

**GENERAL AGREEMENT ON
TARIFFS AND TRADE**

Committee on Balance-of-Payments Restrictions

1985 CONSULTATION WITH THE ARAB REPUBLIC
OF EGYPT
(SIMPLIFIED PROCEDURES)

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205) to assist the Committee on Balance-of-Payments Restrictions in taking the decision referred to in paragraph 8 of this Declaration. It updates the paper prepared for the 1983 consultation (BOP/W/71).

I. Egypt's previous consultations in the Committee on
Balance-of-Payments Restrictions

2. The Arab Republic of Egypt has held seven consultations in the Committee, in 1970, 1973, 1975, 1977, 1979, 1981 and 1983. At the last full consultation held on 19 October 1970, the Committee was encouraged by the evidence of export diversification and hoped that this process would continue. While noting the additional facilities designed to encourage trade with convertible currency countries, members of the Committee expressed the hope that the proposed fundamental reform of the exchange system would be effected so that reliance on import controls and bilateral agreements could be substantially reduced (BOP/R/49, paragraph 32).

II. Egypt's trade and exchange system and main changes since the
last consultation

(a) Exchange restrictions

3. Following a deterioration in Egypt's trade balance during 1984, major changes were made in December 1984/January 1985 to the system applicable to payments for imports and to the lists of products subject to import restrictions. The aims of these modifications were to reform the exchange system and to restrict the volume of private sector imports to a level commensurate with the inflow of foreign exchange. The measures taken are outlined below, in paragraphs 8 and 10. These measures, however, caused serious disruption in Egypt's external trade and payments, and were largely repealed in the period April-June 1985.

4. The multiple exchange rate system maintained by Egypt is complex. The foreign exchange market is divided into three pools - the central bank pool, the free market pool, and the commercial bank pool - and involves an even larger number of exchange rates.

5. The central bank pool, which accounted for about 40 per cent of current account transactions in 1983/84, operates with an official exchange rate which has remained fixed to the US dollar at £E 0.70 = US\$1 since January 1979. The rate is applied to government-controlled foreign trade transactions in basic commodities (i.e. over three-quarters of exports and a smaller, but substantive, share of imports), as well as to Suez Canal dues and public sector capital transactions. Special rates are applied to foreign exchange movements under bilateral payments arrangements with the Soviet Union, North Korea, and China.

6. The free market pool, which accounted for about 25 per cent of current transactions in 1983/84, was established in 1976 through legislation permitting residents to hold foreign exchange. It is fed primarily by workers' remittances, and is used by the private sector to finance transactions in both the current and the capital accounts. The free market exchange rate to the US dollar has steadily depreciated from about £E 0.8 = US \$1 in 1979/80 to about £E 1.4 = US \$1 at the end of 1984.

7. The commercial bank pool accounted for about 35 per cent of current transactions in 1983/84. It is supplied by workers' remittances that are not passed through the free market pool, tourism receipts, and certain export receipts. It is used for public sector imports (mainly by public sector companies) and capital transactions that are not assigned to the central pool, as well as for certain private sector imports. The commercial bank pool exchange rate was fixed at £E 0.70 = US \$1 in 1979, the same as the central bank pool exchange rate. It was devalued in August 1981 to £E 0.84 = US \$1, and has remained officially unchanged since then. However, the government has attempted to attract transactions away from the free market pool and into the commercial bank pool by offering a premium commercial bank pool exchange rate, as well as by imposing certain administrative requirements on the surrender of foreign exchange. The premium was introduced in April 1983, and resulted in an effective commercial bank pool exchange rate of £E 1.08 = US \$1. A higher premium has been applied at varying intervals since then as the government has responded to the depreciation of the free market rate of the Egyptian pound, and in December 1984 the premium commercial bank pool rate stood at £E 1.20 = US \$1.

8. In January 1985, the government implemented policies designed to progressively eliminate the free market pool. It restricted the transactions allowed to take place in this pool, and at the same time introduced a higher premium rate for commercial bank pool transactions, which was to be varied more frequently in line with market developments. This premium rate had risen to £E 1.275 = US \$1 by April 4, 1985. However, this attempt at exchange reform was abandoned by the government, and on April 6 most of the earlier changes were repealed. One of the key reasons for the lack of success with the reform was the uncertainty in the private market about the new system which caused foreign currency inflows (particularly migrants' remittances) to decline significantly. Since then, the premium attached to the commercial bank pool rate has continued to increase.

(b) Import restrictions

9. Imports, apart from those goods imported with own exchange, are subject to approval by the Import Rationalization Committee (IRC). Until 6 December 1984, there were two lists of such items:

- (a) The first list was subdivided into four categories: category A included 21 foodstuffs and human medicines; category B included 115 raw materials, intermediate goods, and capital goods; category C was composed of 20 transportation-related items; and category D comprised 75 other items characterized as luxuries. From March to July 1982, all imports in the first list had to be approved by the Import Rationalization Committee. From July 1982 to 6 December 1984, only items in category A needed approval. This approval requirement was intended to ensure that the price control regulations for these commodities were observed.
- (b) The second list included 135 commodities plus all other products not specified in the first list. Imports in this list were restricted mainly to protect domestic industry.

10. The trade and exchange policy changes made by Egypt in December 1984/January 1985 included an enlarged list of items for which IRC clearance was required. This was reported to contain products in Categories A and B of list (a) above plus luxury goods and large payment items for the construction industry. With the revocation of the January 1985 exchange measures in April and June 1985 this new list is reported to have also been rescinded. However, the secretariat does not have information on the current status of products subject to IRC approval.

(c) Import deposit requirements

11. After an import license has been issued by the Committee for Import Rationalization, but before a letter of credit is opened, the importer is required to lodge an advance import deposit with an authorized bank. The deposit must be redeposited by the commercial bank for a minimum of one month in a non-interest bearing account with the Central Bank. The amount of the deposit was, until January 1985, 25 per cent of the f.o.b. value of the import for items in category A of the first list of import restrictions, 40 per cent for items in category B, 75 per cent for items in category C, and 100 per cent for all other items, to be made in foreign currency. These rates were reduced to 15, 20, 40 and 50 per cent respectively in January 1985 and deposits were required to be made in local currency. In April 1985, with the re-establishment of the "own exchange" market, these lower rates were kept in force.

III. Recent trends in Egypt's economy and foreign trade

12. Over the past two years, Egypt's economic performance has been characterized by a slowdown in growth and an acceleration of inflation, coupled with a serious weakening of the balance of payments in 1984/85.¹

13. The growth of real GDP, officially estimated at 8.5 per cent a year from 1977 to 1982/83, is estimated to have slowed to 7.5 per cent in 1983/84. In 1984/85, preliminary estimates of real growth indicate a further

¹ Fiscal year ending June 30.

deceleration, to as low as 5 per cent according to certain sources. During the period of more rapid growth in the late 1970s and early 1980s, the sectoral composition of output changed as the structure of relative prices (including the exchange rate) encouraged the movement of resources from the production of tradeable goods to the production of petroleum and non-traded services. Growth rates in agriculture and industry were surpassed by those of the petroleum sector (which rose from 6 per cent of GDP in 1977 to 15 per cent in 1982/83), the finance and insurance sectors, and direct government services as well as services (such as construction) receiving the stimulus of public outlays. The slowdown in GDP growth in 1983/84 and 1984/85 involved a deceleration of growth in the service industries, as well as unfavourable developments in the international oil market. At the same time, the progressive change in the sectoral composition of output created a structural weakness in the balance of payments which surfaced beginning in 1982/83.

14. The official price indices showed a slight acceleration of inflation from about 16 per cent in 1981/82 to 20 per cent in 1983/84. In the first six months of 1985 the rate of inflation appears to have levelled off. However, the indices reflect the effects of large and growing direct and indirect government subsidies that have dampened the apparent inflation rate substantially; a more accurate insight into the underlying inflation rate is available from subindices for categories of goods which are more exposed to market influences; the subindices for services, for example, showed a price increase of 34 per cent in 1983/84 compared with 15 per cent in 1982/83.

15. Due to the relatively large size of the public sector in the economy (around half of GDP), the weakening of Egypt's fiscal position since 1980/81 has been an important contributing factor to the worsening of the balance of payments situation. The overall fiscal deficit on a cash basis rose from the equivalent of about 8 per cent of GDP in 1980/81 to 20 per cent in 1981/82, and has since remained at that level. The low elasticity of revenue with respect to domestic economic activity and an increase in expenditure of 24 per cent in 1981/82, followed by annual increases averaging over 10 per cent since then, account for this deterioration. The government resorted heavily to domestic bank financing of the deficit. Domestic credit expansion to the private sector also grew rapidly from 1981/82, contributing to rapid monetary expansion that has been reflected in rising import demand.

16. The changing structure of relative prices that increasingly penalised the traded goods sector of the economy left Egypt's balance of payments vulnerable to changes in domestic demand and to adverse economic developments abroad, particularly the slowdown in world economic activity and the weakening of oil prices. The value of exports in US dollars was no higher in 1984/85 than in 1980/81. As a result, the trade deficit widened sharply in 1983/84 by 18 per cent due to a surge in public sector imports of almost US\$1 billion. Part of the increased trade deficit was offset by higher workers' remittances, which had grown sharply also in 1982/83 following the government's decision to offer a more favourable exchange rate for remittances that corresponded closely to the free market rate. Nevertheless, the current account deficit widened, and this was compounded by a decline in net capital inflows due in particular to higher amortisation payments on suppliers' credits. The overall balance of payments registered a small

surplus of US\$150 million, some US\$700 million lower than in 1982/83, and gross foreign reserves of the Central Bank slipped back to the equivalent of 3.2 months import cover.

17. For 1984/85 the IMF estimates that the balance of payments deteriorated sharply, registering a deficit of almost US\$1.3 billion before taking account of a build-up in external payments arrears of US\$1 billion. The trade deficit is estimated to have declined somewhat due to lower import payments that reflected foreign exchange shortages as well as the tightening of import restrictions in early 1985. The services account deteriorated sharply by an estimated US\$1.2 billion, however, on account of higher interest payments as well as a fall in migrants remittances of almost 30 per cent from the previous year. Net capital inflows fell to less than US\$100 million as net project and commodity loan drawings decreased and repayments increased, while suppliers' credit drawings also declined.

18. More recent data provided in provisional current account figures issued by the Central Bank of Egypt indicate that migrant remittances declined only slightly from US\$3.9 billion in 1983/84 to US\$3.7 billion in 1984/85. Nevertheless, the figure for the overall current account deficit corresponds closely to the IMF's estimate once account is taken of net transfers of US\$220 million in 1984/85, sharply up from US\$4 million in 1983/84, which mainly reflected a cash grant from the United States.

19. Egypt's debt service ratio rose from 25 per cent of current account receipts in 1983/84 to approximately 30 per cent in 1984/85.