EMBARGO:

NOT FOR PUBLICATION BEFORE 1300 HOURS GMT TUESDAY 6 OCTOBER 1992

GATT/1554
25 September 1992

GATT URGES MULTILATERAL SUPPORT FOR EGYPT'S COMPREHENSIVE ECONOMIC REFORMS

Egypt's Economic Reform and Structural Adjustment Programme, introduced in 1990, is a comprehensive attempt to move the country's largely centralized statist economy towards a more market-based outward-oriented pattern of development, and surpasses all previous attempts at reform, according to the GATT Secretariat's report on Egypt's trade policies and practices. "However," warns the report, "implementation of the reforms may be threatened by some adversely affected organized interest groups, and pressure from such groups may become more difficult to resist if the multilateral trading system is not seen to be working effectively or in a credible manner."

The report examines the causes of the chronic balance-of-payments problems and the substantial recurring merchandise trade deficit which instigated the recent major shift in political thinking after some thirty years of centrally-planned socialist-inspired policies.

In the early 1960s, main economic activities were brought under state control, with nearly all imports and three-quarters of the export trade being nationalized. Following a reform introduced in 1974, Egypt enjoyed rapid economic growth from the mid-1970s until the mid-1980s. This was financed, primarily, by earnings from workers' remittances, petroleum exports, Suez Canal dues and tourism. These revenues, however, stimulated growth in output of non-tradable goods and services and, by overheating the economy, encouraged inflation. When earnings of foreign exchange began to decline in the early 1980s, growth was maintained through foreign borrowing so that by 1986 Egypt had become the most heavily indebted country in the world in terms of the foreign debt to GDP ratio which reached 150 per cent.

The report draws attention to the fact that in the agricultural sector, which traditionally served as the backbone of the economy, Egypt turned from being a net exporter into a major importer by 1974. "This position has been exacerbated by the growth in imports of subsidized wheat and other farm products from major trading partners," says the report. "The balance in agricultural trade is both a symptom of Egypt's trade and industrial policies as well as a vivid illustration of its trade performance over the past three decades."

In response to these problems, the current economic reform and structural adjustment programme is set to eliminate existing economic disequilibria, restructure activities according to market-based principles and promote export-led growth. "There are many indications that properly implemented reforms would provide significant benefits to the Egyptian economy," says the report. "Egypt could make use of its rich agricultural resources to pursue rural industrialization. The comparative advantages of Egypt's manufacturing sector - an abundance of skilled labour, a wide range of domestically-produced intermediate goods and a relatively developed infrastructure - remain largely untapped."

The report warns that the reform programme could be jeopardized by the lack of experience in implementing bold and comprehensive reforms and by groups whose short-term interests are threatened. "However, the near-term hardships associated with comprehensive economic reforms must be weighed against the long-term benefits these should bring to the population and against the encouraging stance taken by multilateral lending institutions and Paris Club creditors."

<u>Notes to Editors</u>

1. The GATT Secretariat's report, together with a report prepared by the Egyptian Government, will be discussed by the GATT Council on 5-6 October 1992 under the Trade Policy Review Mechanism (TPRM). The TPRM enables the Council to conduct a collective evaluation of the full range of trade policies and practices of each GATT member at regular periodic intervals to monitor significant trends and developments which may have an impact on the global trading system.

2. The current reports cover all aspects of Egypt's trade policies, including domestic laws and regulations; the institutional framework; bilateral, regional and other preferential agreements; the wider economic needs; and the external environment. Attached are summary extracts from these reports. Full reports are available for journalists from the GATT Secretariat on request.

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3. A record of the Council's discussions and of the Chairman's summing-up, together with these two reports, will be published in Spring 1993 as the complete trade policy review of Egypt and will be available from the GATT Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.

4. Since December 1989, the following reviews have been completed: Argentina (1992), Australia (1989), Austria (1992), Bangladesh (1992), Canada (1990 and 1992), Chile (1991), Colombia (1990), the European Communities (1991), Finland (1992), Ghana (1992), Hong Kong (1990), Hungary (1991), Indonesia (1991), Japan (1990), Korea, Rep. of (1992), Morocco (1989), New Zealand (1990), Nigeria (1991), Norway (1991), Singapore (1992), Sweden (1990), Switzerland (1991), Thailand (1991), the United States (1989 and 1992), and Uruguay (1992).

TRADE POLICY REVIEW
EGYPT

Report by the GATT Secretariat - Summary Observations

Egypt's Economic Reform and Structural Adjustment Programme (ERSAP), introduced in 1990, is a comprehensive attempt to move the country's largely centralized, statist economy towards a more market-based, outward-oriented pattern of development. In scope, the programme surpasses all previous attempts at reform, starting with those initiated by President Sadat in 1974. The main areas of reform concern macroeconomic stabilization; foreign trade liberalization; deregulation of price controls and other administrative practices; reorganization of public enterprises and privatization; and the creation of a Social Fund for Development to alleviate the burden of adjustment on the population.

Under the programme, tariffs are intended to be the main trade policy instrument albeit, initially, at relatively high levels. Non-tariff measures, such as conditional import prohibitions, prior approvals and the fulfilment of special conditions, are to be phased out. Deregulation should encourage production and trade in cotton, Egypt's main traditional export, where low domestic procurement prices and a State monopoly in cotton trading in the past effectively taxed production and restricted exports.

The process of restructuring and privatization of State-owned enterprises is expected to take some time to yield significant results in productivity and output. Near term prospects appear brighter in agriculture, where Government intervention in the past affected the decision-making process rather than the structure of ownership. Earlier policies, which depressed agricultural production, turned Egypt, a net exporter of agricultural products until 1973, into a major importer of foodstuffs. This position has been exacerbated by the growth in imports of subsidized wheat and other farm products from major trading partners. Fully implemented agricultural reforms should lead to a major reallocation of resources and a radical improvement in the agricultural trade balance.

Egypt has experienced recurring balance-of-payments problems since reserves of foreign exchange, accumulated during World War II and the Korean War, were exhausted in the late 1950s. Progress in implementing economic reforms and a positive external environment in the wake of the Gulf War, including the cancellation of some debt, allowed Egypt to move ahead with exchange rate unification and the floating of its currency in October 1991. Liberalization of capital transactions has been successful, attracting significant amounts of foreign funds into Egypt. Such capital inflows have contributed to the appreciation of the effective exchange rate of the Egyptian pound. While this may be expected to help slow inflation, it could have detrimental effects on the process of diversification and expansion in the industrial sector and on export performance.

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The changes in trade policy which form part of Egypt's economic reform programme are being implemented autonomously, irrespective of the outcome of the Uruguay Round. A successful conclusion of the Round would, however, encourage the process of adjustment. In the face of opposition from vested interests, there have been long and complex consultations on the scope and place of reform. This has lent a certain unevenness to the implementation of the reform and generated some uncertainty as to the extent of the Government's ability to sustain the whole reform programme, which is a condition for reductions in external debt agreed with Paris Club creditors.

Egypt in World Trade

Egypt is the most populous country in the Arab world. However, its share of world merchandise trade amounts to no more than 0.16 per cent of the total and its merchandise exports to GDP ratio is less than 9 per cent.

The Egyptian economy has traditionally been based on agriculture, particularly cotton. In 1986-87, the latest year for which comprehensive data are available, the sector accounted for 21 per cent of GDP. Industrialization has largely been financed by taxing agriculture. In consequence, Egypt, which was earlier generally self-sufficient in food, is now a major net importer, with food the largest item in its import bill.

In the early 1960s, main economic activities were brought under State control. Nearly all imports and three-quarters of the export trade were nationalized. Attempts at economic reform, in particular to revive the private sector and encourage foreign investment, were made in 1973-74. Further cautious steps to improve the functioning of the economy were taken in a piecemeal fashion, so that overall improvements remained fragmentary.

Until the mid-1980s, Egypt enjoyed rapid economic growth, financed by earnings from workers' remittances, petroleum exports, Suez Canal dues and tourism. These revenues, however, stimulated growth in output of non-tradable goods and services and, by overheating the economy, encouraged inflation. When earnings of foreign exchange began to decline in the early 1980s, growth was maintained through foreign borrowing. Such an expansion could not be sustained; by 1986-87, Egypt had become the most heavily indebted country in the world in terms of the foreign debt to GDP ratio, which reached 150 per cent. Following a tightening of macro-economic measures to control inflation, Egypt's economic growth has been sluggish since 1986.

The European Communities, with which Egypt has a cooperation agreement, account for around 40 per cent of Egypt's merchandise trade. During the 1980s, shortages of convertible currencies boosted the country's trade with centrally planned economies; the subsequent political and economic changes in these countries have affected Egyptian trade negatively.

In the past, Egypt has made extensive use of trade measures to attempt to control chronic balance-of-payments problems. In consequence, since its accession to the GATT in 1970, Egypt has held ten consultations in the GATT Committee on Balance-of-Payments Restrictions. The last full consultation was held in 1988 and a consultation under simplified procedures was conducted in 1990: a further full consultation is to be held back-to-back with this Trade Policy Review.

Institutional Framework

The Egyptian State is considered to be the oldest continuing political entity in the history of mankind. Egypt has periodically been subject to varying foreign influences; its present legal system reflects principally the influences of Islamic law, English common law and the Napoleonic code.

The present Constitution was approved by the electorate in 1971. Legislative authority rests with the unicameral People's Assembly (Majlis ash-Sha'ab). Executive authority is vested in the President, who is nominated by the People's Assembly and confirmed by popular referendum. The President determines and supervises the general policies of the State in cooperation with his Cabinet. The Government is currently composed of 30 Ministries.

Prime responsibility for trade policies rests with the Ministry of Economy and Foreign Trade, together with the Ministries of Finance and Planning. Formulation, co-ordination and implementation of trade policies frequently involve consultations and conciliation between government institutions, public enterprise management and organized interest groups.

A High Ministerial Economic Reform Committee (HMERC) has been established to guide the implementation and timing of economic reforms, including trade liberalization. The HMERC is assisted by another committee comprising high-level officials and by a technical secretariat.

Egypt's main trade laws are the Customs Law (1963) and the Import and Export Law (1975). Executive implementing regulations are introduced by Ministerial Decree. The present Customs Tariff was promulgated by Presidential Decree in 1986.

Egypt has no statutory body for independent public reviews of trade policies. However, the Shura Council - an institution established to advise the President on major legal and policy questions - is consulted on trade and policy issues.

Trade Policy Features and Trends

In addition to its status as a GATT contracting party, Egypt is a signatory to all the Tokyo Round Agreements except those on Government Procurement and Customs Valuation, where it is an observer. According to Egyptian officials, it has not been in Egypt's interest to join the Government Procurement Code. Acceptance of the Customs Valuation Code is said to involve cumbersome changes in the present valuation system.

Recent evolution

In August 1986, with the introduction of the present Egyptian Customs Tariff, tariffs were reduced by 50 per cent across the board, and all supplementary import charges and duties were eliminated. Another general cut (of about 30 per cent) was made in 1989. However, simultaneous devaluations of the exchange rate used for customs valuation purposes counteracted the effects of the reductions. At the same time, Egypt continued to use non-tariff measures for balance-of-payments purposes.

In May 1991, as a first step in trade policy reforms, prior approval procedures for certain imports were removed, as were requirements for foreign exporters to provide local servicing facilities for various products. A list of goods on which the issuance of letters of credit for importation was suspended, was also abolished. Simultaneously, tariffs were raised across the board by some 25 to 42 per cent, in substitution for the reductions in non-tariff measures.

Liberalization of domestic price controls began in 1983-84. The authorities currently set prices on basic foodstuffs and products receiving implicit input subsidies. Under the reform programme, all administered prices for industrial goods are scheduled to be eliminated by June 1995 except for a few basic commodities, cigarettes and cotton yarn. A start has also been made on phasing out public distribution monopolies to reinforce deregulation of prices. Gradual removal of input subsidies is proceeding hand-in-hand with elimination of production controls.

The system of multiple exchange rates for the Egyptian pound, in force throughout the 1980s, has been terminated. A temporary dual régime, introduced in early 1991, disappeared as exchange rates were unified. The Egyptian pound was allowed to float from October 1991. Contrary to initial expectations of a substantial depreciation, the rate against the US dollar, the benchmark currency, has since then remained fairly stable around LE 3.3 to the dollar, and the Central Bank has purchased large amounts of foreign currency in order to avoid appreciation of the pound. The inflow of foreign exchange has been attributed to high nominal interest rates in Egypt and the effects of other macroeconomic stabilization measures.

Attempts have been made to make private and foreign investment in Egypt more attractive. A new investment law was promulgated in 1989. Applications are processed by the General Authority for Investment. A list of sectors in which investment is not encouraged was promulgated in December 1990. This negative list is subject to annual review.

Approval of investment in certain assembly industries is linked to local content provisions. These measures are stated to be temporary, and scheduled to lapse no later than in December 1993. Investment in projects which are not enumerated in the negative list should, in principle, be subject to automatic approval. However, the process is reported to be hampered by bureaucratic regulations. The investment law has also been criticized for its numerous exemptions and the delegation of authority to grant additional privileges, creating uncertainty concerning investors' legal rights and obligations. Recent delays in approving FDI have also been criticized by the business community.

Type and incidence of trade policy instruments

Most tariff items currently fall under nine steps ranging from 5 to 100 per cent. The simple average duty is estimated at 42.2 per cent (or 30.6 per cent when beverages are excluded). All rates are ad valorem, except for tobacco and tobacco products which bear specific duties. The tariff structure provides a high degree of tariff escalation, which is increased by a significant number of duty exemptions and concessional arrangements.

Egypt bound about 15 per cent of its tariff lines under its original GATT schedule (Schedule LXIII). However, the bindings were not fully effective; in 1991, published m.f.n. rates exceeded bound levels on more than 200 of the 267 bound tariff lines. Egypt has recently been granted a temporary suspension of its obligations under GATT Article II, until 30 June 1993, in order to modify its tariffs in the context of its economic reform programme and to introduce the Harmonized System. The proposal for renegotiation of Egypt's GATT schedule includes increases and reductions in bound tariffs, as well as withdrawals of tariff concessions. Consultations and negotiations are to be held under Article XXVIII of the GATT.

Import licensing was formally abolished in 1986. However, 105 items are on a "negative list" subject to conditional import prohibition, admitted under certain circumstances. The conditional prohibition list is estimated to cover goods representing about 40 per cent of the value of Egyptian production.

The number of products requiring prior Government approval to be imported was reduced considerably in May 1991. The measure currently affects 18 items, including petroleum and derivatives, fire-fighting equipment, and various types of machinery and equipment.

As other non-tariff measures have been reduced in scope, Egypt has extended the coverage of quality controls on imports. Quality controls were extended to imported motor vehicle parts and durable consumer goods in 1989. Inspection requirements currently affect imports corresponding to about 20 per cent of the value of domestic production, up from 15 per cent before May 1991. Most regulations have been justified by the Government for reasons of health, safety and consumer protection.

Trade in cotton is dominated by six State-owned trading companies supervised by the Ministry of Economy and Foreign Trade. Procurement prices are set below world market levels. The pricing system thus taxes producers of raw cotton.

Export prohibitions affect six products: oilseeds and oleaginous fruits, rice straw, forage components, raw hides and skins, scrap paper and waste and scrap of iron and non-stainless steel, copper and aluminium. The restrictions on raw hides and skins and metal scrap are aimed at guaranteeing supplies to, and hence assisting, Egyptian processing industries.

Exports of cotton yarns and fabrics require prior Government approval. Annual export quotas are established for wool and wool waste, waste of cotton and cotton yarn, tanned hides and skins and recycled newspapers. Export taxes are, in principle, applied on nine tariff lines. However, some of these goods are also subject to export prohibitions.

Direct subsidies are generally not provided for exports from Egypt. However, input subsidies accrue to energy-intensive industries in the form of low domestic prices for petroleum products and electricity. The Export Development Bank of Egypt has obtained soft loans from the World Bank, the European Investment Bank and the Egyptian Government for medium-term lending on capital assets for export projects at below market rates.

A sales tax was introduced in May 1991 as part of the economic reform programme. The general rate is 10 per cent ad valorem, but some products are subject to other rates ranging from 5 to 30 per cent. The tax generally does not differentiate between imported and locally produced goods; however, a few Egyptian goods are taxed at higher rates than foreign goods, and vice versa.

Egypt has established a number of public and private free zones. Goods exported from a free zone into Egypt are subject to normal customs tariffs only on the import content. Free-zone enterprises are generally exempt from taxation, including import duties. Instead, a duty of 1 per cent is levied on all import and export transactions.

Temporary measures

The 1963 Customs Law contains provisions authorising actions against dumped or subsidised imports. Import and export regulations also authorize the Ministry of Economy and Foreign Trade to prohibit imports from any foreign supplier who is "intentionally causing harm to Egyptian economic interests". These procedures have apparently never been used. The Egyptian authorities are examining the need to establish more detailed anti-dumping and countervailing regulations.

New initiatives

The trade liberalization programme aims to reduce tariff dispersion. The intention is to narrow the general tariff range from the present 5-100 per cent to 10-80 per cent over the next two years. Tariffs on consumer "luxuries" will remain above this range, while those on basic food items will be lower. The Government has also committed itself to reduce the number of items subject to tariff concession arrangements, and to improve the functioning of drawback and temporary admission schemes.

Egypt intends to continue reducing non-tariff measures on imports and exports. During 1992, the number of products affected by conditional import prohibitions is to be brought down to a level representing

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30 per cent of the value of domestic production protected in this manner in March 1990. The authorities are also to lift four of the remaining 18 prior import approvals; to increase export quotas by 15 per cent annually; and to make the quota amounts public.

The Government also intends to deregulate cotton production, pricing and marketing. Only crop area controls that may be justified on technical grounds are to be maintained. Procurement prices for the eight main cotton varieties are scheduled to reach 66 per cent of equivalent world market prices by 1992-93. Further upward adjustments will be made to bring Egyptian producer prices for cotton equal to international prices. Private cotton trading is to be expanded, leading to the re-opening of the Alexandria Cotton Exchange by 1994.

Trade Policies and Foreign Trading Partners

In the Uruguay Round, Egypt considers that trade in textiles should be integrated into the GATT. All relevant measures should also be integrated into the agricultural negotiations. However, Egypt, as an agricultural importer, has expressed concern about the negative effects of price rises on basic foodstuffs resulting from a general reduction in levels of agricultural subsidies. New issues of concern to Egypt include areas such as labour mobility, financial services and tourism.

Egypt has generally shown great interest in the rule-making aspect of the negotiations. It has particularly supported a comprehensive agreement on safeguards to strengthen the GATT. Egypt's position is that existing GATT rights and obligations should not be disturbed, and there should be no linkage between new agreements or arrangements and the GATT.

Egypt's present reforms, directed towards deregulation and market-oriented growth, and its autonomous trade liberalization should lead to greater efficiency in the economy and improved market opportunities for its trading partners. However, implementation of the reforms may be threatened by some adversely affected organized interest groups. The pressure from such groups may become more difficult to resist if the multilateral trading system is not seen to be working effectively or in a credible manner. This makes a supportive international environment for Egypt's comprehensive economic reforms even more necessary.

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TRADE POLICY REVIEW
EGYPT

Report by the Government of Egypt - Summary Extracts

EXECUTIVE SUMMARY

The major economic policy objectives of Egypt are:

(a) Restoring macroeconomic balances and reducing inflation;

(b) Implementing structural adjustment to stimulate sustainable growth;

(c) Minimizing the effect of economic reform on the vulnerable groups.

To meet such objectives Egypt undertook various measures inter alia:

(i) The development of a market determined economy based on market forces;

(ii) Removal of all undue barriers to economic activities including the elimination of quantitative restrictions related to foreign trade;

(iii) Granting of equal treatment for both public and private sectors including foreign trade activities.

On the macroeconomic front, reforms aim at curtailing inflation, reducing the current-account and budget deficits, improving the efficiency of productive and financial sectors, restoring creditworthiness and bringing about high and sustainable long-term economic growth. The reform of public enterprises aims at increasing economic efficiency through competition, and privatizing and restructuring public enterprises.

Since 1961 Egypt has pursued inward-looking trade policies modelled on import-substitution industrial strategies. A prominent feature of these policies has been the reliance on high protection of domestic economic activity by way of discretionary non-tariff measures and high tariffs. Since 1987, however, significant changes have been introduced under the Economic Reform and structural adjustment programme initiated with the cooperation of the IMF and the World Bank.

A large part of items featuring under "Conditional Prohibitions and Governmental Approvals" has been removed and the rest are expected to be eliminated in the near future. Import and export procedures have been simplified. Furthermore, tariff policies have undergone discernible reforms. The margin between minimum (0.7 per cent) and maximum (160 per cent) rates has been narrowed to between 5 per cent and 100 per cent respectively. Exceptions to this measure are some basic food products and luxury goods. Advance import deposits were eliminated in August 1992.

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Industrial and agricultural production protected by import bans, has been reduced, as a proportion of total production, effective last June, from 22.7 per cent to 10.3 per cent.

New incentives for investment have been implemented including simplifying registration forms and granting automatic approvals for all projects except for those contained in a limited negative list which is reviewed annually with the aim of reducing its coverage.

Dismantling of non-tariff measures was associated with selective increase and decrease in import tariffs depending on the degree of manufacturing, i.e. imposing low tariffs on the raw materials and intermediate goods and higher tariffs on the final products. As a result of the agreement concluded with the IMF and the World Bank, the customs duties have been raised across-the-board, rolled back to 1986 tariff rates and the minimum rate has been increased with some exceptions. A waiver has been granted to enable the government to negotiate the bound rates that may be affected by such changes. The government also intends to introduce a system of anti-dumping, countervailing, and safeguard measures which will be in conformity with Egypt's rights and obligations under the GATT.

Reforms, particularly in the area of exchange rates, aim at boosting exports. In this regard, the government seeks to stimulate savings and investment with the view of stepping up production and productivity which, in turn, will increase and restore the competitiveness of Egyptian products and exports.

Substantial earnings of foreign exchange from workers' remittances, Suez Canal dues and tourism have been boosted by liberalizing foreign exchange and interest rates and expanding the transit capacity of the Suez Canal and the tourist industry.

TRADE POLICY OBJECTIVES

The trade policy of Egypt seeks the achievement of a market-based export oriented growth by adopting a phased programme for the elimination of non-tariff barriers and the phasing out of restrictions in the export sector. In the short term, the policy focuses on phasing out non-tariff barriers and narrowing the range between the lowest and highest import rates. In the medium-term the emphasis would be on eliminating any other remaining non-tariff barriers (except those on grounds of health, national security, public morality and environment), reducing tariff dispersion, phasing out tariff preferences and exonerations, and eliminating any other remaining restrictions on exports.

Foreign exchange budgets of public enterprises have been abolished, thus allowing public enterprise managers, for the first time, to import freely in line with profit considerations and on same footing as managers of private companies. The requirement of opening a letter of credit for imports has been eliminated, enabling the importer to select the appropriate means of import finance. This measure removes an important

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non-tariff barrier that had hitherto discriminated against private sector entrepreneurs.

The policy also provides safeguard mechanisms for enterprises experiencing serious difficulties in adapting to freer trade. This mechanism will take the form of raising import tariffs selectively, or adopting import quotas on a temporary basis.

In April 1992, the government removed the requirement for investors to submit feasibility studies in industrial sectors. In addition, the investment licensing system has been streamlined to provide for faster approval of investment projects.

Achievement of substantial economic growth and improvement in living standards have been the ultimate goal of the government's economic reform and structural adjustment programme which began in 1986. The main objectives of this programme are: (a) stabilization to restore macroeconomic balance and reduce inflation; (b) structural adjustment to stimulate medium- and long-term growth; and (c) modifications in social policies to minimize the effect of economic reforms on the poor.

In the case of domestic price liberalization, the purpose is to increase efficiency by promoting competition and removing distortions in the pricing system. The weighted average of petroleum product prices was increased to about 80 per cent of the internationally traded equivalents effective 28 June 1992. The weighted average of electricity prices was increased to 69 per cent of LRMC effective 1 July, 1992. In foreign trade liberalization the ultimate aim has been to increase economic efficiency through the promotion of import competition, export rivalry, and the removal of distortions in the incentives system. In the private sector, reform is focused similarly on increasing economic efficiency through the promotion of competition. Specifically, the private sector reform will encourage and facilitate private enterprise development and abolish investment and production controls, dismantle government monopolies, and phase out the discrimination against private sector in the purchase of inputs from public sector companies. In order to minimize the effect of economic reform on the poor, a social fund for development has been established to facilitate the smooth completion of institutional arrangements and also help the reintegration of Egyptian workers returning during the Gulf War and to facilitate labour mobility.

The Government of Egypt has additionally taken into consideration a number of elements in the design of the country's economic reform programme. Firstly, there was the danger of inflationary shock, which has been corrected by adopting restrictive fiscal and monetary policies. Secondly, there was the likelihood of a decline in GDP, employment and consumption per capita in the short-term. Thirdly, encouraging the private sector to play a vital rôle in the economy, set up an export-led growth strategy to restore creditworthiness, encourage investment, ensure sustainable growth and to achieve a satisfactory medium-term improvement in welfare.

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WIDER ECONOMIC AND DEVELOPMENTAL NEEDS, POLICIES AND OBJECTIVES

Reforms are seen as crucial in achieving sustainable growth in the Egyptian economy and in maintaining a macroeconomic balance. To this end, emphasis in economic policy has been focused on fiscal, exchange rate and foreign trade questions and on increasing the efficiency of productive and financial system. Financial discipline and a market-determined exchange rate are expected to play critical rôles in the development of a private-sector-led expansion of domestic savings and non-petroleum exports.

In the area of fiscal policy, the ultimate goal has been to:

(i) achieve sustainability in the government's finances; and
(ii) increase further the rôle of the private sector in the economy.

These two objectives are expected to be achieved in the shortest possible time. A rapid reduction in the budget deficit as a proportion of gross domestic product (GDP) is accordingly envisaged. Under the fiscal programme, budget deficit as a proportion of GDP is to be reduced from 20 per cent in 1988/89 to 7.1 per cent in 1991/92. Such reduction is essentially to be achieved through a combination of cuts in public expenditure, especially subsidies, and revenue-generating measures. Subsidies in free sugar and non-rationed edible oil have been eliminated. A continuous decline in public investment outlays, in favour of private investment, is envisaged, with increasing dependence of public investment on financial markets to meet requirements. This policy is intended not only to allow a substantial reduction in overall fiscal deficit, but also to bring about a gradual increase of private investment in the economy. This has been actually achieved as share of private sector investment in national investment increased from 9 per cent in 1974 to 39 per cent in the five-year plan 1982/83 - 1986/87 and to 45 per cent in the five-year plan 1991/92 - 1996/97.

Reductions in the budget deficit are to be achieved through an integrated series of revenue and expenditure measures. Firstly, measures were taken to improve the tax collection system to reduce tax evasion. Furthermore, measures to increase tax revenue entailed, inter alia, the implementation of a comprehensive sales tax, increase in cigarette excise taxes and various increases in local government fees and services taxes. Those measures, and others, participated in boosting total tax revenues.

Secondly, on non-tax revenues, a number of diverse measures are considered, e.g. increases in the prices of domestic energy (petroleum, natural gas, and electricity). Energy prices were increased several times until reaching 80 per cent of the full international price equivalent and are expected to reach full international prices. Similarly prices of electricity were raised several times to reach 69 per cent of its estimated long-run marginal cost, and expected to reach 100 per cent by the end of June 1995.

To improve the functioning of the financing sector, a treasury bills market was created. It has resulted in the emergence of a market-based interest rate structure which enabled the government to minimize reliance on Central Bank financing of the budget. This approach to the government's deficit financing, together with other monetary components of the stabilization plan, resulted in a decline in the annual inflation rate from 20 per cent in 1991 to 10 per cent, on an annual basis in 1992. Further decline is expected. It should be noted that a peak of about 30 per cent in the inflation rate was expected during the early stages of the economic reform program.

The adjustment process was made possible by the debt relief which included reduction of interest payments. The savings to be realized from additional debt relief are expected to stimulate larger private and public investment and accelerate the adjustment programme.

On the interest rate and monetary policies front, the government has: (i) removed all interest rate ceilings affecting deposits and credits; (ii) implemented specific domestic credit expansion ceilings; (iii) eliminated any direct credit-line between the Central Bank of Egypt and the Central government; and (iv) developed a market for treasury bills through auctions administered by the Central Bank. Until the end of 1990, there were nominal ceilings on all interest rates (below inflation rate), and credit rationing intended to curb the ensuing excess demand for credit in the money market. The measures stipulated in the new Banking System Law aim at producing a healthier banking system to boost private savings and provide for more efficient financial intermediations.

The issuance of the treasury bills reduced the reliance on Central Bank financing and it would help to activate the capital market. After liberalization, the three-months treasury bills interest rate increased from 14.2 per cent at the beginning of January 1991 to 19.5 per cent at the end of July 1991, then it relatively stabilized and started to decline slightly and gradually from the end of November 1991, reaching 17.6 per cent at the end of August 1992. The Ministry of Finance issued six-months and one-year treasury bills in September 1991 and March 1992 respectively. The one-year and less than two years deposit interest rate was in the range of 12 per cent before the deregulation of interest rates (since 1989). As regards the lending rate for agricultural and industrial sectors, the one-year rate ranged between 13 per cent and 15 per cent. On the other hand household services sectors rates ranged between 15 per cent to 17 per cent for the same period. With regard to the trade sector the minimum rate was 18 per cent, with no ceiling. After liberalization, and in early 1991 the one-year interest rate increased steadily from 12 per cent until it reached 16 per cent in March 1992. The average lending and discount rate reached 21.3 per cent in August 1991, and then declined to 19.4 per cent in August 1992.

In contrast to the previously existing multiple exchange rate system dominated by administrative decisions, Egypt's economic reform program culminated, towards October 1991, in the establishment of a unified market-determined exchange rate. Under the new system, each bank declares its buying and selling rates. Moreover, in order to enhance competitiveness in the foreign exchange market, non-bank dealers have been licensed to operate in that market. To date about 170 licences have been issued and 60 dealers are operating, many with several branches spread over the whole country. Average opening, mid-day and closing rates are regularly published, based on actual market transactions.

The reform of the foreign exchange system goes back to mid-1987. A new "Commercial Banks' Free Market" was established to replace the "commercial bank pool" which existed previously. Under the Banks' free market, a special committee (composed of representatives of eight commercial banks) declared the rate against the U.S. dollar every day. All transactions within the Banks' free market had to be implemented at this declared rate. The resources of that market included all visible and invisible foreign exchange receipts with the exception of proceeds of cotton, rice and petroleum export proceeds, Suez Canal dues and official loans and grants. The latter proceeds had to be surrendered to the Central Bank of Egypt at a rate fixed by the Central Bank. At the beginning the Central Bank rate remained unchanged at 70 piastres per U.S. dollar, while the rate in the Banks' free market was allowed to depreciate gradually. Both the private and the public sectors had access to the resources of the Banks' free market. Later, the exchange rate in the Central Bank pool was changed several times at irregular intervals. (On 15 August 1989, the Central bank pool rate changed from L.E. 0.7 = US$1 to L.E. 1.1 = US$1 and was adjusted once more on 1 July 1990 to reach L.E. 2, till the introduction of the new exchange system.) In addition to the Banks' free market and the Central Bank pool, foreign exchange transactions took place outside the banking system at rates determined by supply and demand. In February 1991, in a further step towards reforming the exchange system, a two-tier market was established:-

(a) A "primary market", whose resources consisted of all export proceeds as well as Suez Canal dues and official loans and grants.
(b) A "free market" whose resources consisted of all other foreign exchange (including tourism).

The rate in the free market was determined freely by market forces, whereas the rate in the primary market was not allowed to deviate from the free market rate by more than 5 per cent. This system came to an end in October 1991 with the unification of the exchange rate and the establishment of the Free Foreign Exchange Market as described in the preceding paragraph.

Since February 1991, foreign exchange regulations have been considerably liberalized. Both private and public entities have unlimited and unrestricted access to the resources of the free market. Funds acquired through the free market can be transferred abroad through the banking system without restrictions. Moreover, recently, travellers abroad have been allowed to carry unlimited amounts of foreign exchange. Since April 1991 the exchange rate has fluctuated narrowly in the range L.E. 3.29 - 3.32 per US dollar. Exchange rates against other currencies are determined by the cross rates in the international markets, and have shown less stability on account of the changes in the value of the U.S. dollar against other major currencies in recent months.

In the financial sector, supervision in the banking system is being strengthened and the prudential regulatory environment for the banks is being reformed. Measures for the latter include: improvements in the measurement and enforcement of capital adequacy; changes in the regulations concerning liquid asset ratios; improvements in the system of loan classification and provisioning; improved handling of interest for doubtful loans and tighter limits on foreign currency exposure.

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