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STRUCTURAL ADJUSTMENT AND REFORM POLICIES IN EGYPT:

ECONOMIC AND SOCIAL IMPLICATIONS*

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LIST OF ABBREVIATIONS

IMF	=	International Monetary Fund
ERSAP	=	Economic reform and structural adjustment programme
SAL	=	Structural adjustment loan
LE	=	Egyptian pound
ER	=	Economic reform
PSOs	=	Public sector organizations
Hcs	=	Holding companies
PSCs	=	Public sector companies
Acs	=	Affiliated companies
PIO	=	Public Investment Office
LRMC	=	long-run marginal cost
SFD	=	Social Fund for Development
GASC	=	General Authority for Supply Commodities
IDA	=	International Development Association
ECU	=	European currency unit
GDI	=	Gross domestic investment
ILO	=	International Labour Organization

INTRODUCTION

The Egyptian economy has suffered from chronic internal and external imbalances. This has been reflected in increasing deficits in the balance of payments and government budget, and a high rate of inflation. Because of substantial inflows of financial resources in the late 1970s and early 1980s, these imbalances did not prevent the Egyptian economy from achieving high rates of investment and growth, averaging 8.5 percent annually from mid-1970s to mid-1980s. In the second half of the 1980s, foreign exchange inflows slowed down, mainly due to the fall in oil prices and workers' remittances. At the same time, the burden of paying and servicing the large foreign debt already accumulated during the previous period of prosperity started to be felt, and the investment rate dropped. As a consequence, the rate of growth of the economy decelerated significantly to an annual average of 3 percent in the early 1990s.

In 1987, the Egyptian Government signed a stand-by arrangement with the International Monetary Fund (IMF) which resulted in a rescheduling of debt service payments and alleviation of the overall external debt burden; but not for long. Arrears started to accumulate again until they reached $ 11.4 billion in 1990. The rate of growth of the economy continued to fall and the inflation rate to escalate; and the deficits in the balance of payments and government budget widened further.

To eliminate the imbalances in the economy, the Government signed agreements with the IMF and the World Bank in 1991 which were implemented in the fiscal year 1991/1992. These agreements, referred to as the economic reform and structural adjustment program (ERSAP), and the structural adjustment loan (SAL), respectively, have common policy measures components and strong cross-conditionality. A tentative assessment of the impact of both packages is aimed at in this study. Although ERSAP and SAL came to an end in September 1992, a preliminary assessment is feasible. This is because before ERSAP and SAL, Egypt had signed three stand-by arrangements with the IMF since 1976, all of which follow the same line of policy recommendations that advocate, with different degrees, tight fiscal and monetary policies, and liberal exchange rate and trade policies.

Two main objectives are opted for by these IMF stabilization programs: on the demand side, decreasing the absorptive capacity within a short period of time; and on the supply side, transforming the economy to a market-oriented one, with minimum government intervention in economic activity. Although the 1976 and 1978 agreements were discontinued for social, political, and economic reasons, the one-year 1987 agreement was implemented fully (but not renewed). This agreement was preceded in the early 1980s by government policies applied along the IMF policy lines in preparation for signing the letter of intent in May 1987 (for details, see Korayem (1987)). Thus, one may consider the policy recommendations in ERSAP and SAL as a further link in a consistent chain of policies that have been applied since the 1980s.

The objective of this study is to assess the economic and social impact of ERSAP and SAL on the economy. An overview of the Egyptian economy will be first provided as a background for the policy assessments.

The study consists of four chapters. Chapter I provides an overview of the Egyptian economy; Chapter II presents the main features of the IMF and World Bank 1991 agreements with Egypt; and Chapters III and IV provide an assessment of the economic and social impact of the agreements, respectively.

I. AN OVERVIEW OF THE EGYPTIAN ECONOMY[1]

The present structure of the Egyptian economy is not the outcome of a smooth evolutionary process but rather of shifts and deep transformations over a relatively short period that took the economy from one extreme in the 1950s- private sector's domination- to another extreme in the 1960s -public sector's domination- to efforts to move the economy again to a position enabling the private sector to play a greater role in economic activity and improve the management of public sector involvement.

The economy has undergone several structural changes since the revolution of 1952. Then, the economy was a market-oriented one, where the government role was confined to such traditional functions as defence, security keeping, etc. The nationalization of the Suez Canal Company in 1956 ushered in the beginning of a new era, politically as well as economically. The Suez Canal nationalization, followed by the Egyptianization of banks and some businesses that were owned by foreigners, marked the beginning of a more active government role in economic activity. However, the major shift towards greater government participation in economic life took place after the Nationalization Acts in 1961. These Acts led to the creation of a large public sector. The government took control of a large segment of economic activity in the country with the exception of agriculture, where the private sector continued to play the main role. Rent controls were imposed; price controls and minimum wages introduced; a second agricultural land-reform applied; the tax system changed raising tax rates on higher income levels to reach 90 percent on annual incomes of LE 10,000 and more. In short, laws and regulations were introduced to transform the society to socialism, according to official announcements[2]. The government had the upper hand in economic activity in general, with the responsibility of providing more equal opportunities and lessening economic and social inequalities. This situation, characterized by the relatively large government role in the non-agricultural activities, continued until the mid-1970s.

Changes started to occur by the mid-1970s with the introduction of the open-door policy. The main features of this policy were the encouragement of the private sector to play a

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[1] Unless otherwise stated, all the data in this part are taken from Korayem (1991), the Ministry of Planning (1992) and the World Bank (1992), Vol III.

[2] Some social scientists disagree with that on the basis that the Egyptian economy has been transformed to a 'state' economy and not to a 'socialist' one.

larger role in economic activity, and opening the door widely for the emigration of Egyptian labour to work abroad, mainly in the Gulf area. This policy is till prevailing with the consequence of having a kind of a mixed economic structure, with the public sector dominating non-agricultural activities in terms of investment and output, but with a growing role for the private sector encouraged by the government. The present government policy encourages the private sector by all possible means -e.g., by tax exemptions, tariff reductions, etc.

The quick pace of economic transformation witnessed, all within a span of less than fourty years, complicates the adjustment process. This is because the present set up has social and economic ramifications, inherited from the different transformation phases, which any policy package cannot ignore. For example, productivity in public enterprises should be raised, but without laying off excess labour, since labour legislation that favours the employees' and almost prohibits firing -except in some limited cases- is one of the pillars of the socialist phase. Another example is the low esteem for manual work. This is a legacy of the 1950s, where the market-oriented and class structure phase prevailed. This attitude did not change during the socialist phase in the 1960s, inspite of the inherent contradiction. Accordingly, education policies directed towards decreasing the number of university graduates, who are in excess supply, and increasing the number of skilled workers, who are in excess demand, are opposed inspite of the serious production and unemployment problems the Egyptian economy is facing.

Looking at the present structure of the Egyptian economy, one finds that agriculture plays a leading, though declining, role in production and employment. In 1991/92, agriculture contributed 16.5 percent of GDP and employed 33 percent of the labour force, compared to 18.5 percent and 39.5 percent in 1981/82, respectively. The second most important commodity sector in terms of production and employment is manufacturing which accounted for 17.1 percent of GDP and 13.7 percent of employment in 1991/1992. Petroleum assumes special importance as a foreign exchange earner. Its relative share in GDP was 10.6 percent at 1991/92, but the sector's employment capacity is very small (0.3 percent), because of the nature of the production process which relies on highly capital-intensive techniques. Together, these commodity sectors produced 44.2 percent of GDP in and employed 47 percent of the labour force 1991/92 . On the other hand, the services sectors -transportation and communication, trade and finance, and other services- produced together 49.4 percent of GDP and employed 45.7 percent of labour in 1991/92. It has been the trend for sometime in the Egyptian economy for the relative share of the services sectors in GDP to rise, and for the relative share of the commodity sectors (excluding petroleum) to decline.

Another important feature of the Egyptian economy is the distribution of employment between the public and private sectors. The public sector employed about one-third of the labour force in Egypt in the 1980s. For example, in 1982/83 and 1986/87, 32.3 percent and 34.4 percent of all employment, respectively, was in the public sector. This is a significant rise in public sector's employment compared to 26.9 percent in 1976. This increase in public sector's employment cannot be taken as an indicator of a proportionate increase in its contribution to GDP, because of the nature of the relation between production and employment in that sector. The prevailing laws and regulations make the government responsible for providing jobs to the graduates of the intermediate and university levels of education[3]. Whenever economic conditions deteriorate, and employment opportunities in the formal private sector get tight, the public sector becomes the main supplier of jobs to new-comers to the labour market.

The largest share of public sector employment is to be found in public enterprises. The freedom given to public enterprises' managers recently has helped in curbing the growth of employment in these enterprises. About two-thirds of employment in Egypt is in the private sector, of which more than half are in agriculture.

Inspite of the gradual resurgence of private sector activity, starting in the mid 1970s as the result of the open-door policy, the public sector in 1991/92 still accounted for about 40 percent of total GDP and 48 percent of nonagricultural GDP. In manufacturing and mining, the public sector's share is 42 percent. Public sector investment in 1991/92 was more than three times that of the private sector (76.3 percent as against to 23.7 percent, respectively). The fact that the public sector is responsible for one-third of total employment while having three quarters of national investment, is attributed to the capital-intensive nature of the activities in which it is engaged; e.g., petroleum, public utilities, heavy manufacturing, etc.

The growth of GDP slowed down during the 1980s, reflecting the economic crisis that Egypt faced during the period. Between the mid-1970's and early 1980s, GDP grew at an average rate of around 9 percent; and through the mid-1980s the growth rate was still impressive at 6-7 percent per annum (World Bank, 1991 b). But in the second half of the decade, the rate of GDP growth decelerated, reaching as low as 1.5 percent in 1991/92.

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[3] This process of guaranteeing a job to graduates has been slowed down in recent years by lengthening the job waiting period to six years and more.

The prices of many goods and services in Egypt are subject to price controls, and some of them are heavily subsidized. However, the system is changing gradually in response to the IMF policy recommendations, and according to the austerity program applied by the Egyptian government along the IMF line. Despite price controls, the consumer price index rose by an average annual rate of 18.5 percent during 1987/88-1991/92 (Table 7).

Looking at the balance of payments, one finds that the trade balance was in deficit during the last twenty years, with few exceptions. However, until the mid-1970s the trade deficit has been offset by net factor services income, producing a surplus on the current account. This trend has been reversed since then, turning the surplus in the current account balance into a deficit, inspite of rising workers' remittances. The deficit on the current account reached LE 4.3 billion in 1989/90, representing 5.4 percent of GDP. In 1990/91, the current account balance recorded a surplus of LE 4.9 billion, representing 5 percent of GDP.

Egypt is heavily indebted. Its foreign debt reached $40.4 billion in 1986/87, equivalent to 126.6 percent of GDP. The foreign debt service obligations, after rescheduling, were $2.5 billion in 1986/87, or 20.5 percent of Egypt's current receipt of foreign exchange (excluding official transfers) and 7.7 percent of its GDP. By 1989/90, total external debt reached close to $50 billion (132 percent of GDP), with debt service obligations amounting to $ 6 billion, or nearly half of foreign exchange earnings. Less than half of these obligations were actually paid during the year, while debt arrears increased further to $11.4 billion (World Bank, 1991 a). Egypt's main sources of foreign exchange are workers remittances, petroleum exports, and Suez Canal dues.

II. THE IMF AND WORLD BANK AGREEMENTS WITH THE EGYPTIAN GOVERNMENT IN 1991[4]

In 1991, the Egyptian Government signed agreements with the IMF and the World Bank. The main objectives of the agreements are to eliminate the imbalances and price distortions in the Egyptian economy, through reforming it to a market-based economy, and to restore the international credit worthiness of the country.

Reviewing the components of the two agreements, one finds that the IMF Stand-by Arrangement includes economic reform(ER) - with a policy reform component and a performance criteria component[5]- while the World Bank agreement consists of the structural adjustment program (SAP), the structural adjustment loan (SAL), and the Bank's assistance strategy of investment lending. Strong cross-conditionality exists between the two agreements[6].

Four comments are in order before presenting the main features of the agreements with the two Bretton Woods institutions. First, the agreements are formulated in such a manner and overlap that complicates the task of grasping the focus of the ER, SAP, and SAL. Second, the economic reform component is much more involved (in terms of policy content and objectives) than the stabilization program normally presented by the IMF. Third, as it is generally

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4 Unless otherwise stated, this chapter is based on the Agreements' documents of the IMF (1991) and the World Bank (1991a).

5 The measures included in the IMF stand-by arrangement with any country may be classified as performance criteria, preconditions and policy understanding. The measures specified as performance criteria in the adjustment agreements with the Fund have special importance, since the violation of any of those criteria will curtail, or even halt, the country's access to the finance agreed upon under the stand-by arrangement (Ground, 1984).

6 Cross-conditionality exists if the country's acceptance of the agreement of one Bretton Woods' institution (say the IMF) is a precondition for signing an agreement with a second institution/World Bank; and the termination of one agreement implies the termination of the other. In other words, cross-conditionality is a binding constraint on the borrowing country which makes it choose either accepting both, IMF and World Bank agreements, or none of them. Informal cross-conditionality between the two Bretton Woods institutions, as well as the similarity between the policy packages recommended to the countries that seek their support, has been quite common during recent years (Sarkar, 1991).

the case in other countries, there is cross-conditionality between the two agreements; approving the IMF Stand-by Arrangement was a precondition for signing the SAL. Fourth, the ER of the IMF and the SAP of the World Bank include the same policy reforms and measures with few exceptions. Because of this overlap, and of the complimentarity between them, they are usually referred to both together as the economic reform and structural adjustment program (ERSAP).

The two agreements will be presented in four sections: ERSAP; the performance criteria of the IMF stand-by Arrangements; SAL; and the Bank assistance strategy of investment lending.

A. The Economic Reform and Structural Adjustment Programme (ERSAP)

ERSAP consists of the following policy reforms and measures: public sector reform; pricing policies; investment policies; external policies; monetary reform; fiscal policies; and social policies.

1. Public sector reform

The public sector reform has two main objectives: (a) to change the institutional legal, and financial environment of public enterprises, and to raise their efficiency and increase the autonomy of their managers, while making them conform to the same rules as the private sector; (b) Privatization of public enterprises in the commodities and financial sectors, with the exception of strategic enterprises.

A new organizational framework is provided for public enterprises. The 37 public sector organizations (PSOs) will be temporarily transformed into an equal number of Holding Companies (Hcs), with a number of public sector companies (PSCs) affiliated to each HC. This was supposed to take place in July 1992. Five months later, i.e., in December 1992, the PSCs were supposed to be organized in a smaller number (20) of new holding companies. The main functions of the Hcs are to approve the business plans of the affiliated companies (ACs) and evaluate the performance of their managers; and decide on the restructuring of public enterprises and on buying/selling enterprises partially or wholly, and on the liquidation of non-viable ones.

At the top of the new organizational structure is the Public Investment Office (PIO), chaired by the Prime Minister, and guided by the Cabinet of Ministers; the Chief Executive Officer of the PIO will be a member of the Cabinet. The main functions of the PIO is to provide guidance to the Hcs and their affiliated companies regarding the State's privatization policy, liquidation and management of assets. The PIO also supervises the financial performance of the Hcs and ensures strict audit.

To introduce such changes in the institutional framework of the PSOs and in their working environment, a new public investment law was presented to the Parliament in 1991 to replace Law 97. The new Law requires the PSOs to conform to the same rules as the private sector and gives autonomy and freedom in making decision to the managers of the public enterprises . For example, in the new law, the objective of PSOs is to maximize profit, while in the old law their objective was to help in fulfilling the State's economic and social objectives, regardless of the impact of this policy on efficiency. On the employment issue, the PSO managers are free to set terms and conditions of employment and to reward performance through appropriate compensation policies linked to productivity, after the approval of the PSCs Board (see Table I in the Appendix for the main differences between the two laws).

However, the new public investment law represents an interim step for a 'unified law', which will apply equally to public and private sectors activities, and which was supposed to be drafted in December 1992 and promulgated by December 1993 (IMF, 1991). No details on this 'unified law' are revealed in the IMF nor the World Bank Agreements' documents.

The other important change introduced to the public enterprises environment is the new financial regulations of the PSOs. For decades the Egyptian Government had been heavily involved in subsidizing, directly and indirectly, the PSCs. Directly, it has provided investment funds at low interest rates through the National Investment Bank (NIB), and also subsidized them through the budget. Indirectly, financial support has been also provided to the PSOs in the form of guaranteed loans and easy access to credit at low interest rates from the public sector commercial banks. The new financial rules have changed this. The PSOs are not subsidized any more by the government budget, except in very special cases and for limited durations. They are required to meet their financial needs through the same financial channels as the private sector, i.e., through borrowing from the capital market, or from the commercial banks at market interest rates and on the same terms as the private enterprises without any government intervention to facilitate the borrowing operation.

2. Pricing policies

The decontrol of prices in the public sector is essential to move to a market-based economy. Since the mid-1980s, the Government of Egypt has taken important steps in that direction.

In the industrial sector, most products have been freed from administered prices. When measured in terms of 1987/88 industrial production value, only 26 percent of industrial output in 1991 was subject to price control as compared to 53 percent at the beginning of the program. At the end of June 1995, all prices of industrial goods, with few exceptions, are to be liberalized, when the subsidy on the most important inputs -electricity, oil, and gas- is eliminated. Only a limited number of industrial products will still be subject to price control, consisting mainly of a short list of basic foodstuffs (the prices of which to be decontrolled gradually), cigarettes (because they represent an important source of government revenue), and cotton yarn (because of the implicit export tax on cotton).

Energy prices have been highly subsidized during the last 10-12 years. While prices of petroleum products averaged 75 percent of international prices in the mid-1970s, they fell to 20 percent in the early 1980s due to the rise in world oil prices in 1978/79, while domestic prices were unchanged. To rectify the discrepancy, the domestic price of fuel oil was increased so that in 1988 it was four times its level in 1980 (World Bank, 1991a, footnote 6). But because of the Egyptian Pound devaluation, the price of oil products in 1988 averaged only about 30 percent of the world price. A 52 percent increase in the weighted average price of petroleum products was introduced in May 1991, bringing it to 48 percent of the international equivalent. Another increase in oil products' prices was envisaged to take place before the release of the second tranche of SAL, in June 1992[7], which would raise the average domestic price to 67 percent of the world price. This was to be followed by annual increases of 11 percent over the following three years so that domestic prices would equal international in 1995.

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7 This date has been postponed because of the delay in signing the agreements with the IMF and the World Bank for the implementation of the second stage of ERSAP. According to official announcements, the agreements were to be signed soon by the Government, and the second tranche release of SAL would follow, probably in the second half of 1993.

Electricity prices have also fallen short of their long-run marginal cost (LRMC). In May 1991, prices increased by 50 percent but remained only 59 percent of their (LRMC). An annual increase of 10 percent in electricity prices is to take place over the next four years to eliminate the discrepancy by June 1995. Looking at the energy sector as a whole, the programmed increase in prices will reduce the implicit energy subsidy from 9.6 percent of GDP to 6.1 percent of GDP in 1991/92, and to eliminate it completely by June 1995.

In agriculture, advanced steps have been taken to liberalize prices; the process to be largely completed by 1992/93. Controls on crop areas, pricing, and marketing of agricultural products have been removed for most crops. Sugar and cotton, however, remained subject to price and area controls, but to be eliminated gradually. Regarding agricultural inputs, subsidies have been reduced for livestock feed, fertilizers and pesticides; for the remaining inputs, subsidies were to be removed completely by 1992/93. For cotton, the government's objective is to raise the procurement price to 60 percent of the world price in 1991/92 to 66 percent in 1992/93 and to be raised almost its international level over 3-5 years. Also, the crop area controls on cotton will be removed except to the minimum extent technically needed.

In the transport sector, except for some minor adjustments, the tariffs of railways, inter-city trucks and buses have not changed between 1967 and December 1988. The Egyptian National Railway is highly subsidized. In January 1991, rail passenger tariffs were increased by 15-40 percent and rail freight tariffs by 15 percent. It is intended to increase the tariff by five percentage points each fiscal year as of 1991/92, until it reaches 100 percent of the cost in 1997/98. As part of ERSAP, the prices of inter-city trucking and bus services are freed. The new public investment law will allow those companies to set prices and their own terms and conditions of employment.

3. Investment policies

ERSAP attaches high priority to the decontrol of investment. Law 159 (governing domestic investment) and law 230 (governing foreign investment) require getting an investment license before starting new projects or just expanding the production capacity of existing ones. This enabled the government to prevent new entrants and hedge public enterprises against private competition, and also to protect existing private enterprises from new competitors by just refusing to issue new licenses. To provide a competitive investment environment for public and private enterprises, both Laws needed to be changed. In May 1991, Law 159 was effectively eliminated and the licensing requirements for new investments was abolished except for a small list that will be reduced further before the release of the second tranche, leaving in the list only products that need to be protected because of national security, environment, public health and public morality/religion reasons. For expanding the production capacity of existing projects, registration procedures are substituted for license requirements. Abolishing the licensing requirements for joint ventures and foreign investments governed by Law 230 was intended to take place by the end of June 1991 (World Bank, 1991a). Also, the Government started to phase out the public trade monopoly. The public sector companies producing cement and fertilizers were allowed to sell 20 percent of their output to the private sector, beginning July 1991; and this quota was to be increased gradually to 40 percent by July 1992. Eventually, all their production will be opened to private sector participation over the following 2-3 years.

4. External Policies

External policies involve three aspects: (a) exchange reform, (b) trade liberalization, and (c) debt relief.

(a) Exchange reform. According to this reform, the previous exchange system was abolished on 27 February 1991 and replaced temporarily by a dual exchange system. In October 1991, the two rates were unified in advance of the 26 February 1992 target date.

The dual system consisted of a primary market and a free market. The sources of foreign exchange in the primary market were Suez Canal dues; exports including oil, cotton and rice; official loans and transfers; and, invisible proceeds of the public sector. The payments in this market cover all uses in the Central Bank pool[8]. The exchange rate in the primary market was to be determined on a daily basis within 5 percent of the average rate of the most recent seven working days in the free market. The free market rate is the determining mechanism for the new exchange system. The free market, on the other hand, encompassed all foreign exchange resources that are not included in the primary market[9].

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[8] These are imports of essential commodities through the public sector, government foreign exchange expenditures, official external debt payments, and all demand for foreign exchange by public and private sectors as much as foreign exchange availability allows.

[9] These include tourism, free accounts, retention accounts (except those from export returns), banknotes, and travellers cheques' purchases.

The payments in this market cover all public and private sector demand for foreign exchange not satisfied through the primary market.

An important part of the new system is the permission granted to non-bank dealers to deal in foreign exchange after getting a license to undertake such operations. A set of requirements have to be met by those dealers before issuing the license[10].

(b) Trade liberalization. According to ERSAP, the Government is committed to trade liberalization. Important steps have been taken in this direction in 1991, before the SAL's approval by the World Bank; and further steps are programmed to be taken before the second tranche release. These steps include:

(i) The reduction of the product coverage of the import bans to 22.7 percent in June 1991, compared to 37.2 percent in March 1990, which will be reduced further to 10.6 percent of the product coverage of tradables before the second tranche release. However, most of the cut in import bans was in agricultural products, which are mainly produced by the private sector. The product coverage of import bans in agriculture fell from 35.9 percent in March 1990 to 9.5 percent in June 1991, as compared to a decrease from 37.8 percent to only 28.5 percent in manufacturing and mining (see World Bank, 1991a; Table 5). The further reduction in import bans before the second tranche release is to concentrate on manufacturing and goods produced by public enterprises.

(ii) The list of commodities requiring government authorization to import is reduced from 55 to 18, and will be reduced further to 14 by the second tranche release of SAL.

(iii) Narrowing the margin between the minimum (0.7 percent) and maximum (120 percent) tariff rates to range between 5-100 percent, and then reducing it further to 10-80 percent before the second tranche release of SAL, with the exception of basic food items and luxury goods. However, there is the possibility of raising import tariffs on some commodities temporarily to provide a safeguard mechanism to enterprises that will be exposed to serious difficulties in adapting to freer trade; this

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10 For details, see IMF (1991).

will also provide a transitional tax revenue to the government.

(iv) Abolishing the foreign exchange budget of public enterprises as part of the new public investment laws. This will allow managers of public enterprises to import whatever they need for the production process, the same as with the private sector. At the same time, letters of credit which have discriminated against the private sector are abolished.

Regarding exports, the following steps have been taken: reducing the list of commodities subject to export bans from 20 to 6, and that subject to export quotas from 17 to 4; also reducing the number of commodities that needed government authorization to be exported from 37 to 2, namely, cotton yarn and fabrics. With these measures, the domestic production coverage of export restrictions fell from 11.9 percent in March 1990 to 4.2 percent in June 1991 (World Bank, 1991a; Table 4). The Government announced its intention, prior to the second tranche release, to remove all export bans, and to cut the amounts of commodities still subject to export quotas by 15 percent annually.

(c) Debt relief. The large external debt obligations of Egypt makes its balance of payments highly vulnerable. Thus, external assistance is needed, according to the IMF and the World Bank, to reduce the debt burden and make the economic reform successful. The Government of Egypt approached the Paris Club creditors for a comprehensive debt relief, following approval of the Fund stand-by arrangement. According to the Paris Club agreement, which was approved on 25 May 1991 by the 17 creditor countries, Egypt was to be relieved from 50 percent of the official debt outstanding at 30 June 1991. This will be done in three stages over a 3 year period, on condition that Egypt continues implementing the structural adjustment program in collaboration with the IMF (Central Bank Egypt, 1991/92a). According to this agreement, 15 percent of the debt will be cancelled by 1 July 1991, another 15 percent by January 1, 1993 and 20 percent by 1 July 1994. The United States of America is not included in the deal since it has already dropped the military debt, which represents 60 percent of Egypt's debt to it, leaving the civil debt to be rescheduled by negotiation (Central Bank Egypt, 1991/92a). To maintain the debt burden at a sustainable level, external debt information is centralized and guidelines are set for contracting new loans by all public sector activities.

To improve the reserve position of the Central Bank of Egypt, quarterly target levels of international reserves are set[11], to be fulfilled during the program.

5. <u>Monetary reform and policies</u>

The main components are:

(a) The Central Bank of Egypt targets net domestic assets to a level consistent with its economic and financial objectives. In order to do that, the government has to develop its domestic debt management, including sales of treasury bills to financial institutions and to the public at market-determined interest rates. This procedure started 2 January 1991.

(b) A number of changes in monetary policy instruments took place recently to shift to indirect monetary controls. Among those are lowering the reserve requirement on Egyptian pound deposits from a minimum of 25 percent, while extending its coverage to include all Egyptian pound deposits in commercial banks and business and investment banks.

(c) Starting 3 January 1991 banks were free to set their own lending and deposits rates. The treasury bill rate is expected to be the guide to the deposits and lending rates set by commercial banks and other financial institutions.

(d) The Government is committed not to increase its preferential credit to specialized banks from the level that already existed on 3 January 1991. Any new credit to the specialized banks, the Housing Bank and the Export Bank will be given at the prevailing market rate.

(e) The Central Bank of Egypt issued a circular to regulate banks' net foreign currency position in two ways: The banks' ratio of foreign currency liabilities to foreign currency assets and the inverse should not exceed 105 percent, and the difference between foreign currency liabilities and assets should be limited to 15 percent of the individual banks' capital. The same limit applies also to non-bank institutions that deal in foreign currency.

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[11] For these levels, see IMF (1991), Table 2 in the 'Memorandum of Understanding'.

(f) On 31 January 1991, the Central Bank of Egypt issued regulations to standardize banks' capital requirements along the Basle risk-weighted guidelines. Accordingly, each bank is required to bring its capital to 8 percent of its risk-weighted assets by the end of 1993.

ERSAP calls for tight monetary and credit policies. The main features of this policy are: imposing credit ceilings on the banking system; and increasing interest rates, guided by the interest rate on treasury bills.

Regarding credit ceilings, limits have been set for domestic credit and domestic assets of the banking system to slow down their average monthly growth rate and even decrease their levels (table 1). According to the credit ceilings, the stock of net domestic assets of the banking system, net credit to the non-financial public sector, and net credit to the central and local governments and the General Authority for Supply Commodities (GASC), at end of June 1991, end of September 1991, and end of December 1991 should not exceed the limits set in Table 1.

The interest rate on treasury bills, which is the principal guide for a system of market-determined interest rates, was raised from 14 percent in January 1991 to 18 percent in late March.

6. Fiscal policies

The Government of Egypt is committed to achieve a budget deficit of no more than 9.5 percent of GDP in 1991/92[12], 6.5 percent of GDP in 1992/93, and eventually to 3.5 percent in 1995/96. Given this objective, and the anticipated foreign financing and non-bank domestic financing, the Government will be able to limit its recourse to bank financing to LE 0.4 billion, or 0.5 percent of the existing money stock.

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12 This target is to be increased for Social Fund expenditures up to LE 600 million, for any investment outlays financed from abroad for emergency resettlement related to the Gulf crisis, and for foreign grants to be received in 1991/92 and which are explicitly identified by the donor as a compensation for the revenue lost due to the delay in raising domestic energy prices.

Table 1. Limits on domestic credit and net domestic assets of the banking system

(Millions of LE; end of period)

	1990	1991				1992
	December Actuals	February Actuals	June Ceiling	September Ceiling	December Ceiling	June Indicative Ceiling
Net domestic assets	73,928	79,410	78,300	79,120	82,150	93,200
Average Monthly growth rate[1] (%)	-	3.7	- 0.3	0.3	1.3	2.2
Net Claims on non-financial public sector	38,861	38,525	37,400	35,300	35,375	36,060
Average Monthly growth rate[1] (%)	-	- 1.8	- 0.7	- 1.9	0.07	0.3
Net claims on central & local governments and GASC[2]	38,651	38,633	37,930	37,400	38,170	38,445
Average Monthly growth rate[1] (%)	-	- 0.02	- 0.5	- 0.5	0.7	0.1

Source: IMF (1991), Table I in the Memorandum of Understanding.

1) Own Calculations.
2) General Authority for Supply Commodities.

On the revenue side, measures are included to increase revenue and improve its elasticity with respect to GDP. Measures taken in 1990/91 - the restoration of customs duty rates, the introduction of the general sales tax and the increase in energy prices will have a positive impact on revenues in 1991/92. Additional revenue increasing measures included in the 1991/92 budget are: (i) extending the sales tax to some services and including the customs duties in the sales tax base for imported items; (ii) increasing excise taxes on cigarettes, tobacco and other items that are subject to consumer taxes; (iii) increasing specific stamp taxes and levying a supplementary tax on wedding celebrations of LE 40 thousand and more; (iv) a sizable increase in taxes on travel services; (v) requiring public enterprises to remit higher amounts of profits to the Government, based upon the assessed capital investment and the sale of public enterprises assets; (vi) increasing fees and charges to levels covering the cost of providing the relevant services. All these measures, including those taken in 1990/91 regarding energy prices, the sales tax and the customs rate restoration, are expected to yield revenues equivalent to about 6 percent of GDP.

On the expenditure side, the main measures consist of restraining the increase in the wage bill, so that it is not more-than 16.4 percent above that of 1990/91; reducing public investment to slightly less than 11 percent of GDP; and reducing subsidies by about LE one billion, i.e., about one percent of GDP. However, with the new exchange system applied in February 1991, the absolute amount of subsidies will increase due to the depreciation of the Egyptian pound.

To ensure that the above mentioned fiscal targets are achieved, the Government has a contingency plan of compensating fiscal measures, which will be applied if exogenous adverse developments affecting such important elements as the interest rate, import prices and oil export prices, and/or domestic factors such as the exchange rate, inflation rate and domestic interest rates, that may affect those targets. These contingency measures include further subsidy reductions, restructuring of Social Fund expenditures, additional increases in selected customs duties and taxes, and expansion of other cost recovery policies.

Fiscal targets for 1992/93 are also included in ERSAP. The Government is committed to cut the budget deficit to no more than 6.5 percent of GDP in 1992/93, by continuing its effort to increase revenue elasticity and base and cutting expenditures. On the revenue side, important measures to be taken include: (i) implementing a global personal income tax with minimum exemptions, and levying taxes on some agricultural incomes; (ii) widening the base of corporate taxation to cover more private sector enterprises with minimum exemptions and tax holidays; (iii) extending further the general sales tax to cover wholesale activities; (iv) increasing further the fees and charges on public services to cover their costs; (v) continuing the process of converting specific consumption taxes to ad-valorem taxes; (vi) improving the administration of tax services and raising the efficiency of tax collection by computerization, improvement in auditing, targeting areas of wealth, raising penalties for tax evasion,, etc.

On the expenditure side, the Government will continue cutting spending on wages, so that the total bill falls 15 percent in real terms as compared to the 1991/92 level; reducing subsidies by decreasing the amount and number of goods sold at subsidized prices; and reducing public investment in real terms as the privatization process moves ahead and the private sector's share in economic activity expands. A broad civil service reform will be undertaken which will bring about large reductions in government wages and salaries.

7. Social policies

The aim is to minimize the negative social impact of ERSAP on the poor by creating a Social Fund for Development (SFD), to be supported by an International Development Association (IDA) credit of Special Drawing Rights (SDRs) 105 million ($ 140 million) and concessional co-financing of $ 400-500 million.

The objectives of the SFD are: (i) mobilize international and domestic funds on concessional terms; (ii) finance selected projects in the areas of labour-intensive public works, small-enterprise and community development; (iii) develop and implement a labor mobility program that complements the public enterprise reform program; and (iv), strengthen the Government's capacity to design and monitor poverty alleviation policies in the longer term.

The SFD was officially established in January 1991. It is directed by a Board whose members are selected from the public and private sectors; the Prime Minister is the chairman of the Board. The Managing Director of the SFD reports directly to the Prime Minister. According to ERSAP, the SFD is a temporary entity which provides a short-term safety net to vulnerable groups that will be adversely affected by the structural adjustment program. Arrangements will be made to transfer gradually the SFD program to the relevant Government ministries and agencies.

One of the SFD's main functions is to assess the scope of the redeployment resulting from the public enterprises reform, and to design measures to minimize its negative impact on the economy. Accordingly, specific programs will be developed to facilitate labour mobility between public and private enterprise, to provide unemployment insurance and pension options for early retirement, and to deliver on-site employment assistance during redeployment. A second important function is to establish a social sector information system and a permanent data base on living standards, poverty and social development. The objective is to design effective mechanisms for targeting the poor and distributing consumer subsidies and other direct transfer schemes more efficiently. A third SFD's function is to support projects that promote employment in areas with high poverty and unemployment rates.

B. Performance Criteria

Five performance criteria are included in the Memorandum of Understanding on the IMF Stand-by Arrangement of April 1991 (IMF, 1991):

Credit ceilings. The stock of net domestic assets of the banking system, net credit to the non-financial public sector, and net credit to the central and local governments and the GASC will not exceed the limits set during 1991/92 (see Table 1 for credit ceiling limits).

Net international reserves. The net international reserves of the Central Bank of Egypt will not fall below certain limits, set by the IMF, in June, September, and December 1991, and June 1992; these limits are included in the Memorandum of Understanding of the IMF Stand-by Arrangement (IMF, 1991; Table 2).

Arrears on external debt servicing obligations. The Government is to eliminate the existing external arrears, estimated at $ 1.4 billion at the end of June 1990, and not to incur any new arrears during the period of the stand-by arrangement, except transitionally for amounts for which rescheduling is programmed.

External borrowing. Limits are set for the public sector's external borrowing of different maturities (less than one year, 1-5 years, and up to 12 years); these limits are set for three points in time in 1991 (June, September, and December) and for June 1992[13]. The Government is committed not to exceed these external borrowing limits. For this performance criteria, the public sector is defined to include central and local governments, all public authorities and publicly-owned enterprises, and all public financial institutions including the Central Bank and public sector commercial and specialized banks.

Exchange and trade system. The unification of the exchange system will be completed by February 26, 1992. During the period of the stand-by arrangement, the Government will not do the following: (i) impose new restrictions on current international transactions; (ii) introduce or modify multiple currency practices; (iii) conclude bilateral payments agreements; or (iv) impose or intensify import restrictions.

Adjustments will be made to the credit ceiling and the limits on net domestic assets and on net international reserves in specific cases stated in the IMF stand-by arrangement (IMF, 1991; Appendix II).

The stand-by arrangement which has been requested by the Egyptian Government and approved by the Fund is of an amount equivalent to SDRs 278 million, covering the period from May 1991 to November 30, 1992 (IMF, 1991).

C. The Structural Adjustment Loan (SAL)

SAL is proposed to support the implementation of ERSAP. It was first considered in November 1989 in the context of negotiating the stabilization and structural adjustment program with the Egyptian Government. SAL follows from the macroeconomic framework of the IMF program and provides a medium-term framework and financing plan to restore the credit worthiness of the Egyptian economy.

Objectives of SAL. The objectives of SAL are: (i) reducing the role of the State in production activities and re-orienting economic management toward a market-based economy; (ii) improving the private sector environment, putting it on equal footing with the public sector, and enhancing competition; and (iii), liberalizing pricing and trade policies to correct distortions in the price structure and incentive system.

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[13] For the external borrowing limits, see IMF (1991), the Memorandum of Understanding, Table 2.

Loan conditions, amount, and trenching. Several key policy actions have been selected as loan signing conditions. First, the actual promulgation of the new public investment Law, which is crucial to the implementation of public enterprise reform, includes the adoption of the Law's executive regulation, the establishment of the Public Investment Office, the start of the conversion of the 37 public sector organizations into transitional holding companies, tariff liberalization of the parastatal inter-city truck and bus company, and the elimination of the centralized foreign exchange budget of public enterprises. Second, agreement on the formula to be applied to adjust cotton prices to the international level target. Third, extending the liberalized investment system of production licensing and registration of firms, now enjoyed by Law 159, to enterprises organized under Laws 43 and 230.

The amount of the loan is $ 300, to be disbursed in two equal trenches. The first tranche - $ 150- was to be available on September 1991, while the second tranche will be released on completion of the conditions of the second tranche as specified by the Bank (Table II in the Appendix). The loan is made to the Government, and its amount has been specified on the basis of the expected balance-of-payments needs in 1992/93. SAL is supported by co-financing from the African Development Bank of (UA 100 million in two trenches), and the European Economic Community (ECU 60-100 million linked to the second tranche release). SAL and its co-financing represent an integral part of the prospective international financing program for Egypt.

The implementation of ERSAP is estimated to cost the Government's budget in 1991/92 about LE 700-800 million net. This amount includes the following: (i) the net cost of the debt-equity conversion of the Egyptian National Railways (estimated at LE 200-400 million); (ii) the net cost of the unemployment insurance, early retirement benefits, and separation benefits[14] that will result from the implementation of the public enterprises reform (estimated at LE 20 million); (iii) the training cost of workers (estimated at about LE 120 million); (iv) the social program's expenditures (estimated at about LE 800 million over a four year period, or LE 200 millon for 1991/92). The SAL and its co-financing arrangements will help in covering these costs[15]. SAL serves also as an instrument to mobilize additional lending and

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[14] The cost of separation benefits is the cost of moving public enterprises' workers to work in other economic activities during the adjustment period.

[15] According to the given cost figures, the first tranche release of SAL (equivalent to $ 150 millions) will cover about 60-70 percent of the estimated cost to Government in 1991/92.

encourages debt rescheduling and relief in order to restore credit worthiness to the country.

D. World Bank Assistance Strategy.

Besides the proposed adjustment loans covered by SAL, the World Bank's assistance includes also a Bank Group's investment lending program. The main objectives of this lending program are to promote private sector's participation; reform the inefficient public sector; improve Egypt's management of scarce water and land resources and protecting the environment; enhancement of the country's human resources through lending in areas like health, education and water supply/sewerage; and working with the Government, through the International Development Association (IDA), to develop a Social Fund for Development (SFD), which will provide a safety net for the vulnerable groups who will be hurt during the structural adjustment process. The SFD will help also to create employment opportunities through the development of small enterprises and the implementation of labour-intensive investment projects, as well as facilitating the economic integration of Egyptian returnees from the Gulf. The proposed World Bank Group program may allocate about $ 1.5 billion to Egypt in Bank and IDA resources over the period 1991/92-1993/94, depending on the continued implementation of the reform effort by the Egyptian government.

IV. THE ECONOMIC IMPACT

The Egyptian economy has suffered imbalances on both the demand and supply sides of the economy. Excess demand has been reflected in a chronic deficit in the balance of payments, large and widening budget deficits, and a high inflation rate. To restore balance, the IMF recommends a policy package which includes expenditure-reducing and expenditure-switching measures. This policy package (ERSAP) is supposed to work on both the demand and supply sides of the economy, by decreasing the former and expanding the latter. The expenditure-reducing policies, with their contractionary effects (such as tight fiscal and monetary policies, pricing policies), will act to reduce demand. The expenditure-switching measures (such as exchange rate reform) are supposed to increase the flow of real output through two channels: in the short-term, increasing the efficiency of resource allocation by eliminating the distortions caused by an overvalued exchange rate, rigidity in prices, subsidies, and taxes; and in the long-run, through raising savings and investment rates, providing incentives to saving and capital formation, and by investing in human resources (through education and training) and the development of technology (Khan & Malcolm, 1982).

The economic impact of ERSAP and SAL will be assessed by their effect on the symptoms of excess demand, namely, the balance of payments deficit, the budget deficit, and the inflation rate; and on the supply side, by their impact on output and employment.

A. Impact on the Balance of Payments

The impact of ERSAP on the balance of payments is mainly through the expenditure-reducing policies, expenditure-switching policies and debt relief. The decrease in domestic absorption through expenditure-reducing policies will lower demand for imports. The exchange reform affects the balance of payments directly through the Pound devaluation and indirectly through the exchange system applied by pegging the Egyptian pound to the United States dollar. Devaluation is supposed to increase demand for exports because of the decrease in export prices in foreign currencies, and is also supposed to shift factors of production from producing non-tradables to producing tradables, since the latter become more profitable. Generally speaking, pegging the domestic currency to one of the international currencies makes it easier for the monetary authority, namely the Central Bank, to manage the exchange rate. However, pegging the exchange rate has its disadvantage. If the foreign currency to which the domestic currency is pegged appreciate, the balance of payments of the foreign country will come under pressure, and so will also the balance of payments of the country with the pegged currency. For example, the real effective exchange rate of the dollar appreciated by about 30 percent between 1980-1985, and the United States suffered accordingly a deficit in its current account. Any country that had its currency pegged to the dollar at that time would have suffered the same fate (Fisher, 1988). The country will experience a larger deficit if the foreign country to which it begs its domestic currency is not its main trading partner.

The impact of ERSAP on Egypt's balance of payments will be assessed through its actual impact on the current account balance, and the potential impact of the currency-peg system on Egypt's balance of payments.

1. Impact on the current account balance

The Egyptian pound has undergone several devaluations. What is new in this exchange rate reform, compared to what has been recommended in previous IMF stand-by arrangements, is the unification of the exchange rate market -with a transitional period of one year[16]- and pegging the Egyptian pound to the United States dollar. As shown in Table 2, the Egyptian pound was devalued from $1 = LE 2.708 at the end of June 1990 to $1 = LE 3.342 by February 1991, i.e., a devaluation of 23 percent.

The devaluation of the Egyptian currency, together with the application of tight fiscal and monetary policies, are supposed to decrease the deficit in Egypt's balance of payments. One of the main features of the tight monetary policy applied in accordance with ERSAP is the big jump in interest rates. For example, the average annual deposit rate rose from 12 percent in 1989/90 to 16 percent in 1990/91 and further to 17.1 percent in 1991/92 (World Bank, 1992; Vol.III, Table AII.I). As shown in Table 3, the impact of these policies on Egypt's current account was positive. The persisting deficit in the current account, which stood at $ 634 million in 1989/90, turned into a surplus of $ 1391.3 million in 1990/91 and $ 3762.7 million in 1991/92.

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[16] This one year transitional period has been shortened to 8 months, since the Egyptian Government announced the unification of the exchange rate in October 1991 (Central Bank of Egypt, 1991/92).

Table 2. The exchange rate of the Egyptian Pound in the free market*

(End of June)

Year	Exchange Rate	Change (%)
1986	1.330	-
1987(1)	1.470	10.5
1988	2.303	56.7
1989	2.593	12.6
1990	2.708	4.4
1991	3.342	23.4
1992	3.321	-0.6

Source: Central Bank of Egypt, The Annual Report (1986/87, 1987/88, 1989/90, 1991/92).

1) The monthly average of the exchange rate in July 1987 was L.E 2.20.

* Egyptian pounds per one United States dollar.

This implies a quick response of the supply and demand factors to the currency devaluation and to the tight policy measures applied. What is surprising is the short lag (five months) between the devaluation of the pound in February 1991 and the improvement in the balance of payments at the end of June 1991. An important point to note is that this was not the first time that Egypt had coupled currency devaluation with tight policy measures; but the impact on the balance of payments was not that good. For example, in 1987/88, the Pound was devalued by 56.7 percent (table 2), which is much larger than the 1991 devaluation, and it was coupled also with tight fiscal and monetary policies according to the IMF stand-by arrangement; but the impact on the current account balance was not as impressive. The current account deficit remained, though it fell from $ 924.3 million in 1986/87 to $ 544.6 million in 1987/88 (table 3). The main difference between the two situations is that the 1991 devaluation, unlike the earlier one, was coupled with a rise in domestic interest rates. However, the impact of the devaluation and the rise in domestic interest rates would not have been sufficient to induce such a positive impact on the balance of payments and in such a short period of time, had they not been taken at a time when international interest rates were low. In June 1991, the average nominal interest rate on deposits of one year and less in United States dollars and Pound Sterling were 6.2 percent and 11.3 percent, respectively (Central Bank of Egypt, 1991/92), as compared to an average domestic interest rate of 16 percent (World Bank, 1992; Vol. III); and in June 1992, the average nominal interest rates on dollar and Sterling deposits of 3 months were 3.9 percent and 10.1 percent, respectively, compared to an

Table 3. Current account balance in Egypt.

(Million United States dollars)

	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
1- Trade Balance	(4978.4)	(5058.9)	(6567.0)	(7556.0)	(8296.3)	(7537.7)	(6403.1)
Exports	3575.7	2264.4	3274.0	2737.5	3144.8	3886.8	3636.4
Imports[1)]	8554.1	7323.3	9841.0	10293.5	11441.1	11424.0	10039.5
2- Services and Transfer Account	3325.5	4134.6	6022.4	6002.9	7662.3	8929.0	10165.8
Receipts	6924.3	7372.7	8656.0	9301.7	11619.2	12941.0	15152.0
Suez Canal Dues	1028.3	1138.0	1268.7	1306.7	1471.8	1661.9	1950.2
Tourism	315.3	379.6	885.9	900.6	1071.8	924.1	1727.1
Workers' remittances	2972.7	9011.9	3383.9	3532.2	3742.6	3775.3	5467.4
Payments	3598.8	3238.1	2633.6	3228.2	3956.9	4012.0	4986.2
Interest payments	1292.4	1093.5	785.1	1123.2	1688.5	1529.7	1311.2
3- Current account balance (1+2)	(1652.9)	(924.3)	(544.6)	(1553.1)	(634.0)	1391.3	3762.7

Source: Central Bank of Egypt, The Annual Report (1987/88, 1989/90, and 1991/92).

1) Includes imported commodities in the form of grants.

average interest rate on LE 3 months deposits of 16.7 percent (Central Bank of Egypt, 1991/92). Comparing this with the situation in 1987, the average nominal interest rates on three months dollar and sterling deposits were 7.1 percent, and 9 percent, compared to 8.5 percent on the LE deposits (Central Bank of Egypt, 1987/88). Thus, it would appear that the large interest rates differentials between the Egyptian pound deposits and the international currencies deposits played a crucial role in realizing the current account surplus in 1990/91 and the year after.

A supportive argument of this hypothesis, which attributes the positive impact on the balance of payments mainly to exogenous factors, is the short period that elapsed between applying the policies of devaluation and raising interest rates, and the emergence of a surplus on the current account. The measures were introduced in February 1991 and the positive outcome became apparent at the end of June 1991, i.e., after five months only. Another supportive development is the response in the private dollarization phenomenon in Egypt in 1991 as compared to 1987. Private dollarization remained virtually unchanged between 1986/87 and 1987/88 (table 8). The situation was drastically different in 1991/92 relative to 1990/91; private dollarization fell from 62.0 percent in 1990/91 (table 8) to 44.8 percent in 1991/92 (World Bank, Vol. III).

Two points are worth mentioning here. The first is that the response of private dollarization was not as quick as it was on the balance of payments. It took more than a year for the positive impact on private dollarization (from February 1991 to end of June 1992) to become apparent. Second, the immediate response to the devaluation and the rise in interest rates was an increase in the relative share of foreign currencies' deposits to 62 percent, compared to 57.9 percent in 1989/90, before it fell to 44.8 percent in 1991/92. This negative response of private dollarization in the short-term may be explained by two factors: (i) the cautious behaviour of the public reflecting a risk-aversion and wait and see attitude; and (ii) speculative hot money had probably flowed into the country, deposited in foreign currencies for a short period to evaluate the situation properly before converting to domestic currency deposits to realize short-term profits equal to the interest rates differentials.

As shown above, the improvement in the current account balance in 1990/91 and 1991/92 is attributed to a great extent to external factors. To isolate the impact of the Pound devaluation on the current account balance, the impact of the devaluations in 1987 and 1991 on the components of the current account balance which are highly sensitive to changes in the exchange rate will be compared.

These components are the trade balance and receipts from tourism and workers' remittances in the services and transfers accounts.

The large devaluation of the Pound in May 1987 could be expected to have had its impact on the balance of payments in 1987/88 and after, while the recent devaluation in February 1991 to have a partial impact on the balance of payments in 1990/91, and its full impact supposedly in 1991/92.

Assessing the impact of each of the two devaluations of the Egyptian pound on the balance of trade shows (table 3) that the increase in total exports to $ 3274 million in 1987/88, from $2264.4 million in 1986/87, is deceiving because of the large drop in total export that took place in 1986/87 (-57.9 percent). This was mainly due to the large drop in oil exports (table III in the Appendix). Actually the increase in 1987/88 was not enough to bring back exports to their 1985/86 level. Thus, one cannot point out to a positive impact of the large devaluation in 1987 on increasing exports, as was supposedly expected by the Fund and the World Bank. Exports in 1988/89 fell again because of the fall in oil exports, and the large devaluation of the Egyptian Pound was not an offsetting factor in this respect. In 1990/91, exports increased by 23.6 percent to $3886.8 million, and then fell to $3636.4 million in 1991/92 (i.e. by 6.4 percent), which is the year where supposedly a large part of the impact of the 1991 devaluation should be reflected. Thus, one cannot point out to a significant increase in Egypt's exports following the devaluation of the pound in 1987 and 1991. However, an improvement took place in the structure of Egyptian exports in favour of manufactured goods as shown in Table III in the Appendix. The relative share of oil and agricultural commodities in total exports has been declining since the mid-1980s. It fell from 72.2 percent in 1985/86 to 52.2 percent in 1991/92 (Table III in the Appendix). This change in export structure, in favour of manufactured goods, if maintained will make the impact of LE devaluation on the balance of payments more effective[17].

Comparing the impact of the devaluation in 1987 and in 1991 on Egypt's imports, one finds (table 3) that imports continued to rise after the 1987 devaluation. Imports increased from $7323.3 million in 1986/87 to $9841 million in 1987/88 (i.e. by 13.4 percent), and further to $ 10293.5 million in 1988/89 (i.e. by 10.5 percent). In contrast, imports declined in the two years following the 1991

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[17] This is because the prices of exports of raw materials and agricultural commodities are given on the world market, while for manufactured goods there is room for price differentials in promoting exports.

devaluation, by 0.1 percent to $11424.5 million in 1990/91, and by 12.1 percent to $10039.5 million in 1991/92. This implies that devaluation was apparently effective in decreasing imports in 1991 but not in 1987, inspite of the relatively larger devaluation in 1987.

This different response of imports to the Pound devaluation in the two years calls for an explanation. One possible explanation is that the contractionary fiscal and monetary policies applied in early 1991 were stronger, compared to those applied in 1987, resulting in a significant drop in aggregate demand over a short period of time. In the fiscal area, for example, government investment was reduced by 28 percent in 1991/92 as compared to an increase of 52 percent in 1987/88. This could have been reflected partly in increased demand for imports of intermediate and capital goods for public enterprises in 1987/88, and a decrease in 1991/92. In total, the Government succeeded in cutting the overall budget deficit to a level equivalent to 7.2 percent of GDP in 1991/92 as compared to 26.5 percent in 1987/88 (table 5). With respect to monetary policy measures, interest rates were increased by about 33 percent in February 1991, while no change in interest rates took place in 1987/88 (table 8). A second explanation relates to the large debt arrears ($11.4 billion in 1990), which would have probably affected Egypt's credit facilities until debt re-scheduling took place as part of ERSAP. It may be worth noting also that the re-scheduling of the debt service took place within the IMF stand-by arrangement of 1987/88, which may explain the continuous rise in imports after 1987, because of the relief of the debt service pressure on the balance of payments. One would wonder, though, about the course of developments in Egypt's imports after the debt rescheduling in 1991/92. Will the decline be reversed; or would the significant reduction in aggregate demand that took place under ERSAP and SAL have a stronger counter impact which will sustain the declining trend of imports for few years?

The outcome of developments in exports and imports as a result of the devaluation is reflected in the trade balance. This balance remained in deficit after both devaluations. However, the deficit recorded a decline after the 1991 devaluation, falling from $ 8296.3 million in 1989/90 to $ 7537.7 million in 1990/91, and further to $ 6403.1 million in 1991/92, or at an average rate of 9.1 percent a year (table 3). After the LE devaluation in 1987, in contrast, the trade deficit increased from $ 5058.9 million in 1986/87 to $ 6567.0 million in 1987/88, i.e. by 29.8 percent, then increased again by 15.1 percent in 1988/89 to $ 7556.0 million (table 3). The trade deficit/GDP ratio fell from 16.0 percent in 1987/88 to 13.4 percent in 1990/91 (World Bank, 1992; Vol. III, Table AIII.2).

The main impact of the currency devaluation on the services and transfers accounts relates to tourism and workers' remittances. Regarding tourism, it is quite clear from Table 3 that the 1987 and 1991 devaluations were associated with a jump in tourism receipts, with the exception of 1990/91 because of the Gulf crisis and war. Earnings from tourism increased from $ 379.6 million in 1986/87 to $ 885.9 million in 1987/88, or by 133.4 percent over one year, and reached $ 1727.2 million in 1991/92.

The impact of devaluation on workers' remittances, however, has been less impressive. The 1987 devaluation was associated with a 12.4 percent increase in workers' remittances in 1987/88 and 4.4 percent in 1988/89 (table 3). The large increase in workers' remittances in 1991/92 as compared to 1990/91 (from $3775.3 million to $ 5467.4 million) could be attributed to the Gulf War, more than to the Pound devaluation in 1991. The return for good of many Egyptian workers, and the release of assets that were held during the War, have added to the cumulative impact of workers' remittances in 1991/92.

The nature of the Egyptian labour working in the Gulf countries renders the flow of remittances to Egypt inelastic with respect to the exchange rate in the long-run. One should differentiate in this respect between two groups of Egyptians working abroad. The first is a large group consisting mainly of manual workers, peasants, university graduates and low rank professionals; and the second is a relatively small group consisting mainly of professionals and intellectuals. The average worker's earnings in the first group is significantly lower than in the second, and hence the difference in their average saving. However, most of the savings of the first group represent actual and potential remittances to Egypt, which is not the case with respect to a good part of the savings realized by the second group. Much of the savings of the latter, especially those individuals who have worked abroad long enough to accumulate large savings, are deposited abroad.

The main difference between the two groups is that workers in the first group consider working abroad as a temporary means to accumulate capital, which enables them to achieve some pre-set target(s) in their home country (like getting married, acquiring a flat or building a house, starting a business to increase the family's income at home, etc.). However, this is not the case regarding most members of the second group, who have different educational and cultural background and hence different objectives and aspirations. Thus, most of the savings that are accumulated by the first group will be transferred sooner or later to Egypt. In other words, the savings of this group of Egyptians working abroad represent actual and potential remittances that are highly elastic with respect to the exchange rate in the short run, although inelastic in the long run, since most of those savings will be transferred eventually to Egypt.

In contrast, most of the savings of the second group may be considered as potential remittances that are not elastic to the exchange rate. Some of the factors that seem to be more important in attracting these savings are the economic and political stability of the system to secure the owners against capital confiscation and losses, the real return on savings and direct investment, etc. Thus, this part of potential remittances, which may be equal to $ 50 billions or $ 70 billions according to some estimates, cannot be attracted to Egypt by just devaluating the Egyptian Pound.

A positive impact of ERSAP on the balance of payments is reflected in the accumulation of foreign assets. The exchange reform introduced in 1990/91, coupled with the increase in domestic interest rates at a time when international rates were low, have raised net foreign assets from a negative balance of LE 4029 million in 1989/90 to LE 7236 million in 1990/91, and further to LE 21709 million in 1991/92 (table 6). Accordingly, the targeted level of net foreign assets in 1991/92, which is one of the performance criteria, will be slightly exceeded when using the exchange rate of $ 1 = LE 3.34 in converting these assets; it will be equal then to $ 6500 million, while the net international reserves target for 1991/92 is $ 6300 million[18]. But if these reserves are converted to dollars using the exchange rate set by the IMF for the purpose of monitoring performance, i.e., $ 1 = LE 4.49 in June 1992[19], then these reserves will be equal to $ 4835 million, and hence fall short of the target.

Another important factor that contributed to the positive impact on the balance of payments is the debt relief that was part of ERSAP. As the result of the Paris Club meeting, which relieved Egypt from 15 percent of its outstanding debt on a present-value basis, and the writing off of most of Egypt's debt to the United States and the Gulf countries, the external debt/GDP ratio fell from 144.3 percent in 1989/90 to 119.1 percent in 1990/91, and, further to 109.5 percent in 1991/92 (table 8). Accordingly, the ratio of interest payments to exports of goods and services (including workers' remittances) fell from 22.2 percent in 1989/90 to 10.7 percent in 1991/92.

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[18] See IMF (1991), Memorandum of Understanding, Table 2.

[19] See IMF (1991), footnote 2 of Table 1 in the Memorandum of Understanding.

2. The pegged exchange rate system

The pegging of the Egyptian pound to the United States dollar applied under ERSAP will be assessed with respect to its potential impact on Egypt's balance of payments. Reviewing the geographic distribution of Egypt's merchandise trade, one finds that the European Community (EC) countries are the main trading partners of Egypt (table 4). In 1990/91 and 1991/92, exports to the EC countries averaged 34 percent of Egypt's total exports, and imports from them averaged 31 percent of total imports. Egypt's trading with the United States in the same period averaged 12 percent for exports and 16 percent for imports. Ranking Egypt's trade partners on the basis of their relative importance, the EC countries come first with respect to both exports and imports, while the United States ranks fifth as exporter and second as importer (table 4). This means that the United States is not the main trading partner for Egypt, and that any unfavourable development in the exchange rate of the United States dollar with respect to the European currencies will be reflected unfavourably on Egypt's balance of payments. Generally speaking, a safer policy would be to peg the domestic currency to a basket of currencies of the main trading partners, with weights reflecting their relative shares in the country's trade (see Fisher, 1988; and Dornbush, 1988). Thus, a more appropriate exchange rate system for Egypt would have been to peg the Pound to a weighted average of the European Currency Unit (ECU) and the United States dollar, with weights reflecting the relative importance of both trading partners in Egypt's trade. This will reduce the risk of having Egypt's balance of payments exposed to unfavourable influences if the dollar or the ECU appreciate.

B. Impact on the Budget Deficit

Tight fiscal policy is recommended in ERSAP, as was the case in previous IMF stand-by arrangements with Egypt. This implies cutting government expenditures and increasing revenues in order to reduce the budget deficit.

The main IMF policy recommendations for reducing government expenditure are the decrease in the nominal growth rate of wages, in subsidies, and in government investment. Based on preliminary actual data of the government's budget for 1991/92, a tentative assessment of the impact of the implementation of ERSAP on the budget deficit can be made.

Table 4. Geographic distribution of Egypt's merchandise trade

(Percentages)

	1990/91		1991/92	
	Exports	Imports[1]	Exports	Imports[1]
Arab League countries	7.7	2.8	13.3	2.8
EC countries	31.7	29.3	36.4	33.2
East Europe	17.3	7.7	12.1	5.3
Other European Countries	2.2	11.4	2.7	12.2
Afro-Asian countries[2]	21.5	10.9	17.3	11.9
United States	13.7	15.8	10.0	16.8
Australia	0.03	1.6	0.1	3.1
Other countries[3]	5.7	20.5	8.2	14.7
TOTAL	100.0	100.0	100.0	100.0

Source: Calculated from: Central Bank of Egypt, Annual Report, 1991/92, Table 7/5.

1) Includes imports financed by grants.
2) Excludes the Arab countries.
3) The amount Includes "unallocated direct loans".

ERSAP recommends that the increase in wages in 1991/92 should not exceed 16.4 percent, while in 1992/93, the total wage bill should decrease by 15 percent in real terms. Comparing these targets with the wage bill in 1991/92 and 1992/93 (budget estimates), it can be seen from Table 5 that the wage bill has increased from LE 7118 million in 1990/91 to LE 8029 million (preliminary actuals) in 1991/92, or by 12.8 percent only; i.e. the target was more than realized. However, the wage target for 1992/93 cannot be realized according to the budget estimates. The budget estimate of the wage bill for 1992/93 is LE 9980 million (Ministry of Finance, 1993), which implies a nominal growth rate of 24.3 percent above the 1991/92 level. The attainment of the target of cutting the wage bill by 15 percent in real terms in 1992/93 implies that the expected inflation rate will shoot up as high as 40 percent. This is unrealistic in view of the fact that the inflation rate in 1991/92 was only 9.7 percent.

The increase in the wage bill by 12.8 percent in 1991/92, while the inflation rate, measured by the change in the consumer price index (CPI), was 21.1 percent (table 7), means that expenditures on wages decreased in real terms by 8.3 percent. As a matter of fact the wage bill has been falling in all years over the period 1987/88-1991/92 (with the exception of 1990/91), since the annual rate of inflation was higher than the annual increase in the wage bill during this period (compare the annual change in wages in Table 5 with the annual change in CPI in Table 7). The World Bank estimated that real government wages in 1987 were about half their level in 1973, while the real wages of public enterprises' employees were about 90 percent of their 1973 level; managers and senior level civil servants suffering most (World Bank, 1991c).

According to ERSAP, spending on subsidies should decrease by one billion Egyptian pounds from its 1990/91 level, to the equivalent of 1 percent of GDP. It was understood by the Fund, though, that the reduction is expected to be less than that because of the Pound devaluation that took place in February 1991. This target was not achieved. Outlays on subsidies in 1991/92 were higher than the targeted level. Subsidy payments rose from LE 5566 million in 1990/91 to LE 7237 million in 1991/92, i.e. by 30 percent (table 5). Expenditures on subsidies in 1991/92 represented 6.3 percent of GDP instead of the targeted level of 1 percent; as a matter of fact, their relative share in GDP has risen above the 1990/91 level of 5.6 percent.

Despite this increase in aggregate government spending on subsidies, in real terms and on a per capita basis it has been falling. As can be derived from Table 5, outlays on subsidies have been increasing at an average annual rate of 21 percent over the period 1987/88-1991/92, while the average annual inflation rate was 18.5 percent (calculated from Table 7). This implies an average annual increase in real expenditure on subsidies of 2.5 percent. But with the devaluations that took place in 1987 and 1991, and with an average population growth rate of 2.8 percent during the 1980s (CAPMAS, 1992a), the real subsidy per capita has fallen.

In 1990/91, government investment spending was LE 15831 million, representing 16 percent of GDP (Tables 5 and 8). According to ERSAP, the Government has to decrease its investment to 11 percent of GDP in 1991/92. This target has been exceeded;

Table 5. Summary of fiscal developments: 1986/87 -1991/92

(Million LE)

		1986/87	1987/88	1988/89	1989/90	1990/91	1991/92[1]
I-	Total Revenue (I.1 + I.2)	15449	19020	21267	21876	28559	41406
I.1-	Current Revenue	11242	13485	15625	17047	25608	37834
	of which:						
	Income and Profit Taxes[2]	2815	3300	4058	4246	6406	9996
	Indirect Taxes on Goods and Services[3]	1722	1894	2407	2874	3373	6324
	Transfers of Oil Sector and Suez Canal	1024	1229	1453	1229	4597	6730
I.2.-	Investment Revenue[4]	4207	5535	5642	4829	2951	3572
II-	Total Expenditure (II.1 + II.2)	24530	33460	33400	36393	45510	47563
II.1-	Current Expenditure	13137	16198	17432	22446	29679	36198
	of which:						
	Wages	3691	4570	5225	6064	7118	8029
	Subsidies	1652	3915	2573	4140	5566	7237
	Public Debt's Interest	1843	2304	3011	3656	7046	9510
	Local	..	..	..	2969	4176	6359
	Foreign	..	..	..	687	2870	3151
II.2-	Investment Expenditure	11393	17262	15968	13947	15831	11365
III-	Overall Deficit (I-II)	-9081	-14440	-12133	-14517	-16951	-6157
	of which:						
	Foreign Financing (net)	3793	5632	3609	3248	13512	1783
	Domestic Financing	5288	8808	8524	11269	3439	4374
	of which:						
	Domestic Banks Financing	2419	5061	4758	7697	1635	-345
	Treasury Bills	-	-	-	-	890	3594

Table 5. (continued)

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92[1]
As Percentage of GDP[5]						
I- Total revenue	-	34.9	32.4	27.7	28.9	-
II- Total Expenditure	-	61.3	50.9	46.1	46.1	-
III- Overall Deficit	-	26.5	18.5	18.4	17.2	7.2[6]

Source: Central Bank of Egypt, Annual Report, (1988/89, 1989/90, 1990/91, and 1991/92).

1) Preliminary actuals.
2) For 1986/87 - 1988/89, reference is to "taxes".
3) For 1986/87 - 1988/89, reference is to "consumer taxes".
4) Includes self financing.
5) Calculated using GDP figures (at current prices) in Table 8.
6) This is the figure cited in IMF (1992; Vol.III, P.65), which is supposed to be the actual figure. The preliminary actual figure as calculated from the Table is 5.3 per cent.

.. Not available.

government investment decreased to LE 11365 million in 1991/92, representing 9.9 percent of GDP. Government investment has been declining over the last few years (with the exception of 1990/91). It has decreased in nominal terms at an average annual rate of 8.5 percent over the period of 1987/88-1991/92 (table 5). With an average annual inflation rate of 18.5 percent over the same period (table 7), this means that government investment fell annually by 10 percent in real terms over the last five years. Knowing that government (or public) investment represents about three quarters of total domestic investment in Egypt (table 8), this has had a contractionary impact on the economy. For 1992/93, a further reduction in government investment is recommended by ERSAP.

One item in government expenditure is expected to grow rapidly in the coming years, namely interest payments on domestic public debt. With the rising trend of issuing treasury bills to finance the budget deficit, and to sterilize the portfolio shift from foreign currency deposits to LE deposits, interest payments on the domestic debt is expected to grow rapidly, and to represent a financial burden for the government in the near future. Interest payments on domestic debt increased from LE 4176 million in 1990/91 to LE 6359 million in 1991/92, i.e. by 52.3 percent in one year (table 5). It should be mentioned also that the value of interest payments in the budget is approaching rapidly that on subsidies and may exceed it soon; and if it continues growing at this high rate, it may exceed the wage item as well (table 5).

On the revenue side, and according to ERSAP, the measures taken in 1990/91, together with those recommended for 1991/92 (including broadening the sales' tax base, increasing indirect taxes on some items like cigarettes, tobacco, stamps, etc.), will yield revenues equal to about 6 percent of GDP. Performance was close to the target. Indirect taxes on goods and services increased from LE 3373 million in 1990/91, representing 3.4 percent of GDP, to LE 6324 million in 1991/92, or 5.5 percent of GDP. For 1991/92, with ERSAP recommending the implementation of measures to raise revenue and improve its elasticity with respect to GDP, including a universal personal income tax, widening the base of corporate taxation, extending the sales tax to cover wholesale activities, etc., the upward trend in government's revenue is expected to continue.

With these achievements on both the expenditure and revenue side, the Government has more than attained the budget deficit target as recommended in ERSAP. The target was to reduce the budget deficit to 9.5 percent of GDP in 1991/92 and to 6.5 percent in 1992/93. The Government succeeded in reducing the overall budget deficit from 17.2 percent in 1990/91 to 7.2 percent of GDP in 1991/92 (table 5). For 1992/93, the budget estimate for the overall deficit is LE 9144.3 million (Ministry of Finance, 1993). If it is assumed that GDP at current prices will grow at the same annual rate as in the last two years, or by 16.7 percent, the estimated budget deficit will be then 6.8 percent of GDP in 1992/93, which is quite close to the ERSAP's target. Thus, according to the budget estimates for 1992/93, the ERSAP target seems to be feasible.

Finally, the Government achievement also exceeded the target set by ERSAP with regard to the budget deficit financing. The target was to decrease banks' financing to LE 0.4 billion in 1991/92. The domestic banks' financing of the deficit was negative according to the preliminary actuals of 1991/92. It was -LE 345 million as compared to LE 1635 million in 1990/91. The Government has depended more on treasury bills and less on financing from banks in covering the budget deficit.

C. Impact on Inflation

Inflation may be caused by cost-push factors and/or by demand-pull factors. An assessment of the impact of ERSAP on inflation in Egypt will be done by examining the effects of both the cost-push and demand-pull factors included in the policy package, and the policy measures that the Government had taken already along the IMF and World Bank line, in preparation for the agreement with the two Bretton Woods institutions.

The main cost-push factors in ERSAP are: (i) the increase in indirect taxes; the upward adjustment in prices of some goods and services; (iii) the exchange reform; and (iv) raising interest rates.

Several measures were taken in 1990/91, and others are included in the 1991/92 budget, to raise indirect tax revenue, including the introduction of a general sales tax in 1990/91 and broadening its base gradually in 1991/92 and 1992/93 to cover wholesale trade; the restoration of the customs duty rate to its level before 1989 (which implies an increase of about 30 percent), and incorporating it in the sales tax base for imported items; increasing excise taxes on cigarettes, tobacco and other items; and increasing specific stamp taxes.

Several increases in prices of goods and services took place in the first half of 1991 (see IMF, 1991 and World Bank, 1991a) including bread, flour, and cigarettes; the elimination of subsidies on rationed tea and soap; higher annual telephone subscription rates; increasing petroleum product prices by a weighted average of 52 percent, or to 48 percent of the international equivalent; raising electricity prices by 50 percent to reach 59 percent of their long-run marginal cost level; removing pricing and marketing controls on agricultural products; reducing subsidies on fertilizers, pesticides, with the remaining agricultural input subsidies to be removed by 1992/93; increasing rail passenger tariffs by 15-40 percent and rail freight tariffs by 15 percent.

ERSAP Provides for additional price increases to be included in the 1991/92 and subsequent budgets. The planned price increases are mainly: further increases in the price of petroleum products before the second tranche release of the SAL[20] to bring them up to 67 percent of world prices, and annual increases thereafter until such prices reach international levels in 1995; increasing the price of electricity by 10 percent annually for four years until they reach their long-run marginal cost by 1995; price liberalization in agriculture is planned to be completed by 1992/93, with the exception of cotton and sugar cane whose prices will be liberalized gradually thereafter; increasing the prices of rail tariffs by five percentage points each year as of 1991/92 to cover 100 percent of operating costs in 1997/98; and as part of ERSAP, the prices of inter-city trucking and bus services are to be freed.

The devaluation of the Egyptian pound in February 1991 is another important factor for cost-push inflation. The resulting increase in prices of imported goods and the resulting increases in prices of basic consumer goods and of intermediate and capital goods, contributed to raise domestic production costs for many goods and services.

The increase in interest rates is also another important cost-push factor. By raising the cost of borrowed capital, it contributes to raising the cost of production. The bias in favour of borrowed capital, vis-a-vis self-financing, is a common phenomenon in many public and private enterprises. This will give a relatively higher weight to the cost of capital borrowing in raising production costs.

The main causes of the <u>demand-pull inflation</u> are:
(i) the budget deficit, especially when financed by borrowing from

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[20] This was supposed to be in June 1992 but has been postponed because of the delay in agreeing on the second stage of ERSAP which is currently under negotiation.

the Central Bank; (ii) domestic credit; and (iii) increases in wages.

ERSAP advocates tight fiscal policy. As noted above, the Government succeeded in reducing the budget deficit to 7.2 percent of GDP in 1991/92. According to ERSAP, the deficit is supposed to fall further to 6.5 percent in 1992/93, which seems to be a feasible target. Financing the budget deficit is being increasingly done by selling treasury bills to the public and the banks, and less through borrowing from the Central Bank. Domestic banks' financing of the budget deficit was negative in 1991/92 (table 5). This means that the budget deficit is becoming a less important factor in causing demand-pull inflation as the result of the implementation of ERSAP.

The implementation of ERSAP has had a strong impact on the development of domestic credit, the growth of which fell from an average annual rate of 25 percent in 1989/90 and 1990/91, to only 1.5 percent in 1991/92 (table 6). This shows how strong are the contractionary fiscal and monetary policies recommended by ERSAP to cause such a drop of this magnitude in the growth rate of domestic credit in one year.

While this large and fast drop in domestic credit reflects the success of the Egyptian Government in reducing aggregate demand sharply over a short period, it is expected to exert a strong negative impact on output and employment. The drop in domestic credit reflects mainly a large in reduction of net claims on government and public sector companies, which represent about two-thirds of total domestic credit in the Egyptian economy (table 6). The annual growth in claims on government fell from 24.7 percent in 1990/91 to a negative 2.6 percent in 1991/92. This could not have been feasible without the monetary reform measures introduced in ERSAP which, for the first time in Egypt, include financing the budget deficit by selling treasury bills to the banks (other than the Central Bank) and to the public, instead of resorting to borrowing from the Central Bank as before. This will make it feasible for the Central Bank, after developing a sizeable market for treasury bills, to use open market operations in monitoring domestic liquidity in the economy, instead of using direct control measures (such as changing the legal reserve ratio or the liquidity ratio).

Treasury bills have also been used by the Government to sterilize the impact of capital inflows which took place mainly through the portfolio shift from foreign currency deposits to domestic currency deposits (World Bank, 1992; Vol. I). These

Table 6. **Total domestic liquidity and counterpart items: 1985/86 -1991/92**

(Millions of LE)

		1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
I.	Domestic Liquidity (I.1 + I.2)	35169	39418	51076	59972	71813	91553	104616
	Annual Rate of Growth (%)	-	12.1	29.6	17.4	19.7	27.5	14.3
I.1-	Money Supply (MI)	12719	13405	14377	15600	17777	18803	21067
	Currency Outside Banks	8840	9262	9978	10710	12136	13051	14254
	Current Deposits in Local Currency	3879	4143	4399	4890	5641	5752	6813
I.2-	Quasi Money	22450	26013	36690	44372	54036	72750	83549
	Non-Current Deposits in Local Currency	11680	13793	15813	18373	21858	26301	44560
	Deposits in Foreign Currency[1]	10770	12220	20877	25999	32178	46449	38989
II.	Counterpart Items (II.1 + II.2 + II.3)	35169	39418	51067	59972	71813	91553	104616
II.1-	Domestic Credit	38911	45385	54170	64450	82112	100440	101928
	Annual Rate of Growth (%)		16.6	19.4	19.0	27.4	22.3	1.5
	Net Claims on Government of which:	19622	23103	26640	31925	43072	53723	52308
	Treasury Bills	-	-	-	-	-	3113	12569
	Claims on Public Sector Companies	4929	5623	7513	9004	11844	14916	16201
	Claims on Private Business Sector	13554	15838	19034	22329	25795	30079	30942
	Claims on Households Sector	806	821	983	1192	1401	1722	2477
II.2-	Net Foreign Assets	1554	421	1461	458	-4029	7236	21709
II.3-	Other Items (Net)	-5296	-6388	-4564	-4936	-6270	-16123	-19021

Source: Central Bank of Egypt, Annual Report, 1991/1992, Tables (3/2) & (3/2/4).

1) Includes current & non-current deposits in Foreign currencies.

capital inflows, if not counteracted with appropriate measures, would increase the money supply and cause the Egyptian pound to appreciate. This would contribute to undo the impact of tight policy measures and the currency devaluation implemented by ERSAP. Little less than two-thirds of the treasury bills were used for the sterilization of capital inflows. Out of a total increase in treasury bills of LE 9456 million in 1991/92, only LE 3594 million were used to finance the budget deficit (tables 5 and 6).

The annual growth rate of claims on public sector companies fell from 25.9 percent in 1990/91 to 8.6 percent in 1991/92. This is mainly attributed to the policy components in ERSAP of enforcing credit ceilings on public enterprises, and not confining their application to the private sector only as was the case in the 1987 IMF stand-by arrangement. The public enterprises reform introduced by ERSAP opted, besides privatization, for enforcing the same laws and regulations equally on the public and private sectors.

The third important component which represents about 30 percent of total domestic credit is claims on the private business sector (table 6). The growth rate of these claims has also dropped drastically between 1990/91 and in 1991/92 from 16.6 percent to 2.9 percent. Although their relative weight in total domestic credit is low compared to net claims on government and public enterprises, this large deceleration in their growth is quite significant. This is because one of the main objectives of ERSAP is to reform the Egyptian economy into a market-oriented one, through privatization and encouraging private sector activities. This large fall in the growth rate of claims on the private sector does not give the right signal in this direction. The slow growth rate of claims on the private sector is targeted as part of the tight credit ceiling policy recommended by ERSAP.

To sum up, the implementation of ERSAP raised total domestic credit marginally, from LE 100440 million in 1990/91 to LE 101928 million only in 1991/92, or by a mere 1.5 percent (table 6). This had a positive impact on reducing aggregate demand in the Egyptian economy, but is expected to have a negative impact on the supply side by reducing the rate of growth of output and employment as discussed below.

Regarding the possible inflationary impact of the increase in wages on aggregate demand, it has been shown earlier that real wages in the public sector have been falling in Egypt since the 1970s. Wages in the private sector have probably followed suit, given the close similarity in the distribution pattern of wages in the two sectors. For example, in the private establishments employing 10 workers and more, the percentage of employees who were receiving monthly earnings of LE 300 and above in December 1990 represents 26 percent of the total, compared to 26.5 percent of employees working in the public sector and receiving the same monthly earnings (calculated from: World Bank, 1992; Vol III, Table AX.6). Thus, wages should not be considered as an inflationary factor in Egypt.

From the above assessment, it is possible to say that ERSAP was effective in restraining the causes of demand-pull inflation, but has activated the factors causing cost-push inflation in the economy. Disregarding, or belittling, the inflationary cost-push factors in designing ERSAP is quite consistent with the IMF perception of this phenomenon. According to the Fund, the main cause of inflation is the budget deficit; hence its reduction has been one of the stabilization objectives in 86 out of 94 IMF-supported programmes during 1980-1981 (Sarker, 1991). Other important causes of inflation according to the Fund the are expansion in domestic credit and increases in Wages (Sarker, 1991). Thus, the causes of inflation emphasized by the IMF are the demand-pull factors. According to this perception, IMF diagnoses inflation in developing countries as the outcome of excess demand, and consequently the remedy is to reduce domestic absorption as much, and as rapidly, as possible by applying strong contractionary policy measures.

The cost-push factors included usually in the structural adjustment programmes recommended to developing countries -like currency devaluation, upward adjustment of prices, etc.- are conceived by the IMF as necessary means to eliminate price distortions and imbalances in the economy, and not as causes of inflation. According to the Fund, they increase prices only once and for all, and hence they should not be considered inflationary. The links of causality between this 'one time' price increase and the ultimate impact on the economy seems to be assumed away in the Fund's analysis. For example, raising prices of intermediate goods and services, such as energy and transportation, will raise the domestic cost of production for goods and services. The impact of the initial price increase will lead to a rise in the cost of living during the programme's implementation period, even if accompanied by contractionary fiscal and monetary policies. Tight policies will help in slowing down the impact of the chain of causation on the general price level, but it will not stop it. If the upward price adjustment is intended to continue for few years, as it is the case with energy and transportation, one has to expect that the impact of the initial price increases on raising the general price level, and hence the cost of living, will be neither unimportant nor short-lived. The reduction in aggregate demand through contractionary policies, together with these cost-push factors that are planned to last for few years (about 3 years according to ERSAP), will probably lead the economy to a stagflation state, where it suffers from a reduction in real output and higher unemployment and inflation rates.

The second important cause of cost-push inflation is the domestic currency devaluation. It is difficult to consider this factor as a cause for a once and for all increase in prices in the case of developing countries, Egypt included. Because the inflation rate is usually higher in the developing countries compared to the developed ones, and because the latter are usually the main trade partners of the former, the currency of a developing country will become overvalued after a short period, and another devaluation will be called for, and so on. The difference that may exist in developing countries' experiences is a matter of degree only. The exchange rate of the domestic currency may appreciate more rapidly in some developing economies as compared to others, depending on developments in some domestic and international factors, including the exchange rate system applied. With an exchange rate system in which the domestic currency is pegged to a foreign currency, like Egypt's case, it may take a relatively longer period, compared to a system applying crawling pegs, or flexible exchange rate systems. Thus, although currency devaluation may be considered as an effective means of decreasing balance of payments' deficit, it cannot be disregarded as an important and enduring cause for cost-push inflation.

Assessing the impact of ERSAP on inflation in Egypt should be done with caution. The official data on the consumer price index (CPI) is biased downward because of the commodity basket chosen, and the unrealistically low prices for used calculating the cost of goods and services in the basket (e.g. housing rents, education and health expenditures). Having in mind this downward bias of the CPI in Egypt, the inflation rate becomes 21.1 percent[21] in 1991/92 as compared to 14.7 percent in 1990/1991 and an average annual rate of 17.8 percent over the period 1987/88 - 1990/91 (table 7).

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21 The Egyptian Government has announced that the inflation rate in 1991/92 was 9.7 percent. This figure has been derived on the basis of changes in the CPI at the end of fiscal year 1991/92 compared to the end of 1990/91 (Central Bank of Egypt, 1991/92). This figure is difficult to accept, since it implies that the rate of inflation was 1 percent only over the last 6 months of 1991/92 (calculated from: Central Bank of Egypt, 1991/92; Tables on pp. 163 & 164). Moreover, the average value of the CPI over the year is more appropriate to use in estimating the inflation rate than using the value of the CPI at one point of time in the year (at the end of the fiscal year). It may be worth noting also that in referring to the inflation rate in Egypt, the World Bank has also used the average yearly rate of inflation of 21.1 percent (World Bank, 1992; Vol. III, Table AII.1).

One may conclude that inspite of the strong restraining impact of ERSAP on the inflationary demand-pull factors as shown above, an inflation rate of 21.1 percent was, nevertheless, recorded in 1991/92. This implies that the prevailing inflation in Egypt is mainly of a cost-push type. Consequently, it is to be hoped that the cost-push causes of inflation will be considered carefully in designing the second part of ERSAP, which is currently being negotiated and will be implemented soon.

Table 7. Urban consumer price index (CPI)

(Yearly Average; 1986/87 = 100)

	CPI	Rate of Change %
1987/88	118.6	18.6
1988/89	138.4	16.7
1989/90	167.7	21.2
1990/91	192.4	14.7
1991/92	233.0	21.1

Source: Central Bank of Egypt, Annual Report, 1991/92 Table 1/10.

D. Impact on output and employment

The assessment of the impact of ERSAP on output, the supply side in the economy, is not possible since the latest available national accounts data are for 1990/91. What can be done in this respect is to spell out what developments could be expected in the main macro variables, given that the Egyptian Government has been implementing policies along the IMF line since the early 1980s in preparation for signing an agreement with the Fund (Korayem, 1987); and also given the behaviour of those macro variables after implementing the approved stand-by arrangement with the IMF in 1987/1988, where tight policies and devaluation were applied accordingly. The main economic measures in the IMF 1987/88 agreement were: a large increase in the prices of electricity and major fuel products; adoption of a new exchange rate system with interbank free market rate; and modest increases in long-term lending interest rates (Carr, 1990; 243 (footnote 6)).

The performance of the Egyptian economy has been sluggish over the last few years. To assess the impact of ERSAP on the supply side of the economy, the expected performance of output and employment are examined.

1. <u>Impact on output</u>

To assess the expected impact of ERSAP on output, developments in three indicators will be evaluated namely, savings, investment and GDP growth rate.

Gross domestic investment, which averaged 22.5 percent of GDP over the period 1987/88 - 1990/91 was accompanied by a low rate of gross domestic saving, averaging 6.4 percent of GDP (table 8), and resulting in an average saving-investment gap equal to 16.1 percent of GDP. The second indicator, which is also discouraging, is the negative rate of growth of (GDI). Real gross domestic investment decreased from LE 11368 million in 1987/88, to LE 10378 million in 1990/91 (table 8). This reflects the decrease in public sector investment, which represented about three quarters of GDI over the last few years (table 5).

The third indicator of the poor performance of the Egyptian economy, which is correlated with the trend in investment is the low and declining growth rate of GDP over the period 1987/88 - 1990/91. GDP at constant prices grew from LE 47 billion in 1987/88 to LE 50.8 billion in 1990/91; the annual growth rate falling from 3.9 percent in 1987/88 to 2.3 percent in 1990/91 (table 8) and further to 1.5 percent in 1991/92 (World Bank, 1992; Vol. III, Table AIII.6).

Assessing the possible impact of the implementation of ERSAP on savings, investment and output, the following points may be pointed out.

(i) The pricing policies and the exchange reform in ERSAP raise the cost of living, which will raise private consumption expenditure. Since private consumption represents the larger component in total consumption (88.9 percent of total consumption in 1990/91), this behaviour will have a significant impact on raising total consumption and decreasing gross domestic savings. On the other hand, the large increase in interest rates on deposits is expected to encourage domestic savings. The final impact on domestic savings will depend on the net outcome of these two opposing effects.

Table 8. <u>Selected economic indicators</u>

(Millions LE)

	1987/88	1988/89	1989/90	1990/91
At Current Prices				
1. GDP deflator (1986/87 = 100)	1.160	1.354	1.589	1.943
2. Gross domestic product (GDP)	54553	65577	78907	98664
3. Consumption (C)	50102	61812	75120	91713
3.a. Private consumption (PC)	42729	53623	65888	81488
PC/C (%)	85.3	86.8	87.7	88.9
3.b. Government consumption (GC)	7373	8189	9232	10225
GC/C (%)	14.7	13.2	12.3	11.1
4. Gross domestic investment (GDI)	13187	15269	17276	20164
GDI/GDP (%)	24.2	23.3	21.9	20.4
4.a. Change in Stocks	150	240	360	420
4.b. Fixed Capital Formation	13037	15029	16916	19744
Private Investment (PRI)	2015	3549	2665	4677
PRI/GDI (%)	15.5	23.6	15.8	23.7
Public Investment (PBI)	11022	11480	14251	15067
PBI/GDI (%)	84.5	76.4	84.2	76.3
5. Gross national product (GNP)	52603	63934	77280	91410
6. Gross Domestic Saving (GDS)	4451	3765	3787	6951
GDS/GDP (%)	8.2	5.7	4.8	7.0
7. Population Estimates (in thousands)	52827	54188	55571	56910
8. Per capita income (LE)[1] (= 5 ÷ 6)	996	1180	1391	1606
9. Average nominal deposit rate[2] (%)	11.0	12.0	12.0	16.0
10. Average nominal lending rate[2] (%)	15.0	16.0	17.0	18.0
11. Private dollarization[3]	53.7	56.5	57.9	62.0
12. Interest payments/EXPGSR[4]	8.4	20.9	22.2	20.9
13. DOD/GDP[5]	155.0	127.9	144.3	119.1

Table 8. (continued)

	1987/88	1988/89	1989/90	1990/91
At Constant Prices[6)]				
GDP	47028	48432	49658	50779
GDP growth Rate (%)	3.9	3.0	2.5	2.3
C	42245	44662	44794	47668
GDI	11368	11277	19872	10378
GNP	45347	47219	48634	47046
GNP growth Rate (%)	2.9	4.1	3.0	-3.3
Per capita income (LE)	840	853	829	835

Source: World Bank (1992; Vol. III), and CAPMAS (1992a)

1) Assuming gross national income = GNP, i.e. without adjusting for the terms of trade effect. The terms of trade adjustment for Egypt was negative in 1987/88 and 1988/89, which are the latest data available (World Bank, 1991d).

2) On deposits and loans with a maturity of one year or less, except for fiscal year 1992, which is calculated using 3 months LE deposit rate.

3) Defined as the ratio of private sector's foreign currency deposits to private sector's total deposits.

4) Interest payments are calculated on actual basis from fiscal year 1989; prior to that, data on cash basis. EXPGSR is exports of goods and services including workers' remittances.

5) DOD is debt outstanding and disbursed.

6) Deflated by GDP deflator, except for per capita income which is deflated by CPI.

(ii) ERSAP is expected to have a negative impact on investment, at least in the short-run, because of two reasons. The strong contractionary monetary policy applied, which has reduced the growth rate of domestic credit to 1.5 percent in 1991/92 as compared to an average annual growth rate of 21 percent over the period 1987/88 - 1990/91 (table 6). The second reason is the tight fiscal policy which succeeded in reducing investment expenditure in the government budget by 28.2 percent between 1990/91 and 1991/92. This is expected to have a significant negative impact on total investment, since government investment represents more than three quarters of total gross domestic investment in Egypt as shown in table 8. However, the public-sector reform in ERSAP is aiming to compensate for the fall government investment by an increase in private investment through privatization, improving the investment environment and introducing appropriate laws and regulations that encourages private sector participation in economic activity. But the public enterprise reform will take a relatively long period to be implemented, and for its results to be felt[22]. On the other hand, the exchange rate reform and the changes that took place in the investment laws in favour of the private sector may encourage capital inflows to the country, which may be partly directed to investment. However, the Pound devaluation and the high differentials between the domestic and international interest rates makes it easy to realize profits by portfolio shifting from foreign currency to Egyptian pound deposits; this makes investment in projects a less attractive alternative for private capital.

Regarding the expected impact of ERSAP on GDP, it will largely depend on the net effect on investment as described above. If it succeeds in increasing private investment faster than the decline in public investment, GDP growth will higher. However, the impact of the implementation of ERSAP on GDP in 1991/92 is not encouraging; the rate of growth of GDP fell to 1.5 percent in that year (World Bank, 1992; Vol. III, table AIII.6) from an average annual growth rate of 2.9 percent during 1987/88 - 1990/91 (table 8). It should be noted also that government revenues from selling public enterprises will not be re-invested according to ERSAP, but will be allocated to cover current government expenditures in the budget. This represents liquidating assets by the government to cover consumption expenditure. Accordingly, the impact of privatization on investment will be a zero-sum game; private investment will just substitute public investment without a net addition to total investment. This policy is quite consistent with the Fund's objective of reforming the Egyptian economy to a market-based economy with a minimum government role in economic activity. This goal will not be achieved if revenues from privatization are re-invested in new public projects. An alternative that is worth

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[22] Chile, for example, started privatization since the mid-1970s and was still engaged in it throughout the 1980s (Nankani).

considering is to use the sales revenue to re-structure public enterprises that incur losses and to upgrade the strategic enterprises that are planned to remain publicly-owned.

2. Impact on employment

According to 1990 data, which are the latest available, the total labour force in Egypt is 15.7 million of a total population of 53.6 million (CAPMAS, 1993); i.e., representing 29.3 percent of the population. Out of this labour force 1.3 million persons are unemployed, yielding an unemployment rate of 8.3 percent in 1990. The current rate of unemployment seems to be higher than this figure according to several indicators. Some estimates of unemployment range between 2-3 million persons, representing about 13 - 20 percent of the labour force (United States Embassy, 1992). According to the 1990 data, 86.9 percent of the unemployed are new-comers to the labour market, and only 13.1 percent relate to previously employed workers. This low incidence of unemployment among previously employed workers should be interpreted in the context of prevailing labour laws that make laying-off workers very difficult in both public and private enterprises. It should also be noted that the government sector and public enterprises are over-staffed, because of the graduates' employment policy that was in effect until few years ago[23]. If the labour laws are changed to allow laying-off of workers, this low unemployment rate among the previously employed workers will increase significantly.

ERSAP will affect the labour market through two main channels: through its impact on total production; and through the implementation of the public enterprises reform.

The main factor affecting employment is the rate of growth of output and productivity. Given productivity, the higher the growth of output the more employment opportunities will be created in the economy. As seen above, ERSAP's monetary and fiscal reforms have had so far a contractionary impact on total investment and growth of GDP. The GDP rate of growth has been reduced from an already low level of 2.3 percent in 1990/91 (table 8), to 1.5 percent in 1991/92 (World Bank, 1992; Vol. III, Table AIII.6). Although some relaxing of the domestic credit constraints facing the private sector took place already, and the same will be done soon for public enterprises, the important thing is how the business sector (public and private) responds to these changes. Besides the

[23] Officially, the graduates' employment policy is not eliminated yet, but practically it has not been applied for more than six years now.

domestic credit ceiling, the response of the business sector will depend on factors like the behaviour of the lending interest rates (whether it will fall or not), and the outcome of the implementation of the public enterprises reform. It is still too early to assess the impact of ERSAP on GDP in the medium and long-term. But in the short-term, and judging by what has happened so far, a 1.5 percent increase in GDP is certainly not a good achievement and has adverse implications for employment.

The impact of privatization on employment is negative, at least in the short-term as the experience of other countries shows. The overstaffed public enterprises cannot be sold to the private sector, unless the new owners are allowed legally to lay-off workers. The new changes in the labour law are expected to address this issue. This is expected to raise unemployment among previously employed workers to more than the prevailing 1.1 percent level.

The IMF and World Bank are aware of this problem and, to minimize it, some funds will be allocated through SAL and the Social Fund for training programs to enhance workers mobility. Also, unemployment insurance is recommended by ERSAP to minimize this negative social impact of privatization. But the question is how sufficient are those measures to cope with the problem. In 1990, 1.5 million workers, out of a total number of 14.4 million employed, were working in public enterprises (CAPMAS, 1993).

Laying off workers in public enterprises is expected to take place through privatization, and also through reforming the enterprises that will remain in the public sector. The new expected labour Law will probably allow the managers of those enterprises to lay off workers according to work needs; after all, one of the objectives of ERSAP is to equate public and private enterprise business environment. Accordingly, with the implementation of the public enterprises reform, about one-quarter of the already employed workers in public enterprises, or 380,000 workers, may be layed off.

Finance should be available for re-training and creating jobs for the layed-off workers. Estimating that LE 4000 per worker is needed for this purpose (World Bank, 1991a), a total of LE 1.5 billion will be needed[24]. Laying off 380 thousand workers means also adding this number to the unemployment of the previously

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[24] SAL includes allowances for retraining 30 thousand workers in 1991/92, for LE 120 million, and unemployment insurance of LE 12 million (World Bank, 1991a).

employed in the labour market and raising the number of the unemployed in this category by about 200 percent according to 1990 data; the number of previously unemployed in 1990 was 180 thousand workers (CAPMAS, 1993). However, privatization and reforming public enterprises will not be done over a one year period. Therefore, the impact on unemployment will be spread over a number of years; the same applies to the financial resources needed for workers' re-training and jobs creation. The slower is the implementation of the public enterprises reform is, the smaller will be the negative impact on unemployment, and the lower will be the financial burden that the economy has to bear annually.

To have a positive impact on the employment of new-comers to the labour market, it has to be assumed that privatization will create new jobs at a higher rate than in the public enterprises being transferred. This assumption is difficult to sustain in the short- and probably medium-term, because hiring conditions are more strict in private enterprises as compared to public enterprises. Overall, creating enough jobs for new comers depends mainly on the rate of growth of GDP. This largely depends on investment, given productivity. Measures to reduce investment figure prominently in the policy package. It is implicitly assumed that reforming the economy toward a market-oriented one will create an appropriate environment to attract domestic and foreign investment and consequently increase GDP growth rate. Although it is still early to tell, this has not happened so far as indicated by the low growth of GDP.

ERSAP is well stocked with effectively designed policy reforms and measures to rectify the imbalances on the demand side of the economy, but is relatively poorly designed to address the main imbalances and bottlenecks on the supply side. According to the developing countries experiences, the expenditure-switching measures (e.g. exchange reform, pricing policies, etc.), which the Fund promotes to rectify imbalances on the supply side, have proved insufficient to achieve an efficient allocation of resources, raise productivity, and increase the rate of growth of output.

V. ASSESSMENT OF THE SOCIAL IMPACT OF ERSAP

An assessment of the social impact of ERSAP will be made with respect to education, health, poverty, and income distribution.

A. Impact on Education

According to 1986 data, 90 percent of the children of age 6 were enrolled in schools (World Bank, 1991c). This impressive figure is subject to two reservations. First, the school enrollment ratio is overestimated because it is based on the recorded child birth data, which is below the actual figure, since not all child births in the country are reported. Second, quite a number of children drop out at an early stage before they learn to read and write. These illiterate children represent a continuous source of feeding illiteracy at the national level; illiteracy in 1986 was 62.5 percent for females and 37.3 percent for males with respect to the population aged 10 years and more (CAPMAS, 1992a).

Public education in Egypt is officially free at all levels. But, actually, this is not the case. Small fees are paid now at all education levels, and the deterioration in the quality of education makes private lessons a must for most students. This applies to public and private schools, though to a lesser degree in the latter. Several reasons are responsible for the deterioration in the quality of education. Among them are overcrowded classes, low teacher/students ratio, and low salaries for teachers.

Government spending on basic and higher education has been increasing in real terms over the 1980s. Real expenditures on basic education increased from LE 372.2 million in 1980/81 to LE 2564.8 million in 1989/90; for higher education the increase was from LE 180.0 million to LE 1151.3 million over the same interval, (World Bank, 1991c; Tables T10 and T11). However, the largest portion of these increases goes to salaries. For example, in 1989/90, the ratio of salaries in total government spending on education was 99.8 percent for basic education and 93.7 percent for higher education (calculated from: World Bank, 1991 c; tables T10 & T11). This means that the increase in real government expenditures on education has hardly an effect on the improvement of education services provided to students. This applies also to developments in expenditures per student in basic and higher education during the 1980s which increased from LE 51.5 in 1980/81 to LE 230.7 in 1989/90 for basic education, and from LE 331.1 to LE 1951.4 for higher education (World Bank, 1991c; Table J7). This increase is also deceiving because of the high share of salaries in the total.

Public investment in education accounted for over 90 percent of total investment in the sector over the period 1987/88 - 1991/92 (table 9). This ratio is planned to fall to 86 percent in 1992/93 (Ministry of Planning, 1992). Public investment increased from LE 321.4 million in 1987/88 to LE 715.7 million in 1991/92. In real terms, public investment in education increased by 15.6 percent over the four-year period: from LE 277.1 million to LE 320.4 million (table 9). The large increase in public investment in real terms between 1990/91 and 1991/92, by 43.0 percent (table 9), is quite deceiving. This is because of the large fall (64.6 percent) that took place in public investment in education in 1990/91. Thus, even with the recovery in real public investment in education in 1991/92, it was still below its level in 1988/89 and 1989/90, namely, LE 326.9 million and LE 346.9 million, respectively. For 1992/93, planned public investment in education is LE 1200 million (Ministry of Planning, 1992; Vol. I), reflecting a planned increase of 67.7 percent over 1991/92.

To assess the impact of ERSAP on education, it is not quite clear that the increase in investment in education in 1991/92 can be attributed to the implementation of the structural adjustment measures; it may very well represent a recovery to earlier levels. However, the fact remains that despite the reduction in total government investment called for by ERSAP, investment in education increased considerably in 1991/92.

The increase in real investment in education should not be taken, though, to indicate an increase in the supply of educational service at the national level. What counts here is real investment per student. Considering the increase in the number of students, real investment per student in education has been falling over the years. However, this is not attributed to the implementation of ERSAP, but it is the outcome of the general policy of the Government which has given investment in human capital a low priority.

B. <u>Impact on Health</u>

Government spending on health increased in real terms during the 1980s, from LE 148.4 million in 1980/81 to LE 691.4 million in 1989/90 (World Bank, 1991c). However, this cannot be taken as an indicator of improvement in the quality of health services provided to the population because the largest part of the expenditures has gone to salaries. For example, in 1989/90, salaries absorbed 96.4 percent of total expenditures on health (World Bank, 1991c).

Table 9. Public investment in education and health services

(LE millions)

	1987/88	1988/89	1989/90	1990/91	1991/92
Education					
Public investment (PIE)	321.4	442.6	551.3	435.3	715.7
Public investment at constant prices[1)]	277.1	326.9	346.9	224.0	320.4
Total investment (TIE)	341.4	468.6	577.3	468.3	795.7
PIE/TIE (%)	94.1	94.5	95.5	93.0	89.9
Health					
Public investment (PIH)	238.5	303.1	334.3	252.0	437.0
Public investment at constant prices[1)]	205.6	223.9	210.4	129.7	195.6
Total investment (TIH)	283.5	350.1	385.3	311.0	487.0
PIH/TIH (%)	84.1	86.6	86.8	81.0	89.7
Share in public investment at the National Level (%)					
Public investment in education	3.9	4.1	3.0	5.3	12.0
Public investment in health	2.9	2.6	1.5	2.4	5.0

Source: Ministry of Planning (1992; Vol.I).

1) Deflated by the GDP deflator in Table 8.

With the increase in costs, the Ministry of health adopted a cost-effective scheme to minimize subsidies allocated to the health sector (World Bank, 1991c). According to this scheme, a low costis charged for free health services, directly sometimes and indirectly at other times (e.g., by letting the patient buy his own medicine), which reduces the free service to the minimum. An additional factor that increased spending on health, is the increase in the prices of drugs over the last years.

ERSAP has contributed to the rise in the prices of drugs. With the devaluation of the pound in early 1991, the prices of imported drugs rose, as well as the cost of domestically produced drugs as about two-thirds of inputs are imported. With the reduction in subsidies, the increase in the cost of production of drugs led to a rise in their prices. Thus, with the cost effective scheme applied by the Ministry of Health, and the rise in medicine prices, the cost of health services provided to the poor rose significantly.

Public investment in health represents more than 80 percent of total investment in the sector (table 9). Public investment in health at constant prices increased from LE 129.7 million in 1990/91, to LE 195.6 million in 1991/92, but remained lower than it was during 1987/88 - 1989/90 (table 9). Government investment in health is planned to be LE 500 million in 1992/93 (Ministry of Planning, 1992; Vol. I). But despite the rise in public investment on health in 1991/92, and the planned rise for 1992/93, this does not necessarily mean an increase in the supply of health services. What counts here is the per capita investment in health. With an average rate of population growth of 2.8 percent, real public investment per capita has been significantly falling during the period of 1987/88 - 1991/92. The increase in the rate of inflation over this period, the upward adjustment of prices, and the devaluation which took place with the implementation of ERSAP, accentuated the need of the poorer segments of the population for free or low-cost social services, like health and education services.

C. Impact on Poverty

Poverty in Egypt, as measured by the number of households living at the poverty line or below, decreased during 1974/75 - 1981/82; the situation has relatively deteriorated afterwards. The poverty line is defined here as the level of income that is sufficient to ensure a safe nutritional level for the household, as well as to cover its minimum non-food requirements. Table 10 summarizes the household's income poverty line, and the number of Egyptian households living at this line or below it for the period

1974/75 - 1984[25]. It is clear from Table 10 that rural poverty has decreased from 50.9 percent in 1974/75 to 29.7 percent (case A), and to 43.0 percent (case B)[26], in 1981/82, but then increased in 1984 to 33.7 percent and 47.2 percent, respectively. According to case B estimates, which appear to be more realistic -given the prevailing commodities distribution and pricing system in Egypt-the level of rural poverty in Egypt is significantly high compared to Latin America, but relatively low compared to Asia[27]. For the urban sector and at the national level, for which the income poverty line estimates are available for 1981/82 and 1984 only, one finds that poverty has also increased over the interval.

According to case A estimates, poverty in the urban sector increased from 30.4 percent in 1981/82 to 34.0 percent in 1984; and at the national level, it increased from 30 percent to 33.8 percent over the same interval. According to case B estimates, poverty increased from 44.4 percent in the urban sector, and 43.7 percent at the national level in 1981/82, to 51.1 percent and 49.1 percent, respectively, in 1984. A slight deterioration in the average household's standard of living between 1981/82 and 1990/91 was observed in both urban and rural sectors (El-Leithy & Kheir-El-Din, 1992).

The income poverty line estimates show that poverty is widespread in Egypt. This fact is supported by the findings of the National Household Food Consumption Survey, conducted by the Nutrition Institute in 1981. This shows that a large segment of the population are undernourished, judging by their low calories and protein intake (Korayem, 1987). Although ignorance about healthy nutritional habits and patterns may be partly responsible for this, the low income of the population is still the main explanatory factor in this respect.

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[25] For the details on how the poverty line in Egypt has been estimated, see Korayem (1987).

[26] In case A, official prices are used in calculating the cost of food, while in case B, the prices are raised by 20 percent to reflect the fact that not all items could be bought at the low official prices.

[27] In Latin America, an estimate of a conservative 'subsistence' poverty line shows that one-third of the rural population is living in poverty. In Asia, rural poverty affects a higher proportion of the population. In India for example, 50 percent of the rural population is living in poverty, see Korayem (1987; footnote, p. 45).

Table 10. Household's income poverty line and poverty level in egypt, 1974/75 - 1984

<table>
<tr><th rowspan="2"></th><th colspan="3">1974/75</th><th colspan="3">1981/82</th><th colspan="3">1984</th></tr>
<tr><th>Urban</th><th>Rural</th><th>National Level</th><th>Urban</th><th>Rural</th><th>National Level</th><th>Urban</th><th>Rural</th><th>National Level</th></tr>
<tr><td>1. Household's income poverty line</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Case A- Using official prices for food cost estimates (LE)</td><td rowspan="2">-</td><td rowspan="2">284.2</td><td rowspan="2">..</td><td>1297.3</td><td>1020.6</td><td>-</td><td>1794.7</td><td>1354.0</td><td>..</td></tr>
<tr><td>Case B- Raising official food cost estimates by 20% (LE)</td><td>1588.1</td><td>1240.1</td><td>-</td><td>2197.0</td><td>1645.5</td><td>..</td></tr>
<tr><td>2. No. of poor Households[1)] (in thousands)</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Case A</td><td rowspan="2">-</td><td rowspan="2">1906.2</td><td rowspan="2">..</td><td>1196.2</td><td>1240.0</td><td>2436.2</td><td>1444.7</td><td>1476.1</td><td>2920.8</td></tr>
<tr><td>Case B</td><td>1747.1</td><td>1794.8</td><td>3541.9</td><td>2171.2</td><td>2067.4</td><td>4238.6</td></tr>
<tr><td>3. Relative share of poor households (%)</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Case A</td><td rowspan="2">-</td><td rowspan="2">50.9</td><td rowspan="2">..</td><td>30.4</td><td>29.7</td><td>30.0</td><td>34.0</td><td>33.7</td><td>33.8</td></tr>
<tr><td>Case B</td><td>44.4</td><td>43.0</td><td>43.7</td><td>51.1</td><td>47.2</td><td>49.1</td></tr>
</table>

Source: korayem (1987).

1) Households living at the income poverty line or below it.

.. Not available.

The impact of ERSAP on the poor will be through three channels: the cost of living, income earned, and the social services provided by the government.

Devaluation; increases in prices energy, transportation, public enterprises commodities, etc.; the elimination of subsidies; and raising indirect taxes and widening their base are the main ERSAP's policies that could raise the cost of living. With their low incomes, the poor will feel the pinch more than the rest of the population. Subsidies are given on basic consumer commodities and services, like basic food items and transportation services. Reducing subsidies will hurt the poor most, since a large portion of their budget -up to 48 percent for the lowest expenditure deciles- are spent on subsidized basic food items; and 60 percent of the urban population in Egypt were spending almost one fifth to one-half of their total budget on the main subsidized food items (Korayem, 1980; table 8). Also the Pound devaluation will increase the prices of imported commodities, including basic food items like wheat and flour, and will raise also prices of imported capital and intermediate goods, which in turn raise the cost of production of domestically- produced goods. This will contribute also to raising the general price level with adverse effects on the cost of living of the population, including the poor.

The second channel is through the impact on incomes. ERSAP's impact on raising prices will reduce real incomes. The working poor who usually are illiterate or have low educational attainment, earn already low incomes which makes them more exposed to any increase in prices. Moreover, the tight monetary and fiscal policies applied, and the reduction in government investment will depress overall growth and job creation in the short-term. And since the poor are those who are the least educated, and who do not have influential social connections, their chances of getting a job will be relatively slim when the labour market tightens up.

The third channel is through the social services provided by the government, free or at low prices. As shown above, inspite of the increase in real investment in education and health in 1991/92, compared to the previous year, they still fell below the level achieved in the late 1980s (table 9). With the increase in the number of students and population, the result is a decline in real investment per student and per capita in education and health. Consequently, one cannot expect an improvement in the quality of education provided, although a small fee is now paid by students at all education levels; neither can one expect an adequate supply of health services of reasonable quality and at low subsidized cost. Thus, the implementation of ERSAP will have negative effects on the poor. This is already acknowledged by the Fund and the Bank (see World Bank, 1991c). Consequently, some compensatory measures are needed to minimize the hardship on the poor. The creation of the Social Fund for Development (SFD) is to serve this purpose. The question is whether it is possible for the SFD, with its limited resources, to face up to the task.

D. Impact on Income Distribution

No official data on income distribution are available. Estimates of income distribution, based on households expenditure surveys, are available for 1974/75 and 1981/82[28]. Table 11 shows the decile distribution of households' disposable income in 1974/75 and 1981/82[29]. It is clear from the Table that there is a significant improvement in the income distribution pattern in 1981/82 as compared to the situation in the mid-1970s. Two indicators may be used in this regard.

First, the income share of households in the upper decile in the rural sector, and of households in the two upper deciles in the urban sector, declined between 1981/82 and 1974/75. It fell from 31.9 percent of the rural sector's income in 1974/75, to 23 percent in 1981/82, and from 47.7 percent of the urban sector's income (in the two upper deciles) to 40.5 percent, respectively. There has been also an increase in the income share of the rest of the urban and rural households, with those falling in the lower middle deciles benefiting the most.

Second, there has been a significant fall in the Gini Coefficient in the two sectors over the period under consideration. In the urban sector, the coefficient fell from 0.40 in 1974/75 to 0.32 in 1981/82; while in the rural sector, it fell from 0.39 to 0.29, indicating a relatively higher improvement in income distribution in the rural sector, compared to the urban sector. The sharp drop in the Gini Coefficient over such a short period of time is quite surprising and could be attributed to two main factors: the distortion that could have occurred in the income distribution estimates in 1981/82, due to the underestimation of

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[28] For the methodology applied, see Korayem (1987).

[29] To avoid any possible confusion or misunderstanding, it is important to note that the 1974/75 income distribution estimates included in Table 11 are the same estimates included in the World Bank Report (World Bank, 1985; Annex, Table 28), and the ILO Report (ILO, 1984; Statistical Annex, Table A.2). These estimates have been developed by Korayem in a previous study (Korayem, 1984), and adopted by the World Bank and International Labour Office (ILO).

the consumption data in that year's household survey; and the structural changes that took place in the Egyptian economy after the mid-1970s.

Regarding the first factor-the large underestimation of household consumption in the 1981/82 Survey, compared to household

Table 11. <u>The Decile distribution of households disposable income in urban and rural Egypt 1974/75 and 1981/82</u>

(per cent)

Households' Distribution in Deciles	Relative Income share			
	1974/75		1981/82	
	Urban	Rural	Urban	Rural
I	2.3	2.1	2.6	2.7
II	3.8	3.9	4.8	4.9
III	4.9	5.1	6.0	6.3
IV	5.8	6.1	6.9	7.4
V	6.7	7.2	8.0	8.4
VI	8.0	8.2	9.0	9.5
VII	9.5	9.6	10.3	10.8
VIII	11.3	11.4	11.9	12.2
IX	14.8	14.4	14.6	14.7
X	32.9	31.9	25.9	23.0
GINI Coefficient*	0.40	0.39	0.32	0.29

<u>Source</u>: For 1974/75, see: Karima Korayem, the Country's Chapter on "Egypt" in: Wouter van Ginneken and Jong-goo Park (eds), <u>Generating Internationally Comparable Income Distribution Estimates</u> (Geneva: International Labour Office) 1984, p.44 and for 1981/82, Calculated from Korayem (1987), Tables (I-A.7) and (I-A.8).

* Gini Coefficient relates the cumulative proportion of households to the cumulative proportion of incomes.

consumption in the national accounts[30] renders the consumption distribution and, hence, the income distribution estimates of 1981/82 questionable. This is because the same adjustment factor

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30 This underestimation is 25.6 percent for the urban sector, and 26.6 percent for the rural sector (Korayem, 1987).

is used for all the expenditure brackets to bring aggregate household consumption derived from the Households Survey to the consumption level in the national accounts. The discrepancy between the consumption figure in the survey and the national accounts is distributed proportionally to the households in all the expenditure brackets. Therefore, if the extent of underestimation of consumption is not uniform across all expenditure brackets, the income distribution estimates based on a scaling-up factor will be strongly distorted. Thus, one has to be particularly cautious when comparing the 1981/82 income distribution estimates with the 1974/75 estimates, in which the discrepancy between households' consumption derived from the 1974/75 Survey and the national accounts consumption data was very small (Korayem, 1987).

As regards the second factor, namely the structural changes that took place in the Egyptian economy after introducing the open-door policy in 1974, one may point out the two main features of this policy: encouraging the private sector to increase its role in the economy, and opening the door for Egyptian labour to work abroad. It is believed that this open-door policy must have had a significant impact on income distribution in Egypt, mainly through the second feature. For example, in a study on the economic impact of labour emigration on the rural sector in Egypt, it has been found that labour remittances from abroad have increased the average disposable income in the rural sector by nearly 68.9 percent, and 47.6 percent in 1980 and 1984/85, compared to 9.1 percent in 1975, and 0.2 percent in 1970 (Korayem, 1986).

The impact of ERSAP on income distribution is assessed below through its impact on personal income distribution by taxes, subsidies, and wealth effect; and through its impact on wages and prices.

<u>ERSAP's impact on personal income distribution</u>. No change in direct taxes (e.g. income tax, profit tax, etc.) has taken place so far. A unified income tax is expected, but nothing is revealed about it to make a preliminary assessment about its relative progressivity or regressivity, as compared to the prevailing tax system possible. Indirect taxes are by their own nature regressive. Thus, levying new indirect taxes on commodities and services (like the sales tax), and widening the base of the prevailing ones and raising rates, which have been implemented as part of ERSAP, will have a relatively larger adverse impact on the incomes of the population in the lower income brackets. This is because low income earners have a higher marginal propensity to consume, and accordingly allocate a larger part of their incomes to consumption expenditures, which represent the base for indirect taxes.

The wealth effect (of foreign currency deposits) due to devaluation has a negative impact on equity (Abdel-Khalek, 1987). Devaluation will increase the wealth of holders of foreign currency deposits, and will increase also their incomes by raising the return on deposits in Egyptian pounds. This means a redistribution of income in favour of holders of foreign currency deposits.

ERSAP's impact on wages and salaries. According to the preliminary results of the 1990/91 Expenditure and Income Survey, wages represent 53 percent of the net income of the urban population and 27 percent of the income of rural population (CAPMAS, 1992b)[31]. ERSAP calls for a reduction in the government wage bill by 15 percent in real terms. Thus, its impact on government employees' income is negative. However, the distributive impact among government employees will depend on whether this decrease is evenly distributed among all the ranks, or it is distributed unevenly favouring the low- ranking employees as has been the case before. The reduction in real government wages between 1973 and 1987 was borne mainly by the high-ranking employees (World Bank, 1991c).

A decrease in real wages will probably take place also in the private formal sector. The distribution pattern of wages in public sector and private sector establishments seems to be close. For example, according to the wage data in 1990, the employees in public sector establishments, receiving a monthly income of over LE 300, represented 26.5 percent of all employees, while in the private sector establishments of 10 workers and more, the percentage of employees receiving the same level of income represented 26 percent of the total (calculated from: World Bank 1992; Vol. III, table AX.6).

Another view, based on the assessment of the 1987 IMF stand-by arrangement, is that the impact on wages in the private sector is not clear-cut (Abdel-Khalek, 1987). According to this view, the Pound devaluation encourages emigration to Arab countries, which raises nominal wages in the domestic market. The final outcome depends on the rate of inflation, compared to growth in nominal wages. However, with the current scarcity in job opportunities in the Gulf countries, and high unemployment rate in the domestic market, the decrease in real wages in the private sector seems to be more likely, at least in the short-run.

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[31] The calculated percentages are the average of the first and second quarters of the 1990/91 Expenditure and Income Survey; the results of the third and fourth quarters are not out yet.

Regarding the impact on non-wage earners, the elimination of subsidies on agricultural inputs, as well as procurement prices for the main crops, except cotton and sugar cane, will probably raise the nominal incomes received by small farmers. This is because these farmers are the main producers of traditional crops, which were subject to compulsory delivery at controlled procurement prices, and also because the input subsidy received by those farmers was less than the amount of income they were loosing by selling their products to the Government at low procurement prices (Korayem, 1982). Thus, ERSAP is expected to increase the nominal incomes of the small farmers. However, its impact on their real incomes, which is what counts, is not clear-cut because small farmers are also consumers of subsidized commodities. Reducing, or eliminating, subsidies on such commodities will raise their cost of living and decrease their real incomes. The final outcome for small farmers will depend on the rate of increase in their nominal incomes as compared to the rate of increase in their cost of living.

The non-wage earners in the private business sector will be affected negatively by the high interest rates, tightening of domestic credit, and probably trade liberalization, at least in the short-run; while they will be affected positively by the freeing of prices, competition between the private and public sector, and by the devaluation of the Egyptian pound. The final impact of ERSAP's implementation on this group will differ depending on the financial position of the enterprise, especially with respect to the ratio of its borrowed/owned capital[32]. The larger is the indebtedness of the enterprise to the banking system, the more will be the negative impact. The reduction in aggregate demand due to tight policy measures applied under ERSAP will also hurt the business sector (public and private). The fall in the purchasing power and the accumulation of stocks seems to be a concomitant factor of the implementation of ERSAP, at least in the short-run.

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[32] The impact of ERSAP on those business men as consumers will be neglected, because of their low marginal propensity to consume, and also because the gain they realize as producers outweighs normally the increase in their cost of living.

SUMMARY AND CONCLUSIONS

The economic reform and structural adjustment programme (ERSAP), supported by the structural adjustment loan (SAL), was implemented in Egypt during 1991-1992. It aimed at rectifying the imbalances between the demand and supply sides of the economy. The main symptoms of these imbalances are the chronic deficits in the balance of payments and the government budget, and the high inflation rate. Although this was not the first structural adjustment agreement that the Egyptian Government has entered into with the two Bretton Woods institutions - the IMF and the World Bank- it was the first which has been fully implemented. The implementation of the three preceeding agreements with the IMF and the World Bank in the 1970s and 1980s were discontinued for political and economic reasons.

The main features of ERSAP are: tight fiscal and monetary policies, devaluing the Egyptian pound and pegging it to the United States dollar, liberalizing foreign trade, and reforming and rationalizing public sector involvement in economic activity by privatization and unifying rules and regulations governing the business environment for public and private enterprises.

The economic impact of ERSAP has been assessed in terms of its effects on the balance of payments deficit, the budget deficit, inflation, and on output and employment. Assessing the social impact of ERSAP was done by evaluating its effects on the supply of education and health services, on poverty and on income distribution.

The main findings of the study may be summarized as follows:

1- The deficit in the balance of trade continued, but was reduced to a lower level, mainly due to the cut in imports. The main positive impact on the current account balance came from the significant increase in tourism revenues. The final outcome on the balance of payments was positive; the deficit turning into a surplus. This surplus can be attributed to large interest rates differentials between Egyptian pound deposits and international currencies deposits, which have induced considerable short-term capital inflow to the country.

2- A significant improvement has been realized in the budget deficit which fell to 7.2 per cent of GDP in 1991/92, as compared to 17.2 per cent of GDP in 1990/91. Moreover, financing the deficit has been made mainly by selling treasury bills (TBs) to the public and financial institutions, and not to the Central Bank as before. However, issuing TBs in large amounts, and at high interest rates, has considerably increased the item of servicing the internal debt on the expenditure side of the budget.

3- The impact of ERSAP on inflation has not been impressive. While some of the measures put into effect succeeded in controlling the demand-pull factors causing inflation in Egypt such as government borrowing from the Central Bank and aggregate demand, other policy measures have reinforced cost-push type inflation in the economy such as the introduction of a broad-based sales tax and increasing prices of basic commodities and services. As a result, the inflation rate reached 21.1 per cent in 1991/92.

4- The contractionary fiscal and monetary measures contained in ERSAP are expected to reduce public and private investment in the short-run, causing a slowdown in economic growth and job creation. Furthermore, the public enterprise reforms and privatization would aggravate the unemployment problem. In the medium-term, the economic and social impact of the structural adjustment measures will depend on success in increasing private investment to compensate for and exceed the reduction in public investment on raising productivity and output, and creating new employment opportunities.

5- In spite of the reduction in government expenditures advocated by ERASP, Government investment in social services - education and health- have increased in nominal terms in 1991/92. However, in real terms, they have remained below their level in 1988/89; and on a per capita basis, the downward trend in government investment in social services has continued.

6- In the short-run, ERASP has negative implications for the poor mainly because of its impact on raising prices and reducing employment opportunities. The impact on the poor in the medium-term will depend on how successful ERASP will be in stabilizing prices, increasing total investment and raising output. The impact of the Social Fund for Development (SFD) on mitigating the hardships arising from structural adjustment on the poor should not be exaggerated. This is because the SFD has limited resources, and its targets exclude the ultra-poor from its benefits.

7- Regarding income distribution, one may conclude that ERSAP has a negative impact on wage earners, while its impact on non-wage earners is not clear-cut. The impact on the latter depends on the outcome of several factors pulling in opposite directions. For example, farmers' incomes will be affected positively by gains from decontrolling crop prices, and negatively from the elimination of subsidies on agricultural inputs and basic consumer commodities. For the non-wage earners in the business sector, the final outcome will depend on the balance of effects between their gains from decontrolling prices, export promotion, and unifying the business environment for public and private enterprises, and their losses from higher interest rates, lower credit ceilings, and the liberalization of foreign trade.

APPENDIX

Table 1. Comparison of Old and New Public Enterprise Laws

Feature	Law 97 (old)	New Public Investments Law
Company Autonomy	Company managers are under the control of their respective public Sector Organizations (PSCs) and a technical ministry that has supervisory authority.	Company Managers will be autonomous and free to decide on all business matters; they will have no links to technical ministries.
Company Objectives	Companies are supposed to help realize the State's economic and social objectives, regardless of the impact upon their own efficiency.	Companies will have only one objective: to maximize profits and, as a result, their value.
Financial Status	Companies are dependent upon the Government for operational subsidies and the financing of capital expenditures, out of captive sources of funds on subsidized terms.	Companies will be financially independent of the Government and parent holding companies; the latter will not be allowed to routinely subsidize their affiliates; company investments will be financed in capital markets on commercial terms.
Corporate Form	Public Enterprise established under Law No. 07 of 1983.	Joint-stock company listed on the stock exchange in Egypt.
Privatization	Not allowed.	Allowed.
Liquidation	Not allowed except under very special circumstances.	Allowed.
Bankruptcy	Not Allowed.	Allowed.
Employment	Companies are uniformly subject to the provisions of Law 48 on PSE employment.	Law 48 is repealed and companies are free to set their own terms and conditions of employment.

Source: World Bank (1991a).

Table 2. Second Tranche release conditions of SAL

1. <u>Macroeconomic Framework</u>. Adherence to agreed macroeconomic framework includes achieving satisfactory progress with an external financing program (debt relief or equivalent support); reducing budget deficit for FY92 and FY93, and pursuing consistent monetary and exchange rate policies. Satisfactory macroeconomic performance and policies to be evaluated in accordance with indicators attached to the letter of Development policy.
2. <u>Public Enterprise Reform: Privatization</u>. Progress satisfactory to the Bank, in implementing the FY91/92 privatization program. Adoption of a FY92/93 privatization program, satisfactory to the Bank.
3. <u>Public Enterprise Reform: Legal and Institutional Framework</u>. Reorganization of about two thirds of the existing ACs into the new HCs, avoiding monopolization.
4. <u>Price Liberalization: Industry</u>. Implementation of the agreed Action Plan, including the complete freeing of prices for Group IV products no longer subject to high import protection (as defined by the existence of an NTB and/or a tariff of 35 per cent or more).
5. <u>Price Liberalization: Energy</u>. Implementation of the agreed Action Plan, including: (a) the increase of weighted average petroleum product prices to at least 56 per cent of internationally traded equivalents, based on the formula agreed to with the Bank, prior to December 1991, and to at least 67 per cent of internationally traded equivalents by second tranche release, if such release is to take place after June 1992; and (b) the increase of average electricity prices to at least 69 per cent of estimated LRMC.
6. <u>Price Liberalization: Agriculture</u>. Raising of cotton procurement prices to at least 56 per cent of international prices for the 1992 crop year, in accordance with a formula agreed to with the Bank, while eliminating subsidies for fertilizers and pesticides by FY93.

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Table 2. <u>(continued)</u>

7. Trade Policy liberalization. Reduction of the production coverage of import bans to 10.6 per cent of tradeable goods output (measured as the sum of agricultural and manufacturing production); this is equivalent to a 70 per cent reduction in the production coverage in the base period (March 1990).
8. Private Sector Development. Issuance of a decree allowing the public fertilizer and cement companies to sell up to 40 per cent of their production to private distributors/companies by July 1 1992.
9. Other Structural Reforms. Satisfactory implementation of other elements in the Government's economic reform program, as set forth in the latter of Development Policy.

Source: World Bank (1991a).

Table 3. <u>**Exports by commodity group**</u>

(percentages)

	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
1- Agricultural Commodities	14.5	18.0	12.9	14.7	12.9	5.8	6.8
Cotton	8.9	8.9	6.6	7.6	7.0	2.1	1.0
Rise	0.2	0.1	0.2	0.1	0.2	0.1	0.9
Potato	1.0	1.4	1.3	0.8	0.5	0.7	1.0
Citrus	1.9	2.7	1.7	3.1	2.8	1.0	1.5
Others	2.5	4.9	3.1	3.1	2.4	1.9	2.4
2- Petroleum Products	57.7	23.4	29.1	24.9	39.1	50.7	45.4
3- Raw Materials (1+2)	72.2	41.4	42.0	39.6	52.0	56.5	52.2
4- Manufactural goods (excluding Petroleum)	21.0	46.7	48.4	50.6	41.4	29.9	38.6
4.a. Textiles & Yarn	11.7	25.2	26.8	22.7	20.2	13.6	15.5
Cotton Yarn	7.8	16.8	18.9	16.3	14.2	8.2	7.8
Cotton Textile	1.8	4.3	4.4	2.4	1.9	1.9	2.3
Others	2.1	4.1	3.5	4.0	4.1	3.5	5.4
4.b. Other Manufactures	9.3	21.5	21.6	27.9	21.2	16.3	23.1
Food	1.4	3.8	3.0	3.0	1.9	2.2	3.7
Chemicals	2.0	4.0	3.7	6.7	7.9	4.6	6.3
Metallic & Engineering Products	3.7	9.4	11.9	15.3	8.8	7.2	9.9
Others.	2.2	4.3	3.0	2.9	2.6	2.3	3.2
5- Unclassified Commodities	6.8	11.9	9.6	9.8	6.6	13.6	9.2
6- TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0

<u>Source</u>: Central Bank of Egypt, <u>Annual Report</u>, (1987/88, 1989/90 and 1991/92).

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