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Country Development Strategy Statement

FY 1986

EGYPT

ANNEX B

BALANCE OF PAYMENTS

APRIL 1984

Agency for International Development
Washington, D.C. 20523

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Egypt: FY 1986 CDSS
Annex B: Balance of Payments

I. Introduction and Summary

Past and projected trends in Egypt's major transactions are depicted in table 1. Most noticable is a considerable slowdown in the trend of current receipts. While total current receipts rose from $2.6 billion in 1974 to $10.3 billion in 1981, they are projected to rise by less than the rate of inflation through 1989. Suez Canal dues are probably the strongest receipt category and petroleum exports the weakest. While the recent trend in the exports of agricultural and industrial products has been disappointing, Egyptian policy makers hope for a strong boost in the near future. There are finally limited possibilities for attracting larger foreign aid or capital inflows.

With future receipts stagnant in real terms, there is limited room for expanding imports or for meeting all of Egypt's debt obligations on a current basis. Current reserves total only $1.4 billion. Since these are clearly inadequate to sustain drawdowns over more than a couple of years, we have forced the future uses of foreign exchange into balance with projected receipts. A substantial bunching of debt payments is scheduled to take place within the next couple of years which will further tighten Egypt's balance of payments position.

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Table 1

EGYPT'S BALANCE OF PAYMENTS 1974-1989
(IN CURRENT $ BILLIONS)

Transaction	1974	1978	1981	1982/83	1985	1989
Receipts:						
Petroleum exports	0.1	0.7	2.8	2.5	2.7	2.0
Other exports	1.6	1.3	1.1	1.0	1.0	1.5
Worker remittances	0.3	2.5	3.3	4.0	4.2	5.0
Suez Canal dues	0.1	0.5	0.9	1.0	1.3	1.8
Tourism	0.4	0.8	0.9	0.9	1.2	1.6
Other current	0.1	0.5	1.3	1.4	1.7	2.1
Total current	2.6	6.3	10.3	10.8	12.1	14.0
Foreign aid	1.8	1.1	1.5	1.7	2.0	1.8
Other credits & investment	0.6	0.6	1.6	1.8	1.8	2.0
Total receipts	5.0	8.0	13.4	14.3	15.9	17.8
Payments:						
Imports	3.5	6.0	9.6	9.6	10.8	11.8
Civilian debt servicing	0.7	1.2	1.9	1.9	2.6	2.7
Other	0.8	1.2	1.9	2.6	3.1	3.3
Errors & Omissions	-	-	-	-0.6	-0.6	-
Total payments	5.0	8.4	13.4	13.5	15.9	17.8

Source: Mission estimate incorporating flows unrecorded in official statistics. These unrecorded transactions may have been valued as follows during 1982/83 ($ billion): worker remittances-1.0, tourism earnings-0.3 and imports-1.3.
Military imports and foreign military asistance are excluded from this table. Also excluded are the following transactions whose 1982/83 values were probably ($billion): military exports-0.2, foreign company share exports-1.3, and direct investments and imports of petroleum equipment-0.75.

II. Trade Trends

Petroleum has certainly been the most dynamic sector of the Egyptian economy since 1974. Production of crude oil and natural gas has soared from eight million tons in 1974 to 25 million tons in 1978 and to 37 million tons in 1982/83. This production trend combined with rapid price increases during 1979-1980 enabled Egypt's revenues from petroleum net exports to jump from zero in 1974 and 1975 to $0.6 billion in 1978 to a peak of $2.2 billion in 1981 (exclusive of foreign company share shipments omitted from our table and bunkers which we classify under services). Net export revenues from petroleum are expected by most observers to be level over the 1984-1986 period in the range of $2.0-$2.2 billion annually and then to start declining thereafter. An oil company's pessimistic projection indicates that Egypt will become a net importer of energy by 1989, while optimistic projections by the World Bank show that this outcome might be deferred until about 1995 or even after 2000. The pessimistic scenario is based upon gradually rising cost recovery transfers to foreign oil companies in line with higher extraction costs, a minimal slow-down in the rate of increase in internal consumption of petroleum products, and the absence of any significant new discoveries.

Egyptian consumption of petroleum spurted ahead by 12% annually in the 1975-1981 period to over 14 million tons and the pessimistic scenario assumes only a minimal moderation to 9.5% annually through 1989. Our projection of petroleum exports of $2 billion annually in 1989 is much more optimistic than that of the oil company, but not as optimistic as those of the World Bank. (World Bank, Arab Republic of Egypt, Issues of Trade Strategy and Investment Planning, January 14, 1983, pp. 20-35). We assume continuing new discoveries (but not on a large scale) to moderate or delay the decline in total production and significant GOE price reform in the energy field to produce a more significant decline in the rate of increase in domestic petroleum consumption. If significant GOE price reform in the energy field is not forthcoming soon, then the pessimistic scenario would be more likely and the resulting adjustment problem for the balance of payments more severe. Imports would not be able to expand at the modest rate projected in the table and the necessary curtailment in imports would impede developmental programs and might require a reduction of current consumption levels.

Another support for the projected modest expansion in imports is a vigorous program for the expansion of Egyptian production and exports of manufacturing and agricultural commodities. These exports have been declining from about $1.6 billion in 1974 to only about $1 billion per year recently. While agricultural exports have been stagnant since 1978 in the range of $530-650 million annually, industrial exports have been on a generally declining trend since 1978 from about $700 million to $500 million in 1982/83. The basic reason for the stagnant or declining trend in exports is rapidly rising domestic consumption in the face of only modest output increases for almost all commodities. Inappropriately low controlled prices have encouraged consumption excesses and dampened production increases. Bringing about a recovery in non-petroleum exports will require pricing reforms as well as specific promotional measures. Otherwise, there is a real threat that these exports could continue to decline, forcing a retrenchment in imports.

III. Derivation of Trade Statistics

We have chosen to use the Central Bank as our basic source for trade statistics since they appear to be more comprehensive and reliable than other sources. The sole exception is petroleum trade where the data from the Ministry of Petroleum is used in lieu of that from the Central Bank. The Petroleum Ministry data omit foreign company share shipments amounting to $1.3 billion per year in recent years and these shipments are also omitted in our table. Central Bank statistics are recorded when payments are made. Our import figures have been increased beyond the official figures to take account of a significant Central Bank omission: passenger accompanied imports. These are almost totally unregistered in official channels and may have been worth LE 500 million in 1979. To take account of this factor, we have adjusted upward the 1978 figure by $700 million. The 1981 figure has been adjusted upward by $1 billion to take account of this factor and increasing duty free imports through Port Said. Since much of the financing for the unrecorded private imports comes from unrecorded worker remittances, our worker remittance figures have been increased by similar amounts. (Unrecorded tourism earnings now believed to amount to $300 million annually are also partly used to finance unrecorded private imports).

Analysis of trade trends is complicated by the significant devaluation of the Egyptian pound in recent years and the existence of diverse rates. The unified rate since January 1979 of $1=0.70 LE was modified in August 1981 by the introduction of another official rate of $1=0.84 LE. The old rate continued to be applicable for exports of cotton, rice and petroleum and Suez Canal dues and for imports of wheat, flour, sugar, tea, edible oils, fertilizer and, pesticides. The new rate was made applicable to most other transactions. A third rate, the own exchange rate, has complicated the situation further, both by its increasing divergence from the other rates and by its increasing use. The own exchange rate has moved from $1=0.77 LE in January 1979 to 0.92 LE in August 1981 to 1.20 in November 1983. The own exchange system had originally covered only those imports brought into Egypt by emigrant workers; an increasing range of public and private import transactions has been taking place since late 1982 at the own exchange rate. Moreover, an increasing proportion of the transactions in the later years may be calculated officially at the legally applicable rate when a lower rate was actually used and "service charges" or other accounting devices cover the difference.

We have not used the trade statistics published by the Ministry of Economy or by the Central Agency for Public Mobilization and Statistics (CAPMAS). Ministry of Economy figures are recorded through the openings of

letters of credit and application for the use of foreign exchange. Even though imports arranged through the own exchange system are excluded, the figures seem too high. The excess arises from cancellations of letters of credit and the use of an exchange rate different than that legally applicable: an increasing range of import transactions since late 1982 has taken place at the own exchange rate. CAPMAS figures are recorded upon payment of duties at customs. There is close agreement with the Central Bank on exports, usually within 2%, easily explainable by timing differences. The CAPMAS import figures are much too low, owing principally to the temporary withdrawal system. This system was initiated in the 1950's to facilitate release of machinery and equipment from Eastern European countries. Documents do not accompany each individual shipment, but rather one bill for the whole transaction is sent with the last shipment of imports. Currently, the General Organization for Industry and other public bodies are allowed to release their imports through customs before duties are paid. Delays on the payment of duties often amount to a year or two. During 1979, the value of imports released under the temporary withdrawal system amounted to about LE 700 million. Given the rapid increase in imports, the delayed accounting results in a significant understatement of imports. Another omission in the CAPMAS figures is Investment Authority goods which are imported on a duty exemption basis. Thus, for example, CAPMAS figures for vehicles were only LE 285 million during 1979, compared to LE 480 million in the Central Bank figures.

We have concluded, as indicated in Table 1, that total imports have risen from $3.5 billion in 1974 to $9.6 billion in 1981. In the latter year, food imports amounted to $2.3 billion and capital goods $2.2 billion (our import and direct investment figures do not include equipment brought in by foreign oil companies valued at $650-750 million annually. Our import figures also exclude military shipments.)

IV. Trends In Remittances and Other Service Receipts

Worker remittances are the single most important balance of payments receipt category and are likely to remain so. The surge in remittances from 1974 to 1978 was made possible by the rapid rise in the number of Egyptians going abroad for employment. Estimates of their present number range from under two million to 3.5 million. Using a data compilation at the lower end of this range of 2.1 million, Iraq accounts for 1.25 million, other Arab countries 0.72 million, and Europe the remainder. Static oil revenues in Iraq and other Gulf states, and the development of training programs for locals will probably, at best, prevent work opportunities abroad for Egyptians from increasing, and may bring about some retrenchment. We have assumed in the balance of payments table that the numbers of Egyptians abroad will remain almost constant and the small increase in projected remittances represent no increase in real purchasing power.

Official statistics for worker remittances are some $1 billion annually less than appear in this table. Unrecorded flows are of two kinds: remittances to establish foreign currency accounts in Egypt that are not used to finance imports but are kept "idle", awaiting future use or investment, and cash transfers converted outside the banking system through private money changers. A large amount of Egyptian worker earnings never reaches Egypt at all, but is invested directly in Europe or elsewhere. If we assume that total earnings of Egyptian emigrant workers remitted outside the host countries are about $8 billion per year, or $4,000 per capita (cf. similar per capita estimates for Jordan and Yemen in S.Birks and C.Sinclair, Aspects of International Labour Migration in the Arab Near East: Implications for USAid Policy, May 1979, then there is substantial room for Egyptian policy makers to attract to Egypt a greater percentage of these total remitted earnings. To the extent that there is success in this endeavor, worker remittances to Egypt could rise more than is projected here.

Official statistics on tourism receipts are increasingly unreliable since an increasing share of foreign exchange from tourists is converted outside banking channels. This increasing diversion is taking place both because of increased official tolerance and because of the widening disparity between the bank rates and those obtainable from private money changers. Rather than declining modestly since 1978 as portrayed in the official statistics, we assume that tourism revenues have been increasing modestly, and this modest trend is likely to continue.

A continued 10% annual increase rate for Suez Canal dues appears reasonable, half of which might come from increased per ton charges, and approximately half from slightly increased traffic.

V. Debt Servicing

Egypt's medium and long-term public civilian debt has soared from $2.0 billion at the end of 1972 to $8.4 billion at the end of 1977 to $17 billion at the end of June 1983. In June 1983, this disbursed debt, including accumulated interest arrears, included the following amounts (in $ billion): suppliers credits, 2.5; financial institutions, 0.7; IBRD and IDA loans, 1.2; Gulf Organization for the Development of Egypt, 2.3; other OPEC loans and deposits, 3.4; DAC bilateral loans, 6.0; and centrally planned economies, 0.7. While substantial servicing of loans from Iran, Kuwait, and Saudi Arabia took place during 1982/83, other Arab loans remained frozen, especially the GODE loan and all the deposits from Saudi Arabia, Kuwait and Libya totaling $2.2 billion.

The above estimates exclude Russian military assistance which has been frozen since 1977, and other military loans which presumably have been serviced on a current basis. By 1983, the frozen Russian military loans amounted to $1.7 billion, U.S. FMS loans to $2 billion and military assistance from other countries, such as France, Spain and the PRC, to $4 billion.

Debt servicing has been kept within reasonable limits until 1983/84. Official amortization payments on civilian debt doubled from $753 million in 1977 to $1.5 billion in 1982/83 and interest payments rose from $286 million to about $400 million. The debt service ratio has remained just below 20% through 1982/83. This performance has been possible through the freezing of the deposits and some Arab loans: accumulated interest arrears on the GODE loan have totaled $385 million and on the deposits and other Arab loans about $367 million through the end of June 1983. Since external assets of the banking system and other private residents (about $6 billion) exceed their external liabilities by about $2 or 3 billion, net interest earnings of the private sector are positive. Servicing of the military debt gradually rose to $587 million in 1982/83 and then may have doubled to $1.2 billion in 1983/84; future annual payments are scheduled up to $1.5 billion per year over the next six years.

One can easily build up to increasingly unsustainable debt scenarios over the next several years. At one extreme, if no additional debt is incurred, the Arab deposits and most Arab loans continue to be rolled over and military debt is ignored, the debt service ratio falls to a manageable 18% within two years. At the other extreme, if the "usual" amount of additional debt is incurred, all obligations become unfrozen and payments on military debt are made in a timely fashion, then even greater import restraint would be required than is implied in the table with a consequent slow-down in the momentum of Egypt's development program.

VI. Conclusion

The above analysis of Egypt's balance of payments situation is somber. In contrast to a recent very comfortable position, the outlook is for extreme tightness by 1985. The causes of the sudden projected deterioration in Egypt's balance of payments situation are a slowdown in total receipts, a recent major expansion in consumption (including military spending), and the projected ballooning of debt servicing. Egypt's adjustment to this deterioration seems to require a conversion of loan to grant assistance, exchange rate unification and significant price reform in the energy, agricultural and industrial sectors, together with product improvement and other import substitution and export promotion activities to finance a modest expansion in imports required by Egypt's development program.