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# GENERAL AGREEMENT ON TARIFFS AND TRADE

Committee on Balance-of-Payments Restrictions

## CONSULTATION WITH THE ARAB REPUBLIC OF EGYPT

### Background Paper by the Secretariat[1]

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).

### I. Previous Consultations with Egypt

2. The Arab Republic of Egypt has held ten consultations in the Committee (1970, 1973, 1975, 1977, 1979, 1981, 1983, 1985, 1988 and 1990). 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 this information at a tariff line level (BOP/R/176, paragraph 19, 20 and 21). Egypt notified such information in April 1989 (L/6343/Add.1).

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[1]This consultation with Egypt is being held in conjunction with the Trade Policy Review in the GATT Council. In accordance with the decision of the Committee (BOP/R/199), in such cases the Secretariat prepares only a short factual background paper containing aspects relevant to the work of the Committee. In trade policy related questions, this paper draws on the TPRM report prepared by the GATT Secretariat (C/RM/S/28 A and B). The Report prepared by the Government of Egypt for the Trade Policy Review (C/RM/G/28) should be considered as the Basic Document for the consultation.

92-1337

## 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 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 April 1989 (L/6343/Add.1). Since then, a number of reductions have been made to the list of conditionally prohibited goods. As of May 1991, the list comprised 105 commodity groups: it has been estimated that the production coverage of these restrictions prior to these changes was some 52 per cent and that the May 1991 changes reduced this to around 41 per cent of Egyptian production (public and private sector).[2]

5. Certain items on the "negative list" may be imported on 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

6. On application to open a letter of credit, private sector importers are required to lodge with an authorized bank an interest-bearing prior import deposit, in domestic or foreign currency, at the rate of 10 per cent if imports are for own use or 20 per cent if imported goods are for resale. (This deposit was reduced from 35 per cent in May 1991.) The remaining 80 or 90 per cent is required to be deposited at the time the document is issued and can be financed by banks. In May 1991, the list of 65 commodities, on which the opening of letters of credit was suspended, was abolished.

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[2] See document C/RM/S/28A, paras. 182-191. Table AIV.2 lists the product groups subject to restriction.

(c) Exchange regulations affecting trade[3]

7. Up to 26 February 1991, the Egyptian exchange system consisted of three markets: the central bank pool (covering receipts from exports of petroleum, cotton and rice, Suez canal dues and Sumed pipeline royalties, and payments for certain essential subsidized foods, subsidized insecticides and fertilizers, and specified public sector transactions); the commercial bank pool (covering receipts from workers' remittances, tourist expenditures and specified public and private sector export earnings); and the outside-bank free market (covering resident's holdings of foreign exchange deposits in free accounts with commercial banks and an unofficial market in the Port Said free trade zone). In February 1991, three new exchange rates came into effect: an administered rate for public sector transactions, a primary market rate (managed to remain close to the free market rate), and a free market rate. On 8 October of the same year, the primary and free market rates were unified and on 28 November the adminstered exchange rate was abolished, unifying all exchange rates. However, special exchange rates are still in effect for transactions under Egypt's bilateral payments agreements with the republics of the former Soviet Union and with the Sudan.

8. Imports by the central Government, public authorities, and public sector companies are financed within the provisions of the foreign exchange budget, established annually. With the liberalization of much public sector trade, the previous strict division of the foreign exchange budget by sector has been abolished.[4]

9. Public sector companies still dominate exports of cotton and petroleum, proceeds from which must be repatriated within three months. Rice trade has been opened to private participation. 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. Private sector export proceeds may be retained in Foreign Exchange Retention Accounts (set-aside accounts/Export).

III. Macroeconomic and trade developments

(i) Introduction

10. Through the 1980s, the Egyptian economy had been characterized by a dominant public sector which extensively controls public and private sector

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[3]See International Monetary Fund (1992), Annual Report on Exchange Arrangements and Exchange Restrictions 1992, Washington D.C.

[4]C/RM/S/28A, paras. 197-200.

activity; by large price distortions resulting from wide-spread price regulations; by public monopolies in the production and distribution of many goods and services sheltered from competition; by a restrictive import regime; and by exchange rate misalignment. These features of the economy, together with basic macroeconomic imbalances - such as inflation resulting from the monetization of large government budget deficits - caused productivity to grow slowly and seriously hampered its capacity to adjust to domestic and external changes. The result was a weakening of the balance of payments and a build up of substantial arrears on the country's international debt service.

11. In the fiscal years 1986/87-1987/88, the Egyptian authorities began implementing a series of economic measures designed to produce far-reaching structural changes.[5] Administered prices were adjusted and interest rates on Egyptian pound deposits increased, agriculture was partially liberalised, a new commercial bank exchange rate was established and tariff reform began. However, largely due to slippages in policy implementation and the partial character of the measures taken, macroeconomic imbalances intensified. Beginning in 1989/90, new fiscal measures were introduced, including new taxes, higher prices for petroleum products (excluding gasoline) and reduced subsidies. A comprehensive programme of further reform and adjustment was adopted in April 1991. Actions by donor countries to offset the effects of the Gulf War on Egypt's foreign exchange earnings, significant external debt forgiveness and cash assistance were also forthcoming in 1990/91. The exceptional aid was responsible for most of the improvement in the balance of payments and the recovery of the stock of international reserves. The balance of payments situation therefore remains fragile as it depends heavily on aid and on investors' confidence in the adjustment programme. Merchandise exports, for example, represented just 34 per cent of merchandise imports in 1990/91.

12. In the fiscal year 1991/92, the effects of the reforms were evident in the reduction of growth in private sector liquidity[6], a large reduction in the fiscal deficit, the unification of the foreign exchange market, an improved balance of payments position and a rise in the stock of international reserves. Substantial capital inflows contributed to the overall balance of payments surplus (but also led to a real appreciation of the Egyptian pound).

13. Despite the success in reducing macroeconomic imbalances and in beginning structural changes, Egypt needs to continue the process of price

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[5]The fiscal year begins on July 1.

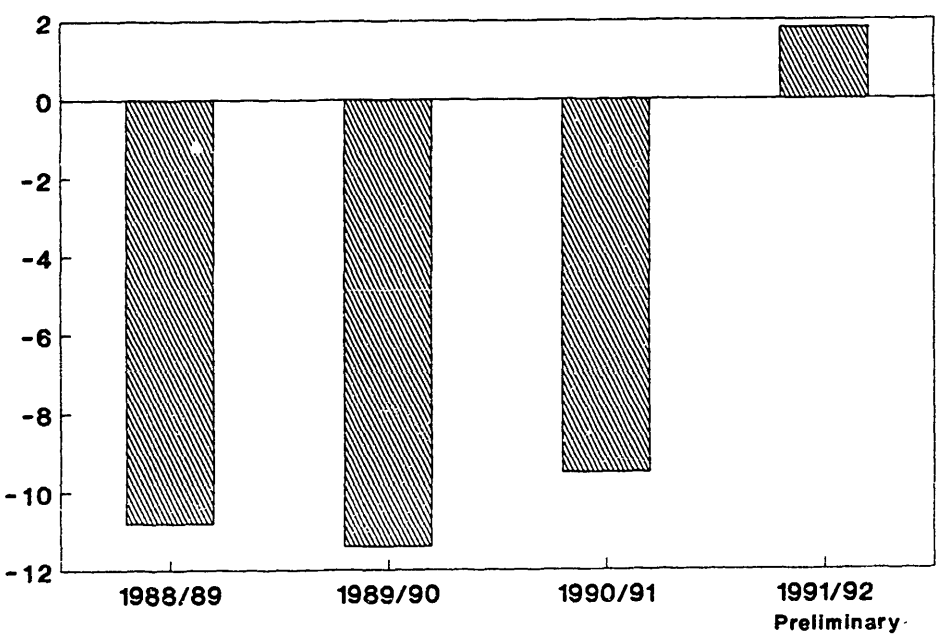
[6]Private sector liquidity comprises broad money including foreign currency deposits.

and trade liberalization, fiscal adjustment and structural change in order to ensure sustainable growth. Since 1990/91, progress in reducing inflation, restoring growth and reducing unemployment has been slow. Another major area of concern is the reform of the manufacturing sector where the government, which still accounts for about 70 per cent of output, exercises control over pricing, input utilization, production and employment decisions. Rationalization and divestiture are proceeding slowly. Plans are underway for a new regulatory environment aimed at increasing domestic and foreign investors' confidence in the state-dominated financial sector, including banks and insurance companies.

(ii) Overview of the balance of payments situation

14. In the period 1988/89-1989/90, the overall balance of payments deficit of Egypt declined to US$1.2 billion (Table 1) from nearly US$1.9 billion in 1987/88. However, this resulted largely from official transfers (mostly commodity grants), as well as what are assumed to be unrecorded current account receipts and capital inflows grouped under ("errors and omissions"). The deficit of the Egyptian current account, excluding official transfers, grew from US$2.7 billion in 1987/88 to nearly US$3.7 billion in 1988/89, equivalent to almost 11½ per cent of GDP (Graph 1). This was largely due to a brisk increase in merchandise imports as monetary and fiscal policies were eased. Medium- and long-term capital inflows could not offset the rise in amortization payments and the deficit in the capital account reached US$1.2 billion at the end of June 1990. The level of international reserves (excluding gold) was mostly stable at around or 1 month of merchandise imports (Graph 2). However, arrears on international debt accrued by about 7 per cent of GDP in each year between July 1988 and June 1990.

**Graph 1- Egypt - Current account balance (excl. official transfers)**
(Percentage of GDP)




Source: IMF.

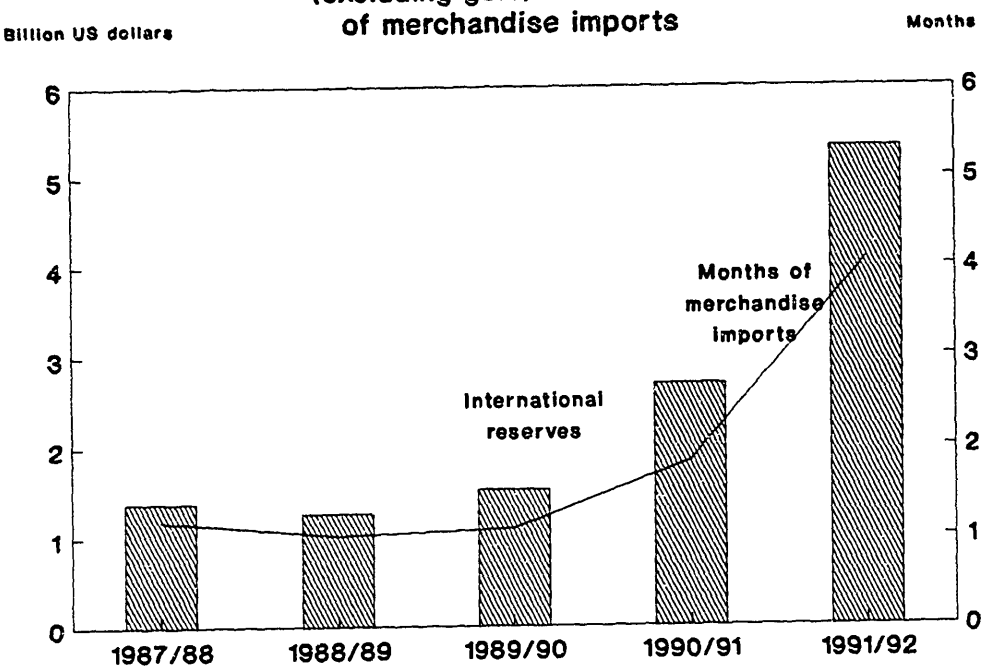
**Table 1**
**Egypt - Balance of payments, 1988/89-1991/92**
(Billion US dollars)

| | 1988/89 | 1989/90 | 1990/91 | 1991/92[1] |
|---|---|---|---|---|
| Trade balance | -7 465 | -8 297 | -7 538 | -8 014 |
| Exports | 2 820 | 3 144 | 3 887 | 3 523 |
| Petroleum | 1 148 | 1 229 | 1 971 | 1 541 |
| Other | 1 672 | 1 916 | 1 916 | 1 983 |
| Imports CIF | -10 285 | -11 441 | -11 425 | -11 537 |
| Services (net) | 671 | 866 | 536 | 3 414 |
| Receipts | 5 389 | 6 094 | 6 734 | 7 572 |
| Suez Canal dues | 1 307 | 1 472 | 1 662 | 1 977 |
| Tourism | 901 | 1 072 | 924 | 1 300 |
| Investment[2] | 1 097 | 1 164 | 1 416 | 1 478 |
| Other | 2 085 | 2 387 | 2 732 | 2 817 |
| Payments | -4 718 | -5 228 | -6 198 | -4 158 |
| Of which: Interest | -2 543 | -2 960 | -3 716 | -1 676 |
| Workers' remittances | 3 532 | 3 743 | 3 755 | 5 240 |
| Current account (excluding official transfers) | -3 262 | -3 688 | -3 247 | 640 |
| Official transfers | 756 | 1 094 | 4 842 | 1 525 |
| Cash grants | 45 | 215 | 633 | 165 |
| Commodity grants | 711 | 879 | 854 | 915 |
| GCFCG[3] | -.- | -.- | 3 355 | 445 |
| Current account (including official transfers) | -2 506 | -2 594 | 1 596 | 2 165 |
| Capital account | -414 | -1 189 | -981 | 2 798 |
| Medium- and long-term loans | -331 | -1 119 | -791 | 516 |
| Drawings | 2 247 | 1 932 | 1 827 | 1 700 |
| Amortization | -2 578 | -3 051 | -2 618 | -1 184 |
| Other | -83 | -70 | -190 | -19 |
| Errors and omissions (including direct foreign investment) | 1 200 | 2 572 | 1 379 | 487 |
| OVERALL BALANCE | -1 720 | -1 211 | 1 994 | 5 450 |
| Memorandum item: | | | | |
| Exceptional financing | 2 134 | 2 314 | 3 997 | -721 |
| Accruals(+)/reductions(-) of arrears | 2 134 | 2 314 | -9 558 | -1 028 |
| Debt service forgiveness[4] | -.- | -.- | 1 279 | -.- |
| Interest | -.- | -.- | 1 174 | -.- |
| Amortization | -.- | -.- | 105 | -.- |
| Stock of arrears forgiveness[4,5] | -.- | -.- | 6 393 | -.- |
| Rescheduling | -.- | -.- | 5 883 | 307 |
| Current maturities | -.- | -.- | 2 592 | -.- |
| Principal | -.- | -.- | 1 246 | -.- |
| Interest | -.- | -.- | 1 346 | -.- |
| Arrears | -.- | -.- | 3 291 | 307 |

1 Preliminary estimates.
2 Includes imputed interest on deposits held abroad.
3 Gulf Crisis Financing Coordination Group.
4 United States, Arab oil producers, and GODE.
5 In addition, debt cancelled not in arrears amounted to US$6,515 million.

Source: IMF.

Graph 2- Egypt-International reserves (excluding gold) and months of merchandise imports

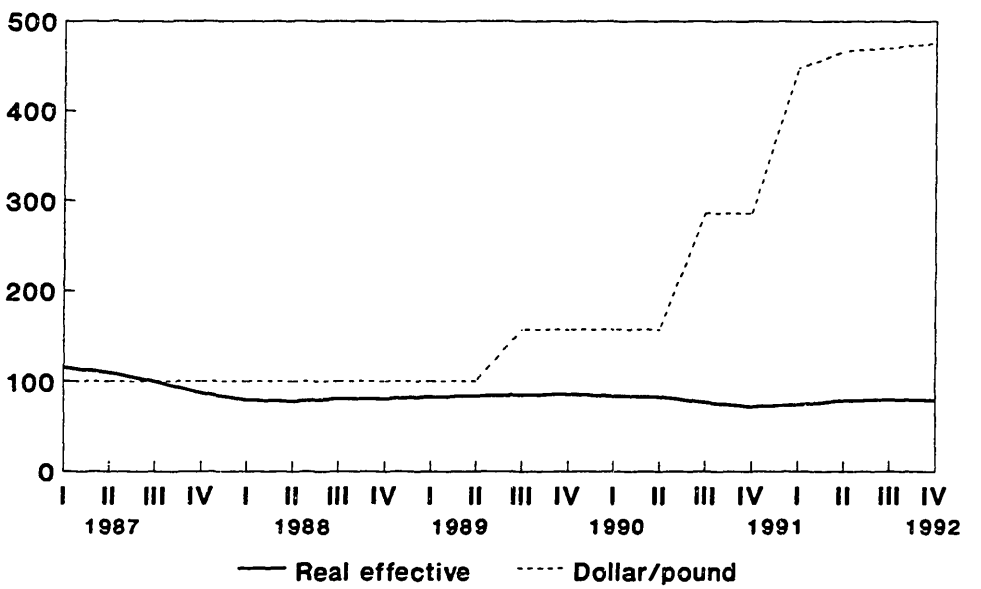



Source: IFS, IMF, August 1992.

15. In the year 1990/91, the overall balance of payments of Egypt moved into a surplus of nearly US$2 billion as the authorities implemented a more comprehensive programme of reform and donors' efforts to offset the impact of the Gulf crisis cleared the way for substantial external debt forgiveness. The improvement in the external position was reflected partly in a moderate decline in the deficit of the current account, before official transfers, to US$3.2 billion, or 9½ per cent of GDP. This was partly due to a reduced merchandise trade deficit. Merchandise imports stagnated because of the low level of investment, the effects of the exchange rate depreciation of February 1991 (Graph 3), and an increase in customs duties together with the introduction of a sales tax in May 1991. Meanwhile, the value of merchandise exports grew by nearly 25 per cent favoured by a large improvement in the terms of trade. While both the volume and value of exports of petroleum products grew rapidly, the value of non-petroleum exports was stagnant, in part because of the impact of the

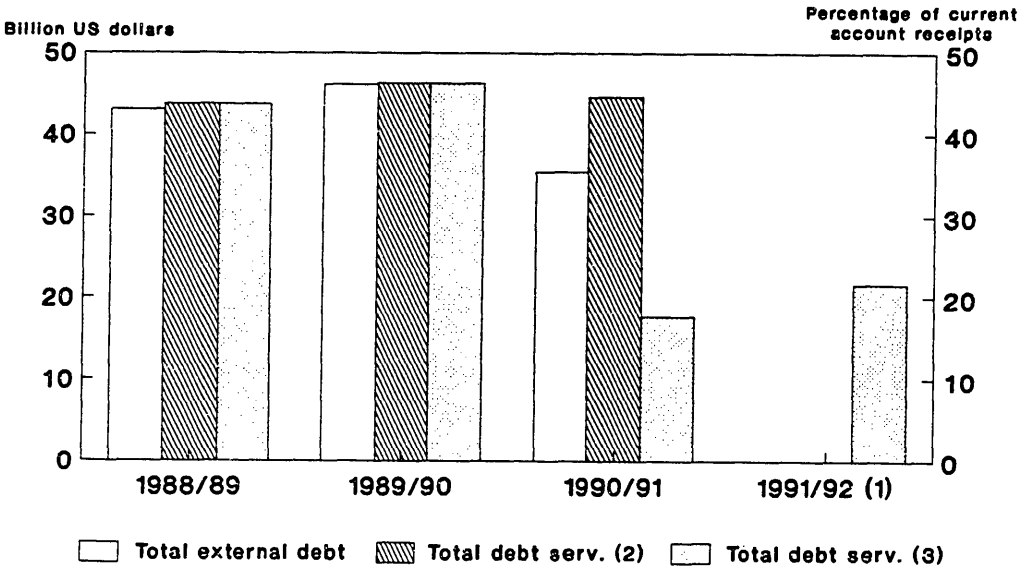
exchange rate and official pricing policies on the profitability of exporting. Significant official transfers through the Gulf Crisis Financing Cooperation Group (GCFCG) and cash grants reached about US$4.9 billion moving the current account into a surplus of US$1.6 billion (a swing of more than US$4 billion from the previous fiscal year). International reserves grew to about 1.8 months of merchandise imports. In late 1990, the United States wrote off US$6.6 billion of Egyptian debt while regional creditors cancelled US$6.3 billion. In May 1991, the Paris Club agreed to reorganise the total external debt of Egypt and to provide a 50 per cent reduction in the net present value of the debt. An immediate 15 per cent reduction in the net present value of the debt was granted, effective July 1, 1991. As a result of this and other actions, the value of Egyptian total external debt fell to US$35.5 billion at the end of June 1991 from US$46.1 billion the previous year (Graph 4). Total debt service as a percentage of current account receipts dropped to less than 18 per cent after rescheduling from about 44½ per cent before rescheduling.

Graph 3- Egypt - Exchange rate indices: real effective and dollar/pound
(1980=100)




Source: IMF, and IFS, IMF, August 1992, and GATT staff estimates.

Graph 4 - Egypt - Total external debt (US$ billion) and total debt service (percentage of current account receipts)




(1)Total external debt figures for 1991/92 are not available
(2) before rescheduling (3) after rescheduling

Source: IMF.

16. In 1991/92, the improvement in the external position of Egypt continued as the surplus in the overall balance of payments reached nearly US$5.5 billion. According to preliminary estimates, the current account, before official transfers, recorded a surplus of US$640 million, or nearly 2 per cent of GDP. The slight increase in the merchandise trade balance deficit was more than offset by a major increase in the surplus in the services account. Merchandise imports continued to stagnate in 1991/92 largely as a result of a tighter policy stance, while a weakening of oil prices affected negatively the value of petroleum exports.

17. The surplus in the services account was mostly the result of the reduction in interest payments on the international debt and of the substantial growth of workers' remittances. Suez Canal dues, which rose by about 12 per cent per annum during 1988/89-1989/90, reached nearly US$2 billion. Tourism receipts also improved following the decline in tensions in the Gulf and the reduction of tourism transactions outside official channels induced by changes in the exchange rate system. Workers' remittances are estimated at more than US$5 billion due to the increase in the number of workers abroad and to the new exchange rate system that

increased incentives for repatriating foreign exchange into Egyptian banks. Also the higher return on deposits on Egyptian pounds after the liberalization of interest rates and the unification of the exchange rate proved to be attractive. The capital account was also in surplus mostly due to the decline in amortization payments following the debt agreement and to increased private capital inflows. The net effect of the positive balance of payments developments was that international reserves grew to nearly 4.1 months of merchandise imports at the end of February 1992. Arrears on the international debt were completely eliminated by June 1992.

18. Following the rise in petroleum prices in 1990/91, the share of crude oil and petroleum products in total merchandise exports increased to 51 per cent from nearly 41 per cent in 1988/89 (Table 2). Another major change in the period was the continued decline in exports of cotton and citrus fruits. Exports of cotton fell to just 2 per cent of total exports in 1990/91 from some 9½ per cent two years earlier. This resulted largely from the increased divergence between government procurement prices and international prices.

**Table 2**
**Egypt - Principal Merchandise Exports, 1988/90-1990/91**
(Percentage share)

| | 1988/89 | 1990/91 |
|---|---|---|
| Petroleum | 40.7 | 50.7 |
| Crude oil | 29.0 | 37.6 |
| Petroleum products[1] | 11.6 | 13.1 |
| Other industries | 17.0 | 16.3 |
| Foodstuff | 1.8 | 2.2 |
| Chemicals | 3.6 | 4.6 |
| Metallic and engineering | 9.7 | 7.6 |
| Other | 1.9 | 2.3 |
| Spinning and weaving | 13.8 | 13.6 |
| Cotton yarn | 15.6 | 8.2 |
| Cotton textile | 1.7 | 1.9 |
| Other | 2.5 | 3.5 |
| Agricultural commodities | 13.2 | 5.8 |
| Cotton | 9.5 | 2.1 |
| Rice | 0.2 | 0.1 |
| Potatoes | 0.5 | 0.7 |
| Citrus fruits | 1.1 | 1.0 |
| Other | 1.8 | 1.9 |
| Other undistributed | 15.5 | 13.6 |
| TOTAL | 100.0 | 100.0 |

1 Excludes bunker oil, which is included in exports of services in the balance of payments.

Source: IMF.

19. Egypt's imports of food and beverages accounted for 14 per cent of total merchandise imports in 1990/91 (Table 3), down from 20 per cent two years earlier as a result of a decline in prices. Imports of fats and oil, in contrast, continued to increase representing in 1990/91 about 9½ per cent of total imports. Imports of intermediate goods and machinery and equipment levelled off, most likely due to weak growth and the fall in investment. Imports linked to commodity grants rose to more than 20 per cent of the total in 1990/91 from 6½ per cent in 1988/89, largely on account of aid related to the Gulf crisis.

**Table 3**
**Egypt - Principal Merchandise Imports, 1988/90-1990/91**
(Percentage share)

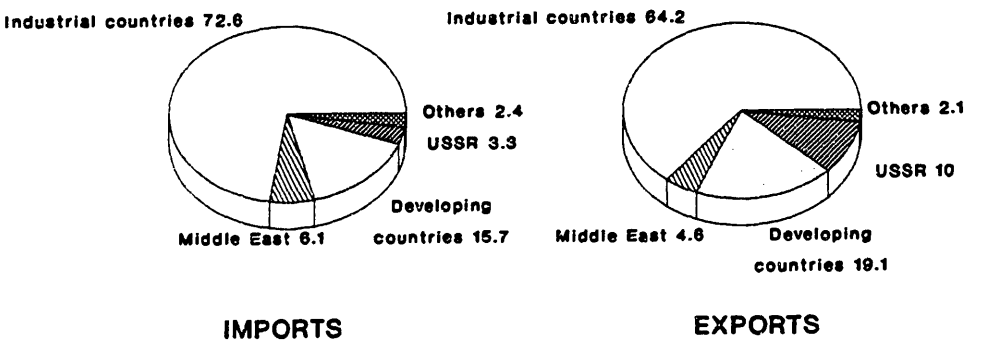
| | 1988/89 | 1990/91 |
|---|---|---|
| Machinery and equipment | 20.0 | 20.4 |
| Food and beverages | 19.9 | 14.2 |
| Chemicals | 9.7 | 10.2 |
| Commodity grants | 6.9 | 10.2[2] |
| Wood, paper, and textiles | 9.4 | 10.1 |
| Fats and oils | 6.6 | 9.3 |
| Metals and products | 9.2 | 7.1 |
| Miscellaneous manufactured | 3.2 | 3.3 |
| Undistributed[1] | 15.1 | 15.2 |
| TOTAL CIF | 100.0 | 100.0 |

1 A substantial proportion represents the counterpart to foreign loans.
2 Includes counterpart to GCFCG grants.

Source: IMF.

20. The share of industrial countries in Egypt's exports increased to nearly 65 per cent in 1990/91, as the Gulf crisis pushed exports to the Middle East down to 4½ per cent, a third of their value in a normal year (Graph 5). Following the collapse of the communist regimes, the share of the former Soviet Union and selected other countries dropped to 10 per cent from an average of 15 per cent in the previous years. The share of merchandise imports coming from industrial countries continued its upward trend, reaching nearly 75 per cent of the total. The share of imports from the Middle East doubled to about 6 per cent, while imports from non-oil developing countries continued to fall to less than 16 per cent.

**Graph 5- Egypt - Regional patterns of merchandise imports and exports, 1990/91**
(Percentage share)




Source. DOT, IMF, March 1992.

(iii) The nature of the balance of payments difficulties and prospects

(a) Macroeconomic and policy developments in 1988/89 and 1989/90

21. In the years 1988/89 and 1989/90, overall fiscal deficits decreased to an average of 18.2 per cent of GDP (Table 4) from nearly 20 per cent in 1987/88.[7] This resulted largely from a drop in expenditure to about 46 per cent of GDP in 1989/90 which more than offset the decrease in revenue. The share of domestic bank financing of the deficit rose to more than 42 per cent in 1988/89 (Graph 6) and to 53 per cent in 1989/90 from 34 per cent in 1987/88. Domestic bank borrowing in 1988/89 represented 12½ per cent of the money stock at the beginning of the year, and during the year 1989/90 it increased to about 14½ per cent of the money stock at end-June 1989. This was the major factor explaining the acceleration in the growth of private sector liquidity to an annual average of 19 per cent in the period 1988/89-1989/90 (Table 5) from 11½ per cent in 1987/88.[8] The increase

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[7]The non-financial public sector of Egypt includes the Central Government, regional and local governments, public enterprises, and some extra budgetary entities.

[8]Expenditure does not include expenditure of the pension funds which represents about 4 per cent of GDP.

in the net indebtedness of the public sector toward the banking system was mostly responsible for the increased borrowing from the consolidated banking system of one billion pounds (1.6 per cent of GDP) in 1987/88 and for 4.5 billion pounds in 1989/90 (5.7 per cent of GDP).[9] As The dollarization of the economy until June 1990 was reflected in a build up of foreign exchange in the commercial and other deposit banks, as the share of national currency in private sector liquidity fell to about 53 per cent at the end of June 1990 from almost 58½ per cent at the end of June 1988 (Graph 7).[10]

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[9]The banking sector of Egypt comprises the Central Bank, 27 commercial banks, 35 business and investment banks, and 4 specialised banks. The National Investment Bank is not covered by the banking statistics. It receives the surpluses of the pension and insurance funds and lends these to the public enterprises and the government traditionally at rates below the market. Its total assets at end-June 1990 amounted to about 44 per cent of GDP.

[10]Until 1990, the interest rate on three-month deposits in Egyptian pounds was fixed at 8½ per cent while dollar-denominated deposits had an average net return in Egyptian pounds of 24 per cent.

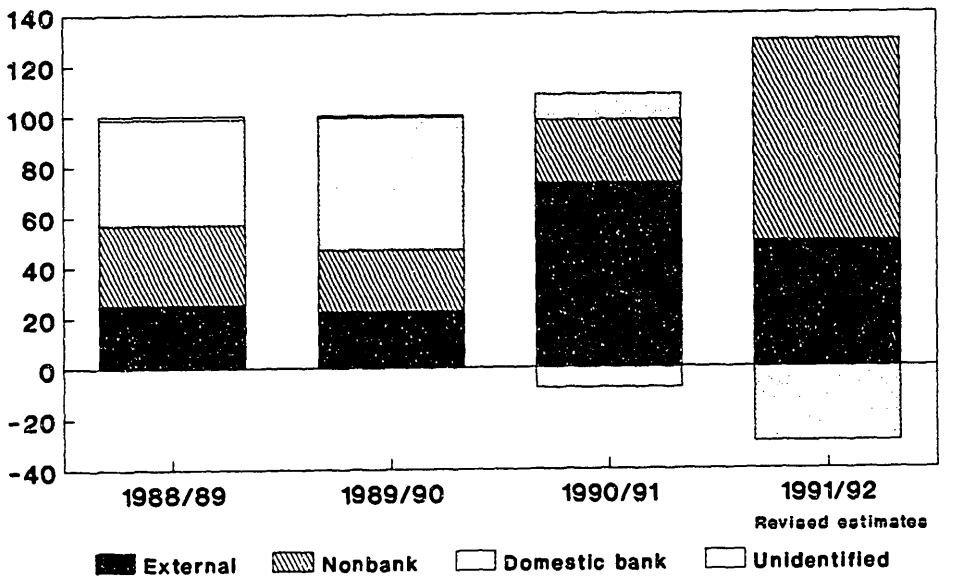
**Table 4**
**Egypt - Consolidated Public Sector, 1988/89-1991/92**

| | 1988/89 | 1989/90 | 1990/91 | 1991/92 Budget | 1991/92 Authorities' revised Estimate |
|---|---|---|---|---|---|
| Total revenue | 18 307 | 21 876 | 30 288 | 42 023 | 41 885 |
| Central Government | 13 552 | 15 643 | 23 639 | 38 260 | 36 022 |
| Tax revenue | 9 876 | 11 742 | 15 525 | 26 387 | 24 271 |
| Nontax revenue | 3 675 | 3 900 | 8 113 | 11 873 | 11 751 |
| Local government revenue | 769 | 928 | 997 | 1 265 | 1 426 |
| Public service authorities | 471 | 476 | 551 | 748 | 730 |
| Investment self-financing | 3 515 | 4 829 | 5 101 | 1 750 | 3 707 |
| Total expenditure | 30 155 | 36 393 | 50 066 | 54 027 | 50 315 |
| Current expenditure | 18 589 | 22 446 | 29 346 | 39 459 | 37 193 |
| Wages and salaries | 5 225 | 6 064 | 7 089 | 8 372 | 8 200 |
| Other goods and services | 2 443 | 2 776 | 3 556 | 4 424 | 4 450 |
| Defense[1] | 3 389 | 3 903 | 4 205 | 4 997 | 4 700 |
| Interest | 3 011 | 3 656 | 6 940 | 13 024 | 10 335 |
| Subsidies and transfers[2] | 3 325 | 4 659 | 6 200 | 5 852 | 7 783 |
| Social Fund | -.- | -.- | -.- | 800 | -.- |
| Other current expenditure | 1 196 | 1 388 | 1 356 | 1 991 | 1 725 |
| Capital expenditure | 11 566 | 13 947 | 20 720 | 14 568 | 13 122 |
| Investment[3] | 11 480 | 14 251 | 15 067 | 13 100 | 13 321 |
| Net capital and investment funds[4] | 86 | -304 | -437 | -644 | -249 |
| Transfers for restructuring | -.- | -.- | 6 090 | 900 | 50 |
| Extrabudgetary investment | | | -.- | 1 212 | -.- |
| Overall deficit (commitment basis) | -11 847 | -14 517 | -19 778 | -12 004 | -8 430 |
| External financing (net) | 2 963 | 3 248 | 14 416 | 5 367 | 4 170 |
| Disbursements[3] | 4 802 | 5 574 | 17 782 | 10 833 | 8 488 |
| Amortization | 1 839 | 2 326 | 3 366 | 5 466 | 4 318 |
| Nonbank financing | 3 771 | 3 528 | 4 997 | 6 250 | 6 719 |
| Domestic bank financing (net)[5] | 4 984 | 7 696 | 1 969 | 387 | -2 460 |
| Unidentified (discrepancy)[6] | 129 | 46 | -1 604 | -.- | -.- |
| | | | (As percent of GDP) | | |
| Memorandum items: | | | | | |
| Overall deficit | -18.1 | -18.4 | -20.0 | -10.1 | -7.1 |
| Total revenue | 27.9 | 27.7 | 30.7 | 35.5 | 35.4 |
| Total expenditure | 46.0 | 46.1 | 50.7 | 45.7 | 42.5 |
| Current expenditure | 28.3 | 28.4 | 29.7 | 33.4 | 31.4 |
| Capital expenditure | 17.6 | 17.7 | 21.0 | 12.3 | 11.1 |
| | | | (As per cent of beginning money stock) | | |
| Domestic bank financing (net) | 12.5 | 14.6 | 3.1 | 0.5 | -3.0 |

1 Excludes foreign-financed outlays on which information is not available.
2 Includes subsidies paid by the General Authority for Supply Commodities (GASC) and assumption of GASC debt by the Government. Special bonds of LE 1,536 in 1987/88 and LE 826 in 1988/89 were issued to cover GASC losses incurred in earlier years.
3 For 1987/88 certain nonfinancial public enterprises were directed to revalue their foreign debt at the prevailing commercial bank accounting rates. The commensurate revaluation adjustments to investment outlays and external financing that resulted are excluded.
4 This item nets out many capital transactions. They include interest and amortization payments to NIB and receipts from public enterprises for their interest and amortization liabilities.
5 From monetary accounts (net of exchange valuation adjustments); includes net credit to GASC.
6 The discrepancy reflects different compilations of domestic bank financing between the fiscal and monetary accounts.

Source: IMF.

**Graph 6- Egypt - Sources of government financing**
**(Percentage shares)**




Source: IMF.

**Table 5**
**Egypt - Selected factors affecting changes in private sector liquidity[1]**
(Annual percentage change)[2]

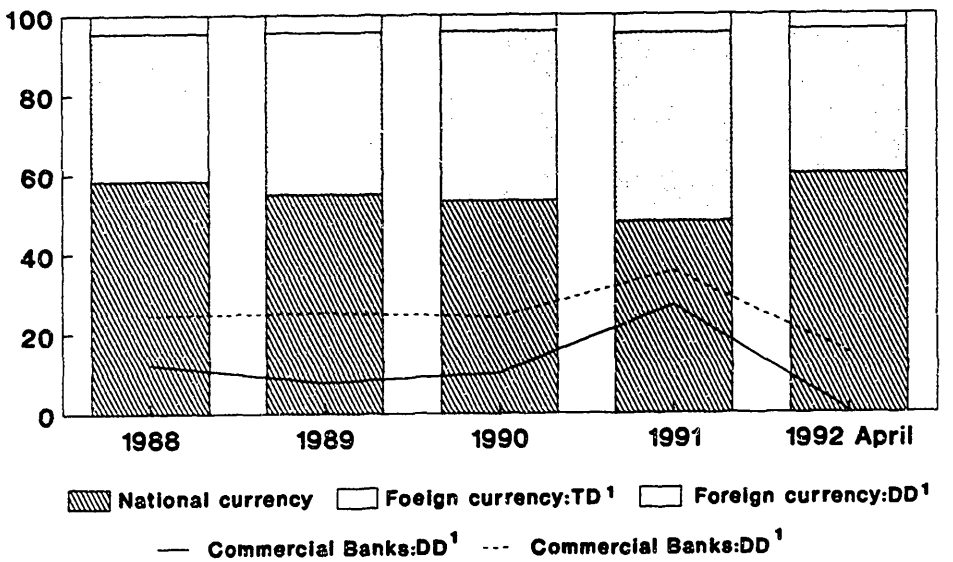
| | 1988/89 | 1989/90 | 1990/91 | April 1991 |
|---|---|---|---|---|
| Private sector liquidity | 18.3 | 19.7 | 28.5 | 11.1 |
| Net foreign assets | -2.3 | -8.5 | 17.9 | 15.7 |
| Net domestic assets | 20.6 | 28.2 | 10.6 | -4.6 |
| Net credit to public sector | 13.4 | 15.2 | -4.1 | -0.4 |
| Credit to private sector | 7.9 | 7.0 | 7.3 | 0.3 |
| Memorandum item: | (Changes from previous June; millions of Egyptian pounds) | | | |
| External borrowing (-) by the consolidated banking system | -1021 | -4466 | 11266 | 12721 |
| Domestic bank borrowing (-) by the government[3] | -4984 | -7696 | -1969 | 2460 |

1 Changes in the consolidated accounts of the central bank, the commercial banks, the business and investment banks, and the specialized banks. Valuation of foreign currency items is at the central bank accounting exchange for the CBE, and for other banks at the new commercial bank market rate until February 27, 1991, the secondary market rate from February 28, 1991, until October 8, 1991, and the unified free market rate thereafter.
2 As per cent of private sector liquidity at beginning of period; June-April growth rates cover ten months only.
3 Domestic bank borrowing is a revised estimate for the year ending in June 1992.

Source: IMF.

**Graph 7 - Egypt - Components of private sector liquidity and commercial banks liabilities**

(Shares and annual rates of growth; June)

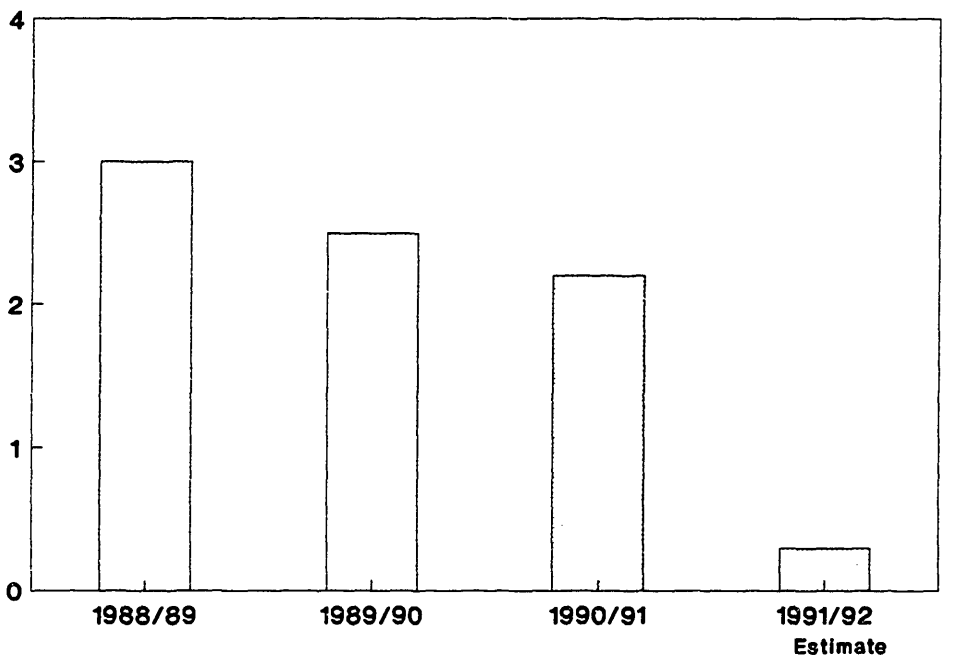



(1) TD refers to time deposits and DD to demand deposits.

Source: IMF and GATT staff estimates.

22. The current account deficit increased despite the fact that the rate of GDP growth decreased to 3 per cent in 1988/89 (Graph 8) and to 2.4 per cent in 1989/90 from 4 per cent in 1987/88. In other words, most of the impact of the expansionary policy stance fell on the current account balance rather than output. Output continued to be constrained by restrictions on private sector activity, the import substitution strategy followed by the authorities and heavy reliance on public enterprises for investment and employment. These features of the Egyptian economy also hampered its ability to adjust to external shocks and to a reduced access to external borrowing from mid-1988.

Graph 8- Egypt - Real GDP Growth
(Annual percentage change)




Source: IMF.

23. The main factor behind the economic growth, in the years 1988/89-1989/90, was the services sector led by tourism. Agricultural growth, in contrast, continued to decelerate as the partial decontrol of selected crops changed the composition but not the overall level of production. Manufacturing, where the public sector controls prices, production and employment, suffered from low value added. Petroleum production remained flat in the absence of new discoveries.

24. Inflation (period average), as measured by the consumer price index (CPI), accelerated to more than 21 per cent in 1989/90 from about 14 per cent in 1987/88.

(b) Macroeconomic and policy developments in 1990/91 and 1991/92

25. In 1990/91, the Egyptian government launched a comprehensive programme of macroeconomic adjustment and structural reform. The authorities decided to recapitalise the official commercial banks, and depreciated the central bank exchange rate as part of the unification of the various foreign exchange rates and the liberalization of interest rates. Weekly treasury bill auctions were started with the aim of making the auctions the central monetary control instrument, and technical changes were made to reserve requirement regulations and to rediscount operations in order to strengthen the control of the Central Bank of Egypt over the supply of liquidity. Prudential and capital adequacy rules were reinforced in order to address banks' weakness due to low capital, unprovisioned losses on loans to public enterprises, and large foreign exchange exposure.

26. A number of new fiscal measures, together with the depreciation of the exchange rate, produced an increase of 38 per cent of government revenue. Expenditure growth was largely accounted for by the losses of the General Authority for Supply Commodity (GASC), due to foreign and domestic bank debt servicing and rising distribution costs, as well as by the doubling of interest payments on the domestic public debt due to higher domestic interest rates and further borrowing. The depreciation of the domestic currency also increased foreign interest payments. In 1990/91, the fiscal deficit increased to 20 per cent of GDP if outlays for recapitalization are included, although it actually declined to 14 per cent of GDP when those transfers are excluded.

27. In 1990/91 there was also a major change in the source of financing of the deficit, as exceptional foreign financing in the form of cash grants and lower amortization due to debt relief reduced the need for domestic bank financing to just 10 per cent of the total (an amount equal to 3 per cent of the money stock at end-June 1990). The acceleration in the rate of growth of private sector liquidity in 1990/91 was mostly related to the significant increase in net foreign assets following the major swing from deficit to surplus in balance of payments. The trend toward a decline in the share of the national currency in private sector liquidity continued in 1990/91 but was reversed after the unification of the foreign exchange market and the freeing of interest rates. The latter is also largely responsible for the acceleration in the growth of time deposits since early 1991.

28. In 1991/92, the fiscal deficit narrowed to an estimated 7 per cent of GDP. This largely reflected an increase in revenue (equivalent to 5 per cent GDP) to nearly 35 per cent of GDP, and a contraction of capital expenditure (equivalent to 10 per cent of GDP). The reduction in the overall budget deficit is expected to exceed the programmed partly because of the larger-than-expected external debt relief and outlays for selected expenditures financed from abroad smaller than budgeted. The major increase in expenditure is expected to be concentrated on interest expenditures (9 per cent of GDP) reflecting the increase in domestic interest rates, and a shift in the composition of debt toward treasury bills. Foreign interest payments are expected to rise due to the depreciation of the Egyptian pound and the assumption by the government of some public enterprise obligations. Subsidies and transfers are expected to rise to about 6½ per cent of GDP due to cost overruns.

**Table 6**
**Egypt - Aggregate demand and supply at current prices, 1988/89-1990/91**
(In per cent of GDP)

| | 1988/89 | 1989/90 | 1990/91 |
|---|---|---|---|
| Aggregate demand | 139 | 142 | 143 |
| Domestic expenditure | 118 | 118 | 113 |
| Consumption | 95 | 96 | 93 |
| Private | 82 | 84 | 83 |
| Government | 13 | 12 | 10 |
| Gross investment | 23 | 22 | 20 |
| Private | 15 | 15 | 13 |
| Public | 8 | 7 | 7 |
| Exports of goods and nonfactor services | 21 | 24 | 30 |
| Imports of goods and nonfactor services | 39 | 41 | 44 |
| Memorandum item: | | | |
| Domestic saving | 6 | 5 | 7 |

Source: IMF

29. The improvement in the government's fiscal position resulted in a net repayment by the government to the banking system equivalent to about 2 per cent of GDP, or about 3 per cent of the beginning-of-the-year money stock. Net indebtedness by the private sector to the banking system was also reduced. The growth of private sector liquidity decelerated to about 11 per cent in the 10 months to April 1992 largely as a result of weak domestic activity, the rise in lending rates, and the preference of banks for new treasury bills. As a result of the contractionary policy stance, net foreign assets of the banking system increased significantly and the current account, before official transfers, recorded a surplus.

30. The Egyptian government began liberalising prices in 1990. However, there is still a large number of prices subject to government control,

including food items, industrial and energy prices, and rents. While the share of industrial production subject to price-controlled output was nearly 35 per cent in 1986/87, it fell to about 21 per cent in 1990/91. With the exception of cotton, prices of agricultural products are consistent with international prices. Prices were raised in energy and transportation, and subsidies were granted to a reduced number of items, although their value increased. Despite a tight monetary policy stance since May 1991, changes in administered prices, together with the increase in indirect taxes in mid-1991, were reflected in higher consumer prices.[11] As a result, after falling to about 14½ per cent in 1990/91, inflation accelerated in 1991/92 to an estimated 21½ per cent (period average). The stability of the exchange rate against the U.S. dollar that followed the depreciation and the unification of exchange rates in February 1991 helped to moderate price increases.[12]

31. As a result of tight demand management, the shares of consumption and investment (mostly public) in GDP dropped in 1991/92. Reduced investment and higher savings in 1990/91 and 1991/92, eliminated the deficit on the current account, before official transfers, in 1991/92. The need for foreign financing was further reduced due a surge in official transfers in 1990/91 and from workers' remittances in 1991/92.

32. Output growth is estimated to have been almost negligible in 1991/92. The slow response of the private sector to deregulation is due to a number of factors. The authorities still maintain lists of activities in which private investment is prohibited and where licenses to produce and invest are needed.[13] Although these licensing requirements began to be removed in May 1991, a long list of products for which approval is needed remains. In March 1991, the monopolies on the distribution of cement and fertilisers were eliminated. In early 1992, the privatization and divestiture programme of the Egyptian government started by de-linking 318 public companies from the ministries to which they reported and affiliating each of them to one of 27 newly-founded holding companies.

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[11]The volatility of the CPI is partly due to large discrete adjustments in administered prices.

[12]Exchange rate depreciation contributed to an increase in both government revenue and expenditure while leaving the fiscal deficit unchanged.

[13]Another factor that slows structural adjustment and reduces price and output flexibility in Egypt is the long-standing policy of creating employment through the public sector, which employs one-third of the workforce. This policy has produced labour migration, misallocation of human resources and lack of labour mobility.

Moreover, employers with ten employees or more are obliged to hire staff for most positions from a list prepared by the Ministry of Labour while firing and layoffs require the approval of labour department committees. Wages in the public sector and private are subject to centralised regulations on minimum wage, cost of living adjustments, and national wage agreements.