

# GENERAL AGREEMENT ON

RESTRICTED

BOP/R/176  
15 June 1988

## TARIFFS AND TRADE

Limited Distribution

### Committee on Balance-of-Payments Restrictions

#### REPORT ON THE 1988 CONSULTATION WITH THE ARAB REPUBLIC OF EGYPT

1. The Committee consulted with the Arab Republic of Egypt on 7 June 1988, in accordance with its terms of reference, pursuant to Article XVIII:12(b) of the General Agreement and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held under the Chairmanship of Mr. J.-F. Boittin (France). The International Monetary Fund was invited to participate in the consultation in accordance with Article XV of the General Agreement.

2. The Committee had the following documents before it:

Basic document by the Arab Republic of Egypt BOP/280 and Corr.1

Secretariat background paper BOP/W/117

Notification on Import Restrictions by the Arab Republic of Egypt L/6343

International Monetary Fund,  
"Recent Economic Developments" dated 10 May 1988

3. A number of representatives commented on the lateness of some of the documentation for this consultation and emphasized that timely provision of information was essential for the Committee properly to perform its tasks.

#### Opening statement by the representative of Egypt

4. The opening statement made by the representative of Egypt is attached as Annex I.

#### Statement by the representative of the International Monetary Fund

5. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in Annex II.

Balance-of-Payments position and prospects: alternative measures to restore equilibrium

6. All members of the Committee recognized that Egypt faced serious balance-of-payments constraints, arising from various external as well as domestic factors. It was noted that the overall balance of payments had been seriously eroded since 1982/83 due to sharp declines in oil exports, stagnation of other exports, and deficits in services and capital accounts. Some debt relief had been achieved through the debt reschedulings agreed since May 1987. Members commended the measures taken by Egypt, in spite of its balance-of-payments problems, to liberalize trade barriers, including the abolition of import licensing and the tariff reforms undertaken in recent years. It was also recognized that Egypt, with the assistance of multilateral financial institutions, was pursuing domestic adjustment policies, including financial, fiscal, monetary, pricing and other internal policies, which should, if continued, lead to improvements in the economic situation. Some members expressed the view that these economic reforms should be pursued more rapidly as delays could lead to harmful trends in the economy; in this connection one member referred to difficulties in achieving IMF programme targets because of increases in trade and exchange restrictions. Continuing efforts should be made to reduce the budget deficit and to liberalize prices, the operation of the exchange rate, and exchange restrictions. In this connection, it was noted that targets agreed with the International Monetary Fund for the budget deficit were not being achieved, that real interest rates were still negative and that price liberalization could have proceeded more rapidly. Other members expressed their sympathy with the economic problems faced by Egypt, which were common to many indebted developing countries. They felt that a steady but gradual approach to economic adjustments was necessary in order to achieve the desired ends without grave social consequences. It was widely recognized that Egypt's present trade policies were justified under Article XVIII:B, although one delegation pointed out that trade restrictions are not an efficient or effective way of addressing balance-of-payments difficulties and that it was open to question how far the maintenance of trade restrictions could have contributed to balance-of-payments problems.

7. A number of questions were asked about the exchange control system applied by Egypt. One member asked whether the foreign exchange quotas referred to in the Secretariat background document were still in effect, what authorities judged how sectoral quotas should be allocated, and whether, after quotas were filled, foreign exchange could still be made available for imports in that sector. Other members asked whether it was true that applications for letters of credit were being reviewed by the Egyptian authorities and being accepted or rejected on criteria which included the level of domestic supply; in this connection the appropriateness of invoking Article XVIII:B as against other provisions of GATT such as Article XVIII:C was raised.

8. Concerning Egypt's exchange rate policy, members welcomed the moves made by the Egyptian authorities towards unifying exchange rates at a

market-related level and encouraged further streamlining of the exchange system. However, it was noted that the depreciation of the nominal value of the Egyptian pound in the new bank foreign-exchange market since June 1987 had been modest, and there was some evidence that the real exchange rate might have appreciated. A substantial volume of trade in basic commodities was still conducted at the fixed official Central Bank rate, which did not reflect market trends. Moreover, it was noted that the rate applied for customs duty purposes, fixed at a level between the Central Bank and market rates, could have differential effects on the prices of goods imported under the different rates. One member asked whether Egypt had considered the possibility of completely floating the Egyptian pound, while others asked what further steps were being considered towards the unification of all exchange rates. One delegation expressed the view that, although positive changes had been made in the Egyptian exchange system, the exchange regulations remained complex, inflexible and discretionary in application.

9. The distorting effects of the present interest rate structure were also noted. Negative real interest rates encouraged the holding of assets outside Egypt and discouraged lending to many sectors. It was asked whether more fundamental changes in interest rates to discourage such distortions were envisaged by the Egyptian authorities.

10. A number of members asked what measures were being considered by Egypt to reduce its dependence on exports of oil and diversify its export structure. It was noted that the present pattern of trade and exchange restrictions would tend to inhibit such export diversification. A question was asked concerning the scope and nature of export subsidies. One observer asked for details of the amounts included in debt rescheduling agreements in the Paris Club.

11. In reply, the representative of Egypt said that the budget deficit had been reduced from 23 per cent of GDP in 1985/86 to 17 per cent in 1986/87 and this process was continuing in a manner consistent with the government's commitment to the interests of low income classes. Concerning exchange controls, Egypt was making consistent and continuing efforts to unify its exchange rates, as noted in the documentation for the meeting. All commercial rates were now unified except for the "Central Bank pool rate" which applied to trade in staple food items. The application of the exchange rate applied for customs duty purposes, which was currently midway between the two, tended to encourage imports; this rate would, in addition, gradually be adjusted to reach the free market rate. The foreign exchange budget allocation system had been abolished, again with the exception of an indicative allocation of funds for import of basic foods. This, however, would also evolve over time. Public sector enterprises were, since March 1988, required to make imports through the banks' free foreign exchange market in the same way as private businesses. No export subsidies were maintained by Egypt; consideration had been given to the possibility of introducing a comprehensive programme of incentives for exports, but this was not possible due to a lack of resources. The

economic reforms undertaken should help to create remunerative conditions for exporting; the Egyptian authorities were receiving valuable assistance from international organizations on export development. The prospects for exports would however also depend on the development of access to importing markets.

12. Concerning the issuance of letters of credit, the representative of Egypt said that under the current import system, all goods except those on the "negative list" of conditionally prohibited items were freely importable. Firms licensed to operate in specified sectors could import any goods on the negative list related to their activities. No import licences were required. The "negative list" was operated entirely through the banking system, although it was jointly supervised by the Central Bank and the Ministry of Economy and Finance. Letters of credit would be granted to any authorized importer applying to a commercial bank; while a scarcity of foreign exchange might imply a certain delay between application for and granting of a letter of credit, no mechanism for approval or review existed. Since March 1988, either foreign exchange for imports could be made available through commercial banks, or imports could be made with firms' own exchange, in which case letters of credit could be opened virtually immediately.

#### System, methods and effects of restrictions

13. Members welcomed the efforts made by Egypt to simplify and liberalize its trade régime, including the elimination of import licensing, tariff reforms and the elimination of additional surcharges. A member expressed concern about the long-standing nature of Egypt's trade restrictions. One member asked whether the 35 per cent import deposit requirement noted in the Secretariat background paper had been notified to GATT as a balance-of-payments measure. In reply, the representative of Egypt stated that this deposit requirement had been abolished.

14. A number of questions were asked about the list of items under conditional prohibitions. It was noted that this list was long. The criteria for inclusion of goods on the list had been stated by Egypt to include availability of goods from domestic suppliers; in this connection, it was noted that measures taken for balance-of-payments reasons should not be used to protect domestic industries. It was questioned whether prohibitions could be justified under the provisions of Article XVIII:9 which states that restrictions "shall not exceed those necessary" to prevent serious declines in reserves. One member also noted that there was no evidence that the system allowed the import of minimum commercial quantities as provided for under Article XVIII:10 and requested import statistics on a tariff line basis for items on the "negative list". Without such information, he would not be in a position to judge that the provisions of the Article had been fully complied with by Egypt. He noted that the system had been in effect for 18 months, although it had only now been notified by Egypt. Statistics must therefore be available, particularly since imports were made under exceptions to general

prohibitions. In addition, he called attention to the clear obligation contained in both Article XVIII:B itself and in the 1979 Declaration promptly to notify all trade measures introduced for balance-of-payments purposes. Adequate and timely notifications were essential to the Committee's work. He also asked whether importers were required to apply on every individual occasion for letters of credit for imports of goods on the negative list and what proportions of conditionally prohibited items were imported by the public and private sectors respectively. One member said that a number of discretionary elements still seemed to exist in the issuance of letters of credit and that the system appeared similar to a discretionary licensing system applied through the banks. Members asked whether and how far Egypt envisaged the reduction of the "negative list" in the forthcoming years; one member suggested that Egypt should make a firm commitment not to expand the list and another urged Egypt to outline its future intentions for removing trade restrictions. Specific questions were also asked about the possibility of liberalization of imports of cars and cigarettes.

15. In reply, the representative of Egypt said that he did not regard Egypt's trade restrictions as being of long standing, as the present system had been in place only since 1986, when the import licensing system was abolished. Concerning the "negative list", domestic availability was used as a criterion in determining whether or not to include a product on the list. Industrial protection was not the objective; simply to judge whether a certain item could be adequately supplied without foreign exchange expenditure. As to a commitment to "freeze" the "negative list", or to phase it out over time, he said that all balance-of-payments restrictions were by definition temporary; as the situation eased, so could the measures be abolished. In the present unpromising situation, it was unlikely that such a "freeze" commitment could be undertaken; however, his authorities had the situation constantly under review. Concerning imports of cars and cigarettes, he noted that the question could be considered from a number of points of view, including the problem of Customs revenue lost through the ban on motor-vehicle imports. In addition, foreign investors were heavily involved in both industries and were in some cases concerned that imports should not be admitted. Statistics on the value of "negative list" imports on a tariff line basis could not be supplied at this stage because of the relatively short time that the system had been in existence; for the same reason, no precise data could be given on public and private sector imports of conditionally prohibited items. He noted that the operation of the system was geared to commercial imports and therefore should allow the "minimum commercial quantities" referred to. However, in reply to further requests, he undertook to make every effort to obtain such information from his authorities and supply it to the Committee at the earliest possible opportunity.

16. One member sought clarification on the non-discriminatory nature of Egypt's import policy; the Egyptian representative replied that no differentiation was made among imports from any source. The only

differences in Egypt's import régime were in the treatment of different products. In answer to a question about Egypt's bilateral clearing account with the Soviet Union, he said that payments were currently effected in "clearing Sterling" at an exchange rate which would be gradually adjusted to parity with the market rate.

17. A number of members asked whether Egypt would consider converting import restrictions and prohibitions to price-based measures such as tariffs or other import charges, which would be less disruptive in nature. The representative of Egypt said that it would be difficult, in the light of the patterns of Egyptian income distribution and potential imports, to envisage this at present.

18. The Egyptian representative stressed that the efforts made by Egypt to liberalize its trade and exchange system should be given due credit in the context of the Uruguay Round.

### Conclusions

19. The Committee recognized that Egypt faced a serious balance-of-payments situation. It commended Egypt for the liberalization efforts undertaken to date, particularly the abolition of import licensing, tariff reform, and movement towards unification of exchange rates. The Committee encouraged the Egyptian authorities to continue this process. In this connection, it noted the problems faced by Egypt in maintaining its adjustment programme and encouraged the authorities to consider macro-economic measures which could assist further in pursuing it. The Committee noted that the medium-term outlook for Egypt's balance of payments would also depend on the availability of external financing on concessional terms and the expansion of non-oil exports.

20. The Committee noted that the operation of the exchange control system had had considerable effects on trade and urged Egypt to continue the streamlining of this system. In relation to the "negative list" of items subject to conditional prohibitions, which covered a substantial proportion of tariff lines, the Committee, while taking note of the difficulties expressed by the Egyptian delegation, encouraged Egypt to give consideration to formulating a time schedule for the phasing out of these restrictions, or their replacement by tariff-based measures, in parallel with other adjustment measures. The Committee noted that Egypt would seek credit in the Uruguay Round for its import liberalization.

21. The Committee sought further detailed information on imports under the "conditional prohibition" system and requested Egypt to provide such information at a tariff line level.

ANNEX IStatement by the representative of  
the Arab Republic of Egypt

A considerable period of time has already elapsed since Egypt last consulted fully on its balance of payments. We, therefore, welcome this opportunity of consultations today which obviously comes under paragraph 12(b) of Article XVIII. In this exposé, an attempt is being made to outline succinctly the developments in the Egyptian economy together with the adjustment efforts undertaken with the new trade measures.

The year 1974 represented a milestone in the orientation of the Egyptian economy towards an "open door policy" an important part of which was the enactment of Law No.43 which aims at encouraging foreign investment and lays the foundation for the expansion of private sector activities to assume a progressively increasing share of the economy.

As mentioned in our basic document for the consultation (BOP/280), the Egyptian economy enjoyed a fairly high rate of growth during the late 70's and early 80's, with GDP growth rates reaching the peak of 9.9 per cent in 1982/1983. This was due mainly to increased foreign exchange earnings from oil exports, inward remittances of expatriate Egyptians, tourism and Suez Canal dues. In making rational use of such resources, the Egyptian Government pursued at that time a policy of economic expansion, aiming primarily at redressing the structural problems in the economy, and raising the living standards of the low-income earning segment of the population.

The general level of expenditure envisaged at that time was based on certain forecasted revenues. By 1985/86 the situation changed drastically, the balance of trade deficit reached US\$6.3 billion, oil export earnings fell by 23 per cent, workers' remittances fell by 15 per cent, tourism earnings fell by almost 20 per cent, the current account deficit reached 20 per cent of GDP and the real growth rate of GDP slowed down to 4.8 per cent. In the same year the budget deficit represented 22.8 per cent of GDP and external debt service obligations reached 48.2 per cent of the current account receipts.

It should be noted that external factors had a major rôle to play in this situation, the most important of which was the collapse of oil prices which caused Egypt's earnings from oil exports to contract from US\$2.6 billion in 1983/84 to US\$1.2 billion in 1986/87. Oil prices also affected workers' remittances since it resulted in recessionary conditions in Arab oil producing countries where the majority of Egyptian expatriates are employed. Such remittances fell by around 22 per cent over the period 1983/84 to 1986/87. Consequently, Egypt's external debt grew to reach the amount of US\$37.6 billion in 1986/87 as compared to US\$ 27.6 billion in 1982/83, with debt service obligations reaching, as we previously mentioned, 48.2 per cent of current account receipts.

It is obvious that Egypt's balance of payments is characterized by structural weakness due to its narrowly based sources of receipts. The problem is not merely one of deficit, and it certainly represents one of the challenges which the government is facing.

In response to such a situation, the authorities have taken a number of corrective measures in 1985/86 which included correcting domestic price distortions by readjusting a number of publicly produced essential commodities to reflect real economic values; in the same time the budget deficit was reduced from 22.8 per cent to 17.1 per cent of GDP through reduced government spending. Also domestic prices of petroleum and electricity tariffs were substantially increased. There was also considerable liberalization introduced into the agriculture sector particularly with regard to production and pricing of different produce. Also in the same time and despite the difficult conditions, a great effort was made to introduce further liberalization and simplification into the trade system through adopting the following measures:

- In 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.
- In August 1986, abolishing the import licensing system which was operated by two import rationalization committees and allowing free import of all produce (except those items on the negative list).
- In 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 had been 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.

It should be noted in this regard that while the system retains some trade restrictions for balance-of-payments purposes, there is always a preference to the measures which have the least disruptive effect on trade, and to measures which are characterized by transparency and non-disruptive effects. Egypt does not resort to measures such as countervailing duties, antidumping actions or safeguards. The only restriction on imports maintained currently in the system is the negative list of some restricted

items which is notified to the CONTRACTING PARTIES in document L/6343 and explained in our basic document (BOP/280).

In May 1987 the government took a major step in the context of its economic reform programme by establishing a new free banks' foreign exchange market.

The Ministerial Decree No.222 issued by the Minister of Economy and Foreign Trade 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\$ 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. This stage was concluded four months ahead of schedule.

The Central Bank pool, which is based on an exchange rate of LEO.7 per US\$, was not closed but its scope was reduced to a very 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.

Also a number of important measures have been taken in the context of an agreed programme with the International Monetary Fund on 15 May 1987. Such measures included tax increases, a further increase in petroleum and electricity prices and an increase in interest rates.

It would be seen that Egypt has undertaken alternative measures to correct its balance-of-payments disequilibria, including measures aiming at increasing productivity and competitiveness of different sectors, as well

as measures designed to stimulate exports. It is obvious that export incentives are not included in such a process clearly due to lack of resources.

However, the prospects for the balance of payments for the medium term remain quite difficult and a substantial deficit is expected to remain for some years to come.

The future course of Egypt's policies would depend to a very large extent on the availability of adequate external finance on concessional terms on the one hand, and on the other hand on improvements in the external environment particularly in relation to factors such as oil prices and the accessibility of Egypt's non-oil exports to other markets.

Members of the Committee would note that Egypt did not invoke paragraph 12 of the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes, and did not request an expanded consultation. Nevertheless we feel that the Committee may recommend to the CONTRACTING PARTIES that Egypt would take credit for its unilateral measures of liberalization in the context of the Uruguay Round and that participants in the negotiations should give due regard to the expansion of Egypt's export earnings as means of alleviating its balance-of-payments problems.

ANNEX II

Statement by the Representative of the  
International Monetary Fund

From the mid-1970s through the early 1980s, the Egyptian economy grew rapidly under the stimulus of rising earnings of foreign exchange from petroleum exports, worker remittances, Suez Canal dues, tourism, and foreign aid. To cover the large external current account deficits, these foreign exchange flows had to be supplemented by foreign borrowing which led to a rapid buildup of external indebtedness and an increase in the debt servicing burden.

In the period 1983/84-1985/86, the underlying vulnerability of the balance of payments was brought into the open by the decline in world oil prices and in workers' remittances. By the end of this period, the external current account deficit--excluding official transfers--reached about 20 percent of GDP and external debt service obligations the equivalent of almost 50 percent of current external receipts; also external payments arrears of US\$3.3 billion accumulated. The growing pressure on the balance of payments was particularly felt in the public sector and was associated with a stagnation of imports. Real growth decelerated while inflation remained at about 16 percent on average.

In 1986/87, the external current account<sup>-deficit</sup> declined to 13 percent of GDP, despite lower petroleum exports, as imports were sharply compressed by a scarcity of foreign exchange. Reflecting a sharp turnaround in net capital flows, the overall balance of payments deficit widened to nearly US\$3 billion from under US\$1 billion in the previous year. Real economic activity contracted by 1-2 percent and inflation accelerated to more than 25 percent. During the four-year period ending with 1986/87 gross and net international reserves continued to increase 1/ as external payments arrears rose.

The major factors accounting for the deterioration in the balance of payments and in growth prospects were domestic structural maladjustments, expansionary financial policies, an insufficiently comprehensive approach to corrective policy implementation, uncompetitive exchange rates, and real negative domestic interest rates. Efficient resource allocation was also adversely affected by cost/price distortions arising from widespread official intervention in price determination, extensive subsidization, trade and exchange restrictions, and administrative controls; energy prices were held well below international levels.

A number of corrective measures were undertaken in 1986/87. The fiscal deficit was reduced to the equivalent of 17 percent of GDP from 23 percent in the previous year, largely through expenditure restraint, and the growth of private sector credit was slowed markedly. A number

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1/ At end-1986/87, gross international reserves (excluding gold, payments agreements balances, and earmarked accounts) were estimated at nine weeks of the following year's imports.

of administered prices were adjusted, and liberalization measures were introduced in agriculture, including the elimination of official trading monopolies for all products with the exception of cotton, sugar, and half the rice crop. Moreover, an increasing number of transactions in foreign currency by public entities were allowed to be carried out at, or close to, market-related exchange rates. A tariff reform was introduced in August 1986, which rationalized the tariff structure, reduced the number of exemptions, and introduced a more appropriate exchange rate for customs valuation purposes. At the same time, existing licensing requirements for private sector imports were abolished and all products not included in the banned list (consisting of 210 categories of goods) were permitted to be imported upon payment of the applicable duty.

On May 15, 1987 the Fund approved a stand-by arrangement for Egypt in the amount of SDR 250 million in support of a financial program covering the period April 1, 1987 to September 30, 1988. The economic reform program was primarily directed at increasing the medium-term rate of real economic growth and improving the balance of payments position and price performance. 1/

The authorities envisaged a series of corrective structural and demand management measures for the program period. These measures were to include a further reduction in the public sector deficit and a tight credit stance; a start toward the unification of exchange markets with the exchange rate in a new bank market determined by market forces; achieving internationally competitive, positive real levels of interest rates; substantial progress in adjusting energy prices toward international levels; effecting broader price liberalization and price adjustments in agriculture and industry; and implementing reforms in the public enterprise sector. The Government also undertook to eliminate all external arrears by June 1988 and not to incur any new arrears during the period of the arrangement.

The authorities took a number of important steps toward the implementation of policies under the program: the consumption tax on cigarettes and stamp taxes were increased; petroleum product and electricity prices were increased; interest rates were raised by 1 to 2 percentage points in May 1987; and tight limits were placed on private sector credit expansion. The new bank exchange market with a more competitive rate was introduced on May 11, 1987, and about 40 percent of the transactions from the commercial bank pool were transferred to it. The unification of the commercial bank pool and the new bank market was completed in mid-March 1988, four months ahead of

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1/ Egypt made a first drawing under the arrangement following Executive Board approval. However, the arrangement became inoperative and no further purchases have been made.

schedule. <sup>1/</sup> Since February 1988, the banks have been permitted to sell up to 10 percent of their available foreign exchange each month for the servicing of nonguaranteed private sector external debt and domestic bank debt denominated in foreign currency (giving priority to debt service relating to imports). Finally, in the area of prices, for most non-major crops, farmers began receiving free domestic market prices, and in January 1988 cotton prices were raised by 26 percent.

The economic and financial performance during 1987/88 has been mixed. Non-oil exports expanded early in the year, and the external position benefited from higher oil exports and from a sharp increase in tourist receipts. However, it is estimated that real GDP could likely contract by a further 1-2 percent, compared to a growth target of 2 percent, and inflation will remain on the order of 25 percent or more. The overall fiscal deficit is estimated at about 17 percent of GDP, about the same level as last year, compared to a program target of 13 percent.

The program envisaged a current account deficit of about US\$5 billion (excluding official transfers), the settlement of all outstanding arrears, and an increase in net international reserves. On the financing side, the program assumed, in addition to normal external capital inflows and debt rescheduling by official creditors, US\$0.7 billion of new money. Mid-year balance of payments projections for 1987/88 anticipated a current account deficit of US\$3.1 billion (nearly 14 percent of GDP), reflecting essentially lower imports and higher workers' remittances than forecast in the program. On the capital account, net outflows are projected at about US\$0.9 billion, reflecting lesser private capital inflows than initially envisaged, reduced drawing on project and commodity loans, reduced cover by export credit agencies, and a lower availability of banking facilities. Consequently, largely as a result of these developments, nearly US\$1 billion of Egypt's external debt service arrears is likely to remain unsettled by June 1988.

These domestic economy and external sector expectations reflect slippages in policy implementation under the program--in particular with regard to the budget, interest rate policies, the management of the exchange rate in the new market, and pricing. The renewed weakening of world petroleum as well as capital account and external assistance developments have also been contributory factors. The shortfall from anticipated capital inflows has complicated the task of economic management for the authorities, and has had an adverse impact on budgetary revenue performance.

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<sup>1/</sup> A description of the exchange system and of the recent changes is presented in Section VI of Arab Republic of Egypt--Recent Economic Developments (SM/88/104; 5/10/88).

Egypt's balance of payments and growth prospects remain difficult for the medium term even with a strong adjustment effort. However, under the assumption of the adoption of a comprehensive and strongly-implemented adjustment program, a moderate resumption of real economic growth would be feasible and the external current account deficit (excluding official transfers) could be limited to about US\$3 billion on average over the period into the early 1990's. Nevertheless, substantial financing gaps would remain, which points to the need for further annual reschedulings and increased external financing on concessional terms over the years to come.

The authorities are committed to an economic adjustment effort. However, they have indicated the need for adopting a gradualist approach to this effort over the coming years in order to avert social tensions. Given that the medium-term outlook of the economy and of the balance of payments remains extremely difficult, the Fund urges the Egyptian authorities to undertake a strong and comprehensive adjustment program with greater action at an early stage. Such a program could prepare the ground for the achievement of sustainable economic growth, lower inflation, viability of the balance of payments over the long term, and the elimination of exchange and trade restrictions.

A central element of the adjustment program would be a substantial reduction in the fiscal deficit, including structural revenue and expenditure measures, supported by appropriate credit policies. The Fund encourages the authorities to adopt and adhere to a schedule of adjustments of domestic energy prices that would quickly achieve international equivalence, and urges the authorities to adjust interest rates to internationally competitive real positive levels. A further element of the program would be the unification of exchange markets with access for all bona fide transactions at a competitive exchange rate and with passthrough to market prices except for a few socially-sensitive commodities. It is also important to improve the management of the new bank foreign exchange market and to pursue a flexible exchange rate policy aimed at improving competitiveness and enhancing balance of payments and reserves prospects. The Fund believes that adjustment policies would also need to encompass initial steps toward eventual full liberalization of the trade system over the medium term through reductions in import prohibitions, and a further rationalization of tariffs.

It is noted that some Egyptian exports are affected by protectionist measures in other countries. In particular, textile exports are subject to quotas (the United States and the EEC).

The Fund encourages the Egyptian authorities to strengthen their efforts to improve the economic data base and has offered further technical assistance.

The Fund urges the authorities to make further progress in reducing exchange and trade restrictions. Egypt's trade and exchange system is complex and relies on a number of restrictions. In particular, Egypt continues to maintain exchange restrictions subject to Fund approval and it also maintains multiple currency practices. In the absence of policies that permit progress toward elimination of the restrictive exchange practices, at the conclusion of the 1987 Article IV consultation on May 25, 1988, approval of the exchange restrictions or multiple currency practices subject to its jurisdiction was not recommended.