Egypt's Economic Reform and Structural Adjustment (ERSAP)

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Abstract

Egypt's economic reform and structural adjustment program (ERSAP) was initiated in 1991 to rectify the imbalances between the demand and supply sides of the economy. The main symptoms of these imbalances are the chronic deficits in the balance of payments and the government budget, and high inflation. This paper assesses the economic and social impact of ERSAP in terms of its effects on the balance of payment deficit, the budget deficit, inflation, output and employment, poverty, and income distribution. It concludes that the initial phase of ERSAP is well designed to rectify the imbalances on the demand side of the economy, but not on the supply side.

ملخص

بدأت مصر تنفيذ برنامج الإصلاح الاقتصادى والتعديل الهيكلى فى عام ١٩٩١، بهدف تصحيح اختلال التوازن بين جانبى الطلب والعرض فى الاقتصاد. وقد كانت أعراض عدم التوازن الرئسية تتمثل فى العجز المزمن فى كل من ميزان المدفوعات والموازنة الحكومية، إلى جانب التضخم المرتفع. وتقدم هذه الورقة تقييماً للآثار الاقتصادية والاجتماعية لبرنامج الإصلاح الاقتصادى والتعديل الهيكلى منذ بدايته فى عام ١٩٩١ وحتى عام ١٩٩٥، من ناحية آثاره المباشرة على عجز ميزان المدفوعات، وعجز الموازنة، والتضخم والإنتاج، والعمالة، والفقر، وتوزيع الدخل. وتنتهى الورقة إلى أن المرحلة الأولى من البرنامج كانت مصممة بعناية لتصحيح التوازن فى جانب الطلب من الاقتصاد، دون جانب العرض.

1. Introduction

Prior to 1991, Egypt's economy suffered from macro imbalances, reflected in growing deficits in the balance of payments and government budget, and high inflation in the late 1970s and early 80s. These were accompanied by rapid economic growth, averaging 8.5% annually from the mid-70s to the mid-80s, due mainly to foreign investment. In the second half of the 80s, however, investment and GDP growth declined, accumulated debt reached $11.4 billion in 1990, and the burden of foreign debt had become unwieldy.

The Egyptian government signed an agreement with the IMF in 1987 to stabilize the economy. In 1991 the government signed agreements with the IMF and the World Bank aimed at rectifying the macro imbalances. These agreements, known as the Economic Reform and Structural Adjustment Program (ERSAP) and the Structural Adjustment Loan (SAL), have common policy measures and strong cross-conditionality.[1] The objective of this study is to assess the economic and social impact of ERSAP on the Egyptian economy, focusing on the 1985-95 period.

In assessing economic reform programs, there are various approaches: the internal approach, which examines the extent of target achievement; the before-after approach, comparing economic performance before and after the program; and the counterfactual approach, which compares the program's results with what would have happened in its absence. The before-after approach—the most commonly used method—is used in this study[2]. Part Two briefly presents the main features of ERSAP; Part Three and Part Four assess its economic and social impacts.

2. The Economic Reform and Structural Adjustment Program (ERSAP)[3]

The main objectives of ERSAP are to eliminate imbalances and distortions in Egypt's economy by transforming it to a market-based economy, and to restore the country's creditworthiness. The program comprises reform of the public sector, investment policies,

[1] Before ERSAP, Egypt signed three stand-by arrangements with the IMF—in 1976, 1978, and 1987. All of them followed the same line of policy recommendations, advocating to different degrees tight fiscal and monetary policies, and liberal exchange rate and trade policies along neo-classical lines. All three agreements were discontinued for social, political, and economic reasons.

[2] In justifying this approach, two familiar criticisms should be addressed. The first is that it may be premature to judge the results of ERSAP, since the program has been through only two phases, with one still to follow. The second is that it may be difficult to separate the effects of ERSAP from effects of other factors.The first criticism is addressed in the introduction, while the second calls for careful attention in attributing results.

[3] Unless otherwise stated, this part is based on the Agreements' Documents of the IMF (1991), the World Bank (1991a), IMF (1993), and Government of Egypt (1993).

external policies, pricing, monetary and fiscal reform policies, and social policies. These are presented briefly below.

Public Sector Reform. The public sector reform has two objectives: (a) To change the institutional, legal, and financial environment of public enterprises, raise their efficiency and increase the autonomy of their managers, while making them subject to the same rules as the private sector; and (b) privatization of public enterprises in the commodities and financial sectors, with the exception of 'strategic' public enterprises.

Pricing Policies. Price decontrol in the public sector is essential to move to a market-based economy. Domestic energy prices are lower than international prices and have been highly subsidized for the last 10-12 years. According to ERSAP, oil prices were to be raised annually in order to match their international equivalent by June 1995. Electricity prices were to increase annually to reach 100% of their long-run marginal cost, also by June 1995. Since the mid-1980s the government has taken steps in this direction, but the targets were not achieved on schedule.

An important measure to liberalize prices in agriculture was Agricultural Land Law No. 96 of 1992, which raised the rent on agricultural land to 22 times the land tax (from seven times under the old law) and terminated existing leases in 1996/97. (Under the old law, leases were automatically renewable, to the disadvantage of landowners).

In transport, tariffs on railways and inter-city trucks and buses were mainly unchanged between 1967–88, and the National Railway (ENR) is highly subsidized. The program calls for tariff increases of 5% each fiscal year as of 1991/92, to reach 100% of the cost by 1997/98, and for freeing the prices of inter-city trucking and bus services.

In housing, the government is to eliminate rent control (Government of Egypt, 1993).

Investment Policies. ERSAP attaches high priority to the decontrol of investment, and calls for a competitive investment environment for public and private enterprises. The government has started to phase out the public trade monopoly.[4]

External Policies. These comprise exchange reform, trade liberalization, and debt relief.

(a) Exchange reform: The old multiple exchange system was ended in February 1991 and replaced temporarily by a dual exchange rate system. In October 1991, the two rates were

[4]For example, the public sector companies producing cement and fertilizers were allowed initially to sell 20% of their output to the private sector, to reach 100% over the following 2-3 years.

unified, and nonbank dealers were allowed to deal in foreign exchange (upon obtaining proper licensing).

(b) Trade liberalization: ERSAP commits the government to trade liberalization. Important steps were taken in this direction in 1991 before the World Bank SAL was approved, and further steps are to be taken under the agreement.

(c) Debt relief: The Egyptian government approached the Paris Club creditors for comprehensive debt relief, following approval of the Fund stand-by arrangement. In May 1991, the 17 creditor countries approved relief of 50% of Egypt's outstanding debt on June 30, 1991, on condition that Egypt continues implementing the IMF structural adjustment program. The three-stage debt relief agreement has been completed: 15% of the debt was cancelled in 1991, 15% in 1993, and 20% in 1996.

Monetary Reform Policies. The main features are imposing a credit ceiling in the banking system, and allowing banks to set their own lending and deposit rates, guided by the interest rate on treasury bills.

Fiscal Policies. In 1990/91 prior to ERSAP, Egypt's budget deficit was equivalent to 17.2% of GDP. The government is to reduce the fiscal deficit to reach a virtually balanced position by 1996/97 (IMF, 1993).

ERSAP provides measures to increase revenue and improve its elasticity with respect to GDP; these include introducing a global income tax and a general sales tax, increasing excise taxes, and raising prices of energy and public enterprise production.

On the expenditure side, the main measures consist of restraining the increase in the wage bill, reducing public investment, and reducing subsidies to about 1% of GDP.

Social Policies. These aim to minimize the negative impact of ERSAP on the poor by creating the Social Fund for Development (SFD), supported by International Development Association credit equivalent to US $140 million and concessional cofinancing of US $400-500 million.

3. The Economic Impact of ERSAP

ERSAP provides measures to cut spending (i.e. tighter fiscal and monetary policies, pricing policies), and expenditure-switching measures (e.g., exchange rate reform) to increase real output. In the short run, resource allocation should become more efficient by eliminating distortions caused by the overvalued exchange rate and rigidity in prices, subsidies, and taxes.

In the long run, saving and investment should increase through better incentives and investing in human resources (education and training) and technology.

The impact of ERSAP on the Egyptian economy is assessed here by examining its effect on the symptoms of excess demand: the balance of payments deficit, the budget deficit, and the inflation rate; and on the supply side, on output and employment.

The Balance of Payments

ERSAP's impact on the balance of payments is exercised through expenditure-reducing policies, expenditure-switching policies, and debt relief. Tight monetary and fiscal policies to cut spending should affect current and capital accounts positively through reducing demand for imports (by reducing domestic absorption), and increasing capital inflow in the form of bank deposits in Egyptian pounds, in response to higher domestic interest rates. The exchange reform (expenditure-switching) affects the balance of payments directly through the pound devaluation, and indirectly through pegging the Egyptian pound to the US dollar. Devaluation is supposed to increase foreign demand for exports and to shift production from nontradables to tradables, which are now more profitable. Pegging the domestic currency to an international currency makes it easier for the Central Bank to manage the domestic currency exchange rate. Debt relief has a positive impact on the balance of payments through reducing interest payments on debt and capital outflows as debt repayment.

The Egyptian pound has undergone several devaluations. What was new about this exchange rate reform was unification of the exchange rates, allowing handling of foreign exchange outside the banking system, and pegging the pound to the US dollar. The Egyptian pound was devalued 23%, from $1 = LE 2.708 at the end of June 1990 to LE 3.342 by February 1991 (CBE 1989/90 & 1991/92). Tight monetary policy led to a rise in interest rates; the average annual deposit rate rose from 12% in 1989/90 to 17.1% in 1991/92 (World Bank, 1992).

Devaluation and tight fiscal and monetary policies had a favorable impact on Egypt's capital and current accounts. FDI (including deposits in Egyptian banks) jumped from $135.6 million in 1990/91 to reach $520.2 million in 1993/94.[5] The current account deficit, which was $634 million in 1989/90, turned to surplus and reached $4.5 billion in 1992/93 (Table 1).

[5] Central Bank balanceof payment statistics do not separate foreign direct investment (FDI) from short-term capital inflows.

[6] These results imply a quick response of supply and demand to the currency devaluation and the tight policy measures.[7]

Devaluation and the rise in domestic interest rates would have had less positive impact on the balance of payments in such a short time, were those measures not taken while international interest rates were low. In June 1991, the average nominal interest rate on deposits of one year and less in US dollars and pounds sterling were 6.2% and 11.3% respectively (CBE, 1991/92); the average domestic interest rate on LE deposits was 16.0% (WB, 1992; Vol. III). The large interest rate differentials between Egyptian pound deposits and international currency deposits may have played a crucial role in the positive impact on the balance of payments in 1990/91 and after.

A supportive argument of this hypothesis (attributing the positive impact on the balance of payments mainly to external factors) is the response in the private dollarization phenomenon in Egypt in 1991 compared to 1987. Private dollarization in 1987/88 represented 53.9% of the private sector's total deposits, up from 44.4% the previous year. In 1991/92 the situation was completely different. Private dollarization fell from 61.9% in 1990/91 to 45.8% in 1991/92, and continued to decline in 1993/94; then increased to 31.3% the following year (Table 3).

To assess the impact of the devaluation on the balance of payments, excluding the external factor effects, we compare the impact of devaluation in 1987 (a 56.7% devaluation) and 1991 (23.4%) on components of the current-account balance, which are highly sensitive to exchange rate changes: the trade balance, tourism revenue, and worker remittances in the services and transfer balance.

Assessing the devaluations' impact on the trade balance, one finds (Table 1) an increase in total exports in 1987/88; this may be deceiving,however, because of the large decrease (57.9%) in total exports in 1986/87 from the year earlier, due mainly to a drop in the relative share of oil exports (CBE, 1987/88). Actually, the 1987/88 increase in exports was not enough to regain the 1985/86 level. Thus, one cannot point to a positive impact of the 1987 devaluation on exports. Exports fell again in 1988/89 due to the drop in oil exports, and the large devaluation was not a compensatory factor in this respect. In 1990/91, exports reached

[6] Some of the drop in the current account surplus in 1993/94 and 1994/95 (see Table 1) is attributed to changes in the classification system (see CBE, 1994/95).

[7] This was not the first time Egypt coupled devaluation with tight policy measures, but the impact on the balance of payments was never so good. In 1987/88, the pound was devalued by 56.7%—much larger than the 1991 devaluation—coupled with tight fiscal and monetary policies according to the 1987 IMF stand-by arrangement. Yet the impact on the balance of payments was less; the current account deficit decreased from $924.3 million in 1986/87 to $544.6 million in 1987/88 (Table 1). The main difference between the 1987 and the 1991 devaluations is that the latter was accompanied by a change in the foreign exchange law to permit free handling of foreign exchange outside banks, and by a considerable rise in domestic interest rates.

US $3.9 billion, but fell in 1991/92 and continued falling to reach $3.3 billion in 1993/94. The next year, exports increased, but the figures are preliminary actuals. Thus, one cannot point to a significant increase in Egypt's exports following the devaluations.

Table 1: Egypt's Current Account Balance 1985/86–1994/95 *(millions US dollars)*

	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95*
1.Trade Balance	(4978.4)	(5058.9)	6567.0)	(7556.0)	(8296.3)	(7537.7)	(6420.6)	(7311.5)	(7309.8)[3]	(7853.5)[3]
Exports	3575.7	2264.4	3274.0	2737.5	3144.8	3886.8	3633.5	3416.7	3337.3	4957.0
Imports[1]	8554.1	7323.3	9841.0	10293.5	11441.1	11424.0	10054.1	10728.2	10647.1	12810.5
2.Services & Transfers	3325.5	4134.6	6022.4	6002.9	7662.3	8929.0	10157.8	11859.4	7501.2	8484.0
Receipts of which:	6924.3	7372.7	8656.0	9301.7	11619.2	12941.0	8628.3	9762.2	8458.8	9905.9
Suez Canal dues	1028.3	1138.0	1268.7	1306.7	1471.8	1661.9	1950.2	1941.1	1990.3	2058.4
Tourism	315.3	379.6	885.9	900.6	1071.8	924.1	1727.2	2375.0	1779.3	2298.9 [4]
Worker remittances	2972.7	8011.9	8883.9	3532.2	3742.6	3775.3	5477.9	5938.5 [2]	3232.4	3279.0 [5]
Payments of which	3598.8	3238.1	2633.6	3228.2	3956.9	4012.0	4987.7	5194.3	5003.6	5619.5
Interest payments	1292.4	1093.5	785.1	1123.2	1688.5	1529.7	1320.1	1455.0		
Current account (1+2)	(1652.9)	(924.3)	(544.6)	(1553.1)	(634.0)	1391.3	3737.2	4547.9	191.4	630.5

* Preliminary actuals.

1. Includes imported commodities in the form of grants.
2. Included under 'private transfers (from one side)' which is equivalent to worker remittances as shown by comparison of the terms 'worker remittances' and 'private transfers' in 1991/92 in Central Bank of Egypt, Annual Report, 1992/93. pp. 92, 105.
3. According to the new classification, services (of fuels and other items) provided to ships and airplanes are included in exports and imports instead of included in the 'services account'; Central Bank of Egypt, Annual Report, 1994/95, p. 72.
4. According to the new classification, this is cited under 'transportation,' comparing the figure cited under "tourism" in the old system in 1993/94 in: CBE Annual Report, 1993/94, p. 65 with the figure cited under 'transportation' for the same year, it was the same. 1993/94 is the only year where comparison between the two systems of classification is feasible, since the balance of payment items are cited according to the old and new systems.
5. This item is cited under private transfers (net) in the new classification. In the old system, this item is cited under 'private transfers (from one side)'. The accounting concept of 'worker remittances' changed to include all private transfers by Egyptians, whether exchanged into Egyptian pounds or added to the banks accounts in foreign currency. In the old system, only private transfers exchanged to Egyptian pounds were cited as 'worker remittances'. Thus the values of this item before 1993/94 are not comparable with the values at 1993/94 and after.

Source: Central Bank of Egypt Annual Report, 1987/88, 1989/90, 1991/92, 1992/93, 1993/94, 1994/95.

Improvement took place, however, in the structure of Egyptian exports, in favor of manufactured goods. The relative share of raw commodity exports (oil, agricultural) declined from 72.2% in 1985/86 to 57.1% in 1993/94 (CBE Annual Reports). If this trend continues, it would make the impact of LE devaluation on the balance of payments more effective.[8]

Comparing the impact of the devaluation in 1987 and 1991 on Egypt's imports, one finds from Table 1 that imports continued to increase after the 1987 devaluation. In the years following 1991, imports showed a decreasing trend (except in 1994/95, which figures are preliminary actuals). This implies that the impact of devaluation on decreasing imports was effective in 1991 but not in 1987, despite the latter's relatively greater devaluation.

One possible explanation for these differing responses of imports to devaluation is that the contractionary fiscal and monetary policies of 1991 were stronger than the 1987 policies, resulting in a significant drop in aggregate demand in a short time. For example, government investment *increased* 52% in 1987/88 and was *reduced* by 28% in 1991/92, perhaps partly reflecting increased demand for imported intermediate and capital goods for public enterprises in 1987/88, and decreased demand in 1991/92. In total, the government cut its overall deficit from 26.5% of GDP in 1987/88 to 2.5% in 1993/94 (Table 2). On monetary policy, interest rates increased considerably in 1991, while no change took place in 1987/88.

A second explanation is the large debt arrears of $11.4 billion in 1990, which may have affected Egypt's credit facilities until debt rescheduling took place as part of ERSAP. Debt service rescheduling within the IMF stand-by arrangement of 1987/88 may explain the continuous rise in imports after 1987, because of the relief from debt service pressure on the balance of payments. Imports also increased after debt rescheduling in 1991/92 (Table 1).

The outcome of devaluation on exports and imports is reflected in the trade balance, which remained in deficit after both devaluations. After the 1987 devaluation, the trade deficit increased. However, after the 1991 devaluation, the deficit decreased for two years (1990/91 and 1991/92), then rose between 1992/93 and 1994/95 at an average annual increase of 7.4%.

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[8] This is because the prices of the raw commodities export are given in the international markets, while for the manufactured commodities, there is a room for price differentials in promoting exports.

The main impact of the currency devaluation on the services and transfer balance relates to tourism and worker remittances. As shown in Table 1, the 1987 and 1991 devaluations caused jumps in tourism revenue, with the exception of 1990/91 due to the Gulf War. There was also some fall in tourism after 1992/93 because of the terrorist acts in Egypt at the time.

The impact of devaluation on worker remittances is not as impressive. The 1987 devaluation increased remittances by just 12.4% in 1987/88, and 4.4% in 1988/89 (calculated from Table 1). After devaluation in 1990/91, worker remittances jumped from $3.8 billion in 1990/91 to $5.9 billion in 1992/93. The 1991 Gulf War may be responsible for this large increase in remittances; the return of many Egyptian workers after the war and the release of their funds that were kept during the war, added to a cumulative impact on remittances. So the large increase in remittances in 1991/92 and 1992/93 may be attributed to the Gulf War more than to the Egyptian pound devaluation in 1990/91[9].

The nature of Egyptian labor working in Gulf countries makes remittance flows to Egypt inelastic to the exchange rate in the long run. One should differentiate between two groups of Egyptians working abroad. The first group is comprised of manual workers, peasants, university graduates and low-rank professionals; and the second is a relatively small group consisting mainly of professionals and intellectuals. The average worker's earnings and hence, saving, in the first group is considerably lower than in the second. However, most of the savings of the first group represent actual and potential remittances to Egypt, whereas the savings of the second group, especially individuals who have worked abroad long enough to accumulate large sums, are mainly deposited abroad. The main difference between the two groups is that workers in the first group consider working abroad as a temporary means to accumulate capital and achieve some pre-set target(s) in their home country (like getting married, acquiring a flat or building a house, starting an enterprise, etc.). Thus, most savings accumulated by the first group will be transferred sooner or later to Egypt, and are highly elastic with respect to the exchange rate in the short run, and inelastic to it in the long run.

However, the second group has different educational and cultural backgrounds, and hence different concepts and targets in life. Most of their savings may be considered potential remittances that are inelastic to the exchange rate. Some of the other factors that seem to be important in

9 The fall in remittances in 1993/94–1994/95 does not support this view; the figures are not comparable with the previous years because a new classification system was implemented in 1993/94.

attracting those savings are the economic and political stability of thesystem to secure owners against capital confiscation and loss, the real return to their savings and direct investment, etc. Thus, these potential remittances, which, according to anecdote, may amount to $50 billion or more, cannot be attracted to Egypt only by devaluing the pound.

A positive impact of ERSAP on the balance of payments is the accumulation of net foreign assets. The exchange reform introduced in 1990/91, coupled with the increase in domestic interest rates while international rates were low,allowed net foreign assets to rise dramatically from LE 4.1 billion in 1989/90 to LE 47.4 billion by 1994/95 (CBE, 1994/95).

Another important factor that contributed to the positive impact on the balance of payments is the debt relief under ERSAP, after the Paris Club cancelled 15% of Egypt's outstanding debt on a present-value basis, and wrote off most of its civilian debt to the US and the Gulf countries. Egypt's external debt/GDP ratio fell from 144.3% in 1989/90 to 109.5% in 1991/92. In 1996, $ 4.2billion of debt was dropped. Egypt's total outstanding debt is presently $ 31 billion, according to official announcements.

The Pegged Exchange Rate System

The exchange rate system of pegging the domestic currency to an international currency makes it easier for the monetary authority, namely the Central Bank, to manage the exchange rate of the domestic currency. However, this system has its disadvantages. If the foreign currency to which the domestic currency is pegged becomes overvalued, both countries will suffer balance of payment deficits. The country pegging its currency will experience a larger deficit if the foreign country is not its main trading partner.

Under ERSAP, the Egyptian pound is pegged to the US dollar. This system is assessed here withrespect to its potential impact on Egypt's balance of payments. Reviewing the geographic distribution of Egypt's merchandise trade, one finds that the European Union (EU) countries are Egypt's main trading partners (Korayem, 1993). In the first two years of ERSAP (1990/91 and 1991/92), with the pound pegged to the dollar, Egypt's exports to the EU averaged 34% of its total exports, and imports from the EU averaged 31% of Egypt's total imports. Egypt's exports to the US in those two years averaged 12% of total exports, and its imports averaged 16% of total. Thus, the EU countries rank first for both export and import, while the US ranks fifth and second respectively. Hence the US is not Egypt's main trade partner, and in 1993/94 and

1994/95, the relative ranking of EU countries and the US did not change (CBE, 1994/95). An unfavorable development in the exchange rate of the dollar with respect to the EU currency would reflect unfavorably on Egypt's balance of payments. It is safer for a country to peg its currency to a basket of currencies of its main trading partners, with weights reflecting relative shares in the country's trade (Fisher 1988; Dornbus, 1988).

For Egypt, then, a more appropriate system would be to peg the pound to a weighted average of the ECUand the US dollar according to their relative importance to Egypt's trade. This is especially important for two reasons: First, the imported input content of domestic production is relatively high (Abdel-Khalek, 1995). The coefficient of total intermediate inputs in important tradable sectors is: 0.551 for transport equipment, 0.544 for wood and furniture, 0.479 for chemicals (except oil), 0.44 for printing and publishing, and 0.438 for food. Thus, the effect of a pound devaluation on domestic costs of production is considerable.

Second, Egypt is negotiating an agreement to establish a free trade area with the EU. The agreement is to enhance the importance of Europe in Egypt's trade. Pegging Egypt's currency to the US dollar means that a devaluation of the dollar vis-à-vis the ECU may hurt Egypt's competitiveness in the European market. Increased prices of European inputs and higher inflation in Egypt compared to Europe may raise the total domestic cost of producing tradables, and their prices in the European market, by an amount exceeding the devaluation of the pound against the ECU following a dollar devaluation.

On the import side, Egypt's demand for imports is inelastic with respect to the exchange rate (elasticity =-0.3), and with a propensity to import of 0.3, a dollar devaluation against the ECU will raise Egypt's import bill considerably, since about a third of its imports come from Europe. If the dollar becomes overvalued, Egypt will suffer a larger deficit with Europe. Pegging the pound to a weighted average of the ECU and the dollar, rather than only to the dollar, will minimize the risks to Egypt's balance of payments if the US dollar is overvalued or undervalued with respect to the ECU.

Impact on the Budget Deficit

The main IMF policy recommendations for reducing government expenditure are to decrease nominal growth rates of wages, subsidies, and government investments. ERSAP recommends that the increase in wages in 1991/92 should not exceed the 1990/91 level by more than 16.4%,

while in 1992/93, the total wage bill should decrease by 15% in real terms. Table 2 shows that the wage bill target was realized for 1991/92, but not for 1992/93. The wage bill increased in 1992/93 by 22.1%, while in real terms it increased by 11.0%, since the average rate of inflation in 1992/93 was 11.1% (Table 3). The wage bill continued to rise in 1993/94 by 38.2%, and with inflation at 9.0%, the real increase in wages was 29.2%, which is hard to explain. According to preliminary actual data, the rate of increase in nominal wages fell to 10% in 1994/95, so the real rate of increase in wages was 0.7% (the inflation rate was 9.3%). The annual rate of inflation has been higher than the annual increase in the wage bill since the 1970s, which led to a fall in real wages. The World Bank estimated that real government wages in 1987 were about half their 1973 level, while real wages of public enterprise employees were about 90% of the 1973 level; managers and senior civil servants got the largest share of the decline (World Bank, 1991c).

According to ERSAP, subsidies were to decrease by LE 1 billion in 1991/92 from the 1990/91 level, to equal 1% of GDP. This target was not achieved, and outlays on subsidies actually increased by 30% during the period (Table 2). Expenditure on subsidies in 1991/92 represented 6.3% of GDP. But in subsequent years, subsidies showed significant reduction, falling by more than LE 3 billion to amount to 2.6% of GDP in 1992/93, [10] and 1.9% of GDP in 1993/94 and 1994/95[11], thus approaching ERSAP's target.

In 1989/90, government investment was 18.1% of GDP. With ERSAP, government investment was to decrease to 11% of GDP in 1991/92. This target was more than achieved; government investment decreased to 10.4% in 1991/92 (Table 3), and continued its declining trend after 1991/92. It has decreased in nominal terms by an average annual rate of 8.3% over the four-year period from 1990/91 to 1994/95 (calculated from Table 2). Since average annual inflation was 12.6% over the same period (Table 3), this means that government investment fell annually by 20.9% in real terms after the implementation of ERSAP. This has had a contractionary impact on the economy.

One item of government expenditure has been growing rapidly since implementation of ERSAP: the interest payments on domestic public debt. With the increasing trend of issuing treasury bills to finance the budget deficit and to sterilize foreign capital inflow, and with the portfolio shift from foreign currency deposits to LE deposits, interest payments on domestic debt grew rapidly, increasing at an average annual

[10] The GDP figure was LE 157300 million in 1992/93 (IMF, 1996).

[11] The GDP figures were LE 175000 million and LE 205000 million in 1993/94 and 1994/95 respectively (IMF, 1996).

increase of 30.1% from 1990/91 to 1994/95 in nominal terms (see Table 2) and 17.5% in real terms, since the average annual inflation rate over the period was 12.6% (Table 3). In 1993/94, interest on domestic debt was about three times as much as subsidy payments and exceeded wage expenditure.

On the revenue side, the measures taken in 1990/91 and those recommended for 1991/92 (e.g., broadening the sales tax base, increasing indirect taxes on items like cigarettes, etc.) were expected to yield revenue equal to about 6% of GDP. The reality was close to the target. Indirect taxes on goods and services increased by 87.5%. For 1992/93 and after, with ERSAP recommending measures to raise revenue and improve elasticity with respect to GDP—like a global income tax, widening the corporate tax base, extending the sales tax to wholesale activity—government current revenue increased from 1990/91 to 1994/95 by an annual average of 20.7% in nominal terms and 8.1% in real terms (calculated from Tables 2 and 3).

With these developments, the government has more than realized the budget-deficit target advised by ERSAP. The target was to reduce the budget deficit to 9.5% of GDP in 1991/92 and to 6.5% of GDP in 1992/93. The overall budget deficit was reduced from 17.2% of GDP in 1990/91 to 1.6% in 1994/95 (Table 2).

The government also exceeded the target for budget deficit financing, which was to decrease bank financing to LE 0.4 billion in 1991/92. Domestic bank financing of the deficit was LE -3.5 billion in 1991/92, compared to LE 1.6 billion in 1990/9; it remained negative until the latest data available in 1994/95, excepting 1993/94 (Table 2). The government depends on treasury bills more than bank financing to cover its budget deficit.

Table 2: Summary of Fiscal Developments: 1986/87–1991/92

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95*
I Total revenue (I.1 + I.2)	15449	19020	21267	21876	28559	41406	46703	52567	55508
I.1 Current revenue	11242	13485	15625	17047	25608	37834	43683	49418	52672
of which: Income & profit taxes[1]	2815	3300	4058	4246	6406	9996	11114	12003	12165
Indirect tax of goods & services[2]	1722	1894	2407	2874	3373	6324	7191	8080	9131
Transfers from oil & Suez Canal	1024	1229	1453	1229	4597	6730	7639	7220	7575
I.2 Investment revenue[3]	4207	5535	5642	4829	2951	3572	3020	3149	2836
II Total expenditure (II.1 + II.2)	24530	33460	33400	36393	45510	47563	52223	56264	58197
II.1 Current expenditure	13137	16198	17432	22446	29679	36198	41292	46097	47416
of which :Wages	3691	4570	5225	6064	7118	8029	9803	11096	12209
Subsidies	1652	3915	2573	4140	5566	7237	4047	3265	3967
Public debt interest	1843	2304	3011	3656	7046	9510	13309	16498	14790
Local	...	...	...	2969	4176	6359	9315	11816	11177
Foreign	...	...	...	687	2870	3151	3993	4682	3613
II.2 Investment Expenditure	11393	17262	15968	13947	15831	11365	10931	10167	10781
III. Overall Deficit (I-II)	-9081	-14440	-12133	-14517	-16951	-6157	-5520	-3697	-2684
of which: Foreign financing (net)	3793	5632	3609	3248	13512	1783	298	524	-408
Domestic financing	5288	8808	8524	11269	3439	4374	5222	3173	3097
of which: dom. bank financing	2419	5061	4758	7697	1635	-3456	-3202	126	-1518
Treasury bills					890	3594	2580	-765	-2386
As percentage of GDP[4]									
I. Total revenue	...	34.9	32.4	27.7	28.9	35.0	35.5	35.2	35.0
II. Total expenditure	...	61.3	50.9	46.1	46.1	40.2	39.5	37.7	36.6
III. Overall deficit	...	-26.5	-18.5	-18.4	-17.2	-5.2	-4.1	-2.5	-1.6

* Preliminary actuals.

1. For 1986/87–1988/89, reference is to 'taxes'.
2. For 1986/87-1988/89, reference is to 'consumer taxes'.
3. Includes self financing.
4. 1985/86-1990/91 calculated using GDP (at current prices) in: World Bank 1992, Vol. III, Table AIII.2 , and 1991/92-1994/95 from World Bank 1995, Vol. I, Table 1.2. 1993/94 figure is estimated, and 1994/95 is projected.

Source: Central Bank of Egypt, Annual Report, 1988/89–1994/95.

Impact on Inflation

Inflation may be caused by cost-push and/or demand-pull factors.The main cost-push factors in ERSAP are: (i) the increase in indirect taxes; (ii) the upward adjustment in prices of some goods and services; (iii) the exchange reform; and (iv) raising interest rates. Theoretically, wages are both a cost-push and a demand-pull factor for inflation. To avoid repetition, we shall examine the impact of wages on inflation in Egypt under the demand-pull factors. ERSAP implementation does not increase real wages, and hence wages should not be considered as an inflationary factor.

(i) Several measures were taken to raise indirect tax revenue: the introduction of a general sales tax in 1990/91 and broadening its base gradually to cover the wholesale trade; restoration of the customs duty rate to its pre-1989 level (about a 30% increase) and including it in the sales tax base for imported items; increasing excise taxes on cigarettes, tobacco and other items; increasing specific stamp taxes; and introducing a value-added tax in 1995.

(ii) Several increases in prices of goods and services took place in the first half of 1991 (IMF, 1991; World Bank, 1991a), mainly: prices of bread, flour, and cigarettes; elimination of subsidies on rationed tea and soap; higher telephone subscriptions; increased petroleum product prices to reach 48% of the international equivalent; raising electricity prices by 50%; removing pricing and marketing controls on agricultural products; reducing subsidies on fertilizers and pesticides, and removing the remaining agricultural input subsidies by 1992/93; increasing rail passenger tariffs by 15-40% and rail freight tariffs by 15%.

Additional price increases included in ERSAP for the 1991/92 budget and after (IMF, 1991; World Bank, 1991a; GOE, 1993) are: increasing petroleum product prices to reach 100% of the international equivalent in 1995; increasing electricity prices from 24% of LRMC in May 1989 to reach 100% of its LRMC by 1995; liberalizing prices of agricultural inputs and outputs, excepting those of cotton and sugar cane, which will be liberalized gradually thereafter; increasing passenger and freight tariffs annually since January 1991 so their revenue/cost ratio would reach 100% in 1997/98; and freeing the prices of inter-city trucking and bus services. Some of the 1995 price increase targets were not achieved on time (e.g. petroleum and electricity prices).

Table 3: Selected Economic Indicators

	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94*	1994/95**
1. Real GDP growth rate (%)	3.0	2.4	2.1	0.3	0.5	2.0	2.2
2. Population growth rate (%)[1]	2.5	2.4	2.3	2.3	2.2	2.2	2.3
3. Income per capita growth rate (=1-2)	0.5	0.0	0.0	-2.0	-1.7	-0.2	-0.1
4. Inflation rate [2] (1986/87=100)	16.7	21.2	14.7	21.1	11.1	9.0	9.3
5. Employment (in thousands)	12880	13248	13527	13742	13991	14436	14664
6. Labor force (in thousands)	13852	14332	14760	15141	15571	16031	16460
7. Unemployment rate	7.0	7.6	8.4	9.2	10.1	9.8	10.9
Percent of GDP							
8. Consumption	89.5	93.2	89.9	89.1	94.6	94.1	93.9
Private	74.7	79.0	76.9	76.7	81.1	80.5	80.5
Public	14.8	14.2	12.9	12.4	13.5	13.5	13.4
9. Domestic investment	23.3	21.9	20.4	18.0	17.0	17.5	16.9
Private	5.4	3.4	9.7	7.1	8.2	10.3	9.9
Public	17.5	18.1	10.3	10.4	8.4	7.2	7.0
Change in stocks	0.4	0.5	0.4	0.4	0.5	0.0	0.0
10. Savings, exc. official grants:							
Gross domestic savings	10.5	6.8	10.1	10.9	5.4	5.9	6.1
Gross national savings	19.8	16.2	20.1	25.6	17.5	16.3	15.0
11. Saving-Investment gap (=10-9)	-12.8	-15.1	-10.3	-7.1	-11.6	-11.6	-10.8
12. Private dollarization [3] (%)	56.5	57.9	61.9	45.0	32.0	28.6	31.3

* Estimated/** Projected; both exclude data on population growth rate, inflation rate, and private dollarization, because of differences in data sources.

1. Does not include workers abroad for 1991 /92 and after.

2. In the urban sector.

3. Defined as ratio of private sector foreign currency deposits to private sector total deposits; calculated from CBE, 1994/95; Annex Tables.

Source: CAPMAS, Annual yearbook, June 1994; Central Bank of Egypt, Annual R eport 1992/93–1994/95 & World Bank, Arab Republic of Egypt, Macroeconomic Framework (Vol. I) 1995, Table 1.1.

(iii) The devaluation of the Egyptian pound in February 1991 was an important factor for cost-push inflation. It increased prices of imported goods and raised the domestic cost of production of many goods and services.

(iv) Increasing interest rates is another important cost-push factor. It increases the cost of borrowed capital, which will contribute to raising the cost of production. The biased capital structure in favor of borrowed capital vis-à-vis self-financing, is a common phenomenon in many public and private enterprises. This gives relatively higher weight to the cost of capital borrowing (lending interest rates) in raising total costs of production.

The main causes of demand-pull inflation are: the budget deficit, especially when financed by borrowing from the Central Bank; domestic credit; and wage increases.

(i) The Budget Deficit. ERSAP advocates tight fiscal policy. The government reduced the budget deficit to 2.5% of GDP in 1993/94 (Table 2), and a virtually balanced budget is supposed to be reached in 1996/97 (Government of Egypt, 1993). The budget deficit is being increasingly financed from real resources by selling treasury bills to the public and the banks.There is less reliance on borrowing from the Central Bank. Domestic bank financing of the budget deficit was negative in 1991/92 and after (Table 2). This means that after ERSAP's implementation, the budget deficit is no longer a factor of demand-pull inflation in Egypt.

(ii) Domestic Credit. ERSAP had a strong impact on domestic credit; its average annual growth rate fell from 25% in 1989/90 and 1990/91, to only 1.5% in 1991/92, later increasing to 11.7% in 1993/94 (Central Bank of Egypt). This shows how strong the ERSAP's fiscal and monetary policies are, to cause such a large and abrupt drop in the growth rate of domestic credit. While this drop, and the tight fiscal policies, imply the success of the Egyptian government in reducing the aggregate demand sharply over a short period of time, it had a strong reducing effect on the growth rates of output and employment. The GDP growth rate fell from an annual average of 2.3% in 1989/90 and 1990/91 to 0.3% and 0.5% in 1991/92 and 1992/93 respectively (Table 3). The annual growth rate of employment fell also. However, the rate of growth of domestic credit did not continue at this low level. To encourage investment and output expansion, monetary policy was relaxed to some extent by lowering interest rates and relaxing credit ceilings in the banking system. This brought a rise in domestic credit of 11.7% and 11.5% in 1993/94 and 1994/95 (Central Bank of Egypt).

(iii) Wage Increases. Regarding the possible inflationary impact of the increase in wages on aggregate demand, real wages in the government and public sectors have been falling in Egypt since the seventies, as noted above. Wages in the private sector seem to be linked to

those in the public sector. This is reflected in the close similarity in the distribution pattern of wages in both sectors. In private establishments of 10 workers and more, employees who received monthly earnings of LE 300 and more in December 1990 represented 26% of the total, compared to 26.5% of employees in the public sector receiving the same earnings (calculated from: World Bank, 1992). Thus, with the similarity of the wage distribution patterns and levels in the private and public sectors, the decrease in real wages in the private sector should be close to the decrease in the public sector wages. Consequently, wages should not be considered an inflationary factor in Egypt.

From the above, one can say that ERSAP has effectively restrained the causes of demand-pull inflation, yet activated the causes for cost-push inflation. It may be argued that the cost-push factors are supposed to raise prices once and for all. This is not automatically true, for it is subject to the policy measures applied in managing the economy afterwards. For example, pound devaluation and raising interest rates have the potential to be continuous sources of cost increase; every devaluation requires further increases in domestic energy prices to reach the targeted international level. Even the increase in indirect taxes and the upward adjustment in prices of some goods and services are not made once and for all, but take place over some years (like raising energy and transportation prices, and broadening the base of the sales tax). Besides, those cost-push factors will have indirect impact on raising prices of other goods and services, since their producers have to raise their income to meet the rise in prices (e.g. raising the profit margin of different goods and services).

What is the net effect of ERSAP on inflation in Egypt? This assessment should be made with caution. The official data of the consumer price index (CPI) are biased downward because of the commodity basket chosen, and the unrealistically low prices used for calculating the cost of goods and services in the basket (e.g. housing rents, education and health expenditures). The rise in the CPI was 21.1% in 1991/92 compared to 14.7% the previous year, and compared to an average annual increase in the CPI of 17.9% over the period 1987/88–1990/91 (Table 3). This means that despite the strong contractionary impact of ERSAP on the inflationary demand-pull factors, an inflation rate of 21.1% was realized in 1991/92. However, the inflation rate dropped considerably after that year, falling to 11.1% in 1992/93 and to 9.3% in 1994/95 (Table 3).

Impact on Output and Employment

To assess the impact of ERSAP on the supply side of the Egyptian economy, we examine the performance of output and employment.

Output. To assess the impact of ERSAP on output, the developments in four indicators in the period preceding ERSAP will be examined, and the impact of the implementation of ERSAP on them will be assessed. Those indicators are: savings, investments, GDP growth rate, and income per capita. It should be mentioned that this is a preliminary assessment of ERSAP, since the third phase of the program has just started in October 1996.

(i) Gross domestic saving averaged 9.1% of GDP over the period 1988/89–1990/91, while gross domestic investment averaged 21.9% of GDP, indicating an average saving-investment gap of 12.8% of GDP. The pricing policies and the exchange reform in ERSAP increase the cost of living. With a falling income per capita (Table 3), the relative share of consumption expenditure in average individual's income is expected to rise (because of the relatively large marginal propensity to consume (MPC) at lower income) lowering, thus, average individual's saving on the national level. Since private consumption represents the largest share in total consumption—it was 76.9% of GDP as compared to 12.9% public consumption in 1990/91 (Table 3)—this behavior is supposed to have a significant impact on raising total consumption and decreasing gross domestic savings. On the other hand, the large increase in interst rates on deposits is expected to encourage domestic savings. Thus, the level of domestic saving will be the net outcome of these two opposing effects of ERSAP measures.According to the recent data available, the negative effect on savings overruled the positive one leading to a fall in gross domestic savings. It fell from 10.9% of GDP in 1991/92 to 5.4% and 5.9% of GDP in 1992/93 and 1993/94, and was projected by the World Bank to be 6.1% of GDP in 1994/95.

(ii) The second indicator is the relative share of gross domestic investment in GDP; this decreased from 23.3% in 1988/89, to 20.4% in 1990/91 (Table 3). This reflects the fall in public sector investment which represented about three quarters of gross domestic investment. Public investment fell from 17.5% of GDP in 1988/89 to 10.3% in 1990/91. ERSAP was expected to have a negative impact on investment in the short run for two reasons: the monetary policy applied reduced the growth rate of domestic credit to 1.5% in 1991/92 from an average rate of 21% between 1987–91 (Central Bank of Egypt, 1991/92); also, the tight fiscal policy reduced investment expenditure in the government budget by 28.2% between 1990–92 (calculated from Table 2). This was expected to have a significant negative impact on total investment, since government investment represented the largest share in total gross domestic investment.

On the other hand, the public-sector reform aims to compensate for the fall in government investment by increased private investment through privatization, and improving the

investment environment by introducing appropriate regulations to encourage private sector participation. These measures are also meant to attract foreign capital into Egypt. However, the pound devaluation and high differentials between domestic and international interest rates may make deposits in Egyptian pounds a more attractive alternative for private capital.

The final outcome on investment was negative, as the data up to 1994/95 reveals. The increase in private investment (domestic and foreign) was not enough to compensate for the fall in public investment. Investment fell from 20.4% of GDP in 1990/91 to 18.0% and 17.0% of GDP in 1991/92 and 1992/93 respectively, and is projected to be 16.9% of GDP in 1994/95 (Table 3). Despite the fall in investment, the saving-investment gap is still high due to the low savings rate: 11.6% of GDP in 1992/93 and 1993/94, and projected at 10.8% in 1994/95.

(iii) The third indicator of the performance of the Egyptian economy, correlating to investment development, is the growth rate of GDP. The average growth rate of GDP over the period 1988/89-1990/91 was 2.5% (Table 3). The impact of ERSAP on GDP depends on its net effect on investment, which was negative so far, as shown above. To increase output, total investment has to be increased. According to ERSAP, government revenue from selling public enterprises should not be reinvested. This means that the direct impact of privatization on investment is nil; private investment is just replacing public investment, with no net addition to total investment. On the other hand, ERSAP's measures did not succeed, so far, to increase private investment (domestic and foreign) at a rate higher than the fall in public investment. The result was the fall in GDP growth rate to 0.3% and 0.5% in 1991/92 and 1992/93 respectively. However, this was projected by the World Bank to reach 2.2% in 1994/95.

(iv) The fourth indicator is the development in income per capita. The annual income per capita growth rate was 0.5% in 1988/89 and zero in the two years preceding ERSAP (1989/90, 1990/91) (see Table 3). The impact of ERSAP on real income per capita depends on the real GDP growth rate and the population growth rate. The latter was 2.8% in the eighties (CAPMAS, 1992). This means that the real GDP growth rate has to exceed 2.8% annually, not a feasible target. The result was a negative income per capita growth rate in 1991/92 and afterwards, though with some improvement. The income per capita growth rate fell to -2.0% in 1991/92 and is projected to be -0.1% in 1994/95.

Impact on Employment

According to 1992/93 data, which are the latest available, the total labor force in Egypt is 15.6 million of a total population of 56.4 million (World Bank 1995; Table 1.1), representing

28.2% of the population. Of this labor force, 1.6 million are unemployed, making an unemployment rate of 10.1% in 1992/93 (World Bank, 1995). The current actual rate of unemployment seems higher than this, by several indicators. Some estimates of unemployment range between 2–3 million persons, representing about 13–20% of the labor force (US Embassy, 1992). According to 1990 data, 86.9% of the unemployed are newcomers to the labor market, and only 13.1% of the unemployed relates to previously employed workers. This low incidence of unemployment among previously employed workers should be interpreted in the context of the prevailing labor laws that make laying off workers very difficult in both public and private enterprises. The government sector, and to a lesser extent, public enterprises, are overstaffed because of the graduates' employment policy that was in effect until a few years ago[12]. If the labor laws are changed to allow worker lay-offs as advocated by ERSAP, the unemployment rate of previously employed workers will increase.

ERSAP affects the labor market through two main channels: (i) through its impact on total production; and (ii) through implementation of public enterprise reform.

(i) The main factor affecting employment is the rate of growth of output and productivity. Given productivity, the higher the output growth rate, the more employment opportunities will be created in the economy. As seen above, ERSAP's monetary and fiscal reforms have had contractionary impact on total investment and GDP growth. Although some relaxing of domestic credit constraints has taken place, what is most important is response of the business sector (public and private) to these changes. Besides the domestic credit ceiling, the business sector response will depend on other factors, like the lending interest rates and the outcome of public enterprise reform and trade liberalization. It is still too early to assess the impact of ERSAP on GDP in the medium and long-terms. But in the short term, judging by what has happened so far, the low rate of GDP growth has adverse implications for employment.

(ii) The impact of privatization on employment is negative, at least in the short-term, as the experience of other countries shows. The overstaffed enterprises cannot be sold to private owners unless the new owners are permitted to lay off workers. Changes in the labor law are expected to address this issue. This is expected to raise unemployment among previously employed workers to more than the prevailing 1.1% level.

The IMF and World Bank are quite aware of this problem, and some funds are allocated through SAL and the Social Fund for training programs to enhance worker mobility. Also,

[12]Officially, the graduate employment policy is not eliminated yet, but practically, it is applied on a small scale and with a lag period of about eight years after graduation .

unemployment insurance is recommended by ERSAP to minimize this effect of privatization. But the question is how sufficient are those measures to cope with the problem; in 1990, 1.5 million workers were employed in public enterprises (CAPMAS, 1993a).

Laying off workers in public enterprises is expected to occur through privatization, and also through reforming enterprises that remain in the public sector. The new labor law will probably allow managers of those enterprises to lay off workers according to need. Accordingly, with implementation of public enterprise reform, about one quarter of workers in public enterprises, i.e. 380,000 workers, may be laid off (WB, 1991a).

Finance should be available for retraining and creating jobs for laid-off workers. Estimating that LE 4000 per worker is needed for this purpose (World Bank, 1991a), a total of LE 1.5 billion will be needed. Laying off 380,000 workers means an increase of 200% or more in the unemployed/previously employed (180,000 in 1990; see CAPMAS, 1993a). However, privatization and reforming public enterprises will not be carried out within one year. The estimated impact on unemployment will be distributed over a number of years; the same applies to the financial resources needed for worker retraining and job creation. The slower the implementation of public enterprise reform, the smaller the negative impact on unemployment and the lower the financial burden the economy has to bear annually.

To have a positive impact on employment of newcomers to the labor market, privatization must create new jobs at a higher rate than public enterprises do. This assumption is difficult to accept in the short—and probably medium—terms, because hiring conditions are more strict in private than in public enterprises. On the other hand, creating enough jobs for the newly unemployed depends mainly on the rate of GDP growth, which largely depends on investment, given productivity. Measures to reduce investment figure prominently in the policy package. It is implicitly assumed that reforming the economy toward a market-oriented base will create the appropriate environment to attract domestic and foreign investment and increase GDP growth rate. Although it is still too early to tell, this has not materialized so far, as indicated by the low growth rate of GDP.

To sum up, ERSAP components are effectively designed to rectify the imbalances on the demand side of the economy, but are relatively poorly designed to address the main imbalances and bottlenecks on the supply side. According to the developing countries experiences, the expenditure-switching measures (e.g. exchange reform, pricing policies, etc.), which the Fund depends upon to rectify the imbalances on the supply side, proved inadequate to achieve an efficient allocation of resources, raise productivity, and increase output.

The Social Impact of ERSAP

An assessment of the social impact of ERSAP is made here by examining its effects on poverty and income distribution. The latest data available on poverty and income distribution is in the latest Expenditure and Income Survey of 1990/91.

Impact on Poverty. Poverty in Egypt, as measured by the number of households living at or below the poverty line, [13] increased considerably during 1981/82–1990/91. The percentage of poor households increased from 30.4% in 1981/82 to 35.9% in 1990/91 in the urban sector, and from 29.7% to 54.5% in the rural sector (Korayem, 1994). The impact of ERSAP on the poor is through three channels: (i) the cost of living, (ii) income earned, and (iii) the social services provided by the government.

(i) Devaluation; increases in prices of energy, tranportation, public enterprise commodities etc.; the elimination of subsidies; and raising indirect taxes and widening their base are the main ERSAP policies that raise the cost of living. Subsidies are given for basic consumer commodities and services, like basic food and transportation. Reducing the subsidy bill hurts the poor most, since a large portion of their budgets—up to 48% for the lowest expenditure deciles—are spent on subsidized basic food items; moreover, 60% of the urban population in Egypt were spending one fifth to one half of their aggregate budget on the main subsidised food items (Korayem, 1980). The pound devaluation raises energy prices, increasing the price of imported commodities, including basic food items like wheat and flour, and prices of imported capital and intermediate goods; this in turn raises production costs of domestically-produced goods, and the general price level, and hence the cost of living.

(ii) The second channel is through its impact on income. ERSAP's impact on raising prices will reduce real incomes. The working poor, who are mostly illiterate or have low education levels, earn low incomes and are more vulnerable to increased prices. Moreover, ERSAP's tight monetary and fiscal policies and reduction in government investment will depress overall growth and job creation, in the short-term at least. Since the poor are the least educated, and do not have influential social connections, their chances of getting jobs will be relatively slim when the labor market tightens up.

(iii) The third channel is through social services provided by the government free or at low price. Despite the increase in real investment in education and health in 1991/92 compared to the previous year , it is still below the level achieved in the late eighties (Korayem, 1993).

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[13] The poverty line is defined here as the level of income that is sufficient to ensure a safe nutritional level for the household, as well as to cover its minimum non-food requirements.

With the increase in the number of students and population, the result is a decline in real investment per student and per capita in education and health. Consequently, one cannot expect an improvement in the quality of education provided, although a small fee is now paid by students at all education levels; nor can one expect sufficient health services at reasonable quality and subsidized price. Thus implementation of ERSAP will have negative effects on the poor, which is acknowledged by the Fund and the Bank (World Bank, 1991c). The Social Fund for Development (SFD) was created to alleviate hardship on the poor, but the limited resources of the SFD may make this unfeasible.

Impact on Income Distribution. Income distribution deteriorated between 1981/82 and 1990/91; the gini coefficient increased from 0.32 to 0.38 in the urban sector and 0.29 to 0.32 in the rural sector (Korayem, 1994). ERSAP is expected to affect income distribution through two mechanisms: its impact on personal income distribution by taxes, subsidies, the Agricultural Land Laws, and wealth effect; and its impact on wages and prices.

Personal Income Distribution. A global income tax was applied in January 1994. The preliminary assessment of its relative progressivity or regressivity compared to the old tax system is controversial. Indirect taxes are by their own nature regressive. Thus, levying new indirect taxes on commodities and services (like the sales tax), widening the base of the prevailing ones, and raising their rates, implemented as part of ERSAP, will have relatively more reducing impact on the incomes of the lower-income population. This is because low-income earners have a higher marginal propensity to consume, and so allocate a larger part of their incomes to consumption expenditure, which forms the base for indirect taxes.

The Agricultural Land Tenure Law of 1992 has two important effects on the income of land holders who rent their land[14]. The first effect is the increase in the annual agricultural land rent by about three times the previous rent. The second effect, which is more serious, is the termination of the current land lease which gives the tenant many rights vis-a-vis the owner, including the bequeath of the lease to children and grandchildren, the indefinite term of the lease, and the almost unchanged rent over the years. Termination of the lease means that the land tenant has to negotiate a new contract with the owner, which will probably exclude the favorable terms in the old lease; the rent will be set at market value and will be subject to change depending on market forces.

[14]The land holders are those farmers who work on their own agricultural land, whether this land is owed or rented by them. We shall be concerned here with the impact on small land holders who rent their land because those are the ones who will be affected by the Law.

In assessing the law's impact on tenants,[15] other agricultural measures in ERSAP should be considered, since the 'new' land law is part of a liberalization package. The net impact will depend on how much small land holders benefit from increased agricultural output prices (given elimination of input subsidies) compared to increased land rent; this depends on many factors which are beyond the scope of this study: the crop mix chosen by farmers in response to price liberalization; how market information is disseminated to farmers; and how successful government measures are in liberalizing the market and *not* impeding agricultural production through lack of information, adhoc actions, bureaucracy, etc.

What is more serious than the increase in land rent is the impact of terminating the leases of small tenants. Will freeing the land rent in 1996/97 lead to a large increase in those rents so that small land tenants will be excluded, or will the law of supply and demand keep the rent at affordable levels? If small land tenants are excluded because of increased rent, they will join the landless labor group, and hence rural poverty will increase. Thus it is important that the government interferes to prevent that outcome. One suggestion is that the government provide loans to those landholders to purchase their rented land at market prices, repaying the loans in small affordable installments over a long period of time (People's Assembly, 1992). But if the outcome is that small farmers can still afford the new rent, then the impact of that law on their standard of living will depend on the relative increase in the land rent compared to the increase in their incomes due to agricultural liberalization.

Wealth effect (of foreign currency deposits) due to devaluation has a negative impact on equity (Abdel-Khalek, 1987). Devaluation will increase the wealth of owners of foreign currency deposits, and raise the return to those deposits in Egyptian pounds. This means a redistribution of income to favor foreign currency deposit owners.

Wages and Salaries. According to the 1990/91 Expenditure and Income Survey, wages represent 49.1% of urban household income, and 26.4% of rural household income (CAPMAS, 1993c). ERSAP calls for reducing the government wage bill by 15% in real terms. The impact on government employee incomes is negative, but the distributive impact will depend on whether the government distributes this decrease evenly among all ranks, or unevenly to favor low-ranking employees; the reduction in real government wages between 1973–87 was borne mainly by high-ranking employees (World Bank, 1991c).

[15]Land holders of three feddans and less are identified as poor, since their income does not exceed the income poverty line (Korayem, 1991).

Regarding the impact on wages in the private sector, the increase in prices caused by ERSAP measures will reduce real wages in the private sector as well. However, the negative impact of ERSAP on the standard of living of private-sector employees would be less than on the public-sector employees, if wage distribution in the private sector is skewed more in favor of high wages compared to the pattern in the public sector. But this does not seem to be the case. The distribution pattern of wages in the public and private sectors are similar.

Another view, based on the assesement of the 1987 IMF stand-by arrangement, is that the impact on the private sector's wages is not clear cut (Abdel-Khalek, 1987). According to this view, the pound devaluation encourages emigration to Arab countries, which raises nominal wages in the domestic market. The final outcome depends on the growth rate of inflation, compared to the growth rate of nominal wages. However, currently, with relatively scarce job opportunities in the Gulf countries, and high domestic unemployment, a decrease in real wages in the private sector seems more likely, at least in the short run.

Regarding the impact on non-wage earners, the elimination of input subsidies in agriculture and introducing the new Agricultural Land Law on one hand, and freeing prices of agricultural products on the other, represent forces that pull in opposite directions with respect to the impact on farmers' income. Elimination of agricultural subsidies and freeing prices may mean an increase in nominal income for small farmers, because they are the main producers of traditional crops, which were subject to compulsory delivery at controlled prices. The input subsidy received by those farmers was less than the income they lost by selling their products to the government at low prices. But with the impact of the new Agricultural Land Law, the outcome may be different. ERSAP's impact on the real incomes of small farmers, which is what counts, is not clear, because they are also consumers of subsidized commodities. Reducing or eliminating subsidies on those commodities will raise their cost of living and decrease their real incomes. The final outcome for small farmers will depend on the rate of increase in their nominal incomes compared to the increase in their cost of living. Marketing arrangements are crucial in this regard; small farmers may not fully benefit from output price liberalization if marketing is controlled by monopsonist traders.

The non-wage earners in the private business sector will be affected negatively by high interest rates, tight domestic credit, and probably trade liberalization, at least in the short run. They will be affected positively by freeing prices and allowing competition between the private and public sectors, and by devaluation of the Egyptian pound. The final impact of ERSAP on this group will differ depending on the financial position of the enterprise,

especially with respect to the leverage ratio (ratio of borrowed/owned capital)[16]. The more the enterprise is indebted to the banking system, the more the negative impact will outweigh the positive, and the enterprise will be a net loser, and may even go bankrupt. Reduction in aggregate demand and the pressure of foreign competition could hurt the public and private business sectors. The fall in purchasing power and the underaccumulation of stocks seem concomitant with ERSAP, at least in the short run.

[16]The impact of ERSAP on those consumers will be neglected, because of their relatively low marginal propensity to consume, and because the gain they realize as producers normally outweighs the increase in the cost of living.

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