FOR AGENDA

SM/83/103

CONTAINS CONFIDENTIAL
INFORMATION

May 26, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Arab Republic of Egypt - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with the Arab Republic of Egypt. A draft decision appears on page 13.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Abed, ext. 57121.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

ARAB REPUBLIC OF EGYPT

Staff Report for the 1983 Article IV Consultation

Prepared by Staff Representatives for the 1983 Article IV Consultation with Egypt

Approved by A. S. Shaalan and Subimal Mookerjee

May 25, 1983

I. Introduction

The 1983 Article IV consultation discussions with the Arab Republic of Egypt were held in Cairo during the period March 19-25, 1983. The Egyptian representatives included the Ministers of Finance, Economy, Planning, Investment and Economic Cooperation, and Agriculture, the Governor of the Central Bank, and other senior officials of these and other ministries and public organizations. The staff representatives were Messrs. A. S. Shaalan (Head - MED), G. T. Abed (MED), R. H. Floyd (MED), B. K. Short (MED), and E. J. Zervoudakis (ETR), and Ms. Mary Windsor (Secretary - RES). The mission was assisted by Mr. J. R. Hill, Resident Representative in Cairo.

Egypt avails itself of the transitional arrangements under Article XIV.

II. Background and Review of Recent Developments

Egypt has achieved relatively high rates of growth in recent years--official estimates indicate that real GDP grew at the average annual rate of about 8 per cent in the three-year period ended in 1980/81. However, general indications 1/ are that growth has decelerated since then, as external sector performance weakened and the high rates of growth in construction began to subside. Stimulated by the open door policy and by a favorable, relatively control-free, environment the services and distribution sectors grew at relatively high rates while the growth of the commodity-producing sectors lagged somewhat. In terms of final expenditure components, consumption growth continued to outstrip the expansion in capital accumulation. Largely in response to these developments, the current Five-Year Plan (1982/83-1986/87) seeks to direct the sectoral pattern of growth toward the commodity-producing sectors and the composition of expenditures toward investment. Although data for the whole of 1982/83 were not available, indications are that the first year of the Plan will not show a discernible movement in the direction indicated.

1/ The Ministry of Planning is presently engaged in a major revision of the national income accounts in constant prices. Real GDP data for the more recent period are therefore not available.

The fiscal situation weakened considerably during 1981/82--the overall budget deficit rose by more than 70 per cent to LE 4.4 billion, equivalent to 21 per cent of GDP and government borrowing from the banking system, which had been exceptionally negative in the previous year, rose to LE 2.3 billion, equivalent to 11 per cent of GDP and to 28 per cent of the beginning period money stock. Total revenues increased by only 5 per cent while expenditures rose by 23 per cent. Of the total increase in expenditures, current outlays accounted for almost 80 per cent, reflecting large increases in the wage bill and substantially higher transfers to public authorities and public sector companies. Investment expenditures rose by about 12 per cent to LE 4.2 billion. Preliminary data for the first half of 1982/83 indicate that revenue growth recovered and that the increase in spending was contained somewhat; as a result, the overall fiscal position appears to have stabilized.

Money and quasi-money rose by 44 per cent in 1981/82, compared with 34 per cent in the preceding year, due especially to much greater bank financing of the government deficit as well as a larger increase in bank credit to the private sector. In the first six months of 1982/83 money plus quasi-money grew at an annual rate of 36 per cent, compared with 58 per cent in the corresponding period of the previous year, despite a highly expansionary turnaround in the balance of payments. This deceleration was the outcome of more vigorous enforcement by the Central Bank of loan-to-deposit ratios which brought the growth of private sector credit down to 15 per cent, as well as an improvement in the net cash position of the public authorities and public sector companies. This improvement reflected the impact of a combination of factors, primarily lower prices for imported foodstuffs (affecting mainly the financial position of the General Authority for Supply Commodities), but also the effect of higher prices for goods and services sold by public sector companies as well as a reduction in the inventories of those companies. The consumer price index, which is based on a sample that includes a great many subsidized and price-controlled commodities, indicates an inflation rate of 16 per cent in 1982, compared with 10 per cent in 1981, although the actual rate has probably remained in the range of 20-25 per cent.

External sector developments indicated further deterioration in 1981/82 as the current account deficit widened by more than 50 per cent to US$2.1 billion, although the trade deficit narrowed somewhat as a result of improved export receipts, primarily from petroleum, and marginally lower import payments (in dollar value terms). However, the services account surplus declined by nearly US$1 billion, the bulk of which reflected a fall in workers' remittances. The capital account, on a net basis, showed some improvement as compared with the preceding year, but the overall payments deficit widened from US$142 million in 1980/81 to US$536 million in 1981/82.

During the first half of the fiscal year 1982/83, the overall payments position swung to a surplus of nearly US$600 million, from a deficit of a similar amount in the corresponding six-month period of 1981/82. This dramatic turnaround was the result of an increase in remittances, a substantial rise in unrecorded, and largely unexplained, capital and current account receipts, as well as a significant reduction in the letters of credit issued by the banking system for public sector imports. The last factor reflected the commercial banks' policy of reducing their net foreign currency exposure, which had reached uncomfortable levels by mid-1982. These banks increased their purchases of foreign exchange from Egyptians working abroad at or near the free market rate and passed the increased cost on to their customers, primarily public sector companies. In addition, banks tended to delay the opening of letters of credit for imports authorized under the foreign exchange budget, thereby causing some public sector companies to approach the free market directly in order to procure their foreign exchange requirements. Reflecting these developments as well as the large and unrecorded current and capital account receipts, the commercial banks substantially reduced their foreign currency exposure by end-1982, mainly through a reduction in their foreign liabilities. Egypt's usable external reserves stood at about US$1.4 billion at the end of December 1982, equivalent to slightly over two months of imports at the estimated 1982/83 level.

Egypt's official exchange system remains fragmented with three pools--a Central Bank pool covering mainly government transactions that are largely exchange rate insensitive; a commercial bank pool covering remaining public sector transactions and a small volume of private sector transactions; and a free market pool including all remaining transactions. The rate in the Central Bank pool has been set at US$1 = LE 0.70, in the commercial bank pool at US$1 = LE 0.84, and in the free market pool, where the rate fluctuates with supply and demand, the rate has been in the range of US$1 = LE 1.14-1.18. During the past year, the commercial banks have increasingly used rates at or near those of the free market for transactions with both public and private sector users of foreign exchange and with remitters of foreign exchange from abroad. On April 21, 1983 a decree issued by the Minister of Economy abolished foreign exchange surrender requirements, with minor exceptions, for all public and private sector exporters. Export proceeds may be kept in retention accounts for up to one year and used for financing imports and current invisible transactions; intrasectoral transfers between accounts are permitted. Egypt maintains four active bilateral payments agreements, of which two are with Fund members, China and Sudan. Two inactive agreements with Jordan and the Yemen Arab Republic were terminated on April 10 and 14, 1983. The multiple currency practice and the remaining bilateral payments agreements with Fund members require approval under Article VIII.

Egypt's total external debt, disbursed and outstanding, stood at about US$17 billion as of June 30, 1982. Medium- and long-term public and publicly guaranteed debt (80 per cent of which was in the form of bilateral and multilateral loans) amounted to US$15.1 billion, short-term debt (mainly in the form of banking facilities) amounted to US$1.2 billion, and private nonguaranteed debt stood at US$0.5 million. External debt service payments on medium- and long-term debt committed as of June 30, 1982 are estimated at US$2.4 billion in 1982/83 (26 per cent of projected current receipts) and US$2.3 billion in 1983/84.

III. Report on the Discussions

The discussions focused on the underlying structural problems in the Egyptian economy notwithstanding the apparent improvement in financial aggregates in the early part of 1982/83. More specifically, the discussions sought to identify the reasons for the lack of progress in resolving the structural problems and to ascertain the authorities' intentions concerning policy reforms in the period ahead.

1. Production and pricing policies

Egypt's development strategy has been formalized in the current Five-Year Development Plan (1982/83-1986/87). In an attempt to redress the structural imbalances that have developed in recent years, the Plan aims at invigorating the growth of the commodity-producing sectors, increasing the levels of domestic savings and investment, and reducing the country's reliance on external resources. Annual growth rates in agriculture and industry are planned to be higher than recent experience would indicate, while growth in the services sectors is to decline. Improved domestic resource mobilization is to double the ratio of domestic savings to GDP (to about 26 per cent), largely through a significant reduction in the ratio of private consumption. Exports are expected to grow at just under 11 per cent per year, while the annual growth of imports is to be restrained to just over 4 per cent per year. Particular emphasis is laid on the expansion of petroleum exports (at 12 per cent annually) as well as exports of agricultural and industrial goods (at 8 per cent annually).

Although the objectives of the Five-Year Development Plan seem appropriate, their achievement remains highly uncertain because of lack of supporting policies to ensure timely implementation. The mission emphasized that the redirection of investment and growth toward the commodity-producing sectors would require higher, and more efficient, investment in agriculture and industry as well as the dismantling of centralized controls on production and prices in these two sectors. The achievement of a significant decline in the level of consumption calls for measures to improve the efficiency of taxation, a restraint on the growth of wages and benefits, as well as considerable adjustments in the prices of consumption goods and public services. Finally, the improvement in trade performance, especially the planned expansion of exports, would require appropriate domestic pricing policies to induce an adequate supply response in the commodity-producing sectors. These actions would need to be reinforced by reforms in the exchange system and in the tariff structure.

The authorities' view is that the Plan document, intended primarily as a statement of objectives and of the broad strategy, would be supplemented by more detailed annual programs containing specific targets and policies in the fiscal, pricing, and monetary areas. In the public sector investment program, more effective project identification and implementation, had already been achieved through the operations of the National Investment Bank. In the context of the 1982/83 budget, the sales tax regime was expanded and higher rates were applied to some luxury commodities, while more measures were being contemplated in the context of the 1983/84 budget.

Turning to specific developments and policies within the main sectors of the Egyptian economy, the mission emphasized that existing pricing and production policies in agriculture had impaired the growth potential of this vital sector. Prices of key agricultural crops had been adjusted too slowly, while production costs, especially the cost of labor, had risen at an exceedingly rapid rate. As a result, the output of tradable crops produced in Egypt has stagnated while the uneven application of controls had led to distortions in the structure of agricultural production.

The authorities have long recognized these structural problems in agriculture. Over time, they have introduced some improvements through gradual adjustment of prices and other administrative measures, but the basic problems remain. Policy action has been stymied in large part by institutional rigidities inherent in the decision-making process affecting agricultural policies. Over the longer term, the authorities intend to increase the output of grains in order to reduce reliance on imports, and in general to improve yields on cropped land in contrast to the more costly reclamation of new land. However, in the absence of concrete and timely action on pricing and decontrol, such targets are not likely to be attained.

One of the main objectives of the open door policy, initiated by Egypt in 1974, was the expansion of the country's industrial sector through joint ventures between the domestic public and private sectors on the one hand and foreign companies on the other. In the event, only a very small part of direct foreign investment has been in the industrial sector, the bulk of such investment having gone into the distribution and services sectors. More importantly, the opening up of the Egyptian economy to greater competition from abroad has not been accompanied by sufficient progress to decontrol the management of the public economic sector and thereby to take advantage of the new opportunities. Officials have been reluctant to permit prices of goods and services produced by the public sector to move in line with rising costs and, as a result, profits have been squeezed, losses have been funded through budgetary transfers, and investment and productivity have remained depressed. To relieve the pressure on the public sector companies' finances, output prices need to be adjusted to reflect movements in costs and to take advantage of the strength of market demand. Administratively, greater authority needs to be devolved to company managers in such areas as pricing, wages, and investment policies. Over the medium term, the public economic sector can only be invigorated through the implementation of an industrial development strategy that takes into account Egypt's underlying comparative advantage on the basis of which projects are carefully screened for economic and financial viability. 1/

1/ See the report, Issues of Trade Strategy and Investment Planning, prepared by the staff of the World Bank.

Recently, the Egyptian authorities have taken some measures to rectify the financial position of public sector companies. Although prices of a number of industrial products (representing about 30 per cent of total public industrial sector output) remain under official control, there have been some price adjustments in the past year. In addition, largely through temporary protective measures, public sector companies have been able to dispose of a substantial portion of their stocks of unsold output. Redundancies have been reduced and excess inventories of inputs eliminated. As a result, the financial position of public sector companies in the latter part of 1982 improved considerably.

The oil sector in Egypt has been an important source of economic growth and of foreign exchange receipts since the mid-1970s. Growth of oil production has recently dropped to just under 5 per cent, while domestic consumption of petroleum products continued to rise at annual rates of about 12 per cent. This divergence has led to a decline in the volume of petroleum exports which has come at a time when petroleum export prices have been falling. As a result, there has been a sharp drop in export receipts in the first half of 1982/83 from the comparable period a year earlier. Continued weakness in the oil market indicates that export receipts would continue to decline through 1983.

One of the key factors underlying the rapid growth in domestic demand for petroleum products has been the low level of domestic prices. At the (free market) exchange rate, domestic retail prices of petroleum products averaged about 17 per cent of comparable world prices, implying a total opportunity loss of about LE 3 billion annually. The Fund staff has long urged that domestic prices of petroleum products be adjusted as rapidly as possible so as to redress the imbalances in the structure of demand, remove cost-price distortions, and enhance domestic budget revenues. In this connection, the mission endorsed the World Bank recommendation (agreed to in principle by the authorities) that, as a minimum, domestic petroleum prices be raised to world levels over a period no longer than ten years. In addition, the mission noted that this time period represented considerable slippage from an earlier position (whereby the full adjustment was to be made over a period of five years) and stressed therefore that substantial adjustment be effected in the earlier years of the ten-year period with full pass through to final consumers. Other energy prices should be adjusted simultaneously so as to maintain comparability in prices and eliminate distortions in the structure of demand.

The authorities were in broad agreement with the mission's assessment and indicated that energy pricing policies were under active study. Electricity rates had been adjusted in April 1982 and the price of premium gasoline had been increased in July 1982. Energy prices were being adjusted toward world levels for companies established under the Foreign Investment Law. Further adjustments were also under consideration for implementation with the 1983/84 budget. The mission's view was that the net impact of these adjustments was small in relation to the size of the problem and that at this rate the ten-year objective was not likely to be achieved. For the longer term, the authorities stated that new gas discoveries were being brought on stream to replace petroleum products, especially in power and industry, thereby increasing the volume of oil products to be made available for export.

2. Fiscal and monetary policy

Given the dominant size of the public sector in the Egyptian economy, fiscal operations tend to capture many of the characteristics of the underlying economic conditions. In addition, the sheer weight of government spending in relation to GDP, which has been almost 60 per cent, tends to have a decisive impact on the course of economic developments in the country. The weakening trend in fiscal performance in recent years has therefore had a destabilizing effect on the economy.

After a sharp deterioration in 1981/82, the budgetary outcome for 1982/83 was expected to be only moderately worse; the overall budget deficit was expected to rise by 5 per cent to about LE 4.7 billion and the Government's recourse to domestic bank borrowing to about LE 2.7 billion, approximately LE 0.4 billion more than in the preceding year. At these levels, the overall budget deficit would be equivalent to about 21 per cent of GDP, while the bank financing of the deficit would amount to about 12 per cent of GDP and 23 per cent of the beginning period money stock. The Egyptian authorities indicated that the relative stability of the fiscal deficit in 1982/83 was the result of efforts to increase revenues, especially from business profits and from taxes on goods and services, coupled with more vigorous efforts to control spending. Direct central government revenues were budgeted to increase by 27 per cent compared with 5 per cent in the preliminary actual figures for 1981/82, while total spending was expected to rise by 8 per cent compared with 23 per cent in the preceding year. The authorities added that a major factor in the slowdown of growth of current spending was the decline in international commodity prices, which had reduced expenditures on food subsidies. Increases in wages and salaries had also been held to a level below that of earlier years.

The mission expressed the concern that some of the improvements in fiscal performance in 1982/83 may be temporary, and that greater effort was needed to strengthen the underlying structure of the budget. Among the possible measures discussed with the Egyptian authorities were: (1) reduction in the size and scope of the consumption subsidy system and controls on the growth of other current spending, especially for wages and benefits; (2) pricing policies which would permit public sector companies to earn a reasonable return on investment; (3) adjustment of petroleum product prices; (4) improving the effectiveness of institutional control over the growth of investment spending so as to keep such growth consistent with the availability of noninflationary resources; and (5) taking other revenue measures including, inter alia, the application of the depreciated exchange rate in the valuation of imports for customs duty purposes, reducing the number of exemptions from customs duty, and expanding the tax base of excises. The authorities indicated that these and other measures were under consideration for the 1983/84 budget.

In response to the mission's concern regarding the projected budgetary outcome for 1983/84 which, in the absence of policy measures, indicated a possible rise in the overall budget deficit by about 30 per cent, the Egyptian authorities emphasized that the fiscal deficit remained the central issue of economic policy and that a significant reduction in the deficit from the 1982/83 level would be the top priority objective in the period ahead.

Concerning monetary developments and policies, indications are that the recent slowdown in the rate of growth of domestic credit was likely to continue through the end of the current fiscal year. However, the authorities agreed with the mission that the growth of the money supply was still in excess of the genuine needs of the economy, and was considerably above the rate of 20 per cent indicated in the Five-Year Plan. The authorities stated that with the planned reduction in the fiscal deficit in 1983/84, pressures on the money supply would subside. In any event, they emphasized that it was their intention to maintain the present anti-inflationary stance of monetary policy for the period ahead.

As regards interest rates, the recent decline in international rates has narrowed the effective gap between domestic rates and comparable rates abroad. However, the interest rate structure within Egypt, following recent changes, contained some internal inconsistencies. In an effort to stimulate activity in industry and agriculture, interest rates on loans to these sectors were reduced to a level about three percentage points below commercial credit rates. However, this action reduced the incentive that commercial banks have for lending to these sectors with the result that, in the most recent period, bank credit to private borrowers in agriculture and industry declined, while commercial credit was either at or above the indicated ceilings. The authorities explained that the decline in credit to industry and agriculture did not reflect the unwillingness of the commercial banks to lend at the preferential rates, but rather to borrowers' difficulties in formulating eligible projects in these two sectors. They expressed confidence that in due course, especially with the help of other supporting policies and with the maintenance of partial credit ceilings, investment in these two sectors and hence the use of credit by them, would expand in line with the objectives of the Five-Year Plan.

3. External sector policies

The turnaround in the balance of payments position during the first half of 1982/83, from a deficit of just over US$600 million to a surplus of nearly an equal amount, was not due to underlying improvements in Egypt's external payments position. Rather, the major factors were a reduction in public sector imports and an unusually large capital account surplus and unrecorded current account receipts during the period July-December 1982, both of which remain largely unexplained. For the year as a whole, the trade deficit was expected to widen by 6 per cent to US$4.8 billion, primarily as a result of a drop in petroleum exports. Import payments were expected to decline by 4 per cent, largely as a result of the fall in international commodity prices in U.S. dollar terms and restriction of access to banks' foreign exchange for public sector imports. The net surplus on the services account was expected to improve only marginally, leaving the current account deficit about 9 per cent higher at US$2.3 billion. Projections for the overall payments position in 1982/83 are difficult to make in view of the unexplained developments during the first half of the year, but the overall payments position is likely to be in surplus. Tentative projections for 1983/84, assuming continued weakness in world oil markets, a moderate rise in international commodity prices, and a recovery of public sector imports, indicate that, in the absence of corrective policies, the current account deficit is likely to widen by 50 per cent to about US$3.3 billion and the overall position to swing to a deficit in excess of US$1.0 billion.

The mission's concerns regarding the balance of payments focused on the continued weakness in the underlying structure. The decline in the international price of oil, coupled with the erosion of the exportable volume of oil, has highlighted the vulnerability of Egypt's export position, as traditional exports have stagnated even in nominal terms. Although the decline in international commodity prices during the current period has helped offset the adverse effects of the decline in exports, such a fortuitous condition was not likely to prevail and the trade balance was therefore bound to come under increasing pressure in the coming period. The mission emphasized that measures to strengthen the external trade position of Egypt required action to revitalize non-oil exports and import substitutes, primarily through reliance on pricing and exchange rate policies. The growth in import demand should be dealt with through appropriate demand management and exchange rate policies. Noting that the services account has long been dominated by inward remittances from Egyptians working abroad and in light of the high variability in such inflows in recent years, the mission cautioned that the apparent increase in remittances through the banking system during 1982/83 may not be enduring. A possible slowdown in economic activity in the net oil exporting countries of the region could begin to have an adverse impact on remittances.

The Egyptian authorities stated that they attached high priority to the expansion of non-oil exports as a means of redressing the trade imbalance. They had been studying alternative methods of promoting such *exports with technical assistance from the World Bank staff, and appropriate* measures were to be taken during the immediate period ahead. Moreover, the production of import substitutes was being increased, primarily as a result of the completion of direct foreign investment projects undertaken in the context of Foreign Investment Law No. 43 of 1974. As regards service receipts, the Egyptian authorities assured the mission of their commitment to pursuing external sector policies that would encourage the inflow of remittances while continuing to develop other sources of service receipts such as the Suez Canal and tourism. They added that recent simplifications and improvements in procedures for processing and approval of direct foreign investment projects have already had a positive impact on investment inflows and that such measures, together with administrative action to accelerate the implementation of development projects, would ensure rapid growth in foreign receipts through the capital account.

Concerning the exchange system, the mission emphasized that for some time exchange rate arrangements had been cumbersome, detrimental to the growth of exports, and increasingly ineffective. The recent action by the authorities abolishing foreign exchange surrender requirements has reduced the segmentation in the exchange markets and has moved the system closer to effective unification. However, a number of anomalies and inefficiencies remain. These include not only the de jure retention of all three markets, but also the fact that commercial banks are still legally prohibited from dealing in the free market and that transactions by these banks are effected at various rates. In addition, the system as amended gives priority, in access to foreign exchange, to exporters over other users of foreign exchange. As a result, the staff remains of the view that the most effective way to deal with existing problems in the exchange system is through a forthright unification of the rates in the commercial bank pool and in the free market at an appropriate level. Thereafter, a high degree of flexibility in the rate needs to be maintained so as to meet all legitimate demands for foreign exchange at the prevailing rate. The recent growth of remittances and decline in imports caused, in part, by commercial banks' increased reliance on the free market rate, underscored the apparent strength of supply and demand responses in the market, and highlighted the potential efficacy of exchange rate action to improve the structure of the balance of payments. An exchange rate adjustment, however, would not by itself yield the desired improvement in the balance of payments position nor in the efficient allocation of resources, unless supported by appropriate measures in the fiscal, monetary, and pricing areas.

Finally, the mission emphasized that the exchange system remained complex and that in the absence of further steps by the authorities to unify the rates, the staff would be unable to recommend Fund approval of existing multiple currency practices beyond the May 31 deadline set by the Executive Board at the time of the last Article IV consultation.

The authorities recognized the difficulties with the existing exchange system and stated that they continued to be committed to full unification as the ultimate goal. However, they indicated that in the current circumstances such a step could have serious adverse effects, especially on domestic inflation rates. They explained that they had begun to implement a set of measures aimed at easing the foreign exchange situation and that as these measures began to take effect, and especially if the external reserves position were sufficiently strong, the complete unification of the rates as proposed by the staff would be seriously considered.

IV. Staff Appraisal

During 1981/82 there was a sharp deterioration in financial conditions in the Egyptian economy. The budget deficit widened considerably and monetary aggregates indicated a resurgence of growth in the money supply, with the Government's domestic bank borrowing accounting for the bulk of the increase. With a drop in workers' remittances and little movement in other external receipts and payments, there was also an increase in the current account and overall deficits of the balance of payments. Although the financial outcome during the current year, 1982/83, is expected to show improvement in several areas, it is uncertain whether such an improvement will be lasting.

The structural weaknesses in the Egyptian economy have also remained largely untreated and continued to portend more serious deterioration in the period ahead. Widespread cost-price distortions sustained by price controls have led to serious resource misallocations while a relatively low tax effort and subsidized prices have reduced the incentive for savings and investment. Despite the dominant role of the public sector in the Egyptian economy, the fiscal structure has not been used as an effective tool for resource mobilization or for demand management. Any meaningful stabilization effort aimed at reversing the current deterioration in the financial situation in Egypt must also seek to address the underlying structural imbalances so as to achieve sustainable growth with financial stability.

The staff concurs in the Egyptian authorities' assessment that the immediate task of economic policy must be the achievement of a significant reduction in the size of the fiscal deficit while laying the basis for a more viable budgetary structure. This structure remains hampered by inelasticity of revenues and burdened by large, and virtually open-ended, expenditure commitments. Moreover, the budget's vulnerability to adverse external influences (Suez Canal and petroleum on the receipts side and international commodity prices affecting subsidies on the expenditure side) has, if anything, increased in recent years. A meaningful reform of the fiscal system therefore requires measures that would not only improve fiscal performance but, by strengthening the underlying structure of the budget, would also have a salutary effect on domestic resource mobilization and on resource allocation in general. Furthermore, the staff believes that if the authorities' objective of a substantial reduction in the size of the deficit is to be achieved in 1983/84, it is imperative that significant measures be put into effect early in the coming fiscal year.

The Egyptian authorities have had a measure of success in slowing down the rate of growth of domestic credit despite the expansionary impact of the budget deficit. However, current rates of liquidity growth are still in excess of the genuine needs of the economy and may have been a factor in the acceleration in the rate of inflation, as indicated by the consumer price index. Excess liquidity needs to be wrung out of the system, and in this regard, the staff supports the Egyptian authorities' intentions that the anti-inflationary monetary stance remain in effect for the coming period. Toward the achievement of this objective, the Egyptian authorities need to maintain existing ceilings on the growth of private sector commercial credit and convert other credit guidelines into similar ceilings. Existing interest rate policy must remain under review so as to keep domestic rates consistent with comparable rates in international financial markets.

The improvement in the balance of payments outcome during the current year was largely due to special factors. For 1983/84, the current account and the overall payments positions are expected to deteriorate. The staff notes the authorities' concern for the country's export performance and welcomes the steps taken recently to promote the growth of non-oil exports. However, the staff believes that greater reliance needs to be placed on pricing and exchange rate actions as instruments for improving the structure of production and trade in Egypt's external accounts. Commercial banks have increasingly resorted to the use of exchange rates comparable to those prevailing in the free market, and this has already helped in restraining the growth of demand for and, more importantly, in augmenting the supply of foreign exchange through the banking system. The recent measure abolishing in effect all foreign exchange surrender requirements has reduced the segmentation in the exchange markets and is likely to increase further the volume of transactions taking place at the free market rate. The staff's view is that as these practices become increasingly institutionalized, the rate officially decreed for use by commercial banks will lose its market significance. As a result, the time may be appropriate for complete unification of the rates in the commercial bank pool and in the own exchange market. Existing exchange arrangements remain complex and continue to involve multiple currency practices. In view of the fact that the authorities do not plan to eliminate these practices in the near future, the staff does not recommend Fund approval of the system beyond May 31, 1983.

Egypt's external debt, although comparatively high, has not posed a serious problem of repayment because of its relatively long maturity structure and the character of Egypt's relations with its debtors. Short-term debt has risen by about US$400 million to US$1.2 billion over the past two years.

It is recommended that the next Article IV consultation with the Arab Republic of Egypt be held on the standard 12-month cycle.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to the Arab Republic of Egypt's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Egypt, in the light of the 1983 Article IV consultation with Egypt conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes the recent measures to improve the efficiency of the exchange system. The Fund considers, however, that the system remains complex and believes that further steps should be taken at an early date toward the complete unification of the existing exchange rates. The Fund welcomes the termination of the two bilateral payments agreements with Fund members and hopes that Egypt will terminate the two remaining agreements with Fund members as soon as possible.

Arab Republic of Egypt - Basic Data

Area and population	
Area	1,002,000 square kilometers
Population	44.7 million (1982 estimate) 1/
Per capita GDP (1981/82)	LE 464 (US$663) 2/
Annual population growth rate (1977-82)	2.9 per cent per annum
Annual growth rate of GDP at constant factor cost (1977-1981/82) 3/	8.6 per cent per annum

	1978	1979	1980/81	1981/82	1982/83
	(In millions of Egyptian pounds)				
National income accounts					
GDP at current market prices	9,787	12,515	16,698	20,727 1/	...
	(In per cent)				
Prices (change during period)					
Consumer price index	11.3	9.8	11.9	16.0	15.8 4/
Wholesale price index	8.2	17.1	6.9	8.2	11.9 4/
	(In thousands of barrels per day)				
Petroleum sector					
Crude oil production 5/	479	522	611	640	674 6/
Petroleum exports from Egypt's share, of which:	185	201	254	292	252 6/
Crude oil	(140)	(166)	(207)	(229)	(201) 6/
	(In U.S. dollars per barrel)				
Average export price for crude oil	...	21.5	33.6	30.9	29.3 7/

	1978	1979	1980/81	1981/82	Staff Estimates 1982/83
	(In millions of Egyptian pounds)				
Public finances					
Total revenue	3,306	3,684	7,279	7,650	8,287
Current expenditure, of which:	3,134	4,044	6,080	7,874	8,996
Subsidies	(710)	(1,352)	(2,166)	(2,200)	(1,704)
Wages and salaries	(...)	(993)	(1,453)	(1,948)	(2,356)
Investment expenditure	2,311	2,547	3,766	4,218	4,021
Overall deficit (-), financed by:	-2,139	-2,907	-2,567	-4,441	-4,731
Foreign financing (net)	(767)	(628)	(762)	(745)	(628)
Domestic nonbank financing 8/	(545)	(677)	(2,001)	(1,396)	(1,367)
Banking system	(827)	(1,602)	(-196)	(2,300)	(2,736)

1/ Preliminary.
2/ Converted at official exchange rate. At the free market rate, per capita GDP would be about US$400.
3/ A major revision of the real GDP series is under way in the Ministry of Planning. Presently, only preliminary data for 1977 and 1981/82 are available.
4/ December 1981-December 1982.
5/ Includes foreign partner companies' shares.
6/ July-December preliminary actual data.
7/ July-March preliminary actual.
8/ Includes balancing item mainly reflecting discrepancy between monetary and fiscal accounts and net change in arrears.

Arab Republic of Egypt - Basic Data (concluded)

	1978	1979	1980/81	1981/82	Proj. 1982/83
			(In per cent)		
Deficit to GDP ratio	22	23	15	21	...
Bank financing to beginning period money stock ratio	26	39	-3	28	23
					July-Dec. 1982
Money and credit (change during period)					
Money and quasi-money	28	30	34	44	36 1/
Net claims on public sector	26	15	11	29	14 1/
Claims on private sector	31	74	91	72	15 1/
			(In millions of U.S. dollars)		
				Prelim. 1981/82	Proj. 1982/83
Balance of payments					
Trade balance	-3,230	-3,818	-4,737	-4,473	-4,760
Exports, f.o.b., of which:	2,070	2,857	3,985	4,144	3,500
Petroleum exports	(768)	(1,693)	(2,857)	(3,032)	(2,400)
Imports, c.i.f.	-5,300	-6,675	-8,722	-8,617	-8,260
Services balance	2,160	2,789	3,338	2,365	2,474
Receipts, of which:	3,585	4,311	5,538	4,991	5,504
Suez Canal	(515)	(589)	(780)	(909)	(950)
Workers' remittances	(1,895)	(2,445)	(2,855)	(2,032)	(2,500)
Tourism	(704)	(601)	(712)	(611)	(587)
Payments	-1,425	-1,522	-2,200	-2,626	-3,030
Unrequited transfers (net)	346	89	63	51	36
Current account balance	-724	-940	-1,336	-2,057	-2,250
Capital account balance 2/	346	1,047	1,194	1,521	...
Overall balance	-378	107	-142	-536	...
International reserves (end of period)					
Total	843	1,089	1,992	2,402	2,382
Usable reserves 3/	426	823	667	1,410	1,360
Ratio of usable reserves to monthly rate of imports	(1.0)	(1.5)	(0.9)	(2.0)	(2.1)
External debt 4/					
Disbursed debt (end of period)	10,306	11,735	13,772	15,072	...
Ratio of debt service to current account receipts (in per cent)	(22)	(16)	(16) 5/	(20) 6/	(26)

1/ At a compound annual rate.
2/ Includes net errors and omissions, workers' remittances held in foreign currency accounts in commercial banks, and SDR allocations in 1979 and 1980/81, but excludes cash loans to the Government and the Central Bank and official deposits with the Central Bank.
3/ Holdings of SDRs, foreign securities, and amounts due from foreign correspondents excluding payments agreements.
4/ Public and publicly guaranteed medium- and long-term debt, including Fund position.
5/ Calendar year 1980.
6/ Calendar year 1981.

Arab Republic of Egypt - Fund Relations

Date of membership:	Original member, 1945.
Status:	Article XIV.
Quota:	SDR 342 million.
Use of Fund resources:	An extended arrangement in the amount of SDR 600 million expired in July 1981, under which Egypt made one purchase of SDR 75 million.
Fund holdings of Egyptian pounds (April 30, 1983):	SDR 392.0 million (114.6 per cent of quota); of which holdings subject to exclusion: Oil facility SDR 0.7 million (0.2 per cent of quota) EFF SDR 49.3 million (14.4 per cent of quota)
SDR position (April 30, 1983):	Holdings amounted to SDR 1.0 million (0.7 per cent of net cumulative allocation of SDR 135.9 million).
Trust Fund:	Egypt received loans of SDR 77.9 million and SDR 105.8 million in respect of the first and second periods, respectively.
Direct distribution of profits from gold sales:	US$29.9 million.
Gold distribution (four distributions):	160,895 fine ounces.
Exchange rate system:	The exchange market consists of three distinct elements--the Central Bank pool (handling most government-related transactions), the commercial bank pool (covering workers' remittances, minor exports, tourist receipts, and public sector imports not qualifying for the Central Bank pool), and the free exchange market. Transactions with the Central Bank are at the official rate of LE 1 = US$1.42857. Since August 1, 1981 the rate in the commercial bank pool has been set at LE 1 = US$1.19048. However, commercial banks have recently been using more depreciated rates. Rates in the free market have recently been about LE 1 = US$0.86.

Arab Republic of Egypt - Fund Relations (concluded)

Technical assistance:	The Fund has a resident representative in Cairo whose term expires in June 1983. In June 1981 and November 1982, joint ETR/MED technical assistance missions visited Cairo to review the exchange and trade system and make recommendations. In May-June 1982 a joint FAD/MED mission visited Cairo to review the budget.
Last Article IV consultation:	Discussions were held by the staff in Cairo during February 24-March 4, 1982. The Staff Report (SM/82/74) was discussed by the Executive Board on May 21, 1982.

The Executive Board's decision (Decision No. 7118-(82/69)), adopted May 21, 1982, was as follows:

> 1. The Fund takes this decision relating to the Arab Republic of Egypt's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with Egypt, in the light of the 1982 Article IV consultation with Egypt conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).
>
> 2. The Fund notes the intention of the authorities to take steps toward the unification of the exchange system. Accordingly, the Fund grants approval of the multiple currency practices as described in the report on recent economic developments (SM/82/90, 5/13/82) until May 31, 1983. The Fund hopes that Egypt will terminate the few remaining bilateral payments agreements with Fund members as soon as possible.