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Country Development Strategy Statement

FY1985

ANNEX D

SELECTED GOE POLICY CHANGES

1974-82

AND IMPLICATIONS FOR THE FUTURE

Egypt

FEBRUARY, 1983

Agency for International Development
Washington, D.C. 20523

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COUNTRY DEVELOPMENT STRATEGY STATEMENT

FY 1985

ANNEX D

SELECTED GOE POLICY CHANGES 1974-82
AND IMPLICATIONS FOR THE FUTURE

EGYPT

USAID/Cairo
February 1983

LIST OF FIGURES

FY 1985 CDSS Annex D
Selected GOE Policy Changes 1974-82
and Implications for the Future

EXECUTIVE SUMMARY

Introduction

Problems tend to make far better press than progress. In order to balance the Egyptian record on this score, this Annex attempts to set forth on a sectoral and cross-sectoral basis the major policy changes, both positive and negative, that have been taken by the Government of Egypt since 1974. The policy actions taken in the 1974-82 period are set in the context of the political-economic situation that had developed by 1973. The review and analysis of major policy trends are accompanied by an examination of generally complementary exogenous factors. The Annex concludes with a brief discussion of possible GOE policy responses to current balance of payments and budgetary pressures, and the implications thereof for the AID/GOE policy dialogue.

It is by no means easy to provide a summary assessment of Egypt's record on reform, particularly an assessment that could objectively "grade" Egypt's efforts as A, B, C, etc. Nevertheless, there are some summary observations that do emerge from the study undertaken here. First, detailed throughout this paper is a record of movement in the legal, institutional and regulatory regimes that lends strong support to the notion that reform has and is taking place. The record does suggest that Egypt gradually is moving toward a "market type" economic structure, even if it is also true that the generation-long period of Nasser socialism has made Egypt's re-entry difficult and painful. Second, there is one particular area where progress has been slow at best. Egypt's price/cost structure is highly distorted. It does not signal properly where Egypt has comparative advantages in production, investment, and trade, either on a sectoral- or cross-sectoral basis. There has been very little progress in correcting the cost/price structure. Third, and finally, Egypt's record on reform is by no means one of uniform "progress." There have been steps backward in some areas, just as there have been steps forward in other areas. Equally, there have been retrenchments in areas where progress has been made. The foreign exchange and payments regime is a case in point: retrenchment toward more centralized control has occasionally occurred and even now is obscuring a trend toward far greater liberalism than existed in 1974.

Pre-1974

The years between the 1952 Revolution and the October 1973 War saw dramatic changes in the economic philosophy and policies of the Egyptian Government. During this period Egypt transformed itself from essentially a free market economy, with an extremely large private sector presence, to a centrally controlled economy with a relatively small private sector role. This was largely accomplished by nationalization of foreign economic interests during the period 1957-60 and large scale nationalization of domestically owned financial and industrial enterprises in 1961. By 1973, the public sector owned most of modern industry; all banks, insurance companies, and financial intermediaries; and a large proportion of construction firms, modern transport, and wholesale trade. The public sector also controlled all of foreign trade and was the source of over 90 percent of total monetized investment in the economy.

The Egyptian economy was characterized in 1973 by state planning, public ownership of the modern means of production, and widespread, highly centralized administrative controls and regulations. It was characterized by an "inward looking" national self-sufficiency/import substitution industrialization strategy, financed in part by agricultural pricing and acreage controls, coupled with delivery quotas. Direct subsidy of basic consumer commodities, services and public utilities was well entrenched in policy and practice, and guaranteed government employment to secondary and university graduates plus former military conscripts had been in effect since 1964. The private sector was tolerated within relatively narrow limits. Foreign investment was still viewed with a jaundiced eye.

Egypt was in serious economic difficulty by the time Egyptian troops crossed the Suez Canal in October 1973. Egypt's economic growth had almost come to a standstill. Egypt suffered from chronic current account balance of payment deficits that steadily grew worse. It was in default or about to default on its external debt, had little or no foreign exchange reserves, and faced dramatic increases in the size of its food import bill. Its physical infrastructure and capital stock were badly deteriorated and in need of replacement or spare parts. Its prospects for international assistance, from East or West, were relatively bleak. Egypt had been a centrally controlled economy for more than a decade and at war for 25 years; it showed in its economic performance.

Policy Changes 1974-82

Essentially, all of the key GOE policy shifts during the 1974-82 period emanate from the 1974 Al Infitah ("Open Door") Policy. Without question, its many complementary facets have had a profound effect on the Egyptian economy. In its broadest interpretation, the Open Door Policy has come to represent a commitment to peace instead of war, a political shift toward the West, encouragement of both political and economic capital inflows, a broadening of the perceived role for the domestic private sector, and a recognition and acknowledgement of the need for public sector reform.

The subsequent attempts to implement the Open Door Policy over the 1974-82 period have resulted in several notable policy trends, including: (i) substantial liberalization of the foreign trade and payments regime, (ii) an almost total reversal in the previously negative attitude toward direct private foreign investment, (iii) corresponding liberalization in the financial and banking sector, and (iv) a gradual, general loosening of restrictions on the domestic private sector, coupled with concern with reform of the management of public sector enterprise. An overall trend toward privatization of the economy also has been very much in evidence.

However, other than the above, which is quite significant, most policy areas reviewed have seen relatively minor reforms in comparison to the size of the problems. Basic reforms in the key areas of pricing and subsidy policy, public sector enterprise management and regulatory policy, government wage and employment policy, and human resource policy, generally have lagged or have been absent. Although certain changes and trends in the 1981-82 period appear to be potentially important, it is still too soon to judge the significance of this period with confidence.

The Open Door Policy, while certainly a success in its overall dimensions, seems to have had mixed success in its basic components. The outward-looking component of the strategy appears to have been generally successful in inducing both political and economic capital inflows during the period under review. The inward-looking (domestic reform-related) component of the strategy, however, has generally moved at a slower, albeit relatively steady pace. In large part, reforms related to the external sector, in particular Law 43 as amended, have provided the initial stimuli for domestic sector reforms related to the privatization of the Egyptian economy, or have induced the public sector to act in a more market-oriented fashion.

Exogenous events have been critical to Egyptian economic performance during the 1974-82 period, particularly those related directly or indirectly to oil prices, and generally were complementary to Egyptian reform measures. The positive resource effects of exogenous factors during the 1974-82 period appear to have been both a major source of current prosperity and liberalization trends, and a major source of the current pricing and subsidy policy dilemma.

Likely Pressures

Many of the underlying factors dictating future economic conditions are relatively unfavorable and probably suggest a steady and increasingly rapid deterioration of the economic situation. This deterioration will be reflected most evidently in growing balance of payments deficits on current account and GOE budgetary deficits, and, consequently, in growth of domestic money supply and external debt. Ultimately, because the situation will be untenable, the consequences must be felt in lower economic growth and higher prices. This outcome can be forestalled as long as the GOE can come up with the means to finance its current highly consumption-oriented policies. In the absence of the necessary finance, something will have to give.

The GOE's options, unless it comes up with major new sources of foreign exchange, essentially amount to reducing or suppressing the trend in aggregate consumption levels or reducing the share of aggregate investment in GDP. Obviously, it is conceivable that public financed consumption and/or investment may tend to be sustained at the expense of private consumption and investment. It also is obvious that the trade-off between consumption and investment and between public and private shares of the economy can be accomplished by stop-gap, deliberalizing measures that suppress basic tendencies or by genuine reform measures that tend to correct basic tendencies by addressing the cause of the problem. The extent to which the GOE sticks to the latter type of measures will determine the longer term prospects for growth.

Likely GOE Responses

The single most fundamental cause of the GOE's current balance of payment and budgetary problems is its insistence on underpricing of consumption. Nevertheless, it is relatively safe to predict that this will be one of the last things that the GOE will address, reluctantly, in its search for ways out of its current dilemma. The GOE is likely to make four basic choices over the next 18-24 months that will set the general tone of the policy environment over the next few years. The GOE is likely to attempt to sustain consumption at the expense of investment, and at the expense of greater inflation should it become necessary. The GOE is likely to focus more on restraining outflows (imports and budgetary expenditures) than it is to promote inflows (exports and government revenues). The GOE is likely to favor direct policy controls (licensing, quotas, rationing, prohibitions and other non-pricing regulatory controls) that work against the pricing system over indirect policy instruments (taxes, pricing, interest rates, exchange rates) that work through the pricing system. The GOE is likely to attempt to maintain public expenditure (consumption and investment) at the expense of the private sector (consumption or investment), if it seems necessary.

In considering GOE options, it is useful to keep in mind that no single action is likely to resolve the current budgetary and balance of payment problems (e.g., "luxury" imports constitute less than 5% of total imports); and that few easy choices exist for cutting back either on imports or on GOE budgetary expenditures (intermediate and capital imports constitute over 60% of the commodity import bill, while 30% of commodity imports are food or food-related; almost two-thirds of budget expenditures are for wages, salaries, and consumer subsidies, with most of the rest for investment). Thus, it is clear that the GOE has little room to maneuver before it is either cutting into politically sensitive basic consumer consumption or government employee incomes, or before it must begin cutting back on investment spending.

Implications for GOE/AID Policy Dialogue

A relatively sensitive period lies ahead in USG/GOE relations because of the magnitude and probable worsening of the GOE budgetary and balance of payments accounts. The GOE will look to the USG as the situation worsens with the expectation that a true friend will step in, when help is needed. How the USG reacts to this probable GOE approach can enhance our relationship and build on the reasonably sound foundation that exists, or can easily detract from the relationship. In dealing with the GOE, AID and the USG should keep in mind the following:

(i) Time is running out. The GOE must take some form of action.

(ii) The GOE will be tempted by stop-gap/repressive measures. AID should encourage GOE to take longer view where possible and take corrective mesures.

(iii) The GOE will wish to focus the dialogue on symptoms and current urgencies (e.g., size of deficits, commodity shortages, etc.). AID should focus the dialogue on causes and policy actions required for long-term adjustment.

(iv) The GOE will increasingly press for balance of payments support. AID should point out that as long as we finance highest GOE priorities (i.e., things that would have been financed by the GOE anyway), implicitly AID is providing balance of payments support because of budget fungibility.

(v) The GOE will continue to argue that it cannot introduce full cost-recovery in pricing or in rate setting on political grounds. AID generally should follow a consistent policy of not financing anything that should normally involve full cost-recovery but is not designed to do so, and note that it would work against long-term GOE interests for the U.S. to provide such financing. Nevertheless, AID should be prepared to consider substantial reform proposals, even if incomplete, in order to encourage the general reform movement.

(vi) It is not necessary for AID to be heavy-handed or to apply "pressure" in order to bring policy issues to the attention of the GOE. The issues are probably fairly well understood and they are surfacing on their own accord. AID and the USG should try to support and extend the GOE's own reform actions. What AID might usefully contribute are practical, possibly innovative, but certainly well thought-out approaches for addressing the issues. Direct AID/GOE collaboration on analysis of issues selected by the GOE, and their hopeful resolution would, of course, be an ideal policy dialogue format.

FY 1985 CDSS Annex

SELECTED GOE POLICY CHANGES 1974-82
AND IMPLICATIONS FOR THE FUTURE

I. INTRODUCTION

1.01 Because problems make far better press than progress, there has been a tendency to focus much more on the former than on the latter. In order to balance the Egyptian record, this Annex attempts to set forth on a sectoral and cross-sectoral basis the major policy changes that have been taken by the Government of Egypt (GOE) since 1974. The actions taken in the period 1974-82 will be set in the context of the political-economic situation that had developed by 1973. This will be followed by a brief discussion of possible GOE policy responses to current balance of payment and budgetary pressures, and the implications thereof for the AID/GOE policy dialogue.

1.02 This Annex is intended to serve a number of purposes: (i) to give the GOE due credit for the substantial measures that have been taken thus far, (ii) to identify for discussion between the GOE and the USG areas where progress has been slow and additional steps are needed, and (iii) to provide AID/State officials in Washington the detailed information needed to respond to issues that have been and might be raised on the Hill about what Egypt has and has not done.

1.03 Section II of the Annex will briefly describe the political-economic events leading up to 1974 and the economic situation in 1973, in order to set the stage and provide the contrast for the subsequent policy review. Section III of the Annex will examine the general policy trends that seem to have emerged during the 1974-82 period, on a sectoral and cross-sectoral basis, and will briefly explore the very substantial exogenous factors at work during the period. The section will conclude with an overall assessment of GOE policy efforts in the 1974-82 period and a judgment on the relative importance of exogenous events. Section IV of the Annex will highlight the economic-related actions of the Mubarak government following the assassination of Sadat and will consider the likely economic pressures on the GOE in the immediate period ahead. It will then explore the possible (and likely) GOE policy responses to the growing balance of payments and budgetary pressures and will conclude with a brief discussion on the implications of the period ahead for the AID/GOE policy dialogue. The Annex includes two appendices: the first appendix sets forth the scope and methodology of the Annex; the second appendix sets forth a more detailed and comprehensive listing of GOE policy changes for the period 1974-82 than that contained within the body of the Annex.

II. BRIEF DESCRIPTION OF SITUATION PRIOR TO 1974

A. Political/Economic Events Leading up to 1974

2.01 Pre-1952 -- Egypt had been under foreign rule for 2,500 years prior to the 1952 Revolution. Its domination began with the Persians and ended with the British, with the Greeks, Romans, Circassians, Arabs, Turks, and French ruling in the period between. Egyptian history over this period (and before) was characterized by strong central governments, an interplay between politics and religion, and the dominance of a small elite, particularly the military elite. It was not surprising that the small military group known as the Free Officers that seized power on July 23, 1952 should enjoy almost instant legitimacy both as military conquerors and as Egyptian nationalists who had ended 2,500 years of alien rule.

2.02 1952-1973 -- The years between the 1952 Revolution and the October 1973 War saw dramatic changes in the economic philosophy and policies of the Egyptian Government. During this period Egypt transformed itself from essentially a free market economy, with an extremely large private sector presence, to a centrally controlled economy with a relatively small private sector role. It transformed itself into an increasingly socialist state that many felt was on the verge of economic collapse by the time its armies crossed the Suez Canal in October 1973. For the purpose of better comprehension of the economic transformation that evolved, the period 1952-1973 should be broken into three sub-periods: (i) 1952-56: continuing predominance of the private sector, (ii) 1957-60: growing government intervention and (iii) 1961-73: nationalization and central planning.

2.03 Phase I (1952-56) -- The Free Officers who took control in 1952 had no clear economic philosophy. They inherited a situation in which the role of the government in the economy was essentially confined to investment in infrastructure (most importantly irrigation) and social services. All of the main productive sectors, internal and foreign trade, banking, insurance, urban transport and a number of utilities, were in private hands. The private sector accounted for 87 percent of GDP. Although remnants of some government controls introduced during World War II were still in existence in 1952, and the government was already engaged in subsidizing and controlling prices of basic consumer goods, private enterprise operated in a relatively free environment.

2.04 During the first four years after the 1952 Revolution the GOE repeatedly emphasized the importance of the private sector. Government investment continued to be directed largely into irrigation related activities, and the government insisted it would confine itself to the areas of heavy, or basic, industry. The most significant restraint of the private sector during the 1952-56 period was the Agrarian Reform Law of September 1952 which placed a ceiling of 200 feddans upon individual owners. Nevertheless, this reform was viewed primarily as an attack on political power rather than an attack upon the principle of private ownership per se.

2.05 Phase II (1957-69) — In the period 1957-60, the GOE moved increasingly in interventionist fashion in the Egyptian economy. Although the private sector was still encouraged, its perceived role in the economy was circumscribed by ideological caveats contained in the 1956 constitution. British and French economic interests, largely concentrated in banking and insurance, were nationalized as a result of the 1956 Suez War. A state Economic Organization, set up in early 1957 to manage these assets and others already held by the government, had gained considerable influence in the economy as early as 1958. At about this same time all foreign banks, insurance companies, and commercial agencies were required to be converted into domestically-owned joint stock companies within a period of five years. Major banks and insurance companies were placed under the control of the Economic Organization. Comprehensive economic planning was introduced and pushed through at the highest levels; public investment in industry took place under the First Industrial Plan of 1957-60. In a significant move, in that earlier nationalizations had been concerned with foreign firms, Bank Misr and the National Bank, both domestically owned, were nationalized in February 1960. Thus, by 1960 the nature of the Egyptian economy had changed substantially. The public sector, although still accounting for less than one-fifth of GDP, was by that time undertaking almost three-quarters of gross monetized investment.

2.06 Phase III (1961-73) — Nationalizations and increased central control (planning) of the economy characterize the period 1961-73. Large scale nationalization of domestically owned financial and industrial enterprises occurred in mid-1961, followed by further nationalizations in late 1961. By the end of that year, the private sector had been relegated to a relatively minor role. Although private property was not abolished, the opportunities for private economic activity were severely circumscribed. The private sector retained the ownership of land, dwellings, small scale industry, most of the retail trade, certain transport, construction, and part of the wholesale trade. By 1973, the public sector owned most of modern industry; all banks, insurance companies and financial intermediaries; and a large proportion of construction firms, modern transport, and wholesale trade. The public sector also controlled all of foreign trade. During the 1961-73 period, over 90 percent of total monetized investment in the economy was accounted for by the public sector, and extensive cost-price controls become the norm of the economic system.

B. The Economic Situation in 1973

2.07 Egypt was on the road to conomic disaster by the time Egypian troops crossed the Suez Canal in October 1973. Egypt's economic growth had almost come to a standstill. It suffered from chronic current account balance of payment deficits that steadily grew worse. It was in default or about to default on its external debt, with little or no foreign exchange reserves, facing dramatic increases in the size of its food import bill. Its physical infrastructure and capital stock were badly deteriorated and in need of replacement or spare parts. Its prospects for international assistance were relatively bleak, both in the East and the West.

2.08 Egypt had been a centrally controlled economy for more than a decade and at war for 25 years. Both of these factors weighed heavily on its economic performance. Between 1966 and 1973 real per capita GDP had grown at less than 1% per year. During the same period, as a percentage of GDP, the economy saw dramatically decreased total investment (18% to 13%) and domestic savings rates (17% to 8%), and increased public consumption rates (20% to 28%) and balance of payments current account deficits (3.5% to 6.4%). (By 1974 the current account deficit had increased to 13% of GDP and by 1975 it had climbed to over 20%.)

2.09 More worrisome for the longer term prospects than the above symptomatic indicators, however, was the policy regime that had evolved. The Egyptian economy was characterized in 1973 by state planning, public ownership of the modern means of production, and widespread, highly centralized administrative controls and regulations. It was characterized by an "inward looking" national self-sufficiency/import substitution industrialization strategy, financed in part (along with the urban sector in general) by agricultural pricing and acreage controls, coupled with delivery quotas. The concept of direct subsidy of basic consumer commodities, services and public utilities was well entrenched, and guaranteed government employment to secondary and university graduates plus former military conscripts had been a legal prescription since 1964. The private sector was tolerated within relatively narrow limits. Foreign investment was still viewed with a jaundiced eye. In sum, by 1973 Egypt had evolved into a centrally controlled, socialist-oriented economy that could not pay for itself (at least not under a wartime footing with an important part of its resources under Israeli control) and was not likely to be able to do so without a major shift in its political-economic strategy.

III. INTERPRETATION AND ASSESSMENT OF 1974-82 PERIOD

3.01 The decision to cross the Suez Canal in October 1973 could be interpreted to be as much an economic decision as it was a political and military one. Clearly, Anwar Sadat was faced with an increasingly impossible dilemma. He had inherited a stagnating, centrally controlled economy that was worsening, with little prospect for its turnabout under a wartime footing. Yet it was politically impossible to ignore the Israeli occupation of the Sinai. In Sadat's analysis, the corrosive effects of "no peace, no war" fragmented national energies. The Arab-Israeli confrontation dominated all issues and policies. Although Sadat had improved his internal political hold by 1973, it was, nevertheless, seriously jeopardized by the worsening economic situation and the unresolved humiliation of the June 1967 war. Pragmatically and symbolically, the October 1973 war was necessary before Sadat could turn to questions of economic reform or to find the means to finance such reforms.

3.02 In this section we will interpret and assess GOE economic and development policy changes during the 1974-82 period in the context of the "Open Door" strategy set forth in the October Working Paper of April 1974 and in the context of the economic policy regime and physical/economic situation from which it was initiated. The policy record also will be considered in light of key exogenous events during this period over which the GOE had no direct economic control. We will (i) begin with a review of general directions of policy trends at the cross-sectoral and sectoral levels, (ii) examine key exogenous events/factors, and (iii) conclude with an overall assessment of GOE policy efforts.

A. General Policy Trends by Sector

3.03 GOE policy changes for the period 1974-82 have been divided into two broad categories for review (sectoral and cross-sectoral) and further sub-divided within those categories. The distinctions implied by these categorizations and sub-categorizations, to some extent, must be considered artificial and oversimplified. Obvious overlaps exist both within and between the categories. We have chosen to maintain our various breakdowns because they yield certain traditional information that would otherwise have no obvious place and because these categorizations tend to be familiar.

3.04 Even when there may be no question about where to place a particular policy change, its assignment still may be misleading for interpretation of its significance because the action was intended to support a policy objective in another area. Changes in monetary, financial and banking policies that actually are intended to support balance of payments objectives are quite usual, for example. Changes in budgetary and fiscal policy that have their motivation in balance of payment objectives and vice-versa, e.g., changes in foreign trade, payments and investment policies that are motivated by budgetary and fiscal objectives also are quite common. What the above caveats imply is that interpretation of policy changes strictly within the context of any of the sub-categories we have chosen is not entirely satisfactory. Hopefully, the overall assessment of GOE policy changes that follows in Part C will fill the gaps that may occur here.

3.05 We will briefly summarize by sub-category, within the sectoral and cross-sectoral breakdowns, what we believe to be the most significant policy changes within those sub-categories. However, in reviewing these summaries it will be important to keep in mind the earlier caveats on the comprehensiveness of our information coverage contained in Appendix I. We can only attempt to summarize and interpret the significance of information that we actually had time to examine. Therefore, the summaries contained herein, particularly for the sectoral sub-categories, must be considered tentative at this time. Appendix II contains a chronological listing of the significant policy changes we have located to date. What we believe to be the most important policy changes in each sub-category is summarized separately within the following text.

1. Cross-Sectoral Policy Changes

3.06 Seven sub-categories make up the cross-sectoral policy change category: (i) foreign trade, payments, and investment policies, (ii) monetary, financial and banking policies, (iii) budgetary and fiscal policies, (iv) pricing and subsidy policies, (v) wages, employment and emigration policies, (vi) decentralization policies, and (vii) energy policies.

3.07 Foreign Trade, Payments, and Investment - The general trend of Egypt's foreign trade, payments and investment policies over the 1974-82 period has been clearly one of "liberalization". Egypt has moved from a restrictive, tightly controlled foreign trade and payments policy regime to one in which the private sector essentially has freedom over its import and export trade decisions via its access to the "own exchange" (free FX) market. Private sector importers now access foreign exchange relatively easily, and private sector exporters are subject to considerably less restrictions on the disposition of their foreign earnings. The growth in the private market for foreign exchange has been spectacular, with private sector imports rising from $379 million in 1974 to over $1.5 billion in 1980/81 and roughly that level in 1981/82.

3.08 Egypt's foreign exchange rate effectively has been allowed to depreciate over the 1974-82 period, through the introduction and subsequent widening of the parallel exchange market, the legalization of the "own exchange" market, the unification of the official and parallel rates at $1 = 0.70 LE on January 1, 1979, and the reintroduction of a commercial bank ("incentive" parallel) rate of $1 = 0.84 LE on August 1, 1981. During the 1974-82 period, Egypt has moved from a system of specific import licensing requirements to one of general import licensing, and has decreased import duties and increased import exemptions. Direct foreign investment, mostly in the form of joint-ventures with Egyptian public sector companies, increased from essentially a zero base to a current average of about $700 million per year. Through the end of 1981, 1626 projects (valued at LE 9.0 billion) had been approved under the Foreign Investment Law 43 of 1974, of which around 1,000 (valued at LE 5.4 billion) were in operation or under construction.

3.09 Although the overall policy trend in the foreign trade, payments, and investment area has been toward liberalization in the period 1974-82, there have been a series of restrictive changes since mid-1981 in response to increasing balance of payments pressures. Not all policy measures have been restrictive in nature, however, and some that were restrictive essentially have been reversed. Nevertheless, recent experience would indicate that an important element of GOE reactions to balance of payments pressures, at least in the short run, is to restrict access to imports either through quantitative controls, import credit controls, or restrictive measures on the "own exchange" market that are intended to depress demand and divert supply to the parallel market.

Figure 3-1
Foreign Trade, Payments and Investment
Significant Policy Changes 1974-82

1973 - Establishment of "parallel market" for foreign exchange September 1973 and subsequent widening that progressively depreciated the official exchange rate.

1974 - Al Infitah ("Open Door") policy introduced. Signaled major shift in GOE attitude toward direct private foreign investment and the domestic private sector.

1974 - Law 43 of 1974, subsequently amended 1977, radically reformed existing foreign investment laws. Intended to encourage Arab and Western capital inflows (including to the banking sector) and to allow domestic private sector activity in consumer goods production and light manufacturing.

1974 - State Trading Organization, with total monopoly on foreign trade, abolished.

1974 - "Own exchange" (free FX) import market established.

1975 - Reopening of Suez Canal as negotiated under the Egyptian-Israeli disengagement agreements.

1975 - Private sector import licensing requirements abolished. Negative import list of 28 commodities established instead.

1976 - Private sector given the right to own foreign exchange deposits and to make free dispositions thereof, provided only that transactions carried out through commercial bank accounts.

1976 - New system of licensing imposed on all "own exchange" imports, with licenses being granted primarily for imports of intermediate goods.

1977 - Major restructuring of Egypt's foreign debt 1977-80 which involved substantial lengthening of its average maturity and a decline in the share borrowed on commercial terms.

1977 - Open General License System established for imports in place of specific import licenses.

1979 - Official and parallel exchange rates unified at $1 = 0.70 LE. Represented devaluation of the official rate.

1980 - Extensive reduction in import duty rates and a broadening of exemptions. Coverage included basic food items, consumer durables, raw materials and intermediate capital goods.

1980 - Commercial and foreign currency banks required to make 15 percent of foreign currency holdings available on call to the Central Bank.

1981 - Public sector companies prohibited from buying foreign commodities in the domestic market for Egyptian currency.

1981 - Commercial banks instructed by Central Bank to sell foreign exchange at newly established $1 = 0.84 LE "incentive rate" instead of unified rate of $1 = 0.70 LE. Official rate ($1 = 0.70 LE) retained only for certain GOE transactions. Represented an effective devaluation of 20 percent.

1981 - Advance deposits for private sector imports required to be paid in local currency (rather than FX as before) three months in advance.

1981 - Import Rationalization Committee established to screen all import requests.

1981 - Proof of origin of foreign bank notes held in Egypt required. Export of foreign currency by commercial banks must be approved by Central Bank.

1981 - "Special accounts," which the private sector could hold in foreign currency without proof of external origin and could use to finance "own exchange" imports, were abolished.

1981 - Central Bank imposed new credit restrictions on import financing by commercial banks to both public and private sector importers.

1982 - Import of foods competing with locally produced items banned unless local production fails to meet domestic demand.

1982 - Commercial banks no longer required to supply FX at the "incentive rate" ($1 = 0.84 LE) to private sector importers effective March 1, 1982. Advance import deposits again to be made in foreign exchange rather than local currency.

1982 - List of 47 new items added to the negative import for private sector importers. Intended to provide protection to domestic industries producing same items.

1982 - New "import accounts" created to allow Egyptian nationals right to deposit foreign currency in commercial banks without proof of origin, provided accomplished within 3 days of returning to Egypt. Once "import account" established, funds transferable at freely determined rate.

1982 - New import ban on "luxury" food items.

1982 - Import of frozen chickens halted for six months.

1982 - Public sector banks reportedly entering "own exchange" market and passing costs on to public sector companies.

1982 - Role of Import Rationalization Committee dramatically reduced.

1982 - Egyptian Import-Export Bank to be strengthened. Capital to be increased from LE 10 million to LE 50 million. Focus to be on export financing.

1982 - Stated GOE policy to hold consumer subsidy payments constant at LE 2 billion. Important to balance of payments because of high import content of subsidized commodities.

1982 - Stated GOE intention to increase oil export earnings at 11% annual rate over 5-year plan, by increased production or decreased domestic consumption, if necessary.

3.10 Monetary, Financial and Banking - The general trend in monetary, financial, and banking policy over the 1974-82 period also seems to have been one of marked liberalization. This is not entirely surprising. The success of the open door policy in inducing massive external capital inflows implied that complementary changes would need to be made in the domestic financial and banking structure to accommodate and encourage these flows. Similarly, an expanded role for the private sector implied the need for greater access to financial institutions that could meet private sector credit and banking requirements. Although the private sector still suffers from a general lack of access to long-term credit and is generally at a disadvantage with public sector enterprises on the terms of credit, the situation in 1982 is markedly improved over 1974.

3.11 Law 43 of 1974 was instrumental in the liberalization of Egyptian finance and banking. The Law encouraged foreign participation in banking, generally in the form of joint ventures with domestic groups, and once again, allowed private sector participation in banking. The number of commercial banks in the Egyptian economy increased from four (public sector owned) banks in 1974 to seventy banks by 1981. Of these, forty-one banks were joint ventures with foreign participation and nineteen were branches of foreign banks. Net foreign assets of commercial banks increased from LE 33 million to LE 1,165 million over this period. Time, savings and foreign currency deposits increased from LE 498 million to LE 4,845 million and private sector credit granted through the commercial banking system grew from LE 148 million to LE 1855 million.

3.12 Other events of significant note over the 1974-82 period included (i) the change from statutory interest rates to interest rates set by the Central Bank in 1975, (ii) the establishment of the Development Industrial bank in 1975, (iii) the new Law granting private sector individuals permission to hold foreign exchange deposits in 1976, (iv) the establishment of the National Investment Bank in 1980, (v) the agreement by the GOE to pay 9.5 percent interest on new government borrowings in 1981, and (vi) the periodic increases in the structure of interest rates by the Central Bank during 1976-82.

3.13 Law 43 allowed increasing privatization of banking and the mobilization and facilitation of capital flows. Removing the statutory interest rate requirements gave the Central Bank flexibility and the means to respond quickly to changing economic conditions. Establishment of the Development Industrial Bank by the GOE was an attempt to provide long-term investment capital on a commercial basis, primarily to the private sector. Granting permission to the private sector to legally hold foreign exchange deposits and to freely transfer the deposits to other individuals legalized the "own exchange" (free) market for foreign exchange and further encouraged the rapid growth of "own exchange" imports. The establishment of the National Investment Bank was part of an attempt by the GOE to consolidate, rationalize, and simplify the system of separate budgets and funds that had previously complicated state finance. The purpose of the Bank was to finance all projects included in the GOE development plan and to monitor subsequent project implementation. The agreement by the GOE to pay 9.5 percent on new credit in the last half of 1981/82 represented a massive change from its previous practice of generally paying 1.5 percent on its borrowings.

Finally, between 1976 and 1982 substantial increases in the interest rate structure occurred: the Central Bank discount rate increased from 6% to 13%; the deposit savings rate increased from 2.4% to 10%; and the minimum commercial lending rate increased from 7% to 13%, except for cotton (11%) and commercial trade (16%).

Figure 3-2

Monetary, Financial and Banking
Significant Policy Changes 1974-82

1974 - Foreign Investment Law 43 allowed foreign and domestic private sector participation in banking.

1975 - Development Industrial Bank established to provide a commercial banking source of long-term investment credit to private sector.

1975 - Central Bank given power to set domestic currency interest rate structures.

1976 - Private sector permitted to own and freely exchange foreign currency deposits.

1980 - National Investment Bank established to improve previous system of GOE investment budgeting, project finance, and implementation monitoring.

1981 - GOE agrees to pay 9.5 percent interest on new government borrowings during 1981/82 beginning in 1982.

1982 - Interest rate structure substantially increased during the 1976-82 period by a series of periodic increases by the Central Bank. Sectoral discrimination in lending rates instituted in 1982 to encourage bank lending for production (industry and agriculture) as opposed to trade.

3.14 Budgetary and Fiscal - The major theme running through Egyptian public finance during the 1974-82 period is the widespead government intervention in consumption, production, and investment for the purpose of providing basic commodities and services to the Egyptian (urban) public at stable prices. Maintaining price stability, especially for basic commodities, has been pursued through a system of direct price controls (at various levels of economic transactions) and by direct subsidies. Faced with a relatively narrow-based and inelastic tax system, an increasing consumer-dependence on government-financed imports, and a leveling of revenues from the Egyptian Petroleum and Suez Canal

Authorities, the GOE budget has come under substantial pressure since 1980. Oil profits, Suez Canal earnings, and external donor assistance had managed to hold budgetary pressures to tolerable limits up until that time.

3.15 In general, the GOE has not adequately addressed the source of its major fiscal problems. On the expenditure side, the GOE has taken no major steps to control its consumption-oriented budget during the 1974-82 period. The sum of public authority deficits and budget subsidies increased from LE 0.5 billion in 1974 to an estimated LE 2.6 billion in 1981/82. Central government current account expenditure, which is largely for salaries and wages, increased from LE 0.8 billion to LE 4.4 billion. Public investment increased from LE 0.6 billion to LE 3.9 billion. Total budget expenditures increased from LE 1.4 billion to LE. 11.7 billion.

3.16 On the revenue side, although transferred profits from the public economic sector increased from LE 0.2 billion in 1974 to an estimated LE 1.8 in 1981/82 (82% from oil and Suez Canal earnings), total government revenues still managed to cover only 67% of expenditures in 1981/82. Tax revenues, while increasing from LE 0.7 billion to LE 4.8 billion (approximately one-fifth of total from oil and the Suez Canal) were simply growing at about three-quarters of the speed of expenditures while starting from a smaller base. The overall budgetary deficit grew from 13% of GDP at factor cost in 1974 to 28% of GDP in 1981/82, in part a natural result of increased donor assistance over this period, (i.e., real resource transfers cannot occur without a current account deficit). Nevertheless, the most important reasons for the growing deficits were the ever-increasing direct consumer subsidy bills and the government wage and salary bills.

3.17 The most important budgetary and fiscal policy changes during the 1974-82 period would appear to be changes made during the 1980-82 period. Because they have occurred recently, it is still too early to determine their true significance. The key changes appear to be concentrated in four basic areas: (i) attempts to improve GOE budgetary procedures and the monitoring of project investment expenditures in 1980; (ii) attempts to increase GOE revenues (and reduce imports) by consumption based commodity taxes during 1981-82; (iii) an attempt to increase GOE revenues from a major reform of income tax laws in 1981, and (iv) the decisions to maintain availabilities of basic food items through imports and to increase public sector wages and salaries during the 1980-82 period. The GOE has taken other steps recently, discussed next under "pricing and subsidies," that will positively affect the budget, including the elimination of subsidized items from ration cards and, actions that directly or indirectly increase consumer prices on commodities currently subsidized or under price control.

Figure 3-3
Budgetary and Fiscal
Significant Policy Changes 1974-82

1980 - GOE budgetary procedures markedly simplified. Several budgets were consolidated, many extra-budgetary funds were eliminated. Economic authorities were given more operational flexibility by excluding their budgets from the state budgeting process.

1980 - GOE budgetary preparation and expenditure control procedures changed with respect to investment outlays. National Investment Bank established and given wide responsibilities for investment expenditures of the GOE and the rest of the public sector.

1980 - Decision made to increase and maintain availabilities of basic food items through imports.

1980 - Extensive reduction in import duty rates and a broadening of exemptions.

1981 - Excise taxes increased or established on 125 imported and locally produced "luxury" goods.

1981 - Comprehensive reform of income tax laws designed to stream-line and improve collection procedures, to declare moratorium on past failures to comply, to substantially reduce rates, to increase base exemption levels, and to revise the penalties for non-compliance. Overall intent was to increase total revenues collected by promoting greater compliance by taxpayers.

1982 - Consumption taxes raised from 5 to 100%, depending on commodity. Coverage was extended from 53 to 124 "luxury" commodities, both domestically produced and imported.

1982 - Substantial upward adjustments occurred in public sector wages and salaries over 1980-82 period, in a series of increases and bonuses.

3.18 Pricing and Subsidies - Pricing and subsidy policies have not been an area of strong, corrective GOE policy performance over the 1974-82 period. As indicated in the previous section on budgetary and fiscal policy, the GOE has followed a conscious policy of attempting to hold down consumer prices of basic commodities and services over this period. To the extent this has been accomplished, it has been done through a system of direct consumer subsidies of basic commodities, substantial underpricing of public services and utilities, price controls on public sector output, and substantial underpricing of petroleum-based products. Considerable other attempts have been made to control consumer prices with much less success, including agricultural output pricing controls coupled with acreage and delivery quotas, rent controls, credit controls, controls on taxicab fares, etc.

3.19 Very few, if any, pricing and subsidy policy changes over the period 1974-82 can be termed "key" reforms. Nevertheless, if the GOE continues the pattern of small changes in pricing and subsidy coverage initiated in 1981 and 1982 (including the "product mix (strategy of introducing "new" products at higher prices while phasing out older subsidized products), at least some of the direct budgetary and balance of payment consequences of present policies may be lessened. Further, if the GOE were to follow through on two of its stated intentions -- the schedule of phased domestic price increases for petroleum products and the freezing of the present nominal level of the direct subsidy budget -- it would have gone a very substantial distance toward resolving its growing budgetary and balance of payments problems. The comprehensive income tax reform of 1982 could prove significant in the future, if successfully implemented, although not crucial in the near term.

Figure 3-4
Pricing and Subsidies
Significant Policy Changes 1974-82

1977 - Announced GOE price increases on subsidized bread and flour resulted in riots. Price increases rescinded.

1980 - Significant price increases on several hundred items produced by public sector companies included as part of CY 1980 budget. Subsequently withdrawn with change of Government in May 1980.

1980 - GOE increased the extraction rate for flour used in production of balady bread. A second, higher quality, bread was introduced at a higher price as part of strategy to phase out lower quality bread.

1981 - GOE announced in January that domestic petroleum prices would be raised, on average, by one-fifth of the difference between domestic and international prices each year for five years. Two years later only minor increases have occurred.

1982 - GOE has begun to reduce basic commodities available with ration cards. Lentils, fava beans, margarine and soap were dropped and per capita rice rations were reduced from 1.5 kg to 1.0 kg per month. Small consumer price increases have occurred for premium gasoline (15%), electricity rates for non-heavy industry (5-20%) and water. A series of large price increases occurred for subsidized red meat sold through government stores, 90 PT/KG to 250 PT/KG between 1980 and 1982. Electricity rates to two high voltage consumers (20% of national production) were increased 50-60%.

1982 - GOE greatly reduced the range of consumer items imported by the government at the subsidized official rate of $ US 1 = 70 PT for sale through government/public sector stores.

1982 - GOE has publicly stated its intention to freeze the nominal level of the direct subsidy bill at LE 2 billion in future years.

1982 - GOE has continued to phase out price-controlled items and replace them with higher priced, "improved" goods.

1982 - GOE procurement prices for domestic agricultural production generally have been increased on an annual basis over the 1974-82 period, although with rare exception they have remained substantially below world market prices.

1983 - GOE announced intent to introduce new ration cards later this year that will more effectively target subsidies.

3.20 Wages, Employment, and Emigration - Egypt has followed a "full employment" policy since the early 1960's when it initiated an "employment drive" following the nationalizations of 1961. In 1964 the GOE passed legislation which guaranteed government employment for secondary and university graduates and military conscripts. By 1974 government and public sector companies were believed to be substantially over-staffed, although little open unemployment was being recorded. Government had come to be seen as employer of the first resort. GOE employment policy seemed to serve essentially three purposes: (i) to staff required government and public sector functions, (ii) to act as a social or employment security safety net, and (iii) to minimize potentially destablizing urban and/educated unemployment.

3.21 GOE policy actions during the period 1974-82 did little on the surface to change this situation. The problems posed by guaranteed government employment are well understood by the GOE and periodically have been debated. Nevertheless, with the exception of limited actions taken in 1978, official GOE employment policy stands unchanged. However, in 1978 the GOE did abrogate the right of guaranteed government employment for military conscripts. At the same time, public sector companies were given considerable freedom to set their own employment policy. This seems to have effectively ended the guaranteed employment of secondary and university graduates by public sector companies.

3.22 A more subtle change in GOE employment policy may have taken place through its emigration policies. It has been argued by Amr Mohie-Eldin, professor of economics at Cairo University, that the GOE shifted consciously into a set of policies that encouraged emigration in the mid-1970s. Although estimates vary widely, it is generally believed that a substantial net emigration of Egyptian workers (0.7 to 1.5 million) occurred in the 1974-82 period, with important implications for domestic wages and employment and for Egyptian balance of payments. The debate on whether the net impact of this emigration has been beneficial to the Egyptian economy continues (legislation restricting labor flows has been considered in the People's Council). Nevertheless, the highly positive impact of workers' remittances on the balance of payments is unquestioned (second most important source of foreign exchange earning behind petroleum), and there are strong grounds to believe that government employment during this period was reduced below levels that probably otherwise would have been assumed.

3.23 Because of the sheer number of employees and limited budget resources, GOE wages and salaries have fallen behind those available in the private sector. The effect of the Open Door Policy and the wage opportunities for emigration to the Arab OPEC countries has been to widen the discrepancy. In the face of these discrepancies, inflation, and growing unrest, the GOE instituted a series of significant government wage and salary increases in the 1980-82 period. The brief upsurge in oil earnings in 1980-81 provided the initial means of finance. Nevertheless, total government employment (not including 1.2 million in public sector enterprises) now exceeds one-fourth of the work force and the wage bill thereof now constitutes approximately one-half of total government revenues.

Figure 3-5
Wages, Employment, and Emigration
Significant Policy Changes 1974-82

1974 - Exit visa requirements abolished; issuance of passports substantially simplified; "own exchange" imports allowed.

1975 - Treaty ratified for manpower movement among Arab countries; new nationality law allowed dual citizenship.

1976 - "Own exchange" (free) market effectively established with law permitting private ownership of foreign currency deposits and free exchange thereof.

1978 - Government employment for military conscripts abrogated.

1978 - Public sector companies given considerable freedom to set their own employment policy, including hiring and setting of total compensation package.

1980 - Substantial increases in public sector payscales. Guarantee of government employment to secondary and university graduates renewed and steps taken to accelerate their employment.

1981 - Major increases in public/government sector pay scales.

1982 - New levels and terms for GOE "incentive pay" established.

3.24 Decentralization - In conjunction with other measures to consolidate his political power in the early 1970s, Sadat expressed an interest in the need to delegate certain central government responsibilities to the local level. During the 1974-82 period, a series of actions were initiated in the implementation of this interest, progressively transferring powers of the central government to the governorate or local councils. Figure 3-6 lists certain of these policy actions. Although a clear and important shift in administrative responsibilities has been occurring, and a similar shift, although to a lesser degree, has been taking place with respect to political power and popular participation, to date the transfer of fiscal responsibilities and powers has been limited. (Considerable expenditure decentralization is taking place but little revenue decentralization is occurring.) The FY 1985 CDSS Decentralization Annex extensively reviews policy changes for the 1974-82 period.

Figure 3-6
Decentralization
Significant Policy Changes 1974-82

1975 - Local councils formed by direct election at various levels.

1975 - "Special accounts" for local services and development fund established in villages, districts, and governorates.

1977 - Eight economic regions and regional planning councils established to set priorities for government revenue allocation.

1978 - Governorates took full control over all local technical and administrative staff, including those appointed by ministries.

1979 - Rank of governor raised to that of Minister, and governor given full authority when functions for government transferred to local units. Two additional special accounts under governorate jurisdiction established.

1979 - Regional Planning Commissions established for the eight planning regions.

1980 - National Investment Bank formed and used to channel shgnificantly more investment funds, from national treasury, directly to the local units.

1981 - Types of local revenue earmarked for local funds increased 1979-81.

1981 - Functional responsibility for several government services progressively transferred from central to local units 1975-81.

1981 - Supreme Council for Local Government, chaired by Prime Minister, established to implement decentralization policy guide lines. Several new sources of revenue for special account to finance economic housing established.

1982 - Functional staff of service ministries transferred from central ministries to local units 1980-82.

1982 - Functional authority for housing transferred from central government to local government.

3.25 Energy - Egypt's future energy policies will, without question, play a highly significant role in the success or failure of its economic development. Unfortunately, Egypt failed to address, in any meaningful fashion, the overwhelming issues of domestic energy pricing during the period 1974-82. The average weighted domestic price of petroleum based products in Egypt was still only one-fifth of world market prices by 1982, ranging from 6% to 77% of world market prices, depending on the product. The adverse implications for the GOE budget, the balance of payments, and economic allocative efficiency have been widely pointed out to the GOE. Nevertheless, to date, the GOE remains largely paralyzed in taking effective action on probably its single largest opportunity for quickly turning around its current balance of payment and budgetary dilemma (i.e., by raising domestic energy prices some portion of domestic consumption would be diverted to the export market with favorable impacts on both foreign exchange earnings and GOE budgetary revenues).

3.26 Figure 3-7 lists a series of the "significant" policy changes identified for the period 1974-82. With the possible exception of the decision by the GOE to build 8-10 nuclear-powered electric power plants of 9600 mw total capacity over the next two decades, and possibly the pricing and substitution strategy decisions relating to the Abu Kir natural gas development project, nothing the GOE has done over the 1974-82 period would seem to represent a major policy change in this vital sector.

Figure 3-7
Energy
Significant Policy Charges 1974-82

1973 - Ministry of Petroleum established to oversee overall mangement of sector. Exploration activities intensified, in part because of attractive production-sharing agreements negotiated with international oil companies.

1974 - Ministerial Committee on Energy set up to coordinate work of the different energy-related agencies, to consider new legislation, and to make decisions on issues of joint agency interest.

1978 - Egypt managed to reap benefits of rapid oil price increases 1978-80 by negotiating one-year contracts, with price to be set at time of delivery.

1978 - Decision made to develop natural gas fields to substitute for consumption of fuel oil by large public sector industrial users.

1980 - GOE increased domestic prices of petroleum products by about 20%, with the exception of the prices of LPG and fuel oil, which remained unchanged. Electricity tariffs for residential and small commercial users also were increased on average by 20%.

1981 - GOE decided to build 8-10 nuclear-powered electric power plants of 9600 MW total capacity during next two decades.

1981 - Price of fuel oil charged to Law 43 companies increased to world market prices.

1981 - Decision made to substitute domestically produced natural gas over next few years for the far more expensive imported butagas.

1982 - GOE signed an Energy Policy Planning Project with AID for the purpose of systematizing the planning of Egypt's energy development and use in the years to come.

1982 - GOE agreed to increase price of natural gas from the IBRD-assisted Abu Kir Gas Development Project from present average levels of $0.20/MCF to an estimated $1.10/MCF (i.e., the average price charged is to cover the marginal cost of production plus a depletion allowance). Nevertheless, the opportunity cost for Abu Kir gas is estimated at slightly above $4.00 by the IBRD.

1982 - Electricity rates increased for residential and low and medium voltage business consumers, on average by 10%. Rates increased for high voltage consumer Nag El Hammadi Aluminum and Kema Fertilizer (responsible for 20% of national electricity consumption) by 50% and 60%, respectively.

2. Sectoral Policy Changes

3.27 Four sub-categories make up the sectoral policy change category: (i) agriculture, (ii) industry, (iii) infrastructure, and (iv) human resources and technology. The last two sub-categories are actually summary groupings for related sub-categories, e.g., the infrastructure sector contains water and sewerage, electrical power, telecommunications, etc.

3.28 Agriculture - Despite some relatively significant increases in agricultural procurement prices in recent years, GOE procurement prices for most crops (soy beans and corn being the significant exceptions) remained substantially (35-65%) below world market prices. Although some dispute exists over the actual impact of GOE procurement prices, given the general absence of acreage controls and delivery quotas (notable exceptions being sugar, cotton and rice), the fact remains that the cropped areas of cereals, beans, and cotton have decreased in recent years while the cropped acreage of berseem, sugar, vegetables and fruits have markedly increased. Egyptian farmers have tended to shift from cereals production for human consumption to production for animal feed, from controlled crops to uncontrolled crops. Over the ten-year period (1973-82) Egypt has gone from being a net exporter of agricultural commodities to an importer of roughly half its value of food consumption. Although agricultural employment is believed to have declined slightly over this period, the fact remains that an economy with over 40% of its labor force engaged in agricultural activities cannot feed itself directly, or indirectly through export sales. In the meantime, Egypt continues to pay foreign producers substantially higher prices than it is willing to pay its own producers.

Figure 3-8
Agriculture
Significant Policy Changes 1974-82

1976 - Principal Bank for Development and Agricultural Credit established. Served as principal supplier of institutional credit, agricultural inputs, and as crop procurement agent for the GOE.

1976 - Area requirement and compulsory delivery regulations for domestic wheat production suspended (and have remained suspended).

1980 - GOE agricultural procurement prices were raised on average 9-18% per year over the period 1976-80, in a series of periodic increases. Price increases ranged from 10-30% in 1980. Increases covered wheat, rice, cotton, sugar cane, beans, lentils, and onions (see Appendix II).

1981 - GOE agricultural procurement prices increased 13-50%, effective July 1, 1981.

1981 - Formation of Supreme Council for Agricultural Extension.

1981 - Vegetable prices to be set by each governor within maximum and minimum limits set by Ministry of Supply.

1982 - Principal Bank for Agricultural Development appears to have substantially reduced the number of branch banks that act as wheat procurement agents 1981-82.

1982 - Ministerial decree consolidated research and extension functions in the Ministry of Agriculture (recommended by BIFAD Extension Team and Presidential Mission).

1982 - "Old-New" lands transferred from Ministry of Land Reclamation to Ministry of Agriculture in an organizational rationalization.

1982 - GOE agricultural procurement prices increased 6-36%. Included wheat, rice, corn, fava beans, soy beans, sugar cane, and cotton.

3.29 Industry - Relatively significant policy changes have occurred in the industry sector during the period 1974-82 when compared with the pre-1974 situation. Two basic threads of reform, both emanating from President Sadat's Open Door Policy, are evident. The first thread of reform is the gradually increasing privatization of the industry sector (along with the commercial, external trade, and banking sectors) under the Foreign Investment Law 43 of 1974. This seminal act, which increasingly is being used to leverage similar types of free market reform, recently was reinforced in its basic directions by the Companies Law 159 of 1981, which extended the free market privileges under Law 43 to the Egyptian domestic private sector. Law 159 also extended these privileges, in principle, to new subsidiaries of public sector companies. A proposed public sector enterprise law, currently under debate, now cites the need to place all domestic public sector companies on equal competitive grounds with Law 43 companies. Thus, what began as essentially an extension of free market rules to joint venture projects of Egyptian and foreign capital now has evolved into a widening of most of these privileges to the Egyptian domestic private sector as a whole (plus new subsidiaries of public sector companies), and "threatens" to encompass all of public sector enterprise under currently proposed legislation.

3.30 The second thread of policy reform revolves around the management autonomy of Egyptian public sector managers and management of public sector enterprise as a whole. Law 111 of 1975 abolished the General Organizations (holding company system) that had played an excessively heavy, centralized role in the management of individual companies and replaced the General Organizations with technical secretariats that were intended generally to play a coordinating rather than a managerial role (although key decisions such as pricing and investment decisions were still to be held at the center). Law 48 of 1978 extended this trend by giving public sector companies considerable freedom over their own employment policies. The proposed public sector reform law would extend management autonomy in several new directions including, importantly, greater control over pricing and investment decisions (considerable autonomy is implicit in Law 43 provisions if granted outright, of course). Finally, the establishment of the National Investment Bank in 1980, with its intended role of public sector project evaluation, investment financing, and project implementation monitoring, may be a significant step forward to putting public sector investments on a more commercially sound basis.

Figure 3-9
Industry
Significant Policy Changes 1974-82

1973 - Creation of parallel exchange market for foreign exchange September 1973 and its subsequent widening.

1974 - Foreign Investment Law 43, amended by Law 32 (1977), allowed joint ventures between Egyptian capital and foreign capital. As amended, composition can be anything from 100% Egyptian to 100% foreign. Companies organized under this law are essentially subject to free market conditions in all respects, plus give liberal tax holiday of 5-10 years.

1974 - "Own Exchange" (free FX) imports of goods allowed by traders or individuals who hold foreign exchange eligible for the parallel market. Market became extremely popular because minimum of formalities required.

1975 - Law 111 (1975) restructured public sector enterprise administration. Holding companies (moassasts) abolished and replaced by supreme councils for each industry. Intent was to make only the important decisions, particularly price changes and investment decisions, at the center and to leave the companies freer to make day-to-day decisions.

1978 - Law 48 (1978) gave public sector companies considerable freedom to set their own employment policy. Compensation to be determined by board of directors within minimum-maximum set by law. (Guaranteed employment of military conscripts abrogated and of "graduates" essentially no longer enforced.)

1980 - National Investment Bank established to evaluate public sector projects, mobilize and channel investment funds to the public sector, and monitor project implementation.

1981 - Companies Law 159 (1981) simplifies procedures for forming joint stock and limited partnership companies for private sector. All Law 43 rights granted to domestic firms, except repatriation of profits. Public sector companies can form Law 159 companies as wholly owned subsidiaries.

1983 - Proposed public sector law under discussion in GOE that would substantially increase managerial autonomy. Overall, proposed law seeks to provide all public sector companies the privileges given to Law 43 companies.

3.31 Infrastructure - We have lumped under this sector (i) water and sewerage, (ii) electrical power, (iii) housing, (iv) telecommunications, and (v) the Suez Canal. Our coverage of materials under these categories has been highly uneven and the results of our survey should, therefore, be treated as highly tentative. In general, the basic generic problem that faces all public utilities and services that serve domestic consumers in Egypt (inadequate rate structures/absence of cost recovery) has not been addressed, or has been inadequately addressed by the GOE during the period under review. Similarly, other basic problems that plague all sectors contained within the infrastructure grouping can be generically categorized and are generally traced to cross-sectoral policy origins, e.g., GOE employment and wage policies, GOE training and education policies, GOE investment budgeting, GOE project evaluation methodology and criteria, etc. Not surprisingly, given their cross-sectoral nature, these types of problems/constraints were not addressed, or were addressed inadequately by the GOE.

3.32 Figure 3-10 presents significant policy changes that did occur during the 1974-82 period for the infrastructure group as a whole. The listing is dominated by changes in the housing/urban policy-related area, at least in part because of (indirectly) better coverage of material in that area. Although certain of the housing-related policy changes can be termed significant (to the extent that functional control over housing is decentralized, rent controls are loosened, and cost recovery is introduced), GOE housing policy still constrains the national supply of housing because of its failure to charge or allow adequate cost recovery.

Figure 3-10
Infrastructure
Significant Policy Changes 1974-82

Mid-1970s -	Decision made to widen and deepen Suez Canal in order to increase transit capacity.
1977 -	Landlord/tenant law allowed landlord to increase annual rent to 20% of major improvements, limited to 50% of present value of building.
1979 -	Law 43 (1979) established a special account to finance economic housing projects within the governorates. Decision making to be primarily local in character.
1979 -	Law 59 (1979) established a sole government agency as responsible for creation and management of new urban communities developed outside boundaries of existing towns and villages.
1979 -	Law 20 (1979) controls establishment of industrial zones in cities and surrounding areas.
1979 -	Presidential Decree No. 363 established the Alexandria General Organization for Sanitary Drainage (A/GOSD) separating it from the national GOSD.

1981 - Law 136 (1981) redefined relationship between tenant and landlord, loosening and restructuring rent controls while still maintaining protection of lower income consumers.

1981 - Decree No. 198 establishing the Beheira Water Company, recognizes the merit of bringing more responsible management to provincial water supply operations.

1982 - Law 272 (1982) transferred several housing functions from the Ministry of Housing to local government.

1982 - GOE moved from providing complete built-out housing to sharing core housing, sites, and service costs with residents.

1982 - Increased GOE attention to water and sewerage requirements reflected in new Five Year Plan which shows LE 3.4 billion in planned investment compared with actual investment of LE 0.7 billion over twenty-year period 1960-80.

1982 - Electric power rates increased an average 10% for residential and low- to medium-voltage users. Rates were increased 50-60% for high voltage users, Nag El Hammadi Aluminum and Kema Fertilizer, which together account for 20% of national electricity consumption.

1982 - Annual Suez Canal toll rates increased average 5-6.5% in 1981 and 1982, with rate structure revised to encourage larger vessels. Rate increases for 1983 under discussion with international shipping interests.

3.33 Human Resources and Technology - The human resources and technology sector grouping, as covered herein, includes (i) education, (ii) health, (iii) population, and (iv) science and technology. The coverage on sector-specific studies relating to policy changes during the period 1974-82 must be considered incomplete. Nevertheless, cross-sectoral materials on the Egyptian economy, which could be expected to note truly major policy changes in these areas, have not done so. In part, this is believed to be because the GOE simply has not made revolutionary policy changes in these areas. On the other hand, the type of economically oriented materials that has tended to be reviewed for cross-sectoral purposes were not likely to reveal policy changes that might only be classified as "significant" within these sub-sectors.

3.34 Of the materials reviewed, only five policy changes or events might be considered truly, potentially significant: (i) the basic education and training reform law of 1981, (ii) the Ministry of Health policy statement in 1982 that the extension of privately funded health insurance coverage will be actively encouraged, (iii) the repeated stress on the importance of the population problem by President Mubarak in public and within the GOE, (iv) the creation or intent to create an Undersecretary of Population within the Ministry of Health and Director Generals of Population at the Governorate level, coupled with the Presidential Decree making population the responsibility of each governor and, (v) the intent to focus the Egyptian science and technology effort on applied development problem solving as indicated by announcements relating to the LE 112 million budgeted for this effort in the new 1983-87 Five Year Plan. Figure 3-11 and Appendix II reflect additional policy changes as well as those indicated above.

Figure 3-11
Human Resources and Technology
Significant Policy Changes 1974-82

1978 - GOE allowed incentive payment to nurses for afternoon and night shifts. Budget increased from LE 300,000 in 1978 to LE 3.5 million in 1982/83.

1981 - Education Law 139 (1981) provided for a redefined and more relevant basic education curriculum and for expanded access through more classrooms and better siting.

1981 - Since taking office October 1981, President Mubarak has stressed repeatedly the burden imposed on the economy by rapid population growth.

1982 - Basic education investment budget has increased from LE 10.4 million in 1979 to LE 39.7 million in 1982-83 and increased as a percentage of the pre-university investment budget from 43.5% to 53%.

1982 - Ministry of Health has formally announced its intention to launch a rural delivery of family planning services test, as well as to significantly increase the proportion of the population covered by the Health Insurance Organization and similar (premium/fee charging) organizations.

1982 - Creation of Undersecretary for Population within Ministry of Health. Creation of Director General for Population in the Ministry of Health within each governorate. Presidential Decree making population the responsibility of each governor.

1982 - Major shift in emphasis away from basic research to applied research. LE 112 million budgeted in "development research" in new Five Year Plan for non-academic joint projects between the Academy of Scientific Research and Technology and the Ministries of Industry, Electricity, Agriculture and Housing.

B. Key Exogenous Events/Factors

3.35 Before proceeding to an overall assessment of GOE policy efforts during the 1974-82 period, it is appropriate to consider the rather substantial circumstances and events outside the direct control of GOE economic policy makers during this period. The making or changing of policy never proceeds in a vacuum and the GOE actions during the 1974-82 period were, no exception. We will consider the major exogenous events impacting on the Egyptian economy during the 1974-82 period and will briefly assess their relationship and importance to the just reviewed GOE policy changes. In the following section, Part C, we will draw conclusions on the overall significance of exogenous events compared with GOE policy changes, in their impact on the Egyptian economy 1974-82.

3.36 A summary of events having major impact on the Egyptian economy for the period 1974-82 (but not initiated by GOE economic policy) seems quickly to break down into two major categories: (i) events taking place in the world economy and (ii) GOE politically inspired events. In the first category, the undisputed single most important factor, dominating the world economy and impacting directly (and indirectly) on the Egyptian economy, was the dramatic increase in the price of oil. In the latter category, three events -- the October 1973 War, the second Egyptian-Israeli disengagement agreement of September 1975, and the Camp David Accords of March 1979 -- stand out for their importance in setting the stage for the Open Door Policy and subsequently making possible its continuation.

3.37 Economic Factors - The key exogenous economic factors that affected the Egyptian economy in the period 1974-82 were the immense increases in world oil prices (and their subsequent decline), rapidly rising world food prices (particular food grains), general worldwide inflation, world recession, and skyrocketing international interest rates. Two related key events, at least in part of an exogenous nature, and at least in part related to oil price increases, were (a) the new oil discoveries in Egypt that resulted in substantial production increases in the late 1970s and (b) the widescale emigration of Egyptian workers to OPEC countries in the mid-1970s and their subsequent repatriation of earnings.

3.38 The influence of oil price increases looms large, directly or indirectly, in all of the above factors. The positive effects of the significant increases in oil export earnings and the remittances from workers abroad, probably outweighed the adverse affects of world inflation (also oil induced) on the size of the import bill, resulting in a net positive impact of exogenous factors during the period with respect to Egypt's balance of payments current account. The capital account, particularly long-term capital and direct private foreign investment flows, also seem to have been favorably affected by oil prices in net, i.e., the effect of increased Arab (oil financed) capital inflows probably more than offset the debt servicing impact of higher (oil-induced) interest rates. On balance, although the massive increases in oil prices affected the Egyptian economy in both positive and negative senses, the net effect during the period under review probably was positive. Unfortunately, the ever-increasing discrepancies between world and domestic prices that were set in motion during this period, through a combination of oil-inspired world-wide inflation and domestic price control and subsidy policies, now lie significantly at the root of the current economic policy dilemma. Figure 3-12 sets out the major exogenous economic factors during the 1974-82 period.

Figure 3-12
Major Exogenous Economic Factors
Affecting the Egyptian Economy 1974-82

World oil prices
- quadrupling of prices between 1972-74
- tripling of prices between 1978-1980
- 20-fold price increases 1972-1980
- partial retrenchment of prices 1981-82

World food prices
- quadrupling of wheat/flour prices 1972-74
- periodic major crop failures in 1970s
- drop in prices of some key imports 1982

General worldwide inflation
- mid-1970s to present

International interest rates
- steady increases since early 1970s
- doubling of rates 1978-81
- leveling and decline of rates 1982

New Egyptian oil discoveries
- doubling of exported production 1977-82

Emigration of Egyptian workers to OPEC countries
- net increase in workers abroad estimated between 0.7 - 1.5 million during the period 1974-82

3.39 Non-Economic Factors - The key non-economic factors affecting the Egyptian economy during the period 1974-82 are either related to the 1973 War or to the subsequent peace initiatives. Together, these events made possible the outward-looking component of the "Open Door" strategy, which was directed toward increasing external capital inflows, and they directly resulted in the recovery of "lost" economic assets. These outcomes are properly named "the peace dividend".

3.40 The major political-military events that precipitated and continued "the peace dividend" (the October 1973 War, the September 1975 Egyptian-Israeli Disengagement Agreement, and the March 1979 Camp David Accords) already have been noted. The economic effects of these political decisions have not been highlighted, however, and they are tremendous. The economic impact resulting from Sadat's "peace initiative" include (i) the reopening of the Suez Canal in 1975, (ii) the return of the Sinai oil fields in 1976 and access to Gulf of Suez oil exploration, (iii) the resumption of tourism, (iv) the reoccupation and reconstruction of the Canal Cities, (v) the return of the Sinai, (vi) decreased pressure for military expenditures as a percentage of GNP 1975-79, and (vii) massive Western and Arab capital inflows beginning in 1974 in the form of grants, loans, and direct private foreign investment (although official Arab oil commitments stopped after the Israeli-Egyptian disengagement agreements and other Arab capital flows dropped following Camp David).

Figure 3-13
Sadat's Peace Dividend

- Massive Western and Arab capital inflows 1974-82
- Opening of the Suez Canal 1975
- Access to Gulf of Suez for offshore oil exploration 1975
- Return of the Sinai oil fields 1976
- Resumption of tourism mid-1970s-1982
- Occupation and reconstruction of Canal Cities 1975-82
- Decreased pressure for military expenditures 1975-79

3.41 It is possible to advance several arguments relating to the major, if not overwhelming, role of exogenous factors in the Egyptian economy during the 1974-82 period. Four propositions of interest are advanced here: (i) exogenous factors, particularly relating to oil and the Suez Canal, rather than basic domestic economic strength, have been the overriding reason for high economic growth during the last part of the 1970s and early 1980s; (ii) exogenous factors probably assisted greater reform to occur in some areas (e.g., foreign trade, payments, and investment) than otherwise would have resulted, simply because it is easier to pursue reform under favorable economic conditions; (iii) nevertheless, the positive resource flows resulting from exogenous factors probably also allowed the GOE the luxury of postponing reforms, particularly in the critical areas of pricing and subsidies, that might otherwise have taken place under less favorable circumstances; (iv) finally, the decision to "shield" consumers from price increases, once set in motion, became an ever-increasing burden on the GOE budget and balance of payments, as domestic and international prices increasingly diverged and as Egypt's import-dependence for basic food commodities continued to climb. Thus, it might be argued that the generally positive resource effects of exogenous factors during the 1974-82 period are both the major source of current prosperity and liberalization trends, and the major source of the current pricing/subsidy adjustment dilemma. An overall assessment of GOE policy efforts in the 1974-82 period follows.

C. An Overall Assessment of GOE Policy Efforts

3.42 Prologue -- At the outset, it should be clear that the motivating force for the Open Door Policy of 1974 was primarily of pragmatic and not of ideological origins. Quite simply, there were not too many short-term options left for rapidly turning around the deteriorating economic situation. What was needed were immediate, massive infusions of external assistance, long-term capital flows, and direct foreign investment. The Open Door Policy was designed to appeal to the most likely sources of these external resources, the West and the Arabs. Although the Open Door Policy represented a structural break/discontinuity with past policy, it probably was aimed far more at inducing external resource inflows to meet the immediate urgencies than at any revolutionary domestic reform of the economy. Nevertheless, the Open Door Policy signaled an important shift in attitude toward the private sector that made possible evolutionary change in the economic structure.

3.43 Key Policy Shifts - Essentially, all of the key GOE policy shifts during the 1974-82 period emanate from the 1974 Al Infitah ("Open Door") Policy. The Open Door Policy by itself represented an indisputable major structural shift in the existing Egyptian political-economic strategy. Without question, its many complementary facets have had a profound effect on the Egyptian economy, when taken together.

3.44 In its broadest interpretation, the Open Door Policy represented (or has come to represent) a commitment to peace instead of war, a political shift toward the West, encouragement of both political and economic capital inflows, a broadening of the perceived role for the domestic private sector, and a recognition and acknowledgment of the need for public sector reform. The subsequent attempts to implement the Open Door Policy over the 1974-82 period have resulted in several notable policy trends, including: (i) substantial liberalization of the foreign trade and payments regime, (ii) an almost total reversal in the previously negative attitude toward direct private foreign investment, (iii) corresponding liberalization in the financial and banking sector, and (iv) a gradual, general loosening of restrictions on the domestic private sector, coupled with an overall reform attitude toward the management of public sector enterprise. An overall trend toward privatization of the economy also has been very much in evidence.

3.45 However, other than the above, which is quite significant (an opening wedge so to speak), most policy areas reviewed have seen relatively minor reforms in comparison to the size of the problem(s). In other words, basic reforms in the key areas of pricing and subsidy policy (including energy, agriculture, industry and public services pricing), public sector enterprise management and regulatory policy, government wage and employment policy, and human resource policy (particularly with respect to population control and higher education and training), generally have lagged or have been absent. Although certain changes and trends in the 1981-82 period appear to be potentially important, it is still too soon to judge the significance of this period with confidence.

3.46 Overall, GOE policy changes made during the 1974-82 period appear to have been corrective reform measures (as opposed to stop-gap), although generally small, except as noted above, and generally incomplete. If a criticism of GOE actions were to be leveled, it would be that they have failed to go far enough, not that they have taken wrong directions. Most of the present GOE policy dilemmas were already in existence or had been set in motion by 1974. The GOE has simply failed, to this point, in coming to grips with the more intransigent of the domestic economic reform issues that grew out of the shift to a centrally controlled economy during the late 1950s and early 1960s.

3.47 The Open Door Policy, while certainly a success in its overall dimensions, seems to have had mixed success in its basic components. The outward-looking component of the strategy appears to have been generally successful in inducing both political and economic capital inflows during the period under review. The inward-looking (domestic reform-related) component of the strategy, however, has generally moved at a slower, albeit relatively steady pace. In large part, reforms related to the external sector, in particular Law 43 as amended, have provided the initial stimuli for domestic sector reforms related to the privatization of the Egyptian economy or have induced the public sector to act in a more market-oriented fashion.

3.48 Relative Roles -- Exogenous events have been critical to Egyptian economic performance during the 1974-82 period, particularly those related directly or indirectly to oil prices, and generally have been complementary to (supportive of) Egyptian reform measures. This is understandable since the exogenous events have generally resulted in net increases in resources available to the Egyptian economy and, hence, make any type of reform easier than otherwise would be the case. Nevertheless, the GOE did not use all of its new-found resources in support of reform, choosing instead to support increased public consumption by continuing to finance conscious policies designed to suppress/contain consumer prices. By choosing this course of action, the GOE avoided taking basic reform steps in the pricing and subsidy areas that, in 1983, loom at politically catastrophic levels. Thus, while exogenous factors appear to have been positive on balance, the present GOE policy dilemmas (e.g., size of implicitly required pricing adjustments) would undoubtedly have been smaller in their absence. This conclusion in no way reflects on (or second guesses) the possible political wisdom of the actual policies that were followed during the 1974-82 period. Nevertheless, it would seem relatively certain at this point that the postponed adjustments are ultimately going to have to be made in large part. It seems likely that a substantial portion of the adjustments postponed during 1974-82 are going to surface in 1983-85.

3.49 In sum, the GOE has taken some relatively impressive policy reform measures during the 1974-82 period. The equally impressive performance of the economy since the mid-1970s, without question, has been assisted by these measures. Nevertheless, the favorable performance of the economy during this period must in large part, be attributed to favorable exogenous factors. This in itself is no cause for apology, but rather a set of circumstances for which Egypt can be thankful. Unfortunately, the current urgencies, being expressed in the form of growing current account balance of payments and budgetary deficits, are the symptomatic reflections (reminders) of the GOE's earlier failure, beginning in the mid-1970s, to address politically difficult, but ultimately necessary domestic economic reform issues. Figure 3-14 provides a summary of some of the major accomplishments and non-accomplishments during the 1974-82 period. We will turn next to explore possible future implications of the recent economic trends and policy changes.

Figure 3-14
Major Accomplishments (and Non-Accomplishments)
Resulting from Purposeful Policy Decisions (or lack thereof)
1974-82

Highly Positive Signs

- Petroleum earnings from increased production
- Direct private foreign investment
- Other commercial capital inflows
- Political/donor assistance capital inflows
- Liberalization of foreign trade and payments
- Liberalization of banking sector
- Increasing privatization of Egyptian economy

Other Positive Signs

- Suez Canal earnings from widening and deepening
- Significant increases in LE deposit and lending rates
- Periodic increases in agricultural procurement prices and relaxation of acreage and delivery controls
- Major reform of business and personal income tax laws
- Reform of private sector company laws
- Public sector enterprise reform legislation under discussion
- Recent electricity rate increases
- Decreases in consumer commodities subsidized or ration cards
- Price increases for various services and commodities

Negative Signs

- Pervasive pricing controls still exist
- Major underpricing of energy still exists
- Significant agricultural pricing distortion still exists
- Fundamental consumer subsidy policy still in place (substantial underpricing of basic commodities and public services)
- Public sector enterprise management and regulations still require major reforms
- No serious reform of government wage and employment policy in sight
- No serious reform of higher education and training policy to date

IV. IMPLICATIONS FOR THE FUTURE

A. The Period After Sadat (1981-82)

4.01 President Mubarak came into power October 6, 1981 not only during a period of potential major political instability following the assassination of Sadat but also at the beginning of increasingly difficult economic circumstances. President Mubarak responded by immediately naming domestic economic problems his number one priority (along with security) and by initiating various task forces and study groups on the question of economic policy reform. A new cabinet was in place by the beginning of 1982 and a major economic forum, made up of leading economists and political leaders from most parts of the political spectrum, was scheduled for February 1982. Egypt's economic problems were openly and candidly discussed throughout the 1981-82 period by President Mubarak and members of his cabinet (and during the February 1982 economic forum). Many positive, encouraging statements were made on the subject of economic reform during this period, although invariably (and understandably) accompanied by disclaimers of any intention to disenfranchise the poor or to dismantle the subsidy system. Clearly, reasonable and informed discussions were taking place on the need for major economic reform.

4.02 Nevertheless, concrete policy changes during the Mubarak Presidency generally have been small, unpublicized, and, to some extent, retrogressively de-liberalizing in nature. Although certain of the policy changes during this period attack root causes of the present economic situation (e.g., by increasing GOE controlled prices, raising taxes and expanding tax coverage, decreasing the number of subsidized items available with ration cards, etc.), others predictably attack balance of payment and budgetary deficit <u>symptoms</u> with increased quantitative, regulatory, and credit controls to suppress imports. The immediate effects of the policy changes (whether repressive or corrective) appear to be generally in the right direction given the existence of the deficits, although they appear much too small to offset/correct the growing adverse trends in balance of payments and GOE budgetary deficits.

4.03 The apparent GOE strategy for dealing with its economic problems seems to be evolving under President Mubarak as follows:

- -- candid public assessments of the economic situation to prepare the public and build concensus for the need to make changes;

- -- involvement of a broad spectrum of political and economic personalities in the discussion and formulation of options (for the purpose of building concensus for the need and type of economic reforms);

-- relatively generous pay increases, bonuses, and tax breaks to public sector and governmental employees who constitute approximately one-third of total employment in the economy and two-thirds of urban employment;

-- small, gradual, and unpublicized policy reform measures (aimed largely at decreasing the size of the direct subsidy bill and at reducing "luxury" imports, including consumer durables).

-- clear, unwavering GOE support for the continuation of the "open door" policy that encourages foreign investment and private participation in the Egyptian economy (although "productive" -- meaning commodity producing -- rather than commercial ventures are to be stressed);

-- diversification and promotion of actual/potential trade and economic assistance ties, including Western Europe, Japan, other Arab countries and, to lesser degree, Eastern Europe;

-- increasing pressure to liberalize or increase the flexibility of U.S. economic assistance.

-- unfaltering emphasis on productivity, as reflected in weekly public statements/events and in the debate surrounding the formulation and approval of the new Five Year Plan 1983-87.

4.04 It is not clear at this time what the long-term GOE adjustment/reform strategy may be. Although a "production first" strategy of economic reform (not possible to raise consumer prices until increases in production and productivity justify comparable wage increases) is implied by the new Five Year Plan, it is doubtful that either stop-gap or gradual reform measures by themselves can bridge the gap between the present and the postulated changes, even if they were to come about. More likely the strategy that will evolve, both by intent and by force of circumstances (or default), is a gradual continuation of some blend of unpublicized genuine reform and stop-gap measures, while at the same time looking for major new sources of foreign exchange (which quite possibly will come with political strings attached, if obtained). We will explore this set of predictions in greater detail next.

B. Likely Pressures and Possible Responses

4.05 Likely Pressures -- Although far from being fundamentally healthy in any long-term sense, the economy has not ended CY 1982 in the occasionally predicted crisis state. Current indicators such as aggregate real economic growth and official measures of inflation are quite favorable despite major increases in balance of payment current account deficits, GOE budgetary deficits, and growth in money supply. The GOE, through a combination of recent policy changes discussed in preceding sections, the resort to commercial credit domestically and externally, and other measures normally taken during a financial squeeze (delay in payments, deferment of expenditure decisions, borrowing from government trust funds, etc.), has managed to end CY 1982 in a temporarily "stabilized" fashion.

4.06 Nevertheless, many of the underlying factors dictating future economic conditions are relatively unfavorable and probably suggest a steady and increasingly rapid deterioration of the economic situation. This deterioration will be reflected most evidently in growing balance of payments current account deficits and GOE budgetary deficits and, consequently, in growth of domestic money supply and external commercial debt. Ultimately, because the situation will be untenable, the consequences must be felt in lower economic growth and higher prices. The "crunch" can be forestalled as long as the GOE can come up with the means to finance its current highly consumption-oriented policies. In the absence of the necessary finance, something will have to give.

4.07 <u>Possible Responses</u> -- Although the <u>apparent</u> deterioration (reflected by the degree of non-autonomous financing of balance payment and budgetary deficits) probably can be forestalled for another 18-24 months by purely stop-gap measures, the GOE must increasingly bring into play remedial, fundamentally corrective measures to both bring the situation under control <u>and</u> to set the stage for future growth. Resort to repressive or stop-gap measures may bring the situation under control (and may even be necessary on a temporary basis) but, generally speaking, will not lay the foundations for long-term growth and stability in the financial accounts.

4.08 This is not to say the GOE has run out of potential options alternative to fundamental economic reform measures, or that Egyptian leaders would not choose them should they become available. It is conceivable, for example, that large-scale Arab assistance, petroleum in some guise (through increased oil prices, production, or new oil finds), or other similar fortuitous events might stave off fundamental reforms. Nevertheless, the GOE has a limited amount of time in which to find new sources of finance for its current set of consumption oriented policies, to dramatically change that orientation, or to compromise between the two. Otherwise, the remaining alternative is to finance current consumption at the expense of investment and, hence, future growth (or perhaps some combination of the three basic choices).

4.09 The GOE's options unless it comes up with major new sources of foreign exchange, essentially amount to reducing or suppressing the trend in aggregate consumption levels or reducing the share of aggregate investment in GDP. It obviously is conceivable that public financed consumption and/or investment may tend to be sustained at the expense of private consumption and investment. It also is obvious that the trade-off between consumption and investment or between public and private shares of the economy can be accomplished by stop-gap, essentially deliberalizing, measures that basically supress basic tendancies or by genuine reform measures that tend to correct basic tendencies by going to the root of the problem. The extent to which the GOE sticks to the latter type of measures determines the longer term prospects for growth. The more the GOE reverts to the former type of measures, the less likelihood that Egypt's current problems ultimately will be resolved.

4.10 In the near term the GOE is likely to focus the bulk of its policy attention and efforts on resolving its most pressing and immediate economic problems, at present the growing balance of payments and GOE budgetary deficits. This is both understandable and necessary in order to deal with the immediate threat to economic stability. However, as implied above, the balance of payments and GOE budgetary deficits are merely symptoms of basic economic dysfunction, not the root cause itself. The GOE is presumably well aware of this distinction. The GOE must be equally aware that it has a number of options available to deal with its current problems, including (i) the specific components of the balance of payments and budgetary accounts it choses to act upon, (ii) the range/type of policy instruments available to achieve a chosen objective, and (iii) the order in which the policy actions might be taken.

4.11 In the most simple terms, in order to "balance its payments", the GOE must either take steps to reduce its imports, increase its exports, increase net capital inflows, or perform some combination of the above that results in a satisfactory balance of payments situation. Similarly, in order to "balance" the domestic budget, the GOE must increase its revenues, decrease its expenditures, find suitable non-inflationary financing, or come up with some combination of the above that satisfactorily "balances" the budget. Obviously, there are a great number of choices that might be pursued within any given component of either the balance of payments or the GOE budget. In order to get some idea of the range of potential choice, Figure 4-1 sets out some of the basic options. In reviewing the options it is important to realize that many of the policy measures the GOE might take to contain balance of payments pressures also will help to contain domestic budgetary pressures, and vice-versa. Also, it should be understood implicitly, even though it will not be discussed here, that complementary monetary, financial and banking policies will be required for the GOE to achieve balance in either its external accounts or the domestic budget.

Figure 4-1
GOE Options with Near Term or
Immediate Financial Impact

It is important to realize that most measures the GOE takes to contain balance of payment pressures also will help to contain domestic budgetary pressures and vice-versa.

Balance of Payments

Imports

- reduce/ban "luxury" imports
- reduce subsidized commodity imports
- reduce intermediate and capital imports

Exports

- increase petroleum exports (through increased production or reduced local consumption)
- capture greater portion of worker remittances
- increase sales of military production
- increase agricultural/manufactured exports (few near-term prospects)

Captital Account

- increase short-term commercial borrowing
- increase long-term commercial borrowing
- increase draw down rate on foreign assistance pipeline
- increase new bilateral assistance commitments and draw down (with increasing emphasis on balance of payments support)
- increase multilateral assistance
  - IMF stand by
  - IMF structural adjustment loan
  - IBRD structural adjustment loan
  - IBRD project lending
- reschedule debt payments

(Obviously, the GOE could devalue by unifying the present multi-exchange rate structure, probably at something above the present commercial bank rate. Nevertheless, the potential benefits on import demand are partially lost to the extent the GOE continues to subsidize imported consumption goods or does not pass along full costs to public sector enterprises.)

GOE Budget:

Expenditures

- reduce direct consumer commodity subsidies by a) decreasing subsidy levels, b) decreasing number of items subsidized and/or c) better targeting of recipients

- reduce public services presently subsidized such as electricity, water and sewerage, transportation, etc.

- reduce current account maintanance, repair and operating type expenditures

- postpone cost-of-living increases in entitlement type programs

- reduce/postpone GOE and public sector investment

Revenues

- impose new taxes, increase existing rates or expand existing coverage (most likely to be directed toward excise consumption taxes and custom duties on imports)
- increase energy prices
- more effectively enforce current tax legislation
- increase rates charged for public services and utilities
- increase prices on the output of public sector enterprises so that an economic return is made on capital

Financing of Deficit

- increase borrowing from banking system
- increase non-banking finance (includes net foreign financing, social insurance and pension funds, domestic bonds, saving certificates, postal savings and energy bonds)

4.12 Likely GOE Responses - The single most fundamental cause of the GOE's current balance of payment and budgetary problems is its insistence on underpricing of consumption. Nevertheless, it is relatively safe to predict that this will be one of the last things, reluctantly addressed by the GOE in its search for ways out of its current and growing policy dilemma. Other predictions on fundamental GOE options are possible as well. In particular, four basic choices the GOE is likely to make over the next 18-24 months will set the general tone of the policy environment over the next few years. First, the GOE is likely to attempt to sustain consumption at the expense of investment, and at the expense of greater inflation should it become necessary. Second, the GOE is likely to focus more on restraining outflows (imports and budgetary expenditures) than it is to promote inflows (exports and government revenues) simply because it is easier to obtain relatively certain results faster. Third, the GOE is likely to favor direct policy controls (licensing, quotas, rationing, prohibitions and other non-pricing regulatory controls) that work against the pricing system over indirect policy instruments (taxes, pricing, interest rates, exchange rates) that work through the pricing system. Again, this is in part because the former instruments prima facie tend to be more certain and immediate in their impact, despite the greater disruption and costs imposed on the economy. Fourth, the GOE is likely to attempt to maintain public expenditure (consumption and investment) at the expense of the private sector (consumption or investment) if it seems necessary.

4.13 Slightly more specific GOE policy responses to reduce expenditures (outflows) in rough order of their likelihood of being taken (some are already partially in process), are set out below:

(i) "Luxury" consumption will be suppressed (particularly durables)

- taxes, credit controls, import licensing, outright prohibition
- other measures to reduce demand and divert supply from "own exchange" (basically private sector) market

(ii) Investment will be postponed/sacrificed to consumption

- public investment will fall as percentage of total budget
- capital and intermediate imports will fall as percentage of commodity imports

(iii) Maintenance and repair expenditures will be postponed

- public infrastructure will tend to deteriorate more rapidly than at present

(iv) Basic services, quality and quantity, will be cut back

- lack of current account and operating expenses
- deterioration of capital
- insufficient price/service charge increases

(v) Basic consumption will be gradually restrained

- reduction in range of commodities subsidized
- reduction in eligible recipients/quantities supplied per capita
- small, gradual (but insufficient) price increases

4.14 The most likely GOE actions to increase revenues (inflows) and, failing that, to find financing, in order of their probability of being taken, are:

(i) Oil production will be increased, even to uneconomic levels of production

- oil may be pumped at volumes that diminish overall output from reserves. Pressures to overproduce increase as world market prices continue to soften.

(ii) Short-term commercial financing and suppliers' credits will be increasingly utilized

- relative scope is limited, however

(iii) Egypt will seek greater Arab capital

- political concessions could be implicit since relatively little left to be done to induce economic capital flows. Egypt's relative barganing power depends on its economic condition.
- Arabs under own budgetary pressures because of falling oil revenues, thus less likely to be as forthcoming as might otherwise be

(iv) Egypt will seek greater Western bilateral assistance

- pressure will be placed on U.S. and Western Europe to be more forthcoming

(v) Egypt will revert increasingly to inflationary financing

(vi) Egypt will reluctantly revert to IMF as it becomes necessary

- Egypt will choose multilateral assistance that requires/implies fundamental reform as one of its last resorts

4.15 In considering the above GOE options, it is useful to keep in mind that no single action is likely to resolve the current budgetary and balance of payment problems. "Luxury" imports, for example, constitute less than 5% of total imports if we use consumer durables as a proxy. "Own exchange imports" (a good proxy for private sector imports) still accounted for less than 17% of the total import bill in 1981. Similarly, although private sector investment has grown remarkably since 1973, it still accounts for only 30% of total gross fixed investment in the economy. In sum, to make up for deficits in the LE 3-4 billion range, it will be necessary for the GOE to look beyond the "easy" choices.

4.16 In actual fact, there are few easy choices in cutting back either on imports or on GOE budgetary expenditures. Intermediate and capital imports already constitute over 60% of the commodity import bill, while primary (mainly food) and consumer commodities (including consumer durables) make up the balance. Almost 30% of commodity imports are food or food-related. On the budget side the situation is no easier. Two-thirds of budget expenditures are for current account and the balance is for investment. Of the current account, which is virtually equal to total GOE revenues at present, the vast bulk of the expenditures are for wages, salaries, public authority (utility) deficits and direct consumer subsidies. Thus, it is clear that the GOE has little room to maneuver before it is either cutting into politically sensitive basic consumer consumption or government employee incomes, or before it must begin cutting back on investment or production spending.

C. Implications for AID/GOE Policy Dialogue

4.17 A relatively sensitive period lies ahead in USG/GOE relations because of the magnitude and probable worsening of the GOE budgetary and balance of payment accounts. The GOE will look to the USG as the situation worsens with the expectation that a true friend will step in, when help is needed. How the USG reacts to this probable GOE approach can enhance our relationship and build on the reasonably sound foundation that exists, or can easily detract from the relationship. The GOE needs no lectures on what their problems are (although the problems may be misrepresented at times) and will not appreciate amateurish kibbitzing from the sidelines. Nevertheless, this should not prevent AID, and the USG more generally, from holding to developmentally-sound policy positions in negotiating terms of assistance or in offering constructive solutions to GOE policy dilemmas where analysis seems to show promise.

4.18 AID generally should be firm and consistent in dealing with project-related pricing and cost recovery issues, if for no other reason than to provide the GOE with an opening wedge (or excuse) on the pricing issues. As previously noted, gross underpricing of consumption lies close to the heart of the current economic dysfunction. Nevertheless, AID should be flexible enough to meet the GOE part way where significant, although incomplete, policy reform is adopted. A brief summary of relatively obvious implications for the AID/GOE policy dialogue follows in Figure 4-2.

Figure 4-2
Implications for GOE/AID Policy Dialogue

(i) Time is running out. The GOE must take some form of action.

(ii) The GOE will be tempted by stop-gap/repressive measures. AID should encourage GOE to take longer view where possible and take corrective measures.

(iii) The GOE will wish to focus dialogue on symptoms and current urgencies (e.g., size of deficits, commodity shortages, etc.). AID should focus dialogue on causes and policy actions required for long-term adjustment.

(iv) The GOE will increasingly press for balance of payments support. AID should point out that, as long as we finance highest GOE priorities (i.e., things that would have been financed by the GOE anyway), then implicitly AID is providing balance of payments support because of budget fungibility. Further, AID should point out that over 60% of total program is essentially balance of payments support at present and that all local cost financing is not only balance of payments support but also "free" (untied) foreign exchange. Also can note that U.S. assistance provides both balance of payments support and GOE budgetary support.

(v) The GOE will continue to argue that it cannot introduce full cost-recovery in pricing or in rate setting on political grounds. AID generally should follow consistent policy of not financing anything that should normally involve full cost-recovery but is not designed to do so, and note that it would work against long-term GOE interests for the U.S. to provide such financing. Nevertheless, AID should be prepared to consider substantial reform proposals, even if incomplete, in order to encourage the general reform movement.

(vi) It is not necessary for AID to be heavy-handed or to apply "pressure" in order to bring policy issues to the attention of the GOE. The issues are probably fairly well understood and they are surfacing on their own accord. AID and the USG should try to support and extend the GOE's own reform actions. What AID might usefully contribute are practical, possibly innovative, but certainly well thought-out approaches for addressing the issues. Direct AID/GOE collaboration on analysis of issues selected by the GOE, and their hopeful resolution would, of course, be an ideal policy dialogue format.

APPENDIX I

Scope and Methodology

The scope of this review is limited by the choice of time periods, the subject (problem) areas selected for consideration, the definition of "policy change" adopted, the criteria on which the significance of a policy change is evaluated, and the information sources utilized.

Time Period -- The choice of the time period 1974-82 is relatively straightforward. It coincides with a major shift in the political-economic strategy of Egypt following the October 1973 War and it marks the resumption of strong U.S.-Egyptian relations. Given the significance generally attached to the Al Infitah ("Open Door") strategy enunciated in the October Working Paper of April 1974, it seems appropriate to contrast subsequent events within its context as well as the economic situation from which it was initiated. Because of the particular economic problems exhibited in the current balance of payments and budgetary deficits, and the significance of the Sadat-Mubarak leadership transition, we have focused on policy changes in greater detail for the years 1981 and 1982 than for the 1974-82 period as a whole.

Subject Areas -- The selection of subject (problem) areas for the policy change review was limited in three ways: (i) by perceived importance to the overall Egyptian development effort, (ii) by the particular focus of USAID interest, and (iii) by the quantity and type of information sources that we had time to utilize. As such, this review is not to be considered comprehensive in either the subject areas covered or the policy changes that occurred within the selected subject areas. The review is economically oriented in nature, with a heavy focus on cross-sectoral policy changes. This bias is the result both of the perceived relative importance of cross-sectoral policy changes to Egyptian development and the limited number of sector-specific information sources that could be consulted.

Definitions and Criteria -- The definition of a "policy change" and the judgment of its significance is not straightforward. A relatively narrow definition of "policy change" might confine itself to formally issued statutory, regulatory and executive acts. A broader definition might not only include new laws, new regulations and executive orders but might also include informal changes in administrative practices (e.g., personnel, management and organization) and changes in the implementation or enforcement of existing laws, regulations and executive orders. An even broader definition might also include greater willingness to change administratively determined values of existing policy instruments or to expand their traditional operating limits. In principle, we choose the broader definitions of policy change (formal as well as informal actions) as most relevant to our needs. In practice, it is difficult to detect the informal type of policy change. We have considered them for inclusion in our review where we are aware of their existence.

If it is difficult to decide what constitutes a policy change, it is perhaps even more difficult to assess its significance. Obviously, a policy change of a cross-sectoral nature will tend to have greater potential for impact than a sectoral policy change of the same order of magnitude. Nevertheless, any given sectoral policy change in a key economic sector may well outweigh the importance of minor changes at the cross-sectoral level. Other difficulties encountered in assessing significance include (i) differentiating between intent and effectiveness of a policy change (exceedingly difficult), (ii) recognizing the cumulative significance of several small actions of the same genre, and (iii) distinguishing between initial policy impacts and (yet-to-be recorded) cumulative or potentially ultimate impacts.

<u>Information Sources</u> -- A wide variety of information sources have been utilized for this review, including IBRD, IMF, ILO, GOE and USG studies, reports, and project papers. However, most information considered in this review has been taken from secondary (non-GOE) sources. In addition, because extensive examination of sector specific studies was not feasible, a cross-sectoral economic bias understandably has occurred. Nevertheless, the results of the review of policy changes are considered of significance because it is believed the most fundamental problems facing the Egyptian economy are largely of a cross-sectoral nature or have their roots in a political-economic philosophy that permeates the way business is conducted in all sectors.

APPENDIX II
SELECTED GOE POLICY CHANGES 1974-75

Foreign Trade, Payments, and Investment

1973

- The "parallel market" for foreign exchange, was established in September 1973. The parallel market, in effect, created a legal free market for specified imports. Coverage of the "parallel market" gradually was enlarged. By the mid-1970s a substantial depreciation of the exchange rate had been achieved by progressively transferring transactions from the official exchange rate to the parallel market rate.

1974

- Al Infitah ("Open Door") policy introduced. Signaled major shift in GOE attitude toward direct private foreign investment and the domestic private sector. (See main text for greater discussion.)

- Law 43 of 1974 was intended to encourage Arab and Western capital inflows and to allow private sector activity in consumer goods production and light manufacturing. Most activity has been in form of joint ventures with public sector companies. Direct foreign investment, largely a result of Law 43 and petroleum investment, currently is averaging about $700 million a year. Through the end of 1981, the number of projects approved by the Investment and Free Zones Authority, the administrative organ of Law 43, totalled 1626. Total value of approved projects was LE 9.0 billion. Around 1000 projects (valued at LE 5.4 billion) were in operation or under construction.

- The State Trading Organization, which previously had a total monopoly on foreign trade, was abolished.

- The "own exchange" (free foreign exchange) import market was established.

1975

- The Suez Canal reopened in 1975 as part of the Egyptian-Israeli disengagement agreements. Foreign exchange earnings rose from $33 million in 1975 to $780 million by 1980/81. The Suez Canal became the third most important source of foreign exchange behind petroleum and workers' remittances and the second most important source of revenue in the GOE budget, again behind petroleum.

- Private sector import licensing requirements abolished. Negative import list of 28 commodities established instead.

1976

- Law No. 97 of 1976, which permitted individuals to hold foreign exchange, is considered one of four primary factors in increasing the "openness" of the Egyptian economy. Egypt's exchange and trade system has changed radically since the mid-1970s, moving from a very restrictive system to one which, although complex, is in most respects quite liberal. The most important factor contributing to this liberalization was Law No. 97 of 1976 which gave private sector individuals and firms the right to hold foreign exchange and to engage in foreign exchange transactions, provided only that the transactions were carried out through commercial bank accounts. As a consequence of this legislation, a free and legal foreign exchange market has emerged, principally supplied by workers' remittances, which grew rapidly after 1975. With the development of this market the private sector has been able to import freely. "Own exchange" imports amounted to some 16 percent of total imports in 1980/81.

- New system of licensing imposed on all "own exchange" imports, with licensing being granted primarily for imports of intermediate goods.

1977

- The Foreign Investment Law of 1974 was amended in 1977, correcting a number of features of the original law that had hampered the timely implementation of investment projects, e.g., the amendment notably allowed all foreign exchange transactions for such projects to take place at the more advantageous parallel market rate.

- Major restructuring of Egypt's foreign debt occurred in 1977-80. This involved a substantial lengthening in the average maturity of the debt and a decline in the proportion borrowed on commercial terms. This was accompanied by a more careful monitoring of short- and medium-term debt. As a result, repayments of long-term debt remained roughly stable despite a considerable increase in the level of outstanding debt.

- Open General License System established for imports in place of specific import licenses.

1978/79

- New customs regulations were introduced requiring cash remittances (deposits) on customs duties payable on luxury imports.

1979

- Official and parallel exchange rates were unified on January 1, 1979 at $1 = .70 LE. Access to exchange at this rate was provided to public sector importers under the foreign exchange budget. However, private sector importers continued to rely almost exclusively on the free ("own exchange") market.

<u>1980</u>

- Extensive reduction in import duty rates and a broadening of exemptions occurred in May 1980. Import duties were reduced for a wide range of commodities, including consumer durables, and the total number of items exempted from such duties was increased. Customs duty exemptions were extended to several new commodities, including frozen fish, meat, chicken, butter, edible fats, sugar, fertilizers, pesticides, tractors, pumps, and iron for reinforcing concrete. At the same time, rates were lowered on imported "essentials," and the maximum duty rate on luxury items was lowered from 300 percent to 150 percent.

- Further import duty rate reductions were introduced November 1980 on a selected range of raw materials and intermediate goods with the intention of assisting domestic manufacturers. Affected items included leather, portland cement, inputs for paper production, wood for furniture productions, and chemicals.

- Amendments to regulations covering private sector "own exchange" imports were introduced in June 1980 and August 1981. Some delays were reported to have occurred in the issuance of import licenses following the latter change.

- Effective July 1, 1980, commercial and foreign currency banks were required to ensure that 15 percent of their foreign currency deposits could be made available on call, if necessary, to the Central Bank. Nevertheless, the private sector and, to a lesser extent, the public sector still enjoys a large measure of discretion in deciding whether or not to surrender their foreign exchange to the banking system.

<u>1981</u>

- The Council of Ministers (May 1981) prohibited public sector companies from buying foreign commodities in the domestic market for Egyptian currency. The intent was to reduce demand for "own exchange" imports (indirectly supplied to public sector companies via private sector firms) and thereby ease demand for hard currency on the free market.

- A series of fundamental changes in the exchange rate and foreign exchange regimes were announced, effective August 1, 1981. The changes were intended to stablize the Egyptian pound and to reduce the spread between the official and free market rates by decreasing and controlling the demand for hard currency. The steps taken were:

-- commercial banks were instructed by the Central Bank to sell foreign exchange at $1 = .84 LE instead of the old unified rate of $1 = .70 LE.

-- the .70 LE rate will be used only for certain official GOE transactions, including Ministry of Supply imports and calculating earnings from exports on petroleum, cotton, rice and Suez Canal revenues.

-- a new comittee under the chairmanship of the deputy director of the Central Bank will periodically review exchange rate developments and adjust the commercial bank ($1 = .84 LE) exchange rate accordingly;

-- the minimum subscribed capital in the formation of new Egyptian/foreign joint venture companies was increased from 33 to 50 percent.

-- commercial banks were required to provide foreign exchange on demand to private sector importers at the $1 = .84 LE rate to meet a specified proportion of the import cost of certain items: intermediate and capital goods at 40% of import CIF and non-luxury consumer goods at 25% of import CIF.

-- the 25% hard currency deposit on the "own exchange" importation of non-luxury consumer goods and the 40% deposit required on imports of intermediate and capital goods must now be paid in domestic currency rather than foreign exchange.

-- the 100% hard currency deposit required for "luxury" imports will be retained and now will be required three months instead of one month in advance.

-- an imports rationalization committee will now screen all requests to import in light of GOE policy and foreign exchange availability.

- Further revisions occurred in foreign exchange regulations during September, 1981. The GOE moved to restrict the use of FX banknotes in Egypt, requiring proof of origin. The GOE also stipulated that export of surplus FX bank notes by commercial banks must be approved by the Central Bank.

- "Special accounts", which the private sector could hold in foreign currency without having to prove the external origin of the deposited funds and which could be used to finance "own exchange" imports, were abolished in September, 1981.

- Additional regulations to deal with the foreign exchange problem were announced in November, 1981. All foreigners are to pay hotel bills in hard currency, effective 1/15/82. The central bank also announced new credit restrictions on import financing by commercial banks. (See section on monetary, financial and banking policy.)

- The decline in worker remittances beginning in 1980/81 may reflect certain administrative restrictions and uncertainties that have affected the flow of "own exchange" imports (in addition to other factors).

- Sequestered property since 1958 is to be restored to its rightful owners by Presidential Decree # 141/1981. Compensation in case of sale is specified.

1982

- The minister of Industry and Mineral Wealth banned the import of any locally produced items unless local production fails to meet domestic demand on January 26, 1982.

- Prime Minister Mohieddin announced on February 20, 1982 changes in the "own exchange" system, including a return to the original practice of full payment for "own exchange" imports in foreign currency. The categories of imported goods were revised, and the GOE's Import Rationalization Committee structure was strengthened.

- The attempt to move toward a unified exchange rate in a nonrestrictive environment (measures announced August 1, 1981) was formally abandoned in March 1982 when new regulations were introduced that effectively returned to the situation prevailing prior to August 1, 1981, with certain modifications. Effective March 1, 1982, commercial banks are no longer required to supply foreign exchange at the "incentive" rate ($1 = .84 LE) to private sector importers (already abandoned in practice). Advance import deposits are again to be made in foreign exchange (rather than local currency), with the size of deposit ranging from 25-100% depending on the category of import. Private Sector imports continue to be financed by the use of the "own exchange" (free) market.

- A list of 47 commodities were added to the negative import list for private sector importers. Ministerial Decree 1036 (1978) of the Ministry of Economy was amended March 2, 1982, to include 47 new items. The list of commodities, created in 1978, was mainly for essential food stuffs and security items that could not be imported by the private sector unless specifically approved by the Ministry of Economy. The measure was designed to provide protection to domestic industries producing the same commodities.

- Legislation was issued in March, 1982 creating "import accounts" that could be opened in foreign currency in commercial banks in the names of Egyptian Nationals. Such accounts could be opened within a 3-day period following their return to Egypt without having to provide documentary proof of the origin of the funds. Once an import account is opened, the foreign currency can be transferred at a freely determined rate.

- The GOE decided not to import frozen chickens for six months effective March 1, 1982, reportedly due to adequate supplies being on hand.

- On April 15, 1982, the Ministry of Industry and Mineral Wealth reiterated the Egyptian policy to encourage foreign participation and investment in the Egyptian mineral sector using a concession or joint venture format.

- A new import ban initiated May 1982 affects food items such as luxury cheeses, apples and bananas.

- Public sector banks are reportedly beginning to quietly pay market rates for foreign exchange in the "own exchange" market and to pass on these costs to public sector companies.

- The role of the Import Rationalization Committee was reduced, effective July 10, 1982, to the review of Category A imports, covering food and medicines. Categories B, C, and D were dropped. A new Decree amends both Decree 1036 of 1978 and Decree 39 of 1982. (Note: the committee was given its review role less than five months earlier.)

- The Egyptian Import-Export Bank is to be strengthened. Established in 1979 with LE 10 million capital, it never really functioned. The GOE is planning to increase its capital to LE 50 million and to carefully consider the type of export financing the bank should provide. The GOE is considering emphasis on export guarantees rather than direct loan commitments in order to leverage export financing.

- It is now stated (informal) GOE policy to hold consumer subsidy payments constant at LE 2 billion in nominal money terms. Exactly how adjustments are to be accomplished is presently left "flexible."

- The GOE has stated its intention to decrease the deficit on current account balance of payments from LE 2 billion to LE 500 million by the end of the 1983-87 Five Year Plan. The GOE has committed itself to increase oil export earnings at an 11% annual rate over the Five Year Plan -- whether through increased prices, increased production or decreased domestic consumption.

Monetary, Financial and Banking

1975

- The system of sectoral specialization (four nationalized commercial banks with each bank taking responsibility for a specific subsector) was abolished in 1975. The government-owned banks were given greater scope to put their dealings with public sector entities on a more commercial basis. They have also greatly expanded the scope of their activities with the private sector.

- Since 1975, 49 new banks have been established under the Foreign Investment Law of 1974.

- The Banking Law of 1975 removed the statutory ceiling on interest rates and, in its place, empowered the Central Bank to fix maxima according to prevailing monetary and credit conditions.

1976

- A maximum loan-deposit ratio for commercial banks was established.

- Private sector has been permitted to hold foreign currency deposits since 1976. (Note: interest rates on foreign currency deposits are not regulated.)

1978

- The loan-deposit ratio was replaced by absolute ceilings on expansion of credit to the private sector (note: rapid expansion of private sector credit has occurred since 1976 - to the point that over half of the credit expansion in 1981/82 went to the private sector).

1979

- Once a year, during 1977, 1978, and 1979, the structure of interest rates was raised, with larger increases being made to longer-term deposit rates.

1980

- The structure of interest rates was raised April 1980.

- Adjustments took place in June 1980 and January 1981 that essentially raised interest rates for longer-term deposits and loans.

- The Central Bank was empowered to require both commercial and foreign currency banks to hold reserves on their foreign currency deposits since mid-1980. The Central Bank exercised this power in September 1981, setting a reserve ratio of 15 percent on each bank's foreign currency deposits (less certain permitted deductions) and paying interest rates on reserve deposits comparable to the rates prevailing in Euro-currency markets.

1981

- Interest rates on pound investment certificates and deposits at commercial banks were raised one percentage point, effective January 1, 1981. New rates range from 8.5% on 3 month deposits to 12% on 10-year investment certificates. (Nevertheless, interest rates on LE deposits are still only half of those offered on dollar savings.) Interest rates on ordinary loans were set at 12% per annum. Loans extended by the newly created National Investment Bank will be a minimum 9.5% per annum.

- The GOE agreed to pay 6 percent in the first half of 1981/82 for credit granted to it during that period and 9.5 percent in the last half for credit extended any time in 1981/82. (Interest rates on loans to Government have been well below interest rates in general. Until the beginning of 1981/82 the rate was generally only 1.5 percent.)

- Eleven provincial banks of the National Bank for Development were established in the first half of 1981/82. Each was registered separately as a commercial bank and has responsibility for a particular governorate.

- The Central Bank announced a new loan-to-deposit ratio and partial credit ceilings in November 1981. Each bank's ratio of loans to public sector companies and to the private sector is not to exceed 65 percent of its deposits from the same sources. Banks which were in violation at the time that the ratio was announced were to submit to the Central Bank a timetable showing how they intended to achieve compliance.

- Also in November 1981, the Central Bank retroactively reimposed partial ceilings on banks' credit to the private sector. Each bank's credit to the private sector for commercial purposes was not to grow by more than 9 percent overall (September 81 - January 82) and 3 percent within each quarter. In addition, each banks' credit credit to households (for any purpose) was not to grow by more than 7.5 percent for the whole period (September 81 - June 82) and 2.5 percent for each quarter.

1982

- Two new Central Bank of Egypt circulars were issued effective July 1. The circulars set higher interest rates for LE deposits, introduced discrimination by sector into bank lending rates, and tightened the restrictions on import financing of automobiles and consumer durables.

- The first circular revised the local currency interest rate structure of commercial banks. The CBE discount rate was raised from 12 to 13 percent. The basic savings account rate was raised from 8.5 to 10 percent. Rates for certificates of deposit of one year or more went up by 1 to 1-1/2 percent. Borowing interest rates were revised from the previous 13-15 percent range to introduce greater discrimination by sector in favor of agriculture and industry. (Note: foreign currency rates never have been controlled).

- The second Central Bank circular bans the financing of sales or purchases of automobiles or imported consumer durable goods effective July 1, 1982. The regulation covers all entities, both private or public sector companies, and all transactions in the Free Zone. Consumer durables covered include refrigerators, freezers, washing machines, radios, televisions, recorders, video machines, electrical fans, vacuum cleaners, air conditioning units, furniture, carpets, stones, ovens, air-heaters, water-heaters, kitchen appliances, etc.

- The Central Bank of Egypt recently has been trying to tighten up enforcement of existing credit ceilings on commercial banks' ability to create credit. The current rule is that credits outstanding cannot exceed 65% of a bank's deposit base, although many foreign, joint venture, and new private Egyptian banks far exceed that ceiling.

- According to the Ministry of Economy, December 1982, credit is being directed to "productive" sectors through a combination of direct controls and differential interest rates.

Budgetary and Fiscal

1976

- The General Income Tax Law was revised. Levels of marginal tax rates on the highest-income brackets were substantially reduced. Taxation of agricultural income exceeding LE 1,200 a year was introduced. A progressive tax on specific capital transactions, covering the sales of buildings (and land) and cars by individuals, was introduced; taxes on commercial profits were changed to give relief on capital gains. The size of family exemptions was increased .

- The tax evasion office, which had been abolished in 1972, was re-established. Incentives to tax office employees for collection of a larger amount of taxes were increased (3% of additional revenues up to 4 times monthly salary).

1980

- Extensive reduction in import duty rates and a broadening of exemptions. (See Foreign trade, payments, and investment.)

- Excise taxes on cigarettes and soft drinks were increased with the 1980 budget, and the price of gasoline was raised; these increases were retained in the 1980/81 budget.

- A policy decision was made to increase the availability of basic food items through imports.

- A proposed 4 percent sales tax in the 1980 budget was not implemented.

1980-81

- Budget actions taken in the 1980/81 and 1981/82 budgets included:

  - 20% reduction in business profits tax rates
  - increased exemptions from customs duties
  - rescission of some administered price rises
  - tighter control over output prices of public sector companies
  - substantial upward adjustments in public sector wages and salaries
  - enlarged subsidy payments

- The GOE budgetary procedures were markedly simplified, with effect from 1980/81. Several budgets were consolidated; many extrabudgetary funds were eliminated. To allow economic authorities more operational flexibility, their budgets are to be prepared separately and are excluded from the state budget.

- Several changes in budgetary preparation and expenditure control procedures with regard to investment outlays began to be implemented with the 1980/81 budget. A National Investment Bank (NIB) was established and given wide responsibilities for investment expenditures both on the Government's own account and for the rest of the public sector. All spending agencies were required to submit requests for authorization of investment expenditures on a project-by-project basis. These requests, which include anticipated costs over the gestation period, including financial implications for current fiscal year, form the basis of the annual investment budget. These procedures have the effect of removing the aggregate amount and composition of investment expenditure from the control of the Ministry of Finance. The NIB also was made responsible for the monitoring of actual investment expenditures.

<u>1981</u>

- Excise taxes on relatively minor items were shifted from a specific to an <u>ad valorem</u> basis with the 1981/82 budget (matches, wool blankets, playing cards, cotton thread, etc).

- Farmers were exempted from national security and defense taxes as part of 1981/82 budget presentation.

- Excise taxes on 125 imported and locally produced "luxury" goods were increased or established in mid-1981. The measures should add about LE 250 million to GOE revenues and reduce the demand for luxury goods.

- Government and public sector employees received a tax break effective November 29, 1981, when higher (20-45%) tax exemption levels were applied to annual salaries. New annual exemption levels range from LE 720 to LE 960 depending on marital status and dependents.

<u>1982</u>

- A law reforming the income tax system came into effect in early 1982. Its principal objectives were to streamline and otherwise improve collection procedures, to declare a moratorium on past failures to comply with income tax requirements, to reduce rates substantially and to raise exemptions to levels that were seen as more likely to promote compliance by taxpayers, and to revise the penalties for noncompliance.

Income Tax Law 157 (1981), effective January 1, 1982, replaced seven older laws (Nos. 14 of 1939, 99 of 1949, 155 of 1950, 7 of 1953, 95 of 1973, 27 of 1977, and 46 of 1978). Law 157 represents a comprehensive reform of income tax laws and is viewed as a step toward unification of the tax strucuture, i.e., a movement toward a simplified flat rate tax structure. The law specifies three main categories for taxation (corporate bodies, financial companies and individuals), sets new tax rates and structures, specifies tax incentives to encourage productivity and promote private and public investment, and exempts income of foreign experts working for 6 months a year in Egyptian firms. In general, the most important change is believed to be the decrease in tax rates across the board, although the tax structure did not shift downward proportionately. The law is believed to encourage the private sector and is most favorable to corporate profits and personal income in the top brackets (e.g., top administrators and professionals). For example, the corporate tax rate was reduced from 41% to 32%. The law also increased the base tax exemption allowed on personal income.

- The consumption tax was raised and coverage was extended. A presidential decree, effective July 6, 1982, significantly revised the consumption tax system by extending coverage from 53 to 124 commodities, domestically produced as well as imported. New ad valorum rates were established, ranging from 5 to 100%, depending on the commodity. (Commodities covered are considered "luxuries" by the GOE and include such items as cigarettes, high octane gasoline, refrigerators, air conditioners, beer and liquor, clothing, pharmaceuticals, cosmetics, electric appliances, phonograph records, wrist watches, etc.)

-A new Five Year Plan (FY 83-87) was approved by the Cabinet. Goals include attracting more investment and reducing the balance of payments deficit by increasing foreign currency receipts from remittances, tourism and Suez Canal tolls. The GOE also wishes to increase exports, reduce imports and provide more jobs. The budget deficit is to be reduced by strengthening the tax department to increase tax collection and enforcement. Subsidies are to be better targeted.

Pricing and Subsidies

1977

- The "food riots" of January 1977 occurred after the GOE announced price increases on subsidized bread and flour. The price increases were rescinded.

1978

- 28 commodities were released from price control.

1979

- A whole range of price increases were permitted, including cement (56%), gasoline (32-38%), cigarettes (8-13%), and soft drinks (33-40%).

1980

- Policies were introduced in February 1980 aimed at reducing wheat and flour subsidies. The policies were streamlined further in June 1980. As a result of the two decrees, the weight and quality (i.e. flour extraction rate) of the various types of bread were changed, and the prices for high-quality flour products were raised. The GOE increased the rate of extraction for flour used in the production of balady bread. The purpose was to target subsidized bread increasingly to the poorest segment of the population by making the bread generally less desirable, i.e., of lower quality (1980). A second, higher quality bread was further improved and had its price raised in 1982. The price of traditional Balady bread was increased from 1/2 piaster to 1 piaster, but with an improvement in quality and weight.

- A number of significant output price increases for public sector companies were made in conjunction with the budget originally issued for calendar year 1980, but following the change of Government in May 1980 most of these were withdrawn. The GOE rolled back the price increases on several hundred items produced locally by public sector firms. Prices remained frozen through December 1980 and other items, notably meat, were added to the list of price controlled goods. Subsequently, there has been a tendancy to raise prices only by means of changes in the product mix and product differentiation. Public sector companies were instructed not to raise prices without authorization.

- The only major change in GASC's sales prices in recent years were the 1980 increase for wheat and flour. Minor increases in the price of rice, sugar, lentils and beans were introduced in the 1980 budget. Apart from these changes in prices, the subsidy system has not been significantly modified at this date.

- Electricity rates and petroleum product prices were raised on average by 20%. See Energy section.

1981

- Agricultural procurement prices were increased. See Agriculture section.

- A time table for closing the gap between domestic and international energy prices was announced by the Government in January 1981. According to the timetable, domestic petroleum product prices would be raised on average by one-fifth of the difference between domestic and international prices each year for a period of five years.

- The subsidy of "Helwan Tihina," a popular sweet made of flour, sesame paste and sugar, was to be reinstated to reduce its price between 10 and 20 percent. The cost of this subsidy was estimated at LE 8.5 million. The subsidy originally was eliminated in the 1979 budget when it equalled LE 7.5 million.

- Petroleum product prices were increased for Law 43 joint-venture companies as part of a phased program of energy price increases for this group.

- "Price watchdog committees" were formed in each governorate in a strengthened effort to maintain controlled prices during May 1981.

- Egyptian postal rates were raised on July 1, 1981. Domestic rates were increased 50%, inter-Arab rates 33%, and international rates 64%.

- Non-residential telephone service rates were increased in December 1981.

1982

- The per capita rice ration was reduced from 1.5 Kg. to 1.0 Kg. per month in February 1982, although the official price of 14 piasters per kilogram remained unchanged. Rice on the black market brings 35 to 40 piasters per kilogram.

- The GOE raised the price of premium gasoline from 13 pt/liter to 15 pt/liter in March 1982 (approximately 53¢ per gallon at the "own exchange rate" of $ 1 = 107 PT). Although the price of gasoline is still substantially below world market prices, the price increase (15.4%) is a step in the right direction and is expected to be followed by other upward price adjustments.

- The cabinet on April 7 approved electricity rate increases ranging between 5-20 percent for customer categories other than heavy industry. The increases are expected to generate LE 10 million in additional revenue.

- The cabinet issued a decision on May 23 forbidding any governmental or public sector organization from raising prices without specific GOE Cabinet approval.

- A new brand of cigarettes (Sinai brand) was to be introduced after Ramadan at 45 piasters a pack compared to 35 piasters for "super" (100 mm) domestic cigarettes. This is an example of GOE efforts to substitute new higher priced goods and later phase out the cheaper product.

- Cabinet decided to create a technical price secretariat in its July 28 meeting which would monitor prices and receive complaints of citizens.

- The Ministry of Supply announced lentils would not be distributed through ration cards after November, and fava beans after December. Margarine and soap were removed from ration books several months ago.

- Agricultural procurement prices have been periodically raised 1976-82. See Agriculture section.

- Over the period of 1980-82 the GOE dramatically increased the price of subsidized red meat sold through government stores. Prices increased from 90 PT/kg to 250 PT/kg during this period.

- An increase in water rates was noted by the Prime Minister, 12/82.

- The GOE has quietly, but publicly, indicated its intention to freeze the nominal level of the subsidy bill by raising prices, reducing the number of subsidized items or reducing the categories of beneficiaries.

- The GOE greatly reduced the range of consumer items imported by the government at the subsidized FX rate of $ US 1 = 70 PT for sale through government/public sector stores (late 1981 and 1982).

- The GOE has continued to phase out price-controlled items and replace them with higher priced improved goods. This "product mix" strategy is the GOE's major effort to reduce subsidies for secondary commodities, e.g., pharmaceuticals, cigarettes, laundry soap, packaged rice.

<u>1983</u>

- The Ministry of Supply intends to issue ration cards later this year in order to better target subsidized consumer commodities. Two kinds of ration cards will be issued. The first (green) card will entitle the owner to "full subsidy". The second (red) card will provide a "partial subsidy" and will apply to owners of commercial shops, tourist facilities, transport companies, import and export bureaus, commercial agents, etc.

- A Ministerial Decree has been issued by the Ministry of Supply that forbids the acquisition or use of fine, subsidized flour, either directly or indirectly, in manufacturing or retail establishments serving the public, including hotels, restaurants, snack shops, casinos and investment companies. Severe fines and penalties for infraction were specified.

Wages, Employment and Emigration

1974

- Foreign exchange policies were enacted to induce transfer of remittances, i.e., establishment of parallel exchange market in 1973 and the right for individuals to own foreign exchange accounts in 1974.

- Exit visas were abolished and replaced by travel permit obtainable at one's place of work.

- Issuing of passports was decentralized. In principle there were to be available at almost every police station within 24 hours.

1975

- Parliament ratified the treaty for manpower movement among Arab countries.

- The new nationality Law No. 26 for 1975 allowed the principle of dual nationality.

- "After 1976 there was a new outlook at the problem of emigration and the government reinstated (sic!) new polices and measures to encourage migration". "What the previous laws, decrees and policy indicate is that labour migration, whether permanent or temporary is carried out in a framework that is conducive and encouraging to it". Amr Mohie Eldin, "External Migration of Egyptian Labour", paper submitted to ILO, September 1980, pgs. 6-7.

1978

- Guaranteed public sector employment for military conscripts, which was initated in 1964, was abrogated for this group in 1978.

- Law 48 gave public sector companies considerable freedom to set their own employment policy, including hiring and setting of total compensation package. Largely freed public sector companies from requirement to hire secondary and university graduates.

1980

- Minimum wage increased by 25%.

- Public sector wages, salaries and pensions were increased.

- Coverage of social security system extended.

- Public sector wages and salaries were exempted from defense and natural security taxes.

- Starting salaries for graduates were raised, the guarantee of public sector employment for all graduates was renewed and steps were taken to accelerate their employment.

- Substantial increases in public sector pay scales were introduced with the 1980 budget and were subsequently augmented in the budget for 1980/81 (estimated LE 530 million combined increase).

1981

- Further increases in public sector pay scales were granted in the 1981/82 budget (estimated LE 600 million). Sadat announced major pay boosts for GOE workers effective July 1981.

1982

- The Ministry of Manpower and Training issued a decree (No. 25) effective February 13, 1982, stipulating the conditions under which foreign expatriate workers may work in Egypt.

- In February 1982, a Presidential Decree was issued on terms and limits of GOE incentive pay. Limits are believed to be three times basic salary. In effect, this device allows the GOE to raise pay levels on a selective basis.

- President Mubarak on June 29 ordered an LE 4 "social increment" to be added to the paychecks of all government and public sector employees and government pensioners. The effect is raise the monthly public sector minimum wage 11.5%.

- The Companies Law 159 (1981), effective April 1982, together with Law 43 (1974) eliminated private sector salary guidelines and largely freed the private sector of any labor-related controls.

Decentralization

1975

- Local councils formed by direct election at various levels.

- Local elected councils given right to interrogate government executives, but right reduced to raising questions with executives in 1979, but partially reinstated in 1981.

- Law 52 (1975) provides for establishment of special accounts "local services and development fund" at the local council level. Funds in this account do not devolve to the Central Government if they are not spent at the end of the fiscal year.

1977

- Eight economic regions and regional planning councils were established, with the main purpose being to help set priorities for allocation of central and local government resources and to develop social and economic development policies at the regional level.

1978

- Governorates took full control over all local technical and administrative staff, including those appointed by ministries.

1979

- Ministerial Committee for Local Government replaced by Board of Governors.

- Regional Planning Commissions established for the eight planning regions.

1980

- National Investment Bank formed and used to channel significantly more investment funds, from national treasury, directly to the local units.

- Law 43 (1979) is perhaps the most significant law in a series of laws attempting to delegate more authority to local units of government. This law changed the rank and status of governor from deputy minister to full minister. This law also provides for the establishment of two additional special accounts -- special revenue from cultivated or reclaimed land sale and special revenue to finance economic housing projects within governorate.

1981

- Expanding on Local Government Law 43 of 1979, and Law 52 of 1975, Local Government Law 50 (1981) further increased the ability of local government to borrow and expanded its role in designing/implementing revenue earning projects. It attempts to better define the financial resources of the governorates and their sub-divisions. However, it restricts local government authority related to service charges, including the restructuring of local rates. Confirmation of changes in local service charge-rates now rests with required decisions by the Prime Minister's office. Law 50 established a Higher Council of Local Government, chaired by the Prime Minister, to implement decentralization guidelines. This Council comprises each Governor and each Chairman of the governorate's elected Popular Council. The law added several new sources for special account to finance economic housing projects, including: (i) receipts from the tax imposed on vacant land by Law 34 (1978), (ii) receipts from rents and payment of installments of governorate-owned houses, and (iii) rents and installments paid for replacement houses built in the three cities of the Canal Zone.

- The GOE has continued to allocate significant resources to local government (revenue sharing) during 1981 and 1982. Between 1979 and 1982/83 the budget for local government investment increased from LE 80 million to LE 295 million.

- Elected councils increasingly involved in decisions regarding delimitation of local government units 1975-81.

- Functional responsibility for several government services progressively transferrred from central to local units.

- The types of local revenue earmarked for local funds have increased 1979-81.

1982

- Responsibility for provision of services to the public continues to be redelegated from central to local government units. For example, Housing Law 272 (1982) transfers functional authority for housing from the central government to local government.

- Functional staff of service ministries transferred from central ministries to local units.

Energy

1973

- Ministry of Petroleum established to oversee the overall management of the sector. Exploration activities intensified, in part because new agreements with international oil companies were almost exclusively of the production-sharing type whereby the oil companies were made responsible for all prospecting and once oil was found, a part of production was earmarked for cost recovery. It was an Egyptian decision to negotiate the profit sharing contracts with foreign oil companies that made Egypt an attractive place to invest.

1974

- A Ministerial Committee on Energy was set up to coordinate the work of the different energy agencies, to review the present organization of the energy sector, to consider the most economic way of the Committee meeting its requirements to consider legislation, and to take decisions on joint issues concerning ministeries and agencies engaged in the energy field.

1978

- Egypt has managed to reap the benefits of oil price increases because exports of crude are sold through one-year contracts, but price is set at delivery according to market conditions. Petroleum prices almost tripled from October 1978 ($11.89/barrel wtg. avg.) to 1980/81 ($33.29/barrel - wtg. avg.).

- Development of natural gas fields undertaken to reduce consumption of fuel oil by large public sector industrial users (date not given) - IBRD assisting in finance of Abu Qir gas field in Nile Delta.

1980

- GOE increased prices of petroleum products by about 20%, with the exception of the prices of LPG and fuel oil, which remained unchanged. Electricity tariffs for residential and small commercial users were also increased on average by 20%. (Nevertheless, average weighted domestic petroleum product prices remained below 15% of world prices.)

1981

- The GOE announced its intention to look to nuclear-fueled electric power generation in the future. Intent is to build 8-10 plants of 9600MW total capacity. A new law was to be passed that would earmark $500 million annually in hard currency from petroleum sales for the "nuclear account". Several bilateral nuclear agreements are under negotiation or have been approved since the statement of intent.

- The Ministry of Electricity and Energy has made a policy determination that 5% of Egypt's energy will come from renewables by the year 2000.

- Price of fuel oil charged to companies operating under Foreign Investment Law 43 was increased to world market prices.

- Decision made to substitute domestically-produced natural gas for far more expensive imported butagas.

1982

- The Energy Policy Planning Project (263-0123), signed 1982, represents a decision by the GOE to systematize the planning of Egypt's energy development and use in the years to come.

- GOE has agreed to increase the price of natural gas from the Abu Kir gas development project (IBRD 3475-EGT) to a level which would recover the marginal cost of production plus a depletion allowance. This implies an estimated $1.10/MCF compared to present price levels of $0.20/MCF. Neverthless, the IBRD estimates the opportunity cost of the Abu Kir gas at slightly in excess of $4/MCF.

Agriculture

Pre-1973

- Although government intervention in agriculture goes back to the 19th century, it became more widespread following the 1952 revolution. A full array of interventionist instruments were in place by 1973 (nationalization of cotton trade, control of international trade in horticultural products, exchange controls, price differentials, compulsory delivery quotas on export crops, credit and input controls, input subsidies, acreage controls, etc.).

1976

- The principal Bank for Development and Agricultural Credit received its charter.

- Area requirement and compulsory delivery regulations for domestic wheat production were suspended (and have remained suspended) since 1976.

1979/80

- Prices of some inputs were raised for the second consecutive year. Fertilizer prices were increased by 25% to LE 30 per metric ton. However, a further increase in the farmers' share of the cost of pest control operations for cotton, intended for 1980, was not implemented; the state continued to carry about two-thirds of the total cost of these operations.

- The second adjustment in the agricultural land tax was put into effect.

1980

- Agricultural procurement prices were raised for several crops in May 1980; subsidies were increased for credit and pesticides. Prices have been raised periodically since 1976.

	Average Percent Increase	
	1976-1980	1980
Wheat	9.2	20.0
Rice	10.2	15.0
Seed Cotton	13.1	10.0 a/
Sugar Cane	13.2	30.0
Beans	14.2	25.0
Lentils	18.6	14.3
Onions	13.1	9.8

a/ GISA 45 variety only.

1981

- Agricultural procurement prices increases, effective July 1, 1981. Total project benefits for farmers estimated at 222 million, of which LE 22 million are from tax relief and LE 200 million from procurement price increases.

	July 1981 Price Increases	New Prices	% Increase
Cotton (all varieties except GISA 45)	LE 10/Kantar	(B)	22
GISA 45 Cotton	LE 15/Kantar	(B)	30
Rice, Unmilled	LE 10/MT	LE 85	13
Onions	LE 7/ton	LE 57	14
Sugar Cane	LE 3/ton	LE 16	23
Peanuts	LE 67/ton	LE 333	25
Sesame	LE 83/ton	LE 625	15
Fava Beans	LE 64/ton	LE 226	40
Lentils	LE 125/ton	LE 375	50

1 metric Kantar = 157.5 KG
(B) = prices vary by type

- The Higher Planning and Policy Ministerial Committee, chaired by Deputy Prime Minister Mohieddin decided on December 28, 1981 to decrease cotton acreage by 7 to 8% in FY 82-83, i.e., from 1,178,000 feddans in FY 81-82 to between 1,080,000 and 1,100,000 feddans in FY 82-83. This was the second consecutive year cotton acreage had been decreased. Domestic L.E. procurement prices also were reduced 19 to 20 percent, depending upon variety, for the 1981-82 season as a result of the downturn in world prices.

- The Higher Committee for Planning and the Higher Committee for the Green Revolution decided, December 9, 1981, that the Ministry of Supply should set maximum and minimum vegetable prices and that each governor should be allowed to set vegetable prices within those limits in light of prevailing conditions.

- Formation of Supreme Council for Agricultural Extension.

1981-2

- Increased pressure by Ministries of Agriculture and Irrigation on donor assisted projects to disseminate research/demonstration results for general use at a faster rate.

- Establishment of a "Consumption Committee" by the Ministry of Agriculture to study ways of reducing consumption (implicitly provides vehicle to discuss pricing policies).

- The Ministry of Agriculture consolidated of project management of functionally related donor-assisted projects under single project directors (e.g., five donor projects relating to mechanization were consolidated under one director).

- Ministerial decree consolidating research and extension functions (recommended by both the BIFAD Extension Team and the Presidential Mission).

- Transfer of "Old-New" lands from the Ministry of Land Reclamation to the Ministry of Agriculture (organizational rationalization).

- The Principal Bank for Agricultural Development appears to have substantially reduced the number of branch banks that act as wheat procurement agents in 1981-82.

1982

- GOE procurement price increases, generally ranging from approximately 6 to 36%, were promulgated for wheat (local and HYV), rice, fava beans, soy beans, sugar cane, and cotton.

L.E./MT

	1982	Percent Increase	Domestic Price As Percent of World Market 1/
Rice	95	12	26 %
Wheat (local)	93	21	62 %
Wheat (HYV)	100	20	90 %
Fava Beans	239	6	76 %
Sugar Cane	18	13	99 % 3/
Seed Cotton 1/ (Giza 45)	447	28	63 % 4/
Seed Cotton 1/ (Aug Wtd)	407	36	

1/ $1 = .84 L.E.
2/ 1980/81 compared to 1981/82.
3/ Domestic procurement price of sugar compared to international sugar (not cane) price.
4/ GOE domestic procurement priceof cotton (lint) compared to international price.

1983

- The status of reform in the agricultural sector: the view from the governorate of Minoufia (Nota bene: this is based on a field trip to a single governorate by Richard Fraenkel/USAID 1/83. Fraenkel concludes in subsequent field reports on Gharbiya and Qena Governorates that important differences apparently exist in the administration of the agricultural sector both within and between governorates.)

1) The production of all crops is voluntary with the exception of cotton; the area devoted to cotton is going down, and it now occupies approximately 10% of the cultivated area of the governorate; cotton has a 3 year rotation, and many farmers never grow it. (Note: on a nationwide basis, cotton, sugar, and rice have mandatory acreage requirements in areas where they can be grown.)

2) The marketing of all crops is voluntary with the exceptions of cotton (100%) and beans (2 ardebs/feddan); that is, if a farmer choses to grow beans, then he must deliver 2 ardebs/feddan to the Principal Bank -- but the initial decision to grow beans rests with the farmer. (Note: marketing requirements exist for other crops on a nationwide basis, if they are grown, e.g., in rice growing areas, farmers must deliver 1 1/2 tons of rice/feddan to the government.)

3) The Principal Bank (the government's procurement arm for agriculture) appears to be of decreasing importance in terms of the volume it handles or total agricultural production whereas alternative channels (for export -- see 4 below) and private traders appear to be handling increasing volumes.

4) Specialized export marketing institutions, both public and private, exist, and they have been handling an increasing share of production during the 1st few years; farmers receive a greater percentage of world prices for the horticultural products (chiefly potatoes and green beans) that are marketed for export than for the same products sold on the domestic market (Rood El Farig prices).

5) Export prices are announced in the governorate and adjusted for timeliness of delivery according to export price fluctuations.

6) Horticultural products are graded according to 3 standards, and marketed according to the highest value channel that quality permits.

7) Extension is working more closely with the Agricultural Research Center in Cairo than ever before due to organizational changes announced last year.

8) The cropping pattern of the Governorate is shifting towards horticultural and livestock production, and away from grains and fibers.

Industry

Pre-1973

Inward looking - Import substitution has been dominant feature since 1930.

1973

- Establishment of parallel exchange market made foreign exchange available to economic agents who previously were denied access to it, but at a higher price than the official rate. See Foreign Trade, Payments and Exchange section.

1974

-Law 43 (1974), amended by Law 32 (1977): Sweeping law intended to cover joint ventures between Egyptian and foreign capital. In fact, composition can be anything from 100% Egyptian to 100% foreign (the latter by special approval). No "foreign" investment in construction -- this is confined to Arab capital. Banks may be 100% foreign if they are branch banks.

- Companies deemed to be in private sector: pay market prices for electricity but are free to set output prices.

- Liberal employment conditions: no LE 5,000 limitations on salaries, no other restrictions on salaries or employment practices.

- Foreign Exchange: can maintain foreign currency accounts; can repatriate profits freely; foreign employees pay no taxes and can repatriate 50% of earnings. All foreign exchange transactions are at the own exchange rate.

- Trade: can export without a license; capital imports are also free of license requirements.

- Tax holiday: liberal tax holiday of 5-10 years, extensions for "important" projects. Dividends disbursed are also tax free during this period as long as taxes are not due in the home country. After the tax holiday, an annual 5% of capital invested continues to be tax free.

- Office buildings and "above-average" housing free of rent-control.

- Cannot be nationalized.

- Applies only to new investment; replacement investment cannot be organized under this law.

- Creation of "own imports" scheme whereby Egyptians holding foreign exchange abroad were permitted to use these funds to import commodities from a special list.

1975

- Sector specialization of four public sector commercial banks removed with Banking Law 120.

- "Small loans scheme" to cater to the needs of artisans was instituted by the commercial banks in 1975.

- Law 111 (1975)

- Part of the re-structuring of public sector administration. Defined spheres of decision-making for board of directors, chairman and general assembly.

- General Assembly had the power to remove chairman and board. Also approved company balance sheet, etc., and increases or decreases in enterprise capital.

- Board of directors given considerable control over the operation of the company. Prepared draft general plan, other plans for production and equipment renewal and replacement, provision and development of finances, etc.

- Chairman to implement board's policies.

- One key provision was that public ownership of a company could not be diluted. New private capital could be raised only if public capital were raised also by the appropriate percentage. For wholly public companies, private capital could not be introduced.

1978

- Forced hiring of military conscripts by public sector companies under Law No. 14 of 1964 terminated.

- Public Sector Labor Law No. 48 (1978). The board of directors of a public sector enterprise has the authority to determine wages and salaries in line with job evaluations for incentives and recruitment purposes within maximum and minimum wage levels set by government. Guaranteed employment of graduates essentially no longer enforced.

1980

- National Investment Bank established to evaluate public sector projects, mobilize and channel investment funds to the public sector, and help ensure the timely completion of projects.

1981

- Companies Law 159 (1981) simplifies procedures for forming joint-stock and limited partnership companies, and makes it mandatory for relevant government agencies to respond to an application within thirty days. Law 159 grants all Law 43 rights (highly market oriented) to domestic firms, except repatriation of profits. Largely frees domestic firms from restrictive labor regulations. Public sector companies can form Law 159 companies as wholly-owned subsidiaries. Executive regulations approved in late Summer 1982.

1982

- Decentralization of management authority and responsibility in public sector firms: budget responsibility and authority for specialized technical assistance and training services shifted from the Ministry of Industry and Mineral Wealth to individual firms.

- Encouragement of private sector and domestic producers in the garment-manufacturing sector more generally: Ministry of Supply agreement with Ministry of Industry to purchase up to a set quota of ready-made garments from domestic private sector firms, as well as a set quota from public sector firms (rather than to rely primarily on Chinese imports). This will require an improvement in the quality of goods produced and the productivity of domestic firms.

- Better targeting of industrial development resources: (1) In 1982, a delegation of Egyptian public and private sector industralists met with potential vehicle-assembly feeder industry investors in Chicago, Spain and Italy. More meetings are planned. (2) AID approved the Minister of Industry's request for a feeder industry study (1982). (3) Ministry of Industry is holding regular sectoral meetings to provide more coordinated approaches to the individual sectors.

- The Bilaterial Investment Treaty between the U.S. and Egypt signed in June 1982, helps to clarify the ground rules for investors and to ensure equitable treatment of U.S. investors within Egypt. The treaty has not yet been ratified, however.

- Investment Minister Shindy cited several decisions he has made since his ministerial appointment (1982) to improve the investment climate. Examples included a) decentralization of decision making in the Investment Authority, b) removal of the requirement that public sector banks have approval of the Prime Minister for investment decisions, c) clarification that joint ventures are not subject to pricing rules and d) approval of 50 projects during three meetings of the Investment Authority.

- A "new" public sector law proposed by the Ministries of Industry and Economy has been discussed twice by the Supreme Committee for Policies and Economic Affairs and reportedly was presented to the Council of Ministers. The law is expected to provide substantially greater managerial autonomy by placing more decision making authority at the company level. The proposal under study reportedly includes provision for individual companies to establish their own system governing workers and to set prices on a cost plus basis. In addition, public sector companies reportedly would be provided most of the commercial advantages of Law 43 companies with respect to wages, prices, finances, imports, etc. (apparently at the expense of forgoing present subsidies or subsidized inputs).

Infrastructure

Water and Sewerage

1979

- Presidential Decree No. 363 established the Alexandria General Organization for Sanitary Drainage (A/GOSD) separating it from the national GOSSD.

1981

- Decree No. 198 establishing the Beheira Water Company, recognizes the merit of bringing more responsible management to provincial water supply operations.

1982

- Increased GOE attention to water and sewerage requirements is reflected in new Five Year Plan which shows LE 3.4 billion in planned investment compared with actual investment LE 0.7 billion for the twenty year period 1960-80.

Electrical Power

1980

- The GOE increased electricity tariffs for residential and small commercial users by an average 20%.

1981

- GOE announced intention to build 8-10 nuclear power plants of 9600 MW total capacity. See Energy section.

1982

- Electricity rates for residential and low and medium voltage business consumers were increased in April 1982. Rate increases varied by level of consumption but averaged approximately 10% for these consumers.

- Electric power rate increases were enacted November 10, 1982 for high voltage consumers Nag El Hammadi Aluminum and Kema Fertilizer which together are responsible for 20.2 percent of national electricity consumption. Although rates are still low in terms of internationally valued production costs, the rate increases were the first since 1975 and were 50 and 60 percent, respectively.

Electricity Authority of Egypt
Electricity Rate Actions

Consumption-Category Of User	Date of Last Increase	% Equivalent Of Last Increase	Proposed New Increase	Possible Date Of New Increase
1. Residual				
a) Up to 100 kwh/mo	(1)	-	15-20	April '83
b) From 101 to 250 kwh/mo	April '82	10	15-20	"
c) More than 250 kwh/mo	"	20	15-20	"
2. Commercial				
a) Up to 75 kwh/mo	(1)	-	15-20	April '83
b) From 76 to 100 kwh/mo	April '82	5	15-20	"
c) From 101 to 250 kwh/mo	"	10	15-20	"
d) More than 250 kwh/mo	"	20	15-20	"
3. Special Categories (2)	"	10	15-20	"
4. Irrigation & Drainage Companies	"	5	15-20	"
5. Industrial Users				
a) Kima	Nov. '82	59.63		
b) Nag Hamadi	"	49.75		
c) Others	(3)	-	15-20	April '83

(1) Not known to AID
(2) Medium and low-voltage non-residential and non-commercial consumers (e.g., government offices, housing companies, etc.)
(3) Unknown to AID, but believed to be no later than 1976.

Housing

1975

- Redirection of the cooperative housing program to shift from upper income projects to middle income level.

1976

- Low Income Housing Fund created within the Ministry of Housing and Reconstruction to finance low cost housing.

- Law 106 (1976) replaced Law 45 (1962). Stiffer enforcement procedures and new building regulations allow governor to set different standards in different areas.

1977

- Landlord/Tenant Law No. 49/1977 is the principal statute covering landlord/tenant relations and the rent control system. Allows landlord to increase annual rent to 20% of cost of major improvement, limited to 50% of present value of building.

1979

- Law 43/1979 established a special account to finance economic housing projects within the governorates. Decision-making regarding this function is primarily local in character. The central government Ministry of Housing employees at the local level are responsible to the governor who has power over hiring and firing.

- Law No. 59 of 1979 established a government agency, the New Urban Communities Authority, which is the sole governmental body responsible for creation and management of new urban communities established outside of the boundaries of existing towns and villages. The Authority was given a number of local governmental powers as well as several types of authority not possessed by units of local government.

- Law No. 20/1979 controls the establishment of industrial zones in cities and their surrounding areas.

1981

- Housing Law 136 (1981) is a small but important first step towards relaxing the rent control and other housing laws that have made the private housing industry operate outside the law. Law 136 redefined the relationship between tenant and landlord, loosening and restructuring rent controls to encourage new construction -- while still maintaining protection of lower income consumers. Represents a compromise among various economic, legal and housing interests and is expected to close a series of loop holes in the present law. Allows one-third of a new building to be sold for any price obtainable but requires remaining two-thirds to be leased at a rate not exceeding 7 percent on the value of land and structure. Landlords will be allowed to increase rents on January 1, 1982 for 5 consecutive years (1st rent increase in Egypt since 10% raise in 1968). Amount of increase will depend on age of building. Half of the increase is to be used for maintenance and repair of the building. The bill specifies the reasons a landlord may evict a tenant.

1981

- GOE housing policy (related to Project 263-0066 and in accordance with objectives of the project paper) has moved from providing complete built-out housing to sharing core housing, sites, and service costs with residents.

- Planning Law 2/1982 attempts to devolve planning activities but gives little new responsibilities to local units of government. The law establishes a framework for planning including the mandatory requirement for the preparation of urban and rural master plans. The local town councils, in cooperation with General Organization Physical Planning in the Ministry of Development and Reconstruction, would propose such master plans.

- Decree No. 272-1982 transfers several housing functions from the Ministry of Housing to local government to include but not limited to the land subdivision; supervision of construction work; selling and/or renting of furnished housing premises; land and building expropriation as may be needed to carry out approval housing plans; and installation of necessary potable water facilities. The terms Ministry of Housing and Minister of Housing are also to be transferred to the concerned governorates wherever they are to be found in laws, rules and decisions dealing with above duties and responsibilities in the housing field. In addition, Law 272/1982 transfers all employees concerned in the above activities with their current grades, positions and privileges from the Ministry of Housing to the local concerned governorate units.

Telecommunications

- No significant policy changes are believed to have occurred.

Suez Canal

Mid-1970s

- It was an Egyptian decision to widen and deepen the Canal and to install a traffic monitoring system that would increase the Canal's transit capacity.

1981

- Suez Canal tolls to be raised an average 5 percent, depending on size of vessel, effective January 1, 1982. The scale of Suez Canal toll charges, denominated as previously in SDRs, was substantially revised with effect from January 1, 1981 so as to encourage use of the Canal by larger vessels (to take advantage of the widening and deepening program completed in late 1980).

1982

- Further modest increase in the scale of changes was announced January 1, 1982, again favoring larger tankers. The average toll increase was 6.5%.

- Increases of Suez Canal toll rates of 5 to 10 percent were under discussion in late 1982 with major shipping interests.

Human Resources and Technology

Education

1974

- Establishment of the National Council for Education, Scientific Research and Technology, which is responsible for planning the country's overall education strategy.

1981

- Education Law 139 (1981) provides for a re-defined and more relevant basic education curriculum and for expanded access through more classrooms and better siting. It also stresses the vocational/technical school track for secondary students (grades 10-12) in an attempt to reverse by 1985 the current 70-30% split in favor of the academic (general) education track.

1982

- The basic education investment budget (Chapter III) has increased from LE 10.4 million in 1979 to LE 39.7 million in 1982-83. Over the same period, the percentage of the basic education component of the pre-university investment budget has increased from 43.5% to 53.0%.

Health and Population

1973

- GOE announces "The Socio-Economic Approach to Fertility Reduction".

1975

- GOE modifies population strategy.

1977

- An office of Director-General for Family Planning was established within the Ministry of Health with authority to plan, develop and implement an intensified family planning program in all governorates.

1978

- In an effort to upgrade nurses' status, GOE allowed incentive payments to nurses for afternoon and night shifts. Started in 1978 budget with LE 300,000 and in 1982/83 budget reached LE 3.5 million and was extended to all nursing categories, i.e., administrators/supervisors.

1980

- GOE revises national population strategy.

1981

- Since taking office in October 1981, President Mubarak repeatedly has stressed the burden imposed on the economy by rapid population growth. The President has called for an early 1983 Conference on Egypt's population problem. Although this high-level attention to the population program is welcome, Mubarak's concern has yet to be reflected in GOE program efforts. Nevertheless, this type of concern has not previously (actively) been stressed at this political level.

1982

- In 1982, the Ministry of Health formally stated its intention to launch a rural population campaign test, as well as increase significantly by 1990 the proportion of the population covered by the Health Insurance Organization and similar (premium/fee charging) quasi-public sector organizations. This would represent a shift from "out-of-pocket" (and possibly government provided "free care") financing to an insurance financing health care scheme.

- Creation of an Undersecretary for Population within the Ministry of Health. Creation of a Director-General for Population in the Ministry of Health staff within each governorate.

- A Presidential decree made population a responsibility of each governor (1982/3).

- The GOE stated its intention to cut back size of enrollment into medical schools with the purpose of improving the quality of medical education.

- MOH decentralized planning and implementation to Governorates (continuing).

- GOE has increased its emphasis on water and sewage.

- The Peoples Assembly passed legislation requiring training and certification of dayas (traditional birth attendants).

- MOH emphasis on continuing education and training for nurses to develop a cadre of trainers for all governorates.

Science and Technology

1982

- The Second National and Second International Technology Policy Seminars held in November 1982, funded in part by AID, will lead to incorporation of a national technology policy into the Five Year Plan. (An AID financed National Academy of Science S&T policy advisor is working on this subject full time.)

- President Mubarak announced in December 1982 that LE 112 million will be budgeted for development research (applied research) over the next five years. Research will be for production and services in the form of non-academic joint projects between the Academy of Scientific Research and Technology and the Ministries of Industry, Electricity, Agriculture and Housing. (There has been a major shift in emphasis away from basic research to applied research. This policy shift is motivated by the belief that applied research reaches end users and will contribute to the solution of high priority development problems.)