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Socioeconomic Aspects of the Economic Reform Policies In Egypt

Dr. Magdi Khalifa

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DR. MAGDI KHALIFA
SENIOR EXPERT
(ASSO.Prof)

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INTRODUCTION:

Reform initiatives in developing countries have typically taken one of two forms: repeated attempts to improve the existing system of planning and management or moving towards a market oriented system. The latter group of countries emphasized greater price flexibility, fewer controls on inputs and foreign trade, greater financial discipline, a generally deeper concern of avoiding market imbalances. These countries carried out these programs through institutional changes in several key areas. Egypt's economic reform policy falls under this group of Countries. It will be the subject of this study.

By the end of the seventies, Egypt accomplished peace. The first order of business was to rebuild the infrastructure of the economy in the eighties. Priorities were given to rebuilding roads, telephone systems, water and sewage projects, housing and airports. Meanwhile, Egypt was pursuing, gradually, an open door policy in conducting its economy.

During the period from 1987 to 1990, Egypt started a dialogue with the International Monetary Fund and the World Bank to design an economic reform policy. Through that dialogue, the ills of the Egyptian economy were identified as follows:

1- a high unemployment rate of 17% with no hope in the near future to reduce it to a reasonable level

2- a high inflation rate of 25-27% that was damaging savings and investments and causing negative interest rates.

3- a high level of foreign debts estimated at $ 45 billion by 1990 with no hope in the near future for extending more credit and existing fear to default on debt service.

4- no increase in percapita income during the eighties.

The dialogue between Egypt and the two sister international organizations led to establish some sets of targets to be pursued. They were:

1- to take the necessary steps to reach positive interest rates
2- to replace the multi level foreign exchange system by a floating system that determines one exchange rate per currency.
3- to curb inflation by reducing public spending and imposing sales taxes to reduce consumption
4- to induce productivity in the conduct of public sector companies
5- to establish an aggressive policy to privatize the public sector companies
6- to put in place policies to encourage investment by the private sector.

The above targets were put in terms of steps of implementation in a letter of intent signed by Egypt, the IMF and the World Bank in early 1991. Implementation of the economic reform policy started by the beginning of 1991 even before signing the letter of intent. In the following, we will trace the implementation process with an eye on accomplishments as well as shortcomings.

One of the most important areas of reform was labor and how to improve it in order to achieve new and advanced technology which was used to advance the national economy. The major aspects for labor reform policy were redirecting training and creating new jobs expansion of ownership base. Also, it included policies to improve balancing out wages, prices and productivity.

A major aspect of the initial phase of the economic reform was introduce some conditions for successful financial reform. This included tax system reforms, budgetary reforms and inflation control.

On the foreign sector level, Egypt's program dealt with foreign loans and the liberalization of foreign trade by relaxing trade controls, limiting quantitative and qualitative restrictions, and reducing import tariffs and export taxes.

As a result of a dynamic equilibrium of market powers a new exchange rate system emerged to reflect balance of payment strength and competitiveness of domestic exports in world markets.

The purpose of this study is twofold. First, it presents the ills of the Egyptian economy that led to the reform. Also, it describes the implementation of the reform process, with an eye on its accomplishments and shortcomings. Second, it reviews the impact of the reform policies on the foreign sector, both in terms of balance of trade and balance of payment, in order to arrive to some policy recommendations for the future

I): MONETARY POLICY

Prior to 1991, the Central Bank used to determine interest on deposits and loans for all banks in Egypt to follow. To give an idea, the Central Bank determined that interest on loans were 14, 15 and 16%, on short, medium and long term loans respectively. These rates prevailed in 1990 where inflation rate was estimated at 25-27% during the same year. Also, the Central Bank had three values of exchange rates against major currencies. Finally, the Treasury used to borrow directly from the Central Bank. The economic reform policy started in 1991 by a number of decisions made by the Central Bank. In fact, those decisions were the spearhead of the reform and set the stage for other steps to be taken later. These decisions by the Central Bank were:

1- On January 1, 1991 the Central Bank liberalized the determination of interest rates on a condition that the term deposits for 3 months earn no less than 12% per annum. This decision was the equivalent of increasing interest rate structure by about 50% than it used to be in the financial market.

2- The Treasury was barred from borrowing from the Central Bank to finance budget deficits starting from January 1, 1991. Rather, it was allowed to borrow from Commercial Banks, insurance companies and the private sector through weekly auctions conducted by the Central Bank.

3- Consequently, the discount rate was established to be two percentage points above the yield of the 91 days treasury bills. As a result, the discount rate jumped from 14% at the beginning of 1991 to 21.5% by the end of the same year.

4- The Central Bank established credit ceilings that banks were asked to observe for a period of eighteen months.

5- By October 1991, the Central Bank unified all exchange rate multi-levels in one price that was left then for market forces to determine. The intention was to establish a floating exchange rate system.

Commensurate with the above tough decisions, the results were more than rewarding. They were:

1- Inflation rate went down from 25-27% in 1990 to less than 10% in 1995.

2- For the first time in a quarter a century, Egypt had finally reached positive interest rates. The prevailing discount rate is 13.5% and the yield of 91 days treasury bills is 10.4% in the early part of 1996.

3- Egypt accumulated $ 18 billion in foreign reserves which is enough to pay for a year and a half of imports.

4- The balance of payment started to be in the black (surplus) since 1993 to the present.

5- As a result, the Paris-Club dropped 30% of Egypt's foreign debt. Currently, Egypt is engaged with the IMF to drop the last tranche of 20% of its foreign debts or $ 4 billion.

However, this admirable performance on the monetary side leaves some room for improvement. The most important area of improvement is the area of foreign exchange rate. Egypt linked the Egyptian Pound to the US dollar at a rate of LE 3.31 per 1 US Dollar in October 1991. The same rate is 3.40 at the early part of 1996. During that period there was no serious fluctuation but dismal increases estimated to be 2.7% over five years.

As the IMF compared the inflation pressure on the Egyptian Pound with the inflation pressure on the U.S Dollar; the IMF suggested to Egypt to devaluate its currency by 25%-30% against the U.S dollar and other major currency. Egypt rejected the idea on the grounds that it would increase the value of its import bill in domestic currency, it would increase the burden of its foreign debt and eventually it would cause an inflationary pressure internally. Egypt seems to be wining the argument. However, the policy marker in Egypt knows that it is a temporary victory. Once the Central Bank's intervention in the exchange market ceases; the exchange rate of the Egyptian Pound against the U.S Dollar will drop by a considerable percentage whose magnitude is hard to estimate precisely.

II) THE FISCAL POLICY

Parallel to the monetary policy, the fiscal policy made some strides towards reform. They were:

1- Budget deficit was estimated to be 17% of domestic national production during 1989/1990. Through serious expenditure cuts, the same percentage was reduced to less than 2% in 1994/1995. That was a serious supplement measure to curb inflation.

2- The Treasury adopted a sales tax whose burden varies according to merchandise and production process. However, it is estimated that its burden is about 10% Also, this measure intended to curb consumption.

3- Not to repeat what was mentioned earlier but to complete the picture, the treasury was barred from borrowing from the Central Bank. Rather, it is allowed to borrow from Commercial banks, insurance companies and the private sector. This measure contributed directly to reduce inflation.

4- The tax system, originally started in 1939, still imposes different scales to different sources of income. Sometimes, these scales escalates with increase of income. It is a rather complex system that acts as a regressive one.
Egypt unified all taxes imposed on salaries with a single rate of 20% and fewer exemptions than before 1992/1993.

Also, this respectable performance of the fiscal policy leaves some room for improvement. The most important area of improvement is the tax system. The problems of this system are rather complex with social connotations. First, Egypt needs to redefine the taxable income. The current system is antiquated. Second, Egypt needs to fix tax rates with clear understanding as to who is paying taxes in its society. Third, the efficiency of the tax collectors should be tremendously improved. They tend to increase the tax burden of those known to system to compensate their in efficiency to locate those who escape the system. Forth, Egypt needs to unify its scattered legislations of investment tax incentives in one law. Fifth, there is the need to simplify tax forms, rules and procedures and method of collection.

1): BUDGETARY REFORM

Budgetary reform has many sides to it:
improve the transparency of budget account and extend the coverage of basic fiscal accounts to encompass most public activity, reduce or eliminate the implicit subsidies resulting from undervalued interest rates or exchange rates, reduce military expenditure or government expenditure, and reduce the civil service wages as a percentage of GDP and coupled with reforming its structure,.. ...etc.

The main purpose of this part is to throw light on how we can use budgetary reform to achieve the employment capabilities for facing new economic reform programs.

In this case, the budget has to be re-prepared to increase the training budget to cover all types of training to fulfill the following :

* Raise the efficiency and skills of employment.

* Create a new staff with a high qualification and skills to face modern techniques.
* Improve and achieve information system.
* Train all management levels.
* Support overseas training to gain international knowledge.

The main target of the government is to get the budget deficit down to about 2.5% .Through permanent measures which would guarantee that the budget deficit would go down year by year . The government were able to bring the deficit down to 1.6 % of GDP, and this target was achieved.(1)

2): TAX SYSTEM REFORM

The tax system is one of the important tools for the fiscal policy adjustment. Therefore, we can say under the fiscal policy adjustment, there are four major types of structural adjustments in the fiscal area that have been promoted in the reform program of any country:

* Reforms of the tax structure
* strengthening tax administration
* Improvements in budgetary accounting and in the composition and control of expenditure.
* Privatization of public enterprises and improvement in pricing and efficiency.

In general, the reform of the tax system will have a new structure. It will be convenient with the main reform targets, and it is supported by stronger tax administration, including better training, salaries, and conditions of service of revenue collection personnel. Therefore, we

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(1)Al-Ahram Weekly ,21-27 March ,1996.

can't say that, change in the tax system will fulfill the reform purpose, without better staff, better training, and higher salaries .

One of the main reform targets, to fulfill the social justice,in case of, the tax system adjustment is to fulfill the following:

* Encourage the projects which have the social impact,by giving it a grace period or a lower tariff.
* Encourage small projects to be feeding projects for national economic development programs.
* Encourage savings and investment by giving some savings and investment deposits tax free or tax less.

In conclusion, tax system reform can play a big role in the reform policies, where it can encourage savings , investment and establishing new small projects. Also, increasing national income in the long term, may be in the short term, will produce less tax proportion. However, in the long term they increase with more small projects, more savings and investments, with simplifying and unifying the rate structure , reduce exemption, and making customs duties responsive to price changes.

III) FOREIGN LOANS POLICY REFORM

Foreign loans are among of the main resources of financing projects, especially in developing countries. Most development projects used the loans to finance the its capital. With high interest rates, foreign loans become costly . Using loans to finance investments, the loans financing capital of projects will be costly. Also, the loan conditions, related to foreign loans, are often complicated and costly in implementation.

Also foreign loans lead to reduce tax revenues as a percentage of GDP. As policy makers tried to turn current account deficits into surpluses to service foreign loans they frequently restrained domestic demand. In turn, it led to a smaller tax base. Increasing administrative and technical problems in tax assessment and tax collection did not help. In addition, inflation, led to a reduction in real tax revenue.

To counter this problem, Government budget was constructed to accomplish the following fiscal objectives:

* Any increase in foreign loans should be matched by an increase in government revenues or decrease in government expenditures.
* Debt service of domestic and foreign loans should be included in the expense side of the budget.

In conclusion, we have to reduce the use of both types of loans in development projects as they are costly and hinder development.