pricing policies in order to correct the resource availabilities/requirements balance;

- the extraordinarily difficult economic management/adjustmment problems that will inevitably accompany these changes;

- the unavoidability of beginning the adjustment process if recently achieved gains in real income are to be preserved in the future;

- and, in a class by itself, population.

3.03 Some of these problems have deeply entrenched, historical roots. Others date from Egypt's domestic policy response to the worldwide run up in international food and energy prices that began with the world grain harvest shortfall in 1972 and the initial round of OPEC energy price increases in 1973. In particular, food and energy price subsidies in the Egyptian economy, by being incorporated in household and firm investment, consumption and production decisions, are currently providing income equivalents equal to over L.E. 4.5 billion to economic units throughout the economy. This represents approximately 30% of GNP and, when allocated on an urban/rural household basis, they provide income equivalents to urban households amounting to an astonishing 40% of average urban household expenditures.

A. The Historical Legacy

3.04 Following the Free Officers' Revolt of 1952, Egypt gradually embarked on a development strategy characterized by autarkic import substitution and state control over industrial and agricultural production. Illustrative of these policies were the nationalization of the banking system and industrial firms in the 1960s and the gradual introduction of pervasive price, input-output and marketing controls over both the industrial and agricultural sectors. Many of the production and investment decisions taken in this period were at variance with an efficient allocation of resources. Import substitution was seen as the path to industrialization and national self-sufficiency as ends in themselves. In support of these objectives, prices for intermediate industrial inputs were often set at levels designed to make it "profitable" to produce desired outputs or, alternatively, border protection assured financial viability. Unemployment trends were kept at socially acceptable levels through employment policies which forced the public industrial sector and the central government to become employers of last resort. In essence, the cost/price structure increasingly became a vehicle for achieving social objectives and did so at increasing expense to signaling properly opportunities for employment generation, production, investment, import substitution and export growth that could be sustained in the absence of an increasingly complex system of price subsidies and border protection.

3.05 In spite of the introduction of the Open Door Policy in 1974, Egypt remains today an economy in which the public sector dominates resource allocation. It does this directly through its sheer size relative to the private sector and, in particular, through its "customer" relationship to the private sector in the purchase and sale of commodity production ranging across a wide spectrum from cement, aluminum and steel to

textiles and fertilizer. It also does this through establishing the pricing, foreign exchange, tax and credit regimes that determine economic decisions in the private sector. These regimes, particularly in the tax and foreign exchange areas, differ not only between the public and private sectors but also within the private sector itself. To many Egyptians, Egypt is three economies at once: the public sector, the domestic private sector and the Law 43 or Open Door sector.

B. Public Sector Investment Criteria

3.06 The historical legacy of import substitution and national self-sufficiency goes beyond the incorporation of this legacy into Egypt's "inherited" industrial base. One enduring legacy from the pre-1974 period is a continuing emphasis on national self-sufficiency and import substitution as a development strategy.

3.07 Indicative of this continuing orientation is the ranking of national objectives and priorities for investment presented in a recent report by A. D. Little & Co. and replicated as Table 1 below. This ranking was derived from an extensive series of interviews with a broadly representative group of senior government officials from a wide variety of ministries/public sector entities. The objectives are ranked from 1 to 8 with 1 designating the highest objective. The degree of priority associated with each objective is ranked from 10 to 1 with 10 representing the highest priority. As is evident from the Table, national self-sufficiency and import substitution are the most important objectives and have the correspondingly highest priorities. At the opposite end of the scale, efficiency in resource allocation and export earnings' generation are the lowest ranking objectives with the least priorities. These investment criteria extend beyond the public sector itself. They also represent the investment approval criteria which public sector decision-makers seek to apply to projects which fall under the legal regime of the Open Door Policy.

TABLE 1

National Objectives and Priorities for Investment in Egypt

	Objective	Priority
1.	Insure food security (eliminate food deficit)	10
2.	Provide adequate housing (eliminate deficit of housing and building materials)	9
3.	Develop and expand national resource base: human and physical (investment in stock of raw materials, capital goods, technology and know-how, infrastructure, new and improved land, critical inputs, manpower training, etc.)	8
4.	Encourage regional decentralization (reduce congestion in Cairo and Alexandria)	8
5.	Improve utilization of manpower (reduce unemployment and utilize underemployed labor)	6
6.	Modernize production and improve utilization of resources	5
7.	Improve net foreign exchange savings	4
8.	Enhance export diversification (non-traditional exports)	2

SOURCE: Investment Opportunities in Egypt: Project Listings and Profiles, A. D. Little and Co., Cairo, Egypt, 1981

C. Agricultural Policies

3.08 A second continuing legacy from the pre-1974 period is a set of agricultural pricing policies which, bolstered by administrative controls over input supplies and acreage requirements, has traditionally been used to transfer income out of the agricultural sector. As noted in the Agriculture Pricing Annex, these policies are less pervasive now than they used to be. Nevertheless, at an estimated annual transfer out of the agricultural sector of L.E. 1.2 billion, these policies obviously continue to affect a substantial portion of agricultural output. Moreover, they do so in a manner which significantly distorts production, consumption and investment decisions. These distortions and their perverse effects are pointedly illustrated by the portrayal in Table 2 of the four sets of prices guiding government, farmer and consumer decision-making for a selected group of agricultural commodities.

TABLE 2

Price Structure for Selected Agricultural Products
(1980 in L.E. per metric ton)

	L.E. Equivalent[1/] of International Price at "Market" Exchange Rate	L.E. Equivalent[1/] of International Price at Official Exchange Rate (GASC Price)	Farmgate Price	Consumer Price
Rice	320	269	75	50
Wheat	133	112	76.50	41.20
Sugar	436	366	176.80	100.0
Beans	243	204	161.29	100.0
Lentils	441	370	250.0	110.0
Cotton	959	806	229.50	333.0

SOURCE: Ag Annex, Cotton Consumer Price is USAID estimate of price paid by domestic industrial users of cotton.

1/ Market exchange rate: L.E. .84 = U.S.$1; official exchange rate: L.E. .70 = U.S. $1.

3.09 As indicated in Table 2, rice has a border price to Egypt of L.E. 320 per metric ton. It is procured from farmers at L.E. 75 per metric ton and resold to consumers at the equivalent of L.E. 50 per metric ton. Measured from border prices, the farmer is taxed by the government at the rate of L.E. 245 per ton of rice and the consumer is subsidized by the government at the rate of L.E. 270 per ton. A similar story unfolds for wheat. Wheat has a border price to Egypt of L.E. 133 per metric ton, an internal procurement price of L.E. 76.50 and a consumer price of L.E. 41.20. From the point of view of economic efficiency as measured by the L.E. equivalent of international prices, rice is about 2.5 times more expensive than wheat; from the point of view of the Egyptian consumer rice is about 1.25 times more expensive than wheat and from the point of view of the farmer, the price he receives from the two crops are almost identical. In effect, consumer decisions to purchase rice or wheat and farmer decisions to produce rice or wheat diverge substantially from the relative prices that would promote efficient resource allocation. Consider a single example to illustrate one aspect of these distortions. Suppose a farmer could increase rice yields by one ton with the introduction of off-the-shelf technology involving an additional investment cost of L.E. 1,000. His return at the government procurement price of L.E. 75 would be 7.5%. His return at the border price of L.E. 320 per metric ton would be 32%. From this single example, it is easy to see why and how technology transfer is thwarted by agricultural pricing policies. Similar efficiency debilitating price distortions affect cotton and sugar -- two other major crops produced in Egypt. In effect, while the agricultural system is designed to meet food security objectives, it may, in fact, be a food insecurity program in terms of its effect on the value, volume and commodity composition of production. Quite simply, the use of low procurement prices as a basis for taxation -- rather than an income tax itself -- radically alters the value and commodity composition of agricultural production and may, in fact, be sending signals into the agricultural sector to produce substantially less output, valued at international prices, than currently being produced.

D. Industrial Structure and Policies

3.10 All countries, Egypt included, have comparative advantages in production. In Egypt, these comparative advantages are grossly underexploited by a continuing, efficiency restricting lack of uniformity in the regulatory, legal and administrative treatment of the public and private sectors. As pointed out in the Industrial Sector Annex, the public sector remains in a preferred position in a number of important areas. Entry into production by the private sector in areas that might compete with existing or even distantly planned public sector production is subject to de facto administrative veto. The public sector enjoys rationed access to official foreign exchange balances at a preferred price. The private sector, in contrast, must obtain foreign exchange on the residual, own exchange market at a substantially higher price and must surrender export earnings at a lower official price. The own

exchange market itself is encumbered by administrative restrictions which make it both costly and difficult to obtain access to the amounts of foreign exchange that a private importer requires. Import license applications must be submitted by the private sector and their approval is subject to administrative delays. Private sector importers, unlike public sector importers, are subject to prior import deposit requirements which raise substantially the price of imports to them.

3.11 By no means, however, is the pattern one of uniform regulatory discrimination against the private sector. Public sector industrial enterprises operate in a largely non-market environment. It is not up to public sector industry managers to determine what products to produce or the prices at which the products will be sold. Employment levels and wages are subject to administrative controls which narrow considerably, and in some cases reduce to zero, the ability of public sector managers to reward productivity increases and retain/attract qualified staff. The disposition of public sector profits, if any, is subject to controls outside the enterprise itself. Public enterprise investment budgets are controlled -- in amounts, in allocation and in ability to fund investment through retained earnings or through borrowing to obtain the local and foreign exchange resources required to finance them. In essence, both the opportunities and incentives to make investment and production decisions in accord with efficiency considerations are narrowed. The purpose of the public sector enterprises is to meet the goods bill of the social contract -- providing "essential" goods at affordable prices to the masses. Seeking out and developing export opportunities is a distant second to satisfying the claims of the domestic market on production. This social purpose of public sector production is in sharp and conflicting contrast to the private sector. The two sectors live in a kind of wary coexistence with mutual concern about the viability of the market experiment.

E. Price Controls, the Structure of Relative Prices and Inflation

3.12 Beginning with the world grain harvest shortfall in 1972 and the initiation of massive energy price increases by OPEC in 1973, virtually every country in the world began to experience correspondingly sharp inflationary pressures. Some countries began a process of adaptation of their economies to these inflationary pressures. They permitted domestic prices for food and energy to rise sharply relative to other prices. They accepted the fact that increases in the overall price level were a unavoidable consequence of sharp, relative price increases for food and energy because of the heavy weight of food/energy products in household and firm expenditure baskets both as direct consummables and as intermediate production inputs. They also allowed nominal interest rates to rise pari passu with the inflation rate, thus allowing the interest rate to signal properly an appropriate balance between capital and labor intensity in investment decisions. They allowed exchange rate adjustments to offset differential movements in domestic and foreign overall price levels and, in particular, they permitted a pass through of exchange rate adjustments into the prices of tradeable goods.

3.13 The countries which accepted these adjustment burdens -- and they were not easy to accept for any one of them -- are in a relatively favorable position today. Over the last seven years, the energy intensity of production and consumption has dropped markedly in these countries. In the industrial sector, firms have invested in less energy intensive production processes and capital equipment. They have engaged in retrofitting expenditures to reduce the energy intensity of production of existing investment. Households have similarly reduced their expenditures on energy relative to other goods/services. Similar adjustments have taken place in the agricultural sectors of these countries. Consumers have shifted their pattern/composition of food consumption towards commodities which have risen less in price. Farmers, in response to food price increases have had incentives to increase production and in response to energy price increases, to reduce the use of energy, fertilizer and irrigation inputs into agricultural production.

3.14 Egypt, for reasons noted below, has not been among the countries which have permitted the new post-1973 regime of international food and energy prices to be incorporated in to the structure of relative prices guiding production, investment and consumption decisions throughout the economy. With respect to agricultural prices, this is evident from Table 2 above. With respect to energy prices, it is suggested by Table 3 below.

3.15 In brief, Egypt's domestic energy prices average about one-fifth their international market price equivalents and are exceptionally low relative to other prices in Egypt. Both now and over the last seven years, these low energy prices have fed price signals into the economy which have promoted energy intensity in production, consumption and investment. None of this should be taken to imply that the investment decisions taken in favor of the iron and steel complex at Helwan, the aluminum complex at Nag Hamadi and the Kima fetrilizer complex were wrong at the time they were taken. At the time the High Dam was completed, Egypt did have a super-abundance of energy and the High Dam could provide it at a marginal cost that was effectively near zero. This is clearly not the case today.

3.16 The structure of food and energy prices relative to other prices in Egypt is indicative rather than an exhaustive illustration of the pervasiveness of the cost/price distortions guiding resource allocation decisions in Egypt. Interest rates, for example, are arbitrarily fixed at low (or negative) real levels in the interest of promoting capital formation. They do so at the expense of promoting capital intensity over job creation, at the expense of reducing voluntary savings and at the expense of requiring arbitrary administrative decisions in allocating savings to investment.

TABLE 3

EGYPT: Selected Energy Price Subsidies
as at October 31, 1980

Product	Unit	Domestic Sale Price (1) (In Egyptian Pounds)	International Price[1/] (2) (In Egyptian Pounds)	Ratio (1)/(2) (In Per Cent)
Gasoline (premium)	Liter	0.130	0.180	72
Gasoline (regular)	Liter	0.110	0.175	63
Kerosene	Liter	0.030	0.187	16
Gas oil	Liter	0.030	0.185	16
Diesel Fuel	Liter	0.026	0.180	14
Fuel Oil	Metric ton	7.500	152.250	5
Butane Gas	Cylinder (12 1/2 kg)	0.650	2.848	23
Electricity	KWH	.009	.05	18

SOURCE: Egyptian General Petroleum Corp., USAID estimates

1/ Estimated import price (c.i.f. Alexandria); excludes all local taxes and transport costs. International price converted to L.E. price at L.E. .70 = U.S.$1.

3.17 As noted in the Urban Annex, the charges levied for water, sewerage, transport and telecommunications services have been held at levels which do not cover operating and maintenance costs let alone make a positive contribution toward investment requirements for service expansion and improvement. Rents in the private sector are frozen at levels which require resort to formally illegal practices ("key" money) that only very partially succeed in creating a housing supply and market. In the public sector, housing is provided at rents that are substantially below minimal cost recovery and the housing that is provided is substantially less cost effective than it could be.

IV. POLICY REFORM: WHY REFORM, WHAT REFORMS AND REFORM MANAGEMENT

A. Is There Cause for Concern

4.01 None of the observations above would be in the least bit relevant -- except as an economist's jeremiad -- if Egypt were Saudia Arabia or Kuwait in terms of resource availability. She is not.

4.02 Over the last seven years, Egypt could, in a sense, afford not to address the structural, institutional management and price signaling problems outlined above. Progress was being made in spite of the biases and inefficiencies inherent in the public sector investment selection process and in the restrictions imposed on both public and private industrial development. Substantial additions to the housing stock were being created even though this was often in spite of rather than because of public sector housing policies. The impact of population growth was blunted by a rapid growth in job opportunities for Egyptians abroad, by socially motivated public employment policies and by job opportunities created by competitive market forces.

4.03 Equally, Egypt could "afford" to maintain a structure of relative prices for food and energy that increased the import bill for food products, reduced agricultural output below potential, encouraged domestic energy consumption and reduced petroleum exports. More generally, Egypt could afford to ignore the problem of establishing a set of relative prices that would direct production, investment and consumption decisions in accordance with Egypt's comparative advantages and that would create employment opportunities sustainable in the absence of reliance on price subsidies and border protection. None of this is true any longer.

B. The Current Situation

4.04 The boom in resource availability that has fueled Egypt's impressive macro economic performance over the past seven years is now tapering off. Aid in real terms is declining. Petroleum export earnings in real terms are flat. Moreover, the exportable surplus of domestic petroleum production over domestic consumption stands a good chance of being eroded in the near future as a result of domestic energy prices

which are stimulating domestic consumption growth averaging 10-12% per year in real terms. Workers' remittances in real terms have leveled off and are unlikely to register real increases in the future. There are bleak prospects for a continuing alleviation of Egypt's population and employment problems through emigration. Now that the reopening and widening and deepening of the Suez Canal have been completed, real earnings from the Canal are also likely to be flat. Only tourism among these sources which have fueled Egypt's favorable performance is likely to continue to register gains. The implications are clear.

4.05 The ability of Egypt to sustain growth, continue to provide widely distributed real income gains and to create gainful employment opportunities on the basis of a continuation of current policies is exhausted. This is argued at length and cogently in the Employment Annex. Quite simply, the import requirements for sustaining growth under current policies have caught up with the foreign revenues available to meet them. The really critical issue, however, is the strength of the government's objectives for growth, widely distributed real income gains and the provision of gainful employment opportunities. Are these objectives strong enough to motivate the government to undertake the difficult policy reforms necessary to achieve them?

C. The Nature of the Reforms

4.06 As suggested above, the policy reforms that are required to restore favorable performance are substantial. Moreover, it is by no means certain whether, when, if and how a political consensus can be established in favor of their implementation. Whatever the prospects in this regard, the required reforms do need to be listed and explained. While they are a far cry from being feasible targets for immediate policy reform, they do represent appropriate targets to shoot for as well as standards against which staged or incremental policy reforms may be judged. For convenience, they can be placed under five broad categories:

- removing the distorting effects of price subsidies on the structure of relative prices guiding public and private sector investment, consumption and production decisions

- getting the public sector to act on the basis of the "correct" structure of relative prices in the investment selection process

- unifying and liberalizing the policy environment in which both public and private sector firms operate

- managing the transitional adjustment problems implied by the above

- addressing the population problem.

4.07 More specifically, the key reform areas from an operational point of view are:

- energy price subsidies
- food price subsidies
- industrial pricing/investment and business environment policies
- agricultural input/output pricing
- exchange rate and interest rate policies
- population/family planning policies

4.08 Obviously, the key reform areas from an operational point of view represent a selection among a host of competing alternatives. The selection of these specific reform areas is based on a blend of practical considerations. First, each of these areas represents topics of Egyptian policy debate that are well defined and broadly understood. Quite literally, hardly a day goes by without explicit mention of new proposals on food and energy price subsidies, on public and private sector industrial reform and on adjustments in agricultural procurement prices. Active reform initiatives in each of these areas are continuously being presented and represent opportunities for our support both programmatically and through dialogue. Second, the volume of resources being moved and misallocated on the basis of current policies in these areas is massive. From the point of view of having large impact, they are appropriate areas for concentration. One illustration of the magnitudes involved is the L.E. 1.2 billion tax burden on agricultural income that derives from agricultural procurement prices which are only a small fraction of border prices for a significant volume of agricultural output. Food and energy price subsidies are an even more important example. These subsidies provide "hidden" income transfers to firms and households that are equivalent to 30% of GNP. Third, there are self-reinforcing linkages among reforms in these areas. It will, for example, probably be fiscally impossible to raise agricultural procurement prices toward world market levels in the absence of a tandem reduction in consumer food price subsidies. Fourth, but not exhaustively, reform in each of these areas can have immediate impact on Egypt's current balance of payments problem. As noted further on, this is particularly true in the area of interest/exchange rate reform because of the almost immediate impact that reform in these areas would have on financial foreign exchange flows to Egypt as distinct from their more longitudinal immpact on commodity trade flows.

4.09 These practical considerations for reform emphasis should not, however, obscure the reason why reform is necessary. Nor thould they obscure the broader categories of reform requirements outlined above.

4.10 In essence, the choice of the broad categories as well as the specific reform areas follow from three sources: the need to restore the balance between resource availability and requirements, the need to do this through addressing the primary price and regulatory distortions that are creating the imbalance and the particular need to support price and regulatory reform in the two sectors -- industry and agriculture -- in which Egypt has comparative advantages in developing efficient import substitution possibilities and export earnings supplements to current revenues from petroleum, remittances, the Canal and tourism.

4.11 To restore the balance between resource availabilities and requirements essentially means two things. First, Egypt will have to supplement export earnings from traditional sources and conserve on import expenditures through the development of efficient tradeable goods industries in the commodity producing agricultural and industrial sectors. Second, Egypt will have to expand the exportable surplus of petroleum and reduce the heavy import content of the food subsidy bill in as efficient as possible a manner.

4.12 To accomplish both of these objectives in the most efficient possible manner -- i.e., with minimum domestic resource availability cost to the economy -- the price signaling environment must be set right. It must signal properly opportunities for conserving on existing foreign exchange requirements through signaling properly the true scarcity values of foreign and domestic resources. It must also signal properly where in the commodity producing industrial and agricultural sectors, Egypt does in fact have comparative advantages in production, investment and opportunities for gainful employment creation. The price signaling environment does neither at present because of the subsidies implicit in it, especially in the energy and food/agriculture areas. While some Egyptians would argue that centralized, administrative determination of resource flows can effectively substitute for a proper price signaling environment for efficiently allocating resources, few would argue that there exists such a management capacity in Egypt today. Moreover, the balance of worldwide empirical experience with centralized management does not support the theoretical possibility as an operational reality.

4.13 While getting the right price signals in the economy is a necessary condition, it is by no means a sufficient condition. It is also essential that the right price signals, once established, are acted upon in the investment selection process and in production decisions. The private sector will automatically act upon whatever price signals exist in the economy if it is permitted to do so. The public sector simply may not have the economic analysis expertise required to make the correct investment choices. Given the dominance of the public sector in total investment, establishing this expertise is obviously of key importance. After all, the quantity of investment is irrelevant if the quality of investment is lacking.

4.14 Another requirement relates directly to the regulatory environment in the economy. Even a willingness and ability to act upon the right price signals won't be enough if regulatory, administrative and legal impediments foreclose taking advantage of the opportunities revealed by the price signaling environment. Obviously, if someone tells a public sector manager to produce widgets because that's what the economy "needs", that's what he has to produce. If someone tells the private sector that producing widgets for foreign markets is precluded, the private sector won't produce them.

4.15 Finally, there are extremely demanding and difficult transitional management and adjustment problems that will be associated with making the changes outlined above. These problems derive from two sources. First, even making changes efficiently implies some adjustment costs. Second, the magnitude of these adjustment costs are large in Egypt. This is so both because of the size of the price distortions that have to be eliminated and the volume of resources that are being misallocated on the basis of these distortions.

4.16 Both of these points need to be explicitly addressed because they establish the practical considerations on what needs to be done, the difficulties involved in getting things done and what AID itself can and cannot expect to happen or accomplish from a practical point of view.

4.17 First, consider the current major sources of export revenues to Egypt: petroleum, workers' remittances, the Suez Canal and tourism. With only minor exaggeration, they share a common characteristic. None of these sources implies a cost in terms of existing resources available for domestic use. With respect to petroleum, Egypt is only exporting the surplus of domestic production over domestic consumption. Workers' remittances also don't come at much cost to the economy. Nobody is, for example, taking a worker away from producing consumption goods and putting him to work producing export earnings. The use of the Suez Canal by foreign vessels isn't reducing the access of Egyptian vessels to the Canal. The tourists who come to Egypt aren't consuming resources which would otherwise be available for Egyptian consumption. This will no longer be true. The development of supplements to export earnings from the commodity producing industrial and agricultural sectors and/or the reduction of import requirements means one of two things: either some resources currently used domestically to produce output for the domestic market have to be shifted into producing output for the foreign market or, more hopefully, the management of existing resources can be improved in a way that will expand total production sufficiently to increase exports without reducing the amount of output and resources available for domestic use. Consider a few examples. If Egypt doesn't expand rice production and/or cotton production, increased exports mean less available for domestic use. If Egypt can expand rice/cotton production, can this be done at minimum additional cost in terms of the human, capital and intermediate inputs that have to be withdrawn from other uses? The same is true for the goods produced in the industrial sector.

4.18 Consider the following example. Suppose a firm had a choice of two technologies in producing an additional 100 widgets. Technology one involves capital expenditures of L.E. 1,000 and uses 2400 KWH of electricity per year. Technology two involves a capital expenditure of L.E. 1,100 and uses 1200 KWH of electricity per year. Thus, for an additional capital cost of L.E. 100, technology two would generate a savings in electricity usage of 1200 KWH per year. At an electricity price of 1 piaster per KWH, the enterprise would save L.E. 12 per year by choosing technology two over technology one, a return of 12%. This is fairly marginal and not much of an inducement to choose the energy saving technology alternative. At an electricity price of 6 piasters per KWH, however, the firm would save L.E. 72 per year, a return of 72% on the additional L.E. 100 of capital cost associated with the energy saving technology. Of course, the firm does have to bear an additional capital cost of L.E. 100 and, in spite of lower electricity use, the annual bill for electricity does rise by L.E. 48. On the other hand, the government, the Egyptian Electricity Authority and the nation as a whole have reduced electricity demand by 1200 KWH per 100 widgets produced. At the (shadow) price of 6 piasters per KWH, this amounts to L.E. 72 per year. If this price were in fact put into place, the government would have more than enough additional revenues to "compensate" the widget producer for choosing technology two. The annual savings to the nation of L.E. 72 is much more than sufficient to offset the once-and-for-all additional capital cost of L.E. 100 and the increase in the annual electricity bill of L.E. 48. This is what efficiency means: getting more for less. Moreover, it is the pricing system that is the key to getting more for less.

4.19 More generally, if there are to be, say, exports of stoves, refrigerators, furniture, garments and processed agricultural products, will this have to be bought at the expense of reduced domestic availabilities of these products? This is a key question to Egyptians. It's the local market which counts as a major policy objective for many Egyptians. Are there, on the other hand, ways to expand production of these items at little or no cost to resources that have to be drawn from other uses through more efficient utilization and management of available resources? All of this first observation boils down to a very simple point. The non-aid foreign revenues that have supported Egypt's economic performance over the past seven years are much like foreign aid itself -- an unrequited transfer of real resources, a transfer of resources that has not had to be paid for at a cost in terms of reduced resources available for domestic uses. This will be true no longer.

D. An Adjustment Scenario

4.20 Now, Egypt faces the prospect of having to "pay" for the import requirements necessary for sustaining growth through more efficiently managing domestic resources. If this is to be done at minimum cost in terms of output/resources available to the domestic market, it will have

to be done through getting the right price signals into the market. In essence, getting more for less requires the subsidy system to be decoupled from the price system.

4.21 The adjustment problem this poses is massive and, at the same time, is unavoidable because further postponement will simply greatly exacerbate the problem. The impact on the household sector of eliminating food and energy price subsidies provides a good illustration of the adjustment problem and why its further postponement will exacerbate the adjustment requirement.

4.22 As indicated in Table 4, the average urban household in Egypt received in 1979 an income equivalent from food and energy price subsidies equal to an astonishing 41% of average household expenditures. That is, if food and energy prices were adjusted overnight to unsubsidized levels, either real living standards would fall by an obviously socially unsustainable 41% or it would take an income transfer equal to 41% of average household income to enable the household to buy the same basket of goods as before. In 1974 the income equivalent of these subsidies was probably less than 10% of income. The growth in the subsidy bill reflects two primary factors: the growth in price subsidies since 1974 and the positive incentives these subsidies have created toward consuming these subsidized products and incorporating them in investment decisions and production processes. This latter point merits special emphasis because of its magnification effect on this adjustment problem through postponement.

4.23 Especially since 1974, low energy prices have created a positive stimulus in favor of energy intensive capital equipment expenditures and production processes. Much of the high levels of investment since 1974 has been based on low energy prices. The adjustment to a new regime of relative prices in which energy prices are substantially higher relative to other prices is likely to cause substantial adjustment problems because much of this investment may no longer be profitable on the basis of the new regime of relative prices. In some cases, retrofitting expenditures could restore profitability. In others, the investment may simply have to be scrapped. Obviously, the problem can't be solved simply by ignoring it through not increasing energy prices. Doing this would simply magnify the problem by continuing to provide positive incentives toward more energy intensive investment expenditures in the future.

TABLE 4

Concentration of Subsidies in Each Household Expenditure Class (Urban)
by Alternative Measures of Importance
(1979)

	Lowest Expend. Class			Lower Middle Expend. Class			Upper Middle Expend. Class			Highest Expend. Class			All Expend. Class		
Expend. Range % of Pop.	(LE 0-778) (bottom 27%)			(LE 779-1113) (next 24%)			(LE 1114-1782) (next 29%)			(LE 1783+) (highest 21%)					
	Subsidy as % of Expend.	Subsidy as of Total Subsidy	% of Total Subsidy on Item	Subsidy as % of Expend.	Subsidy as % of Total Subsidy	% of Total Subsidy on Item	Subsidy as % of Expend.	Subsidy as % of Total Subsidy	% of Total Subsidy on Item	Subsidy as % of Expend.	Subsidy as % of Total Subsidy	% of Total Subsidy on Item	Subsidy as % of Expend.	Subsidy as % of Total Subsidy	% of Total Subsidy on Item
Food Subsidy	28.5	100	22	25.5	100	22	20.2	100	29	12.5	100	27	19.1	100	100
Wheat	17.5	61	23	15.5	61	23	11.7	58	29	6.6	53	25	11.0	58	100
Fats & Oils	4.7	17	19	4.5	18	20	4.0	20	30	2.9	24	32	3.7	20	100
Others, NES	4.0	14	22	3.5	14	22	2.8	14	29	1.7	14	27	2.6	14	100
Sugar	1.5	5	27	1.2	5	24	0.9	4	29	0.4	3	21	0.8	4	100
Meat	0.8	3	14	0.8	3	17	0.8	4	28	0.8	7	41	0.8	4	100
Energy Subsidy	23.4	100	16	24.0	100	18	21.6	100	27	20.8	100	39	21.9	100	100
Indirect(1)	11.9	51	15	12.4	52	18	11.6	54	28	10.4	50	38	11.3	51	100
Kerosene	6.9	30	33	4.7	20	26	2.9	13	26	1.1	5	15	3.1	14	100
Electricity	2.9	13	17	4.1	17	18	4.0	19	30	3.7	18	41	3.7	17	100
Gasoline	0.9	4	6	1.2	5	9	1.3	6	16	3.9	19	70	2.3	11	100
Butagas	0.7	3	7	1.6	7	17	1.8	8	32	1.6	8	44	1.5	7	100

NES = Not Elsewhere Specified.
Discrepancies due to rounding.

SOURCE: FY 1983 CDSS Annex on Food and Energy Price Subsidies.

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(1) Subsidy is indirect in the sense that energy is used as an intermediate input into products which are final consumption items, e.g., electricity is used to produce textiles and textile products.

4.24 The adjustment problems facing Egypt can be solved. This is not a doomsday scenario. First, the price subsidies don't have to be eliminated overnight. Second, the process of eliminating them can and should incorporate income transfers to firms and households so that the adjustment burden can be phased in a relatively sustainable manner. Third, there are good possibilities for reducing part of the subsidy bill through better targeting. Fourth, price subsidies can be reduced in tandem with real growth, thus preserving and even increasing real living standards at the same time as the price subsidies are being reduced. In this connection, Egypt lost a golden opportunity to do precisely this. As pointed out in the Benefits of Growth Annex, high real income gains from occupational employment were achieved between 1978 and 1981. Had half these real income gains been offset by price increases for food and energy, Egypt would face a significantly smaller adjustment problem today. The costs of postponement have been high. Finally, the subsidy system as it currently stands is simply an open-ended entitlement system for all income classes and, correspondingly, an open-ended claim on foreign exchange resources that the government is increasingly finding it difficult to fulfill.

E. Managing the Transition

4.25 While it is possible to solve the adjustment problem, no one should underestimate the management difficulties and economic management expertise that will be required to do it.

4.26 There are some highly qualified people in the bureaucracy and in non-governmental positions in the universities and private sector. The problem is that there are not enough of them. Moreover, the problem is exacerbated by a substantial bureaucratic constituency in favor of maintenance of the status quo either for reasons of political orientation against a more liberal regime for pricing and investment decisions or because such a regime might affect their role in economic management.

4.27 A couple of examples of the management difficulties are worth noting. First, inflation is unavoidable and, in fact, is necessary to solve the adjustment problem. The elimination of price subsidies will result in an increase in the overall price level at the same time as it produces the essential changes in the structure of relative prices necessary for adjustment to occur. It is by no means certain that the present economic experts in the government are aware of the critical need for distinguishing between inflation which results from essential adjustments in the structure of relative prices and inflation that is characterized by an equiproportionate increase in all prices. The latter form of inflation generally does represent policy mismanagement; the former represents policy management.

4.28 Second, the inflation that will result will require offsetting adjustments in the exchange rate. Trying to prevent this directly or through disallowing a pass through of exchange depreciation into domestic

prices for importables and exportables will thwart the adjustment process. Moreover, with the new regime of relative prices and in spite of offsetting exchange rate adjustments on the overall price level, Egypt will face a new set of comparative advantages in trade. The problem is that the existing capital stock, markets and managerial expertise are based on the old set of relative prices. This has two implications. First, Egypt may well have to "write off" much of past investment and/or engage in costly as well as time-consuming retrofitting expenditures. Second, while Egypt will enjoy a new set of comparative advantages in trade, much of the investment, marketing skills and outlets necessary to take advantage of the new opportunities is not in place. Adjustment to the new opportunities will be neither quick nor cheap in terms of investment requirements, which the government may be reluctant to recognize.

4.29 Finally, it is easy to talk about substituting income transfers for price subsidies. It is another thing to implement and manage such a program. First the government does not have nor can it hope to obtain quantitative information on the price subsidies that need to be offset on a firm-by-firm and household-by-household basis. Second, even if it did, the administrative problems go beyond the capacity of the government. In essence, it will not be possible to manage the transition without problems. What is required and what may be possible is the establishment of a management unit capable of acting on as close to a real time basis as possible to address the transitional implementation problems.

F. Population

4.30 Placing population here is designed to emphasize rather than detract from its importance. Every one of the problems noted above is being magnified on a daily basis by the time bomb of population growth. Over 40% of the population is under 16 years old. Family formation by this group will sharply increase the population over the next 20 years even if the birth rate falls substantially below its current rate of 2.9% per year. As emphasized in the Employment Annex, providing gainful employment opportunities is already an enormous problem.

4.31 The problem of dealing with population is its longitudinal character. Policies have to be initiated now and perservered with over the next 20 years before any measurable result will be obtained on population growth. In a word, if Egypt is currently facing a foreign exchange shortfall, the magnitude of the future shortfall will be multiplied many fold if measures are not initiated now to arrest and reverse the population growth rate.

G. Exchange Rates, Interest Rates and the Current Foreign Exchange Shortfall

4.32 Virtually all of the discussion up to this point has dealt with the policy issues facing Egypt from the perspective of the reforms required

to promote sustainable development as a longitudinal phenomenon and problem. Oftentimes, however, these reforms can be partially throttled through policies that deal in an expedient fashion with problems of an immediate nature.

4.33 Egypt's current foreign exchange shortfall in the official foreign exchange market is a case in point. Egypt could markedly -- though only temporarily -- expand the breathing space available for introducing some of the policy reforms outlined above by the "simple" step of devaluation, preferably combined with interest rate reforms. By reducing or preferably eliminating the wide current gap between the exchange rate ruling in the official market and the exchange rate ruling in the own exchange market, there would no longer be any price incentive for, say, tourists and workers remitting funds from abroad to convert dollars into L.E. through channels that bypass the official market. Further, by combining the devaluation with establishing a positive real interest rate on L.E. denominated debt assets, there would correspondingly be less incentive for Egyptians to hold their wealth in dollar rather than L.E. denominated assets in the first place.

4.34 Instead of following this course, the government appears to be taking steps simply designed to clamp down on the own exchange market through introducing more and more administrative encumbrances on it instead of attempting to compete with it on competitive market terms. Our estimate, while somewhat speculative, is that the government is probably losing to the own exchange market between $500 million and $1 billion annually by not competing on market terms with it. This is an amount equal to about 1 to 2 months' imports at recent annual import rates. Moreover, there is probably a net cost in foreign exchange availability to the economy as a whole as distinct from merely a shift in the composition of availability between the official and own exchange markets. Because of restrictions imposed on financial transfers within the own exchange market, an increasing volume of foreign exchange that might otherwise enter Egypt is probably being held outside of Egypt entirely.

4.35 More important from the perspective of desirable policy reforms, this administrative clamping down on the own exchange market rather than attempting to compete with it on equal terms is directly contrary to one of the important reform desiderata noted above: reducing public/private imbalances through unifying the legal, administrative and regulatory regimes they now separately face. There is no simple explanation for current government policies toward the own exchange market. Certainly, though, one element is the "special" role the public sector enterprises are viewed as playing in meeting national self-sufficiency goals in production.

4.36 It was noted above that devaluation, even devaluation coupled with interest rate reform, would only provide some temporary breathing space. It's worth briefly pointing out why.

4.37 Suppose that Egypt were only to devalue in an attempt to restore the resource requirements/availabilities balance. Given how low energy prices in Egypt are relative to other prices, Egypt would simply end up exporting energy disguised as an intermediate input into the products which are actually exported. Suppose that Egypt were to combine a policy of devaluation with a policy of interest rate reform designed to maintain positive real interest rates. This would improve the likelihood of appropriate capital/labor intensity in investment decisions but there is little doubt that Egypt would still be investing in energy intensive production processes and exporting energy intensive products. All of this boils down to a simple point: devaluation alone or coupled with interest rate reform is weakly rather than strongly supportive of efficient development policy unless also combined with steps designed to eliminate the distortions in the price signaling structure of intermediate and final goods and services as well.

V. ECONOMIC CONSIDERATIONS FOR AN AID STRATEGY

5.01 Economic considerations form only part of the content of an AID strategy. As reviewed above these economic considerations do, however, have some rather striking implications for the economic content of an AID strategy. In particular, and without being exhaustive, they establish constraints on what AID can do and expect to achieve. They establish a sectorial thrust for AID efforts. They also imply the need to develop a strategy for a "no reform" scenario. They point to both programmatic and policy dialogues as modes for stimulating and supporting reform efforts and they point to different levels at which policy dialogue may best take place. They imply the need to develop a strategy that will both stimulate and support reform.

A. Key Implication for an AID Strategy

5.02 These key points are first briefly summarized and then the more important points are developed further:

> We need to position ourselves to respond positively and flexibly to Egyptian reform efforts, especially in the energy area and in other critical areas of the price signaling environment. The program simply has to be flexible enough both to stimulate a reform effort and to support a reform effort if one develops.
>
> We need to try to internalize within the GOE the concerns we have on Egypt's development constraints through a policy dialogue carried on at different levels and through training/institutional development programs which will improve the ability of the GOE to understand and manage the reform effort. Quite simply, it is impossible to engage in a successful reform effort without the understanding, managers, expertise and data base required to implement it.

We need to focus our efforts to the extent possible on population and on the agricultural and industrial sectors, the latter two being the key sectors for relaxing the resource availabilities/requirements constraint. Sectorial concentration should be designed to broaden impact beyond the narrow project bound of impact.

We need to accept interim targets and indirect approaches to achieving objectives if these provide reasonable, although risky, prospects of achieving reform objectives.

We need to seek programmatic approaches that can have positive and broad demonstration effects throughout the economy, e.g., in infrastructure services pricing.

B. Stimulating and Supporting Policy Reform

5.03 If there is one point that merits emphasis, it is that the development of Egypt is an Egyptian problem. Gross disbursements on foreign aid amounts to 8% of GNP and three-quarters of this 8% is provided by AID. While 8% is high by international standards, for practical purposes, it is small relative to the 92% of the resources that are under the direct management of Egyptian policymakers. This has two implications. First, our targets must be Egyptian policies and policymakers themselves. Second, the effectiveness of AID will be critically dependent upon the effectiveness with which we can influence these policies/policymakers in a framework of partnership and collegiality rather than confrontation.

5.04 There are both dialogue and programmatic modes that can and should be employed to stimulate and then support reform.

C. Role for Policy Dialogue/Programming

5.05 Obviously, we need to draw to the attention of the GOE at the highest possible level, the need for reform and to express our willingness to work in partnership in providing advisors and assisting on reform. This is especially the case in the area of population. There is little that we can do here without the strongest possible political support for an effective domestic program. It is no less true in the extremely complex areas of energy, food and agricultural input-output pricing. This is so because of the multiplicity of powerful structural adjustment impacts that reforms in these areas would have on the household, industrial, agricultural and macro/financial sectors of the economy. Below the highest level, but at the senior executive level, we do need to discuss in a collegial fashion, try to shape and ultimately achieve a congruence of understanding on Egypt's development policies and how they relate to current policy reform possibilities.

5.06 Programmatically, we need to build up a constituency in favor of reform and build up the economic management expertise and policy-related data base required to develop and implement reform. The reasons are clear.

5.07 Reform, in part, is being held back by a public sector bureaucracy that, in many respects, is oriented toward and was trained under the influence of the Eastern Bloc. While an expanded training program along Western lines is a longitudinal solution, there is, unfortunately, no other solution. At the same time, it will have high pay-off.

5.08 Reform is also being held back by a current lack of depth of economic expertise in government. Shortly, we hope to have in place an economic consultant services contract that will provide quality advisors on a quick turnaround time basis for both immediate and longer range problems.

5.09 Third, reform is also being held back by the absence of an appropriate data base for policy formation. In this connection, an identification of the critical gaps in the data base required for policy formation is one of outputs that we expect to obtain from the Cairo University/USAID/World Bank economic modeling project. More, however, will remain to be done in improving the statistical services generating capability in government, both in terms of quality and timeliness.

5.10 Finally, we need to be very careful about how we try to stimulate and support reform. We have too often been put in the position of believing that reform was imminent and subsequently been disappointed. It would clearly be a waste of AID resources to try to "buy" reform in anticipation of concrete steps that are in fact never taken. Unlike the IMF, we would be put in an extremely untenable position if we were to promise resources on the basis of a set of conditions and then be put in the political spot light of saying "no" because the conditions are unfulfilled.

5.11 In preference to buying reform, we need to demonstrate to the Egyptians how we could position ourselves and mobilize existing resources in direct support of the actual structural adjustments which would accompany reform. An explicit, indicative example of this approach is rather concisely set forth in Table 5: Energy Pricing: Policy Reform, Transitional Management Problems and Addressing the Problems. In brief, in support of actual pricing reforms, an "Energy Adjustment Financing Facility", in combination with the existing Energy Planning Project and the economic consultant services contract, would be mobilized to provide investment financing assistance along with technical and advisory assistance in economic management. The Table concisely outlines the transitional management problems that would hit the agricultural, industrial, household and macro/financial sectors. It also indicates how we could be directly supportive of ameliorating the structural adjustment difficulties of implementing reform.

D. Interim Targets/Indirect Approaches

5.12 There is an immense gap between, say, where prices are and where they should be. There is an equally large gap between the regulatory and institutional environments affecting the public and private sectors. Reducing these gaps won't happen over night. AID will simply have to accept far more gradual movement than we would like to accept. We will, for example, simply have to put up with some continuing inequities in the public/private regulatory environment in order to allocate some of our resources in favor of the private sector. AID may have to move funds through on-lending facilities and accept the fact, on an interim basis, that financial rather than "economic" prices in commodity markets are driving borrowing decisions. In essence, AID has to operate in a second-best situation and be shaped by the environment at the same time as AID is trying to reshape it.

TABLE 5

ENERGY PRICING: POLICY REFORM, TRANSITIONAL MANAGEMENT PROBLEMS AND ADDRESSING THE PROBLEMS

EFFECTS ON \ POLICIES	Current Policy: Energy Price Subsidies	Desired Policy: Eliminate Energy Price Subsidies	Transitional Management Problems	Addressing Transitional Problems: GOE	Addressing Transitional Problems: USAID	Comments
I. QUALITY/EFFICIENCY OF INVESTMENT IN KEY SECTORS FOR GOE/USAID						
1) Industrial Sector						
-Qual. of Inv.	Reduces	Promotes	Some existing firms will face lg cost incs. due to heavy use of energy as intermed. inputs. Examples: cement, fertilizer, steel, aluminum	Balance between: 1)Cost pass thru 2)Absorb cost inc. thru reduced profits 3)Create subsidy acct. in budget on interm. basis	Create Energy Readj. Fin. Facil. for capital equip. & TA in support of adjustment	Some intn'l. competitiveness problems will also arise - competitiveness of domestic production against imports & competitiveness of Egyptian exports in world markets. See macro/financial sectors. Other intersectorial linkages incl. cost increases for indl. inputs into Ag. sector, e.g., fertilizer
-Structure Relative Prices	Unfavorable	Favorable				
2) Agricultural Sector						
-Qual. of Inv.	Reduces	Promotes	Moderate cost incs. for pumping water, diesel fuel. Also cost increases for such other energy intensive inputs as fertilizer, pesticides	Balance between: 1)Raise Ag proc. prices if below intn'l. 2)Create subsidy acct. in budget, phase it out over defined period	As above with e.g., invest support for leaking pumps, reducing lift requirements, etc.	Both indl. and household sectors will face cost incs. for energy intensive agrl. products, probably fairly small impact from agr. on household/indl. sectors
-Structure Relative Prices	Unfavorable	Favorable				
3) Infrastructure Services Sectors						
-Investment Requirements for Electricity, Water Sewer, Transport	Raises	Reduces	Cost incs. for energy inputs into the provision of these services need to be passed on into Ag, Ind and Household sectors	1)Full cost pass thru complemented by interim budget subsidy in favor of Ag, Ind. & Household sector users if required/feasible 2)Phased cost pass thru complemented by interim budget subsidy in favor of infrastructural services sector if 1) not admin. feasible.	As above	Immediate, full cost pass thru could result in 5-fold electricity price increase; phasing probably essential. For efficiency reasons, preferred approach is subsidy in favor of end-users rather than in favor of infrastructural services sector
II STANDARD OF LIVING						
Household Sector						
-Structure Relative Prices	Promotes excess consumption,	Reduces excess consumption	Cost of living incs. due to direct energy consumption plus indirect energy consumption in form of energy inputs into consumer goods.	Protect Standard of Living thru: 1) Wage Adjustment 2) Coupon system	TA on coupon system admin, on calculating price pass thru requirement for wage adjustment	Wage adjustment offset is preferred and may be more feasible than coupon system. Details can't be provided in space available.
-CPI	Holds Down CPI	Raises CPI				
-Gainful Employment	Opportunities	Reduces	Promotes Some transitional unemp. from shifts from higher to lower energy intensities in production.	Continuation of socially motivated employment policies. Adequate incentives to shift out.		Transitional employment problems are partly offset by adjustment systems provided in favor of indl., ag, infra services sectors.
III MACRO/FINANCIAL SECTORS						
1) Foreign Sector						
-Exports	Reduces	Raises	1) New comparative advantages in trade poses competitiveness problems for some existing ind. firms; opens new opportunities to be exploited. 2)Associated increases in absolute price level will require exchange rate adj.	Soften and phase adj. burden as noted in Ag and Ind. sectors above thru interim budget subsidy; monitor and adjust exchange rate in response to price level changes	1)Use ERFF to restore competitiveness where possible. 2)TA to identify new comparative advantages, market development assistance.	Energy Planning Proj. could be tapped to provide ind. specific adj. studies. Implied favorable impact on foreign balance is somewhat speculative but probably would be borne out.
-Imports	Raises	Reduces				
-Capital Flows						
-Official Reserves	Reduces	Raises				
2) Government Sector						
-Tax, etc., Revenues	Reduces	Raises	Increased financial transfers from energy sector but must be used to fund the transition.	1)Fund the subsidy acct. with incr. profit, tax receipts from energy sector 2)Establish economic management monitoring unit to address exchange rate issue, structural adjustment needs, monitor and offset std. of living impact.	TA for mgt. control unit through economic consultant services contract	Current fiscal surplus derives from reduced domestic energy consumption and associated incr. in petro exports
-Expenditures	Reduces	Raises				
-Current Fiscal Surplus	Reduces	Raises				