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Introduction

The political revolution that overthrew the monarchy in 1952 was of little immediate consequence for the Egyptian economy. Land reforms resulted in some redistribution of land and wealth, but the economy continued to be based on private enterprise. As before, quantitative regulations remained directed mainly toward foreign trade and payments, and were largely of the type introduced by many other less developed countries as temporary emergency measures, to be abolished whenever circumstances permitted. It is always difficult to identify precisely what the policy objectives are in such transitional periods, but at least until the Suez War of 1956 there was nothing to indicate that the economy would not continue on a private enterprise basis.

By the end of the fifties government attitudes had shifted in favor of public participation in and direct regulation of the economy, and in 1961 sweeping nationalization measures brought most big business and virtually all foreign trade into the hands of the state. The ideals of private enterprise and free trade were now replaced by those of Arab socialism. In practice, that meant a mixed economy with a large public sector (which included all foreign trade) and with the remaining private economic activities subject to various kinds of direct controls. Prices were regulated for purposes of income distribution and stabilization, and resource allocation in important fields became a matter of administrative decision.

This metamorphosis is described in some detail in Chapter 1. It has the important consequence for our study that the exchange regimes after 1961 have to be appraised as an integral part of the general control system, while their impact on the pre-1961 period has to be analyzed on the basis of the regimes in conjunction with the accompanying aggregative economic policies. The shift in emphasis is related also to a change in the role of prices. In a private enterprise economy the impact of a foreign exchange regime can be gauged through the price distortion it causes, assuming that private producers adjust to the distorted prices. Under extensive price control, domestic market prices will no longer exclusively reflect the exchange regime, and with a large public sector where investment decisions are made by the government, as well as direct intervention in production decisions in both public and private sectors, the allocation of resources will not reflect domestic market prices, either. A system that deliberately intervenes in resource allocation through direct commands may conceivably attain efficiency in production and investment—or create even more inefficiency than would follow from the given exchange regimes under a market system.

Problems of this nature compelled us to supplement the investigation of exchange regimes and trade controls with a rather detailed study of government decisions regarding industrial and agricultural investment and production to gauge directly the degree of efficiency or inefficiency in these areas. As a consequence, we have found it appropriate to divide the monograph into three parts. Part One describes the exchange regimes from World War II until the end of the sixties and examines their effects at an aggregate level; Part Two analyzes cropping patterns in agriculture during the sixties; and Part Three studies the investment and production developments in ten manufacturing industries during the fifties and sixties.

From World War II until 1961 Egypt was the happy owner of very substantial—though largely blocked—foreign exchange reserves in London. During this period Egypt's foreign exchange policies basically consisted in responding to the ups and downs of world economic conditions as they manifested themselves in the international markets for long staple cotton. Their aim was to stabilize both the Egyptian balance of payments and the domestic economy under the constraint set by the speed at which the British government would agree to release Egyptian sterling reserves and convert them into U.S. dollars. The phases of Egyptian exchange policies from the second half of the forties to the beginning of the sixties thus tended to coincide with the phases of the world economy.[1] During an international upswing, cotton prices and export earnings generally increased, generating an upswing with tendencies toward price increases in the domestic Egyptian economy. To stabilize the economy the obvious policy was to relax whatever exchange controls might have existed and to appreciate the domestic currency in an effort to dampen export earnings, expand imports, and keep down domestic prices. Vice versa, during a downswing in world business conditions, cotton prices and export earnings declined and deflationary tendencies were transmitted to the domestic economy. Stabilization now required tightened exchange controls and some measure of currency depreciation. Note that the aim of stabilizing domestic prices and production went nicely hand in hand with that of stabilizing free foreign exchange reserves.

It is along the lines of this paradigm that Chapters 2 and 3 attempt to describe and analyze the Egyptian exchange regimes from World War II to 1961. During this long period the country was vacillating between what the co-directors term Phases I, II, and V;[2] the problem is to trace possible subphases to understand these vacillations. To be fully understood, the Egyptian exchange regimes have to be viewed as integral parts of general aggregative stabilization policies, not merely as palliatives adopted to save a troublesome exchange reserve situation or protect domestic industries. Their success was rather limited; generally, they could be characterized as "too little and too late."

In 1962 the foreign exchange reserves were exhausted and Egypt entered a period of permanent, severe foreign exchange crisis—as yet unresolved. A devaluation with unification of exchange rates was undertaken in 1962 (as discussed in Chapter 4). In a sense, it could be said that here we have Phase III, to use the co-directors' terminology: after fifteen years of fumbling with foreign exchange regimes, the government finally decided to devalue overtly.

De facto, however, the devaluation was imposed upon the country by the International Monetary Fund as a condition for obtaining short-term credits in a critical situation, possibly in the hope that it might be an overture to liberalization in the conventional sense of the word. The Egyptian government had not wanted to devalue—it saw no reason for it, and had no intention of liberalizing trade and foreign exchange in any sense of the word. For by that time, the fundamental institutional changes in Egyptian society alluded to above were a *fait accompli,* rendering it difficult and, indeed, inappropriate to pursue the analysis in terms of deviations from and approaches to free trade.

With the introduction of Arab socialism, foreign trade and financial transactions became government prerogatives that were not going to be abolished even if the economy, internally and externally, had been in a state of equilibrium. Indeed, what were emergency controls before 1961 now became the normal institutions of the country, and how the economy would work was going to depend, *inter alia,* upon the rules for their operation. Refusing to see anything but palliatives in such a system would be an absurdity, almost like insisting that the communist system in the Soviet Union is really only an expedient that would be superfluous if that country just pursued appropriate demand management policies and introduced a realistic exchange rate! With controls established as permanent institutions in a system dominated by the public sector and by government ownership and decisions, the basis for their evaluation should be above all how well they serve that particular system, with its particular constraints on private economic activity and its particular economic and social aims (as best as these can be identified).

It is along these lines that Chapter 5—and Parts Two and Three in their entirety—attempt to appraise exchange regimes and domestic controls after 1961. Chapter 5 describes the situation after the nationalizations of that year and the devaluation of 1962, focusing on the formal machinery of exchange allocation. The motives for the actual allocations, apart from certain very general principles, are hidden behind a wall of administrative secrecy which we have not been able to penetrate (yet another reason why we have been compelled to study directly the allocation of resources in Parts Two and Three).

Chapters 6 and 7 study cropping patterns in agriculture during the sixties. An econometric technique was developed to measure the deviation of actual crop acreages from optimal acreages, the portion of the deviation that can be ascribed to price distortions, and the impact of direct government controls. Generally, we find that, rather than neutralizing them, the direct controls have added to the deviations from optimal cropping patterns that the price distortions alone would have created. Thus, on balance, far from improving the situation in regard to efficiency in production, the direct acreage controls only served to make it worse.

Chapters 8 to 10, comprising Part Three, analyze ten important manufacturing industries from the point of view of efficiency and international competitiveness. Because the government—before 1961 with the participation of private industry—attempted to broaden the industrial structure, it did not concentrate investments in the most efficient, traditional industries. Hence, a tendency to a relative decline in measured competitiveness is apparent over the period. It may be partly explained by the emergence of infant industries, but some long-term misallocation of investments clearly did take place. There is no evidence that this went beyond the misallocation that would have occurred in any case as a consequence of genuinely private investment decisions made by private firms on the basis of price distortions created by the government to provide adequate profits in inefficient industries. Before 1961, low efficiency was, in fact, always accommodated by the necessary price distortions. After 1961, inefficiency was reflected in low profits or losses, financed by government subsidies, rather than in greater price distortion. Thus, it can be argued that after 1961 there was less misallocation in respect to manufactured consumer goods in the sense that price distortion of consumption patterns was reduced. Moreover, there was no automatic "resource pull" to inefficient industries. These positive features may have been more than offset, however, by shortages in consumer goods caused by trade controls and by undue concentration of decisions at the ministerial level, severely disrupting the incentive system at the plant level, misallocating labor, crippling its discipline, and generally creating a rather erratic pattern of trade and inventories. Albeit some labor misallocation may have been adopted for the sake of income redistribution, the latter can certainly not serve as an excuse for the nepotism in hiring practices and personnel management prevailing over the whole period and aggravated after 1961. There is, on the other hand, little evidence of production disruptions as a direct consequence of the exchange regimes, although this circumstance is probably related to discrimination in favor of the big, modern manufacturing industries, as discussed in Part Three.

It should be emphasized that our paradigms at best capture only the most essential characteristics of Egyptian foreign exchange regimes. Actual developments were more complex than that. Moreover, the aims of successive governments were never clearly formulated, and more often than not policy moves were badly prepared, poorly executed, and occasionally inconsistent. In explaining our paradigms, we warned against considering the exchange regimes as mere palliatives. To some extent, of course, they were just that. Thus, both the Organization of Free Officers and, later, Nasser himself were obsessed by the idea of the stability of the Egyptian pound—that is, of its official par rate—as a symbol of the soundness of the economy and perhaps even of the nation. (In all fairness, let it not be forgotten that this was conventional wisdom at that time, codified in the IMF.) When, during the fifties, exchange regimes followed each other in rapid succession, they doubtless also served to conceal the true nature of the policy pursued. And the resistance to the 1962 devaluation, not to mention the blunt refusal to devalue further in 1966, may have been more a question of paying homage to the national (and international) symbol than the logical consequence of sponsoring an economic system where prices serve to regulate income distribution rather than resource allocation and where, for that reason, devaluation has a different role to play—if it has a role to play at all—than within a conventional, private enterprise-oriented liberalization program.

While we are fully aware of this aspect of Egyptian foreign exchange policies, making it the focus of our analysis would be misleading. It would tend to hide the real problem that the government was seeking to solve: the administration of a mixed economy, dominated by the public sector, with nationalized foreign trade. How to make such a system function efficiently is a problem that socialist regimes in general and the Egyptian government in particular have yet to solve.

NOTES

1. For a listing of specific phases in tracing the evolution of exchange control regimes, delineated by the co-directors of the present series, Jagdish Bhagwati and Anne Krueger, as an overall guide, see Appendix B, pp. 348–349.
2. See Appendix B, p. 349.