Country Study for Development Assistance to the Arab Republic of Egypt

"Basic Strategy for Development Assistance"

April 1992

Country Study Group
for Development Assistance to the Arab Republic of Egypt
Organized by the Japan International Cooperation Agency

This paper is based on the discussions and findings of the Country Study Group for Development Assistance to the Arab Republic of Egypt organized by the Japan International Cooperation Agency (JICA). The views expressed in the paper are those of the members of the Study Group and do not necessarily reflect those of JICA.

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Foreword

This report is the result of a year-long study by the Country Study Group set up in March 1991 under consignment from the Japan International Cooperation Agency to study Japan's official development assistance strategy towards Egypt.

Egypt is, needless to say, a country which has to play a central role in international peace-keeping efforts in the Middle East since the Gulf War. Through this role, Egypt also holds a decisive key to the creation of a framework for the maintenance of world peace in the post-Cold-War era. Despite these vital global responsibilities, however, Egypt is by no means in a strong economic position as an independent nation. Years of intense efforts to diversify and industrialize its economy and thereby break away from a monocultural export economy, and attain self-reliance have not yet borne fruit, nor are the prospects for success yet certain.

On top of this, Egypt has been plagued by severe fiscal and balance of payments crises since 1980. When it sought relief from the International Monetary Fund and the World Bank, it was requested to implement, in addition to severe stabilization policies, those structural adjustment policies which would require an end to centrally-controlled economic institutions and policies, which date back to the days of Gamal Abd al-Nasser, and the introduction of private-sector-led, market-oriented institutions and policies in their stead.

In recent years, Egypt has occupied first place in Japan's ODA to the Middle East but lower than tenth place in Japan's ODA overall. Compared to Asian recipients of Japanese ODA, Egypt has gotten relatively little aid, in addition the accumulated stock of research done on her economy has also been very little. However in the future, Japan is certain to be counted on to provide more economic support for Egypt now that Egypt has assumed such a major international political role. If Japan is to respond to these expectations, not by waiting for specific aid requests, as in the past, but by independently and actively formulating a strategy for development assistance individually tailored to Egypt's needs, the task is by no means an easy one. Japan must approach the problem based on the realization that, given the relatively weak previous attempts to study the Egyptian situation and the current precarious state of the Egyptian economy, aid to Egypt will involve exceedingly difficult problems of planning and implementation of economic aid policies which are saddled with three major challenges: stabilization, structural adjustment, and long-term development to achieve independence.

Instead of immediately proposing guidelines and policies of Japanese aid programs responding to the above requirements, this report focuses on several basic questions: what are the ideal steps for formulating a country-wise aid strategy that will eventually adapt aid programs to today's requirements? How can aid programs be temporarily expedited at the present stage, where there are not yet sufficient survey data and experience with aid to generate adequate strategies? How can aid programs aimed at macroeconomic, microeconomic, and institutional reforms be harmonized? What stages must be passed through to develop this into a full-scale aid program?

Given these emphases, we hope that this report will be taken as a case study for the development of country-wise aid strategy in a country which Japan has not made sufficient studies of, and where both development policies and aid programs are difficult to formulate. Within the above-mentioned limited framework, we have nonetheless mentioned, in the section titled "Japanese aid implementation," specific areas that are to be dealt with in the future.

In conducting these studies, discussing the findings, and drafting this report, this group has counted heavily on the hard work of its members and, beyond this, the kind comments of Japanese Foreign Ministry staff and the expert cooperation and assistance of a task force consisting mostly of International Cooperation Agency staff, to whom it wishes to express special gratitude. In the process of conducting these studies, field surveys took place in Egypt, with visits and talks involving local aid related organizations and donor agencies. We also heard the opinions of experts in Japan. These surveys were a tremendous help to us in our work, and we wish to thank everyone who helped us during them.

Shigeru Ishikawa, Chairman
Country Study Group for Development Assistance to the Arab Republic of Egypt
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Introduction

i) The importance of aid to Egypt

Egypt is a leader among the Middle East Arab states and for this reason it has become one of the most important diplomatic and military bases in the Middle East phase of America's global strategy. Relations between Egypt and the United States have been steadily cultivated since President Anwar al-Sadat came to power in 1970 and, during the Gulf Crisis and War (August 1990 to February 1991), the Egyptian government's actions reinforced its importance.

While Egypt is playing such a crucial international role, it still lacks a firm domestic footing as an independent state, both economically and politically. Economically, it has still not achieved the goals pursued since 1923 when Egypt gained political independence: namely, to break away from a monocultural economy through industrialization and diversification of its economy, to establish social welfare institutions, and to achieve independence. This failure has occurred despite repeated efforts under military governments from Nasser to Sadat and Muhammad Hosni Mubarak. Since the mid-1980s, Egypt has been suffering from a severe foreign debt crisis. It sought relief from the IMF and the World Bank, who demanded that Egypt make structural adjustments, replacing its centrally-controlled economic institutions and policies with market-oriented mechanisms and policies. The Egyptian economy is saddled with three interrelated and extremely difficult issues: stabilization, structural adjustment, and long-term development to achieve independence.

On a net disbursement basis, Japan's ODA to Egypt has averaged $170 million a year in recent years, greater than its aid to any other Middle East country, but only eleventh on Japan's overall list of recipients. Egypt's biggest aid donor is the United States, which gives $800 million a year, also on a net disbursement basis. The United States gives all of this on a "quick disbursement" basis, as Economic Support Funds (corresponding to the former Security or Defense Support), in light of Egypt's important military and foreign policy role. According to reports, the United States is hoping Japan to increase its aid to Egypt, qualifying this as international assistance in the Post-Gulf-War reconstruction of the Middle East. If Japan acquiesces, it will mean taking part, whether it desires to or not, in the three tasks now faced by the Egyptian economy. The "aid on request" approach to ODA practiced thus far in Japan appears to be due for review, and developments in aid to Egypt are likely to lend impetus to this trend.

ii) Development of country-wise aid strategies

At a time when the administration of Japan's ODA seems headed beyond the "aid on request" approach towards a more active stance, methods of aid program formulation for specific recipients must be found by formulating country-wise aid strategies. Ideally, country-wise strategies should be formulated through the following six administrative steps [1]:

Step 1 Gaining an understanding of the aid recipient's present development situation and the challenges it faces. (These must be approached on three levels: short-term stabilization, medium- and long-term structural adjustments, and long-term development. This applies also to the remaining steps below.)

Step 2 Development optional development scenarios to meet these development tasks.

Step 3 Jointly formulating, through dialogue with the aid recipient, development strategies necessary for the realization of an opted feasible development scenario. This scenario is based upon the agreement on the types and amounts of economic aid which the recipient should expect to obtain from major donors.

Step 4 Discussing among main, donor countries for "aid coordinator" concerning the above agreed upon economic aid. The result is that the tasks of economic aid and its amount that Japan should share is broadly determined.

Step 5 Formulating a specific Japanese aid strategy for the recipient country.

Step 6 Determining and implementing individual projects and programs using different forms and approaches.

As should be immediately obvious, a variety of constraints currently prevent the formulation of country-wise aid strategies according to these steps. Especially noteworthy are the incompleteness of past country-wise surveys and data on aid recipient economies and the lack of staff with sufficient expertise to perform such surveys. The only way to overcome these restraints is to spend time training the necessary personnel and making the studies. Some progress has been seen thanks to accumulated experience with ODA thus far, and the recent expansion of the scale of Japanese ODA is accelerating the nascent efforts being made by concerned organizations to formulate country-wise aid strategies. Efforts are being made in the same direction by private research institutions and universities. However for the time being, at least, the following types of efforts must still be made under present constraints in order to take the six steps mentioned above.

First, Japan should actively exploit its own historical experience in economic development. Japan's place in economic history is that of the last "late comer," to use Alexander Gerschenkron's concept (2). England was an "early comer," followed by the "late comers" of Europe and North America. Japan's development came between theirs and that of the "late-late comers," namely today's developing countries. Japan's experience often provides excellent suggestions for developmental efforts in today's developing countries.

Second, it is also important to appropriately summarize and to rely on the insights obtained from the development of neighboring Asian countries, with which Japan has close economic ties and to which it gives priority in its foreign aid, and from Japan's aid experience with them. This, together with the first type of effort mentioned above, will help to compensate for the research and survey weaknesses in Japan's aid administration.

Third, Japan should make as much use as possible of the analytical framework it gains from developmental economics and international development policy research.

Fourth, it is desirable that Japan should refer to international aid agencies' accumulated studies and experience and thereby increase its understanding, especially of the development situation of, and development tasks faced by, countries that did not receive priority in Japanese aid in the past, areas in which Japan has had insufficient experience with studies and aid implementation.

iii) Objectives and characteristics of this report

Unlike past reports on aid to specific countries, this report adopts the order of the above methodology in presenting the findings of the Group's studies. However, because it is beyond the scope of this Group's consignment to go too deeply into Step 6, we only follow Step 1 to Step 5.

Egypt, the object of this study, in several respects is a unique recipient of Japanese aid. First, Japan has done comparatively few studies of Egypt in the past. The consequent lack of data impeded our work at every stage, but we have tried to remedy this lack by using the additional resources mentioned above. This report will therefore have reference value in future studies on countries about which Japan similarly lacks information.

Second, Egypt is one of the heavily indeted countries, suffering serious short-term difficulties in servicing its foreign debts. Factors behind this include the need for serious reform of its controlled economy, the need to achieve long-term economic independence, and the unsolved problems of poverty and unemployment. Possible aid strategies, such as aid and technical cooperation (including advice) for short-term macroeconomic policies, medium-term structural adjustment policies, and long-term investment projects, will have major impact and will help, at multiple levels, to solve these problems. This report addresses model methods for dealing with the problems of countries where both development and aid pose difficult challenges. Finally, given Egypt's special position in international political and military affairs in the Middle East, the possibility is strong that aid to Egypt will be decided according to international political considerations. Thus, corrections will often be called for in observations which are based on purely economic considerations. Although not discussed in this report, the possible need for such corrections must also be borne in mind.

In April 1991, the Japanese government issued the following guidelines for the future implementation of Japan's ODA.

The ODA (Official Development Assistance) of Japan is provided based upon humanitarian consideration toward such problems facing the developing countries as poverty and famine that cannot be ignored and recognition of the fact of interdependency among the nations of the international community in the sense that stability and further development of the developing countries are indispensable to the peace and prosperity of the entire world. Based upon these ideas, the Government of Japan hence forward will pay full attention in the implementation of ODA to the following points with respect to recipient countries: (1) trends in military expenditures; (2) trends in the development and production, etc., of mass destructive weapons; (3) trends in the import and export of arms; and (4) efforts for promoting democratization and introduction of a market-oriented economy and situation on securing basic human rights and freedom. In all determinations of aid, it will take into account comprehensively such factors as bilateral relations with the recipient countries, the international situation including the security environment in which the recipient countries are placed, aid needs, economic, and social situation of the recipient countries, etc.

It is important in the implementation of aid to Egypt that Japan repeatedly explain these guidelines to the government of Egypt and seek their understanding.

Notes:

(1) Ishikawa Shigeru, "For More Effective Economic Cooperation," in Kikin Chosa Kiho (The OECF Research Quarterly), No.69, February 1991.

(2) This concept is taken from the noted economic histerian at Harvard University, Alexander Gerschenkron's book, Economic Backwardness in Historical Perspective, Harvard University Press, 1962.

I. General Considerations

1. Status and issues of development

1.1 Present development status

The position of the Egyptian economy today, in mid-1991, is characterized clearly by Egypt's difficulties in the amortization of its huge and escalating debt, a problem that has been with it persistently from the mid 1980s. Independently of this, in the medium and long terms it faces other substantial difficulties and the challenge of resolving them.

To see the problems from the long-term perspective, one must go back at least to 1919, when Egypt achieved independence from the Ottoman Empire, or better, to 1805 and the accession of Muhammad Ali to the throne of Egypt. It was Muhammad Ali who introduced the cultivation of cotton to Egypt and by promoting the cotton industry sought to establish an industry that would process and export indigenous resources and provide a basis for the national economy. After Ali's death in 1849, however, the Egyptian government, in its haste to modernize, borrowed heavily from England and other European powers (to finance irrigation projects in the Nile basin, to build the Suez canal, to build transportation and communications networks, and to build railroads, etc.). It failed in the management of this task and by 1876 had reached the point where it was virtually unable to repay either interest or principal. From 1880 to 1890, accordingly, most of its revenues were seized by the major powers, and after Egypt's occupation by British forces in 1881, a British High Commissioner had de facto control over the Egyptian government.

The pattern of these events — default of a debt-ridden independent country with a shaky economic basis leading to outside control over its financial autonomy and economic policy and ultimately to the loss of its political independence — is one of the characteristics of 19th century international transfers of capital. We know well how this pattern turned China into a quasi-colony in the period from the end of the 19th century through the 1930s. The revolution that led to the establishment of the People's Republic of China was the antithetical response to this outside semi-colonial domination. It must not be overlooked that Nasser's revolution played a similar role in Egypt. However, Nasser failed in his attempt to use socialistic state control to achieve the goal, which was given up once upon Ali's death, of transition from an economy based on primary commodity exports to an industrialized economy. The tasks of diversification and industrialization of the primary commodity export-based Egyptian economy remain today, with almost no progress toward a solution, even after Sadat's open-door policies. The present short-term crisis is therefore in a more basic sense a crisis both of liquidity and of solvency.

The phrase "medium-term perspective" is used here in the sense intended by the World Bank. The World Bank believes that from five to seven years will be needed for its "structural adjustment" loans to take effect and for the balance of payments to recover to a sustainable level. (The period of loan disbursement is from three to five years.) This, specifically, is the length meant by "medium term." The World Bank's prescription for developing countries whose balance of payments have had chronic and critical deficits since the 1980s is to impose short-term stabilization measures (reduction of aggregate demand and lowering of the exchange rate) and reforms aimed at introducing market economy principles to economic institutions and policies. In the strict sense, structural adjustments refer to the latter reforms. As we said previously, market-oriented economic reforms are aimed at the centrally-controlled economic institutions and policies that are prevalent in developing countries. We are in basic agreement about the necessity of structural adjustments, but we have certain reservations, as to whether it is justified to regard such extremely basic reforms, especially institutional reforms, as achievable in the medium-term according to the World Bank's definition of this time span. What we discuss here in terms of the medium-term perspective refers therefore to the contents of structural adjustments, regardless of the length or brevity of the period under consideration.

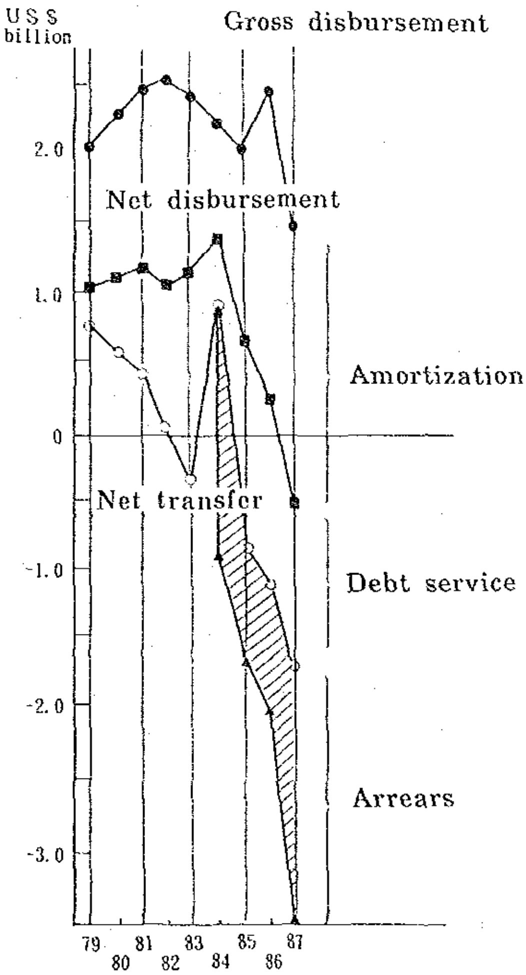
In this sense, Egypt's structural adjustment problems have their remote causes in the centrally-controlled economic, nearly socialistic-planned-economic, model adopted during the Nasser era, and the necessity of reform seems to be vastly greater in Egypt than in any other developing countries with controlled economies. Though Sadat raised the banner of open-door policy, little appears to have been done to dismantle state control. On the contrary, under Sadat, the extremely generous terms under which huge amounts of American military and economic aid were given did not encourage reforms (underlining the problem of so-called "moral hazards" of foreign aid) and state control remained intact. Egypt under Sadat also became a producer and exporter of oil. When oil prices soared during the oil crisis, so did Egypt's oil revenues, causing the so-called "Dutch disease," where the rapid increase of oil revenue dampens the production of other tradable goods. This conjunction of circumstances also stifled the urge to carry out reforms.

1.2 Short-term development issues: debt repayment, balance of payments deficit, and inflation

The most explicit case of a short-term obstacle to Egypt's development appears in the debt repayment crisis which resulted from the protracted deficit in balance of payments. Egypt's foreign debt began to swell during the Sadat era. (Limited to the long-term debt balance, $1.78 billion in 1970 grew to $16 billion in 1980 and $44 billion in 1989.) But the real repayment crisis struck after 1983, when Egypt's gross external borrowings (on a gross disbursement basis) were no longer sufficient even for debt repayments, not to speak of meeting the deficit in the current account (excluding debt service payments). Hence, Egypt's arrears in amortization service have persisted since 1984 (Figure 1.1). In 1987, after lengthy negotiations, IMF standby credit was acquired, making possible the rescheduling of $5 billion by the Paris Club. And now that the IMF standby agreement was reached in 1991, another round of rescheduling, new credits and debt reduction are to be made.

Certainly these measures help to relieve the pressure of existing debts but, in the foreseeable future, the debt crisis is certain to increase in scale and urgency. According to World Bank forecasts, Egypt will owe $5.4 to $6.2 billion in debt repayment annually from 1990 to 1992, even with these alleviatory measures, whereas the amount Egypt is expected to be able to borrow through the regular channels — grants, official loans, and private-sector support — is in the neighborhood of $3.6 to $3.8 billion. The shortfall must be met by new credits, debt reduction and/or rescheduling by major aid donors. The likelihood of this new financing via regular channels is subject to Egypt's first making its best possible efforts towards stabilization and structural adjustments, as advised by the IMF and World Bank, but yet stronger efforts are no doubt called for if Egypt is to obtain "exceptional financing" to make up the difference.

Figure 1.1 Egypt's external borrowings (excluding military debt) and debt repayment: the onset of the debt crisis, 1979-1987

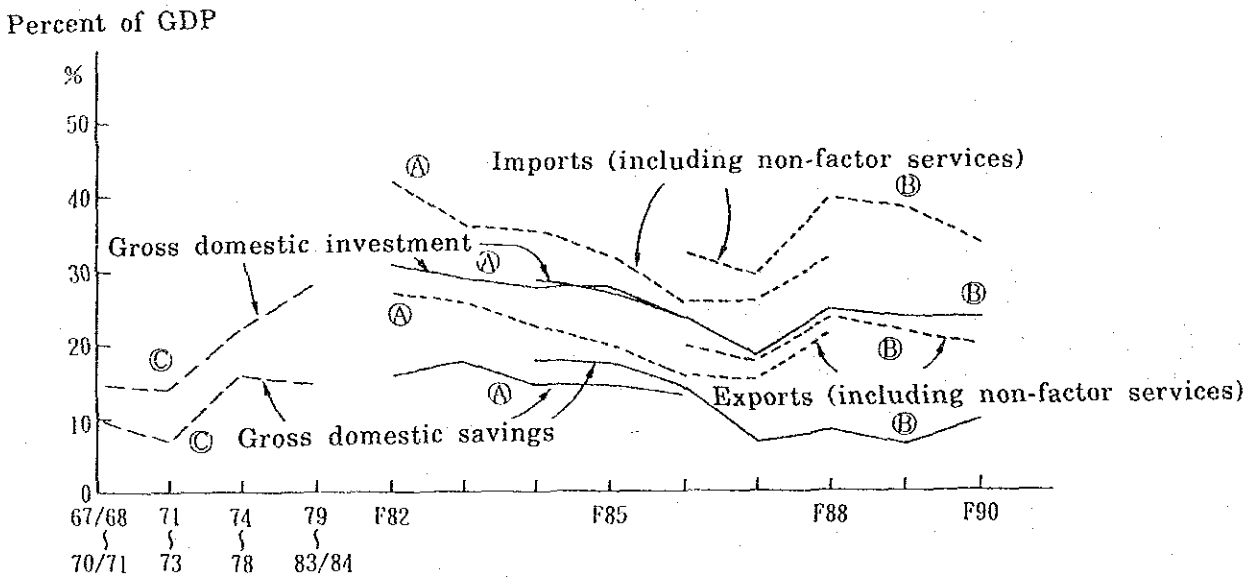


Note: The amount shown in the case of private-sector borrowings (excluding suppliers' credit) is net; when this figure is positive, it is part of gross disbursements, when it is negative, it is classified as amortization.

Source: World Bank.

The same sort of short-term challenges are presented by the current balance of payments deficit and domestic inflation that form the backdrop to the debt crisis. The current account is affected by the constant decline of export revenues due to the drop in oil prices since 1982 and overvalued exchange rates (due to the "Dutch disease," the importance of rice and raw cotton, once the main exports, has diminished). Recovery of the current account balance must be achieved mainly by cutting imports. (Imports have fallen from 42% of the GDP in 1982 to 26% in 1987.) But curbing imports has had led to curtailed industrial production through the reduction of intermediate goods necessary for industrialization and modernization. But the current account balance, especially resource and non-factor service balances, still has a huge deficit, and it is urgent for Egypt to increase exports.

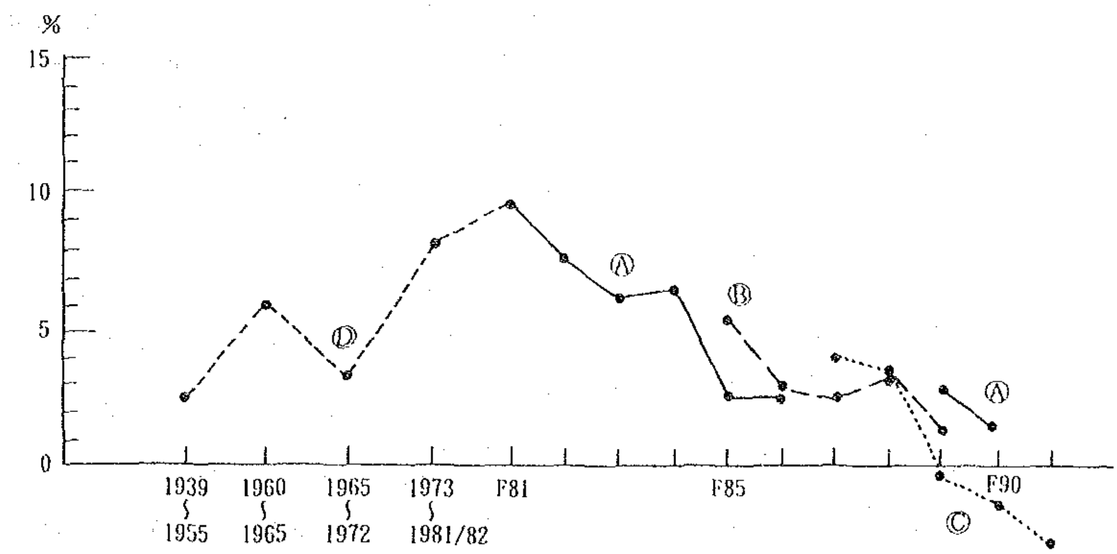
Figure 1.2 Trends in export-import and investment-savings in Egypt



Source: (A) and (B) are World Bank; (C) is an estimate by Bent Hansen.

Finally, the lowering of the investment rate and cuts in imports (especially imports of intermediate goods) lower the GDP growth rate. This tendency has been noticeable since 1981, resulting in a negative growth rate at the end of the 1980s (Figure 1.3). Negative growth has exerted an especially severe, direct impact on the unemployment problem.

Figure 1.3 The GDP annual growth rate in Egypt



Source: (A) and (B) are World Bank; (C) is IMF; (D) is an estimate by Bent Hansen.

1.3 Medium-term development issues: state controls and structural adjustments

Ignoring temporarily the question of whether solutions are possible in the medium term (the period required probably depends on the policy area), here we will look at the issues presented in the structural adjustments program advocated by the IMF and World Bank. This necessitates knowledge of the system of state control remaining from the Nasser era that is subject to the structural adjustments. Information about this is lacking in the most critical areas, and we will begin by citing a research paper that succinctly summarizes the complex economic control systems that arose during the Nasser era(1). After describing how Egyptian state controls were the most extensive of any developing country outside the Communist bloc, it summarizes these controls under the following ten headings:

a. Foreign exchange

Almost all foreign exchanges are allocated to users under central control. Users are for the most part government agencies or public sector enterprises.

b. Domestic prices

The majority of domestic prices are officially controlled by government ministries or agencies or supervisory organizations responsible for the product concerned. Public sector enterprises follow unofficial price policies.

c. Public sector enterprises

All big companies (with 50 or more employees) in the sectors of manufacturing, mining, transportation and other public utilities, construction, finance and commerce operate as public sector enterprises.

d. Private sector enterprises

Private sector companies are hindered by a number of employment regulations. This control is especially marked in hiring via recruiting agencies and ensuring employment opportunities. Companies must receive government approval for investment projects, and part of the profits of an incorporated company must be distributed to the workers.

e. Agriculture

Small-scale irrigated farming units operated by small-scale farmers occupy more than half of Egypt's cultivated land, and their farming activities are subject to very comprehensive state control. The state decides how much area is utilized for each crop and ultimate allotments are made to individual production units at the village level. The supply of irrigation water and planning of its usage are also carried out by government agencies. Most major crops are sold through government-controlled cooperatives at official prices.

f. Labor market

Government agencies and public sector organizations and enterprises dominate the official labor market. These agencies, organizations, and enterprises are expected to absorb as much of the labor force as possible to prevent open unemployment. The government therefore has de facto controlling power over wage structures and wage-change patterns in the official labor market.

g. Consumer subsidies

The prices of a considerable number of basic consumer goods are lowered by explicit or implicit subsidies. The government's retailing cooperatives are active mostly in the cities and they act as distribution channels for the majority of subsidized goods.

h. Housing

Rents have been considerably reduced, in two stages, from the prevailing levels of the 1950s and are controlled at their present levels.

i. Money supply and banking

Every year, the government determines the amount of credit and money supply, and how money is allocated among borrowers (almost all are in the public sector). Interest rates on loans, fixed deposits and savings are set at very low levels.

j. Taxes

The government's revenue structure is greatly dependent on import duties and domestic commodity taxes. The government also obtains considerable revenues from taxes on the profits of most public sector enterprises and dividends from public sector organizations and enterprises.

In short, the characteristics of the Nasser era's state controls are the following. The regulatory systems common in today's developing countries control the economy in two ways: i) by creating a public sector that is directly controlled by the government to take care of the most important production activities (bypassing market failures), and ii) by exercising discretionary control over the private sector (through such instruments as licensing and authorization).

In Egypt's case, the first method, use of a public sector, is especially preponderant. (In 1987-1988, it accounted for about 70% of total industrial production, excluding small private-sector producers; the more important the industry, the stronger this tendency (Table 1.1). In 1985 data, the public sector accounted for 60% of total value-added, 82% of capital stocks, 54% of jobs, and 90% of exports.) The biggest branch of the private sector in Egypt is agriculture, in which the family farm system survives, but crop area control affects the main crops and procurement prices are kept low. Land reform gave land to those who cultivated it, and comprehensive social welfare policies are in place that ensure full employment in the cities, provide education, health care and social services at no cost, and food rationing at subsidized process.

Table 1.1 Composition of industrial production in public and private sectors in Egypt (covers only industries under the supervision of the Ministry of Industry, 1987/88)

Industry	Gross value (million LE)	Percentage of total (%)	Public sector's share of total production (%)	Ratio of public sector exports to production (%)
Textiles	3,804	23.3	67.1	32.5
Foodstuffs	3,838	29.7	82.6	1.9
Chemicals	1,961	12.0	78.9	
Engineering and metallurgical	3,494	21.4	87.2	25.3
Mining & refractory	442	2.7	42.1	
Woodworking products	913	5.6	0	
Leather products	845	5.2	0	
Total	16,297	100.0	69.5	

Notes: 1. In 1986, 71.7% of total industrial production by value was generated by enterprises under the direct control of the Ministry of Industry. Total industrial production data are from the U.N. Statistical Yearbook, 1988 vol. I; data on enterprises under the direct control of the Ministry of Industry are from the IMF.
2. Statistical coverage according to scale of the enterprise here includes all public sector enterprises and all private sector enterprises with 10 or more employees.

Source: IMF.

These state controls became established after the mid-1950s, when the Nasser revolution's anti-western, pro-Soviet leanings became apparent. By 1963, all financial institutions, public utilities, transportation, industrial firms employing 50 or more people, department stores, and hotels were nationalized, whether foreign or Egyptian. State organizations were also set up with the aim of carrying out comprehensive planning on the model of the Soviet Union's planned economy, and commodities balances, the basic technique of Soviet-style planning, were prepared (in 1954 and 1959). After a variety of other preparations, the First Five-Year Economic Plan was drafted for the period 1960/61 to 1964/65.

In reality, the five-year plan was not as comprehensive as it was intended to be, nothing more than a government public investment program, and the Ministry of Planning, which should have been the central agency responsible for the plan, was unable to take the administrative steps necessary to implement it. A second plan was never drafted. But however lacking in thoroughness Nasser's central control was, it created a system characterized by the most wide-ranging government intervention outside of the Communist bloc.

Sadat's open-door policy in 1973 emphasized new policies: promotion of economic growth and modernization, encouragement of the private sector, improvement of the public sector's efficiency, increased inflow of foreign capital, and incentives for private investment by Arabs and other foreigners. Behind this shift lay the end of the Arab-Israeli wars of 1948-1973 and the ensuing liberalization of Nasser's state-control mechanisms through which it was sought to realize recovery and growth of the Egyptian economy. The annual GDP growth rate based on factor costs recorded during the Sadat era (1973-1981/2) was, in fact, much better than that of the Nasser era: in comparison with 6.5% from 1960 to 1965 and 3.1% from 1965 to 1973, it was 8.1% during the Sadat era. Contributions to this are undeniably due, directly and indirectly, to the attempt to decontrol foreign exchange under liberalization policies (especially the admission of an unofficial foreign exchange market, which encouraged workers' remittances), greater import liberalization than ever seen even in Korea or Taiwan(2), and the reactivation of private sector companies, including foreign capital and joint ventures (especially Law No.43 of 1974, Law No.32 of 1977, Law No.159 of 1981). But the main cause of high economic growth seems to have been due to the development of the international economic situation in Egypt's favor from 1973 on, resulting in oil exports, earnings sent home by Egyptians working in other gulf states and greatly increased foreign revenue after the reopening of aid from the United States. By stimulating imports of intermediate and capital goods, these changes contributed to increased investment and current production (especially in the four main modern industrial branches of textiles, foods, chemicals, and metal and machinery).

Despite progress in liberalization in these policy areas, however, during this period almost no essential change in the system took place in the areas of the huge public sector, agriculture and social welfare policies, and in the monetary and financial system that supported them. Difficulties stemming from these areas even worsened due to the "oil or Dutch disease," or a syndrome akin to it which produced windfall profits in the period 1973-1982.

To better see the basic problems created by this situation, further explanation is needed of Egypt's administration and organization of public enterprises, its use of private sector enterprises, its agricultural production system, and its social welfare policy.

1.3.1 Management of public enterprises

Management of the public enterprises that form the core of the Egyptian public sector has two facets: government controls on the enterprises (on production and business policies,staffing, wages, and organization) and their internal organization and management. Data on both are extremely scarce. Judging from the incomplete available information, management of public enterprises is very similar to practices in the Soviet Union, China, and other socialist economies. The economic issues in the management of public enterprises in Egypt appear to relate to such practices.

First let us address government controls. In 1990, some 370 public companies were under 18 ministries. (These numbers are based on World Bank data, but the data on organizations are scarce and contradictory.) Six public sector corporations (in metalworking, chemicals, textiles and apparel, mining and ceramics, foods, and machinery) and 117 companies are controlled by the Ministry of Industry(3). This three-tiered (ministerial, public sector corporation, public company) management appears to be the common approach in industry, but it has gone through a number of transitional phases. The reasons are unclear.

Incomplete information indicates on the one hand that there are no agencies responsible for coordination of economic administration and for joint policy making via public companies under ministerial control used as implementation units. On the other hand, it is clear that public companies have no autonomy: all of the important decision-making powers over production and management are controlled by supervising ministries. Not all of the decisions on production planning are made by order from above but, in effect, state control on imports and exports hampers production planning. Restrictions on the autonomy of public companies are especially severe in connection with employment, producer price and investment decisions, and access to inputs and product markets. It should be mentioned in connection with employment that under Egyptian labor legislation, public companies may not lay off or discharge employees once they are hired except for very serious misconduct. Except through the channels of its supervisory agency, a company cannot even contact another company about the purchase of inputs or the sale of products. Producer prices are determined by adding a normal profit to the cost. This is not a price that reflects the market conditions of supply and demand. (The procedure that balances supply with demand for a product is the administrative order based on the formulation of commodities balances, as is done in the Soviet Union's planned economy. This is the method used in the Second Social and Economic Development Plan now in progress (1987/88-1991/92). This plan uses 179 commodities balances.) The government's use of these distorted prices to make investment project decisions (instead of using shadow prices in calculating the internal rate of return) distorts the allocation of resources and results in serious economic inefficiencies.

One study by the World Bank gives a good example of this, although the data are slightly out of date. The study was made on the performance during 1981/82 of the four most important public sector industries in manufacturing and exports — textiles, foods, chemicals, and metals and machinery. It was shown that comparative advantages were highest in foods, textiles, ceramics, and chemicals (in terms of a comparison of domestic resource costs), in that order, while most new investments were focused on metals and chemicals. This indicates that investment project choices are tending in the wrong direction. The study also covered effective rates of protection and revealed that incentives were unfavorable to foods and textiles but favorable to the chemicals industry.

Next, with regard to internal relationships in public companies, it seems that the seniority-based wage system and the social security system, associated with overstaffing due to the legal restraints mentioned above, have major undermining effects on employee motivation. The problem of incentive to work applies to the upper echelons of public companies' management also. So-called "soft budget constraints" — namely the situation where a public company will not go into bankruptcy even if it records losses because the state will always compensate for them — reduce or eliminate public companies' incentive to innovate, improve productivity, and cut costs. Problems manifest themselves through the persistent budget deficits in most public companies except for financial institutions. The total deficit was 8% of GNP in 1983/84, outweighing the surpluses owed to oil production and the Suez canal.

1.3.2 The private sector's latent potential

Nationalization of private enterprises was so thorough during the Nasser era that in manufacturing, only enterprises having fifty employees or less remained private. Important rectifications were made in this private-sector policy by Sadat under the open-door policy. In particular, Law No.43 of 1974 authorized the establishment of joint ventures associating foreign companies with Egyptian public companies, and these joint ventures were exempted from the labor legislation and wage and salary constraints applicable to public companies. Law No.32 of 1977 extended the same provisions to Egyptian private companies. But on the whole, private-sector activity remained entwined in a vast network of state control, and conditions for private investment are still poor.

This suggests that much remains to be achieved in structural adjustments related to private-sector development. Here, we will nonetheless point out a number of encouraging developments.

The first concerns the way large-scale private companies were nationalized in the early 1960s. Egypt's modernization and industrialization began between the first World War and 1930 and continued until the tariff reform that came later with the restoration of tariff autonomy. The Misr Group represented by Tala'at Herb, then the leading figure of a capitalist group, led this modernization and industrialization and established the Misr Bank in 1920. From the 1920s to the 1930s, it built up a conglomerate consisting of Egypt's largest cotton mills, and spanning chemicals, cement, mining, paper, bookbinding and printing and aviation. One of the characteristics stressed in recent research on the nationalizations of the 1960s is that original owners were not necessarily driven from managing positions and some continued to exert powerful influence in the companies, even after they were nationalized (for example, "Arab Contractor" of Osman Ahmad Osman)(4).

Within the Misr Group, the Misr Bank and many of its corporate affiliates retained their names after nationalization(5). More detailed study is needed to find out how many of the original board members remained.

Whatever the case, Egyptian public companies' privatization will probably take place smoothly to the extent that the status and vitality of former entrepreneurs have been maintained de facto in the public sector. (And even in cases where they have not been maintained, it has only been twenty years or so since nationalization, and unless the entrepreneurs have followed the example of many economists and planners by leaving the country, their rehabilitation should not be difficult.)

The second encouraging item of information is the fact that the authorization to establish joint ventures with preferential treatment under Law No.43 of 1974 and Law No.32 of 1977 may lead to the enhancement of technology and management skills in the private sector via direct investments by foreign capital. Already, joint ventures have been formed at an astonishing pace between foreign banks and major Egyptian national or nationalized banks. By 1983, 40 commercial bank and 30 investment/business bank joint ventures had been established(6).

1.3.3 Agricultural institutions and organizations

Knowing what sort of farms sprung up from the land reform that began in 1952 and went through two more phases in 1961 and 1969 and what became of the rural agricultural laborers and non-agricultural households is important in order to understand the medium-term issues to the development of Egypt's agriculture.The information is insufficient, but to know what the land reforms did, it appears to be important to distinguish the part (about one-tenth of Egypt's total cultivated area) that consisted of plantations with more than 200 feddan (1 feddan is approximately equal to 0.42 ha) that were established in the 19th century and belonged to nobility, the high officials, and absentee landlords from the part belonging to smaller Egyptian landowners and small holders. The first land reform affected large-scale landowners. The land taken from them was redistributed to the tenant farmers, although this did not make them independent farmers. Instead, they were forced to join land reform agricultural cooperatives, which became the basis of state control of agriculture with priority on maintaining pre-land reform large-scale production structures and productivity. The remaining part was not affected by land reform, and substantial inequalities still exist in the scale and structure of farmland ownership (Table 1.2). Nearly half of Egypt's arable land is still tenant land.

Table 1.2 Structure of farmland ownership before and after land reforms in Egypt

Size of holding in feddan	% of total before 1952	% of total in 1985
Less than 5 feddan	35.5	53.5
(Less than 1 feddan)	(13.0)	
5 ~ 10	8.8	10.6
10 ~ 20	10.7	10.8
20 ~ 50	10.9	11.4
50 ~ 100	7.2	7.5
100 ~ 200	7.3	6.1
200 feddan or more	19.7	
Total	100.0 (5,431)	100.0 (5,984)

Note: Figures in parentheses in the totals row indicate total farmland area in thousand feddan.
Source: Suzuki, Hiroaki, editor, Monkokaihoukano Ejiputokeizai, (Egypt's Economy Under the Open-Door Policy) pp. 32, 39.

When considering agricultural organizations after the land reform, attention should be paid to agricultural cooperatives. All farmers must join a cooperative, which, in addition to performing ordinary cooperative activities, is the basic unit of organization through which, via local bureaus at the government and district levels, the central authority assigns to individual farmers crop area allotments for their main crops each year.

Next to crop area allotments, the main vehicle for state intervention in agricultural production is price control over the main crops and other agricultural products. The degree of this control over individual items strongly influences farmers' decisions on the composition of products. A USAID study in 1982 says the following(7). Cotton farmers tend to switch to long-term berseem production, because of delivery quotas of cotton at low prices. Production of berseem, a non-controlled item, has increased, stimulated by the increased production of animal products whose prices are 10% to 15% higher than world prices. For the same reason, prices for wheat straw for animal feed have at times become higher than the price of wheat. Lax controls over vegetables and fruit make it more advantageous for the farmer to grow them than to grow cotton, wheat, sugar cane, or other controlled products. Although, of the items subject to lax controls, animal products are the most profitable of all, prompting farmers to flock to this field. Thus livestock production flourishes in the winter and spring instead of low-price cotton and wheat, and likewise, in the summer, forage production flourishes instead of low-price rice and cotton. Livestock production is labor-intensive, making it better suited to small farmers.

The findings of a 1986 World Bank report should also be noted(8). The comparative advantage of growing the main crops under state control (cotton, wheat, and sugar cane) has decreased; the comparative advantage of growing other major crops (corn, sorghum, and rice) is unchanged; the comparative advantage of growing berseem, onions and other vegetables and fruit has increased; trends in individual crop production and the composition of products reflect these changes in comparative advantage.

The distortion of resource allocation and the inefficiencies of the *national economy generated by state control over agricultural production* are clear from their impact on agricultural imports and exports and on the foreign currency balance. This analysis is handled in the section on long-term obstacles to development, Section 1.4. Other diverse influences of state control on different strata of rural communities are addressed in the next subsection.

1.3.4 Social welfare policy

1.3.4.1 Since the 1952 revolution, the Egyptian leadership has stressed social development aimed at greater equality and improvement of public welfare. A World Bank source classifies government measures as follows(9):

a. Implementation of land reforms and business nationalization measures

b. Establishment of an egalitarian wage structure and the pursuit of generous employment policies in the public sector

c. Operation of a moderately progressive taxation system

d. Establishment of a nationwide public health care network

e. Establishment of comprehensive educational and training systems

f. Introduction of direct and implicit subsidies in a wide range of economic and social sectors

Although these measures were justified from the standpoint of fair allocation of resources, they were too ambitious, having possibly lowered Egypt's rate of economic growth and diminished welfare on the whole.

1.3.4.2 An excessive proportion of the budget is spent on social welfare and contributes to further swelling of Egypt's already huge budget expenditures.

Total budget expenditures (recurrent expenditures plus investments) grew from between 50% and 55% of GDP in the 1970s to a 63% peak in 1982; this was cut to 40% in 1990 but it is still much greater than in other countries.

Social expenditures taken as "subsidies and recurrent transfer payments" were equivalent to 21.3% of government recurrent expenditure in 1985; this was 7.8% of the Egyptian GDP in the same year. Social expenditures by the four ministries involved in social outlays (Health, Social Affairs, Education, and Higher Education) peaked in 1985/86 at 5.9% of GDP and sank to 4.0% of GDP in 1989/90[10].

1.3.4.3 A common sense view of ordinary welfare policy would indicate that the measures listed in (d), (e), and (f) of subsection 1.3.4.1 above, which are social welfare policies in the strict sense, were excessively comprehensive and ambitious. According to detailed data from the same World Bank source, Egypt's welfare policies break down into the following three categories.

Income transfers by the government budget for social welfare

Food subsidy programs include a rationing of rice, edible oils, sugar, tea, and soap; other food products distributed through nationally run cooperatives at discount prices; and wheat and bread sold without any restriction at discount prices.

Potable water, electricity, fuel, and transportation have also been subsidized.

Direct income transfers by the government include long-term pension support payments, short-term disaster relief payments and various family income support programs for widows, orphans and the like.

Social security system co-funded by the government, employers, and employees

The general scheme covers all government employees and most private and public sector employees and operates the four following social insurance systems: old age, disability, and death; sickness and maternity; workers' accident compensation; and unemployment. Three other schemes are available to the self-employed, Egyptians working abroad and domestic servants and temporary workers.

Social services for human capital formation

Health care and education fall under this category.

1.3.4.4 Overall assessment of social welfare policy

It is true that Egypt's social welfare policies have improved the level of social welfare of the majority of the population, but this improvement was attained at a high cost to the economy. The failure of attempts to eradicate poverty through economic growth is evident from two facts.

First, in rural villages, access to arable land, the basis of the people's livelihood, has not been adequately realized.

Second, in cities, the possibility of giving regular work to wage earners has been undermined. Disadvantaged groups of the population, in particular, are likely to be hit hardest by this situation.

Even the existing social welfare policies have serious flaws. On the one hand, programs dispose of far too little funds in proportion to their scope, and on the other hand, programs are inefficient and do not always reach those who really need them.

1.4 Long-term development issues: economic independence and alleviation of poverty

In the previous sections, we have addressed the main problems faced by the Egyptian economy in the short and medium terms. The main short-term issues are the difficulties of amortization and servicing of the huge foreign debt accumulated from the Sadat era, and slow economic growth and worsening unemployment and poverty resulting from the curbs on imports that stemmed from Egypt's huge debt. Its main medium-term problems are the continued existence, despite partial deregulating remedies applied under Sadat's open-door policy, of a centrally-controlled economy, resembling the Soviet Union's planned economy and inherited from the Nasser era, which is causing resource allocation distortion and impeded economic growth. Of course, this list of development issues is not yet exhaustive. Even if these problems could be solved immediately, there is no guarantee that development would proceed smoothly in the long term. The first thing that must be done to ensure sound growth of industry and agriculture is to look for ways to adapt programs to the Egyptian economy's conditions and achieve a sustained balance of payments and a current account balance, and at the same time to take steps that will lead to the creation of more jobs and the alleviation of poverty.

A sustained equilibrium in the balance of payments could be achieved by finding external sources of revenue such as oil exports, workers' remittances of earnings home, and income from the Suez canal and tourism, sources that unexpectedly turned the balance of payments in Egypt's favor in the 1970s. But the World Bank forecasts that Egypt's exploitable oil reserves will begin to dwindle sharply as early as the mid 1990s. And although the remaining sources could contribute to foreign currency earning, the future of Egypt cannot be dependent upon them. (Egypt should not base its economy on tourism, the way some island nations in the Caribbean have done.)

1.4.1 Sustained development patterns in primary commodity exporting countries

What path suited to Egypt's economic circumstances will lead Egypt to sound industrial and agricultural growth? The general answer is suggested by referring to typical patterns of sustained development observed in primary commodity exporting countries. The development of typical primary commodity exporting countries passes through two partially overlapped stages. In the first stage, development relies on exploitation of the country's most advantageous initial conditions, that is the existence of natural resources or land in relative abundance compared to supplies of labor. As demand for primary commodities produced using these abundant resources arises overseas, continuing demand primes development; as the intermediaries grow and transportation and communication facilities are developed that transmit the demand to producers, and if producers respond to the market, then development continues until either cultivable land is exhausted or further development aggravates the conditions of production and destroys the country's international competitiveness. (This process has been described by Prof. Hla Myint in his vent for surplus theory, a well-regarded economic model of development in developing countries[11].)

The end phase of this stage is prolonged if primary export commodities are replaced by other more advantageous primary commodities. Nonetheless, even if this "switching" happens, it must lead to the next stage of industrialization. Items that lead relatively quickly to industrialization include both processed goods that use the primary commodities that until then were exported and intermediary goods produced through the effects of inter-industry relations based on primary commodities. Recently, however, unlike and unrelated to industrialization via spontaneous evolution from the first stage, patterns of industrialization have appeared that are promoted either as a type of international subcontracting or as a type of import-substitution through foreign direct investments. Foreign capital shares the initial fund raising burden in these cases[12]. The primary source of investment in this case is the natural rent obtained from primary commodity exports. This is proportionate to the difference between the world market price and the domestic production cost of a primary commodity. Unlike the normally obtainable initial capital for industrialization in over-populated countries, the natural rent is abundant and can be easily obtained.

1.4.2 Egypt's trials and errors

The following observations can be made regarding Egypt's progress toward long-term economic development in light of the typical patterns of the sustained development of primary commodity exporting countries.

a. Under Muhammad Ali, Egypt became an exporter of primary commodities, specializing in cotton. Ali intended for Egypt to become an industrialized country based on the cotton industry, but this dream was not realized.

b. After Ali's death, the Egyptian government tried to achieve modernization with huge amounts of foreign loans by establishing irrigation systems using water from the Nile, opening the Suez canal, and constructing railroads, transportation and communications facilities.

However, failure to manage its loans made the government unable to repay its debts around 1876 and in the end Egypt lost first its sovereignty over its finances and then ended up handing over all sovereignty to a syndicate of creditors, primarily Great Britain. During the 1920s and the 1930s, private sector manufacturing, especially the textile industry, saw some growth, but not enough to achieve economic independence.

c. The Nasser government tried to attain the objectives of industrialization that had thus far not been achieved via conversion of the economy to a system very similar to the planned economy of the Soviet Union, but the goal was not achieved.

d. The Sadat government half tried to return things to the starting point with its open-door policy, replacing the policies of the Nasser era. But the attempt didn't fully succeed. With growth in oil production and Egypt's becoming a net oil exporter in the mid 1970s and because of the extremely generous economic aid given to Egypt by the United States, Egypt succumbed to the "Dutch disease" and "moral hazards."

e. The present balance of payments crisis and significant resource allocation distortions are the short- and medium-term outcomes of the events described above, especially under (c) and (d). More basic challenges from the long-term perspective, however, can be shown by reassessing existing main economic policies in the light of the typical course to sustained development of primary commodity exporting countries.

In the following subsections, we attempt a reassessment of existing policies in specific phases of agriculture and industry.

1.4.3 The collapse of the agricultural accumulation model

First, we should note that both the pattern of capital accumulation from agriculture seen in the typical model of the primary commodity exporting country and the pattern of structural transition in the trade of agricultural products have collapsed, leading to inefficiencies from the long-term perspective.

According to the typical model, when a high level of natural rent generated by major primary commodities is suitably obtained and distributed, possibilities for industrialization are increased. These conditions applied to cotton at least until the 1960s. The proportion of cotton exports to total exports was 60% to 70% in the 1880s, and set a record at 85% in 1955. Taking the ratio of the difference between the CIF price and the domestic purchase price of cotton to the CIF price as an approximation of its natural rent, it varied in the range from 30% to 60% from 1971 to 1984, tending generally to rise. Although we must take into account the fact that, as we said above, procurement prices are controlled by the state, a high level of natural rent seemed to be produced while cotton exports were maintained at high levels. Cotton's share of exports fell, however, from 45% in 1970 to 7% in 1983/84.

Egypt's natural conditions are suited to the cultivation of cotton, but agriculture has been subject to severe limitations on arable land. The expansion of farmland ended around 1900, and the increase in cultivation since then has been dependent on investments in irrigation. On the other hand, however, Egyptian cotton has a comparative advantage because of its high-quality long fibers. The drop in its production and export to present levels is undoubtedly due to policy failure and to planners' having overlooked the historical role of cotton in capital accumulation. Nor were efforts made, for the same reasons, to replace cotton with any other primary export commodities to effect the "switching" mentioned earlier.

The decline of cotton production is important also in connection with food imports. Egypt originally had food surpluses to export, but it turned into a net food importer as a result of increased cotton exports. This by itself is not necessarily a cause of concern. Indeed, it can be a positive step toward achieving a better international division of labor based on comparative advantage. The problem is, however, continuous increases in food imports making Egypt dependent on imports for 60% of its domestic food consumption in the 1980s, when cotton exports dropped sharply. For these reasons, the total agricultural trade balance which ran an annual average surplus of 120 million Egyptian pounds for seven years from 1967 to 1973 turned into a 350 million pound annual average deficit from 1980 to 1986. This structural transition in agricultural production can be efficient if industrialization makes progress, as it did in Taiwan and Korea, offsetting huge net food imports by net industrial exports. This is not the case in Egypt, however, and failure of policy is again inevitably the cause of the total agricultural trade deficit.

1.4.4 Expectations for industrialization and industrial exports

Second, in the field of industry, we must state from the beginning that lack of information is a handicap and we cannot precisely identify problems from the long-term viewpoint.

Roughly speaking, as Egypt has developed so slowly from producer and exporter of primary commodities to exporter of industrial goods, it *is uncertain to what extent the statistically observed increase in industrial* production and exports from around 1987 or 1988 constitutes a lasting trend. Nevertheless, in the light of possible long-term stagnation of oil production and invisible trade revenues, the growth of export industries can be said now to constitute an increasingly important element tending to stabilize Egypt's current account balance. Another basic challenge for industry is whether it will be able to absorb much of the population newly arrived on the labor market that is aggravating the situation of existing excessive latent unemployment and overemployment in the cities. We will cover this issue in a later section. To a certain extent, an idea of the progress achieved in industrialization and the growth of industrial exports can be obtained using the World Bank's international comparative statistics. Using 1989 data, we can compare Egypt with India and China, both of which have the same sort of institutional structures and comparable per capita incomes. (Egypt's is \$640, India's is \$340, and China's \$350.) The percentage of the GDP produced by secondary industry (30%) and its percentage of manufacturing industry (14%) are less than China's (48% and 34%) but very close to India's (29% and 18%). But Egypt's manufacturing exports are far less favorable than those in China and India. (Egypt's, India's, and China's ratios of exports as a percentage of GDP are respectively 8.1%, 6.6%, and 12.6%, but manufacturing industry's share of total export values are respectively 35%, 73%, and 70%.) Textiles' part of total export value is almost the same for all three (27%, 23%, and 25%), but machinery and transport equipment accounted for 7% of both China's and India's total exports, while Egypt exported none.

If we wanted to analyze Egypt's industry in further detail, we would have to either acquire statistical data or make estimates of successive years for each industry and each group classified by employment and/or capital. The same is true of imports and exports. Information is also needed about the level of technology and skills, equipment, and production, quality control, and work control. But being unable to obtain these data, we have no choice but to conduct a further study on some future occasion.

Table 1.1 (p. 14) shows that in value terms, four major industries accounted for considerably large shares of industrial and mining production in 1987/88. Textiles and foodstuffs are of course major Egyptian industries traditionally and constitute core export industries. Chemicals and engineering and metallurgical have been given priority in investment allocations under the national economic planning since the Nasser era. From Table 2.1 (p. 60) found later in this report, it is clear that these industries are still expected to account for similarly high percentages of the total industrial and mining production in 1991/92.

Interviews conducted in Egypt and Tokyo indicate that these sectors include a considerable number of large enterprises, and that because they lack supporting companies they are therefore built to be vertically integrated plants, producing all parts and materials themselves, in-house. But there are some productive companies in areas such as steel and textiles. The automaker GM Egypt has said that its local content could not exceed 40%, despite admonitions from the Investment Authority to raise the minimum to 60%, indicating the insufficient technological level of supporting companies. (By contrast, in India, a joint venture called Multi-Suzuki, which we visited in February 1992, has local content of 93%, albeit in a situation where car imports are prohibited.)

Judging from an interview study, Egypt's industry has a dual structure with only big and small enterprises, but nothing in between. (This is similar to the Japanese situation prior to the early Taisho era.) From the standpoint of absorbing surplus labor, it is important to examine small enterprises' potential. A study must be conducted and include the situation of rural industries in this regard.

The admission of domestic-foreign joint ventures under the open-door policy definitely appears to be opening up new possibilities. However, the most active introduction of foreign capital has taken the form of the establishment of banking joint ventures, and joint ventures in manufacturing appear still to be sporadic. Another essential tool of liberalization is the establishment of specially circumscribed free zones to provide incentive for direct foreign investment by manufacturing companies. However, this opportunity has rarely been used, except by warehousers. The free zone in Port Said is said to have become a consumer goods import base directed at the Egyptian consumer market(13).

1.4.5 The necessity of industrial policy

The lack of information that we are facing in our analysis of the industrial sector is due, it seems, to the fact that the international organizations and the main donor countries such as the United States, which are in a good position to obtain data from the Egyptian government, are normally not very concerned with industrial structural policy in recipient countries and do not show much interest in obtaining specific data about the above-described types of problems. Those who place their faith in price mechanisms believe that a desirable industrial structure will arise automatically once a market economy is rebuilt. Because this is an issue affecting our every step from investigation of bottlenecks impeding development to the formulation of development scenarios, development strategies and aid strategies, we believe it is appropriate to address this question here, albeit momentarily, including consideration of a new approach to industrial policy that has emerged recently from the World Bank's work.

Industrial policy has many facets, but in general industrial policy can be defined in the case of developing countries as having as its objective to promote industrialization, an important pillar of economic development, at the most rapid pace and in the most appropriate forms possible. Macroeconomic policy, trade policy, fiscal policy, and monetary policy are among the tools at its disposal, and the level of intervention varies from the entire economy down to individual sectors (industrial finance, technology, "incentive reform" and other functional reforms), sub-sectors (individual industries), and the corporate level.

The approach traditionally adopted by the World Bank and IMF since the 1960s has been the implementation mainly of macroeconomic policy at the whole-economy level whenever an industrial policy can be justified convincingly. It is also necessary for industrial policy to be neutral with respect to specific sub-sectors and enterprises when other methods were used at the sector level. According to this approach, it is unjustified to single out priority industries, as Japan, Korea, and Taiwan have done, for selective financing and other methods with the aim of achieving discriminatory development. The approach was the same, even when a structural adjustment program set forth as its task to correct a distorted industrial structure, and the World Bank's first structural adjustment program evaluation report in 1988 was critical of countries that sought to achieve their objectives by taking steps at the sub-sector level(14).

This approach by the World Bank and the IMF is clearly based on the neoclassical school's economic policy. According to this theory, industrial policy implemented at the whole-economy and sector levels serves to offset and eliminate the effects of market failures when they occur due to externality, public utilities, or imperfect competition. Such an industrial policy forms an organic structural component of the IMF's and the World Bank's structural adjustment programs. According to them, if these are properly carried out, the resulting application of market mechanisms should correct and reshape into its ideal form any industrial structure, no matter how distorted, without any need for a government ever to intervene directly to restructure its industry.

Given the present underdeveloped state of developing countries' market economies, and that it takes a long time in many cases to achieve their objectives, no matter how successful the structural adjustment policies you use may be, there remain certain problems requiring examination in connection with these approaches. For the past several years, especially recently, the World Bank itself has begun to show remarkable flexibility in its interpretation of industrial policy(15). Coinciding with this change, the World Bank has begun to show a new approach that amends its previous severe (neoclassical school) stand on the question of government intervention in the market(16).

Its new view on industrial policy is that it is justifiable, as the second best measure, to adopt an industrial policy that selects certain industries and takes action at the sub-sector level to give them special support, only if it is almost impossible to isolate problems in trade, budgeting, finance and so on, or if remedial measures cannot be taken, or if market failure is observed only in specific industries due to externalities or other causes. In the final analysis, this is a revival of the "infant industry" argument. There is, however, the following difference. It is constantly stressed in the process of their discussions that industrial policy must never prevent movement to strengthen competition and market forces in the economy overall but should be regarded instead as a step to actively promoting and strengthening them.

The problems resulting from actually implementing a selective industrial policy are also being discussed, including cases where the wrong infant industries were chosen (for example, in the Philippines, Thailand, and Indonesia). What is principally suggested is that the presence or absence of required institutional and personnel skills to formulate and carry out adequate policies has decisive importance at this juncture. From this point of view, it must be said that choices of an appropriate industrial policy are likely to be dependent on the government's abilities. The World Bank's report states that, at the initial lower stages of industrialization, it may be more appropriate in industrial policy to regard all industries as fledgling and protect them accordingly, rather than to single out certain priority industries, because of the government's low level of ability. As industry develops and the government's administrative ability improves — say, to the ASEAN level —, a more selective approach toward determined industries is necessary to provide incentive and protection. Once a country has reached Korea's stage, the sub-sector approach should be abandoned and a shift should be made to functional support, especially via technological improvement.

The new approach of the World Bank regarding the issue of government intervention into the market is summarized by the term "market friendly approach." In the past, the World Bank did not approve of government intervention into the market except in cases of market failure. The new view is that intervention can be condoned provided that it improves the condition of an underdeveloped market economy and that it strengthens market mechanisms. This is equivalent to adding a new clause to provide for "under development of a market economy" as a case of market failure, along with externality, public utilities and others. Obviously, the use of the "market friendly approach" means a shift in thinking at the more fundamental level, including a new industrial approach.

The fact that the World Bank has adopted this new approach is an especially welcome development for the evolution of Japanese aid policy. Japan has long stressed, based on its own post-World War II development experience, the rightness of an industrial policy at the sub-sector level. We, of course, understand the importance of industrial policy at the macroeconomic and sector levels, but economic policy at the sub-sector level is no less important. Especially in a country where strong state control has molded industrial structure through central planning, industrial structure (because the market is simultaneously underdeveloped and unlikely to evolve overnight) tends to develop gradually in the direction of light industry, and small-scale enterprises, and to duplicate investments in the same industry when authority is vested in companies and local governments with the means of former state control such as decisions on investment projects, use of financial investment funds, bank loans and foreign currency allotments. China's experience shows this. If, on the other hand, today's developing countries were to attempt to carry out industrial policy at the sub-sector level and found their government's lack of administrative ability an obstacle, Japan both should and very feasibly could supply through technical aid what developing countries lack in that area.

1.4.6 The critical labor structure

Under the impact of the internal and external policies of the Sadat era, the most serious long-term challenge to development is finding employment opportunities for the rapidly growing labor force. The most reliable figures on the labor force and employment are found in the 1986 census, according to which open unemployment is an unprecedented 2 million (14.7%) out of a labor force of 13.7 million. More important, however, are the existence of huge latent unemployment and that the social and economic mechanisms which formerly absorbed the redundant labor force, preventing them from appearing as open unemployment, no longer function.

In Egypt before Sadat, agriculture had already lost marginal land, but thanks to expanded irrigation and land redistribution it was possible for agriculture to absorb additional labor. The government and the public sector absorbed the largest part of the labor force in Egypt's cities. This situation was sustained by the law of 1964, by which the Government guaranteed employment to all graduates of institutions of higher education. Open unemployment was maintained at 2.3% of the labor force. During the oil boom of the 1970s, the "Dutch disease" caused employment to stagnate in productive sectors (excluding construction but including agriculture). However, according to recent, more accurate estimates, Egyptians working in the neighboring gulf oil producing countries swelled to 2 million, and when the domestic construction boom also increased labor demand, the Egyptian economy on the whole suffered a labor shortage.

After 1982 and especially since the Gulf War, the number of Egyptians returning from abroad has greatly exceeded the number of emigrants. Inside Egypt, the government and public sectors, because of their overemployment, are unable to absorb further labor force and the past policy of guaranteed employment has been practically suspended. The possibility for further labor absorption exists only in the non-farming private sector, which for the most part can be considered equivalent to the "informal sector." Compared to census data of 1976, data for 1986 show that 60% of the labor force increase of 1.5 million over this period have entered this non-agricultural private sector. Contrastingly, the agricultural labor force has shrunken by numbers equivalent to 22% of the labor force increase. During this period, the government and public sector's employment exceeded 1 million, 69% of the total. The increase in mining and heavy industry during the same inter-census period was a mere 125,000, with an average annual increase of 0.8%(17). Available statistics on wage disparities in cities show that the private sector has the highest average wage followed by the public sector and the government in that order — an unusual situation for a developing country. This of course reflects the fact that the real rates of remuneration, which regulate demand and supply of labor, differ from one sector to another. The only way left to correct this is to deregulate labor mobility, but in the present situation this would greatly increase open unemployment.

Notes:

(1) Clark, G. Paul. "Step by Step Liberalization of a Controlled Economy: Experience in Egypt." In Economic Structure and Performance, edited by Syrguin M., Taylor L., & Westphal L.E., Academic Press, Orlando, Florida, 1984.

(2) Shimizu, Manabu. "Mubarakutaiseino seijikeizaigaku" (The Politics and Economics of the Mubarak Regime), Gendai no Chuutou, Ajia Keizai Kenkyuujo, No.3, 1987, p.3.

(3) Sekine, Eiichi. "Kougyouka to Gaikokuboueki" (Industrialization and Foreign Trade). Suzuki Hiroaki, (editor), Monkokaihouka no Ejiputokeizai (Egypt's Economy Under Open-Door Policy), Ajia Keizai Kenkyuujo, 1991, p. 79.

(4) Shimizu, op. cit.

(5) Suzuki, Hiroaki. Ejiputoginkoushi, sono 1 (Egyptian Bank History, Part I), Ajia Keizai Kenkyuujo internal document, August 1969.

(6) Shimizu, op. cit.

(7) Egypt, Ministry of Agriculture and USAID. Egypt: Strategies for Accelerating Agricultural Development. A Report of the Presidential Mission on Agricultural Development in Egypt, July 1982.

(8) World Bank. Arab Republic of Egypt: Current Economic Situation and Economic Reform Program, October 22, 1986.

(9) World Bank. Egypt: Alleviating Poverty During Structural Adjustment, 1991.

(10) Ibid, p. 222.

(11) Hla Myint, translated by Watanabe Toshio et al. Teikaihatsukoku no keizairiron (The Economics of Underdeveloped Nations), Touyoukeizai

Shinpousha, Chapter 5.

(12) For a study of the process of industrialization in a country that exports primary commodities, see Chapter 8 of Shigeru Ishikawa's Kaihatsukeizaigaku no kihonmondai (Basic Issues of Development Economics), Iwanami Shoten, 1990. Examples of successful industrialization by the second method include Thailand, which mainly replaced imports by providing incentives to direct foreign investment, and Malaysia, through international subcontracting.

(13) Shimizu, op. cit., pp 12-13.

(14) World Bank. Country Economics Department. Report on Adjustment Lending, December 1988, pp.77-78.

(15) Amarendra Bhattacharya and Johannes F. Linn. Trade and Industrial Policies in the Developing Countries of East Asia, World Bank discussion papers, 1988.

(16) World Bank. World Development Report, 1990.

(17) World Bank. Egypt: Alleviating Poverty During Structural Adjustment, 1991, p.176.

2. Development scenarios and strategies

The step that follows the study of development issues is the formulation of development scenarios. Drafting a scenario means describing the hoped-for situation of the economy in a given future target year and clarifying the main economic processes that must take place in order to advance from the present situation to that goal. Because of the uncertainties surrounding future values of the main internal and external variables, it is desirable to have multiple alternative scenarios. Choosing from among the available scenarios is one of the main decisions at the next step, the formulation of development strategies.

For the reasons stated at the beginning, however, our data and materials are insufficient to draft our own alternative scenarios for Egypt and then, on that basis, to make development strategy choices. We must therefore abandon the idea of formulating development scenarios and strategies according to the above-described method. Instead, we have adopted the following method: first, we accept as given the development scenarios that the IMF, the World Bank, and other multilateral agencies and the Egyptian government itself have used and the strategies they have formulated (through dialogue with the Egyptian government), deciding in some cases to accept or reject them as necessary for our purposes; then we comment on them as much as possible.

However, even when IMF and World Bank have drafted alternatives, in most cases only the relatively most efficient and feasible scenarios are announced. These scenarios correspond, furthermore, to selected and agreed upon development strategies. In this section, we proceed in the following order: first we describe the development strategies agreed upon by multilateral agencies and the Egyptian government, then we address the government forecast made when the strategy was adopted. This description of scenarios and strategies is divided into two levels: short-term and medium-term. We were not able to use the same method for long-term development scenarios and strategies and have used other methods for later examination.

2.1 Agreements with the IMF and the World Bank

Given the rather irregular order in which we proceed, we shall start from the development strategy jointly agreed upon on the basis of a series of loan and financing agreements between the Egyptian government, the IMF, and the World Bank made between the beginning and the summer of 1991, namely the Economic Reform and Structural Adjustment Program (ERSAP) as named by the World Bank, for our short- and medium-term consideration.

Agreement was reached on three points:

a. First, the IMF standby agreement of 278 million SDR (during the period from April 1, 1991 to September 30, 1992.) approved at the IMF directors' meeting of May 17, 1991.

b. Second, a $300 million World Bank(IBRD) structural adjustment loan to Egypt, with a maturity period of 20 years and a grace period of 2 years, at a floating interest rate that is currently 7.75%. This was approved June 21, 1991. $300 million in co-financing is to be provided by the African Development Bank and $79 million by the EEC.

c. Third, the World Bank (IDA) financing of $140 million for the "Social Fund for Development" (SFD) was approved in March 1991. (It is hoped that the fund will reach $500 million, including co-financing by major donor countries.)

The discussions of development strategy that preceded these agreements beginning in the summer of 1989 referred to the stabilization and structural adjustment programs forming the de facto basis for the conditionalities for financing and loans. These discussions were tantamount to reopened talks on the May 1987 IMF standby agreement for Egypt (250 million SDR, on which basis large-scale rescheduling of private-sector debt also took place), which had been broken off in November 1988. The development strategy discussion behind the 1987 agreement was held between the Egyptian Government, the IMF and the World Bank beginning in 1986 and led to an agreement on a comprehensive macroeconomic plan. Its elements were incorporated into the Egyptian government's second five-year plan (1986/87-1990/91).

Three further agreements are connected with the three agreements mentioned above.

d. Fourth, Egypt's debt to the United States for $6.6 billion in foreign military sales (FMS) was written off in November 1990.

e. Fifth, the Paris Club of Egypt's creditors agreed in May 1991 to reduce Egypt's official foreign debt of about $21 billion (of which $2.5 billion was owed to Japan) by 50% (by 15% on and after July 1, 1991, by 15% again on and after January 1, 1993, and by 20% on and after July 1, 1994).

f. Sixth, at the Consultative Group (CG) meeting held in July 1991 it was agreed to give Egypt an average annual aid flow of $4 billion over the next two fiscal years to support the Egyptian government's reforms.

2.1.1 Organic links among stabilization, structural adjustment, and the social safety net programs

The first three of the above-mentioned agreements originated, of course, from requests to the IMF and the World Bank for aid from the Egyptian government to overcome its debt repayment, balance of payments and inflation crises (mentioned in section 1.2 on short-term development issues). Specifically, the aid given to Egypt by the IMF and World Bank was provided on a quick-disbursement basis in foreign currency to help equilibriate Egypt's balance of payments, with the condition that Egypt revise its policies and institutions.

Some comment is required on the fact that the first, second and third agreements above (a, b and c) are stressed as conductable as a mutually interdependent whole. Formerly, stabilization was the exclusive province of the IMF and structural adjustment was that of the World Bank. The close ties between these problems, however, forced both institutions to intrude in each other's territory, but their views and methods did not always fully coincide. Great progress was made from about 1986, however, when the IMF inaugurated its new Structural Adjustment Facility (SAF) for low-income countries with balance of payments difficulties, and the IMF and the World Bank conducted a joint study of certain countries' requests for aid to overcome their balance of payments crises, preparing joint papers to be submitted to the directors of the two organizations. They did this in the end because they had found that their previous stabilization policies, even when they succeeded, often had to be paid for at high cost by markedly lower growth rates. Using this new method from 1986 on, Egypt's requests to the IMF and the World Bank have been processed jointly by the two organizations. This is also why such policy papers are called "ERSAP" by the World Bank.

The above paragraph explains the ties between stabilization and structural adjustment. The third agreement, the Social Fund for Development, and its integration with the first and second measures also constitutes an extremely novel approach. Attempts were made via these agreements to provide a short-term social safety net, given awareness that special factors also affect Egypt's case — such as the return of migrant workers home because of the Gulf War — and that existing social welfare programs could not lessen the impact of growing unemployment and the sinking of the real incomes of the low-income bracket caused by the severe stabilization and structural adjustment programs.

The agreements above (d, e, and f) stem from a new trend affecting international rules for helping debt-ridden countries to overcome their debt crises. The old rule was that, after establishment of an IMF standby agreement, debt would be rescheduled through Paris Club or commercial bank syndicate negotiations. In response to U.S. Treasury Secretary Brady's proposal of a "new debt strategy" in August 1989 and the Toronto scheme, a new approach has been added where the establishment of an agreement with the IMF and the World Bank is followed by partial cancellation of the consolidated amount and alleviation of interest payments.

2.2 The short- and medium-term development strategies chosen

2.2.1 The goals and vision of the Economic Reform and Structural Adjustment Program (ERSAP)

According to World Bank sources, the ultimate objectives of ERSAP are sustainable economic growth and improved standards of living. Emphasis is laid on three policy areas:

a. Stabilization aimed at restoration of macroeconomic balance and creditworthiness, and controlling inflation.

b. Structural adjustments to promote efficient resource mobilization and allocation.

c. Modification of existing social policies to minimize the adverse effects of economic policies on the poorer segments of the population.

Needless to say, these three items are handled by the first three agreements, namely (a), (b), and (c), mentioned earlier. The IMF's sources consolidate the objectives in these three areas as a new policy vision integrated as follows:

The highest objectives of the Egyptian government are, in the medium term, to create a decentralized, market-based, outward-looking economy that will make possible growth without inflation and the restoration of Egypt's creditworthiness. The characteristics of the economy sought for are a private sector that operates and grows rapidly in a free, competitive and stable environment while the public sector reduces its scale and operates in the same environment and under the same rules as the private sector without government intervention. To this end, control of economic activities is abolished, allowing them to rely on market forces for resource allocation and on the private sector for growth and income and job creation. Thus far, all consumers have been beneficiaries of subsidies, but the scope of subsidies should be reduced and given only to the truly needy.

The stabilization and structural adjustment program intended to achieve this medium-term vision is both ambitious and extremely severe.

2.2.2 Stabilization program

Under traditional IMF methods, any stabilization program involves a combination of control over aggregate demand using fiscal and monetary policy and control over real exchange rates using foreign exchange policy. With the ERSAP, however, these objectives overlap with those of structural adjustment, namely scaling-down of the public sector and expansion of the private sector.

2.2.2.1 Fiscal policy

Egypt's fiscal expenditures are huge, in the vicinity of 50% of its GDP, as we have seen. The fiscal deficit, which is covered by borrowing at home and abroad, is nearly 22% of GDP in the fiscal 1991 budget. The core of the stabilization program is focused on drastic budget adjustments. To cut expenditures, spending on public investment will be reduced to 8% of GDP by fiscal year 1995 from 15% in fiscal 1990. Revenue measures include the introduction of a comprehensive sales tax and the raising of domestic energy prices. As a result, the public sector deficit requiring loans will be reduced from 22% of GDP to less than 6.5% in 1993 and to 3.5% in 1995.

2.2.2.2 Exchange rate policy

The foreign exchange market has been an extremely complicated one since the Sadat era: because priority was given to imports for the public sector, the exchange rate was set higher against the dollar than a competitive market could justify, and second and third exchange rates existed for Egypt's main sources of foreign exchange — exports, emigrant workers' remittances home, and tourism — in addition to the black market rate. It was decided first to institute a dual exchange system with a primary and a secondary (free) market as of February 1991, as a one-year transitional measure with the ultimate goal of unifying and liberilzing the foreign exchange market by February 1992. The foreign exchange transactions based on the free market involve mainly emigrant workers' remittances home and tourism. Foreign exchange payments for certain international transactions are to be permitted without restrictions. Foreign exchange needs of public and private sectors will also be allowed to be fulfilled through the free market when they cannot be fulfilled through the primary market. The foreign exchange markets were unified in October 1991, ahead of the original schedule.

2.2.2.3 Monetary policy

Until early 1991, the Egyptian money market had a ceiling imposed on all interest rates that effectively made real interest rates negative, and credit rationing was in force. Several financial institutions were insolvent due mainly to huge foreign exchange losses, and supervisory and regulatory mechanisms were weak. The government then removed all interest rate ceilings, removing all credit rationing systems, and implemented specific domestic credit expansion ceilings to eliminate any direct credit line between the Central Bank of Egypt and the Central Government. These measures are more in the nature of monetary reform and, of course, contribute eventually to stable development.

2.2.3 Structural adjustment programs

A broad range is covered by the structural adjustment programs designed to abolish systems of central control and to introduce market-based competitive systems and policies, and they can be summarized as follows.

a. Foreign trade policy

By mid-1993, almost all non-tariff barriers to foreign trade will be lifted. Egypt's high import tariffs will be lowered and the gap between the lowest and the highest tariffs will be narrowed. Export duties will be abolished.

b. Public enterprise reform

One of the steps toward public enterprise reform is the privatization program announced by President Mubarak in May 1990. This includes the divestiture of public sector equity worth 2.6 billion Egyptian pounds in about 240 joint ventures and the sale of more than 2,000 smaller enterprises owned by local governments.

In the medium term, however, the public enterprises that remain will still be of considerable size and strategic importance. The new, governmental public-enterprise control structures consisting of the Public Investment Office, holding companies, and affiliated companies will be set up to manage the remaining public companies more effectively.

The Public Investment Office will perform only the role of shareholder for joint stockholding enterprises. Under the new system, they will no longer be subject to the controls from supervisory ministries that applied in the past.

Holding companies will approve the business plans of affiliated companies and supervise their execution. They will also decide on the reform of unproductive affiliated companies, on the sale of their stock, and on their liquidation. They will assume responsibility for their own business results based mainly on capital returns. Public companies will be transformed into affiliated companies (two-thirds by the end of June 1992, and the remaining one-third by the end of December 1992). Their purpose is to seek maximization of profit, exactly like public companies. From the beginning of 1991 they have been given autonomy in decision making on product pricing, foreign exchange procurement, employment and wages, and marketing. Budgetary investment financing for public companies has already been abolished in the 1990/91 budget. From now on, it will be absolutely forbidden to give subsidies to affiliated companies, which will rely solely on capital markets for loans.

c. Investment licensing for the private sector

In the May 1991 revision, the investment licensing requirements were limited to a small number of economic activities in a negative list. In a few years, the number of items on this list are to be further diminished, leaving only activities concerning national security, environmental protection, health and sanitation, or religion.

d. Production and price controls on manufactured goods

By mid 1990, 40% of all industrial production, and by the mid 1990s, all industrial goods will be sold on free markets. Energy prices and shipping rates will be raised to cover marginal costs at about 80% of economically operable levels.

e. Crop area and price controls in agriculture

Since the mid 1980s, the government has been relaxing its control on crop area determinations and the pricing and marketing of agricultural products. Deregulation has already been completed for most crops. Rice delivery quotas were completely abolished in 1991. The procurement price for raw cotton was 60% of the international price in 1991/92, but this will be raised in three to five years to approximately the international price. Subsidies on animal feed, fertilizer, and pesticides have been reduced. By 1992/93, subsidies on certain inputs will be totally abolished.

2.2.4 Social policy: the Social Fund for Development (SFD)

The implementation of such a rigorous program of stabilization and structural adjustment is likely to bring about severe unemployment, at least momentarily, especially when the reflux of workers due to the Gulf War is taken into account, and further lower the real incomes of the poor. The ERSAP approach is that Egypt's social welfare programs lack systematic means to deal with these problems (especially the ability to help the poorest segment of the population), and when budget expenditures are being reduced, the scale and quality of social services of all kinds, food subsidies, and social security will all decline, making existing social welfare programs unable to cope with the new situation. (The reforms of social welfare programs remain to be solved by the structural adjustment plan at some future date.) To deal with this facet, a series of emergency programs must be put in place to provide short-term safety nets for the groups that have been hardest hit by the Gulf Crisis and structural adjustment.

The Social Fund for Development that oversees these programs was inaugurated in January 1991. Under it, six core programs are to be operational:

a. Many labor-intensive public works projects will be started at the local level to improve social services through the construction and restoration of water supply, sewerage systems and roads and the maintenance of irrigation canals and buildings.

b. Public transport services will be improved to promote labor mobility.

c. Community development programs will improve, through local community participation, primary health care, immunization programs, maternal nutrition enhancement programs and child health care centers, and implement short-term literacy and practical training programs and a variety of productive self-help activities, aimed at relieving the plight of the poor.

d. Enterprise development programs will promote the establishment of small enterprises by employing returnees from the Gulf, the development of productive activities for the unemployed, and the expansion and improvement of existing micro-enterprises (which number in the millions) by providing technical assistance, training, and credit.

e. Labor mobility promotion programs will assist workers who will lose their jobs due to public enterprise reform to find new jobs.

f. Institutional development programs involve technical assistance, studies, and research to improve systems for targeting, monitoring and evaluation under SFD as the first step toward aiding the government's efforts to rationalize its social welfare programs.

These programs seek to ease the shocks of stabilization and structural adjustment by assisting beneficiaries in their own efforts to increase their income and create jobs, rather than by customary social policy means.

2.3 Medium-term growth scenarios

The medium-term vision of the ERSAP described at the beginning of the previous section will be realized by implementing these stabilization, structural adjustment and social policies. But what sort of changes in the economy are expected to take place, beginning with ERSAP implementation and leading to attainment of the medium-term vision? The steps to take at the systems level to effect the transition from a controlled economy to a market economy have been explained already in describing the ERSAP itself. Here, we will state the main points in the scenario described as feasible in related documents concerning economic growth.

2.3.1 The real GDP growth rate, which was negative (-0.5) in 1989/90, will fall even further in 1991/92, and then by 1995/96 will recover to 3.3% as shown in Fig. 1-3 (p. 11). It is not until the late 1990s that the real GDP growth rate will reach 4% to 4.5%, which is considerably above the estimated population growth rate. The initial decline in the economic growth rate is due to the stringent curbs placed on aggregate demand by the ERSAP, in addition to the growth inhibiting factors that were active until 1989/90. The recovery thereafter will be due to the effects of the respective areas of the structural adjustment measures.

2.3.2 The liberalization of prices in the first year of structural adjustments will aggravate inflation (the rise in consumer prices will exceed 30%). But normalization will occur more rapidly than the growth rate recovery and by 1995/96 it will subside to the 5% level.

2.3.3 The current account deficit will shrink from 12% of GDP in 1990/91 to 9% in 1992/93 due to curbing of aggregate demand and demand switching. As non-petroleum exports and services (especially revenues from tourism) pick up and emigrant workers' remittances home begin to increase, the deficit will further decline to about 7% in 1995/96.

2.3.4 Behind the improvement in the above basic macroeconomic indicators are striking improvements in savings and investment data. The gross national savings rate will rise from 9% of GNP in 1990/91 and 1991/92 to 17% in 1995/96, due to fiscal reform, increased emigrant workers' remittances home and direct foreign investment. An increase in private sector investment will raise the investment rate from 20% of GNP in 1990/91 to 25% in 1995/96.

2.3.5 The budget deficit will be reduced from 20.9% of the GDP in 1990/91 to 3.5% in 1995/96.

2.3.6 Despite this macroeconomic improvement, Egypt's debt repayment requirements will average $5.5 billion annually between 1991 and 1994 and will rise to $6 billion after 1995. Despite many promises of international financial support, to continue to pay back its debt, Egypt will have to find additional financing of between $900 million and $3 billion a year from 1992 until the end of the 1990s. Until it is sure to have that support, Egypt must continue to make strenuous efforts to reestablish its finances.

2.4 Problems concerning Egypt's short- and medium-term development strategies

We cannot comment responsibly about the problems with Egypt's short- and medium-term strategies without doing our own research using primary data, nonetheless we can attempt an evaluation using international comparisons.

2.4.1 Comparison with reforms in India and China

First, the more serious the balance of payments situation of a country, the more severe its stabilization and structural adjustment programs must be, because there are essentially a set of conditionalities attached to IMF or World Bank structural adjustment loans.

China and India are in comparable economic situations. China has the most favorable macroeconomic situation of the three, and although China is proceeding, under the IMF's and the World Bank's advisement, with economic reform, it is neither receiving structural adjustment loans nor accepting accompanying conditionalities. At a gradual pace, it is proceeding with its own independent reform program to establish market-oriented systems and institutional reforms. From the end of 1984 to 1989, China was hit by inflation, and there was also a more transient spate of current account imbalances, but the government took administrative steps to put these dislocations in check. Stabilization itself appeared as a second generation problem with respect to the structural reform, but it did not itself trigger structural adjustment, as it did in Egypt and India.

From the end of the 1970s, especially at the beginning of the 1990s, India has had very serious balance of international payments crises and has received IMF and World Bank standby and structural adjustment loans. Especially during 1991, the aid in the form of IMF and World Bank standby and structural adjustment loans exceeded \$4.5 billion (in addition to which it received \$1.2 billion from bilateral donors and the Asian Development Bank, and the CG approved of \$6.7 billion); the conditionalities were therefore harsh. In July 1991, the Indian government substantially revised its industrial policy, one of the main control measures, reduced the number of industries where the public sector had a monopoly from 18 to 8, and abolished licensing for private companies for investment and import of inputs, thereby liberalizing market entry into a wide range of industrial sectors. Direct foreign investment was authorized in 34 areas of industry up to a 51% share of the enterprises' capital. The central government's budget deficit, which was 8.8% of GDP in 1990, was compressed to 6.5% in the new 1991/92 budget, mainly by reducing agricultural and food subsidies. But reform of public enterprises themselves, which symbolize the inefficiencies of the Indian economy, is proceeding very slowly and in general the pace of stabilization being targeted is slower than Egypt's.

The rigor of Egypt's stabilization and structural adjustment program stems, as we already saw, from depth of the roots and the seriousness of its international liquidity crisis. Symbolic of this are the objectives whose attainments are being sought between 1990/91 and 1995/96: first, drastic reduction of the total central and regional governments' budget deficits from 21% to 3.5% of GDP; second, abolition of agricultural and food subsidies, reduction of public investments, and other steps to shrink the total budget's outlays (from 51% to 42% of GDP); third, the abolition of non-tariff barriers to imports and lowering of import tariff; fourth, the privatization of most public enterprises; fifth, the abolition of licensing requirements for private company investments; and sixth, the abolition of controls on the pricing and marketing of industrial and agricultural products. Without swift, drastic action, it will be almost impossible for Egypt to overcome its international liquidity crisis and the underlying solvency crisis, but at the same time, it is a common-sense fact that much uncertainty surrounds the possibility to enforce these steps.

2.4.2 The dilemma of public enterprise reform

Our second comment is addressed to the question of the reform of public enterprises. Information is scarce on Egypt's public enterprises, but some hints can be obtained from the cases of China and India, about which more is known.

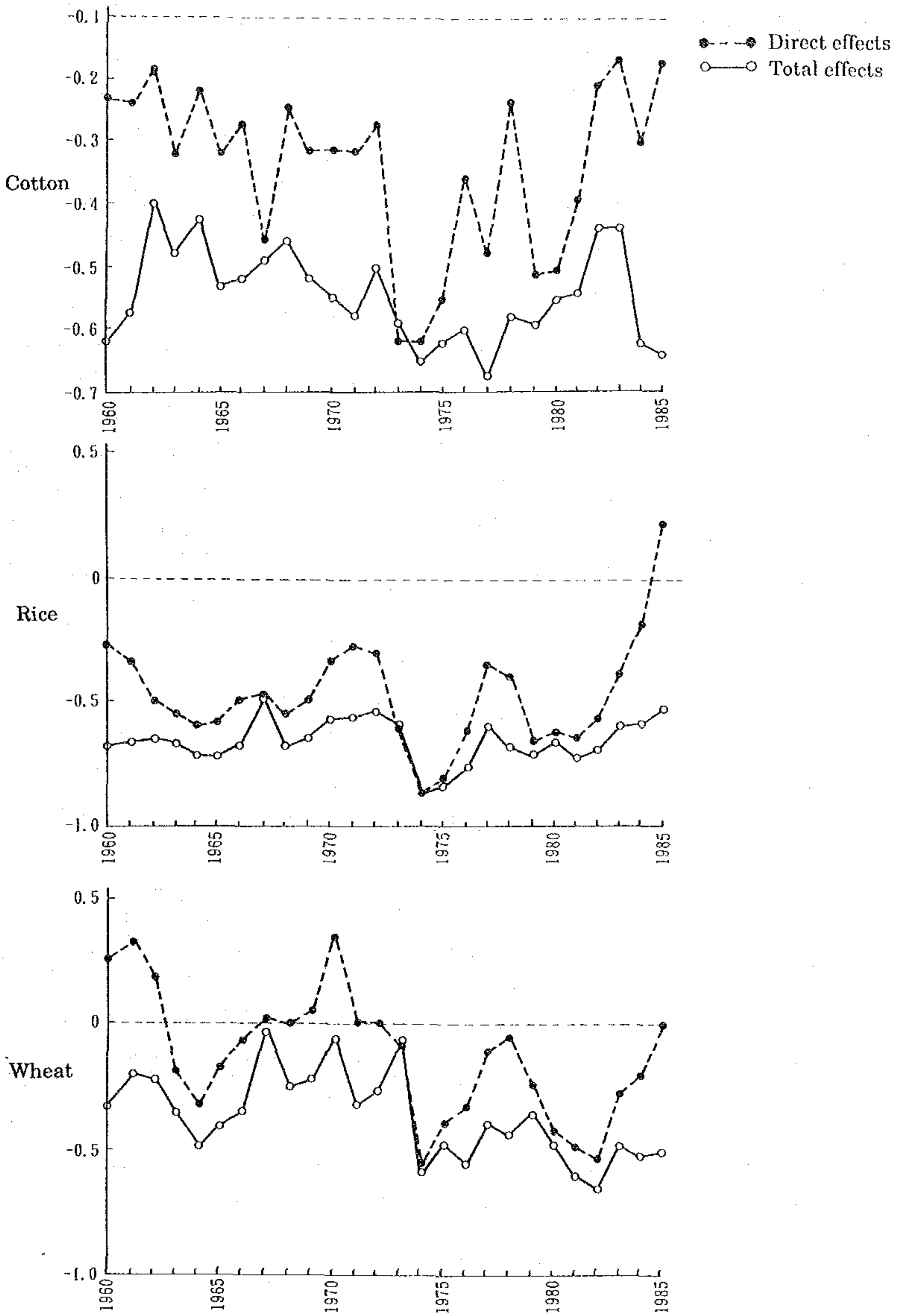
We must learn more about the inefficiency of Egypt's public sector enterprises and their causes as a precondition to formulating plans for their reform. China and India can be taken as the starting point for our investigation. The most extreme manifestation of inefficiency in these two countries is the poor financial performance of public enterprises, especially the growth of losses to the point that they affect the balance of the national budget. This problem is especially serious in India, where many industries are "sick," i.e., deficit-ridden. Public enterprises are also grossly overstuffed. The roots of the inefficiencies are numerous, none of which can be singled out for priority remedial attention. One is that employees regard affiliated companies as communities. In China, an artisan is granted the privilege of passing down the status of artisan to his children. And it seems that something similar applies to coal miners in India, for example. Supervising ministries intrude on a daily basis into company business and may ask arbitrarily for pecuniary tributes. Companies are also dependent on their supervising ministries. When their autonomy is reinforced, they do not want to take the responsibility for failures. Kornai's so-called "soft budget constraints," stem from this kind of relationship.

There is a strong possibility, even judging from the incomplete data, that these same phenomena and background factors apply to a greater or lesser degree to public enterprises in Egypt, therefore requiring further study. In discussion of public enterprise policies in today's developing countries, two approaches — either privatization, or internal reform and rationalization without privatization — are taken, and they can be regarded as complementary or selective. However, where unemployment is a serious problem and people stick deeply to communities, as in China and India, privatization is not easy. (In India, the problem is complicated by the power of the labor unions.) It takes a long time to find effective steps to rationalize public enterprises internally, especially when a variety of inefficient factors are entangled. The establishment of holding companies has been tried out in China as a way to eliminate discretionary intervention in businesses by government departments in charge, although that is nothing more than cutting into one single cause of inefficiency. A new alternative is provided in this sort of situation by fostering a private sector separately from the existing public enterprise sector and at the same time encouraging direct foreign investment to stimulate managerial and technical initiative. It is worth examining to what extent this would be a practical and effective option for Egypt.

2.4.3 Agricultural liberalization and landless farmers

Next we will address the liberalization of pricing, crop areas, and marketing of agricultural products. The question is to what extent output can be boosted and farmers' incomes can be increased by decontrol. Information on Egypt in a recent World Bank comparison of 18 countries covering the period 1975-1984 is instructive in this regard(1). The study showed that producer prices of Egypt's main crops were set considerably lower by government intervention than border prices (in the case of exports, FOB prices), just as they were in 17 other countries, and that for this reason the nominal protection rates were negative. Figure 2.1 shows values for

Figure 2.1 Nominal protection rates for cotton, rice, and wheat: direct and total intervention on producer prices



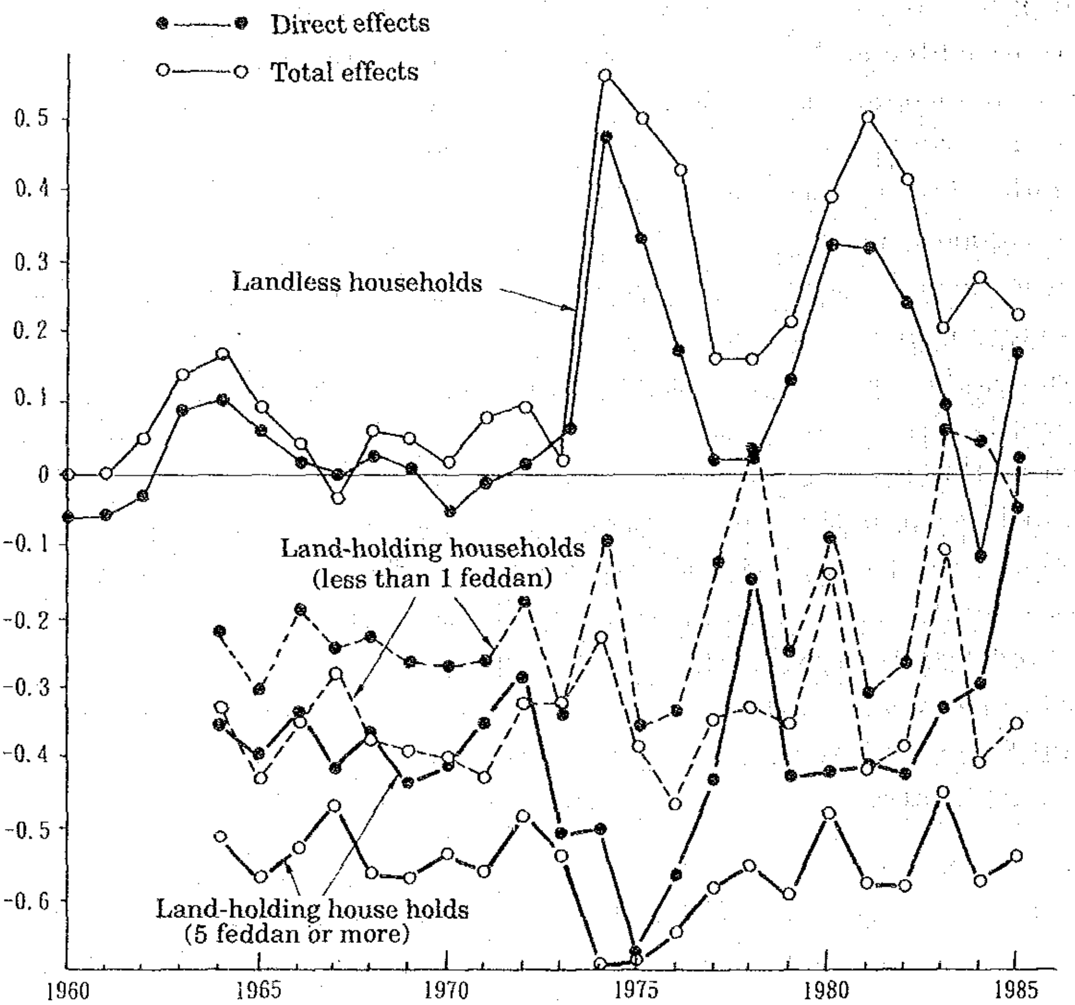
Source: Jean-Jacques Dethier. The Political Economy of Agricultural Pricing Policy: Trade, Exchange Rate, and Agricultural Pricing Policies in Egypt. Vol.II: The World Bank, Washington, D.C., 1989, pp.106-108.

three items in a time series comparison. The "direct effect" measures "the deviation of the average producer price from the border-price equivalent evaluated at the farm gate in percentage to the border-price equivalents, which are measured at the official exchange rate." The "total effect" has added to it as the "indirect effect" the impact on farmers' incentives of over-valued exchange rates, protective policies affecting industrial products and other factors. When the nominal protection rate is negative, this comparison is called "agricultural exploitation" or "agricultural taxation." This agricultural taxation is quite high for rice, wheat and especially cotton. Although deviating a little from the context, we should address here the next related subject. As we stated, we interpret the negative nominal protection rate as equivalent to the exploitation rate or the tax rate for primary commodity exports (corresponding to the natural rent) and, for primary commodity exports such as cotton seen in this report, as a normal source of capital accumulation for a country exporting raw materials. Which interpretation is correct should be decided by looking at the impact on the income of farming households. In 1974/75, the poverty line in rural villages according to the Egyptian government's definition was 270 Egyptian pounds per household(2), but as shown by the income bracket distribution for 1974/75 in Figure 2.2, this poverty line lies between those with less than 1 feddan of land (equivalent to land less peasants with income ranging from 75 to 100 Egyptian pounds) and those with from 1 to 3 feddan (with income ranging from 300 to 350 Egyptian pounds). The average income of farmers with 5 feddan or more was above 2,000 Egyptian pounds(3). This appears to corroborate the accuracy of this report's interpretation.

The effect of this agricultural price intervention on agricultural output is determined by supply elasticity to price changes and by the comparative advantage of agricultural products. In any situation where all but labor inputs are controlled, supply elasticity can only be low. But an even more decisive influence is exercised by the comparative advantages of agricultural products. In recent years, less cotton, wheat, and sugar cane and more berseem, vegetables, and fruit have been planted, as mentioned above (p.21). This is explained by the difference in comparative advantage between controlled and uncontrolled products.

Even more important, however, is the wide gap in the effects that farm price intervention is exerting on farm household incomes. Landless farmers who make up about 30% of farm households(4), landed farmers owning less than 1 feddan, and landed farmers owning 5 feddan or more are represented as different income brackets in Figure 2.2, which estimates how real income would change for these three groups, with or without price interventions. The agricultural prices that affect the real incomes of landless farmers are the official prices at which commodities are distributed to consumers; on the other hand, what influences land-holding farmers are the farm-gate prices at which goods are bought from the producer. It is clear that price intervention has tended to increase the real incomes of landless farmers and increasingly to reduce those of land-holding farmers, especially those with a lot of land. At the same time, it immediately suggests that such policies as decontrol of crop area and marketing, abolition of subsidies and the introduction of market prices have quite different effects on the welfare of different sectors of the farming population. The most important problem here is of course to determine to what extent the land less farmers already below the poverty line can withstand the effects of new agricultural policies and to what extent the government's Social Fund for Development can provide an effective safety net for them. We must continue to keep these questions in mind.

Figure 2.2 Effects of agricultural pricing policies on the real income of landless and land-holding households



Note: Effects on land-holding households are taken as short-run effects. A value of 0.1 (-0.1) indicates that real incomes would have been 10% higher (lower) than their actual levels if price interventions for cotton, rice, wheat, maize and sugar had been removed and domestic prices of outputs and inputs had been equal to their border price, with the exchange rate measured at the official rate (direct effect) or at the equilibrium rate (total effect).

Source: As for Figure 2.1, pp. 137-138.

2.5 Problems impinging on Egypt's long-term development scenarios

2.5.1 Multilateral agencies' approaches to long-term development issues

Although we can depend on the IMF and World Bank sources for our study of short- and medium-term scenarios, this is not the case with long-term scenarios. IMF and World Bank sources hardly touch upon long-term development as we conceive it. The ERSAP covers, in the range of its economic projections, 1991-1995 and possibly also 1995-2000. However, these projections seek only to examine the effect on macroeconomic indicators of short-term and medium-term stabilization and structural adjustment programs; they do not address the questions from the long-term development standpoint of forecasting changes in industrial and import-export structures at the sub-sector level and exploring policy measures in order to affect desirable changes. It is no accident that IMF and World Bank materials do not allude to the sub-sector level, but rather it is an outcome of the characteristic approach of the IMF and the World Bank to industrial policy. This approach is based on the tacit belief that economic development will naturally follow from the lowest possible degree of government intervention (in other words, the market acts on industrial structure to optimize it), provided that market systems are functioning efficiently and the macroeconomic environment has been stabilized.

IMF and World Bank sources do, however, address one aspect of industrial structural problems regarding public investment. However, as their basic approach to structural adjustment policy is that public sector activity should be reduced to the minimum and everything should be left to the private sector, the position asserted in these sources is, again, that public investment programs should not intrude into areas meant for private investment. They state that steel, cement, and fertilizer projects in the public sector, which the World Bank itself has financed, should be completed as quickly as possible and stronger incentives should be given to encourage private sector participation. (It is scheduled to issue specific proposals on public investment in 1993.) Here, again, the question of industrial structure itself is not addressed.