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Annual Report on Economic Conditions in Egypt

February, 1992

I. Summary and Conclusions

A. Conclusions

Egypt should be able to meet its external debt service obligations in 1992 because of the relief provided by external transfers and debt forgiveness provided in conjunction with the Gulf Crisis, the country's foreign exchange reserve situation, and the debt service relief following the Paris Club debt rescheduling.

Egypt should also be able to continue to service its debt in the medium-to-long term if it stays the course on the ambitious economic reform program on which it has embarked (and on which it is making notable progress) and if external factors such as industrial country growth, oil prices, tourism and remittance earnings remain favorable.

B. Background and Summary

For nearly two decades, Egypt's centrally planned economy stimulated consumption and domestic investment through subsidized foreign exchange, domestic consumer goods and resources including energy (see Attachment B for a more complete survey). The principal external sources of funds were oil exports, Suez Canal tolls, remittances from workers abroad and bilateral foreign assistance in the form of loans, credits, credit guarantees and grants. Egypt borrowed heavily during the 1970's and 1980's to finance consumption, infrastructure and military spending. By 1980, external debt stood at nearly $21 billion (98% of GNP and 227% of exports). By 1985, it had doubled to $42 billion before peaking at $55 billion (including arrears) in 1990. This placed the debt/GNP ratio at roughly 163% and the debt/export ratio at about 678%. By 1990, according to World Bank data, debt service absorbed 45% of goods and services export earnings, with 21.8% accounted for by interest payments alone. The bulk of this debt resulted from long term official borrowing from bilateral sources (see Table 5).

Debt service problems appeared in 1980 when Egypt's external debt surpassed GNP and the government began to accumulate arrears to official and commercial creditors to cover growing current account deficits. By 1984, interest payments arrearages had become serious because oil export earnings had declined from their 1981 high and the government was unable to identify new, alternative sources of foreign exchange. From 1984 to 1988, debt service arrears increased from about $1 billion to $4 billion. Scheduled debt service rose from $4 billion in 1983/84 to $7.6 billion in 1990. In late 1984 and through 1985, the government of Egypt began deliberations on the underlying causes of the debt service problem and initiated a number of minor austerity measures, including subsidy reductions. In 1986, following a further decline in the price of oil, with severe macroeconomic imbalances and a dramatic increase in debt service arrearages, the government opened discussions with the IMF for a stand-by arrangement and with the Paris Club for a debt rescheduling.

To stabilize its macroeconomic situation, Egypt negotiated an 18-month stand-by with the IMF, which covered the period April 1987 to October 1988. In early 1987, Egypt rescheduled $7 billion in arrears and maturities coming due to Paris Club creditors in 1987-88. The stand-by called for a number of economic reforms including initial actions to devalue the currency, minor increases in interest rates and budget deficit reduction, primarily through partial price corrections to reduce subsidies. In addition, the IMF and Paris Club understood that stronger measures would be taken before the end of 1987 in order to increase the speed of economic stabilization.

By November 1987, the inadequacy of the Egyptian reform effort became clearly manifested in missed IMF performance targets and the continued deterioration in key macroeconomic indicators. The 1987 stand-by became inoperative and negotiations began in early 1988 for a new stand-by arrangement. By the early summer of 1990, Egypt's lack of foreign exchange threatened its ability to meet Brooke-sensitive debt service payments to the U.S. and the country was estimated to have accumulated $10 billion in arrears. Without help, the economy appeared to be on the verge of a major crisis. The situation changed markedly during the Gulf Crisis and its aftermath, with debt forgiveness, large inflows of donor assistance, a new IMF stand-by and agreement on a World Bank Structural Adjustment Loan. After the first review in December 1991, the IMF Board approved continuation of the stand-by and modified targets for the remainder of the program.

The significant easing of its debt service burden, donor transfers and the economic policy changes implemented during 1991 have greatly strengthened Egypt's capacity to service its debt. However, some difficult times lie ahead if Egypt is to capitalize on its newly found gains. Retaining a better balance in external accounts and growth in the economy will require continued, and sometimes unpopular, comprehensive reform. The donor and creditor response to Egypt's situation since August 1990 has given Egypt what could be its best opportunity to proceed with the needed reforms. Undue hesitation in restructuring the economy could draw the economy back toward the economic morass from which it has just emerged.

II. Developments Since late 1990

The Gulf Crisis of late 1990 was an economic watershed for Egypt. Assistance to Egypt as a coalition partner dramatically changed the conditions which confronted the Egyptian economy. While there were foreign exchange gains from the sudden spike in the price of oil, there were large losses in tourism, worker remittances and some nontraditional exports. Domestic economic pressures for food, housing and jobs increased as Kuwaiti refugees and Egyptian workers fled the Gulf. The business climate was depressed. Without help, the economy appeared to be on the verge of a major crisis. The IMF noted in retrospect that, "In such a crisis environment massive economic disruption was a possibility."

However, Egypt's early and staunch support of the multinational effort to restore Kuwait led to important short-term relief from the country's economic problems. As one of several "front line" states in that conflict, Egypt received substantial levels of new external assistance via the Gulf Crisis Financing Working Group (GCFCG) countries. In addition, the President made a determination that reduction of Egypt's outstanding Foreign Military Sales debt to zero, pursuant to the authority in Section 592 of the Foreign Operations, Export Financing, and Related Programs Act of 1991, was essential to the national security interests of the United States and to enhance the chances for peace and stability in the Middle East. As a prerequisite to forgiving Egypt's $6.7 billion military debt, the statute required the President to seek comparable debt relief from Egypt's other official bilateral creditors. The Administration was successful in this regard. Gulf States and other creditor countries cancelled some $6.2 billion in Egyptian debt. Together, the debt reduction of about $12.9 billion reduced Egypt's debt service burden in the first year alone by $1.3 billion. Other creditor countries chose to take action in the Paris Club framework, which would depend on Egypt obtaining an IMF program.

With the breathing room provided by external assistance and debt relief, movement toward a reform program accelerated. In early 1991, Egypt implemented a number of prior actions required by the IMF, including floating foreign exchange rates, freeing interest rates and raising energy prices. On April 19, 1991 Egyptian authorities formally submitted a request to the IMF for a new stand-by arrangement. On May 17, the IMF Board approved a stand-by covering the period ending November 20, 1992. Paris Club members agreed in May 1991 to reduce Egypt's bilateral debt by 50% of the present value over three years, conditioned on adherence with IMF program criteria.[1] On July 8-9, 1991, for the first time in a decade, a World Bank-led Consultative Group of bilateral and multilateral donors meeting in Paris reviewed and broadly endorsed Egypt's proposed economic structural adjustment program. In June 1991, the World Bank Executive Board approved a $300 million policy-conditioned Structural Adjustment Loan (SAL) for Egypt. The loan was signed on November 22, 1991. In addition, in June the Bank Board approved an SDR 105 million IDA credit for a "social fund" project and $84

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[1] Because this figure reflects the present value of the debt forgiven, data for changes is the debt stock do not necessarily add to these amounts. Rather, the reduction appears more starkly in outyear debt service payment streams, after non-Paris Club arrears are cleared in 1992.

million for a gas investment project.

A. Main Features of the Government of Egypt's Economic Reform Program

The government of Egypt's economic reform program contains three general components: (a) a stabilization effort supported by the IMF to restore macroeconomic balance; (b) structural adjustment measures, assisted by the IBRD and other donors to improve overall economic efficiency; and (c) "safety net" provisions supported by a Social Fund for Development project, financed by IDA and other donors, and intended to cushion the adverse impact of economic reforms on the poor.

These, in turn, are broken down into seven specific target areas:

1. **Macroeconomic reforms** to contain inflation, reduce the balance of payments current account deficit and the government budget deficit and restore international creditworthiness. Toward this end, the IMF targeted fiscal deficit reduction from 20% of GDP in 1990/91 to 10% of GDP in 1991/92 and 6.5% of GDP in 1992/93. Subsidy payments are to be reduced. The elasticity of the revenue system is to be improved. A sales tax is already implemented in one move toward that end. Introduction of a Global Income Tax (GIT) in 1992/93 will be the second major step in a comprehensive tax reform program for which technical assistance is being provided under an AID project.

2. **Financial Sector Reforms** to improve supervision and regulation, strengthen bank solvency and remove impediments to efficient mobilization and allocation of investment resources. Market-determined interest rates have been effected and overall credit expansion is to be restrained to rates consistent with inflation targets.

3. **Public enterprise reforms** including restructuring and privatizing of public enterprises and severing the "umbilical cord" between public enterprises, the government treasury and the banking system. Public enterprises are to be subject to the same rules as private firms and access to credit is to be based on creditworthiness. Public enterprise managers are to be given full management autonomy, including employment decisions. Liquidation of nonviable enterprises will be permitted and privatization is encouraged. A new Public Investments Law has already been enacted.

4. **Private sector reforms** are intended to foster private sector development through dismantling of government monopolies, elimination of numerous

investment and production controls, and creating a "more level playing field" for private firms vis a vis public enterprises in the purchase of inputs.

5. **Price liberalization** aimed at having most prices in the economy determined by market forces within three years. Transport, energy and power prices are to rise gradually to international levels or, in other cases, to equal their long-run marginal costs of production. In January, 1991 rail passenger tariffs were increased by 15 to 40 percent. Cotton prices are to reach 60% of world prices by 1991/92 and 66% in 1992/93, eventually to approach international prices.

6. **Foreign trade liberalization** includes phasing out most nontariff trade barriers, lowering high tariffs, reducing the dispersion of tariff rates, and generally eliminating the anti-export bias in the trade regime. By mid-1991, import bans were reduced from 37% import coverage to 23%. This figure is to fall to 11% of agricultural and manufacturing output. Protection still remains high on certain public enterprises and will need to be a focus of the second phase of liberalization. The multiple exchange rate system is replaced by a single exchange rate that reflects underlying market forces.

7. **A Social Fund for Development**, in addition to softening the impact on the poor, includes the development of institutional arrangements to facilitate labor mobility.

B. Main Features of the IMF Agreement

The IMF stand-by is couched in the context of the complete reform package, of which ". . . the priority objective as stated in the Memorandum of Economic Policy of the Egyptian Government is to create, over the medium term, a decentralized market-based, outward-oriented economy that will restore noninflationary growth and Egypt's creditworthiness." A number of prior actions and performance criteria for the stand-by are spelled out in the Memorandum of Understanding. The agreement calls for two program reviews. The first completed in December 1991, focused on progress on economic and financial policies and on exchange rate and monetary reforms. During that review, understandings were reached on performance targets for end-March 1992, end-June 1992 and end-September 1992. The second review is scheduled for June 1992 and will focus on progress on economic and financial policies.

1. <u>Actions required and completed before signing the Fund Agreement:</u>

Before a Fund agreement could be signed, the government had to certify, among other things, that: it had implemented a sales tax; it had increased customs duty rates by 30%; it had increased domestic petroleum and energy prices to specified levels; it had secured $70 million in additional grant donor funding for 1990/91; it had identified $300 million in additional grant funding for 1991/92.

2. Performance Criteria

Program performance criteria to be monitored during the stand-by include:

a. credit ceilings not to exceed specified quarterly targets;
b. net international reserves at the Central Bank not to fall short of specified quarterly benchmarks through 1991;
c. specified limits on public sector borrowing short term and external debt is limited to specified quarterly amounts;
d. exchange rate and trade regime covenants that call for:
    1. unification of the exchange rate (completed December 1991),
    2. no additional or intensified restrictions on international payments,
    3. no reversion to multiple currency practices,
    4. no new or intensified import restrictions for balance of payments improvement.
e. specified adjusters to (a) and (b), above

B. Main Features of the IBRD SAL

The SAL draws upon the main elements of the broad program outlined in section A, above. The macroeconomic framework dovetails with that worked out with the IMF. SAL conditionality and performance monitoring tend to emphasize the structural dimension of the overall reform effort. The conditions comprise two categories: (a) loan-signing conditions, and (b) conditions for second tranche release.

1. In outline, the **loan-signing conditions**, which were met in November 1991, involved:

    a. promulgation of a new Public Investment law as a keystone of public enterprise reform, and establishment of various institutional, regulatory, and staffing procedures necessary to implement that law and elimination of centralized foreign exchange budgeting for public sector companies;
    b. establishing a formula and time frame for cotton price adjustments to reach international levels;
    c. extension of the liberalized investment law previously enjoyed by only

selected firms.

2. Conditions for the **second tranche release** are detailed in Attachment B. In essence, nine categories of reform are specified: (1) satisfactory progress in macroeconomic reforms; (2) privatization of public enterprises; (3) legal and institutional changes supportive of public enterprise reform; (4) industrial price liberalization; (5) energy price liberalization; (6) agricultural price liberalization; (7) increased privatization of fertilizer and cement distribution; (9) other reforms as set out in the Letter of Development Policy.

III. Changes to Date and What Remains To Be Done

A. General Progress

By any standard, the Government of Egypt has accomplished a great deal since the Spring of 1990 in setting the stage for a comprehensive reform of its economy. In mid-1991, the Government of Egypt presented an list of accomplishments to that point. These included, *inter alia*, President Mubarak's May 1, 1990 announcement of a path-breaking privatization program; approval of the People's Assembly of a new "Public Investment Law;" virtual elimination of investment licensing requirements for private firms, except for a limited "negative list;" streamlining of investment approval processes; beginning the phase-out of public trading monopolies; a 300 percent increase in wheat byproduct prices; a 500 percent increase in the price of petroleum products over the previous five years; a 400 percent increase in electricity prices over the same period; the declared intention of the government to move petroleum prices to their international equivalents, and electricity prices to their long run marginal production costs, by mid-1995; elimination of subsidies on "free" sugar and nonrationed edible oils; reducing the value of industrial production covered by administered prices from 53 percent to 26 percent; removal of all interest rate ceilings; institution of domestic credit ceilings; introduction of a new sales tax; progress toward a revision of the income tax, with target date for a law by mid-1992 and hope for implementation by early 1993; sales of locally-owned public enterprises; breaking the direct credit line between the Central Bank and the Central Government; creating a market for Treasury bills; opening the market to private foreign exchange dealers; and unifying the foreign exchange rate. The agenda is an ambitious one. In all, more than 30 separate reform measures were slated just for the period April-June, 1991.

B. Progress on World Bank and IMF Targets

The loan-signing conditions for the SAL were met by November, 1991. It is too early to measure progress on second tranche IBRD performance measures, but the schedule assumes that these are to be met in mid-1992.

The IMF held its first performance review, as scheduled, in December 1991. The evaluation covered two quarters of 1991; April-June and July-September. The staff concluded that, overall, "Developments under the program have been mixed," citing both positive and less positive developments. While overall macroeconomic reforms remained generally on track, several numerical performance targets for June and September were not achieved. The Board approved continuation of the stand-by and modified targets for the remainder of the program.

Progress under the program:

- o directly specified policy measures called for in the program were generally met on time
  - introduction of a treasury bill market and market-based interest rates
  - inauguration of a sales tax
  - subsidy reductions
  - energy price increases
  - initial banking reforms
  - exchange rate reform
- o better-than-expected growth performance, control of inflation and balance of payments performance
- o external arrearages were much less than programmed, thanks to debt forgiveness and Paris Club rescheduling
- o the treasury bill market appeared to be working smoothly, and in order to compete, banks have had to increase their deposit rates (though still not positive in real terms)
- o the pound was more stable and stronger than expected

Areas requiring continued effort:

- o growth rates of net domestic assets of the banking system exceeded the target
- o growth in credit to the public sector exceeded the target
- o government bank borrowing was above the target
- o revenue and expenditure deviations from respective targets deviated by about 3% of GDP
- o the pace of monetary expansion, if not brought under control, could add inflationary pressures

- o the pace of public enterprise reform was slower than hoped (thereby accounting in part for the better than average growth and balance of payments performances and the excessive credit to the public sector)

According to the conditions of the original agreement, performance targets for the balance of the program were agreed to in December. These, again, include quarterly quantitative performance targets for: net domestic assets, public sector credit, external debt ceilings, clearing of arrearages, and international reserve ceilings. Corrective measures were needed to counter the effects of previous slippages. These include several revenue increasing and expenditure reducing measures, and increased control over credit expansion. June 30, 1992 was set as the new date for eliminating all arrears, rather then December 31, 1991. As in the first phase, performance "adjusters" are included to allow for changes in circumstances such as debt forgiveness or a shortfall in actual debt service payments. The second program review is set for mid-June 1992.

Because of the need to modify the timing for meeting quantitative targets, the phasing of purchases has been likewise been amended for the remaining period of the program. Egypt reportedly made a purchase after the December review.

C. What Remains to be Done?

In the simplest terms, what Egypt needs to do is to stay the course on the reform program that has been inaugurated. In the short term, continued fiscal discipline, restraint in external borrowing, tax reform, control of excessive credit creation, continued trade liberalization, and price liberalization are all key to ensuring that the stabilization effort endures.

However, the key to the long-term viability of the reform effort will lie in measures that decontrol investment, maximize the use of markets as a resource allocation mechanism and privatize public enterprises early and at the most rapid feasible rate. Failure to correct the atrophy that impairs economic productivity and international competitiveness could ultimately undercut the very real, substantial, and hard-won gains that have already been achieved.

The recent history of economic reform attempts in Egypt is not particularly encouraging. Yet, the Government of Egypt seems to be committed as never before to real economic reform, and has never previously taken as many bold steps as it has thus far. The most generally expressed feeling among outside observers is "cautious optimism." While some quantitative targets have been missed, the general thrust is still forward, and to date the government seems ready to counter shortfalls with additional corrective measures. Yet, the remaining required changes are substantial. Despite the best intentions, progress will not always be rapid. The administrative burden of these reforms falls on a small number of government officials and staff, who must simultaneously manage: an IMF stand-by; and World Bank SAL; a Paris Club Restructuring; numerous bilateral aid programs; internal policy reform; and the day-to-day operations of the government. Decisions will be unpopular with one group or another. How far reforms can go before "adjustment fatigue" settles on the population cannot be known at this time, but will be a decisive factor in determining whether this ambitious program will reach fruition.

Attachment A

Tables

Table 1
Egypt: Principal Foreign Exchange Receipts and Government Borrowing
$U.S. Million

	1975	1980/81	1984/85	1987/88	1988/89	1989/90	1990/91	1991/92
Petroleum Exports*	289	3,179	2,891	1,385	1,148	1,229	1,971	1,544
Other Merchandise Exp.	1,402	1,128	1,294	1,713	1,672	1,916	1,916	2,024
Suez Canal	85	780	897	1,269	1,307	1,472	1,662	1,977
Tourism	332	712	410	886	901	1,072	924	1,360
Worker Remittances	366	2,855	3,496	3,384	3,532	3,743	3,755	4,900
Other Transfers	0	0	0	0	0	0	3,364	568
Supplier Credits	70	234	850	480	540	563	553	400
Net Gov't Borrowing	2,300	4,400	5,200	n.a.	n.a.	n.a.	n.a.	n.a.
Total	4,844	13,288	15,038	9,117	9,100	9,995	14,145	12,773

* Excludes foreign company petroleum exports

Sources: 1975–87, Government of Egypt and IBRD. 1988–92, IMF estimates

Table 2
Egypt: Balance of Payments
(million current U.S. dollars)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	Est. 1990/91	Proj. 1991/92
CURRENT ACCOUNT									
Trade Balance	-6254	-6633	-6291	-5367	-6740	-7457	-8296	-7538	-8677
Exports	4033	3883	3236	2585	3098	2820	3145	3887	3568
Petroleum	2640	2589	2027	1225	1385	1148	1229	1971	1544
Other	1393	1294	1209	1360	1713	1672	1916	1916	2024
Agriculture	663	554	475	467	498	372	341		
Other	730	740	734	893	1215	1300	1575		
Imports	-10287	-10516	-9527	-7952	-9838	-10277	-11441	-11425	-12245
Services Balance	53	-326	-687	376	671	671	866	536	3211
Services Receipts	3968	3982	3824	4445	4849	5389	6094	6734	7667
Shipping	521	606	574	508	447	534	536	535	540
Suez Canal	974	897	1028	1148	1269	1307	1472	1662	1977
Tourism	288	410	315	380	886	901	1072	924	1360
Investment Income	1079	1042	914	1042	898	1097	1164	1416	1570
Other	1106	1027	993	1367	1349	1550	1850	2197	2220
Services Payments	-3915	-4308	-4511	-4069	-4178	-4718	-5228	-6198	-4456
Interest due	-2040	-2486	-2443	-2061	-2427	-2543	-2960	-3716	-1784
Other	-1875	-1822	-2068	-2008	-1751	-2175	-2268	-2482	-2672
Worker Remittances	3930	3497	2973	3012	3384	3532	3743	3755	4900
Current Account Balance	-2271	-3462	-4005	-1979	-2685	-3254	-3687	-3247	-566
Official Transfers	772	1097	1209	974	698	756	1094	4775	1648
Cash grants	—	222	567	345	39	45	215	393	165
Commodity grants	772	875	702	629	659	711	879	101[illegible]	915
Unspecified	—	—	—	—	—	—	—	3[illegible]64	568
Current Account Balance (after off'l transfers)	-1499	-2365	-2796	-1005	-1987	-2498	-2593	1528	1082
Memo item:									
Actual Interest Paid			129	1094	785	1123	1686		

(Continued, next page)

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Table 2 (cont'd)
Egypt: Balance of Payments
(million current U.S. dollars)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	Est. 1990/91	Proj. 1991/92
CAPITAL ACCOUNT	986	1418	1942	-747	-352	-414	-1189	-981	1162
Medium, L-term Loans (net)	n.a.	n.a.	n.a.	-429	-529	-331	-1119	-791	884
Drawings	n.a.	n.a.	n.a.	1970	2195	2247	1932	1827	2050
Multilateral lenders	n.a.	n.a.	n.a.	264	246	294	265	167	600
Bilateral lenders	n.a.	n.a.	n.a.	1283	1469	1413	1104	1107	1050
Of which: GCFCG	—	—	—	—	—	—	—	314	368
Supplier/Buyer Credits	825	850	1192	423	480	540	563	553	400
Amortization Payments	n.a.	n.a.	n.a.	-2399	-2724	-2578	-3051	-2618	-1166
To Multilateral lenders	n.a.	n.a.	n.a.	-170	-197	-212	-191	-208	-241
To Bilateral lenders	n.a.	n.a.	n.a.	-989	-1712	-1630	-2146	-1921	-761
On Supplier/Buyer Credits	-1318	-886	-1397	-349	-395	-336	-331	-128	-97
Other Official Credits	n.a.	n.a.	n.a.	-891	-420	-400	-383	-361	-67
OTHER	n.a.	n.a.	n.a.	-318	177	-83	-70	-190	285
ERRORS, OMISSIONS AND DIR. FOREIGN INVESTMENT	1547	1539	2011	221	472	1192	2571	1447	593
OVERALL BALANCE	-513	-947	-854	-1531	-1867	-1720	-1211	1994	2844
FINANCING, BY SOURCE:	513	947	854	1531	1867	1720	1211	-1994	-2844
Change in international reserves [(-) = increase]	-99	-406	-420	-822	-1588	-406	-1103	-5994	-2300
Use of IMF Credit (net)				139	-17	-8		3	102
Accruals (+), Reduction (-) of arrears	612	1353	1274	-1015	277	2134	2314	-9558	-1920
Debt service forgiveness								1279	
Interest								1174	
Amortization								105	
Stock of arrears forgiveness								6393	
Rescheduling				3229	3195			5883	1274
Of Current maturities				1396	3195			2592	266
Principal				815	1942			1246	244
Interest				581	1253			1346	22
Of Arrears				1833				3291	1008
FINANCING GAP									

Source: IMF. For 1990-92, some subcategories (e.g., shipping & other) are AID staff estimates.

Table 3
Egypt's Debt to the U.S. Government
(In U.S. $ Millions)

	Principal Outstanding (as of 6/91)	Arrears* (as of 6/91)	Total Debt Outstanding (as of 6/91)
ESF/DA	2,550.07	10.59	2,560.66
PL 480	2,974.11	2.40	2,976.51
CCC	263.33	0.10	263.43
Eximbank	71.25	2.68	81.93
Total	5,858.76	15.77	5,882.53

Source: U.S. Treasury Department

Memorandum item: 1990/91 debt forgiveness:

Total Outstanding Sept, 1990	11,562.48	936.26	12,498.74
FMS debt forgiveness	5,871.16	855.34	6,726.50
Total after forgiveness	5,691.32	80.92	5,772.24

* Includes interest arrears of 90 days or more

Table 4
Egypt's Projected Debt Repayments to the U.S. Government**
(In U.S. $ Millions)

	1991	1992	1993	1994
Concessional				
ESF/DA	127.1	137.2	162.6	161.8
PL 480	110.4	127.8	147.5	147.2
Subtotal	237.5	265.0	310.1	309.0
Commercial				
CCC	299.3	204.1	133.4	63.0
Eximbank	27.1	26.4	27.5	21.8
Subtotal	326.4	230.5	160.9	84.8
(of which, guarantees)	(279.6)	(184.0)	(68.5)	(1.3)
TOTAL	563.9	495.5	471.0	393.8

** NB: Does not reflect new loans committed after June 1990 nor the effects of the 1991 debt rescheduling, for which estimates are not yet available. Includes service on guaranteed debt not included in Table 3. DOD debt service assumed to be zero.

Source: U.S. Treasury Department

Table 5
Egypt Total Debt 1988 to 1991
(In $ Billion)

Year	1988	1989	1990	Approx. 1991
Total Debt (Long and Short Term)	52.0	51.2	39.9	38.9
Long Term Debt	45.1	43.4	35.2	34.3
Public and Publicly Guaranteed	44.0	42.3	34.2	33.4
Official Creditors	37.7	35.7	27.0	26.5
Multilateral	5.2	5.3	3.7	3.8
Bilateral	32.5	30.5	23.3	22.8
Private Creditors	6.3	6.5	7.3	6.9
Bonds	0.1	0.0	0.0	
Other, Incl. Supplier Credits	5.9	6.1	6.7	3.3
Commercial Banks	0.4	0.4	0.6	0.6
Private Nonguaranteed	1.1	1.1	1.0	0.9
Short Term Debt	6.7	7.6	4.5	3.7
Short Term Debt	4.4	4.5	3.0	3.0
Interest Arrears on Long Term Debt	2.3	3.1	1.5	0.8
Concessional Long-term Debt	16.0	16.8	15.7	15.3
Gross National Product (GNP)	28.3	30.7	31.5	31.9
Exports of Goods and Services	11.6	12.1	13.3	13.7
Imports of Goods and Services	12.8	14.9	15.8	16.2
Government & Guaranteed Borrowing (net)	1.7	0.7	0.4	0.2
Total Debt Service (TDS) Payments	2.9	3.4	3.4	3.2
Of which, on multilateral debt	0.2	0.2	0.2	0.2
International Reserves	2.3	2.5	3.6	3.8
Worker Remittances	3.4	3.5	3.7	3.9
Suez Canal Dues	1.3	1.5	1.7	1.8
Concessional as % of Total Debt	30.8%	32.8%	39.3%	39.3%
Concessional as % of Public & Guaranteed	36.4%	39.7%	45.8%	45.7%
Multilateral as % of Total Debt	9.9%	10.3%	9.3%	9.7%
Multilateral as % of Public & Guaranteed	11.8%	12.5%	10.9%	11.3%
Multilateral debt service as % of TDS	7.1%	5.1%	10.6%	5.3%
Average interest rate, new debt	6.7%	7.2%	5.3%	n.a
Average maturity, new debt (yrs)	16.9	15.4	27.2	n.a
Ratios:				
Debt/GNP	184.1%	166.7%	126.6%	122.0%
Debt/Exports of goods & services	449.6%	421.2%	300.8%	284.3%
Debt Service/Exports of g & s	25.0%	27.8%	25.7%	23.6%
Long-term debt, by debtor:				
Central government	68.0%	64.9%	60.0%	
Local governments	0.3%	0.3%	0.3%	
Central Bank	6.1%	7.9%	2.6%	
Development bank(s)	0.6%	0.5%	0.7%	
Public corporations	22.3%	23.7%	33.4%	
Private sector	2.7%	2.6%	3.0%	

Sources: 1988-90 data from World Debt Tables. 1991 and beyond are AID staff approximations of calendar year data derived from IBRD scenarios for future fiscal years. Post-1990 projections include IMF with short-term debt

Attachment B

Background and Recent Economic Developments

Background and Recent Economic Developments

Following the overthrow of King Farouk in 1952, Egypt's President Nasser moved steadily toward a centrally planned economy, culminating in a series of nationalizations in the 1960's. During this period, the Soviet Union succeeded Britain as Egypt's main financial sponsor and along with Eastern European countries, an important source of technical and economic advice. Through large projects such as the Aswan Dam, and the purchase of military and consumer goods, Egypt ran up a substantial ruble debt with the USSR. The government of Egypt directed the economy through a series if five year plans, and embarked on programs which are contrary to the country's productive comparative advantage. It has severely restricted private investment and exports in favor of publicly owned production for domestic consumption. Finally, it set the prices of virtually all essential and most non essential products and services in order to achieve social and political distributive objectives rather than allocative efficiency.

A. The Growth Period of the 70's.

Prior to 1973, government policy promoted rapid industrialization and a strengthening of the military. After 1973, the government expended substantial resources to promote consumption and social welfare. To achieve this latter objective, prices were held down in order to significantly subsidize consumption. Between 1975 and 1980, Egypt's real economic growth soared to some 8% annually. The principal sources of foreign exchange were petroleum exports, Suez Canal and tourism receipts, supplier credits, worker's remittances and foreign borrowing (See Table 1).

Following Nasser's death in 1970, President Anwar Sadat announced an economic policy that he termed *al-infitah* (the "opening"). While there was some initial optimism in the international community that this would be the first step in a general liberalization of the economy, in the end it fell well short of this objective. There was a flood of imported goods, many of them consumer goods purchased by the government and resold domestically at far below their international prices. Construction boomed, fueled by large government projects and the intense demands for housing and infrastructure in the exploding urban areas, notably Cairo. However, a general widening of private sector investment did not occur. External private capital tended to flow into the petroleum sector, hotels and banking. The economy still retained most of the trappings of the central planning period. Licensing, regulation and price controls abounded. State-owned enterprises dominated the manufacturing sector and the controlled pricing system effectively taxed agriculture heavily in order to subsidize consumption of a rapidly increasing number of urban dwellers. Resources were grossly misallocated. Heavy government subsidies kept inefficient industries afloat. Domestic petroleum and fuel prices were a fraction of their international levels, fostering energy waste, excessive motor vehicle usage and startlingly high levels of urban pollution. Valuable agricultural soil was baked into bricks for urban houses, and Egypt relied increasingly on imported food (often paid for by government external borrowing) to feed its rapidly growing population. The government's most serious attempt at what today would be called a "shock therapy" reform in 1977 touched off "bread riots" that forced the government into a hasty retreat and cancellation of an IMF stand-by. The specter of this experience has remains fresh in the minds of Egyptian policy makers to the present day and is an important reason for the caution with which reforms are proposed and undertaken. As the 1980's began, the economy was ripe for a crisis if the delicate balance between external expenditures and oil-based foreign exchange earnings was upset.

B. The Pre-Reform Period of the 80's.

Egypt's economic growth in the 1970's relied on ever-increasing quantities of resource inputs. It did not result from improvements in the economy's productivity or its comparative advantage. Between 1980 and 1985, when several important sources of external earnings stagnated or declined, real economic growth tapered off to an annual average of about 3.4%. In 1985/86 the economy experienced a more precipitous decline in petroleum earnings. The collapse of the world price of oil also restricted the demand for Egyptian labor in the oil producing Gulf states.

The large decline in petroleum earnings from 1984/85 levels and slower recovery of worker remittances from their 1985/86 decline, occurred at a time when debt service payments were becoming an important outlay in the balance of payments (See Table 2). Through 1985, the growth in the remaining traditional sources of foreign exchange earnings and non-traditional exports was not sufficient to compensate for the decline in petroleum related earnings and to meet rising debt service obligations. By 1985/86, with imports continuing to rise at 20% per year, the current account deficit before grants rose to $4.0 billion by 1985/86. Even after including external assistance, much of it in the form of U.S. cash and commodity grants, the current account deficit averaged nearly $2.5 billion from 1984-86. The overall external deficit increased throughout much of the 1980's. Despite this, Egypt continued to accumulate international reserves by not servicing debt (and not counting past-due payments as short-term liabilities). By 1990, Egypt was estimated to have accumulated $10 billion in arrears.

During the first half of the 1980's, the government took no significant actions to correct the growing imbalances in the external accounts or in domestic supply and demand. Instead, the government continued to borrow (see Table 1), pushing Egypt's official external long-term debt to over $43 billion in 1987.In that same year the country's total external debt stood at $50 billion (159% of GNP and 534% of export earnings).

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Egypt's economy in the mid-1980's exhibited the following characteristics: Eighty five percent of industrial production occurred in the public sector with numerous formal and informal restrictions on private investment. The production of principal crops was strictly controlled with the government monopolizing agricultural inputs' supply and most crop procurement. Principal exports were controlled by government monopolies. The allocation of energy and essential raw materials was under government monopoly. Construction, transportation, housing, tourism, health and education were also essentially government owned or controlled functions. Under a standing policy, the government guaranteed a job to any university graduate. After years of this policy, understaffed universities were crammed with thousands of students seeking a virtually tuition-free "ticket" to a guaranteed government job in an already bloated bureaucracy.

In the area of pricing, the government maintained multiple, overvalued fixed foreign exchange rates, negative real interest rates in the controlled banking sector, energy prices which were as low as 8 percent of world market prices for a number of important products, cotton farm gate prices at 1/3 of the world price, and residential rents fixed at the 1956 nominal price. In addition, large implicit and explicit subsidies were provided in agricultural inputs, construction materials, clothing, transportation and all socially sensitive consumption goods such as bread, vegetable oil, meat, cereals and dairy products.

By 1986, the economy's foreign exchange earnings including grants and loans could no longer simultaneously finance the country's consumption of imports and service its debt, so arrearages grew. With a bleak forecast for the balance of payments, slow growth in the economy, and a loss of creditworthiness, in 1986 the government began negotiations with the IMF on an economic stabilization program supported by a stand-by arrangement and Paris Club debt rescheduling. At the same time, the government introduced a series of measures, including trade restrictions, to control demand for foreign exchange.

The scarcity of foreign exchange and the severe restrictions on imports resulted in a 16.5% percent decline in commodity imports and a 50 percent decline in the current account deficit in 1986/87. After lengthy negotiations, the GOE reached an agreement with the IMF in April 1987. In May, several major economic reforms were introduced and a Paris Club rescheduling was expeditiously concluded.

C. The May '87 IMF stand-by

The reforms associated with the May '87 stand-by included a phased program to reduce the number of official foreign exchange rates and devalue the commercial bank rate to the level existing in the parallel market. Interest rates on loans were raised by 2 percent

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and tight credit ceilings were imposed, primarily on the private sector. In an effort to reduce the budget deficit, a number of price increases on subsidized commodities were introduced. These included energy, some industrial and construction raw material, and numerous consumer goods. In addition, it was the IMF's understanding that additional reform measures were to be introduced in November of 1987. For one of the few times in the decade, Egypt managed by reduce its external arrears by $1 billion.

The May '87 stand-by and Paris Club rescheduling provided significant relief from the immediate balance of payments problems. However, the government's reform program was not adequate to reverse the deterioration in key economic indicators. After the initial improvement in the balance of payments due to the rescheduling, a rise in imports unmatched by new foreign exchange earnings brought on additional deficits in the current account and renewed accumulation of arrearages on debt. Domestic revenue measures were also inadequate to bring the government's budget under control and the reliance on money creation to help finance the deficit fueled inflation. Real interest rates remained negative. Nominal energy prices, even after price increases, averaged only 20 percent of the economically appropriate price. The foreign exchange regime remained restricted and contained a complicated array of multiple, overvalued rates. Severe controls remained on the private sector and significant inefficiencies remained in the public sector. Implicit and explicit subsidies continued to fuel consumption and distort investment choices, while nonmarket prices inhibited efficient production decisions. Finally, there was no obvious progress in implementing stronger reform measures in November 1987.

By the Spring of 1988, it was apparent that performance in meeting stand-by targets was unsatisfactory. Without further reforms and debt rescheduling, the government believed it would eventually be unable to provide a number of subsidies which had long been considered essential for social stability. Consequently, discussion of a stronger reform program for a second stand-by and debt rescheduling commenced with the IMF.

By late 1990 the government and the IMF had not yet reached agreement on the economic reform program needed to correct Egypt's economic problems. Meanwhile, in mid-1989, the government began discussions with the World Bank for a Structural Adjustment Loan (SAL), including a policy agenda focused on reforms in industrial policy, pricing and the trade regime and complementary to the macroeconomic reform program then under discussion with the IMF. From November 1989 until June 1991, the Bank and the government worked together to design a reform program and establish an implementation schedule. The World Bank approved the SAL in June 1991. The important elements of this agenda included: 1) The sale of non-strategic companies and assets owned by the public sector; 2) the transformation of the remaining public sector

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companies to a commercial basis of operation; 3) liberalizing investment laws to remove barriers to private sector investment; 4) significant reductions in subsidies in energy, transportation, pharmaceuticals, consumer goods and agricultural inputs; 5) significant improvement in the pricing of cotton and rice; 6) a reduced and tightly controlled government investment budget; 7) removal of trade restrictions; and 8) reform of the tariff structure.

D. Sector Reforms and Prelude to IMF, IBRD Programs

In the years following the economic crisis in 1986, the government implemented a number of important sectoral reforms. The most important sectors affected have been tourism and agriculture. In tourism, the government has shifted to market prices and transferred investment and management responsibilities for tourist hotels to the private sector. Egypt Air's monopoly service to tourist areas has been ended and a program to privatize hotels has begun. Investor and tourist response to these measures has been dramatic and tourism receipts have become a major source of foreign exchange earnings (see Table 2).

Agriculture is leading the way in economic liberalization. Reforms supported by U.S. sector assistance have ended all government planting, procurement and pricing controls on ten of the thirteen principal field crops. Subsidies for agricultural inputs such as feed corn and fertilizer have been essentially ended and credit subsidies reduced. In addition, the farm gate price for cotton has been raised in real terms and controls on rice have been reduced. The private sector is now permitted to export fruits and vegetables and to import important items such as animal feed and fertilizer. These agricultural sector reforms have resulted in measurable increases in production and productivity in the uncontrolled crops. In particular, wheat production has increased dramatically as the market prices induced farmers to shift to high yield varieties. In 1990, the Ministry of Agriculture divested 33,000 acres of land which formerly landless people are now buying in 5 to 10 acre plots on an installment basis. Price deregulation in agriculture is scheduled to be largely complete by 1992/93. Remaining subsidies on agricultural inputs are scheduled to be eliminated by fiscal year 1993. Rice delivery quotas were abolished in 1991. Because of its political and institutional complexity and sensitivity deriving from its importance to the industrial sector, liberalization of the cotton sector has moved more slowly than some other areas. Still, the government increased procurement prices substantially in March of 1991 and previously stated its objective of having each variety priced at 60% of its international equivalent in 1991/92 and 66 percent in 1992/93.

Reforms supported by U.S. sector assistance have increased the authority of local government units to raise revenue and manage their investment programs. A program to

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privatize local government owned businesses has also begun. At least 1,400 properties have been put up for sale, of which at least 250 had been sold by mid-1991 (other reports say 1,900 properties, and nearly 1,200 sales).

Domestic energy prices were increased in real terms so that non-electrical energy was 45 percent of the economic price by May 1990. Under terms of the SAL, Egypt agreed to increase the average of petroleum prices to 56% of international levels by the end of 1991. In May 1991, electricity prices were raised in to average 59 percent of the long run marginal cost of production. Another increase in January 1992 increased this to 64 percent. This ratio is to increase in steps to 100 percent by June 1995. As in agriculture and local government, U.S. sector assistance has supported reforms in the power sector through the financing of needed new electrical generation capacity. USAID-financed consultants are assisting in an electricity tariff study that will form the basis of price adjustments after May 1992.

E. Endnote: Background and Profile of Egypt's External Debt

Prior to 1974, Egypt's debt was quite small relative to GDP (Fig 1). With the end of the 1973 hostilities, bilateral lenders began to increase their exposure (Fig 2). The bulk of these new loans were on concessional terms reflecting donor support for post war reconstruction. While these loans contributed to the overall increase in Egypt's debt, they had little effect on the country's debt service obligation during the period before 1977 (Fig 3). By 1977, concessional debt reached 74 percent of public or publicly guaranteed debt (Fig 4).

In 1976, the private sector joined Egypt's ranks of official creditors with large amounts of short term and a small increase in long term lending (Fig 2). The country's creditworthiness appeared sound because of growing export earnings, high world oil prices, renewed operations of the Suez Canal, rapidly rising worker remittances and the prospects of regional peace (Fig 5). However, after the initial increase, these new lines of credit grew slowly and the primary factor driving the growth of total debt was the continued government borrowing from official bilateral sources (Fig 2).

With improved creditworthiness, the terms of bilateral loans hardened after 1978 (Fig 2). The decline in the percentage of concessional lending resulted in part from Egypt's use of new facilities such as the commercially priced FMS credits. Also, Egypt increased its market rate borrowing from multilateral banks.

A structurally sound economy may have accommodated a rapidly rising foreign debt by encouraging exports and domestic and foreign equity capital as substitutes for borrowing.

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Egypt was in an unusually good position to pursue these kinds of policies because of factors which were supporting her creditworthiness. However, Egypt's domestic economic policies at the time discouraged exports, private domestic investment and foreign equity capital. In addition, government policy stimulated the demand for imported consumption goods, public sector capital equipment and raw materials by the provision of substantial subsidies. These imports were sustained by continued foreign borrowing.

In 1980, Egypt's total debt surpassed GDP and trouble appeared in the form of repayment arrears and a high and rising debt service ratio (Figs 1 and 6). But the most difficult period began after 1985, as oil prices fell. By 1987, Egypt had reached her credit limits and total debt plateaued. Substantial, but temporary debt service relief was obtained from the Paris Club in 1987, but the total burden remained undiminished until the U.S., Saudi Arabia and Kuwait forgave substantial amounts of debt in late 1990.

Egypt's debt to the U.S., as of June 1991, is shown in Table 3. The debt forgiveness in December eliminated Egypt's outstanding debt under the FMS category, thus bringing the remaining debt down from $12,498.74 to $5,772.23 billion plus any further arrearages accumulated after September 1991 on non-FMS loans. Of the remaining $5,882.53 of debt (including arrears) to the U.S., $5,537.17 billion is highly concessional economic and food aid with debt service payments projected to be in the neighborhood of $240 to $300 million per year (Table 4). The balance of the remaining debt to the U.S. is $345.36 million of commercial rate borrowing with a projected debt service of about $230 million in 1992 (of which $184 million is on guaranteed debt). It should be noted that the declining trend in CCC debt service (shown in Table 4) will be reversed if new GSM-102 credits are extended to Egypt.

Table 5 presents estimates of Egypt's debt since 1988. The 1991 estimate includes the effects of the U.S. and Gulf States' debt forgiveness.

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Figure 1
Egypt: Total Debt and GNP

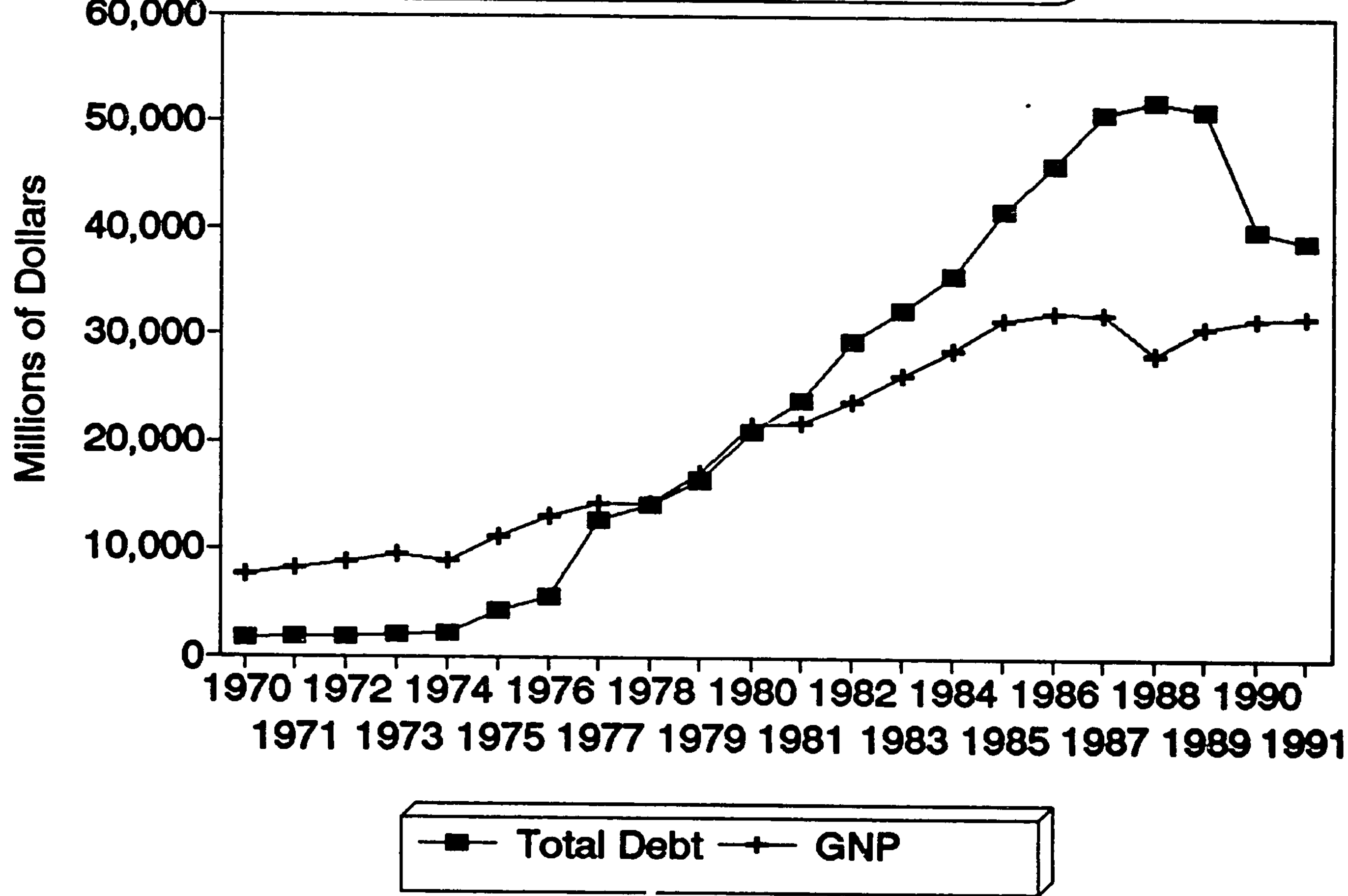
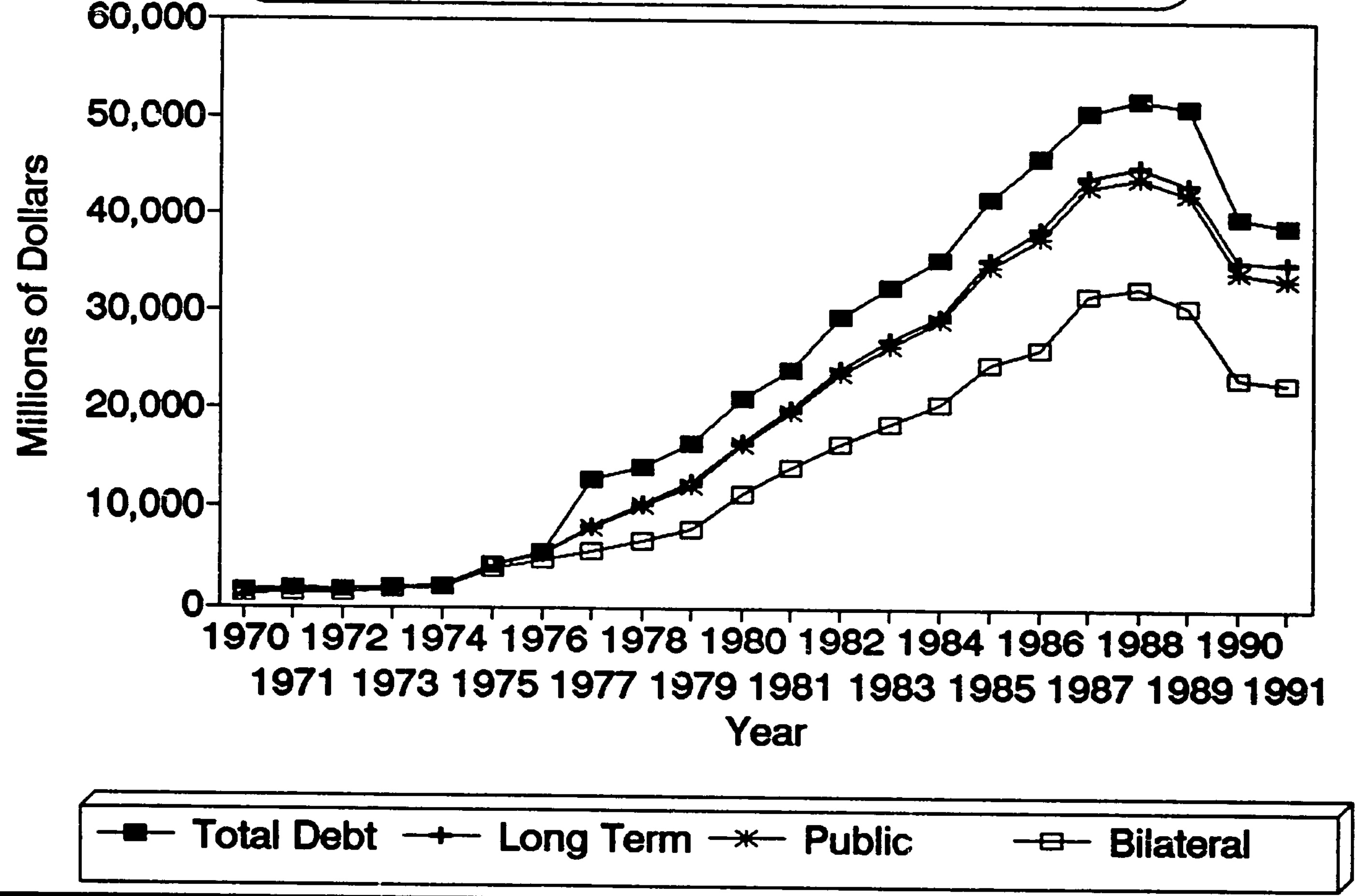


Figure 2
Egypt: Components of External Debt



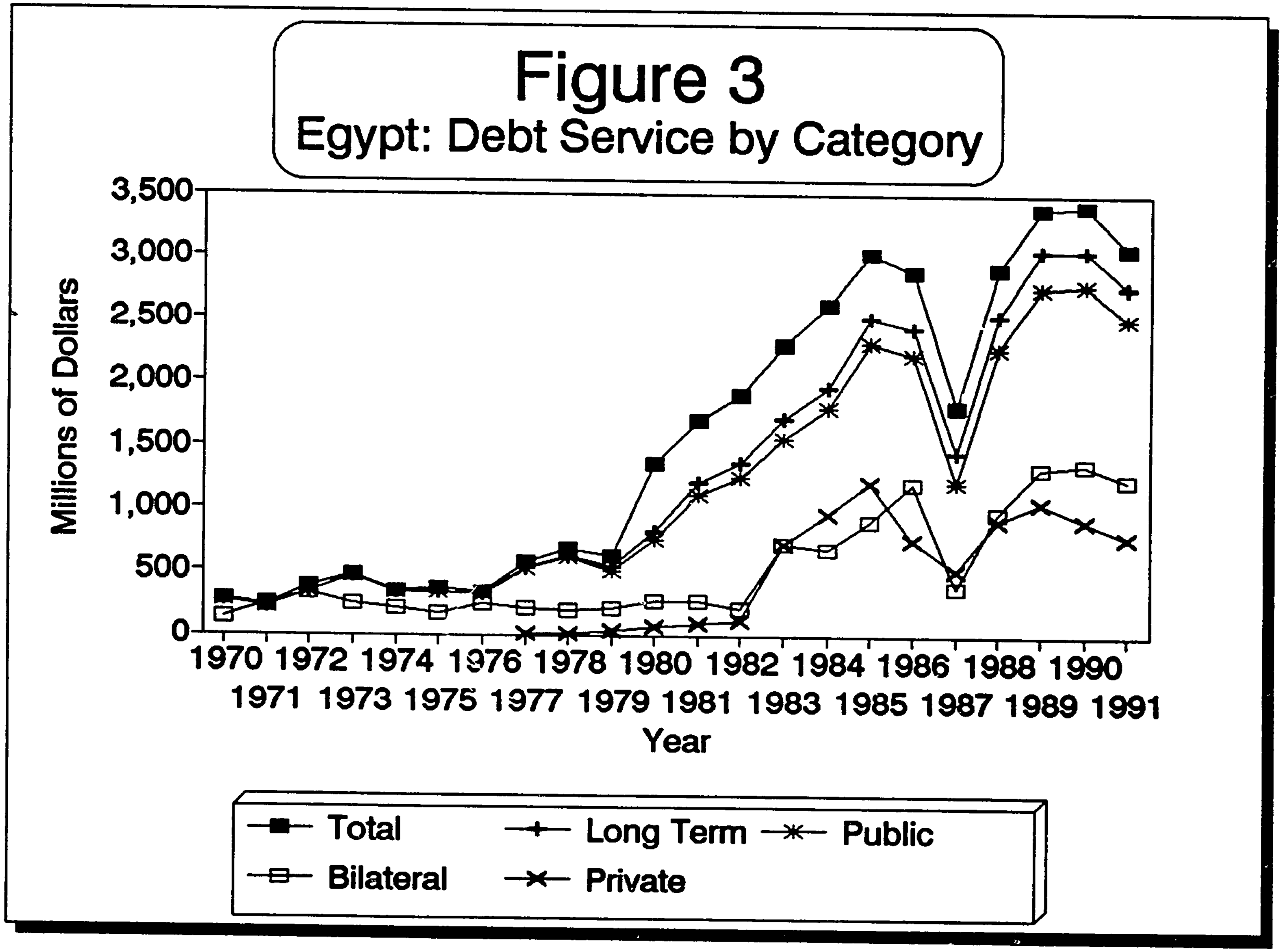


Figure 3
Egypt: Debt Service by Category
3,500
3,000
2,500
2,000
1,500
1,000
500
0
Millions of Dollars
1970 1972 1974 1976 1978 1980 1982 1984 1986 1988 1990
1971 1973 1975 1977 1979 1981 1983 1985 1987 1989 1991
Year
Total
Long Term
Public
Bilateral
Private

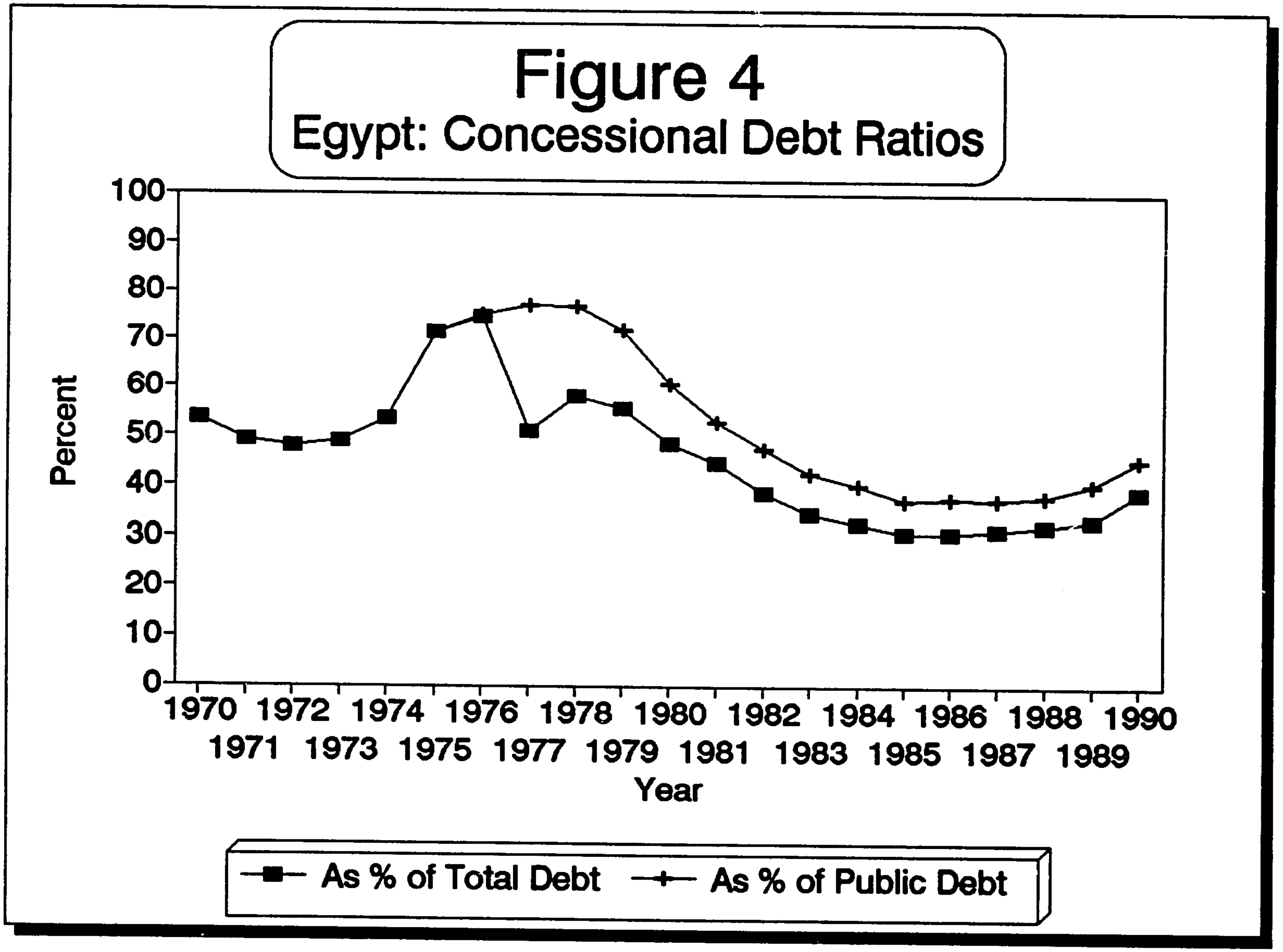


Figure 4
Egypt: Concessional Debt Ratios
Percent
Year
As % of Total Debt
As % of Public Debt

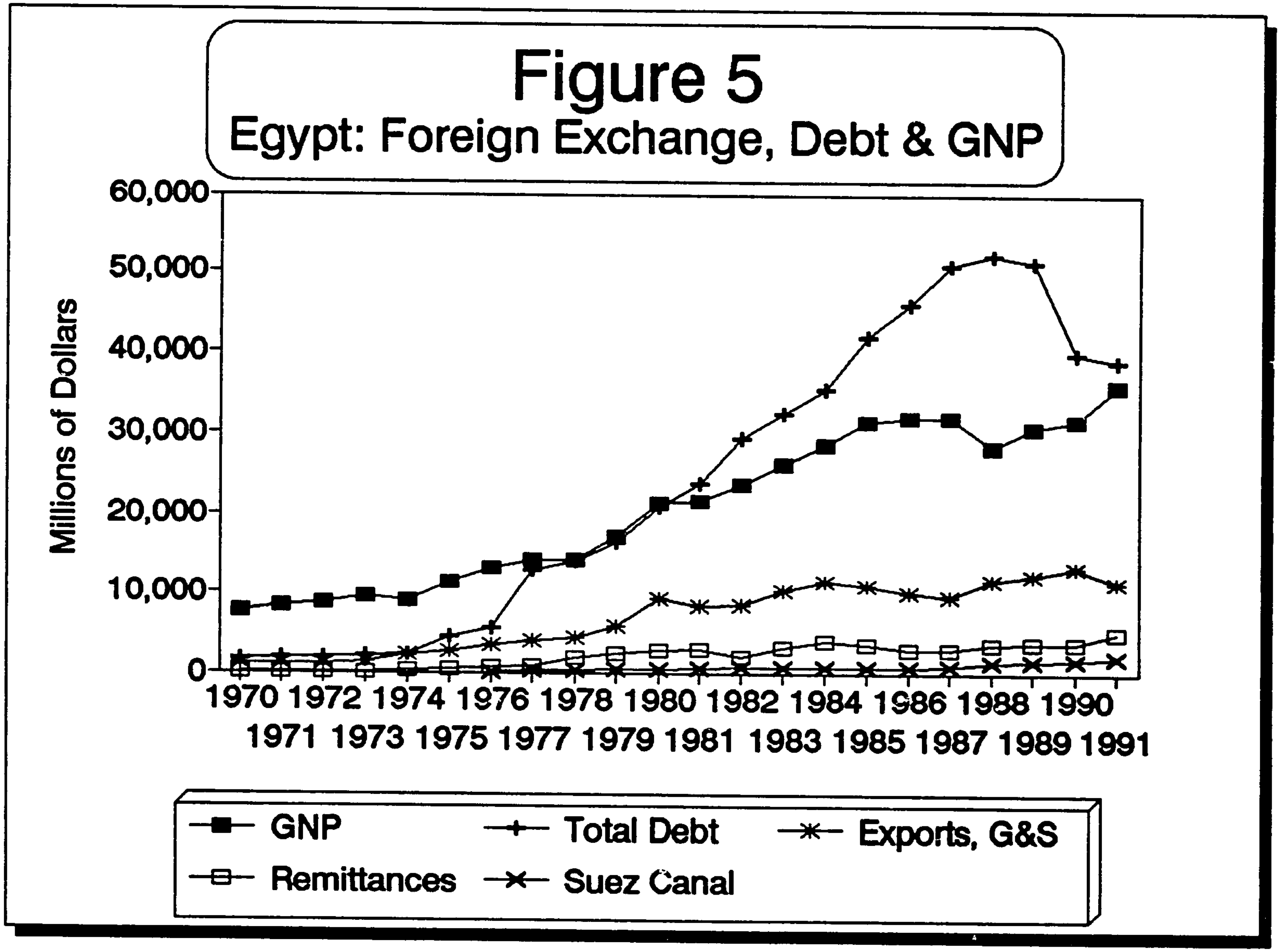
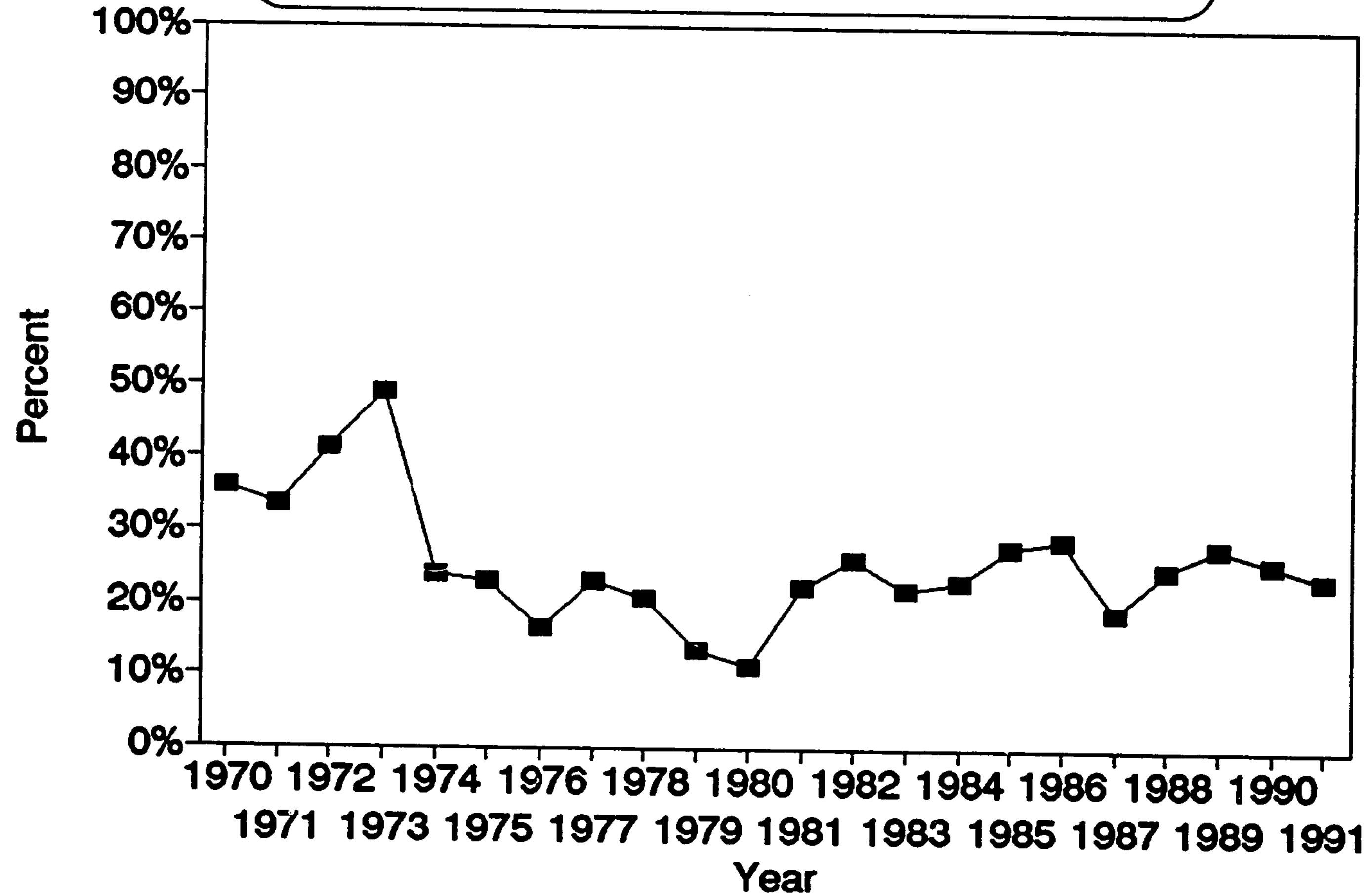


Figure 5
Egypt: Foreign Exchange, Debt & GNP
Millions of Dollars
60,000
50,000
40,000
30,000
20,000
10,000
0
1970 1972 1974 1976 1978 1980 1982 1984 1986 1988 1990
1971 1973 1975 1977 1979 1981 1983 1985 1987 1989 1991
GNP
Total Debt
Exports, G&S
Remittances
Suez Canal

Figure 6
Egypt: Debt Service/Exports of G&S



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