GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

BOP/W/133
11 June 1990
Limited Distribution

Committee on Balance-of-Payments Restrictions

1990 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 in taking the decision referred to in paragraph 8 of that Declaration. It updates the paper prepared for the 1988 consultation (BOP/W/117).

I. Previous Consultations with Egypt

2. The Arab Republic of Egypt has held nine consultations in the Committee (1970, 1973, 1975, 1977, 1979, 1981, 1983, 1985 and 1988). At the last full consultation, held on 7 June 1988, 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 pursue their adjustment programme and urged them to continue to streamline the exchange control system, which had considerable effects on trade. In relation to the "negative list" of items subject to conditional prohibitions, the Committee encouraged Egypt to give consideration to formulating a time schedule for the phasing out of these restrictions, or their replacement by tariff-based measures. 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 (BOP/R/176, paragraph 19, 20 and 21).

II. Egypt's Trade and Exchange System: Evolution since the last Consultation

(a) Import restrictions

3. All goods, except those contained in a "negative list" of conditionally prohibited goods and 65 items to which a temporary suspension

of opening of letters of credit applies, can be freely imported subject to foreign exchange availability.

4. The value of imports of conditionally prohibited goods, based on 1987 import values, was notified by Egypt to GATT in May 1989 (L/6343/Add.1). Imports of products on the "negative list", which comprises 305 items, accounted for 12.5 per cent of the total value of imports in 1987. Certain items on the "negative list" may be imported upon the approval of the Ministry of Economy by licensed local manufacturers and assembly lines, for the tourist sector, turn-key projects, or under the draw-back system for processing and re-export. Certain items may also be imported by returning emigrants. Conditional import prohibition is justified by Egypt by means of Article XVIII:B for all items on the list apart for those whose import is prohibited for reasons of health, public morals or security (Articles XX or XXI).

(b) Advance import deposit requirement

5. Private sector importers are required to cover 100 per cent of a letter of credit from own sources or credit facilities. Thirty-five per cent of the value of imports must be financed from own sources and placed at the time of application to open a letter of credit. The remaining 65 per cent is required to be deposited at the time the document is issued and can be financed by banks[1]. These deposits may be made in domestic or foreign currency. Goods may not be shipped before a letter of credit is opened. In March 1988 65 commodities were put on the list of goods for which letters of credit could not be opened until further notice.

(c) Exchange regulations affecting trade[2]

6. Imports by the central Government, public authorities, and public sector companies are financed within the provisions of the foreign exchange budget through the central bank pool and the new bank market. The annual foreign exchange budget provides a specific quota for each sector in which the Egyptian economy is divided such as agriculture, industry, and transportation. The authorities in charge of each sector decide on the goods to be imported and the entities that are to import them.

7. Private sector imports are financed through the new bank market, created in May 1987, or from own sources. Foreign exchange for the "own

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[1]Importers may not be required to cover the remaining 65 per cent of the letter of credit if suppliers' credit facilities are available.

[2]Egypt's exchange regulations and exchange system are described by the IMF in the 1989 Annual Report on Exchange Arrangements and Exchange Restrictions and in Arab Republic of Egypt - Recent Economic Developments (dated 7 December 1989).

exchange" system is channelled through four currency accounts: Free Accounts, Foreign Exchange Retention Accounts, Import Accounts in Foreign Exchange, and Capital and Working Accounts.

8. Proceeds from exports of cotton, rice and petroleum (exported by the public sector only) must be repatriated within three months. Proceeds from all private sector exports must be repatriated within one year from the date of shipment, except for those from exports of books, newspapers, and other publications,

for which a period not exceeding five years may be accepted. Most private sector export proceeds may be retained in Foreign Exchange Retention Accounts.

(d) Exchange rate

9. In principle, after the abolition of the commercial bank pool in March 1988, the exchange rate system consists of two rates. These are the central bank rate and the bank market rate. In December 1988 the central bank rate was at LE 0.7 per US dollar, while the bank market rate was set, by a special committee, at LE 2.35 per US dollar.

10. A number of special exchange rates are also in effect, which apply to visible and invisible trade transactions within the framework of the bilateral payments agreements with the Democratic People's Republic of Korea, the U.S.S.R. and Sudan. In addition, an outside banks (free) market exists, including a free accounts market, an unofficial market in Port Said (a free trade zone), and the illegal street markets. The free accounts market covers mainly workers' remittances and other transfers from abroad. At end-March 1990, the outside banks market rate was estimated at LE 2.70 per US dollar.

11. The central bank rate is used, on the payments side, to convert revenues from petroleum, cotton and rice exports, Suez Canal tolls and SUMED pipeline royalties. On the receipts side, the rate applies to imports of wheat, wheat flour, edible oils, tea, sugar, insecticides, fertilizers, and some public sector capital transactions. In August 1989, the central bank exchange rate was changed from LE 0.7 to LE 1.1 per US dollar. However, the Government subsequently announced that for domestic pricing purposes, imports of wheat, edible oils and flour would continue to be converted at the rate of LE 0.7 per US dollar.

12. Introduction of the central bank rate of LE 1.1 per US dollar was accompanied by certain changes in accounting procedures. For 1989-90, exchange operations were regulated according to three "subaccounts". Export proceeds from rice and excess resources of the Suez Canal and the Petroleum Company were valued at the new rate of LE 1.1 per US dollar, while the foreign exchange seller received a domestic currency payment converted at the old rate of LE 0.7 per US dollar. The difference of LE 0.4 was used to finance, through Subaccount One, a reduced rate of

LE 0.7 per US dollar for imports of wheat, flour, and edible oil as well as for military imports, invisibles payments and foreign exchange expenditures by Egyptian embassies abroad. Export proceeds from cotton were valued at the rate of LE 0.7 per US dollar and the difference with the new rate was used, through Subaccount Two, to cover losses of the cotton sector and to pay a supplement to cotton growers and spinning and weaving companies. Subaccount Three handled Government debt service, which was valued at the old rate of LE 0.7 per US dollar.

13. In 1987-88 and 1988-89, transactions through the central bank pool represented approximately two thirds and one quarter of merchandise exports and imports, respectively.

14. The bank market rate is determined daily by a committee of representatives from participating commercial banks on the basis of market supply, demand and others indicators chosen by the committee. At end-March 1990, this rate was set at LE 2.63 per US dollar.

(e) Other elements

(i) Customs valuation

15. After the abolition of the commercial bank pool in March 1988, the exchange rate for customs valuation was set at the discretion of the Minister of Economy. Accordingly, in July 1989, the rate was devalued from LE 1.89 to LE 2.55 per US dollar. With effect from July 1989, the customs valuation rate is set monthly on the basis of the average bank market exchange rate for the previous month.

(ii) Import duties and other taxes

16. In July 1989, some import duties were reduced. The new tariff rates are as follows: for food (20 per cent of total imports), the import duty was set at 0.7 per cent down from 1 per cent; for capital and intermediate goods (27 per cent of total imports), the rate was set at 3.5 per cent, down from 5 per cent; and for all other goods, the reductions were approximately in the range of 25 to 35 per cent. Goods previously charged at 10, 20, 30, 50, 60, 85, and 110 per cent are now dutiable at 7, 14, 21, 35, 42, 65, and 80 per cent, respectively. The top rate of 160 per cent, levied on five-cylinder cars, was reduced to 120 per cent.

17. At the same time, a number of tariff rates were increased, especially for manufactured or agricultural goods already produced in Egypt. Some of the products for which tariff rates were raised are: live birds for consumption, bath tubs, chickens and ducks, elevators, olives, coffee beans, tea packed and blended, and certain car components.

18. In July 1989, the consumption tax, which is either ad valorem or specific and is imposed on some 124 commodities (imported or of local production), was reduced by 35 per cent. It is reported that the

Government is considering shifting specific rates to ad valorem and expanding the coverage of the consumption tax.

III. Economic and trade developments

Overview

19. In fiscal years 1986/87 and 1987/88, the Egyptian authorities began the implementation of a series of economic measures which included adjustments of some administered prices, a partial liberalisation of agriculture, an increase in interest rates, a new commercial bank exchange rate and a tariff reform. However, economic performance fell below expectations due to slippages in policy implementation and a shortage of foreign financing. In 1988/89, output failed to recover and inflation remained at around 20 per cent. The Government continued its policy of selective liberalisation.

20. While the overall Government budget deficit was reduced from nearly 20 per cent of estimated GDP in 1987/88 to about 17 per cent of estimated GDP in 1988/89, net domestic credit growth accelerated. Real interest rates remained negative, despite moderate upward adjustments of nominal rates. A weak export performance in 1988/89 was translated into a widened current account deficit (excluding official transfers) of $4 billion, from $3.1 billion in 1987/88. The overall balance of payments deficit of $3.8 billion was largely financed by the accumulation of arrears on foreign debt service obligations. Total external debt was estimated at $46 billion as of June 1989.

21. Little real GDP growth is expected in the current fiscal year ending June 30, 1990. A poor cotton harvest is likely to further reduce export earnings. A decline in industrial production is also expected. The tourism sector, in contrast, remains robust. Overall, a small narrowing of the current account deficit is expected for the current fiscal year. The budget deficit forecast (about 12 per cent of GDP) seems unlikely to be met. Inflation is expected to accelerate from the 1988/89 level.

Aggregate supply and demand

22. According to official statistics, the rate of growth of the Egyptian economy was 5.3 per cent in 1987/88. However, according to the International Monetary Fund, it is possible that real output growth did not exceed 1 per cent. Non-governmental sources put growth in 1988/89 at 1.5 per cent, largely due to the performance of foreign merchandise trade and to an increase in revenues from tourism. It is estimated that both consumption and gross domestic investment declined in real terms in 1988/89.

23. For the current fiscal year, real GDP growth is expected to reach 2 per cent, well below the official target of 5.2 per cent. In the last two fiscal years, inflation has been high and foreign exchange shortages

(largely due to the overvaluation of the Egyptian pound) have disrupted imports of food and industrial inputs.[3]

24. Agricultural output remained sluggish in 1987/88-1988/89. Despite the removal of some price controls and procurement requirements, the main crops - cotton, sugar and rice - are still subject to strong intervention by the Government.

25. The Egyptian manufacturing sector is dominated by public sector companies. In 1987/88, a shortage of foreign exchange translated into shortages of imported inputs. Growth was very modest. Preliminary data for 1988/89 show continued stagnation in industrial activity, heavy borrowing by public sector companies from the banking sector and accumulation of payment arrears on public sector company debts to the Central Government.

26. Suez Canal revenues account for roughly 11 per cent of current foreign exchange receipts. In 1987/88, the stagnation of Middle East oil production and the Iran-Iraq military conflict depressed the volume of Canal traffic and there were no indications of a recovery in 1988/89. Tourism income recovered strongly after 1987/88, with foreign exchange earnings close to $1 billion in 1988/89. Following the implementation of liberalisation measures, tourism has become the least regulated sector of the economy.

Public finances

27. Egypt's public sector comprises the central and local administrations, decentralised Government agencies, and public sector enterprises. The latter provide a wide range of services and perform commercial, industrial and agricultural processing activities, usually with a dominant rôle in the relevant sectors.

28. In fiscal year 1987/88, the overall budget deficit reached almost 20 per cent of GDP continuing a trend of expansionary fiscal policies (Graph 1). However, in 1988/89, it fell to under 17 per cent of GDP, in part due to a reduction in Government investment expenditure. The main causes of Egyptian budget deficits include difficulties in increasing fiscal revenue, commitments to safeguard the living standards of low-income

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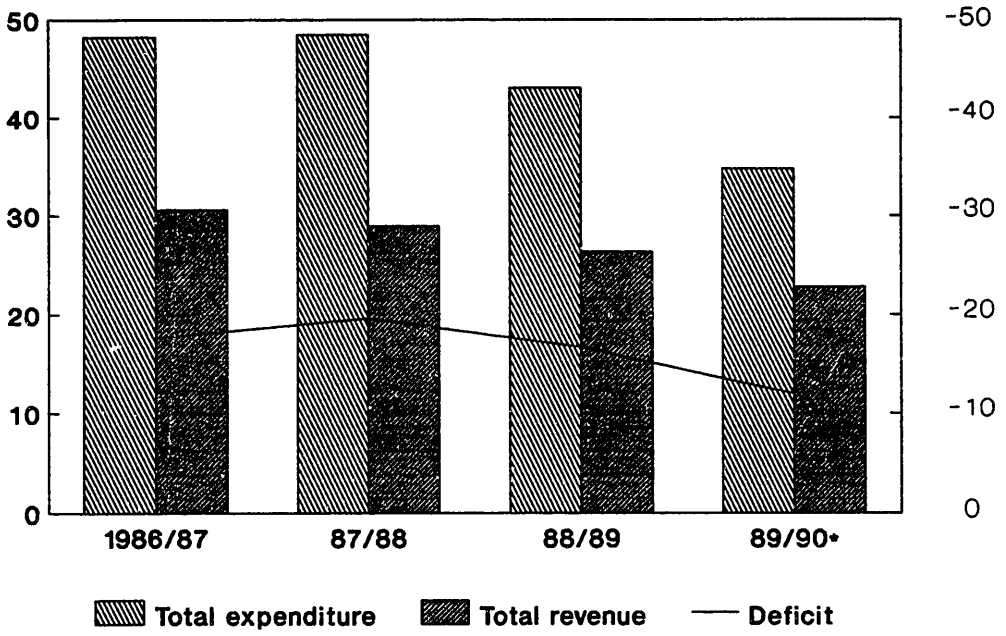
[3]Measuring inflation is difficult due to the extensive Government control of most food, energy, some agricultural products, rents, and a large part of industrial output. The result is that inflation manifests itself both in terms of rising prices and in terms of shortages and delivery delays. The inflation rate as measured by the wholesale price index was almost 26 per cent in 1987/88 and an estimated 25 per cent in 1988/89. Inflation is expected to accelerate this year.

groups, rises in civil service wages and salaries and growing interest payments on the increasing domestic public debt.

Graph 1 - Consolidated budget deficit
(Percentage of GDP)



* Official revised budget.

Source: IMF

29. The share of budget deficits financed from external resources has fallen from one-fifth in the mid-Eighties to an estimated 9 per cent in 1988-89. Domestic bank financing constitutes the major domestic budgetary financing source: it accounted for almost 38 per cent of budget finance in 1987/88 and nearly 44 per cent in 1988/89. This funding source has traditionally had an expansionary effect on monetary growth, an inflationary impact on prices, and a negative effect on the balance of payments. The remainder of the Government financing needs comes from domestic non-bank sources, notably the social insurance and pension funds.

30. In 1989/90, the overall budget deficit is forecast to fall to about 12 per cent of GDP. The authorities have adopted several measures for increasing revenue, including tax increases, new taxes and higher prices for all petroleum products (excluding gasoline). The growth of current expenditures is to be contained mainly through reduced subsidies and through a reduction of the increase in interest outlays to 9 per cent. Investment outlays are also projected to decline, affecting development programmes.

Money and credit

31. At the end of August 1989, the Egyptian banking sector was composed of the Central Bank, 27 commercial banks, 33 business and investment banks and four specialised banks. The activities of Islamic investment companies and three other banking institutions are excluded from monetary statistics.[4]

32. In 1987/88 and 1988/89, the growth of private sector liquidity was limited to levels below the expansion of net domestic assets, through the contraction of net foreign assets.[5] Large increases in net international reserves, mostly credited to commercial, business and investment banks, were more than offset by the accumulation of external arrears, for which counterpart payments were made to the central bank's blocked Egyptian pound account, established in association with the International Monetary Fund programme and the Paris Club rescheduling of 1987.

33. The growth of net domestic assets in the years 1987/88-1988/89 resulted from credit to both the public and the private sectors. However, public sector credit (mainly borrowing by central and local Government and by public sector companies) grew most rapidly.

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[4]Those institutions include the National Investment Bank, which handles the main outlays related to public sector investment and a bank owned by Egypt and other neighbouring countries over which Egyptian authorities do not have direct supervision and which is believed to accept significant amounts of deposits from residents.

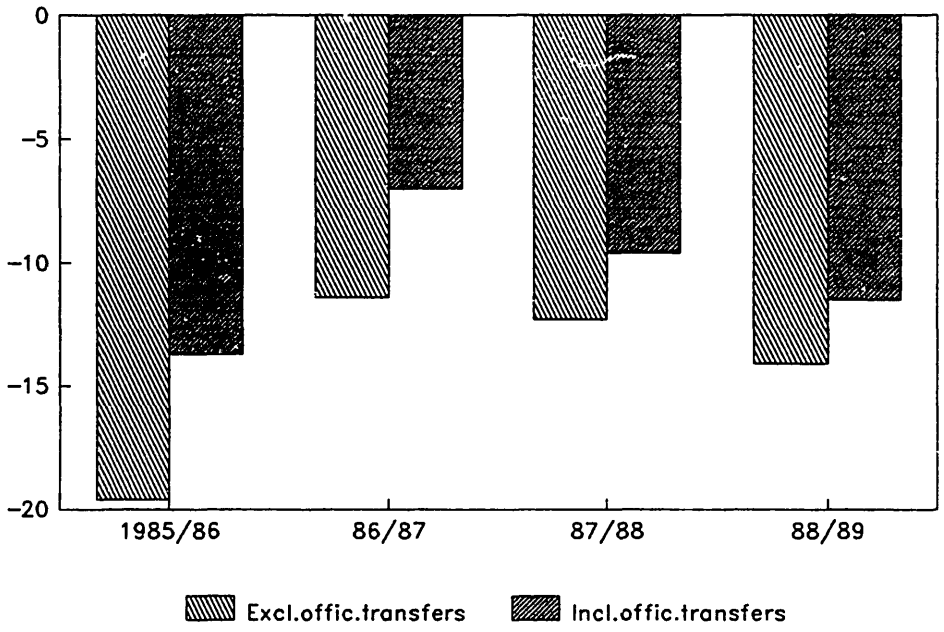
[5]Private sector liquidity comprises broad money including foreign currency deposits valued at the new commercial bank market rate.

34. Credit to the private sector grew modestly in 1987/88 as a result of increased central bank control over bank lending activities and the effects of the recession. In 1988/89, credit ceilings on private sector lending were raised, and Egyptian pound credit increased by 19 per cent against 12 per cent the previous year. Expansion of credit to the private sector in foreign currency grew slowly in 1987/88-1988/89. These resulted mainly from the depreciation of the domestic currency and from new import deposit requirements affecting letters of credit (see paragraph ... above), both of which reduced funds available for loan repayments.

Balance of payments

35. Egypt's overall balance-of-payments deficit was US$2.4 billion in fiscal year 1987/88, rising to $3.8 billion in 1988/89 (Table 1). The current account deficit (including official transfers) rose from 7 per cent of GDP in 1986/87 to over 11.5 per cent in 1988/89 (Graph 2). Workers' remittances covered almost half of the merchandise trade deficit in 1987/88-1988/89. Despite the overall deficit, international reserves of the banking system increased marginally. The deficit in the balance of payments and the growth in reserves were financed by the rescheduling of arrears in 1987/88 and by new arrears in 1988/89. It is expected that the current account deficit will narrow this fiscal year as a result of a reduced merchandise trade deficit.

Graph 2 – Current account balance
(Percentage of GDP)

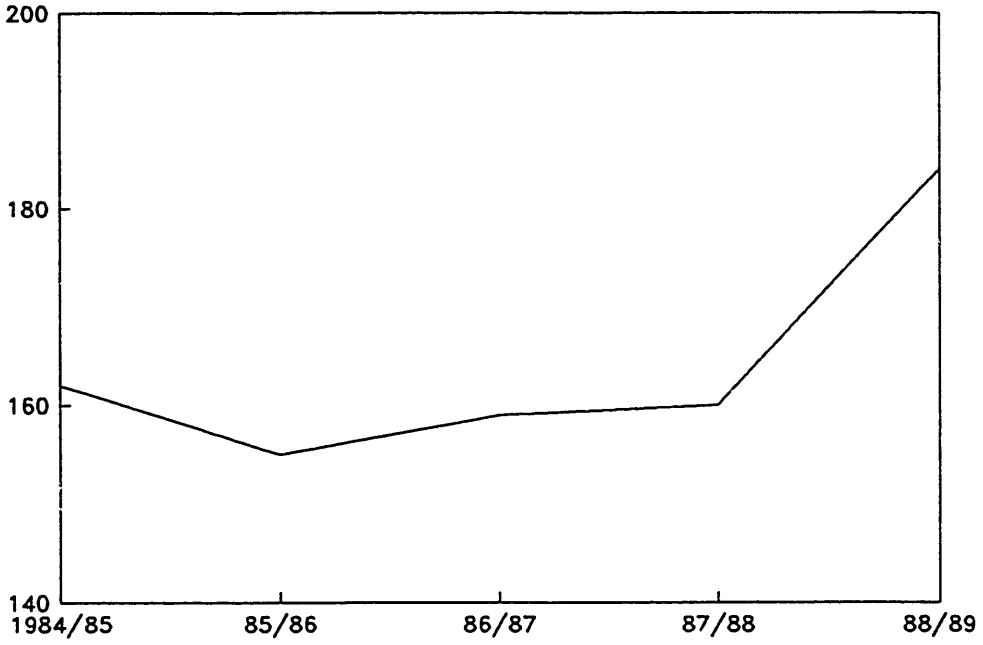


Source: IMF

The merchandise trade balance

36. Egypt's merchandise trade deficit increased from US$6.7 billion in 1987/88 to $7.5 billion in 1988/89. Merchandise exports rose to $3.1 billion due to the recovery of oil prices in 1987/88, then dropped to $2.6 billion in 1988/89 as oil prices fell and other non-oil exports were negatively affected by the appreciation of the real effective exchange rate (Graph 3), low procurement prices and shortages of imported inputs. Increased availability of foreign exchange in the last two years was an important factor in the recovery of merchandise imports in 1987/88-1988/89, (Table 1).

Graph 3 – Real effective exchange rate
(Index 1980=100; end of period)



Source: IMF

37. Egypt's main non-oil exports consist of cotton and cotton textiles, non-ferrous metals, food and raw materials (Table 2). Together they account for more than 54 per cent of total export revenues, against about 40 per cent for oil. The main merchandise imports of Egypt in 1988 were food, machinery and equipment, chemicals, other non-electrical machinery, and other semi-manufactures. Public sector trade accounts for about three-fourths of total merchandise imports.

Services, workers' remittances and transfers

38. The services account balance deteriorated in 1988/89. It is projected to improve further in the current fiscal year, largely due to a rise in Suez Canal dues, earnings from tourism and investment income. Payments of investment income (mainly interest) constituted the major service outflow in the same period. Workers' remittances have also been growing partly due to the availability of bank accounts yielding higher rates of return following the financial reforms of May 1987. However, they are still below historical levels largely as a result of the decline in the demand for labour in the region and low domestic interest rates.

The capital account and international indebtness

39. Reflecting large and growing amortisation payments, net official capital outflows reached $0.5 billion in 1987/88 and $1.6 billion in 1988/89. The main components of those flows are repayments of project and commodity loans (mostly in concessional terms) and suppliers' and buyers' credits. Inflows of suppliers' and buyers' credits were heavily reduced by creditors in 1988/89 due to the re-emergence of payments arrears. Net inflows of other private capital recovered after 1987/88, partly due to institutional changes in the foreign exchange market. Foreign direct investment in Egypt has been traditionally negligible.

40. Egypt's total external debt (including accumulated arrears) was estimated at $45.8 billion at the end of June 1989. This represented nearly 400 per cent of current receipts for exports of goods and services. More than 84 per cent of the total was accounted for by public and publicly guaranteed medium- and long-term debt. Debt service obligations were equivalent to nearly 60 per cent of current foreign exchange receipts in 1988/89.

Table 1 - Balance of payments
(Million US dollars)

	1985/86	1986/87	1987/88	1988/89*
Trade balance	-6 291	-5 368	-6 740	-7 490
- Exports (f.o.b.)	3 236	2 585	3 098	2 589
- Imports (c.i.f.)	-9 527	-7 952	-9 838	-10 079
Services (net)	-687	-165	-298	-83
Workers' remittances	2 973	3 012	3 384	3 530
Official transfers	1 209	974	698	755
Current account balance	-2 796	-1 546	-2 360	-3 288
Capital account	1 942	-591	-31	527
Direct investment	219	176	124	124
Project and commodity loans	34	211	-179	11
Suppliers' & buyers' credits	-205	-86	-300	-1 281
Other official capital	102	-860	-20	-300
Other private capital (incl. errors and omissions)[1]	1 792	-32	344	919
OVERALL BALANCE	-854	-2 137	-2 391	-3 815

[1]Mainly private sector foreign exchange inflows used to finance imports, interest, and other invisible payments, or deposits into foreign currency accounts held by the private sector with the domestic banking system.

*Estimates.

Source: IMF.

Table 2 - Principal merchandise exports
(Percentage shares)

	1986	1987	1988
Food	6.8	11.4	9.0
Raw materials	16.2	10.5	9.3
Ores and minerals	0.1	...	0.4
Fuels	51.3	35.8	33.2
Non-ferrous metals	5.7	8.0	12.6
Iron and steel	0.6	1.0	2.2
Chemicals	1.4	2.0	3.1
Other semi-manufactures	0.8	1.1	1.4
Machinery and transport equipment	...	...	0.3
Electric machines and apparatus	...	...	0.1
Textiles	14.7	26.9	23.5
Clothing	1.2	2.1	3.2
Other consumer goods	1.2	1.2	1.6
Total	100	100	100

Source: Comtrade, United Nations Statistical Office.

Table 3 - Principal merchandise imports
(Percentage shares)

	1986	1987	1988
Food	24.0	21.4	21.0
Raw materials	3.9	4.2	5.0
Ores and minerals	0.3	0.6	0.8
Fuels	2.7	2.1	2.0
Non-ferrous metals	0.5	0.5	0.7
Iron and steel	6.9	4.7	5.5
Chemicals	7.5	9.6	10.4
Other semi-manufactures	10	8.9	8.6
Machinery and transport equipment	20.4	22.1	21.2
Power generating machinery	0.8	0.8	0.6
Other non-electrical machinery	10.3	9.5	9.0
Office machinery and telecommunication	1.9	2.5	2.0
Electric machines and apparatus	3.0	3.8	3.7
Automotive products	3.3	4.2	4.0
Other transport equipment	1.0	1.3	1.7
Textiles	0.8	1.2	1.4
Clothing	...	...	0.1
Other consumer goods	2.7	2.6	2.3
Total	100	100	100

Source: Comtrade, United Nations Statistical Office.