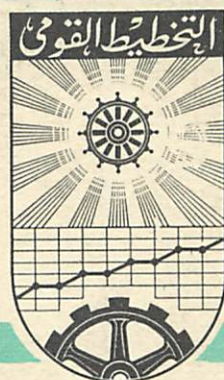


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State Budget and Long-term
Planning in the U.A.R.

by

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State Budget and Long-Term Planning
in the United Arab Republic

I. Preface

One can clearly observe that the adoption of central long-term planning and the growth of government interference in economic activities have influenced the development of the budget system in the United Arab Republic. Since the adoption of central planning and the budget is undergoing considerable changes in form and content to reflect the economic policies of the country and the financial aspects of the national plan.

Besides, the relative importance accorded the budget function and the budget role in controlling and carrying out economic activities have undermined its classical role as a tool for balancing government revenues with government expenditures. Instead, and as a result of the increasing importance of the economic role of public enterprises, the budget has become the major financial tool for controlling and executing the national central plan at a number of annual stages.

The national long-term plan is a projected course of action which includes social and economic objectives and the policies, procedures, and programs necessary for achieving these objectives; it is a decision or a set of decisions as to what to be done in order to achieve certain long-term objectives.

And, while the plan objectives are long run objectives the fulfillment of these objectives takes place on gradual annual stages. The budget plays its economic role here and attempts to establish a self balanced annual financial plan to implement the central economic plan.

Accordingly, the relation between the budget and the plan cannot be overlooked. The budget is affected by the plan and in turn affects the plan; the relation between the budget and the plan is a two way relation.

In this paper the writer surveys the way in which the budget of the United Arab Republic is used as a tool for implementing the national plan of long-term economic and social development, and as a tool for establishing annual or short-term financial plans which necessitate the revision of long-term planning objectives.

However, it must be noticed that this paper represents the actual procedures which were used by the Ministry of the Treasury of the UAR in preparing the state budget during the budget years 1965/66, 1966/67, and 1967/68. At that time the writer was given the opportunity to participate in the economic studies which were made for preparing the budget framework and structure. The most pressing problem during that years was the

inflation which resulted from the expansion in the utilization of the concept of deficit financing and foreign loans during the first five year national plan. Therefore most of the efforts of the Ministry of the Treasury were directed towards curbing inflation and bringing the UAR economy back to a state of internal as well as external equilibrium. The same problem may not be equally in existence today. Nevertheless, the budgetary tools, procedures and techniques which were used during that years are still applicable today.

II. The State Budget and the First Five Year Plan

The year 1960 witnessed the execution of the first formal five year plan of social and economic development in the United Arab Republic. The general objective aimed at in the initial preparation of that plan was to double the national income. This required a full utilization of our human and limited material resources. The surplus of labor force compelled us to seek to employ the largest possible number of workers, thereby increasing the domestic purchasing power. This policy was reflected in the budget text in the form of a considerable increase in chapter one which measures the cost of employment.

The employment of a great number of workers required a horizontal expansion in investment projects. These expansions in investment projects were reflected in the budget text in the form of a considerable increase in chapter three which measures the value of gross investment expenditures.

Besides, the Treasury took several measures to control chapter two of the budget text which reflects the government purchases of current goods and services.

During the first five year plan the responsibility of government was extended to the productive units of the economy through the public sector's general organizations. This new responsibility required the government to undertake and finance the major part of investment projects.

Accordingly, heavy reliance was placed upon the state budget as a tool for executing the national plan. The budget was able to exercise some control over the rates of expenditures of the government administration and government business sector. The government became a producer and a consumer and through increasing its expenditures on wages, investments, and purchases of current goods and services it was able to influence and direct the national economy. However, because of our limited financial resources, foreign loans and budget deficits played an important financial role. The Budget had to rely to a great extent on the Central Bank of Egypt and on credit granted by foreign governments and institutions.

III. Evaluation of the Economic Situation

The execution of the first five year plan which resulted in a great expansion in investment and employment financed by a budget deficit, and the dealings with the external world have led to internal and external imbalances in the national economy. These imbalances are crystalized in two major phenomena which are:

1. A continuous deficit in our international balance of current transactions, and our balance of payments, in general.
2. An increase in the purchasing power of individuals which is not matched with an equal increase in the available consumption goods. In other words, the money flows have exceeded the commodity flows and the apparent effect was a continuous pressure on prices which led to an average price increase of 4.5% to 8.5% of the base year (1960/1961) prices. This unexpected price increase has led to an inflationary gap.

These bottlenecks or imbalances became the subject matter of an intermediate three year financial plan. The main role of the budget was to bring the economy back to a state of internal and external equilibrium. The extent to which the budget could be used as a financial tool for executing the national plan at that time was measured by

the extent to which it can bring the economy back to a state of equilibrium.

IV. The state Budget and the Intermediate Three Year Plan

The purpose of setting up an intermediate three year plan (65/66-1967/68) was to correct the economic and social imbalances resulted from the execution of the first five year plan. These imbalances were external and internal. The budget of the state as a financial tool played an important role.

1. The State Budget and External Equilibrium

By external equilibrium we mean an equilibrium between the available foreign cash resources which are derived or obtained from visible and invisible exports, and foreign loans and credit facilities, and the utilization of these cash resources in the form of commodity imports, invisible imports, and payment of installments of foreign debts. The tool used for reaching this external equilibrium is called the foreign cash budget. The relation between the state budget and the foreign exchange budget is very strong because the state budget is affected by and, in turn, affects the status of the foreign exchange budget.

The projections of government revenues and expenditures are made according to a predetermined level of production. The revenues of the state budget such as taxes and the surplus of the government owned enterprises depend, directly or indirectly, upon the level of domestic production. The fulfillment of production targets depends upon the availability of the foreign currency required for importing raw materials and intermediate goods. And, the realization of government estimated revenues depends upon the fulfillment of production targets. Accordingly, any shortage in foreign currency would result in a shortage in production targets and a shortage in government revenues or financial resources. For that reason the foreign cash factor plays an important role in determining the level of the government budget.

The government budget also affects the foreign cash requirements. Government appropriations for investments and current consumption, and their influence on the level of private consumption determine the foreign cash requirements. This takes place in the following manner.

The government, in its attempt to provide the public with the necessary public services such as health and educational services, has to acquire certain goods and services.

Some of these goods and services are imported and the rest represent a part of domestic production which utilize imported raw material or intermediate goods. Besides, some of the goods and services which the government consumes could be exported. All of these types of government expenditures have considerably increased in the past few years to the extent that they represent now a sizable percentage of the final demand on goods and services. And, since these expenditures have a direct effect upon the requirements of foreign exchange the government budget plays a major role in determining the needs of foreign currency and achieving an external economic equilibrium.

Besides, the considerable increase in private consumption during the past few years required the government to increase the size of imports and such an increase in imports has led by necessity to an external imbalance. Accordingly, it was necessary to use budgetary policies which could limit private consumption by controlling the income available for consumption and absorbing the increase in the purchasing power of individuals. The effect of these policies on the internal equilibrium of the economy will be covered when we discuss the role of the

budget in obtaining an internal equilibrium between commodity and money flows.

Finally, it could be said that the government investments by both the government business sector and the government administration represent about 95% of total new investments. These investments place a great pressure on foreign cash requirements because any new investment consists, to a great extent, of imported equipments and intermediate goods and services. Accordingly, it is necessary for the budget to control the level of new investments.

This brief account shows how the state budget affects and is affected by the foreign cash budget. Accordingly, it became necessary for us to start our budget estimates with a realistic projection of the foreign cash resources and to plan our needs accordingly. This means that the foreign cash budget is regarded as the foundation of the state budget and the controlling factor in planning the levels of production, consumption, and investment.

Since the foreign currency situation affects most of our plans the Ministry of the treasury and the Ministry of the National Economy start the budgeting process with

a projection of the export capabilities in order to determine the size of foreign currency which could be made available for our importing needs.

Our export estimates are divided into commodity exports and invisibles. Commodity exports consist of agricultural and industrial goods. The main components of invisibles are the Suiz Canal revenues, and revenues, from tourism.

Anticipated Receipts from Exports

- | | | | |
|----------------------|---|---|----------------------|
| a) Commodity exports | — | [| Agricultural exports |
| | | — | Industrial exports |
| b) Invisibles | — | [| Suiz Canal |
| | | — | Tourism |

After the anticipated receipts are determined, a projection is made of the unavoidable foreign liabilities and invisibles which reduce the receipts available for commodity exports. The difference between the anticipated receipts and the unavoidable payments represent the estimated net cash resources. To this last figure we add the amount of foreign loans and credits which we expect to receive during the budget year. The result gives us the final balance of foreign currency available for commodity imports. This process could be shown as follows:

Resources of the Foreign Cash Budget
=====

Anticipated Receipts from exports	XXXX
less - unavoidable foreign liabilities	
	<u>X</u>
	XXX
less - Anticipated invisibles	<u>X</u>
cash balance	XX
plus - Expected loans and credits	<u>X</u>
Foreign Resources available for commodity imports	<u>XXX</u> =====

After the foreign resources are determined we turn to the utilization of these resources. The next step is to determine our needs from imports. These imports are divided as follows:

- Commodity imports required for private consumption.
- Commodity imports required for government consumption.
- Commodity imports required for investments.
- Commodity imports required for exports.

In other words, we estimate the commodity imports necessary for each component of the final demand. For that reason, we have to determine in the same time each component of the final demand taking into consideration the amount of foreign currency

available for commodity imports. Each component of the final demand consumes a given amount of foreign currency. Therefore, the determination of the optimum level of final demand and its components is a necessary step for estimating the requirements of commodity imports. When these requirements are determined we start to balance the import requirements with the resources available for commodity imports in order to reach the state of external equilibrium. The problem which always exist is that our needs of commodity imports exceed the available resources. Therefore, we have to review the planned level of final demand and its several components till we reach the state of equilibrium. In attempting to control the elements of final demand we exclude the imports requirements for exports because these exports represent one of the foreign cash resources. Therefore, any reduction in the level of exports would result in reducing our capabilities for obtaining foreign cash. The Pressure is then placed on the levels of private consumption, government consumption, and investment. We must control these three elements of final demand in order to balance our import needs with the available resources. And, any diminution in the elements of final demand would affect the state of internal equilibrium. Therefore, our next step in the budget process is to review our estimates of the final demand at a given level of prices and income available for final consumption.

2. The State Budget and Internal Equilibrium

By internal equilibrium we mean an equilibrium between the income available for final consumption of goods and services and the commodities made available for such consumption. In other words, we mean an equilibrium between money flows and commodity flows. The objective here is to equalize the flow of goods and services for final consumption at given prices and the purchasing power available for the consumption of these goods and services.

The state budget plays here an important role. As pointed out before, the budget is in a position to control private consumption by controlling the level of incomes available for consumption, or by absorbing the excess in the purchasing power of individuals over the planned level of private consumption. The budget plays that role by:

- 1) Determining the amount of wages and other fringe benefits (Chapter one of the budget) to be paid during the budget year. The budget controls at least 60% of the wages and salaries earned in the whole economy. Accordingly, the budget is in a position to control, to a great extent, the purchasing power of individuals.

- 2) Revising the budget revenues and complementing these revenues with other economic tools such as forced savings and social security installments.

In order that the budget could play that controlling role it is necessary for the treasury to make three types of projections which are:

- 1) To plan the rate of consumption which will be allowed during the year.
- 2) To estimate the earnings or incomes of the household sector which could be derived from the main sources of income such as:
 - a) The salaries and wages paid by the government administration sector.
 - b) The salaries and wages paid by the government business sector.
 - c) The salaries and wages paid by the private business sector.
 - d) The net profits of the private business sector after deducting the expected investments of the household sector.
 - e) The share of employees in corporation profits on the basis of existing profit sharing laws.

- f) Financial indemnities, pensions, and insurance.
- g) Other domestic financial transfers.
- h) Transfers from abroad.
- i) Other payments to the household sector.

3) To estimate the part of these incomes which would be absorbed by budgetary tools such as:

- a) Direct taxes such income tax, real estate tax, and defense tax.
- b) Organized savings such as social security deductions, life insurance policies, and forced savings.
- c) Government accounts receivables which would be due during the budget year. These accounts receivables represent the liabilities of the household sector due to the government, such as accrued taxes and other liabilities accrued on the household sector.
- d) Other financial transfers.

Through these estimates we can anticipate the net income which will be devoted by the household sector for consumption. And, by matching the purchasing power of the household sector with the planned rate of consumption we can arrive at the expected inflationary gap. This processes may be represented by the following table:

Internal balance between commodity and money flows

1. The value added by the business sector (both public and private).	xx	Consumption Target (goods and services available for consumption).	xx
2. <u>Add</u> -salaries paid by the government administration sector	xx		
3. <u>Add</u> -Subsidies to the household sector	xx		
4. <u>Add</u> -Pensions and social security payments	xx		
5. <u>Deduct</u> -Direct taxes and other assessments <u>xx</u>			
6. <u>Deduct</u> -Organized savings <u>xx</u>			
7. <u>Deduct</u> -Anticipated private investments <u>xx</u> (Total deductions-items 5 through 7).	(xx)		
8. <u>Add</u> -Estimated hoardings accumulated through previous years	xx	Estimated Inflationary gap	xx
9. <u>Add</u> -Transfers from abroad	xx		
Net cash balance available for consumption.	xx		xx

If the estimates show that the incomes devoted for consumption exceed the consumption targets, the difference would represent the inflationary gap or the excessive purchasing power. At that point the problem of absorbing this excessive purchasing power imposes itself. And, in order to reach a state of internal equilibrium estimates of incomes and the deductions from these incomes are reconsidered. In the same time, we also reconsider the planned government current and capital expenditures. In other words, we review the estimates of the three main chapters of the budget which are salaries and wages, current expenditures, and investments. The revision of budget figures affects the national plan and necessitates the revision of planning targets.

V. Revision of the State Budget and the Impact Upon the National Development Plan.

With the appearance of an inflationary gap the Treasury starts another round of studies, analyses, and estimates. The purpose of these studies is to revise the government budget and, consequently, to make the necessary revisions in the national long-term or intermediate planning targets.

1. Revision of Capital Expenditures

One of the possible measures which could be used for avoiding an inflationary gap is to change the level and structure of investments or, in other words, to adapt the structure of investments to the prevailing economic conditions. This adaptation may be done as follows:

- a) To increase investments in light industries in order to increase the quantity of consumer goods.
- b) To reduce temporarily investments in heavy industries since the effect of these industries on the market appears in the long-term.
- c) To limit investment plans to the projects which could generate future income faster than the others.
- d) To complete investment projects which were started before and are still under construction.

In making all of these revisions the factor of foreign currency must be taken into consideration. Certain projects may be dropped completely or postponed for lack of foreign currency.

2. Revision of Government Current Expenditures

Another measure which may be taken to avoid the inflationary gap is to review the government current expenditures in order to cut down these unproductive expenditures to a minimum. These expenditures represent the

government purchases of goods and services and, therefore, they constitute a portion of the final demand. Accordingly, any reduction in government consumption of goods and services would increase the goods and services available for the household sector, and would decrease government deficit or give the government additional resources for investment.

3. Revision of Wages and Salaries

Chapter one of the budget expenditures measures the total cost of employment. The major part of this cost is controlled by government laws and regulations. Contractual salaries and wages which represent the major source of income for the household sector cannot be decreased to avoid an inflationary gap. Besides, one of the social responsibilities is to provide the public, especially new graduates, with jobs. These social responsibilities and government laws determine the amount of wages and salaries to be paid during the budget year. This predetermined amount of wages and salaries cannot be manipulated. Accordingly, it is not possible to place any considerable reliance upon wages and salaries to avoid an inflationary gap. But what could be controlled and used as an effective tool for absorbing the excessive purchasing power are the deductions from these wages and salaries.

4. Tools Used for Absorbing the Excessive Purchasing Power

The most effective budgetary technique which is used for equalizing income flows with commodity flows is the absorption of the excessive purchasing power. To apply this technique we use several tools which compliment each other. These tools are:

- a. Production and consumption taxes.
- b. Direct Taxes.
- c. Social Security Plans.
- d. Cash Bounuses and Other Benefits.
- e. Forced Savings.
- f. Increasing the Reserves and Provisions of Public Enterprises.
- g. Investment Certificates.
- i. Increasing the Prices to Consumers.

Production and Consumption Taxes are imposed on the producers of certain goods and commodities. The burden of these taxes is transferred to the consumers of these commodities. These taxes are usually imposed on luxuries such as electric appliances and tobacco which are mostly consumed by consumers of upper brackets of income. In a socialist country such as ours, production and consumption taxes are very effective

tools for absorbing a great part of the excessive purchasing power and represent one of the major sources for financing government expenditures.

Direct taxes such as real estate tax, personal income tax, enterprise income tax, and defense tax represent other budgetary tool for absorbing the excessive purchasing power. However this tool is not very effective since the rates of direct taxes cannot be increased indefinitely. Besides, the upper brackets of incomes which could be censured by direct taxation are not in existence anymore in the United Arab Republic. For these reasons, direct taxes are merely used as a complementary tool not as a primary one.

Social security plans represent a very effective tool for absorbing a great portion of the excessive purchasing power because these plans regularly absorb 10% of the employees salaries. The social fund which represent deductions from the present purchasing power could be increased by covering individuals and groups who were not covered before.

Cash bounuses and other similar cash benefits could also be used as a complementary tool for absorbing the

excessive purchasing power. This could be done by reducing the level of these benefits or subjecting them to higher rates of direct taxes.

Forced savings is another budgetary tool used in the United Arab Republic to absorb the excessive purchasing power. At the present time $2\frac{1}{2}\%$ of the monthly salary of each employee is deducted from the salary and saved for him. These obligatory savings could be used for financing government investments.

Another tool which is used for absorbing the excessive purchasing power is the reserves and provisions of public enterprises.

According to the present profit sharing plans the employees and workers of any public enterprise are entitled to 25% of the net annual profits; 10% are paid in cash, 10% for centralized government services, and the remaining 5% for local services. This 10% paid in cash gives the workers and employees an additional purchasing power. This additional power could be decreased or eliminated by increasing the reserves and provision of public enterprises. This action reduces the amount of net profits which would be available for distribution and, consequently, the workers share in net profits.

Investment certificates which are issued by the National Bank of Egypt are used for absorbing the excessive purchasing power. These certificates bear a high rate of interest (5%) and are exempted from all types of direct taxes, except inheritance tax. In this manner, we encourage domestic savings and absorb the excessive purchasing power.

These several budgetary tools vary in their effect in absorbing the excessive purchasing power or reducing the monetary flows. And, any one of these tools cannot be used by itself but should be used in connection with the others. We have to take into consideration the psychological effects of each tool and the institutional settings that could limit the role of any single tool. And, since these tools are limited in their power to absorb the excessive purchasing power, we may still end up with an inflationary gap. At that point we have to rely on prices.

Prices are used as a tool for absorbing the excessive purchasing power. This happens by increasing the prices of certain consumer goods. The difference between the planned prices and the budgetary prices goes to the treasury. The most recent application of this tool was to rice. In 1966 the price of rice was increased to the

consumer from four to eight piasters per Kg., and the difference went to the treasury. In the same time the demand on rice has decreased allowing rice exports to increase and provide the government with an additional amount of foreign currency. Later on in 1968 the price of rice was decreased to six piaster per Kg. in order to provide the local market with an additional quantity.

But before using the price policy we have to calculate the financial effects of price increases and the extent to which these increases can absorb the additional purchasing power. Also, we should first determine the class of consumers who possess the excess purchasing power, the types of commodities which they consume, and the elasticity of demand of these commodities.

By using these different tools we can, to a great extent, absorb the excessive purchasing power and reach the required state of internal equilibrium. However, we are aware of the fact that the amount of hoardings which the consumers use occasionally to buy consumer goods cannot be absorbed in the short-run, or by using any of the previous budgetary tools. These hoardings create a problem because they can distort the internal equilibrium of the economy if not treated carefully.

VI. Redistribution of the Absorbed Purchasing Power and the Determination of the Budget Framework

The budget of the state assimilates over 60% of the national income. This large portion of the national income is then redistributed by the treasury in the form of wages and salaries, current expenditures, and investments. These expenditures constitute the main chapters of the budget. The determination of the size of each chapter depends on all previous considerations regarding the internal and external balances of the national economy. At that point we can say that the budget framework could be determined and we turn from the economic aspects to the financial aspects of the budget. Our objective here is to estimate the revenues and the expenditures of the budget for a forthcoming year.

1. Determination of Budget Revenues

In order to determine the revenues of the budget we distinguish among the revenues of the government administration sector, the revenues of public business sector, and other secondary revenues.

The determination of the revenues of the public business sector depends on our analysis and projections of the foreign currency situation. The availability of foreign

currency would determine the size of imports for the business sector, the size of investments, and the anticipated level of production.

The determination of production level makes it possible for us to determine wages, inputs, distributed profits, retained earnings, and taxes. Also, at that point we can determine the net amount of earnings which would be transferred to the government administration sector for financing government expenditures.

The revenues of the government administration sector consist of the net amount of earnings of the public business sector which is determined, and the absorbed purchasing power. The absorbed purchasing power is determined on the basis of foreign currency and the level of internal equilibrium. The foreign currency factor determines the permissible level of private consumption, and the factor of internal equilibrium determines the government revenues as deductions from income flows in order to reach the state of equilibrium, between income flows and commodity flows.

Finally, after determining the optimum level of internal equilibrium other government revenues such as price differences and accrued taxes would be determined.

These estimates and balances determine the total revenues of the government which would be available for financing government expenditures.

2. Determination of Budget Expenditures

The budget expenditures are classified into wages and salaries, current expenditures, and investments. The wages and salaries of the government administration and the general organizations which supervise the activities of the government business units are determined according to the estimated level and factors of internal equilibrium. The wages and salaries of the business units are determined according to the planned level of production.

Both current revenues and investments are influenced in their determination by the foreign currency factor and the fulfilment of the planned objectives and level of production.

To conclude this paper we can say that the budget framework is determined after the budget revenues and expenditures are determined. And, by matching revenues and expenditures we can find out the amount of surplus or deficit. Any budget deficit would be financed by the

Central Bank of Egypt. However, it is our opinion that in a socialist economy where all means of production are in the hands of the government, and where the government is in a position to control all sources of finance and to use any budgetary measure to correct internal or external imbalances in the economy, the utilization of the concept of deficit financing would be irrelevant and inappropriate. Deficit financing is a characteristic of a capitalist economy. Its utilization is appropriate only during the period of recession in order to revive the economy during that period of the business cycle. But in a planned economy where it is said that business cycle do not exist, we wonder about the relevancy of the concept of deficit financing.