

GENERAL AGREEMENT ON

RESTRICTED

TARIFFS AND TRADE

BOP/280
3 June 1988

Limited Distribution

Committee on Balance-of-Payments Restrictions

Original: English

1988 CONSULTATION WITH THE ARAB REPUBLIC OF EGYPT UNDER ARTICLE XVIII:12(b)

Basic Document for the Consultation¹

SECTION I

A. An overview of the economy

The Egyptian economy has enjoyed a reasonably high rate of growth during the late seventies and early eighties, with nominal GDP growth rate reaching a peak of 9.9 per cent in 1982-83.

Such high rate of growth was facilitated by substantial increases in foreign-exchange earnings generated mainly by increasing oil exports, remittances from expatriate Egyptians, Suez Canal traffic and an expanding tourism sector.

During that period the Government pursued policies of economic expansion aiming primarily at raising the living standards of the low-income earning segment of the Egyptian population, and redressing the structural problems in the economy.

Such policies normally involved increasing government spending particularly in areas such as new investments, creating new job opportunities and social welfare.

The general level of expenditure envisaged in the first Five-Year Plan (1982/83-1986/87) was based on a certain level of foreign-exchange earnings estimated at that time. Nevertheless towards the latter part of the Plan external factors had a severe negative effect on the foreign-exchange earnings particularly the collapse of oil prices in 1988, which has not only affected Egypt's oil export revenues, but also the remittances of expatriate Egyptians who are mainly employed in Arab oil exporting countries, the resources of which have suffered from the same problem of oil price collapse.

The increasing expenditures related to the above-mentioned objectives of expanding and restructuring the economy and the commitment to the massive number of low-income earners, outpaced the foreign exchange receipts accruing to the Government, resulting thereby in a budget deficit reaching 23.1 per cent of GDP in 1983-84.

¹Material supplied by the Egyptian authorities

Responding to this situation, the Government adopted a number of measures in 1984-85 designed to reduce the deficit, such as price increases for key commodities produced by the public sector, higher procurement prices for various agricultural products, as well as efforts to reduce government expenditure.

During the following year 1985-86, the Government adopted a number of additional measures designed to increase its revenues. Such measures were mainly in the form of tax increases and repricing some basic commodities produced by the public sector in order to reduce its deficit which represented a considerable burden on the economy.

In the light of such circumstances, there was an increasing trend towards foreign borrowing which resulted in the accumulation of a sizeable external debt with a heavy burden of debt service obligations that reached approximately 50 per cent of the current account receipts in 1985-86.

All that resulted in a sharp depreciation of the Egyptian pound on the free market. Such a depreciation could have been more severe if necessary import restrictions had not been in place.

A declining trend in the nominal GDP growth rate continued until it reached 4.2 per cent in 1986-87, compared to 9.9 per cent in 1982-83. The gross investment/GDP ratio declined from 26.2 per cent in 1982-83 to 19 per cent in 1986-87.

Also the balance-of-payments prospects started to weaken, mainly because of rising imports which peaked at US\$10.5 billion in 1984-85, on the one hand, and declining export earnings on the other hand. The trade deficit reached its worst level of US\$6.6 billion in 1984-85. The current account deficit increased from US\$1.8 billion in 1982-83 to US\$4.0 billion in 1985-86.

B. Developments in 1986-87

In 1986-87 the Egyptian Government adopted a number of corrective measures in the light of the developments that took place both at the national and international levels. Such measures included the readjustment of several administered prices of some essential commodities. A considerable relaxation was introduced with regard to exchange regulations of public entity transactions in order to allow more realistic exchange rates for such transactions. There was also a comprehensive revision of the tariff system as well as a general simplification of the import system.

Such measures resulted in a sizeable reduction in the budget deficit/GDP ratio which came down to 17 per cent against 23 per cent in the previous year. There was also an increase of about 25 per cent in the consumer price index, mainly as a result of the repricing of a number of essential commodities.

On the revenue side there was a considerable decline at a negative rate of -3.0 per cent as compared to the previous year (1985-86) in which it had increased at the positive rate of 13.1 per cent.

Such decline was mainly due to reduced revenues from oil exports which dropped by 40 per cent, as well as a considerable decline in customs revenues, due to reduced imports which dropped by 20 per cent.

In spite of declining revenues the measures adopted by the Government resulted in a reduction in the overall budget deficit bringing it down to LE 7.5 billion compared to LE 8.2 billion in the previous year, as well as reducing the current account deficit to US\$2.9 billion compared to US\$4.0 billion in the previous year. A major factor in reducing the current account deficit was the measures taken by the Government to reduce the growing size of imports.

Towards the end of the year, the Government adopted a number of additional reform measures, the most important of which was the establishment of the free-exchange market to which transactions would be gradually transferred from the existing pool of the commercial banks. The exchange rate in the new free-exchange market is decided mainly on the basis of supply and demand as well as other relevant indicators.

There was also a number of further price increases of 66 per cent in petroleum prices as well as 29 per cent in electricity tariffs. Interest rates were also increased by 1-2 percentage points.

C. The balance of payments

The situation of Egypt's balance of payments has clearly deteriorated over the last few years. The current account deficit has gradually increased from US\$1.8 billion in 1982-83 to US\$4.0 billion in 1985-86. The narrowing-down of the deficit to US\$2.9 billion in 1986-87 was to a great extent due to the compression of imports, particularly by the public sector.

As a percentage of GDP the current account deficit increased from 8.0 per cent in 1982-83 to 20.4 per cent in 1985-86.

The structural weakness in the balance of payments is due to the overdependence in the current account revenues on a limited number of items namely, oil exports, workers' remittances, tourism and the Suez Canal revenues.

It is also clear that the wide merchandise trade deficit represents a major pressure on the balance of payments. Over the past five years imports were 2.5-3 times the size of exports.

As a result of the structure of Egypt's exports which is narrowly based on oil, the export performance has been deteriorating, reaching its

lowest level of US\$2.58 billion in 1986-87. This reflects the fall in oil prices in 1986 on the one hand, and the stagnation in non-oil exports on the other hand.

The share of oil export earnings dropped from 70 per cent in 1983-84 to 47 per cent in 1986-87 as a result of declining prices and reduced volume of exports.

As imports reached their peak of US\$10.5 billion in 1984-85 the trade deficit reached its highest level of US\$6.6 billion in that year. In the light of the circumstances prevailing with regard to the overall decline in all major revenues, the Government had to compress imports, mainly by the public sector, in a manner that would help to narrow down the deficit. The result of such measures was a substantial reduction in the trade deficit in 1986-87.

The capital account inflows decreased in 1986-87. This decrease was mainly due to a sharp fall in the disbursement of foreign loans by about 22.3 per cent.

Net outflows in 1986-87 reached their highest level of US\$2.0 billion.

Private capital outflows were considerably lower in 1986-87 recording US\$902 million as compared to US\$1.93 billion in the previous year. The reform of the foreign exchange market which started in May 1987 is considered to be the main reason for this decline in outflows.

As a result of declining export earnings and rising debt service obligations that reached nearly 50 per cent of the current account receipts, the overall balance deteriorated from a surplus of US\$452 million in 1982-83 to a deficit of US\$2.91 billion by 1986-87.

D. The external debt

Due to the different economic factors previously explained, Egypt's foreign debt has grown from US\$27.6 billion in 1982-83 to US\$37.6 billion in 1986-87, with debt service obligations growing from US\$3.2 billion in 1982-83 to US\$4.8 billion in 1985-86.

In view of the increasing pressure of such obligations a debt rescheduling was inevitable.

On 22 May 1987, Egypt signed a rescheduling agreement with a number of creditor countries within the Paris Club. As a result of this agreement the burden of debt service obligations was reduced to US\$2.5 billion (or 26.2 per cent of current account receipts) in 1986-87 as compared to US\$4.8 billion (or 48 per cent of current account receipts) in the previous year.

According to this agreement all maturities falling within the period from 1 January 1987 to 30 June 1988 of the official or officially guaranteed loans contracted before 31 October 1986, and with an original maturity of more than one year, were to be rescheduled or refinanced. Repayments are to be made over five years in semi-annual instalments starting from 31 December 1991.

E. The exchange system

The problem of the multiple exchange rate of the Egyptian pound became more complicated since the early eighties. The multiple exchange-rate system was designed mainly in the light of the Government's commitment to the massive number of low-income earners. Before May 1987, the exchange-rate structure of the Egyptian pound encompassed a stable rate for the central bank foreign exchange pool, an adjustable rate for the commercial banks' pool and a freely floating rate for an unorganized private market.

The exchange rate fixed within the floating private market used to attract an important part of the commercial banks' resources, particularly the remittances of expatriate Egyptians and tourism revenues, thus affecting the banking sector's ability to respond effectively to the demand for foreign exchange.

The Government started its exchange reform by the Ministerial Decree No. 222 issued by the Minister of Economy and Foreign Trade. This Decree established a new banks' foreign-exchange market, being operative on 11 May 1987, to which, on a gradual basis, transactions executed either through the commercial banks' pool or the private foreign-exchange market would be transferred. The authorized banks participating in this market are to determine, through their representatives in a committee, the exchange rate of the Egyptian pound which applies to the market transactions on a daily basis, and according to the supply and demand forces.

In opening the market, an initial exchange rate of LE 2.165 per US dollar was set. This initial rate represented a depreciation of 37 per cent of the Egyptian pound from the previous authorized commercial banks' rate, which was approximately equivalent to the difference that existed before 11 May 1987 between the highest official rate and the private free market rate.

The progressive reform designed by the Government was implemented in three stages, over which different kinds of transactions were gradually transferred from the commercial banks' pool to the new banks' free foreign-exchange market.

The third and final stage was implemented by the issuance of Ministerial Decree No. 107 of 1988 by which the commercial banks' pool was closed and all its transactions were transferred to the newly established free market.

The Central Bank pool, which is based on an exchange rate of LE 0.7 per US dollar, was not closed but its scope was reduced to a limited number of transactions.

The Central Bank pool derives its supply from exports of oil, cotton and rice, and it finances payments of imports of wheat, flour, sugar and edible oils.

SECTION II

Import Measures

A. Legal and administrative basis for the import measures

The simplification of the trading system and increasing its efficiency is one of the main components of Egypt's economic reform programme. A number of measures in this direction were implemented by the Government over the past two years.

The Ministerial Decree No. 333 of 1986, issued by the Minister of Economy and Foreign Trade, and taking effect from 22 August 1986, is considered to be a major reform. According to this Decree, the import licensing system, which was operated through two import rationalization committees, was abolished.

Starting 22 August 1986, all products are to be freely imported upon payment of applicable duties, except for a number of items which were included in a negative list attached to the above-mentioned Decree. The importation of items contained in this list is conditionally prohibited, i.e. generally prohibited but exceptionally allowed for the following categories:

- imports by licensed local manufacturers and assembly lines, imports for the sector of tourism, imports for turn-key projects and imports under the drawback system.

Several amendments to that list were issued over the time since it was introduced. Such amendments have generally been in the direction of liberalization.

In the light of the simplicity of this system of managing imports, its administration is mainly carried out by the banking system through the issuance of letters of credit for imports. Since the new system did not require any licence or approval, it is the banks which would decide on the issuance of letters of credit according to the importers' compliance with the rules of the system. All commercial banks in this regard are subject to the supervision of the Ministry of Economy and Foreign Trade and the Central Bank.

B. Methods used in restricting imports

Egypt's policy with regard to imports is designed to serve its development objectives as envisaged in the development plan. Such objectives include narrowing down the huge trade deficit, particularly at a time when export revenues are taking a sharp decline. Also, an essential component of the government policy, as mentioned above, is to simplify the trading system and increase its efficiency in a manner that would provide for the necessary stability and predictability which would facilitate

harmonized planning of domestic sectors of the economy in the light of the prevailing conditions.

Therefore it was imperative, while applying import restrictions to reduce the trade deficit, at the same time to maintain the availability of the necessary imported inputs to productive sectors of the economy as well as the essential supply goods.

Under the current import system, any private sector importer may directly apply to any of the authorized banks for the opening of a letter of credit; the preceding step of obtaining an import licence was abolished since 22 August 1986. All products may be freely imported except those on the negative list as indicated above.

The importation of items included in the list is not completely prohibited, but allowed for certain categories of importers, whose applications for letters of credit would be accepted by authorized banks.

The banks would not accept an application for a letter of credit to import an item on the negative list, if such an application was submitted by an importer who does not fall within the defined criteria.

Under this system there are no predetermined quantities for the imports of items on the negative list.

It is also important to note that, as a result of this system, the major part of import compression achieved so far was in the public sector's imports. Provisional figures indicate that the total of private sector imports was only marginally affected.

C. Treatment of imports from different sources

The import system is applied in a non-discriminatory manner on a commodity rather than on a country basis. However, Egypt maintains three bilateral payments agreements which are still in force, although the proportion of its trade conducted under this type of agreement has declined sharply in recent years. The three agreements are with the Governments of Sudan (since 1965), the Democratic People's Republic of Korea (since 1963) and the USSR (since 1963). Payments for transactions under these agreements are made through clearing accounts held by the Central Bank of Egypt, with a corresponding authorized bank on the other side. The exchange rates applied for transactions within these clearing accounts are being gradually adjusted until they will eventually reach the level of the free-exchange market.

D. Commodities or group of commodities affected by the import restrictions

The Ministerial Decree No. 333 of 1986, as mentioned above, introduced a negative list of items the importation of which is restricted. Nearly one third of the 305 items in this list fall within CCCN Chapters 1-24 while the other two thirds fall within CCCN Chapters 25-99.

Since the items on the negative list are restricted for balance-of-payments reasons, the criteria used for restriction were the local availability and the luxurious nature of the item.

Several amendments were introduced to the original list in the light of practical experience and the evolving conditions of the economy which might affect the extent to which certain commodities are locally available.

E. State trading

State-trading enterprises in Egypt operate purely on an economic basis and in a non-discriminatory manner.

After the establishment of the banks' foreign-exchange market, transactions by State-trading entities, which were previously executed through the commercial banks' pool, were progressively transferred to the new free market. Hence the foreign-exchange budgeting, by which foreign-exchange allocations were determined for State-trading enterprise at the commercial banks' pool exchange rate, was gradually abolished. Under the current system, State-trading enterprises are to execute their transactions through the new free exchange market, the same as private sector importers.

However, while this is the rule, there are two items, namely wheat and flour, the imports of which are confined to the public sector and financed from the Central Bank's foreign exchange pool. For two more items, namely sugar and edible oils, although these are not subject to a public sector monopoly, nevertheless, public sector imports of these items are financed also from the Central Bank's pool.

F. Measures taken since the last consultation in relaxing or otherwise modifying import restrictions

The Egyptian Government, within its economic reform programme, has taken a number of measures over the past two years which are designed to achieve progress towards simplifying and increasing the efficiency of the trading system and stimulating productive capacities of the economy. Such measures include:

- March 1986, ending the public sector monopoly on the import of a wide range of foodstuffs by permitting the private sector to import them at the free market exchange rate.

- August 1986, abolishing the import licensing system which was operated by two import rationalization committees and allowing free import of all products (except those items on the negative list).
- August 1986, a comprehensive tariff reform which included simplification of product-group classification as well as major tariff reductions reaching 50 per cent across-the-board (with some exceptions).
- Along with the tariff reform, additional surcharges on imports have been abolished, most important of which was the "Consolidation of economic development tax" (10 per cent on all imports) which was approved by the GATT CONTRACTING PARTIES to remain in effect until 1990.
- Other taxes and surcharges on imports which were also abolished are:
 - . maritime surcharge introduced by Law No. 12 of 1964;
 - . additional tax on imports introduced by Law No. 43 of 1979;
 - . statistical surcharges imposed by Law No. 5 of 1969.
- May 1987, the establishment of the banks' free foreign exchange market to which transactions were progressively transferred (as previously explained).
- March 1988, the abolishment of the commercial banks' foreign exchange pool and the transfer of its remaining transactions of the public sector to the new free-exchange market.

ANNEX I

Summary of Egypt's Balance of Payments

(in million US\$)

Items	1982/83	1983/84	1984/85	1985/86	Prov. 1986/87
I. <u>Current account</u>					
- Trade balance	-5,485	-6,254	-6,633	-6,312	-5,177
- Services (net)	502	53	-326	-667	-596
- Workers remittances	3,166	3,930	3,497	2,973	2,845
- Current account balance	<u>-1,817</u>	<u>-2,271</u>	<u>-3,462</u>	<u>-4,006</u>	<u>-2,928</u>
II. <u>Capital account</u>					
- Direct investment	247	146	212	219	176
- Project and commodity loans (net)	433	245	267	34	-186
- Suppliers and buyers credits (net)	-64	-493	-36	-205	-683
- Other private capital (includes errors and omissions)	862	1,401	1,327	1,927	902
- Capital account balance	<u>1,478</u>	<u>986</u>	<u>1,418</u>	<u>1,953</u>	<u>-956</u>
Official transfers	791	772	1,097	1,209	974
Overall balance	<u>452</u>	<u>-513</u>	<u>-947</u>	<u>-844</u>	<u>-2,911</u>

Source: The Central Bank of Egypt

ANNEX II

Summary of Egypt's Balance of Trade

(in million US\$)

	1982/83	1983/84	1984/85	1985/86	Prov. 1986/87
Exports (f.o.b.)	3,555	4,033	3,883	3,215	2,583
Petroleum	(2,468)	(2,640)	(2,589)	(2,017)	(1,222)
Other	(1,087)	(1,393)	(1,294)	(1,198)	(1,361)
Imports (c.i.f.)	-9,040	-10,287	-10,516	-9,527	-7,760
Public sector	(-6,737)	(-7,482)	(-7,646)	(-6,573)	(-5,082)
Own exchange	(-2,046)	(-2,659)	(-2,627)	(-2,598)	(-2,383)
Other	(-257)	(-146)	(-243)	(-359)	(-296)
Trade balance	<u>-5,485</u>	<u>-6,254</u>	<u>-6,633</u>	<u>-6,312</u>	<u>-5,177</u>

Source: The Central Bank of Egypt

ANNEX III

Egypt's External Debt Service Obligations, 1982/83-1986/87

(in million US\$)

	1982/83	1983/84	1984/85	1985/86	Prel. 1986/87 ¹
Amortization ²	1,587	2,028	1,836	2,573	1,332
Interest	1,632	1,938	2,325	2,214	1,175
Medium- and long-term debt	(1,095)	(1,428)	(1,736)	(1,798)	(888)
Short-term debt	(537)	(510)	(589)	(416)	(287)
Total debt service	<u>3,219</u>	<u>3,966</u>	<u>4,161</u>	<u>4,787</u>	<u>2,507</u>
(In per cent of current account receipts)	30.1	33.2	36.6	48.2	26.2

¹After rescheduling

²Medium- and long-term public and publicly guaranteed debt only

Source: Central Bank of Egypt